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November 1, 2011

VIA ELECTRONIC MAIL – To: Regs.Comments@federalreserve.gov

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Re: Comments on Section 239.8(d) of Regulation MM of the Interim Final Rule Regarding Dividend Waivers by Mutual Holding Companies – Docket No. R-1429; RIN No. 7100 AD80

Dear Ms. Johnson:

This comment letter regarding Section 239.8(d) of Regulation MM of the above-referenced Interim Final Rule (the “Interim Final Rule” or the “Rule”) relating to dividend waivers by mutual holding companies, is being submitted by this law firm on behalf of numerous mutual holding company clients. Luse Gorman Pomerenk & Schick, P.C. has completed more than 100 mutual holding company reorganizations and our attorneys completed the first mutual holding company reorganization and minority stock offering by a federal savings association in 1991. Since then, we have represented issuers and underwriters in raising billions of dollars of new capital for mutual holding companies in either their initial public offerings or subsequent conversions to stock form. We also have represented mutual holding companies in a variety of merger and acquisition transactions, including acquisitions of stock savings banks and commercial banks. As a result, we believe our law firm has unparalleled experience with mutual holding companies, including mutual holding company dividend waivers, which gives us unique insight into understanding the structure and the benefits it offers to both mutual and stock-owned community banks.

A. Introduction and Summary

In its notice adopting the Interim Final Rule, the Board of Governors of the Federal Reserve System (the “Federal Reserve Board” or the “Board”) specifically requested comment as to whether the conditions of the Rule “sufficiently address concerns regarding the inherent conflict of interest with dividend waivers.” We believe that the conditions imposed by the Interim Final Rule are punitive, and if adopted in final form, the Interim Final Rule will harm mutual holding companies and will discourage capital formation within the mutual holding

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company structure because it will, as a practical matter, prohibit mutual holding companies from waiving dividends from their savings bank (“Bank”) or mid-tier stock holding company (“Company”) subsidiaries (collectively referred to as a “subsidiary”). A mutual holding company needs to be able to waive dividends for the simple reason that paying dividends to minority stockholders is key to the subsidiary being able to attract capital. Furthermore, paying dividends to an entity (the mutual holding company) that (i) has not contributed additional capital to a subsidiary, (ii) has no use for the dividends, and (iii) would have to pay significant taxes on the dividends received, is inequitable to the subsidiary and its minority stockholders. Moreover, a dividend waiver by a mutual holding company will almost always enhance the safe and sound operation of a subsidiary savings bank because more capital will be retained by the subsidiary to support future growth and operations. Accordingly, mutual holding company boards of directors, consistent with their fiduciary duties to members, have routinely waived the receipt of dividends from their subsidiaries.

The basis for the Interim Final Rule is the presumption that an “inherent” conflict of interest exists when a mutual holding company board of directors elects to waive the receipt of dividends from its subsidiary. We do not believe that this presumption is warranted. To address this perceived conflict, the Rule establishes new corporate standards and conditions for waiving dividends that are inequitable to mutual holding companies, their boards of directors and management, as well as their minority public stockholders who have invested capital in mutual holding companies. The Rule does not fully consider how the mutual interest of a mutual savings association or mutual holding company is converted to stock ownership, and ignores the different ownership characteristics of subsidiary common stock held by a mutual holding company compared to minority stockholders. Moreover, in implementing the Interim Final Rule, we believe the Board exceeded its statutory authority under Section 625(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”) by mandating that so-called “Grandfathered MHCs” obtain a member vote before waiving the receipt of dividends.

This comment letter will explain why the Board should not assume that there is an “inherent” conflict of interest when a mutual holding company waives dividends from its subsidiary, and why such a waiver is both reasonable and equitable to a mutual holding company and its members. In doing so, we will also explain why value is not necessarily transferred from the mutual holding company to minority stockholders when the mutual holding company waives dividends, and why a mutual holding company in most cases *should* waive the receipt of dividends from its banking subsidiary. As part of this explanation, we will review how the mutual interest of a savings association or savings bank (collectively referred to as a “savings bank”) is converted to stock form in both a standard conversion and mutual holding company stock offering. We will also review the ownership rights of mutual members under federal and state law, since these rights are also a source of the Federal Reserve Board’s concern about the potential inequitable treatment of members resulting from mutual holding company dividend

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waivers. In this regard, it is unfortunate that in implementing the Interim Final Rule the Federal Reserve Board elected to disregard the significant experience of the Office of Thrift Supervision (the "OTS") and other banking regulators with mutual holding companies over the past 20 years, as well as the fact that during the period in which dividend waivers have been granted by the OTS there has been no finding of abuse or waste as a result of such waivers. The Rule essentially affirms the conflict of interest concerns expressed by the Board over 15 years ago in its *Greater Delaware Valley Holding, MHC* and *Northwest Bancorp, MHC*¹ decisions. Instead, we are requesting that the Board consider, particularly in light of its new responsibilities as the sole regulator of savings and loan holding companies, how dividend waivers may be effected in ways that are equitable to both minority stockholders and mutual members.

This letter will also explain why, assuming *arguendo* that there is a conflict of interest associated with mutual holding company dividend waivers, the conflict has been overstated by the Federal Reserve Board, and how it can be readily addressed in ways that do not damage the mutual holding company structure or the ability of mutual holding companies to raise capital. In particular, we believe that a mutual holding company board of directors has a fiduciary responsibility to preserve its most valuable asset – its subsidiary savings bank, and a dividend waiver may be the best way for a mutual holding company to preserve the subsidiary by allowing capital that would otherwise be paid to the mutual holding company and subject to significant tax to remain with the subsidiary. Unfortunately, the Interim Final Rule is impervious to the benefits that the mutual holding company structure offers to mutual institutions, and the importance of dividend waivers to the ability of mutual holding companies to raise capital. If this were not the case, surely the Board would have allowed Grandfathered MHCs to continue to waive dividends (who have years of experience with mutual holding company dividend waivers with no adverse impact to mutual members) as provided under Section 625(a) of the Dodd-Frank Act, without the imposition of the additional membership vote requirement (which is not referenced in the Dodd-Frank Act).

Mutual holding companies were authorized by Congress more than 30 years ago, and community banks around the nation have used the structure successfully in raising billions of dollars of capital. We believe the Federal Reserve Board's first priority should be to preserve and, where possible, enhance this highly successful capital raising structure, particularly in the current distressed economic environment where banks are having significant difficulty raising equity capital. Yet, Section 239.8(d) of the Interim Final Rule would create the opposite result. That is, the member vote and other extraordinarily burdensome requirements of the Interim Final Rule, including the requirement that directors or trustees of a mutual holding company that waives dividends also personally waive their right to receive dividends, would effectively prevent mutual holding companies from waiving cash dividends. The Interim Final Rule is also inequitable to existing public stockholders who have invested in mutual holding companies with

¹ 80 Fed. Res. Bull. 1131(1924)

the expectation that they would receive dividends without dilution in the event of a conversion of the mutual holding company to stock form. The Rule's requirement that dividend waivers be taken into consideration in determining an appropriate exchange ratio in the event a mutual holding company converts to stock form *would unfairly take value from minority stockholders and eliminate the mutual holding company as a viable long-term structure for savings banks.*

Although there are fewer than 100 publicly-traded mutual holding companies at the present time, the viability of the mutual holding company structure is very important to all mutual institutions, including credit unions that may wish to convert to savings bank charters. Members of our law firm have counseled more than 200 mutual institutions that have converted to stock form in so-called "standard conversions," and we can state with confidence that the mutual holding company alternative to a standard conversion is for many institutions the more practical and prudent method for raising capital and converting to stock ownership. Most mutual institutions have very limited knowledge or understanding of the Interim Final Rule or of the significance of mutual holding company dividend waivers to the attractiveness and viability of the mutual holding company structure. However, mutual institutions fully understand the need for, and value of, having greater flexibility in raising capital and converting to stock ownership. The mutual holding company has been a highly successful capital raising vehicle for mutual institutions, and we respectfully request that the Federal Reserve Board reconsider the restrictions imposed on mutual holding company dividend waivers in the Interim Final Rule. These restrictions would significantly harm mutual holding companies and the mutual holding company structure. (We note, for example, the significant increase in conversions of mutual holding companies to stock form that was precipitated by the Dodd-Frank Act and the anticipated elimination of the OTS as a regulator of mutual holding companies. These conversions were often driven by regulatory uncertainty, including in particular, uncertainty regarding the Federal Reserve Board's treatment of mutual holding company dividend waivers.) Unfortunately, there has been disparate treatment of mutual holding company dividend waivers at both federal and state levels, and we believe that it is important that the Board, as sole regulator of all mutual holding companies, resolve this matter in a way that is equitable to mutual holding companies, their members and minority stockholders.

The OTS had the most experience of any banking regulator in chartering and regulating mutual holding companies. After nearly a decade of experience with the mutual holding company structure, the OTS recognized the need for mutual holding companies to be able to pay reasonable dividends to minority stockholders without penalizing those stockholders receiving the dividend. The OTS amended its dividend waiver rules in 2000 to allow mutual holding companies to waive the receipt of dividends if the waiver would not have an adverse effect on the safe and sound operation of the subsidiary bank and the board of directors of the mutual holding company determined the waiver was consistent with their fiduciary duties. The amended OTS rules provided that mutual holding company dividend waivers would not cause dilution to minority stockholders in the event of a "second-step" conversion of a mutual holding company to

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stock form. The amended rules provided much needed certainty to mutual institutions that were evaluating their capital raising alternatives and provided clarity to mutual holding company investors regarding the terms of their stock investment. (Under the prior OTS rules these investors were never quite sure whether and by how much their ownership interest would be diluted in the event of a conversion of a mutual holding company to stock form.) Moreover, the amended OTS rules allowed mutual holding companies to remain in the structure indefinitely since there was no possibility of accumulated dilution to minority stockholders over time resulting from mutual holding company dividend waivers. Lastly, the amended OTS rules allowed mutual holding companies to grow and raise unprecedented amounts of capital. There is absolutely no evidence that any mutual members have been harmed or treated unfairly in any way as a result of mutual holding company dividend waivers. Indeed, a reasonable case can be made that members benefit from the ability of a mutual holding company to waive dividends, which allows the subsidiary to grow, preserve capital, retain its mutual ownership, and continue to provide banking services to the community.

