MHC deals top 2004 and should remain attractive in the future.

Conversions - a review of 2004 and the outlook for 2005

By Eric Luse and John Gorman

2004 was the most active year for conversion transactions since 1998 as 25 institutions completed mutual holding company and standard conversion transactions during the year. As of Jan. 31, 15 conversion transactions were announced or pending in 2005. By comparison, there were a total of 14 conversion transactions completed in 2003. The 2004 results show that mutual holding companies have become the preferred means of going public, as they accounted for 17 of the 25 conversion transactions that closed in 2004. By contrast, only three institutions completed standard conversions in 2004, although there were five "second-step" conversions of publicly traded mutual holding companies during the year. While conversion transactions are off to a good start for 2005, aftermarket price appreciation is significantly down from 2003 and early 2004, as several recent conversion transactions have traded below their initial offering price. Lower appraisals for deals in the first half of 2005 will be necessary to reverse this trend.

There is no doubt that the historically high valuations for converting institutions were partly responsible for the popularity of the mutual holding company structure last year. But other factors, including the desire of most mutual boards to retain control and pursue their business strategy without having to worry about activist shareholders, the fact that most mutual institutions are well-capitalized and the relatively favorable regulatory environment for federal mutual holding companies, will continue to make the mutual holding company structure the most attractive charter alternative for converting mutuals in 2005.

Of the 25 transactions completed in 2004, four involved former credit unions that converted to federal charters. **Atlantic Coast Federal** (ACFC), **Monadnock Community Bank** (MNCK), and **Kaiser Federal Bank** (KFED), (all former credit unions) completed mutual holding company offerings. **Synergy Financial Group Inc.** (SYNF), the holding company of Synergy Bank, (a former credit union) completed its second-step conversion to stock form. With fewer than 750 mutual savings banks remaining, future conversion activity will be affected significantly by the volume of credit union charter conversions. To date, approximately 25 credit unions have converted to a savings bank charter, and more credit union conversions are expected despite the active opposition of various credit union trade groups. While Congress enacted the Credit Union Membership Access Act in 1998 to facilitate credit union charter conversions by reducing the membership vote required to approve such conversions, the National Credit Union Administration (NCUA), in the name of full disclosure, has done its best to make the process more difficult and cumbersome.

Eric Luse
Luse Gorman Pomerenk & Schick

Recently, the NCUA adopted a new rule that requires significant additional disclosure in materials mailed to members, including the costs of a potential conversion to stock form. Many credit unions are watching closely to see how credit union charter conversions will fare under the new NCUA rules. It is interesting to note that in 2004, two large credit unions — Columbia Community Credit Union and Lake Michigan Credit Union, failed to complete their conversions to a state savings bank charter. Columbia Community Credit Union's charter conversion was invalidated by the NCUA, while Lake Michigan Credit Union failed to obtain the necessary two-thirds membership vote. Hopefully, these two cases will be an aberration since the vote required under state law in each instance was greater than the simple majority vote required to convert a federal credit union to a federal savings bank charter.

Trend toward mutual holding companies

Few industry insiders observing the mutual-to-stock conversion market in the early 1990's would have believed that mutual holding company offerings would someday outpace standard conversion transactions. On the surface, there were reasons for this skepticism, including the novelty of mutual holding companies, the desire of many converting mutuals to sell or consolidate shortly after a standard conversion, and regulatory ambivalence, if not hostility, toward the mutual holding company structure. Only a handful of financial and legal experts really understood the advantages of mutual holding companies, including the flexibility they offer converting mutual institutions, and their capital-raising ability and investment potential. Clearly, the greatest appeal of the mutual holding company structure is that it offers mutual savings banks the ability to raise capital and enjoy the benefits of stock ownership without risking a loss of control. Mutual holding companies cannot be acquired by stock companies, and the mutual holding company board controls the election of all directors of its subsidiary stock holding company or savings bank. However, three things have been largely responsible for the current success and market acceptance of mutual holding companies:

- The decision by the Office of Thrift Supervision (OTS) to issue a new rule in 2000 that clarified that mutual holding companies may waive the receipt of dividends without diluting minority stockholders in the event of a second-step conversion.
- The aftermarket performance of mutual holding companies and, in particular, the market's understanding of the accretive impact of second-

step conversions.

