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September 18, 2006

VIA US MAIL AND E-MAIL (REGS.COMMENTS@OTS.TREAS.GOV)

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G. Street, N.W.
Washington, DC 20552
Attn: No.2006-29

Re: Comments on Notice of Proposed Rule Making: Stock Benefit Plans in Mutual-to-Stock Conversions and Mutual Holding Company Structures (OTS Docket No. 2006-29 and RIN 1550-AC07)

Dear Sir or Madam:

Luse Gorman Pomerenk & Schick, PC, is pleased to submit our comments in support of the proposed Office of Thrift Supervision ("OTS") regulations that would clarify existing OTS rules regarding the implementation of stock-based benefit plans by mutual holding companies. Our law firm fully supports the proposed rules and, most importantly, the proposal to eliminate the need for a separate vote of minority stockholders to approve stock benefit plans implemented by mutual holding companies more than one year after the completion of a minority stock offering.

The mutual holding company has been a very successful charter alternative and capital-raising vehicle for mutual savings institutions, and in recent years has been the preferred corporate structure for converting mutual institutions. We believe that the voting standards for approval of stock benefit plans contained in the proposed rules are necessary to improve the mutual holding company structure and to protect mutual holding companies from stockholder activists intent on using their voting power over stock benefit plans to weaken the mutual holding company charter for their own short-term financial gain. At the very least, the actions of stockholder activists, when combined with the ambiguity of the current OTS rules, have resulted in the unnecessary commitment of management time and corporate resources to implementing stock benefit plans that, in past years, were implemented routinely. Accordingly, for this reason as well as the other reasons discussed in this letter, we strongly encourage the OTS to adopt the proposed clarifying regulations (subject to our comments below) as soon as possible.

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Background of Luse Gorman Pomerenk & Schick, P.C.

Before commenting on the proposed rules, however, we would like to briefly summarize our experience and credentials regarding mutual holding companies. Luse Gorman Pomerenk & Schick, PC, has been actively involved in advising and representing mutual holding companies chartered under federal and state law for nearly 15 years. We believe we are uniquely positioned to comment on the need for and feasibility of the proposed rule changes. Attorneys in our law firm completed the first federal mutual holding company reorganization in 1991, and since then we have acted as counsel in more than 100 mutual holding company formations. Attorneys in our firm also were involved in crafting the original federal mutual holding company legislation in 1987 and the amendments to this legislation in 1989. As such, we have experienced first-hand the advantages and disadvantages of both state and federal mutual holding company laws and regulations that have been implemented and amended over the years. We also have seen how the mutual holding company structure has enabled community-based savings institutions to expand their franchises by making decisions based on their long-term objectives. Consequently, we believe we have a firm understanding as to which laws and regulations work to enhance the mutual holding company charter, and which do not.

Our law firm has actively and consistently supported the mutual holding company charter since its inception, as well as the need for mutual savings institutions to have a capital-raising alternative to "full" or "standard" mutual-to-stock conversions. Accordingly, our comments are premised on the assumption that OTS regulations should be crafted to enhance the long-term viability of mutual holding companies.

Introductory Statement in Support of Proposed Rules

Because a mutual holding company combines elements of mutuality and stock ownership, any OTS regulation in this area must address the needs of public stockholders while recognizing that the mutual holding company is a mutually controlled organization. In the past, the OTS has been very successful in promulgating mutual holding company regulations that balance these interests. Indeed, current OTS regulations regarding the size of mutual holding company stock benefit plans, combined with the accounting rules requiring the expensing of stock benefit plans, have limited the magnitude of such plans and have protected the interests of public stockholders. Specifically, regardless of the vote required to approve stock option and stock award plans, such plans currently may not exceed 4.9% and 1.96%, respectively, of the outstanding shares of a mutual holding company's mid-tier or savings bank subsidiary. Moreover, generally accepted accounting principles ("GAAP") require the expensing of options and stock awards, and all aspects of such plans, including cost, must be disclosed in great detail to stockholders.

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The OTS' success in balancing these competing interests has been reflected in the popularity of the mutual holding company structure, both to mutual managements, as evidenced by the large number of mutual holding company formations, and to stockholders in the public markets, as evidenced by oversubscribed mutual holding company offerings and the after-market price performance of mutual holding company stocks.