We recognize the significant time constraints and challenges imposed on the Federal Reserve Board and other federal banking agencies in promulgating new rules pursuant to the Dodd-Frank Act. However, in light of the nearly 20 years of experience that the industry has had with mutual holding companies and dividend waivers by such companies, we respectfully request that the Federal Reserve Board and staff consider and examine the mutual holding company structure, including the relative rights and interests of public minority stockholders and the mutual holding company in common stock of their mid-tier holding company or bank subsidiaries. Section 239.8(d) questions the ability of mutual holding company directors to make those fiduciary decisions and implies that they are incapable of making decisions that are in the best interests of a mutual holding company and its members due to an inherent conflict of interest. Section 239.8(d) would require the boards of Grandfathered MHCs to incur the unnecessary cost of soliciting proxies from mutual members to obtain the approval of a majority of the total eligible votes of members to approve the waiver. Moreover, the Rule suggests that mutual holding company directors who are also stockholders of their subsidiary should waive their individual right to receive a dividend. This is punitive and singles out mutual holding company boards as being uniquely unqualified to address potential conflicts of interest.

B. Specific Concerns and Recommended Changes to the Rule

As noted above, we believe Section 239.8(d) of the Interim Final Rule is fundamentally flawed since the entire basis for the Rule is the presumption that there is an inherent conflict of interest when a mutual holding company's board of directors elects to waive the receipt of dividends and members of the mutual holding company's board are also stockholders of the subsidiary paying the dividend. Our specific comments and recommendation regarding the Rule are as follows:

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1. *A dividend waiver does not create an "inherent conflict of interest."* There is not an "inherent conflict of interest" when a mutual holding company board of directors or trustees (which we refer to interchangeably and collectively as a "board of directors"), consists of persons who also own shares of stock in the subsidiary that is declaring a dividend and elects to waive the receipt of dividends on such class of stock. First, the most important fiduciary duty of a board of directors of a mutual holding company is to preserve the assets and value of its subsidiaries, which are its principal assets. A dividend waiver will always increase the overall capital and retained earnings of a subsidiary because the cash that would otherwise be paid to the mutual holding company is retained by the subsidiary and is not reduced by any tax on the waived dividend amount. Moreover, waiving dividends will increase the value of the subsidiary's common stock, which will benefit all stockholders, including the mutual holding company and assist in attracting additional capital as needed. In addition, it is impossible to determine whether mutual members benefit or are disadvantaged by a waiver, particularly since the rights of mutual members are extremely limited as a matter of law. Lastly, persons who purchase shares of a subsidiary in a minority stock offering pay fair value for their shares, while a mutual holding company does not. The per share capital contribution represented by minority shares (which reflects the fact that minority stockholders have paid fair value for their shares), will *always exceed* that contributed by a mutual holding company.

When a mutual savings bank forms a mutual holding company and conducts a minority stock offering to raise capital, depositors and other persons who purchase shares of common stock must pay *fair value* for such shares, while the mutual holding company makes no additional capital contribution to the subsidiary in exchange for its shares. We note that the shares of a subsidiary held by a mutual holding company are the same as minority shares *in name only*. The mutual holding company shares are the repository of the mutual interests and represent the depositors' future right to purchase shares in an offering and to share in a liquidation distribution. The shares owned by the mutual holding company are substantially different, particularly from an investment or financial perspective, since they were *issued* to the mutual holding company for no additional consideration and not sold for fair value. Moreover, unlike minority shares, they are not traded on a securities exchange and cannot be transferred. The shares held by a mutual holding company represent the unsold portion of a mutual savings bank. Accordingly, since the subsidiary shares owned by the mutual holding company are different from the subsidiary shares owned by the public, there are a number of reasons why a board of directors of a mutual holding company may wish to, *or should*, waive dividends. Moreover, mutual holding company boards of directors must deal with the structure that has been authorized by the federal banking regulators. Since the bank regulators have not, as of this date, permitted mutual holding companies to issue more than one class of common stock, a dividend declared by a mutual holding company subsidiary must necessarily be payable to all stockholders, including its mutual holding company. This does not mean, however, that it is equitable for a mutual holding company to receive the same dividends as minority stockholders or that an inherent conflict of interest exists when a mutual holding company board considers

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waiving dividends. On the contrary, mutual holding company directors, as a matter of course and consistent with their fiduciary duties to members, waive dividends declared by their subsidiary.

Recommended changes to Rule. For the reasons discussed above, the Interim Final Rule should be amended to delete any references to “inherent conflict of interest” as well as language that presumes a conflict of interest exists. We are not suggesting that there can never be a conflict of interest when a mutual holding company board waives the receipt of dividends. Rather, we are simply stating that the Interim Final Rule should not presume that a conflict of interest exists (*i.e.* there should not be one as a matter of law). Moreover, we have no objection to the requirement that all mutual holding companies should submit a notice to the Board requesting its non-objection to proposed dividend waivers. In addition, since a mutual holding company board of directors can readily address any potential conflicts of interest associated with dividend waivers, there is no need for any prior member vote to approve a mutual holding company dividend waiver, or for directors of a mutual holding company who own subsidiary shares to abstain from voting or waive their right (along with waivers by officers and employee stock plans of the mutual holding company and its subsidiaries) to receive dividends.

2. All mutual holding companies should be treated the same with respect to dividend waivers. As discussed above, even if there is a potential conflict of interest associated with mutual holding company dividend waivers, there are many reasons why a mutual holding company board of directors elects to waive dividends, and any potential conflict of interest can be readily addressed by demonstrating sound business reasons for the dividend waivers. Moreover, as discussed above, since the common stock of a subsidiary held by minority stockholders has different ownership characteristics from the common stock held by its mutual holding company, the mutual holding company may not be entitled, from an equity standpoint, to the same dividends as minority shares. These principles apply to all mutual holding companies, whether or not organized before December 1, 2009, and whether or not organized under state or federal law. Therefore, their mutual holding companies should be treated similarly and should not be subject to the punitive conditions of the Interim Final Rule, including a member vote requirement to approve a mutual holding company’s decision to waive dividends.

Recommended changes to Rule. Section 239.8(d)(4) contains additional conditions to dividend waivers by Non-Grandfathered MHCs, which should be eliminated in its entirety since the same dividend waiver rules should apply to all mutual holding companies. We note further that several conditions set forth in section 239.8(d)(4) are so onerous and impractical as to be tantamount to a prohibition against dividend waivers by Non-Grandfathered MHCs.

3. No member vote should be required to approve dividend waivers. For the reasons noted above, the decision whether to waive dividends is appropriately a decision for the board of directors of each mutual holding company. Even if one assumes that a waiver presents a

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potential conflict of interest, it is a decision that a board of directors can readily address and resolve as boards do every day. In any case, the cost of a member vote could be prohibitive, especially since the approval threshold is a majority of the eligible votes of members. Moreover, members will have no interest in this issue, will not understand it, and will not be affected in any way by dividend waivers (other than being “harassed” by proxy solicitors assisting in obtaining a member vote). Therefore, members are unlikely to cast a vote on the matter and not voting is the equivalent of a “no” vote under the Interim Final Rule. In summary, the annual exercise, expense, burden and uncertainty associated with a membership vote is a significant deterrent to waiving dividends. Moreover, with respect to Grandfathered MHCs, we do not believe the Board has the authority to require a member vote to approve dividend waivers. Section 625(a) is very specific in its directive to the Federal Reserve Board. It provides that the “Board may not object to a waiver of dividends” if (i) the mutual holding company is a Grandfathered MHC, (ii) the waiver would not be detrimental to the safe and sound operation of the savings association, and (iii) the board of directors of the mutual holding company expressly determines that the dividend waiver is consistent with the fiduciary duties of the board of directors to the mutual members of the mutual holding company. Section 625(a) does not give the Federal Reserve Board *any discretion* to add additional conditions to granting dividend waivers by Grandfathered MHCs. The language and intent of Section 625(a) is very clear, and nowhere is there any mention of member voting as a precondition to dividend waivers.² Lastly, we note that all proxy materials mail to members to approve a mutual holding company reorganization generally contain disclosure regarding dividend waivers. This disclosure could be expanded and highlighted so that mutual members will have the opportunity to consider dividend waivers as part of their decision whether to vote in favor of a mutual holding company reorganization.

Recommended changes to Rule. Eliminate any member vote requirement under section 239.8(d)(2)(iv) and 239.8(d)(4)(iii) as a precondition for dividend waiver approvals for any mutual holding company.

4. Non-Grandfathered MHCs should not be subject to additional restrictions. As discussed above, we believe that the Interim Final Rule incorrectly assumes that a mutual holding company board has breached its fiduciary duty to members when it elects to waive the receipt of dividends because of an inherent conflict of interest associated with waiving dividends. Dividend waivers are essential to the mutual holding company structure and the ability of all mutual holding companies to attract equity capital. This is the case whether or not the mutual holding company is a Grandfathered MHC. As a matter of policy, the Board should apply the same dividend waiver standards applicable to Grandfathered MHCs (but with no member vote)

² We note that the U.S. Supreme Court in the seminal case, *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984) made clear that courts will not accept an agency’s interpretation of a statute if Congress has spoken clearly to the issue presented. If the agency’s interpretation is contrary to the clear intent of Congress, the agency’s interpretation is invalid.

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to all mutual holding companies, since every mutual holding company board will potentially face the same conflict of interest issues in connection with a dividend waiver and will be able to address and resolve such conflict.

In addition, the conditions imposed on Non-Grandfathered MHCs are punitive and bear no relationship to the magnitude of the potential conflict of interest. As discussed below, members of a mutual holding company will not directly benefit from a mutual holding company's receipt of dividends, and may in fact benefit from a waiver. It is extremely unlikely that a mutual holding company board would be able to have a majority of the entire board approve a dividend waiver with directors who own subsidiary stock abstaining. Mutual holding company boards, like other stock holding company boards, typically consist of the same persons who sit on the boards of subsidiaries, and such directors are encouraged to own stock in their subsidiaries. How can a board member ask others to invest in his or her company or bank if such board member has not done so? Moreover, because there is no inherent conflict of interest or, at most, no conflict of interest that a mutual holding company board cannot readily address, there is no need for mutual holding company board members, officers and stock benefit plans to waive dividends that all other public stockholders will be receiving.

Recommended changes to Rule. Section 239.8(d)(4) and any distinctions applicable to Non-Grandfathered MHCs should be deleted in their entirety.