- The reduction in the federal tax rate on dividends to 15%, which took effect in 2003. (Mutual holding companies are well-positioned to pay attractive dividends since most are well-capitalized and cash dividends are only paid on shares held by the public.)

These changes, combined with the ability of a mutual holding company's board to maintain control, have made mutual holding companies a superior charter choice for mutuals that want to grow and remain independent.

Impact of higher valuations

The strong market for community bank stocks in recent years has had a substantial impact on the conversion market. As the average price-to-book value ratio for all publicly traded thrifts has increased from 105.0% at December 31, 2000 to 164.3% at December 31, 2004, so has the average price-to-pro forma tangible book value ratio of conversion transactions. The average price to pro forma tangible book value ratio of all standard conversion and mutual holding company transactions (calculated on a fully-converted basis) in 2002 was 69.4% and 64.6%, respectively, compared to 72.8% and 78.8% in 2003, and 96.6% and 86.0% in 2004. (The 2004 standard conversion data includes **NewAlliance Bancshares Inc.** (NAL) which involved the concurrent acquisition of two stock savings bank holding companies and was priced at 129% of pro forma tangible book value.) A modest percentage increase in the average price to book value ratio of all publicly traded thrifts has a magnified impact on the amount of capital raised by converting institutions because of the unique nature of mutual-to-stock conversion transactions. For example, a thrift that is valued at 50% of pro forma tangible book value will double its capital in a standard conversion transaction (before taking into account expenses, a charitable foundation and stock benefit plans). That is, if ABC Mutual has tangible equity capital of $10.0 million, and is valued at 50% of pro forma tangible book value, it would raise an additional $10.0 million in a standard conversion transaction, ending up with $20.0 million of equity capital (without taking into account expenses, a charitable foundation and stock benefit plans) when the conversion is completed. Similarly, if ABC Mutual were valued at 66 2/3% of pro forma tangible book value, it would raise $20.0 million of new capital and end up with $30.0 million of equity capital upon completion of its stock conversion. As shown in Table 1, a 75% price to pro forma tangible book value and an 80% price to pro forma tangible book value increases a converting thrift's capital by four and five times, respectively. A 90% price to pro forma intangible book value increases the thrift's capital geometrically to nine times the original book value!

Given these valuations and the daunting prospect of quadrupling a converting institution's capital in today's market, the mutual holding company alternative makes sense because the amount of capital raised can be "managed" since only a minority of the converting institution's value is sold and, therefore, less than half the capital of a standard conversion is raised. This enables management to more prudently invest the capital raised, which will improve returns on equity and assets.

Smaller "pops" and maturing valuations

It is difficult to predict the extent to which valuations will moderate or decline in 2005 from their current levels. As in the past, conversion valuations will be driven by the market performance of publicly traded thrifts, which will be affected by a variety of factors, including market interest rates (trends in the yield curve), broader trends in the equity markets (i.e. sector rotation) and overall performance of the economy. As a practical matter, conversion valuations cannot go much higher from their current levels for a variety of reasons, including that the higher valuations will produce smaller immediate after-market appreciation, known as "pops," which in turn usually results in less demand for conversion stocks and lower valuations.