Unfortunately, however, current OTS mutual holding company regulations, *as interpreted by the OTS staff since 2004*, have had the unintended effect of disrupting this balance by giving small groups of activist stockholders disproportionate influence over corporate governance, management and policy through their ability to influence stockholder voting on stock benefit plans. Specifically, in recent years, stockholder activists have used the requirement of a separate minority vote to approve stock benefit plans to influence the management and operations of mutual holding companies generally. This influence has been facilitated indirectly by the mutual holding company structure itself. That is, the anti-concentration rules of the standard conversion regulations (which also apply to mutual holding companies) limit an individual or group acting in concert from acquiring more than 10% of a recently converted company for three years after a conversion transaction. The purpose of this rule is to prevent one stockholder or a small group from exercising undue influence over the management and policies of a recently converted company. This same rule, however, allows minority stockholders to purchase up to 10% of the *outstanding* shares of a mutual holding company immediately following a stock offering. As a result, because less than half of a mutual holding company's common stock can be held by the public, a single minority stockholder could own more than 30% of the public shares of a mutual holding company and still comply with OTS rules.

This concentrated ownership has enabled a small handful of stockholders to control or significantly influence the outcome of any vote on stock benefit plans. However, these groups of stockholders have no basis for complaining about the size of plans, since, as noted above, these plans can never exceed regulatory thresholds established by the OTS and, in any case, can never be even half the size of the stock benefit plans of fully converted stock holding companies. These groups' true objective can only be to take advantage of their ability to own up to 30% (or more) of the public shares of a mutual holding company in order to influence the management and operations of the company more generally. Permitting this to occur is contrary to the regulatory intent of the OTS' anti-concentration regulation – to prevent a single stockholder or group of stockholders from exercising undue influence over the management and policies of recently converted institutions by acquiring a significant amount of stock immediately after a conversion offering. This result can be prevented by either adopting the proposed rule or amending the OTS' anti-concentration rule to prohibit any person or group acting in concert from acquiring more than 10% of the *public shares* of a mutual holding company for three years after its initial minority stock offering.

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Specific Comments and Analysis Regarding Proposed Rules

Our specific comments to the proposed rules are as follows:

A. Vote Required to Approve Stock Benefit Plans

We strongly support the proposal to: (i) reduce the minority stockholder vote required to approve stock benefit plans adopted within one year after the completion of a minority stock offering; and (ii) eliminate the need for a separate minority vote for plans adopted more than one year after the completion of a minority stock offering. The requirement for a separate minority stockholder vote to approve stock benefit plans implemented *within the first year* of a minority stock offering was added to the mutual holding company regulations in 1994. We believe the plain language of the mutual holding company and conversion rules *does not* require a separate vote of minority stockholders for plans adopted *more than one year* after a minority stock offering, although a separate vote of minority stockholders after the one year "cooling off" period has been required of mutual holding companies since the OTS staff issued an interpretive opinion in 2004. Accordingly, the proposed rule on the required vote to approve plans adopted more than one year after a minority stock offering is an affirmation of the existing OTS rules. In addition, we note that until recently, minority stockholders never expressed a concern about the lack of separate voting rights to approve plans adopted more than one year after an offering. (We assume that this acceptance of the OTS regimen for mutual holding company stock benefit plans was largely due to the OTS limits on the size of such plans, discussed above.) Finally, we are aware of no abuse on the part of institutions that adopted stock benefit plans during the period in which a separate minority vote was either not specifically required by OTS or not construed as being applicable for plans adopted more than one year after a minority stock offering.

From a corporate governance perspective, we do not believe that a separate vote of mutual holding company minority stockholders should ever be required to approve stock benefit plans, since a separate minority vote is inconsistent with the mutual holding company's status as a controlling majority stockholder, and the separate vote in effect disenfranchises the mutual holding company as majority stockholder. However, we recognize that the OTS has historically imposed greater restrictions on plans adopted within one year of a minority stock offering or standard conversion (including a more rigorous voting standard), in order to address any concerns about potential "windfall" benefits to insiders. Accordingly, if the OTS believes a separate minority stockholder vote is necessary for plans adopted within one year of a minority stock offering, the vote required to approve such stock benefit plans should be a simple majority of those voting, rather than a majority of the outstanding minority shares. A simple majority is the voting standard generally applicable under Delaware and other state laws, as well as under the NASDAQ rules. A higher voting standard, such as a majority of the outstanding minority shares, is unduly burdensome relative to the subject matter of the vote (stock benefit plans), and

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would normally apply only to transactions that involve a fundamental change in the organization of a company, such as a merger.

Requiring a separate minority vote to approve stock benefit plans is also problematic from a policy standpoint since it is tantamount to eliminating the voting rights of the mutual holding company with respect to those benefit plans. From a corporate governance standpoint, the OTS needs to balance the interests of public stockholders with those of the mutual membership and management. This balance can never be in favor of public stockholders because, by law, the mutual holding company is the controlling stockholder and it would violate the basic premise of a mutual holding company – mutual ownership and control. Accordingly, we believe that the best policy is for OTS rules to recognize the significant role of stockholders and equity capital in the mutual holding company structure, while at the same time acknowledging that the mutual holding company must *always be* the controlling stockholder.

