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Via facsimile (202) 906-6518 and Federal Express
Regulation Comments, Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington DC 20552
Attention: No. 2006-29

Re: Notice of Proposed Rule Making Stock Benefit Plans in Mutual-to-Stock Conversations and Mutual Holding Company Structures OTS Docket No. 2006-29

Dear Sir or Madam:

I am writing to address that portion of the above referenced proposed rule (the "Proposed Rule") that applies to stock benefit plans offered by a thrift controlled by a mutual holding company ("MHC"). If the Proposed Rule is implemented, it will permit the shares owned by a MHC, one year after conversion, to vote for the stock benefit plans for officers and directors of the MHC's subsidiary thrift. Since the MHC must control greater than 50% of the outstanding shares, the decision of the MHC will govern the outcome of the vote. The very individuals who will determine the voting position of the MHC, i.e., the MHC officers and directors, generally serve in similar capacities at the subsidiary thrift. Consequently, under the Proposed Rule, the individuals who will receive the benefits of the compensation plan will have the power to implement it and the vote is no more than a formality and a sham.

The Office of Thrift Supervision (OTS) states that the amendment is needed because the present rule is "unduly restrictive." Unfortunately, no explanation is provided for this claim. In addition, the Proposed Rule provides no support or factual basis for this statement.

A Historical Perspective

Prior to 1995, an independent shareholder vote was not required to approve a stock benefit plan because the stock benefit plans were included in the mutual-to-stock conversion offering.

During the 1994 rule revision process, and with specific reference to those thrifts controlled by a MHC, the OTS noted:

> "In this regard, § 10(o)(8)(B) of the HOLA requires that a mutual holding company, which is generally controlled by the management of its thrift subsidiary, must own more than 50% of its thrift subsidiary. Thus, absent a disinterested stockholder vote requirement, management will be able to ensure approval of its compensation plans." (emphasis supplied)[1]

Based on the foregoing, the OTS determined that stock option plans for a thrift controlled by a MHC should be approved by a majority of the non-MHC owned shares, i.e., by a vote of the disinterested stockholders of the thrift.

In a 2004 Letter[2], the OTS opined that, under the current version of the rule, the vote of the majority of the minority shareholders was required to approve an MHC stock-based benefit plan. OTS stated "[E]ven though it otherwise exceeds the general charter requirements, requiring approval by a majority of the minority shares prevents the mutual holding company from controlling the outcome of every such vote." (emphasis supplied)

Why Change the Rule Now?

The decision by the OTS to reverse its policy on stock option plans seems at odds with the principles of good corporate governance. Additionally, the timing of this reversal seems to fly in the face of current concerns about the propriety of executive compensation procedures. At a time when there are calls to make the executive compensation process more independent of management and to increase the accountability and transparency of compensation plans, the OTS is proposing to eliminate the very independence and accountability that, at one time, the OTS correctly felt was very important.

In 1994, the OTS determined that it was unacceptable to allow individuals to have the absolute power to set their own compensation. In 2004, the OTS felt that the current requirement was necessary to prevent such individuals from exercising such absolute power. What has changed in the world of corporate governance that causes the OTS to believe that granting such power is now an acceptable corporate practice?

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[1] Similarly, the FDIC, when updating its conversion regulations, noted: "In fact, it may be an inherent conflict of interest for management to decide to convert the bank to stock form, when, as part of the proposed conversion, management will reap significant benefits. Independent business judgment is essential to the proper carrying out of a manager's obligations. This judgment may be severely clouded when [employee benefits] are provided as part of the conversion transaction."

[2] P-2004-6, dated September 17, 2004.

In fact, there have been daily reports of insider abuse in the area of corporate compensation, particularly in the area of stock options. In response to these reports, there have been calls for greater control and accountability in the procedures for executive compensation. Why, as the rest of the business world is becoming aware of the problems in this area, is the OTS seeking to reverse its position and allow the very practice that concerned the agency 12 years ago? One would think, given the current environment, the OTS would be moving toward greater accountability and control, and not reducing accountability and control.

Qui Bono – Who Benefits from the Proposed Rule?

