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# Charter Choice and Corporate Alternatives For Mutual Banks

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**LUSE GORMAN**

# Who We Are

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Luse Gorman is a Washington, D.C. based law firm specializing in:

- Mutual Holding Companies
- Mutual-to-Stock Conversions
- Mergers and Acquisitions
- Executive Compensation
- Bank Regulatory and Compliance Matters
- Tax
- Corporate and Securities Law
- Corporate Governance

# Our Rankings

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## MHC Reorganizations:

- Counseled 110+ Transactions
- No. 1 Nationally Since 1991

## Mutual-to-Stock Conversions:

- Counseled 150+ Transactions
- No. 1 Nationally Since 2001

## Mergers and Acquisitions:

- Top 10 Nationally Every Year Since 2001
- No. 1 in 2009, 2011, 2012, 2015 and year to date 2016

# Regulatory/Industry Update

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## Banks, by the Numbers

- 6,058 FDIC insured banks - down 31% in 10 years
- 509 mutual banks in US (traditional and private MHCs)
- 8% of FDIC-insured banks are mutual (by number)
- 2.1% of FDIC insured deposits held by mutual banks
- 133 private MHCs (7 in PA)
- 28 public MHCs (one in PA –William Penn)
- 9% of all mutuals located in Pennsylvania (44 total)