In reviewing the independent valuations or appraisals of converting institutions, the bank regulatory agencies, such as the OTS, try to strike a balance between fair valuations and maintaining investor interest in conversion transactions. Since 1994, however, both the OTS and the FDIC have also tried to moderate the aftermarket "pop" of conversion offerings by favoring higher valuations than market conditions may warrant. Like all IPOs, conversion transactions should be priced so that there is sufficient aftermarket appreciation to warrant investment risk. Unfortunately, in recent months the market data indicates that valuations have been too high. Specifically, the 30-day IPO "pop" of mutual holding company stock offerings declined from an average of 65.6% in 2003 to 18.1% in 2004, and the 30-day IPO "pops" for standard conversions declined from an average of 42.2% in 2003 to 14.3% in 2004. Moreover, for the first time in several years, initial mutual holding company and standard conversion transactions have actually traded below their IPO price. Three of the four conversion transactions that closed in the first three weeks of January 2005 are now trading below their initial offering price, and the average IPO price decline for the three mutual holding company transactions after two weeks of trading was 1.3%. These aftermarket results would suggest that valuations should moderate or trend downward in the near term. This is not the first time conversion IPOs have traded below their

Table 1

The impact of valuations on the amount of capital raised

Existing Capital ($M)	Price to Pro Forma Tangible Book Value (%)	Total Capital Raised ($M)	Ending Capital ($M)	Ending Capital as a % of Beginning Capital
10.00	50	10.00	20.00	200%
10.00	66.7	20.00	30.00	300%
10.00	75	30.00	40.00	400%
10.00	80	40.00	50.00	500%
10.00	90	90.00	100.00	1000%

original issue price. Several of the mutual holding company offerings that were completed in 1998 (at the end of a very strong market for bank stocks), traded below their IPO price when the market dropped in August 1998, and remained below their IPO price until the broader bank and thrift market improved significantly.

Projected 2005 deal flows

Historically, conversion transactions have peaked when market conditions are strong and valuations are high. In particular, second-step conversions of mutual holding companies to stock provides existing public stockholders the opportunity to exchange their shares for new shares of a fully-public company at an attractive exchange ratio. A strong market also reduces the risk that a conversion transaction will not be completed, although this risk has been minimal based on results over the past 15 years. For smaller institutions, the current higher valuations present unique opportunities to raise enough capital (even with a mutual holding company) to fundamentally transform their business, improve products and services, and have a stock with more liquidity. **Lincoln Park Savings Bank** (LPBC), **Wawel Savings Bank** (WAWL) and Monadnock Community Bank are three savings banks with less than $100.0 million in assets that raised $8.5 million, $8.0 million and $3.4 million, respectively, in mutual holding company transactions and more than doubled their capital in doing so. With 15 conversion transactions announced or pending in 2005, we anticipate another good year for conversion transactions, although the total number of completed deals is unlikely to reach the 2004 levels. Well-capitalized mutuals are likely to continue to prefer mutual holding company offerings, even if valuations decline moderately in 2005.

Outlook for second-step conversions

As noted above, the pace of second-step conversion activity accelerates when thrift market indices are strong and conversion appraisals are rising. Generally, the aftermarket "pops" of second-step conversions are significantly less than those for initial mutual holding company offerings or stan-