The fact that a separate minority vote relates only to stock benefit plans should make no difference. Indeed, as noted above, OTS regulations, both current and proposed, contain significant restrictions on the size of such plans, which restrictions apply whether minority stockholders have separate voting rights or not. Minority stockholders normally are concerned whether stock benefit plans are excessively dilutive to their ownership interests – a factor that is more than adequately addressed by the comprehensive OTS regulations restricting the size of plans, extensive pro forma disclosure regarding the impact of such plans and GAAP regarding the expensing of such plans.

The proposed rule needs to be adopted because the existing OTS rule, as interpreted by OTS staff, raises significant governance issues that affect the viability of the mutual holding company structure. For example, in 2006 certain stockholder activists attempted to amend the Home Owners' Loan Act (*citing as precedent OTS rules requiring a separate vote for minority stockholders to approve stock benefit plans*) to eliminate the ability of mutual holding companies to vote for the election of directors or their mid-tier holding company or savings bank subsidiaries. Such a change in the law would have negated the benefits of the mutual holding company structure and would have made mutual holding companies *more vulnerable* to stockholder activists than fully converted stock holding companies. The single most important element of the mutual holding company structure – control over its mid-tier holding company or savings bank subsidiary, would have been eliminated. Very simply, the OTS must keep in mind that any rule that requires a separate vote of minority stockholders, in effect, eliminates the majority vote of the mutual holding company and, therefore, disenfranchises the mutual holding company and its members.

While activist minority stockholders may complain about their inability (by definition as minority stockholders) to influence or control the operations of a mutual holding company, their concerns should not be addressed by adopting rules that have the effect of weakening the mutual holding company charter. Instead, the OTS should continue, as it has done in the past, to ensure

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that investors are provided with adequate information at the time of a minority stock offering to make an informed decision regarding the impact of stock benefit plans. If these investors do not like the fact that, by law, they can never control the election of a mutual holding company's directors, then they should not invest in mutual holding companies. The success that mutual holding companies have had in raising capital clearly demonstrates that there are more than enough depositors and other investors who are willing to invest in a minority position in mutual holding companies. So why change the rules for a limited group that has the transparent objective of eliminating mutual holding companies and mutuality? Since there is no evidence that mutual holding companies have abused their ability to approve stock benefit plans, we can only surmise that stockholder activists who oppose the proposed rule on voting are intent on reducing the attractiveness of the mutual holding company structure and forcing existing mutual holding companies to convert to stock form.

Under existing (as well as proposed) OTS regulations, the OTS has substantial and comprehensive control over the size and scope of mutual holding company stock benefit plans. This control is more than sufficient to protect the legitimate concerns of minority stockholders regarding the costs and dilutive effect of such stock benefit plans. The proposed rules would continue to limit the aggregate size of stock benefit plans adopted by mutual holding companies. By comparison, these limits do not apply to fully converted stock holding companies. Mutual holding company stock benefit plans *can never be even half as large* as the plans that may be implemented by fully converted stock holding companies. In addition, since the implementation of SFAS 123R, all companies, including mutual holding companies, must be particularly sensitive to the cost of stock option plans and stock award plans. Accordingly, we believe that the public markets (as well as OTS regulations) will have, and should have, the greatest impact on the size of stock benefit plans implemented by both mutual holding companies and fully converted stock companies.

B. Proposed Rule Changes to Section 563b.500 Regarding Stock Benefit Plans

We recommend revising the proposed rules (at Section 563b.500) to refer to a "tax-qualified employee stock benefit plan" rather than an employee stock ownership plan ("ESOP") because an ESOP is only one type of tax-qualified plan. Tax-qualified plans may also include a 401(k) plan or other tax-qualified plans that may be established and qualified under Section 401 of the Internal Revenue Code. 401(k) plans do participate in standard conversion and mutual holding company stock offerings, and they are a useful way for employees to become owners of their institution. "Tax-qualified employee stock benefit plan" is currently defined in Section 563b.25, and that definition clearly excludes stock option plans and restricted stock plans, such as a management recognition plan. Accordingly, there should be no confusion as to what constitutes a tax-qualified employee stock benefit plan.

Furthermore, we agree that the language of Section 563b.500(a)(7) should be amended to remove any reference to mutual holding companies, since this would be addressed under Part

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575. We have no objection to specifying that a stockholder vote is not required to establish an ESOP or any other tax-qualified plan.