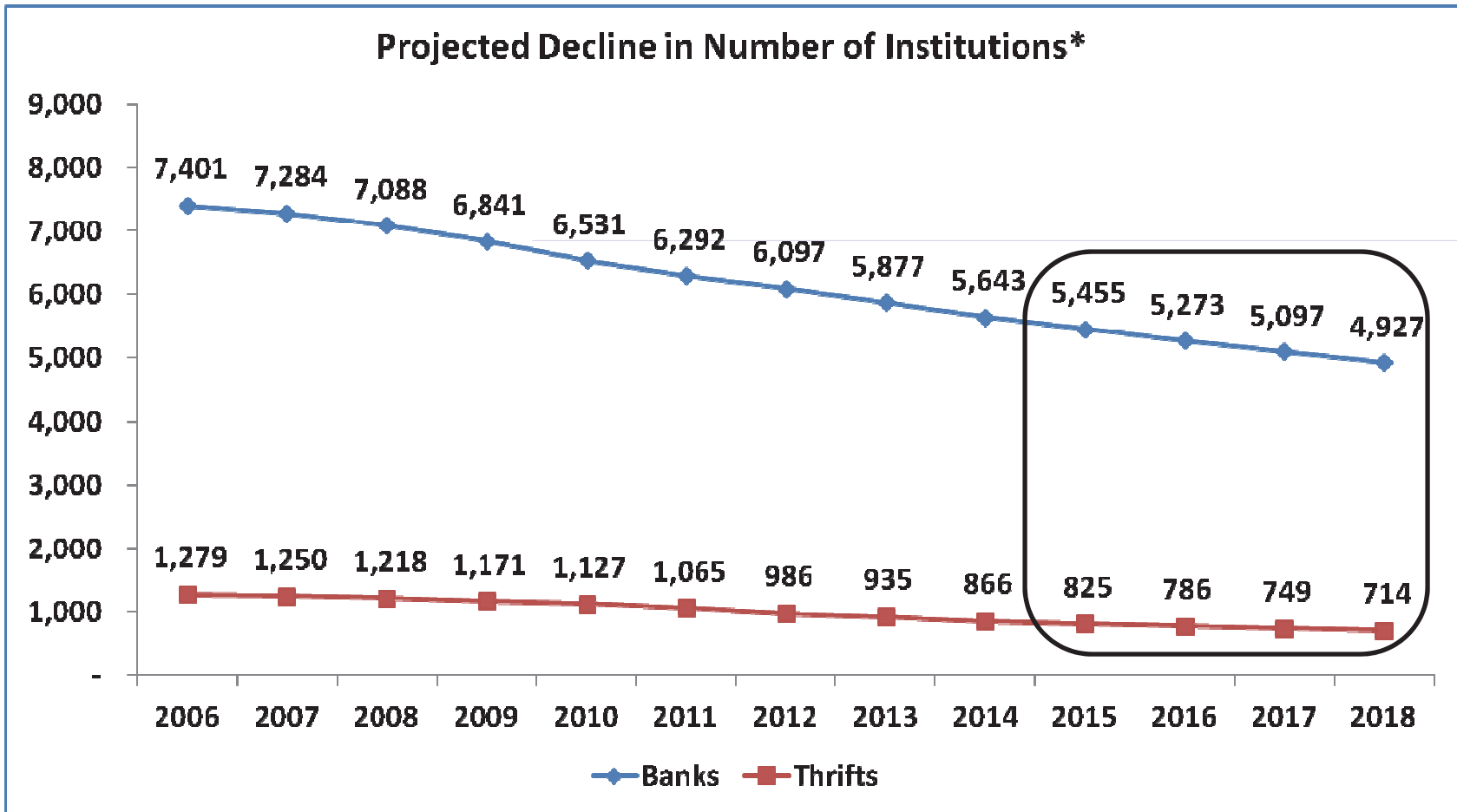
# Regulatory/Industry Update

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## Banks, by the Numbers

- Average bank size has more than doubled in past 10 years
- 2016 average US bank - \$2.7B (up from \$1.3B in 2006)
- Consolidation expected to continue and reduce overall numbers and lead to increasing average bank size
- Scale will continue to be important as costs increase
- Small bank replacement wave not expected:
  - De novo activity non-existent (only 2 post-Dodd Frank)
  - CU conversions non-existent (only 2 post-Dodd Frank, none on the horizon)

# Regulatory/Industry Update



\*2015-18 based on average annual rate of decline from 2008 -14. 3.3% for banks and 4.7% for thrifts  
 Industry wide data  
 Source: FDIC

# Regulatory/Industry Update

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“Too big to fail” is inevitable and is coming... but so too is “too small to succeed.”

- Sen. Tim Scott (R-SC)  
March 15, 2016  
ABA Government Relations Conference  
Washington, D.C.

# Regulatory/Industry Update

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## Dodd-Frank Effect on All Community Banks

- Higher capital requirements
- Additional consumer disclosure and compliance procedures
- Increased pressure on banks to grow (improve scale)
- Increased pressure on smaller banks to consolidate (lack of scale)
- Bar raised on regulatory applications (more scrutiny, longer processing, more regulatory coordination and second guessing)
- Overall effect – more costly to operate, more capital needed, more emphasis on scale
- Regulatory relief will likely be revived especially with regard to Dodd-Frank and CFPB



# Strategies for Success for Mutuals

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- To preserve or enhance the mutual charter, mutual banks need to understand:
  - (i) their role or mission as a community bank;
  - (ii) their competition and customers; and
  - (iii) the options, opportunities and challenges they have in maintaining or growing their presence as a viable alternative to stock-based institutions.

# Strategic Planning

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## Questions to Consider

- Why do we have a mutual charter option?
  - Serve underserved customers or communities?
  - Promote locally “owned” community banks?
- What is the mission of mutuals and how do we or should we distinguish ourselves from stock banks?
  - Who are our customers?
  - Is the community served equally well by stock banks or savings banks?
- Does our charter drive our business plan or does our business plan drive our charter?

# Strategic Planning

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## Questions to Consider

- Can mutuals survive with dwindling numbers if there are no new charters?
  - Impact of credit unions
  - Impact of de novos
  - Impact of industry consolidation-opportunities for mutuals?
- Do mutuals have to perform and grow like stock companies to be relevant players in their markets?
  - Are earnings and growth essential to a positive community bank culture?
  - Is growth and profitability necessary to attract qualified and incentivized employees?
  - Is perceived safety and stability enough to attract talent?

# Charter Options for Mutuals

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- State savings bank
- State savings association charter in PA eliminated several years ago; existing savings associations become savings banks
- Federal savings bank
- State or Federal MHC
- No national or state commercial bank charter available for mutuals
- Charter conversion option generally available to “1” or “2” rated banks with no outstanding regulatory orders or agreements

# Advantages of a Pennsylvania Savings Bank Charter vs. Federal Savings Bank Charter

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- No QTL Test (unless optional SLHC structure)
- No loan restrictions as a percent of assets
- Pennsylvania parity statute allows Pennsylvania institutions to have powers of national banks, federal savings banks and state banks in other states with regulatory approval

# Advantages of a Federal Savings Bank Charter vs. Pennsylvania Savings Bank Charter

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- Federal Preemption of state laws (particularly useful for interstate branching)
- More detailed set of regulations provides more certainty
- Only one regulator at bank level (OCC); avoids dual bank regulators applicable to state banks (state charter can choose between FDIC (nonmember bank) or FRB (member bank) for federal regulator)

## Other Considerations

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- Difference in name recognition, goodwill, prestige?
- Localized regulator v. nationwide regulator?