5. There should be no dilution of minority stockholders resulting from dividend waivers. We have discussed at length in this letter the reasons why it is reasonable and equitable for mutual holding company boards of directors to waive dividends from their subsidiaries. A mutual holding company dividend waiver does not necessarily involve any transfer of value from the mutual holding company and its members to minority stockholders. Moreover, mutual members will be unaffected regardless of whether a mutual holding company waives or receives dividends. In fact a case could be made that the members may benefit from dividend waivers by a mutual holding company because the waiver may increase the value of the mutual holding company's stock interests in its subsidiary. Accordingly, there is no basis for requiring minority stockholder dilution in the event of a conversion of a mutual holding company to stock form. Dilution is bad policy because it will reduce the value of minority shares for no sound reason. This will add significant uncertainty to any investment in a mutual holding company's stock, which will make it more difficult for mutual holding companies to raise capital and remain in the mutual holding company structure indefinitely. There are other ways to address any potential transfer of value without taking value from minority stockholders. For example, as a condition to approving a dividend waiver, the Board could require that the amount of waived dividends be set aside and added to any liquidation account established in the subsidiary bank in the event of a conversion of a mutual holding company to stock form. This is precisely how the pre-conversion equity of a mutual savings bank is preserved for former members of a mutual savings bank that converts to stock form.

Recommended changes to Rule. Section 239.8(d)(5) of the Interim Final Rule, which authorizes the Board to consider waived dividends in determining an appropriate exchange ratio in the event a mutual holding company converts to stock form, should be deleted. If the Board has the authority to review dividend waiver requests, then presumably any approved waivers would be reasonable in view of the earnings and capital position of the subsidiary and would not involve any inappropriate transfer of value to minority stockholders. Moreover, a dividend waiver may in fact increase the value of the mutual holding company's stock interest in its subsidiary, which should not result in dilution to minority stockholders. The Board has the discretion to approve or not approve dividend waivers. Introducing uncertainty associated with potential stockholder dilution in the event of a conversion of the mutual holding company to stock form will have an adverse impact on the mutual holding company and all of its stockholders. The "Valuation" provisions of section 239.8(d)(5) of the Interim Final Rule should be amended to be substantially the same as section 575.10(d)(3) of the former OTS regulations.

C. Background of Mutual Holding Company Dividend Waivers and Ownership

Mutual holding companies are substantially the same as stock holding companies except they have a majority stockholder that is mutually owned, which represents the mutual interest in a savings bank that has not yet been converted to stock form and offered for sale to the public. The initial reason for authorizing the mutual holding company structure was to provide a vehicle that would allow mutual savings banks to raise capital and grow responsibly. Standard conversions require that 100% of a converting mutual savings bank's stock be sold at fair value in a single offering, which can increase a bank's capital by 200% or more. In many cases, conversions of mutual savings banks to fully public stock organizations in a single transaction resulted in a surplus of capital that led to unsafe investment decisions. Allowing a "partial conversion" using the mutual holding company structure has been good public policy because it allows mutual savings banks to raise capital incrementally and promote measured growth which does not put the savings bank at risk. That is, a mutual holding company minority stock offering results in less than half the capital raised in a standard conversion. A mutual holding company, for example, may effect several minority stock offerings as its capital needs require, and still remain in the mutual holding company structure.

However, a minority stock offering is far less attractive to investors and would raise less capital (because of the lower valuation of minority stock) if minority stockholders are unable to achieve a reasonable return on their investment. Since minority stockholders do not have a controlling vote and there is limited potential for capital appreciation from a sale of control of a mutual holding company, a dividend is an important part of the overall return that investors seek in exchange for the capital they have invested and the risk that they have assumed. Most, if not all initial stockholders who invest in a mutual holding company minority stock offering, are depositors of a savings bank. A dividend paying stock also attracts more investors and enhances the interest in, and market valuation of, a mutual holding company and its subsidiaries. If a

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mutual holding company cannot waive dividends (and must receive dividends whether the mutual holding company has a need for the cash or not) the value of the subsidiary's stock would be less compared to the value of stock sold in a standard conversion to stock form. Moreover, if minority stockholders are diluted because of mutual holding company dividend waivers, mutual holding companies will be forced to convert to stock form before their capital needs and business plan would call for such a conversion to avoid excessive dilution to such stockholders.

Understanding how the mutual "ownership" of a mutual savings bank is converted to stock ownership is key to understanding the mutual holding company structure, including how it sells shares to raise capital and the fundamental differences between public shares held by minority stockholders and shares held by a mutual holding company. Under existing federal law and policy, mutual holding companies can only be acquired by other mutual institutions or mutual holding companies. As a result, there is limited takeover premium in the common stock of mutual holding companies and investors look primarily to dividends and long-term capital appreciation when they invest in mutual holding companies.³ Therefore, a key to the mutual holding company structure and the ability of mutual holding companies to raise capital, is the ability of their subsidiary banks or mid-tier holding companies to pay reasonable dividends to minority stockholders who have invested capital in the organization. Since all mutual holding company subsidiaries must issue only one class of common stock to both public stockholders and their mutual holding companies, if a subsidiary wishes to distribute some of its earnings to minority stockholders in the form of dividends, it must declare a dividend on all of its common stock. As a common stockholder of the subsidiary, a mutual holding company has the legal right to receive the same per share cash dividends as minority stockholders.

Unlike the shares sold to minority stockholders at fair value in exchange for additional capital (at least 50% of which must be contributed to a mutual holding company's subsidiary bank), the shares of common stock held by the mutual holding company *have not been sold for fair value* and instead are simply issued to the mutual holding company as a repository of the mutual interests and represents the depositors future right to purchase share in an offering or share in liquidating distribution. This means that the capital contribution represented by the shares held by a mutual holding company is in most cases at least 50% less per share than the capital contribution per share of minority stockholders.⁴ In the example contained in the footnote

³ In this comment letter, we often refer to "investing in mutual holding companies" or "purchasing mutual holding companies," to mean investing in the mutual holding company group or the mutual holding company's stock holding company subsidiary. Mutual holding companies are mutually owned and investors who purchase common or preferred stock must invest in a mutual holding company subsidiary.

⁴ For example, if a mutual savings bank is valued at 75% of pro forma book value, then (setting the expenses of an offering aside) if it had pre-mutual holding company conversion capital (book value) of \$25.0 million, it would raise \$75.0 million (\$75.0 million is 75% of \$100.0 million) in a full or "standard" conversion offering by selling 100% of its common stock, and \$33.75 million in a mutual holding company minority stock offering of 45% of its common stock (assuming comparable valuations for mutual holding company offerings and standard conversion offerings). In this example, minority stockholders will have purchased their shares at fair value and will have paid/

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below, we demonstrate how minority stockholders in a typical conversion/mutual holding company offering valuation of 75% of pro forma book value, contribute approximately three times the capital contributed by the mutual holding company on both a per share and aggregate basis.

The reason why a mutual holding company does not pay for its shares is that it is essentially a placeholder for the common stock of its subsidiary bank or mid-tier holding company that has not been offered for sale to depositors and the public. As a result, while the mutual holding company also owns common stock like other minority stockholders, its ownership interest is quite different. As noted above, a mutual holding company does not purchase its shares for fair value and federal regulations do not allow a mutual holding company to trade or transfer its shares. Yet the Interim Final Rule considers form over substance and treats mutual holding company shares as if they had the same characteristics as minority shares and were purchased for value just like minority shares. This is simply not the case and the Interim Final Rule produces an inequitable result for both minority stockholders and the mutual holding company structure.

This substantive difference between the capital and ownership represented by minority shares versus mutual holding company shares is a principal source of the underlying confusion regarding mutual holding company dividend waivers. It has led to what we believe is the inequitable result of the Federal Reserve Board effectively requiring that mutual holding company subsidiaries pay the same per share dividends to their mutual holding companies as they pay to minority stockholders, and characterizing the decision by mutual holding company boards of directors to waive dividends as a breach of fiduciary duty. Section 239.8(d) of the Interim Final Rule is the latest affirmation of this policy.

The common stock held by a mutual holding company, while of the same class as common stock held by minority stockholders, is similar in name only. However, it is this ownership of the same class of common stock as minority stockholders, but with very different ownership rights and characteristics, that has created the need for mutual holding companies to waive dividends and resulted in the Federal Reserve Board's concern that such waivers present a potential conflict of interest for the mutual holding company's board of directors.⁵ As discussed

contributed \$33.75 million for shares that had a pre-offering book value of \$11.25 million, while the mutual holding company will have paid/contributed no additional capital for shares that it received that had a pre-offering book value of \$13.75 million. Similarly, in a full or standard conversion transaction, public stockholders will have paid/contributed \$75.0 million of new capital for 100% of the converted bank's shares that had a pre-offering book value of \$25.0 million.

⁵ Arguably, the shares issued to the mutual holding company should be treated or designated as a separate class of stock since the common stock held by the mutual holding company: (i) is not and cannot be traded or transferred; (ii) was not purchased by the mutual holding company; and (iii) does not bear the same risk characteristics as the common stock issued to minority stockholders. If the shares were treated as a separate class of stock, then dividends could be paid to minority stockholders without paying dividends to the mutual holding company.

in more detail below, the very limited ownership interests of depositors/members and the significantly different ownership rights and characteristics of subsidiary common stock held by a mutual holding company, significantly mitigates any potential conflict of interest associated with a mutual holding company board's decision to waive the receipt of dividends.

A mutual holding company has the right to waive the receipt of dividends, subject to any required regulatory notices or approvals, and most federally-chartered mutual holding companies have waived the receipt of dividends because: (i) they do not have a need or use for, nor an expectation of, cash at the mutual holding company; (ii) the cash amount of the dividends can be deployed more effectively by their stock holding company or savings bank subsidiaries, thereby strengthening the capital position of such subsidiaries and the organization as a whole; and/or (iii) they do not want to pay taxes on dividends received.

When a mutual holding company receives cash dividends from its subsidiary savings bank, it must pay taxes on those dividends⁶ and the funds received, less taxes paid, are held as assets of the mutual holding company. If a mutual holding company elects to waive the receipt of dividends, it does not pay federal and state taxes on the cash dividends received. The cash that would otherwise have been paid to the mutual holding company remains as capital of the subsidiary holding company or savings bank, thereby preserving and increasing capital for the benefit of the entire mutual holding group. By waiving the receipt of dividends, a mutual holding company is increasing the amount of capital available to its subsidiary savings bank because no tax is paid on the waived dividends, and therefore it is acting as a source of strength to the subsidiary savings bank. Conversely, by accepting dividends from its subsidiary, a mutual holding company reduces the capital resources available to its subsidiary savings bank by the amount of state and federal tax on the dividends paid.