Table 2

Conversion class of 2004

Ticker	Company name	State	IPO date	Conversion type	Gross proceeds ($000)	Pro forma price/ tang bk[1] (%)	Industry price/ book discount[2] (%)	IPO pop (%)
CHEV	Cheviot Financial Corp. (MHC)	OH	01/06/04	MHC	43,884	83.14	45.30	33.20
PBCP	Provident Bancorp, Inc.	NY	01/15/04	Second-Stage	195,730	151.10	21.50	15.00
SYNF	Synergy Financial Group, Inc.	NJ	01/21/04	Second-Stage	70,359	125.00	18.50	9.00
CSBK	Clifton Savings Bancorp, Inc. (MHC)	NJ	03/04/04	MHC	137,387	92.10	40.20	22.50
CZWI	Citizens Community Bancorp (MHC)	WI	03/30/04	MHC	9,787	83.24	46.00	23.70
KFED	K-Fed Bancorp (MHC)	CA	03/31/04	MHC	56,868	92.00	40.30	34.90
OFFO	Osage Federal Financial Inc. (MHC)	OK	04/01/04	MHC	6,844	85.18	45.40	20.00
WAWL	Wawel Savings Bank (MHC)	NJ	04/01/04	MHC	7,993	92.82	40.50	29.50
NAL	NewAlliance Bancshares, Inc.	CT	04/02/04	Standard	1,024,938	123.90	50.40	51.70
SEFL	SE Financial Corp.	PA	05/06/04	Standard	25,789	86.60	40.70	(0.50)
FFFS	First Federal Financial Services, Inc. (MHC)	IL	06/29/04	MHC	17,640	75.90	48.00	15.00
MNCK	Monadnock Community Bancorp, Inc. (MHC)	NH	06/29/04	MHC	3,383	85.45	41.50	3.75
TDCB	Third Century Bancorp	IN	06/30/04	Standard	16,531	75.30	48.40	13.20
PRTR	Partners Trust Financial Group, Inc.	NY	07/15/04	Second-Stage	148,750	198.00	37.50	(0.10)
DSFN	DSA Financial Corporation	IN	07/30/04	Second-Stage	8,485	102.80	30.00	(2.00)
NVSL	Naugatuck Valley Financial Corp. (MHC)	CT	10/01/04	MHC	32,699	90.25	41.10	8.00
SIFI	SI Financial Group Inc. (MHC)	CT	10/01/04	MHC	50,255	90.71	40.80	12.00
RBLG	Roebling Financial Corp, Inc.	NJ	10/01/04	Second-Stage	9,107	111.50	27.20	0.00
ACFC	Atlantic Coast Federal Corporation (MHC)	GA	10/05/04	MHC	58,190	87.91	42.60	17.50
PSBH	PSB Holdings, Inc. (MHC)	CT	10/05/04	MHC	30,897	85.16	44.40	5.00
HOME	Home Federal Bancorp, Inc. (MHC)	ID	12/07/04	MHC	60,835	89.36	38.80	24.90
ABBC	Abington Community Bancorp, Inc. (MHC)	PA	12/17/04	MHC	71,415	84.85	47.90	33.50
LPBC	Lincoln Park Bancorp (MHC)	NJ	12/20/04	MHC	8,517	88.59	45.70	10.00
OSHC	Ocean Shore Holding Company (MHC)	NJ	12/22/04	MHC	38,352	91.09	38.40	21.50
SFBI	SFSB Inc. (MHC)	MD	12/31/04	MHC	13,390	82.72	44.60	7.50

1 - Fully-converted price-to-tangible book ratio for MHCs

2 - Discount to the median price-to-book ratio for all exchange-traded thrifts at the month-end prior to the IPO date

Source: SNL Financial LC

Table 3
Standard conversion trends

	Median pro forma price/book (%)	Median Industry P/B discount* (%)	Median IPO pop (%)	# of conversions
1995	68.2	30.7	15.6	81
1996	71.7	32.5	9.8	63
1997	72.9	45.8	42.2	33
1998	76.3	49.8	28.1	40
1999	64.0	41.5	8.1	18
2000	54.0	39.3	10.0	11
2001	58.5	42.7	20.8	10
2002	68.7	40.7	22.8	6
2003	70.7	45.5	37.5	6
2004	80.3	48.4	13.2	3
(1995-2004)	**69.7**	**42.1**	**18.2**	**271**

* Discount to the median price/book ratio for all exchange-traded thrifts at the month-end prior to the IPO date.
Source: SNL Financial LC

dard conversions because pricing better approximates current market value. The reason for this is that the stock sold in a second-step conversion, representing the unsold mutual interest of the converting bank that is owned by the mutual holding company, is sold at market value which approximates the public trading price of the mutual holding company's outstanding minority stock. After-market "pops" for second-step conversion transactions averaged 17.4% in the first 30 days for transactions in 2003, compared to 1.2% for the five second-step conversion transactions in 2004. Three of the five second-step conversions are now trading below their IPO price.