# Conversion of Pennsylvania (Stock) Savings Bank to Commercial Bank Charter

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- A stock savings bank in an MHC structure could theoretically convert to a commercial bank charter
- This is a unique structure. Only one state or federal savings bank in an MHC has converted to a commercial bank (1997).
- Given legislative changes earlier this decade, the powers of a Pennsylvania savings bank are at least as broad as either a Pennsylvania or national commercial bank



# Advantages of Bank Holding Company vs. Savings and Loan Holding Company

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- No need to obtain FRB approval to dividend cash from bank to holding company.
- Most common holding company structure
- Subsidiary savings bank is not subject to QTL test

# Advantages of Savings and Loan Holding Company vs. Bank Holding Company

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- SLHCs may engage in certain holding company activities (e.g., real estate investment) not eligible for BHCs
- Other advantages of SLHC structure have largely been eliminated with the elimination of OTS and transfer of regulatory jurisdiction to FRB
- SLHC's are now subject to BHC-like regulatory principles by FRB

# Mutual National Bank Charter

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- Comptroller Curry wants to expand federal savings bank powers but has not endorsed a mutual national bank charter
  - He considers cost of charter conversion excessive
  - Instead, he would give federal savings bank same powers as national banks – increased commercial lending authority
  - Relax QTL test
  - All require legislation
- Why not just authorize a mutual national bank charter?
  - Simpler fix but also requires legislation
- Curry's term ends March 2017

# Capital Raising - Current Market Conditions

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## A Good Environment for Raising Capital:

- Access to capital: will primarily depend on (1) asset quality, (2) size/liquidity and (3) market area
- Full conversions: very favorable market
- MHC offerings: very favorable market
- Sub Debt: gaining popularity especially as “bridge financing”

# Capital Raising - Takeaways

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- Market very favorable for conversions and MHC minority offerings
- Regulatory execution risk now a reality for banks with issues
- Capital still “king” but regulators more conservative – can no longer assume regulators will support an offering
- When you need capital to survive – you will NOT get it – whether in conversion or MHC offering
- No regulator is going to bet his/her career to give you more time to raise capital
- Targets will not wait for capital (deal funding) unless they have no other choice or mutual “pays up” for the financing contingency

# Periodic Review of Corporate Alternatives

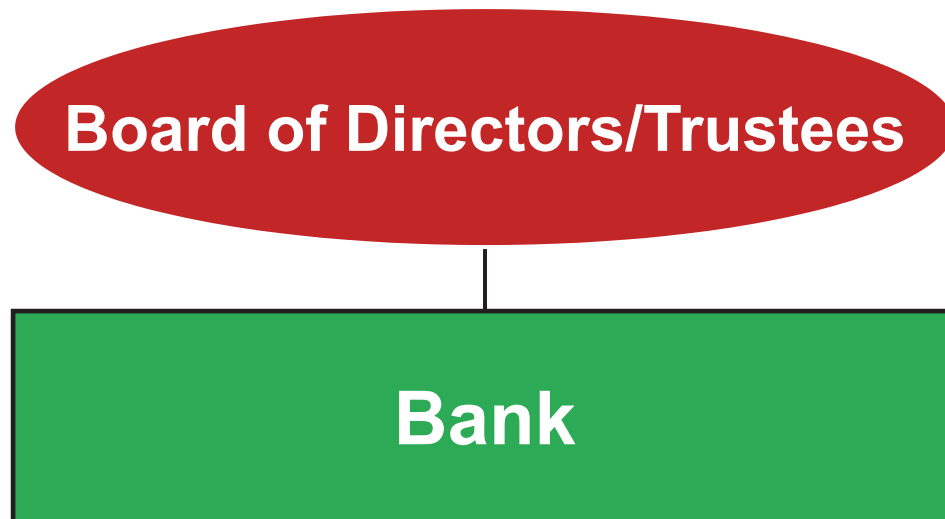
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## Corporate Alternatives for a Mutual Savings Bank

- Traditional Mutual Bank Structure
- “Private” Mutual Holding Company
- “Public” Mutual Holding Company
- Fully-Converted Stock Holding Company
- Mutual-to-Mutual Business Combination

# Current Traditional Mutual Structure

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# Traditional Mutual Structure - Advantages

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- Secure and stable operating environment
- No stockholder pressures
- Complete autonomy, subject to regulatory oversight