D. Dividend Waiver Policies of Federal Bank Regulators Prior to the Dodd-Frank Act

Federal and state regulation of mutual holding companies has evolved over the years as both the industry and regulatory agencies have accumulated more knowledge regarding the performance and operations of these companies. The mutual holding company structure was originally intended to preserve mutuality by providing mutual institutions with more flexibility in raising capital without converting entirely to stock form.⁷ Consistent with this objective, the original policies of the Federal Reserve Board and the OTS anticipated that mutual holding

⁶ Generally, 80% of the amount of dividends received by a mutual holding company is excluded from federal income tax. Dividends received by a mutual holding company are also subject to state taxation.

⁷ Mutual holding companies were first authorized under federal law by Section 107 of the Competitive Equality Banking Act of 1987 (Pub. Law 100-86). The objective of the mutual holding company legislation was to offer mutual institutions some of the powers that were available to stock holding companies, such as greater flexibility in raising capital and structuring acquisitions. *See, generally*, S. Rep. No. 100-19 (1987).

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companies would waive the receipt of any dividends declared by their subsidiaries, thereby preserving the capital resources of their subsidiary savings banks.

For example, in 1987 when People's Bank of Bridgeport, Connecticut formed People's Mutual Holdings, the expectation of the Board was that the mutual holding company would waive the receipt of dividends from People's Bank, and that such dividend waivers would help preserve the capital resources of People's Bank. The Federal Reserve Board's order approving the People's Bank mutual holding company reorganization contained no restrictions on the ability of People's Mutual Holdings to waive the receipt of dividends from People's Bank.⁸ Moreover, in November 1992, the Federal Reserve Board entered into an agreement with People's Mutual Holdings *requiring* the mutual holding company to obtain the consent of the Federal Reserve Bank of New York *before the mutual holding company could accept any dividends* from People's Bank. The underlying purpose of the restriction on People's Mutual Holdings' ability to accept dividends from its stock savings bank subsidiary was to strengthen the capital position of People's Bank. As of September 30, 2006, the latest financial quarter prior to its conversion to a full stock organization, People's Mutual Holdings had waived the receipt of approximately \$554.0 million of cash dividends declared on the shares of People's Bank common stock owned by the mutual holding company.⁹ The Federal Reserve Board *did not place restrictions or conditions* on the capital of People's Bank or on its minority stockholders as a result of these dividend waivers. The \$554.0 million of waived dividends was retained as capital of People's Bank or its mid-tier stock holding company and was available to support new loans and the growth of the savings bank. At March 31, 2011, People's Bank had total assets of \$25.0 billion, stockholder's equity of \$5.2 billion and was the largest independent bank headquartered in Connecticut. Between 1996 and its conversion to full stock form in 2006, People's Bank had aggregate earnings of approximately \$1.1 billion.

Before 1995 no federal or state bank regulatory agency, including the Federal Reserve Board, the Federal Deposit Insurance Corporation ("FDIC") or the OTS, either prohibited mutual holding company dividend waivers or required dilution of the ownership interest of minority stockholders because of waived dividends. The change in the initial dividend waiver policies of the Federal Reserve Board and the OTS came in the aftermath of the 1994 mutual-to-stock conversion of Greenpoint Savings Bank, a New York-chartered savings bank with assets of approximately \$6.5 billion at the time of the conversion, and the perceived unfairness of the benefits accruing to management in connection with Greenpoint Savings Bank's conversion. The Greenpoint Savings Bank conversion, which occurred at the height of a bull market for mutual-to-stock conversions, resulted in hearings before the Senate Banking Committee on the mutual-to-stock conversion process and more oversight of mutual-to-stock conversions by both the FDIC and the Federal Reserve Board. Accordingly, in 1994, the OTS amended its mutual-to-

⁸ See *People's Mutual Holdings, Bridgeport, Connecticut*, 73 Fed. Res. Bull. 885 (1987).

⁹ See *Peoples United Financial Inc.*, Form S-1 F.37 n. 12 (filed Nov. 2, 2006).

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stock conversion and mutual holding company regulations,¹⁰ the FDIC adopted new mutual-to-stock conversion regulations that substantially incorporated the OTS regulations,¹¹ and the Federal Reserve Board assumed a more active role in reviewing both mutual holding company formations and mutual-to-stock conversions by state chartered savings institutions.¹² As part of this new role, the Federal Reserve Board indicated that in reviewing these transactions it would take into account the extent to which they conformed to OTS and FDIC regulations and any non-conformity would be “closely scrutinized.” The Board also noted that conformity with OTS and FDIC requirements would not be sufficient if the Board determined that a transaction would “pose a risk to the institution’s safety and soundness, violate any law or regulations, or present a breach of fiduciary duty.”¹³

As part of this regulatory oversight, each of the federal banking agencies also reevaluated its policies regarding dividend waivers by mutual holding companies. They concluded that a mutual holding company’s waiver of dividends presented a potential conflict of interest for the directors or trustees of the mutual holding company who are typically also directors and stockholders of the subsidiary savings bank or mid-tier holding company. Since a portion of the dividends waived by the mutual holding company would accrue to the benefit of minority stockholders in the form of increased book value per share, the directors/trustees of the mutual holding company would benefit personally from such waivers. In *Greater Delaware Valley*, the Federal Reserve Board discussed the potential conflict of interest that could result from the decision by a mutual holding company’s board of trustees to waive the receipt of dividends:

“In most cases, the board of trustees of the mutual holding company . . . is comprised of the same individuals as the board of directors of the subsidiary bank, and these same individuals are also minority shareholders of the bank. As a result, the individuals who establish the dividend rate for the bank and declare the dividends on behalf of the bank, may also waive them on behalf of the holding company, and, as minority shareholders, gain personally from any financial benefits stemming from the waiver. The decision to execute such a waiver is not reviewed by the mutual members of the bank holding company, and rests exclusively with the trustees, who have a financial interest and cannot be removed by the mutual members.”¹⁴

¹⁰ See 59 Fed. Reg. 22,725 (1994).

¹¹ See 59 Fed. Reg. 7,194 (1994).

¹² See *Northwest Bancorp, MHC*, 80 Fed. Res. Bull. 1131 (1994).

¹³ See *Northwest Bancorp, MHC*, 83 Fed. Res. Bull. 833 (1997).

¹⁴ Similarly, in *Northwest Bancorp, MHC*, the Board stated that:

“A waiver of dividends by the holding company without a corresponding waiver by the minority shareholders would result in a transfer of equity from the mutual owners of the holding company to the minority stockholders, to the possible detriment of the mutual owners. The decision to execute such a waiver is not reviewable by the mutual members of the holding company, and rests exclusively with the

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In *Greater Delaware Valley*, the Board stated that, to address the conflict issue, the mutual holding company had made certain commitments, including a commitment that “the amount of waived dividends . . . would not be available for payment to, or the value transferred to, minority shareholders of the bank, either through dividend payments, upon the conversion of the mutual holding company to stock form . . . or by any other means.” Similarly, as a condition of the Federal Reserve Board’s 1994 approval of Northwest Savings Bank’s mutual holding company reorganization, the Board required the mutual holding company to obtain prior approval before waiving the receipt of dividends from Northwest Savings Bank, and, if the approval was granted the subsidiary savings bank would be required to establish for the benefit of the mutual members of Northwest Savings Bank a restricted capital account for the cumulative amount of any dividends waived by the mutual holding company and such waived dividends would be added to any liquidation account in Northwest Savings Bank established in connection with its conversion to stock form.¹⁵

trustees of the bank holding company, who have a financial interest in the waiver as direct minority shareholders of the bank. This potential conflict of interest is of particular concern when a holding company is organized in mutual form and, unlike the case of management in a stock bank holding company that may be replaced by shareholders . . . state law does not provide a mechanism for management of the mutual holding company to be changed by the mutual members. This potential conflict of interest raises a question whether the proposal is consistent with the convenience and needs of the community, which is represented by the depositor-owners of [the savings bank], and whether the proposal reflects adversely on the managerial resources of the bank holding company.” See *Northwest Bancorp, MHC*, 80 Fed. Res. Bull. 1131 (1994).

¹⁵ See *supra*.

The Federal Reserve Board’s decision is premised on the proposition that depositors of a savings bank are the “owners” of the savings bank, and that this ownership, retained in the mutual holding company and represented through the mutual holding company’s interest in the common stock of the subsidiary savings bank, is of equal value and with the same rights as all public shareholders of the subsidiary savings bank. We believe this premise is incorrect and the Board should revisit and reconsider its analysis in *Greater Delaware Valley* and *Northwest Bancorp, MHC* for the reasons discussed in this letter. The Federal Reserve Board’s decision is also premised on the notion that members/depositors do not consent to such dividend waivers and are disadvantaged by such waivers. This is also incorrect. Depositors/members have had the opportunity to vote on and either approve or disapprove every mutual holding company reorganization and stock offering and to purchase common stock in such offering, and each member proxy statement and each offering prospectus has disclosed the mutual holding company’s intent to waive the receipt of dividends.

It also has been argued that requiring a mutual holding company to accept its share of dividends on the common stock of its subsidiary will enable the mutual holding company to become a “source of strength.” This turns the holding company “source of strength” doctrine on its head. A holding company should be a source of capital or “strength” to its subsidiary savings bank independent of the financial resources of the subsidiary bank; whereas the source of all mutual holding company earnings is dividends from their subsidiary savings banks or holding companies. By requiring the subsidiary to pay dividends to the mutual

It is important to emphasize that while the Board in *Greater Delaware Valley* denied the specific dividend waiver request of Greater Delaware Valley Holdings, MHC, neither this decision nor *Northwest Bancorp, MHC* prohibits mutual holding companies from waiving dividends. Instead, in each of the above decisions, the Board established standards or guidelines for approving mutual holding company dividend waivers that were intended to address the perceived conflict of interest created by such waivers.

Moreover, we note further that in *Northwest Bancorp, MHC* the Federal Reserve Board established a reasonable mechanism for mutual holding company boards to address potential conflict of interest concerns that is not punitive to minority stockholders. The Board stated that, if a dividend waiver is granted, the amount of waived dividends would be a restriction on retained earnings of the subsidiary savings institution, would not be available for distribution to minority stockholders, and would be added to the subsidiary savings institution's liquidation account in the event of a conversion of its mutual holding company parent to stock form. The restriction on retained earnings and liquidation account would prevent minority stockholders, and members of the board of directors of the mutual holding company who are also minority stockholders, from benefiting from a mutual holding company's decision to waive dividends.

