

New Charter Options Give Mutual Holding Companies More Flexibility

By Eric Luse

The Office of Thrift Supervision, the only federal banking agency that charters mutual savings banks and mutual holding companies, boosted the mutual holding company structure recently by expanding the charter and corporate governance options for state savings banks that form OTS-regulated mutual holding companies. These charter options are “industry friendly” and will eliminate some of the uncertainty that community banks face when they consider forming mutual holding companies.

Mutual holding companies are no longer

mutual savings institutions in the United States are organized as “private” mutual holding companies. In addition, there are more than 70 public mutual holding companies. From a capital raising perspective, 17 savings institutions raised capital by selling common stock through a mutual holding company in 2004, while only three institutions converted to stock form in a standard or “full-stock” conversion transaction.

There is little doubt that two developments—the creation of the so-called “two-tier” mutual holding company and the ability of mutual holding companies to waive the

tax consequences or pay dividends without diluting public stockholders. Yet these were the regulatory constraints placed on mutual holding companies in the mid-1990s.

The stock repurchase problem was solved by creating a “two-tier” mutual holding company that uses a middle-tier stock holding company (rather than the savings bank itself) to issue stock to the public. This effectively enables a mutual holding company to become a stock holding company, but with a controlling stockholder (the mutual holding company).

The resolution of the dividend dilemma required convincing the federal bank regulatory agencies that it was equitable to pay dividends only to those stockholders who paid for shares in the public offering. In 2000, the OTS (but not the Federal Reserve or the Federal Deposit Insurance Corp.) clarified its rules to allow mutual holding companies to waive the receipt of dividends without diluting minority stockholders. This paved the way for OTS-chartered mutual holding companies to pay market dividends to their public stockholders. Moreover, it reduced the pressure on mutual holding companies to undertake so-called “second-step” conversions to full-stock form to avoid dilution to minority stockholders resulting from paying dividends.

The lessons learned from these regulatory changes are revealing. In both cases, change was precipitated by a basic market need for mutual holding companies to be able to pay

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the occasional exception to “standard” mutual-to-stock conversion transactions. Since People's Bank of Bridgeport, Conn., formed the first mutual holding company in 1988, the structure has evolved to the point that mutual holding companies are now the charter of choice for most mutual savings institutions contemplating a change in their organizational structure.

Today, approximately 85 of the 700

receipt of cash dividends—were largely responsible for the increased popularity of mutual holding companies because they enhanced the economic appeal of the structure to investors.

Dual Banking Paves the Way for MHCs

It would be hard to imagine investors having an interest in stock holding companies that cannot repurchase their stock without adverse

dividends and repurchase common stock in order to be competitive. In these instances, change required the blessing of the federal bank regulatory agencies. In both instances there was not a consensus among the federal agencies for change, and the improvements to the mutual holding company structure would not have been possible but for the choice of bank regulators that we have under our dual banking system.

The Panoply of Charter Options

While savings banks and the capital markets now recognize the growth and investment potential of mutual holding companies, one obstacle to more widespread acceptance of the mutual holding company structure has been the difference in charters and corporate governance between state- and federally-chartered savings banks.

Charter choice and corporate flexibility have made the mutual holding company charter more user friendly than ever.

Federal savings banks generally have a board of directors that is elected annually by depositors. By contrast, in most New England states, mutual savings banks are managed and governed by trustees who are elected by a board of corporators and not depositors. Finally, in many of the Mid-Atlantic states, mutual savings banks are managed and governed by a board of trustees who elect themselves. There is no depositor voting except for extraordinary transactions such as a mutual-to-stock conversion. Many of these state-chartered savings banks, while attracted to the OTS mutual holding company model, may be uncomfortable changing their corporate governance by eliminating trustees and corporators and substituting directors who are elected by depositors.

Now, these state-chartered savings banks do not have to worry since OTS policy

allows state-chartered savings banks to retain their state charters and keep their existing corporate governance even if they form an OTS-chartered mutual holding company. If a savings bank has trustees and corporators prior to forming a federal mutual holding company, then the federal mutual holding company's charter would authorize trustees and corporators with no depositor voting.

Moreover, OTS regulations allow state-chartered savings banks that form federal mutual holding companies to retain their mutual corporate governance in the federal mutual holding company even if the savings bank converts to a federal savings bank charter. For example, Georgetown Savings Bank in Georgetown, Mass., converted to a federal savings bank concurrent with its formation of a mutual holding company and retained its previous form of corporate

governance—corporators and trustees, in its new federal mutual holding company.

The OTS also allows existing state-chartered mutual holding companies that either convert to a federal charter or elect to have their mutual holding company regulated by the OTS (rather than the Federal Reserve Board) to have their mid-tier stock holding company chartered under state law. While there are benefits to an OTS-chartered mid-tier stock holding company (such as lower costs and convenience), there are benefits (such as broader indemnification rights) to having a state-chartered mid-tier stock holding company.

Taking Advantage of the MHC Charter

All of this should be good news for mutual community banks and mutual holding companies (including credit unions that may be contemplating conversion to a

savings bank charter). Charter choice and corporate flexibility have made the mutual holding company charter more user friendly than ever. Even if a savings bank has no immediate need or plans to raise capital, the reasons for simply forming a mutual holding company without issuing stock (a so-called "private" or no-stock mutual holding company) are compelling.

Significantly, forming a mutual holding company requires regulatory approval, which should not be taken for granted. For example, a deficiency in Bank Secrecy Act compliance that turns up in a routine regulatory examination can prevent any holding company formation for years. So forming a private mutual holding company while the regulatory environment is favorable can make a real difference in a savings bank's future.

Moreover, forming a private mutual holding company has no effect on the employees, management, board of trustees or corporate governance of a savings bank.

Once a mutual holding company is formed, a savings bank will be positioned to take advantage of many of the growth and investment opportunities that are simply not available to mutual savings banks directly. This includes investing in equity securities and raising capital by selling common stock or trust preferred securities without the need to get a vote of depositors. A mutual holding company also can be used to acquire and hold other financial institutions as separate entities. Lastly, management can evaluate a whole bank or branch acquisition with far more confidence if it knows that capital can be raised without the delay or concerns associated with a depositor vote.

In the 1990s, savings bank boards had many reasons for retaining their mutual charters. Today they have many more reasons for forming a mutual holding company. **15**

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