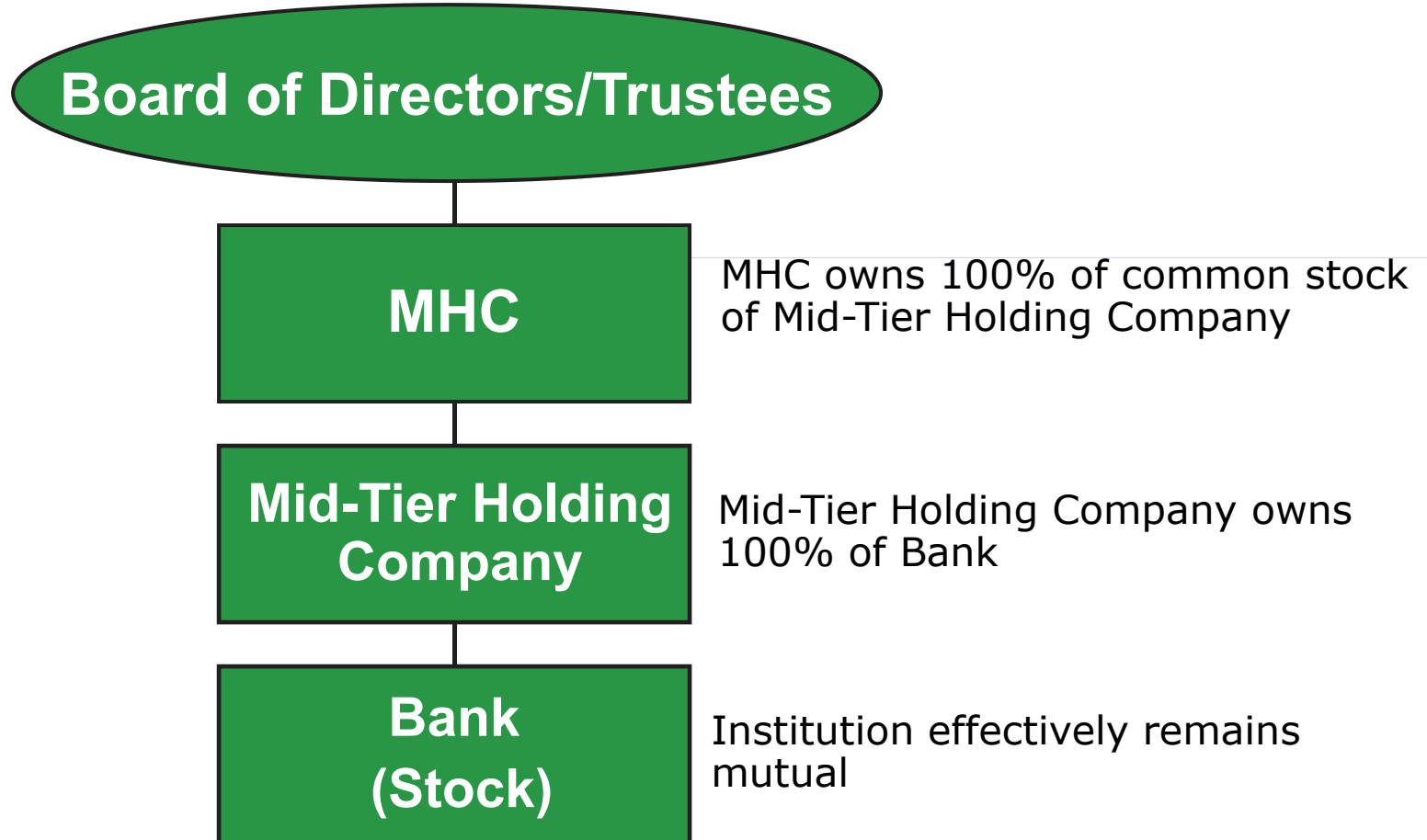


# Traditional Mutual Structure - Disadvantages

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- Inability to augment capital, except through earnings
- Limited flexibility for merger opportunities
- No ownership by employees and directors/trustees
- No “strength in numbers” (limited legislative and regulatory voice)

# Private "Two-Tier" MHC



# Private MHC - Advantages

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- Secure and stable operating environment
- No stockholder pressures
- Complete autonomy, subject to regulatory oversight
- No change in culture or philosophy
- Creates a “mutual” structure with more options and flexibility (including with regard to mergers)
- Can raise equity in the future (including Subordinated Debt)
- **Takes FDIC out of future stock offering transactions**

# Private MHC - Disadvantages

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- Limited capital raising opportunities
- Growth is still limited to earnings
- No currency for acquisitions
- Customer, employees and directors do not become owners of the bank