The restriction on retained earnings preserves the waived dividends for the benefit of a mutual holding company's members in precisely the same way, and for the same reason, that a liquidation account established when a mutual savings bank converts to stock form preserves the ownership interests of the converting mutual saving bank's members. Specifically, to address the ownership rights of members and the potential conflict of interest associated with a mutual board's decision to convert their mutual savings bank to stock form, the pre-stock conversion retained earnings of the mutual savings bank, representing the mutual "ownership" interest in the converting savings bank, is transferred to a liquidation account solely for the benefit of members and is available for distribution to members only in the event of a complete liquidation of the converted savings bank. (We note that while the mutual holding company and the subsidiary would agree to the foregoing restrictions as a condition to the Board's approval of a dividend waiver request, such restrictions on the retained earnings of the subsidiary would appear to be excessive in light of the argument that a mutual holding company should not be entitled to the same dividends that would otherwise be paid to minority stockholders).

The OTS originally followed a different approach in its regulation of mutual holding company dividend waivers. The OTS routinely authorized federal mutual holding companies to waive dividends, but attempted to address the perceived conflict for mutual holding company directors by placing restrictions on the waived dividend amounts. Under this OTS policy, the

holding company, the subsidiary in effect becomes the source of strength for the mutual holding company. Preventing mutual holding companies from waiving dividends or making the standards for a waiver punitive to minority stockholders, also results in a waste of capital resources to the insured savings bank subsidiary in the amount of taxation on the dividends received by the mutual holding company.

amount of dividends waived by a mutual holding company was required to be set aside, monitored, and taken into account in any valuation associated with a subsequent conversion of the mutual holding company to stock form. Cumulative waived dividends were required to be recorded as a restriction on retained earnings and *could not be paid to minority stockholders*. The OTS amended its dividend waiver policy in 2000 because of the negative impact of its policy, as well as those of the Federal Reserve Board and FDIC, on the ability of mutual holding companies to raise equity capital. The amended policy, reflected in OTS rulemaking, is discussed below.

Lastly, the FDIC also adopted a policy that required the amount of waived dividends to be added to the ownership interest of the mutual holding company upon its conversion to stock form and taken into account in determining minority stockholders' ownership interest/percentage of the fully-converted stock holding company, thereby effectively diluting the ownership interests of minority stockholders.¹⁶ Under FDIC policy, this ownership dilution of minority stockholders increases over time as the subsidiary savings bank continues to pay dividends and the mutual holding company waives all or a portion of those dividends.¹⁷

The restrictive dividend waiver policies adopted by the federal banking regulators in the wake of the Greenpoint Savings Bank mutual-to-stock conversion emphasized the "ownership" rights of depositors and arguably created new rights that did not previously exist as a matter of law. These new policies impaired the ability of mutual holding companies to pay dividends, which had the effect of reducing the value of the common stock being offered by such companies and the attractiveness of mutual holding company minority stock offerings generally. The data indicates that capital raising transactions by mutual holding companies decreased significantly because of these federal policies regarding dividend waivers.¹⁸ The consequence of this policy was to reduce the amount of capital available to the mutual banking industry.

¹⁶ See Michael J. Zamorski, Acting Director, Federal Deposit Insurance Corporation, *Comment Letter to OTS*, dated November 8, 2000 available at <http://files.ots.treas.gov/48586.pdf>.

¹⁷ In a so called "second-step" mutual-to-stock conversion of a mutual holding company, the shares of common stock of the subsidiary savings bank held by the mutual holding company are sold at market value. Since waiving dividends does not affect the *pro forma* market value of the converted mutual holding company and its subsidiary savings bank, any increase in the mutual holding company's ownership interest in the converting savings bank to reflect waived dividends will result in more shares offered for sale in a second-step conversion and fewer new shares issued to minority stockholders in exchange for their existing shares.

¹⁸ Between 1995 and July 2000 when the OTS issued new regulations clarifying that federal mutual holding companies could waive dividends without dilution to minority stockholders, the OTS approved 15 mutual holding company stock offerings. From the July 2000 amendments until 2008, the OTS approved 49 mutual holding company stock offerings. See *Holding Company Search*, available at <http://www.ots.treas.gov>.

E. OTS Regulations Amending Its Dividend Waiver Policy

On July 12, 2000, the OTS amended its mutual holding company and mutual-to-stock conversion regulations, and proposed new regulations that were intended to enhance the mutual holding company structure.¹⁹ The new regulations reflected the significant experience that the OTS had in overseeing the majority of publicly traded mutual holding companies. In issuing the proposed rule, the OTS acknowledged that some of its prior regulations and policies discouraged mutual institutions from raising capital through the mutual holding company structure, which structure was particularly effective in enabling these institutions to raise capital incrementally. In effect, the OTS acknowledged that its prior policy had placed the very limited ownership interests of depositors and members on an equal, if not superior, footing compared to public stockholders. In particular, it noted that its dividend waiver policy (which paralleled that of the FDIC) contemplated dilution of minority stockholders upon conversion of the mutual holding company to stock form if the mutual holding company had previously waived the receipt of dividends. Since this dilution becomes substantial over time as a mutual holding company continues to waive dividends, it created significant pressure on these companies to convert to stock form before their business and growth plans otherwise called for such a conversion.²⁰ This defeated one of the original purposes of mutual holding companies – to enable mutual institutions to form holding companies and raise capital gradually, thereby enabling them to reinvest the capital more prudently and without undue short-term pressure from public stockholders.

The amended OTS regulations specifically authorized mutual holding companies to waive the receipt of dividends, subject to the prior approval of the OTS, provided the dividend waivers were not detrimental to the safe and sound operation of the subsidiary savings bank and the board of directors of the mutual holding company determined that the waiver was consistent with their fiduciary duties to members of the mutual holding company. Moreover, Section 575.11(d)(3) of the OTS regulations provided that “the OTS will *not* consider waived dividends in determining an appropriate exchange ratio in the event of a full conversion of [a mutual holding company] to stock form.” (Emphasis added.) Accordingly, the OTS allowed mutual holding companies to waive dividends, with its approval, and very significantly did not require the amount of waived dividends to affect or reduce minority stockholders’ ownership interest in the subsidiary bank or holding company in the event of a conversion of the mutual holding company to stock form.

¹⁹ See 65 Fed. Reg. 43,088 (July 12, 2000).

²⁰ See *Id.* at 43,088, 43,089. This made a standard mutual-to-stock conversion more attractive than a mutual holding company formation, even though a standard conversion would often result in an institution raising far more capital than it could effectively deploy. This often placed the continued existence or independence of converting institutions in jeopardy as they inevitably made riskier loans and investments to improve shareholder returns.

A key objective of the OTS in adopting and proposing new mutual holding company regulations was to make the mutual holding company a more attractive long-term structure for raising capital.²¹ The OTS acknowledged that the dividend waiver policies of the federal banking regulators was a significant impediment to raising capital since they either effectively prohibited mutual holding companies from waiving dividends, or permitted such waivers so long as the ownership interest of minority stockholders was diluted in the event of a second-step conversion to reflect the dollar amount of waived dividends. These policies were difficult for stockholders to understand, caused significant uncertainty about the mutual holding company structure, and caused a number of mutual holding companies to implement second-step conversions prematurely. At the same time, there was no evidence that dividend waivers adversely affected ownership interests of the mutual holding company members. In support of its decision, the OTS also noted that paying dividends to the mutual holding company caused unnecessary additional taxation and reduced the capital available to the subsidiary savings bank.

“OTS will not object to the notice [of intent to waive dividends] if it determines that the waiver would not be detrimental to the safe and sound operation of the savings association. . . .Waiving dividends saves the MHC from corporate taxation on the dividends and leaves the capital at the subsidiary savings association where, in most cases, it can be deployed more efficiently.”²²

F. Summary of the Board’s Dividend Waiver Policy for State-Chartered MHCs

The Federal Reserve Board requires state-chartered mutual holding companies to address the concerns outlined in *Greater Delaware Valley* when requesting approval to waive dividends. While the Board does not prohibit mutual holding companies from waiving dividends (See *People’s Mutual Holdings, MHC*), to our knowledge it has not approved or acted upon any dividend waiver request by a state-chartered mutual holding company since its decision in *Greater Delaware Valley*. As a result, there is no Board precedent for either approving dividend waiver requests by state-chartered mutual holding companies or considering waived dividends in connection with conversions of publicly-traded mutual holding companies to stock form. However, there is Board precedent in *People’s Mutual Holdings, MHC*, for *requiring* a mutual holding company to waive the receipt of dividends as a means of preserving the capital resources of a subsidiary bank, particularly in a weak economic environment.

In an effort to mitigate any potential conflict of interest associated with mutual holding company dividend waivers, the Board has required state-chartered mutual holding company applicants to commit to the following as a condition to the Board’s approval of their mutual holding company applications:

²¹ See 65 Fed. Reg. 43,088, 43,093 and 43,095-96. Between 1993 and 2000, 37 mutual holding companies, or

²² See 65 Fed. Reg. 43,088 (July 12, 2000).

- (i) the aggregate amount of waived dividends must be segregated and reported as a restriction on the retained earnings of the subsidiary savings bank and is not payable to minority stockholders; and
- (ii) in the event of a second-step conversion of the mutual holding company to stock form, the aggregate amount of waived dividends may be added to the liquidation account established in the subsidiary savings bank to preserve the liquidation rights of depositors.²³

G. Reasons Why Dividend Waivers Are Consistent With Director Fiduciary Duties

We believe that mutual holding company dividend waivers are consistent with the fiduciary duties of directors and do not represent an inherent conflict of interest because, in nearly all instances, a dividend waiver will enhance the safe and sound operations of a mutual holding company's most important asset—its subsidiary savings bank. Moreover, a dividend waiver is likely to increase the value of the subsidiary's common stock, which will benefit all stockholders, including the mutual holding company. Lastly, members of a mutual holding company will not benefit directly if a mutual holding company accepts dividend from its subsidiary, and may be disadvantaged if the mutual holding company does not waive dividends. In addition, such waived dividends would not be available for distribution to minority stockholders. Moreover, there should be no dilution of minority stockholders in the event a mutual holding company converts to stock form since the amount of waived dividends would not be available for distribution to minority stockholders, and upon conversion of the mutual holding company to stock form the aggregate amount of waived dividends would be added to any liquidation account established in the subsidiary savings bank.