The volume of second-step conversion transactions will also largely be affected by the supply or number of seasoned publicly traded mutual holding companies, and by acquisition or expansion opportunities for mutual holding companies. There are only 12 publicly traded mutual holding companies that were formed prior to 2002, leaving few second-step conversion opportunities in the near term. Moreover, the boards of most mutual holding companies that undertake second-step conversions want to have a use for the additional capital raised in the transaction, which is usually an acquisition opportunity or internal growth. **First Niagara Financial Group Inc.** (FNFG), Lockport, New York, a $3.3 billion asset mutual holding company, completed its second-step conversion and simultaneous acquisition of Finger Lakes Bancorp Inc. in January 2003, and used the remaining conversion proceeds to acquire $1.4 billion asset Troy Financial Corp., and $2.6 billion asset Hudson River Bancorp Inc., in 2004. First Niagara Financial formed its mutual holding company in 1998 and has grown from $1.2 billion to $8.0 billion in total assets since then. Similarly, **Provident Bancorp Inc.** (PBCP), a $1.5 billion asset mutual holding company, completed its second-step conversion and simultaneous acquisition of Florida National Bank in January 2004, and used additional conversion proceeds to acquire $780.0 million asset, Warwick Community Bancorp Inc. in October 2004.

Remutualizations will be few and far between

With all of the mutual holding company offerings in 2003 and 2004, investors will inevitably show renewed interest in so-called remutualization transactions, whereby a mutual savings bank acquires a publicly-traded mutual holding company and its savings bank subsidiary by buying out the public stockholders for a premium. While eight remutualization transactions were completed between 2000 and 2004, none are pending at the present time. There are several reasons for this, and they are all driven by the fact that in a remutualization transaction the acquiror pays the control premium to minority stockholders only. This understandably has raised a variety of regulatory and policy issues including fairness of the transaction to mutual members (i.e. are selling stockholders effectively receiving part of the value of the mutual interest?) and the fairness of mutual holding company appraisals. As a matter of policy,

Table 4
MHC conversion trends

	Median pro forma fully converted price/book (%)	Median industry P/B discount* (%)	Median IPO pop (%)	# of conversions
1995	63.7	36.9	10.0	8
1996	67.4	36.9	20.6	2
1997	69.5	46.3	28.1	4
1998	69.7	48.1	12.2	14
1999	57.7	46.1	1.3	9
2000	44.3	51.9	2.5	4
2001	60.1	42.8	33.4	3
2002	65.0	45.6	26.2	4
2003	79.0	50.0	62.9	2
2004	87.9	42.6	20.0	17
(1995-2004)	**66.2**	**45.9**	**20.3**	**67**

* Discount to the median price/book ratio for all exchange-traded thrifts at the month-end prior to the IPO date.
Source: SNL Financial LC

the OTS (and presumably other federal regulators such as the FDIC), has stated that it will carefully scrutinize transactions where the premium paid for public or minority shares exceeds the "highest priced transaction in the third quartile of all acquisitions of all stock institutions announced during the preceding four quarters." In other words, higher than average "control" premiums paid to minority stockholders (which generally has been the driving force behind remutualization transactions) will be unacceptable. For example, in the 2003 **Kearny MHC** acquisition of publicly-traded West Essex Bancorp (MHC) and its subsidiary West Essex Bank minority stockholders were paid 357% of tangible book value on a per minority share basis. In addition, the accounting for remutualization transactions has changed significantly and results in far too much goodwill to make much sense for the average buyer. Specifically, remutualizations are now accounted for under both the pooling and purchase methods of accounting, and the entire purchase price is allocated to the minority shares for purposes of determining goodwill. As a result, most mutual institutions that look at potential remutualization transactions closely will come away disappointed. Lastly, by regulation only mutual savings banks (and mutual holding companies) can acquire other mutual holding companies. This makes the universe of potential buyers very small. On a more positive note, while there are limited prospects for remutualization transactions so long as market valuations for thrift stocks remain high, we expect stock-for-stock mergers between publicly-traded mutual holding companies to generate more interest. These transactions will be difficult to complete, much less to understand, from a corporate and regulatory standpoint, but are permissible under federal and most state laws.