C. Proposed Rule Changes to Section 575.8 Regarding Stock Benefit Plans

For the reasons discussed above, we recommend that OTS continue the use of the term "tax-qualified stock benefit plans" in Section 575.8.

We concur that the restrictions contained in Section 563b.500(a)(4) through Section 563b.500(a)(14) should apply for only one year after a minority stock issuance in order to make the mutual holding company regulations consistent with the conversion regulations. We also agree that the specific limitations on the size of restricted stock plans, and combined restricted stock plans and ESOPs (tax-qualified employee stock benefit plans), contained in Section 563b.500 should be added to Section 575.8. Including such limitations in Section 575.8 provides clarity to the regulation and avoids ambiguity as to any inconsistencies between the mutual holding company regulations and the conversion regulations.

We agree with the proposal to retain the current aggregate limitation on the size of option plans and restricted stock plans set forth in Section 575.8(a)(9) of the mutual holding company regulations. We recognize that Section 575.8(a)(9) is intended to provide an overall cap (as a percentage of outstanding minority shares) on stock option and restricted stock plans that are implemented by mutual holding companies that elect to undertake smaller minority stock offerings as a percentage of total outstanding shares of the mid-tier stock holding company. The overall limit contained in Section 575.8(a)(9) seems to be reasonable, and if a mutual holding company has awarded all shares and options under a stock benefit plan, it would need to obtain a regulatory waiver to implement a supplemental plan that exceeds the limit.

The current language of Section 575.8(a)(3) and (a)(4) is confusing and we concur with the proposal to eliminate the language in such sections regarding individual and associate purchase limits, and instead rely on the purchase limitations set forth in Section 563b.370 of the conversion regulations. We believe such purchase limitations should not apply to purchases in the secondary market, since such purchases do not affect the rights of members of a mutual holding company and do not have any dilutive effect on public stockholders that otherwise would be associated with issuing additional shares to fund stock benefit plans.

We concur with the OTS proposal to clarify Sections 575.8(a)(3) through (a)(9) to make clear that the limitations on benefit plans are set in relation to the stock outstanding at the close of the most recent minority stock issuance made in conjunction with the implementation of a stock benefit plan. However, the proposed rule should be revised to provide specifically that existing plans do not have to be reduced if the plans exceed the 25% limit because of stock repurchases. We also believe that all the plan limits based on the equity of an institution should be eliminated, since such limits penalize holding companies that leverage their capital to

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generate better returns for stockholders. However, we assume that if a mutual holding company adopts a supplemental stock benefit plan (after filing an MHC-2 with the OTS) and there is no minority stock offering associated with the adoption of a supplemental stock benefit plan, the OTS will apply the limits in proposed Sections 575.8(a)(3) through (a)(9) to the latest minority stock issuance, or grant a waiver of such limits.

We concur with proposed Section 575.8(a)(7), which provides that if a plan is adopted or modified more than one year after a minority stock issuance, the limitations of Sections 575.8(a)(3) through (a)(6) can be exceeded to the extent awards in excess of such limitations are made with stock purchased in the secondary market, and such purchases take place at least one year after a minority stock issuance made in substantial conformity with the purchase priorities set forth in Section 563b. As noted above, mutual holding companies proposing to adopt plans that are funded by shares purchased in the secondary market would need to obtain prior stockholder approval, regardless of OTS limitations. Moreover, purchases in the secondary market to fund plans do not affect the rights of mutual members and do not have a dilutive effect on minority stockholders that would otherwise be associated with stock issuances to fund such plans. Finally, the adoption of the proposed rule would provide mutual holding companies parity with fully converted stock institutions, and would remove a regulatory bias in favor of full conversions.

We also concur with proposed Section 575.8(a)(8)(2), which provides that if a plan is adopted or modified more than one year after a minority stock issuance, the limitations in Section 575.8(a)(8)(i) may be exceeded to the extent awards in excess of those limitations are made with stock purchased in the secondary market and such purchases take place at least one year after the most recent minority stock issuance made in substantial conformity with the purchase priorities of Part 563b.

D. Maximum Purchase Limitation

We support the OTS proposal to amend the maximum purchase limitation rule to permit a maximum purchase limitation to be as low as one tenth of one percent of the offering amount.

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Once again we appreciate the OTS' efforts to clarify and simplify the regulations relating to mutual holding company stock benefit plans. Please do not hesitate to contact the undersigned or any member of this firm if you have any questions regarding the comments contained in this letter.

Sincerely,

Luse Gorman Pomerenk & Schick, PC

By: Eric Luse
Eric Luse