1. Dividend waivers would not be detrimental to the safe and sound operation of a mutual holding company subsidiary savings bank

The dividend waivers by a mutual holding company cannot be detrimental to the safe and sound operation of the subsidiary savings bank because the waivers will result in more net capital retained by the mid-tier stock holding company and the mutual holding company group. Therefore, more capital will be available to its subsidiary savings bank. In effect, the mutual holding company is acting as a source of strength to the subsidiary savings bank by waiving the receipt of dividends and the dividend waivers will *enhance* the safe and sound operation of the subsidiary savings bank. If dividends are not waived by the mutual holding company, the federal

²³ Based on *Greater Delaware Valley* and *Northwest Bancorp, MHC*, if the Federal Reserve Board permits a mutual holding company to waive dividends, accrued waived dividends would be unavailable to minority stockholders and would be a restriction on retained earnings. However, allowing a mutual holding company to waive dividends would still adversely affect minority stockholders and the value of their stock if the Board requires dilution of the ownership interests of minority stockholders to reflect the amount of the waived dividends in the event of a conversion of the mutual holding company to stock form.

and state income tax on dividends received by the mutual holding company will reduce the total amount of cash that would otherwise be available to support the capital and operations of the subsidiary savings bank. This tax on dividends and the corresponding reduction in capital available to support the savings bank is significant and increases over time as the subsidiary holding company continues to pay dividends.

Waiving dividends will also increase the value of the subsidiary holding company's common stock, which will benefit all stockholders, including the mutual holding company, and will result in more capital being available to the subsidiary holding company and savings bank on more favorable terms. Stockholders are more likely to invest in a mutual holding company subsidiary and pay a higher price for the subsidiary holding company's common stock (which increases the capital resources available to the savings bank and the subsidiary holding company and the value of the company's common stock) if they understand that they can receive reasonable dividends on their common stock without suffering dilution in the event the mutual holding company converts to stock form. Conversely, not allowing a mutual holding company to waive dividends or allowing dividend waivers but diluting minority stockholders in the event the mutual holding company converts to stock form, will adversely affect the value of the holding company's common stock, the ability of the holding company to raise capital, and the mutual holding company's ability to convert to stock form.

Additionally, a stronger stock price may have the effect of increasing a community bank's presence in its retail markets because they typically have a local stockholder base. Paying dividends to minority stockholders, with the mutual holding company waiving dividends, will help build long-term shareholder loyalty and value by providing minority stockholders with a reasonable dividend and overall return on their investment. This is important for community banks with a local stockholder base, particularly in the current weak economic environment where stockholders have suffered significant losses on financial institution stocks. These stockholders are seeking dividend paying stocks to improve their overall return on investment.

2. Dividend waivers are consistent with a mutual holding company board's fiduciary duties to members

Any analysis of the fiduciary duties of the board of directors of a mutual holding company owed to the depositors of the savings bank (who are members of the mutual holding company) must begin with an analysis of the rights and interests of depositors under federal and state law as the chartering authority of a mutual holding company and its subsidiary savings bank.

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a. Depositors'/Members' Ownership Rights Under Applicable Law

Depositors of a reorganizing mutual savings bank who become members of a mutual holding company retain the same ownership rights in the mutual holding company as they had in the mutual savings bank immediately prior to a mutual holding company reorganization. Depositors of a federal savings bank have voting rights and a right to share in any remaining surplus, after the payment of all creditors, in the event of a liquidation of the savings bank. Under many state laws, depositors have *no voting rights*. They only have a right to share in any surplus remaining upon liquidation of the mutual savings bank after payment of all liabilities, claims and deposits.

Members of a mutual holding company do not have the right to force a liquidation of the mutual holding company or subsidiary bank, or to receive any distribution of the assets of the mutual holding company other than in the event of a liquidation of the mutual holding company. (In this regard, we note that there has never been a voluntary liquidation of a mutual holding company and distribution of its surplus to members). Members also do not have the right to receive any portion of the dividends paid to a mutual holding company. Any dividends paid by a subsidiary, net of taxes owed by the mutual holding company, will increase the assets of the mutual holding company but will not result in any tangible benefit to members either at the time of the payment of the dividend or in the event of a conversion of the mutual holding company to stock form. That is, any dividends paid to the mutual holding company are not distributed to members, and members do not receive all or part of the dividends or the value thereof in the event of a conversion of the mutual holding company to stock form. Instead, members must pay the same price for their shares as any other purchasers of common stock in a stock conversion transaction. Lastly, members do not have the right to receive any common stock of the subsidiary holding company held by the mutual holding company as such common stock, unlike the common stock of the subsidiary held by public or minority stockholders, is non-transferable. In the event of a conversion of the mutual holding company to stock form, the shares held by the mutual holding company will be cancelled and new shares of an equivalent amount will be offered *for sale to members and the public at the same price and at fair value*. Instead of distributing the mutual interest to members upon conversion of a mutual holding company to stock form, federal regulations require a subsidiary savings bank to establish a liquidation account equal to the mutual holding company's share of the pre-conversion capital or retained earnings of its subsidiary bank and/or stock holding company. This liquidation account is available for distribution to members only in the event of a complete liquidation of a converted bank after the payment of all claims of creditors of the bank. *There has never been a distribution from a liquidation account of a converted savings institution.*

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b. Case Law Interpretation and Analysis of Members' Ownership Interests

The courts, as well as federal regulations, have recognized the very limited ownership rights or interests of members/depositors of a mutual savings institution. In *Paulsen v. Commissioner*,²⁴ the United States Supreme Court considered whether the equity or ownership characteristics of passbook savings accounts and certificates of deposit were the equivalent of common stock. The Supreme Court noted that savings accounts were not subordinate to creditors' claims, the deposits were not considered permanent contributions to capital, depositors had the right to withdraw the face amounts of their deposits in cash, the savings association paid a stated rate of interest on the deposits, and the deposits were insured by the FDIC. Although the Supreme Court acknowledged that depositors had the only ownership interest in the association, including the right to vote on certain matters, it concluded that the equity features of a deposit or account in a savings association were not equivalent to owning an equity interest in a stock corporation:

"These equity characteristics, however, are not as substantial as they appear on the surface In our view, the debt characteristics of Citizens' [deposits] greatly outweigh the equity characteristics. . . . Their investment was virtually risk free. . . . The debt value of the shares was the same as the face value . . . because no one would pay more than this for the shares, the incremental value attributable to the equity features was practically zero."²⁵

Similarly, in *Society for Savings v. Bowers*, the Supreme Court considered whether a depositor recognized taxable income as a result of the accumulation of surplus in a mutual savings bank.²⁶ The Supreme Court held that the savings bank's accumulated surplus was taxable to the savings bank and not the depositor.²⁷ The Court reasoned that the right to receive a portion of the surplus in the event of a liquidation of the savings bank was highly contingent and not within the control of the depositor.

"It stretches the imagination very far to attribute any real value to such a remote contingency, and when coupled with the fact that it represents nothing which the depositor can readily transfer, any theoretical value reduces almost to the vanishing point."²⁸

Even the right of depositors under federal and most state laws to receive any remaining assets on liquidation of a mutual savings bank has not been immune from criticism. Some of the

²⁴ See *Paulsen v. Commissioner*, 469 U.S. 131 (1985).

²⁵ *Id.* at 138, 140.

²⁶ See *Society for Savings*, 349 U.S. 143 (1955).

²⁷ See *Id.* at 154.

²⁸ *Id.* at 150.

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earliest cases involving the liquidation rights of depositors recognized that a liquidating distribution to depositors is not necessarily equitable and exposed an institution to what has been characterized as the “free-rider” problem. A depositor who makes a deposit in a mutual savings bank shortly before its liquidation would share in any remaining assets on the same basis as the long-standing depositors who actually helped build the retained earnings of a mutual savings bank. Even worse, long-term depositors who closed their accounts shortly before a dissolution would not share in any assets at all.

“There is, indeed, no known mode of dividing a surplus of a savings bank . . . except among the bona fide depositors at the time of dissolution. But it does not follow that such division is just and equitable. It is a rule of convenience and necessity, not of equity I am confirmed of the view . . . that the attempt to make an equitable distribution of the surplus of a savings institution, such as we have to deal with here, presents an insolvable problem. That surplus is the result of the surplus of earnings of all the money that has been deposited by all of the depositors from the beginning of the bank. . . . [M]any of those have already withdrawn and thereby . . . have abandoned their share in the surplus, but it by no means follows that the equitable rights of those that remain are any greater by such abandonment”²⁹

As discussed above, the case law generally confirms that depositors have the right to share *pro rata* in the distribution of any remaining assets or surplus upon dissolution or liquidation of a mutual savings bank. In recognition of these limited ownership rights, the OTS and state legislatures and banking regulators adopted rules that do not grant depositors or members any rights to receive a distribution of a mutual institution’s net worth if it voluntarily terminates its mutual status by converting to stock form. Instead, both the OTS and state banking regulators adopted mutual-to-stock conversion rules that grant eligible depositors in exchange for their ownership interests: (i) a priority right to purchase stock in a conversion at market value;³⁰ and (ii) a *pro rata* interest in a liquidation account established at the time of conversion.³¹ These regulations were challenged by depositors who argued that a mutual-to-stock conversion was a dissolution or liquidation that required a distribution of the mutual savings bank’s retained earnings to depositors.

²⁹ *Barrett v. The Bloomfield Savings Institution, et al.*, 64 N.J. Eq. 425, 452, 54 A. 543, 553 (1903).

³⁰ See e.g., 12 C.F.R. § 563b.3(c)(2). Depositors, however, have no additional rights in a mutual-to-stock conversion.

³¹ See Section 563b.3(f) of the OTS mutual-to-stock conversion regulations which requires a converting savings institution to establish a liquidation account for the benefit of eligible account holders and supplemental eligible account holders equal to the net worth of the converting institution as of the latest statement of financial condition contained in the offering circular. Such eligible and supplemental eligible account holders have the right to share *pro rata*, based on the amount of their deposit accounts, in the liquidation account only in the event of a complete liquidation of the savings institution. The liquidation account never increases, and is reduced if an eligible or supplemental eligible account holder reduces his or her deposit balance or terminates the account.

