

## LEGAL UPDATES AND NEWS

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### **Comments on the Federal Reserve Board's Interim Final Rule on Dividend Waivers are Due By November 1, 2011. We Encourage All Mutuels and Mutual Holding Companies to Submit Individual Comment Letters.**

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#### **Comments are Due November 1<sup>th</sup>**

Comments on the Interim Final Rule regarding dividend waivers by mutual holding companies ("MHCs") chartered under the Home Owners' Loan Act ("HOLA") must be submitted to the Federal Reserve by November 1, 2011. Comments can be submitted as follows:

- **E-mail:** [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov). Include docket number (No. R-1429 and RIN No. 7100 AD 80) in the subject line of the message.
- **Facsimile:** (202) 452-3819 or (202) 452-3102.
- **Mail:** Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20<sup>th</sup> Street and Constitution Avenue, NW, Washington, DC 20551.

We encourage all mutual savings institutions and MHCs, whether chartered under federal or state law, to submit their own comments on the Interim Final Rule. Unless the dividend waiver restrictions of the Interim Final Rule are changed, the ability of MHCs to pay dividends and attract capital will be impaired. This would be unfortunate as MHCs have been a highly successful alternative corporate structure for mutual institutions that have raised billions of dollars of capital for community banks.

#### **How the Interim Final Rule Affects MHCs**

The Interim Final Rule, codified at 12 C.F.R. § 239.63(d), regulates dividend waivers by all MHCs chartered under the HOLA ("Federal MHCs"). While the rule does not directly affect state chartered MHCs, we believe the rule will impact dividend waivers by all MHCs and will inevitably affect the way the Federal Reserve Board regulates dividend waivers by state chartered MHCs. The specific terms of the Interim Final Rule are discussed in our August 29, 2011 *Legal Updates and News* which can be accessed on our website at [www.luselaw.com](http://www.luselaw.com). The Interim Final Rule affects MHCs in the following ways by changing the dividend waiver standards that were previously contained in Office of Thrift Supervision regulations:

- It requires a majority of the eligible votes of members to approve an MHC board's decision to waive dividends (the same standard applicable to significant corporate events such as a mutual to stock conversion). The vote must be obtained annually. As a practical matter, this would prohibit dividend waivers by all Federal MHCs since the vote would be very expensive and difficult to obtain.
- It requires that any proxy statement used in connection with obtaining the member vote contain a detailed description of the proposed dividend waiver and the reasons for the waiver, disclosure of the MHC directors' ownership of stock in the subsidiary declaring dividends and actions the board has taken to eliminate any conflict.
- All Federal MHCs that were not formed prior to December 1, 2009 or did not sell stock and waive dividends prior to that date (so-called "Non-Grandfathered MHCs") are subject to additional onerous requirements before they may waive dividends. These include: (i) requiring non-stockholder directors, consisting of a *majority of the entire board of directors*, to approve the dividend waiver, or having officers, directors and stock benefit plans waive the receipt of dividends; (ii) requiring the Federal Reserve Board's non-objection to the amount of the dividend; and (iii) requiring that the amount of waived dividends be considered in determining an appropriate exchange ratio in the event of a conversion of the MHC to stock form.
- For Non-Grandfathered MHCs, either (i) a *majority of the entire board of directors of the MHC must approve the waiver*, and any director with direct or indirect ownership or control of shares of the subsidiary declaring the dividend, or who otherwise benefits through an associate from the waiver, must abstain from the board vote, or (ii) each officer or director (or their associates) of the MHC and any tax-qualified and non-tax-qualified employee stock benefit plan in which such officer or director participates that holds any shares of stock of the class to which the waiver would apply must *waive the right to received any dividend declared by a subsidiary of the MHC*.