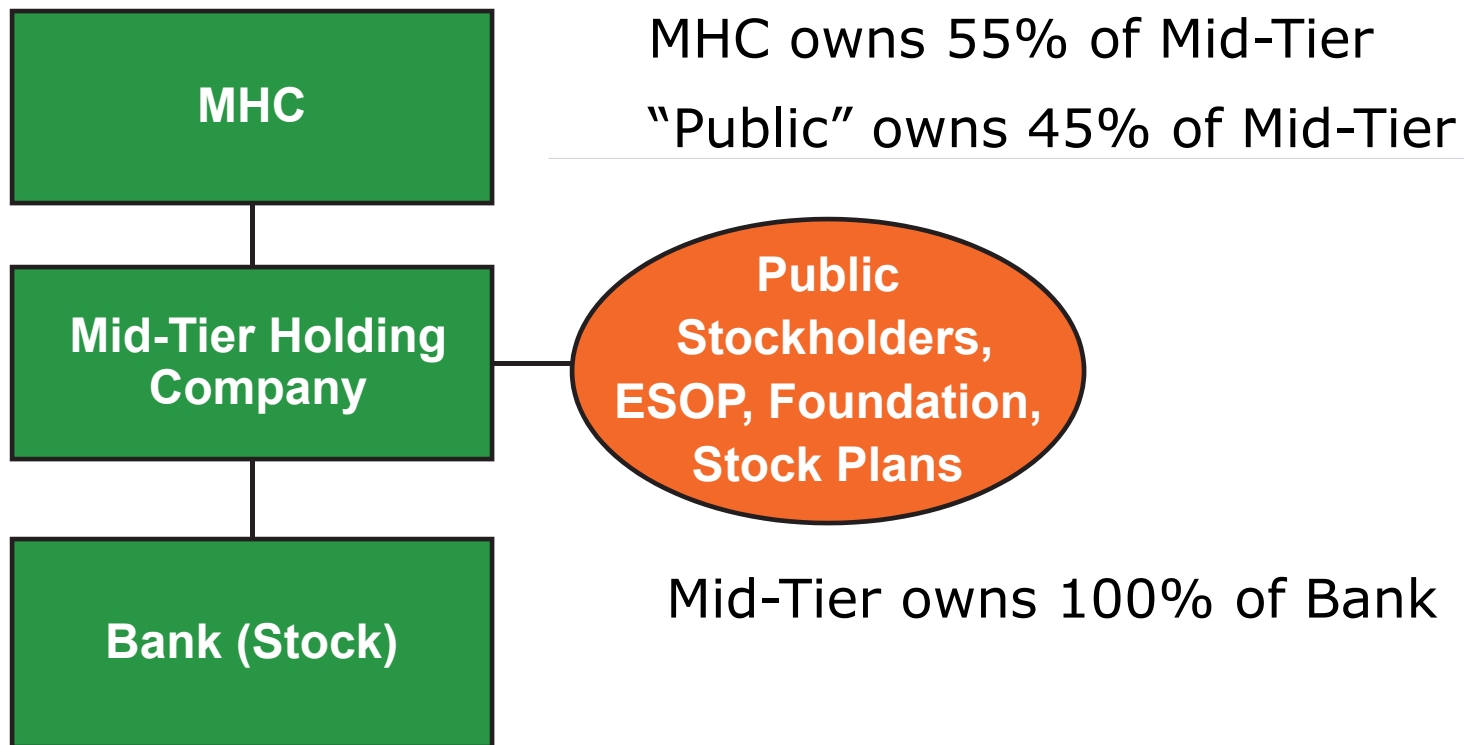
# Impact of Private MHC

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- Depositors – No change in deposit accounts or liquidation rights
- Borrowers – No change
- Employees – No change. Remain employees of savings institution
- Officers and Directors – No change at Bank level. Become officers and Directors of Mid-Tier Holding Company and MHC

# Public “Two-Tier” MHC

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# Public MHC - Advantages

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- Enhances capital position
- Control remains with MHC Board (takeover proof)
- Equity ownership for employees, management, directors
- Customers become owners with increased ties to bank
- Stock benefits for employees, management and directors
- Can still acquire mutuals
- Have currency (stock) for acquisitions

# Public MHCs - Disadvantages

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- Need to interface with stockholders
- Cost of being a public company (accounting, SEC, SOX, D&O)
- Possible timing/execution risk in the event of a future full conversion



# Required Corporate Approvals

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- Majority of Board of Directors
- Majority of depositor votes authorized to be cast, based on deposit size (one vote per \$100 on account with 1,000 vote max)
- Proxy voting permitted

# Required Regulatory Approvals

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- Pennsylvania Department of Banking and Securities
- FDIC
- Federal Reserve Board – Holding Companies
- U.S. Securities and Exchange Commission (if a minority stock offering)

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Questions?

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