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In *In re City Savings Bank of Berlin and Berlin City National Bank*,³² the New Hampshire Supreme Court held that dissenting depositors in a mutual-to-stock conversion were not entitled under the due process clause of the Fourteenth Amendment to a right of appraisal or a cash payment for their share of the bank's surplus. The court concluded that, to hold otherwise, would provide depositors with a "windfall" that is "something they neither earned nor bargained for."³³

Similarly, in *York v. Federal Home Loan Bank Board*, the court rejected arguments that the conversion would deprive depositors of their property rights in the association while providing windfalls to those purchasing stock:

"Although depositors are the legal 'owners' of a mutual savings and loan association, their interest is essentially that of creditors of the association. . . . They are not allowed to realize or share in the profits of the association, but are only entitled to an established rate of interest. The depositors do not share in the risk of loss since their deposits are federally insured Thus, it is apparent that depositors will not be deprived of property rights by conversion to a federal stock organization. Depositors' only actual rights, their rights as creditors of the association, will remain unchanged by the conversion."³⁴

It is interesting to note that in 1973 the Federal Home Loan Bank Board, the predecessor of the OTS, proposed mutual-to-stock conversion regulations that provided for a free *pro rata* distribution of stock. However, these proposed rules were criticized for a number of reasons, including that they would not reward long-standing depositors who withdraw their accounts before a conversion, and that they would encourage shifting of deposits to institutions that were likely to convert.³⁵

In summary, federal courts and regulations have long recognized the very limited ownership rights of depositors/members of mutual savings banks and associations, and it is in the context of these very limited ownership rights that the fiduciary duties of directors of the mutual holding company and potential conflicts of interest must be considered. In other words, the concern that there is a potential breach of fiduciary duty of the board of directors is diminished in this context if it can be demonstrated that depositors/members are not being deprived of anything of value or their rights are not diminished as a result of the mutual holding company's waiving dividends.

³² *In re City Savings Bank of Berlin and Berlin City National Bank*, 113 N.H. at 382-83, 309 A. 2d at 33.

³³ *Id.* at 381, 309 A. 2d at 32-33.

³⁴ *York v. Federal Home Loan Bank Board*, 624 F. 2d 495, 499-500 (4th Cir. 1980).

³⁵ See *Business Transactions Division Memorandum: Mutual Savings Associations and Conversion to Stock Form*, Office of Thrift Supervision, 1997 OTS LEXIS 10 at 38 (May 1997).

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c. *Directors' Potential Conflict of Interest*

Bank regulators have permitted both stock and mutual holding companies, as well as their subsidiary savings institutions, to have the same individuals serve on each of their respective boards of trustees or directors. These individuals must balance their fiduciary duties to their different constituencies, which has been acknowledged by the federal and state banking regulators in their regulation and supervision of both mutual and stock holding companies. Bank regulators understand that such individuals can balance their fiduciary duties to the different entities, the stockholders and the members, and various federal and state banking regulations have been implemented to help ensure that this is the case. For example, directors of a stock holding company must decide whether to declare dividends and participate in stock incentive plans even though such directors may personally benefit from such dividends and stock plans. A director or trustee is responsible for evaluating the benefits of such dividends and stock plans to stockholders and the organization as a whole, notwithstanding the personal interest the director or trustee may have in such a dividend or stock plan. In addition, we note that it is often preferable to have the same individuals serve on the board of each entity, as they have the greatest understanding of the operations of the overall organization. Moreover, federal and state laws provide adequate legal remedies in the event a conflict of interest does occur, including, for example, the requirement that a mutual institution establish a liquidation account for the benefit of members when a mutual board determines to convert the mutual institution to stock form. An activity should not be restricted outright merely because it potentially benefits an interested party.³⁶

The Federal Reserve Board has previously addressed the potential conflict of interest associated with mutual holding company dividend waivers in *Greater Delaware Valley*, which we consider here. In *Greater Delaware Valley*, the Board decided that there was an inherent conflict of interest when the same persons who declare dividends as directors and minority stockholders of the savings bank subsidiary of a mutual holding company are also directors of the mutual holding company that waives the receipt of dividends and stand to benefit from the waiver. The Board went on to note that there were two means by which minority stockholders can benefit from a dividend waiver. First, part of the value of waived dividends is transferred to minority stockholders through their stock ownership in the bank. That is, by waiving dividends, the cash that would otherwise be paid to the mutual holding company is retained by the mid-tier stock holding company and thus benefits all stockholders, including minority stockholders. Second, the Board reasoned that if a mutual holding company waived dividends, the subsidiary would be able to pay higher dividends to minority stockholders.

³⁶ As stated by the OTS, "there is always a potential conflict of interest for directors and officers who make financial decisions where they may personally benefit. OTS may take enforcement action if it discovers wrongdoing. OTS notes that the waiver of dividends results in more capital at the savings association, enhancing the safety and soundness of the savings association." 67 Fed. Reg. 17,231 (April 9, 2002).

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The argument that directors/stockholders of the mutual holding company receive a benefit from waiving dividends because part of the value of the waived dividends is transferred to minority stockholders assumes: (i) mutual depositors/members are entitled to such value and are deprived of a benefit as a result of such dividend waivers and transfer of value, and (ii) value that should otherwise be paid to the mutual interest is in fact being transferred to minority stockholders. We believe the Board should reconsider and reevaluate these assumptions. As discussed above, the value transfer argument enunciated in *Greater Delaware Valley* assumes the mutual members are owners with an interest that is comparable to the equity ownership interests of public stockholders and that public stockholders are receiving value from such mutual members. As noted by the Supreme Court in the *Paulsen* and *Society for Savings* decisions, this is clearly not the case. The debt characteristics of the depositors' or members' ownership interests greatly outweigh their equity characteristics and the value of their ownership interest is practically zero. It follows, therefore, that if the value of members' interests in a mutual savings bank (or mutual holding company) is essentially zero, then members are not being deprived of a benefit if the mutual holding company waives the receipt of dividends from its subsidiary holding company. This is particularly the case if we consider that members do not have the right to receive any portion of the dividends paid by the subsidiary holding company to the mutual holding company, and in the event of a conversion of the mutual holding company to stock form members do not receive any benefit from the additional cash received by the mutual holding company. Members must pay fair value for the shares issued by the subsidiary holding company regardless of the amount or value of mutual holding company assets. Moreover, waiving dividends declared by the subsidiary holding company will not reduce the liquidation interests or accounts of depositors in the event the mutual holding company converts to stock form, since the mutual holding company's share of the cumulative amount of waived dividends (which has not reduced by taxes) becomes part of the members' liquidation account in the converted stock savings bank. The liquidation interests of members would be *increased* by the amount of tax savings resulting from dividend waivers in the event the mutual holding company converts from mutual to stock form.

The argument that value is being transferred from the mutual interest to minority stockholders assumes that the mutual holding company has the same right to receive dividends on the subsidiary's common stock as minority stockholders notwithstanding the significantly different ownership rights and characteristics of the common stock held by the mutual holding company as compared to the common stock held by minority stockholders. As discussed above, the shares of the subsidiary's common stock held by a mutual holding company are fundamentally a different class of stock than the common stock held by minority stockholders. Minority stockholders invested new risk capital in exchange for their shares, while the mutual holding company did not.

The shares of subsidiary holding company common stock owned by a mutual holding company are not transferable, and in the event of either a conversion of a mutual holding

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company to stock form or an incremental offering of additional shares of common stock, the mutual holding company's shares of subsidiary holding company common stock are cancelled and new shares of subsidiary holding company common stock are sold to investors at fair value. The mutual holding company receives no additional consideration upon cancellation of its shares of subsidiary holding company common stock. Conversely, minority stockholders may freely trade their shares and receive fair value for them in any transfer. In effect, the mutual holding company acts as a placeholder for new shares of common stock that may be issued by its subsidiary holding company in the future. In this regard, we note that it would have been preferable (and simpler) if the federal banking regulators had authorized mid-tier holding companies to issue separate classes of common stock to the mutual holding company and minority stockholders. This would have avoided any need for the mutual holding company to waive the receipt of dividends from the subsidiary since a dividend declared on shares held by minority stockholders would have no impact on shares of common stock held by the mutual holding company.³⁷ Multiple classes of common stock that reflect different ownership or voting interests are very common.

If the common stock of a subsidiary held by a mutual holding company is essentially a different class of common stock from that held by minority stockholders, then it follows that the mutual holding company would not necessarily be entitled to the same dividends paid to minority stockholders. Indeed, an argument can be made that the mutual holding company should not receive the same dividends on its shares of subsidiary common stock as minority stockholders since the mutual holding company has not contributed the same amount of risk capital for its shares.

d. A Waiver Would Enhance the Financial Strength and Health of the Overall Organization

By waiving dividends, mutual holding company benefits the overall organization for the reasons set forth above. In particular, a waiver allows more capital to remain at the subsidiary levels thereby enhancing the overall safety and soundness of the subsidiary savings bank. Moreover, to the extent the cash from waived dividends is retained by the subsidiary holding company or contributed to the subsidiary savings bank, it increases the subsidiary savings bank's capital resources for the benefit of borrower customers and depositors/members. Maximizing the financial strength and health of the organization as a whole benefits stockholders and mutual depositors/members alike.

³⁷ Indeed, the conflict concerns noted by the Board in *Greater Delaware Valley* and with mutual holding company dividend waivers generally could be resolved by having the mid-tier stock holding companies, like the Company, issue two classes of common stock – one to the public stockholders and one to the MHC. No dividend waivers would be necessary as each class of common stock would have the same rights, except that dividends paid to one class (minority stockholders who have invested risk capital in the Company) would not necessarily have to be paid to holders of the other class (the MHC which has not invested risk capital in the Company).

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e. A Waiver Does Not Create Significant Financial Benefits to Insiders That Should Accrue to Depositors/Members

One of the primary concerns expressed in *Greater Delaware Valley* is that allowing a mutual holding company to waive dividends will enable insiders of the mutual holding company and its subsidiaries to receive a financial benefit that should accrue to the mutual members. We disagree with this premise since members will never receive a tangible and quantifiable benefit if the mutual holding company receives (rather than waives) dividends paid by its holding company subsidiary, and arguably a mutual holding company should not be entitled to receive the same dividends as those paid to minority stockholders. Conversely, neither a mutual holding company nor the members are being deprived of a benefit if the mutual holding company waives the receipt of dividends from its subsidiary. Not allowing a mutual holding company to waive dividends would have an adverse effect a subsidiary holding company's value which would be particularly detrimental to all of its stockholders (including the mutual holding company) in the current economic environment. Lastly, as discussed above, the amount of waived dividends would be added to any liquidation account of the subsidiary savings bank established at the time of any conversion of the mutual holding company to stock form and waived dividends would not be available for distribution to minority stockholders. Historically, the liquidation account has been the vehicle for preserving and protecting the very limited ownership interests of members.