### **Comments/Points That You Should Make In Your Comment Letter**

By any measure, the Interim Final Rule is a setback for MHCs that had anticipated that the Federal Reserve Board would take a fresh look at MHC dividend waivers in view of the capital raising success of the MHC structure and the key role that dividend waivers play in the ability of MHCs to attract capital. We recommend that all mutuals and MHCs submit individual comment letters and these are some of the points that you may want to make in your letters. Of course, any additional comments that you have and that relate to your particular institution or MHC would be encouraged.

- The Interim Rule, as drafted by the Federal Reserve, effectively eliminates the ability of MHCs to waive dividends by requiring a member vote approval that few MHCs will be able to obtain.
- The vote threshold is effectively designed to prevent MHCs from waiving dividends, and shows a clear bias by the Federal Reserve Board against MHCs and mutuality.

- The plain language of Section 625(a) of the Dodd-Frank Act authorizes Grandfathered MHCs to waive dividends without requiring a member vote.
- The Federal Reserve Board's analysis and concern over potential conflicts of interest in connection with waiving dividends is overstated and can be resolved in ways that do not damage the ability of MHCs to pay reasonable dividends to their minority stockholders. Depositors, for example, have been and can be advised of the MHC's intent to waive dividends when they vote on an MHC reorganization.
- MHCs have successfully raised billions of dollars of new capital for community banks since 1995. The ability of MHC subsidiaries to pay dividends is key to the attractiveness and capital raising ability of MHCs, and the Interim Final Rule would effectively eliminate the ability of MHCs to pay reasonable dividends.
- There is no evidence that any members or depositors have been adversely affected by MHC dividend waivers under the OTS regulations. Instead the evidence suggests that dividend waivers have helped members and depositors by allowing their bank to grow and provide more services.
- For some institutions, forming an MHC and issuing minority stock is a more prudent and rational way for mutual institutions to go public and raise capital. The transition from mutual to stock form in one step is not practicable for many mutual institutions and the MHC has been a successful alternative. The Interim Final Rule and its restrictions on MHC dividend waivers would make the MHC structure less attractive to mutuals.
- Adopting a rule that has a negative effect on the ability of mutuals to raise capital is counter-intuitive particularly in the current economic environment.
- Mutual community banks have a long history of providing service to their communities and would like to grow and prosper and continue as independent banks. The MHC structure is the best vehicle for many mutuals for accomplishing this.
- The Federal Reserve's perceived conflict of interest associated with MHC dividend waivers and minority stockholders benefiting from such waivers can be readily resolved by requiring that waived dividends be unavailable for distribution to minority stockholders and added to any liquidation account created when a mutual institution converts to stock form. This is precisely what is done with the mutual interest when a mutual converts to stock form in a standard conversion transaction.
- The provisions applicable to Non-Grandfathered MHCs requiring board members who own stock in their subsidiary bank or holding company to abstain from voting and not receive any dividends is unnecessary and excessive. Directors of stock holding companies regularly declare and receive dividends on common stock they own. Any conflict can be addressed by the creation of a liquidation account.

- There should be no dilution of minority stockholders in the event an MHC that has waived dividends converts to stock form. Minority stockholders have invested risk capital and must be able to receive a reasonable dividend without suffering dilution in the event of a conversion of the MHC to stock form. Adding waived dividends to the converted bank's liquidation account would address any conflict concern.
- The Interim Final Rule has a decidedly anti-mutual and anti-MHC tone. We encourage all mutuals and MHCs to ask the Federal Reserve Board to devote the necessary resources to better understand the MHC structure, and to reexamine and reevaluate their treatment of MHCs.

Of course, we believe that every comment letter submitted to the Federal Reserve Board should include information about your bank, including your history of being a community bank, your size and your experience as a mutual institution or MHC.

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Luse Gorman is one of the leading firms nationally in advising financial institutions on capital-raising, mergers and acquisitions, corporate and securities, regulatory and executive compensation/employee benefits matters. Please contact any of the attorneys listed below if you have any questions or would like to discuss any information contained in this newsletter.

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