The regulatory environment

Overall, federal and state regulation of conversion transactions has been generally favorable during the past few years, particularly with respect to federal mutual holding companies. The most positive regulatory development for mutual holding companies in 2004 was the OTS' affirmation that state-chartered savings banks that convert to federally chartered mutual holding companies can retain their savings bank corporate governance even if they convert to federal savings bank charters. This ground-breaking development came when **Putnam Savings Bank** and its state-chartered mid-tier and mutual holding companies all converted to federal charters as part of the minority stock offering by **PSB Holdings Inc.** (PSBH), the mid-tier stock holding company of Putnam Savings Bank, which raised $40.9 million in October 2004. Although, in the past, the OTS had permitted federally-chartered mutual holding companies to retain corporator voting and depositor voting where the subsidiary savings bank retained its state charter, in the Putnam Savings Bank transaction the OTS permitted the savings bank to convert to an OTS charter and still retain corporator voting in the OTS-chartered mutual holding company. As a result, depositors of Putnam Savings Bank do not have voting rights while it remains in the mutual holding company structure, and the savings bank's board of corporators remained intact as the corporators of the federal mutual holding company. Two other Connecticut-chartered savings banks have followed the Putnam Savings Bank model. Similarly, Mass.-based **Georgetown Savings Bank** (GTWN) converted to a federal savings bank charter, retained its corporator voting and formed an OTS-chartered mutual holding company as part of its $12.5 million minority stock offering that closed in January 2005.

The option of permitting state-chartered savings banks with a corporator governing body (which is the typical model in New England states) to convert to federal charters and retain corporator voting is significant. Many state-chartered savings banks have a long history of being governed by a board of corporators, and substituting corporators with depositors as the group that elects directors or trustees often presents practical challenges. The OTS policy enables mutual savings banks to focus more on capital raising (instead of systemic corporate governance changes), when forming a mutual holding company. Importantly, the OTS policy enables savings banks chartered in Massachusetts (the only state which currently does not permit state-chartered savings banks to form OTS-chartered mutual holding companies) to now form OTS-chartered mutual holding companies and preserve their corporator governing body.

As noted above, the regulatory environment for mutual to stock conversions and mutual holding companies generally remains favorable. However, several regula-

Table 5

Second-stage conversion trends

	Median pro forma price/book (%)	Median industry P/B discount* (%)	Median IPO pop (%)	# of conversions
1995	80.4	20.6	8.3	5
1996	76.8	25.8	6.2	7
1997	93.8	34.7	23.4	7
1998	106.6	29.7	6.3	11
1999	74.4	34.2	(0.3)	2
2000	76.8	13.2	6.7	3
2001	81.2	18.5	22.8	2
2002	95.4	17.8	9.5	3
2003	96.4	27.2	12.4	6
2004	111.5	27.2	0.0	5
(1995-2004)	**87.5**	**26.5**	**7.5**	**51**

* Discount to the median price/book ratio for all exchange-traded thrifts at the month-end prior to the IPO date.
Source: SNL Financial LC

tory developments in 2004 have unnecessarily complicated conversion transactions and increased the time and costs associated with completing them.

For instance, the OTS now requires, as a matter of policy, that the firm preparing the independent appraisal may not also prepare the business plan. The need for this bifurcation of responsibility can be debated, but the practical effect of the new policy is to generally double the cost of the appraisal and business plan functions.

In addition, OTS rules now require a board of directors or a committee of the board to meet with the OTS before adopting a plan of conversion or mutual holding company reorganization. While the rule seems simple enough in theory, in practice it involves additional costs and delays, and complicates timing and the ability to retain confidentiality since these meetings must be established and coordinated before adopting and publicly announcing a plan of conversion or reorganization.