Insiders of the mutual holding company have the ability to receive benefits through their purchase of stock in the subsidiary holding company and by participating in stock based benefit plans. This would be the case for insiders of a full stock holding companies as well. There is nothing inherently wrong with insiders sharing in the profits and strength of their institution. Bank regulation continues to advocate that insiders' interests be tied in some way with the institution's stockholders. For example, directors of a national bank are required to own stock of the bank or its holding company.³⁸ Furthermore, it is important to note that if a mutual holding company waives the receipt of dividends, insiders do not benefit any more than other minority stockholders.

f. Members' Rights Would Not Be Adversely Affected By Dividend Waivers

In general, depositors or members have only two economic rights in a mutual holding company -- liquidation rights and rights to purchase common stock in a conversion of the mutual holding company to stock form at the same price as any other investor. Although both state and federal banking regulators have recognized that depositors have an ownership stake in a mutual savings institution, the United States Supreme Court and other federal and state courts have uniformly concluded that their ownership rights are very limited and that the debt characteristics

³⁸ See 12 C.F.R. § 7.2005.

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of a depositor relationship greatly outweigh the equity characteristics. Members do not have the right to receive any portion of the dividends received by a mutual holding company. Furthermore, the liquidation rights of members and the right to purchase common stock in a conversion are not necessarily enhanced by the mutual holding company receiving dividends and, in fact, could be reduced by receiving dividends. This liquidation interest would actually increase by the net tax savings in the event the mutual holding company waives dividends, and therefore, the waiver would be beneficial to the depositors. Moreover, assuming a mutual holding company does not convert to stock form, it is not clear whether the liquidation value of the mutual holding company's interest in its subsidiaries would increase if the mutual holding company accepts dividends. For example, if a mutual holding company waives the receipt of dividends and the waived dividends are contributed to the capital of the subsidiary savings bank and invested in loans and other earning assets, the value of the mutual holding company's interest in the subsidiary savings bank and its holding company could actually increase as a result of the waiver. **Exhibit A** shows how the value of a hypothetical mutual holding company's equity interest in its subsidiary bank or holding company would be affected by waiving and not waiving dividends under various scenarios.

The federal banking regulators have considerable experience in addressing the ownership rights of depositors of a mutual savings bank. In recognition of the contingent and limited nature of these rights, the federal banking regulators have concluded that in a mutual-to-stock conversion, which involves a substantive ownership change of a mutual savings bank, members are not entitled to receive a distribution of the equity of the converting institution, or even receive a free distribution of stock of the converted entity. Rather, the federal banking regulators concluded that the ownership interest of members would be preserved in the form of a liquidation account in the converted savings bank. This liquidation account would be available for distribution to members upon liquidation of the converted savings bank. Similarly, any ownership claim of members to waived dividends could also be readily preserved in a liquidation account that would be available to members only upon liquidation of the mutual holding company or its successor stock holding company. In summary, since members' rights are limited to liquidation rights, it makes sense that any value in the form of waived dividends that is arguably transferred to minority stockholders when the mutual holding company waives dividends, would be monitored and added to a liquidation account in its subsidiary savings bank in the event the mutual holding company converts to stock form.

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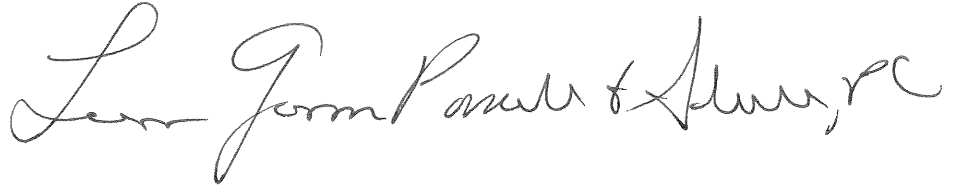
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We appreciate the opportunity to submit these comments on the subject Interim Final Rule and we would look forward to discussing our comments with Federal Reserve Board staff.

LUSE GORMAN POMERENK & SCHICK, P.C.

A handwritten signature in cursive script, appearing to read "Luse Gorman Pomerenk & Schick, P.C.", written in dark ink.

cc: Mutual Holding Company Clients

Appendix A

Financial Analysis of Dividend Waivers

Introduction to Financial Analysis – Summary of Assumptions

This appendix contains the financial analysis of RP Financial regarding the impact of dividend waivers by a mutual holding company on the financial interests of depositors/members. The financial analysis uses a generic \$1.0 billion asset-size mutual holding company organization (hereinafter referred to as “Sample MHC”) for illustrative purposes, and includes two financial projections that analyze the ongoing impact of dividend waivers on the financial interests of depositors of Sample MHC’s subsidiary savings bank (referred to as “Sample Savings Bank”).¹ Sample MHC owns 57.2% of a mid-tier holding company (“Sample Mid-Tier”), which owns 100% of Sample Savings Bank’s common stock. Sample Mid-Tier has \$90 million of consolidated equity, generates earnings equal to 0.85% of average assets, has 11.3 million shares outstanding, and initially pays an annual cash dividend of \$0.20 per share.

The financial analysis incorporates two sets of financial projections for Sample MHC: (1) assuming Sample MHC waives its right to receive cash dividends, with such dividends retained as capital Sample Mid-Tier; and (2) assuming Sample MHC receives cash dividends, incurs a tax liability upon receipt, and accumulates cash at the mutual holding company level. The financial projections calculate the projected size of the Sample Mid-Tier balance sheet and the market value/offering size of a second-step conversion of Sample MHC after 10 years of operations. The shares of common stock issued in the second-step conversion of Sample MHC are assumed to be sold at an estimated market value of 100% of pro forma fully converted book value (i.e., book value after raising capital in the second step conversion) and using normal and customary parameters, including an 4% leveraged employee stock ownership plan (“ESOP”), a 4% restricted stock plan and offering expenses equal to 4% of shares sold. A market value of 100% of pro forma fully converted book value was used because it is consistent with the historical pricing and after-market trading characteristics of large second-step conversion transactions. A higher (or lower) pro forma valuation would result in a larger (or smaller) second-step offering, but would not affect the conclusions reached herein.

Scenario #1. Dividends Waived by Sample MHC

This scenario projects operations for Sample MHC assuming: (1) an initial \$0.20 per share annual cash dividend, increasing by 5% annually; (2) the Sample Mid-Tier generates earnings at a rate of 0.85% of average assets; (3) the MHC waives its right to receive cash dividends and such funds are retained by the Sample Mid-Tier as capital; and (4) Sample Mid-Tier generates asset growth of 9.0% annually, which is sufficient to maintain a targeted capital ratio at Sample Mid-Tier of 9.0% over the ten year term of the financial projections.

¹The model could be applied to any existing mutual holding company with minority stockholders.

Scenario #2. Dividends Not Waived by Sample MHC

This scenario projects operations for Sample MHC assuming the same return on assets and per share dividend as described in Scenario #1 except: (1) no waiver of dividends by Sample MHC with taxes paid on dividends at an effective rate of 40%, and 80% of dividends received by Sample MHC are not subject to taxation; and (2) an annual growth rate for Sample MHC assets of 7.65%, which is sufficient to maintain a targeted capital ratio at Sample Mid-Tier of 9.% over the ten year term of the financial projections.

Quantification of Financial Analysis

The following table summarizes the financial projections, including the initial operating and balance sheet assumption (lines 1-5), the pro forma balance sheet and operating assumptions after ten years of operations (lines 6-10) and the pro forma impact of a 2nd step conversion of Sample MHC after ten years of operations (lines 11-16). In Scenario #1, the result of Sample MHC waiving its right to receive dividends results in \$25 million of increased capital at Sample Mid-Tier (line 7), increased capacity to pursue balance sheet growth and as a result generate greater earnings and, will upon a second-step conversion, result in a larger offering and greater market capitalization (line 15). Specifically, compared to the projected results in Scenario #2, the waiver of dividends will: (1) support an additional \$292 million of assets, a balance sheet 14% larger than supportable if dividends are not waived (line 6); (2) support \$2.2 million of higher projected year 10 earnings due to the larger balance sheet (line 8); and, at the time of a second-step conversion, (3) generate a common stock offering \$12 million larger than if dividends are not waived (line 15).

The benefits of a larger balance sheet accrue primarily to depositors/members of the Sample MHC, who benefit from the improved service levels provided by economies of scale and greater convenience provided by a larger branch network (assuming the larger balance sheet is accomplished through expansion of the branch network). Moreover, the waiver of dividends increases the market value of the ownership interest held by Sample MHC, which is largely the result of the greater capital and earnings generated by Sample Mid-Tier by virtue of the incremental capital retained through waived dividends.

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		Scenario #1	Scenario #2		
		Dividends	Dividends		
		Waived	Not Waived	Difference	
		(1)	(2)		
(dollar in thousands except where noted)					
Beginning assets and capitalization					
1	Assets	\$ 1,000,000	\$ 1,000,000		
2	Equity	\$ 90,000	\$ 90,000		
3	Earnings (year 1)	\$ 8,808	\$ 8,808		
4	E/A	9.0%	9.0%		
5	MHC ownership	57.2%	57.2%		
Mid-tier, pre-conversion after 10 years of operations (3)					
6	Assets	\$ 2,354,961	\$ 2,062,563	\$ 292,398	
7	Equity	\$ 211,650	\$ 186,128	\$ 25,522	
8	Earnings (year 10)	\$ 19,073	\$ 16,914	\$ 2,159	
9	E/A	9.0%	9.0%		
10	MHC ownership	57.2%	57.2%		
Mid-tier, after 2nd step conversion @ 100% pro forma P/TB					
11	Assets	\$ 2,569,806	\$ 2,281,739	\$ 288,067	
12	Equity	\$ 426,495	\$ 405,304	\$ 21,191	
13	E/A	16.6%	17.8%		
14	MHC ownership	57.2%	57.2%		
15	Memo: offering	\$ 244,142	\$ 232,011	\$ 12,131	
16	Memo: pro forma BV/share (\$)	\$ 37.65	\$ 35.78	\$ 1.87	
<p>(1) \$0.20 annual cash dividend paid to public shareholders and waived by Sample MHC. Sample Mid-Tier equity leveraged to maintain a 9% target capital ratio. Cash dividends increase by 5% annually.</p> <p>(2) \$0.20 annual cash dividend paid to public shareholders and Sample MHC (no waivers). Sample MHC dividends taxed. Equity is leveraged to maintain a 9% capital ratio. Cash dividends increased by 5% annually.</p> <p>(3) Annual ROA of 0.85% of average assets. Asset growth sufficient to maintain a 9% tangible capital ratio as a mutual holding company institution.</p>					