While the OTS expressed a clear desire to give mutual holding companies regulatory parity with (if not a preference over) stock holding companies in its 2000-2002 rulemaking, including a desire to grant mutual holding companies more flexibility in adopting stock benefit plans, recent OTS staff interpretations of mutual holding company rules have done just the opposite. As a result, there is little consensus as to what the parameters are for stock incentive plans adopted by federal mutual holding companies, including the vote required to approve such plans. (Ironically, many practioners believe the stock benefit plan rules for mutual holding companies worked better before the new OTS rules were implemented in 2002, and clearly before a recent OTS legal interpretation regarding stock benefit plans.) The new OTS interpretations require mutual holding companies to incur the cost of obtaining rule waivers that stock holding companies simply don't have to worry about. Uncertainty can be a board of directors' greatest fear in deciding what type of conversion transaction to pursue, and the new OTS interpretation has already had the effect of steering several mutuals to either a standard conversion or a state chartered-mutual holding company. The OTS is sensitive to this dilemma and has announced that it will be proposing new amendments to its mutual holding company rules to address these issues.

Impact of Sarbanes-Oxley

Another consideration for boards of directors considering a conversion transaction is the cost of compliance with the requirement of the Sarbanes-Oxley Act. In particular, Section 404 of the Sarbanes-Oxley Act requires management of a public company to prepare and file with the Securities and Exchange Commission an internal control report stating management's responsibilities to establish and maintain internal controls over financial reporting and management's conclusion as to the effectiveness of these internal controls at year end. The public company's accounting firm must attest to, and report on, management's evaluation of its internal controls over its financial reporting. The effect of Section 404 has been to significantly increase the cost of raising capital and being a public company, as many companies have had to hire independent advisors to assist in preparing and testing their internal controls. While the 2004 conversion data suggests that Sarbanes-Oxley has not adversely affected conversion transaction activity, its long-term impact on conversion transactions, being a public company, and even mutual institutions is unclear. It would not be unreasonable to expect that many of the "best corporate practices" resulting from Sarbanes-Oxley will be made applicable to all mutual and stock savings banks in the future.

Credit union conversions

There are many practical business reasons for credit unions to convert to savings bank charters, despite the significant tax advantage enjoyed by credit unions. Given the political clout of credit unions and Congress' reluctance to tax credit unions like banks and thrifts, the banking and thrift industry would be well advised to devote more resources toward preserving the ability of credit unions to readily convert to savings bank charters. In 1998, Congress limited the NCUA's authority to intervene in the charter conversion process by taking away the NCUA's approval authority and substituting it with the authority to review a credit union's "methods and procedures" for converting. Notwithstanding Congress' directive, the NCUA has greatly expanded its limited authority by adopting rules that effectively presume that a charter conversion is contrary to the interests of members and requires, among other things, speculative disclosure as to the potential impact of a stock conversion transaction (even if none is contemplated) and the benefits of such a transaction to management. Credit unions will continue to have many reasons to convert to a savings bank charter, including the need to grow and to compensate directors if they are expected to properly exercise oversight responsibility over federally-insured financial institutions. As a result, credit unions will continue to convert to savings bank charters, but the costs of conversion will increase (unnecessarily in the view of the authors) as a result of the NCUA rules.

Conclusion

2004 witnessed a relatively healthy increase in conversion transactions compared to the prior few years. This year is already getting off to a solid start with the announced second-step conversion of $19.3 billion asset **Hudson City Bancorp Inc.** (MHC) (HCBK), and the mutual holding company offering by $760.0 million asset **United Bank**, a federal savings bank that converted from a Massachusetts cooperative bank in 2004. Mutual savings banks will continue to undertake conversion transactions so long as market conditions remain favorable. The reasons for these transactions will vary from the need for capital to grow internally, increase profitability or finance the acquisition of a stock bank, or simply the desire to become more competitive by establishing stock incentive plans for employees and management. In any case, it would be reasonable to expect that in 2005 most mutuals will continue to prefer the mutual holding company structure as the first step in their transition to stock form. **TI**

The authors acknowledge the contribution of Kent Krudys, Alan Schick, Kip Weissman and Richard Garabedian in the drafting of this article.