The decision by the OTS to reverse its position on shareholder voting for stock option plans will not benefit the public shareholders of a thrift controlled by an MHC. Nor will the decision benefit the thrift. Nor will the decision benefit the members of the MHC. Nor will the decision benefit the MHC. Who, then, will benefit from the change in the Rule? I think the OTS knows. When updating its conversion rules in 1994, the OTS noted:

> "Given that mutual savings associations currently seeking to convert generally are well-capitalized, the OTS has become increasingly concerned that the association's management may be undertaking conversions for reasons other than the need for capital. Some thrift insiders may be sacrificing the interests of their associations and mutual account holders to acquire significant amounts of conversion stock and other benefits as cheaply as possible in the conversion process. In addition, in some cases the issuance of conversion stock to a MRP lessens the opportunity for depositors to obtain conversion stock. Finally, the issuance of stock options at the conversion price, rather than at aftermarket trading prices, which in recent years has been substantially higher than the conversion price, creates the impression that management is structuring an excessive compensation package. While the OTS believes there are valid business reasons for thrifts to adopt MRP's and stock option plans in order to attract and retain qualified management, these plans are now more appropriately implemented subsequent to the conversion and with shareholder approval." (emphasis supplied)

If the OTS thought that the mutual associations were well capitalized in 1994, there is no question that such institutions are vastly better capitalized today. Therefore, most mutuals today are converting for reasons other than the need for capital. This is demonstrated by recent conversions.

Northeast Community Bank (NECB) exemplifies the fact that conversions are being approved when capital is not an issue. In early July 2006, NECB completed a MHC conversion. NECB's stated goals of going public are at odds with the facts. NECB's prospectus discloses that it was principally converting to raise capital to grow. What growth? For the ten years ending December 31, 2005, the total assets of NECB had declined by $5.7 million, or 2.3%. Ten years with

no growth hardly classifies NECB as a growth company, especially compared with its peers. Over that same decade, mutual thrifts had a median growth of 59%. Even if NECB is about to change directions and actually grow the company, there was no need to undertake an MHC conversion. During a five-year time-frame, the present cash flow would likely pay for the costs of the proposed new branches and offices. If NECB had to dip into retained earnings to pay for the growth, that would not be a problem. It has plenty of excess capital. As of December 31, 2005, its tangible equity to tangible assets ratio was 18.06%. To put that in perspective, the median for mutual thrifts was 11.33%. The median for public thrifts was even lower, at 9.00%. NECB could have increased its asset base by $142 million, or 59%, and still would have had a comparable capital ratio to the mutual thrift sector. That 59% growth figure is equivalent to that sector's growth for an entire decade. If NECB took the capital ratio down to the public thrift median, it could more than double its assets.

It is obvious that growth was not why NECB went public. In my opinion, the real reason NECB went public is to enrich management with the stock benefit plans. If the Proposed Rule is approved, the NECB Board and management is assured of receiving these benefits.

Assuming the offering stock price of $10.00, management will receive up to $2.6 million in free stock grants and $2.4 million in stock options. At $10.00, the cumulative cost of the benefit plans is $5.0 million, which represents approximately 45% of the NECB net income of $11.3 million over the last five years. If the stock price goes up, the value of the benefits increase. That leaves very little money, if any, for shareholders.

The amount of compensation that management could reward itself is significant, as demonstrated by Investors Bancorp, Inc. (ISBC). At a market price of $14.00, the restricted stock and stock options would be valued at approximately $64 million, which is well more than double ISBC pro-forma calendar year 2006 net income. Under the Proposed Rule, ISBC's management could award itself this compensation without the safeguard of shareholder scrutiny.

It is obvious that the NECB management team was going public to reward themselves; which is exactly what the current rule was created to stop. The current rule has functioned well for approximately 11 ½ years; change is not warranted and would be ill-advised.

OTS Interpretive Letter of September 17, 2004 for Voting Requirements for Benefit Plans Implemented After a Minority Stock Issuance in a Mutual Holding Company Structure

(2004 Letter)

In the OTS' 2004 Letter, the OTS opined that the vote of the majority of the minority shareholders was required to approve an MHC stock based benefit plan. OTS even stated the obvious "[E]ven though it otherwise exceeds the general charter requirements, requiring approval by a majority of the minority shares prevents the mutual holding company from controlling the

outcome of every such vote." (Pages 2-3). OTS should be required to substantiate what circumstances have changed since 2004 that requires the proposed 2006 Rule.

Conclusion

In this period of heightened corporate governance concerns, closer scrutiny of executive compensation by the Securities and Exchange Commission, Sarbanes-Oxley requirements, and more corporate transparency, OTS cannot justify permitting officers and directors to approve their own stock-based compensation plans, especially when the dollar value of some of the stock benefit plans is so enormous.

Under the current rule, the vote for the benefit plans is the one meaningful mechanism for the public shareholders of an MHC controlled thrift to check the power of management. From the perspective of public shareholders, the benefit plan is the proverbial carrot and the possibility that those plans will be voted down is the stick. So the OTS wants to change the rules, thus removing the stick, because they are "unduly restrictive?"

What is needed is a connection between executive compensation and financial performance. What is needed is greater transparency so shareholders are aware of management's actions. And what is needed, is shareholders having the ability to effect change to strengthen corporate governance. The Proposed Rule goes in the opposite direction and should not be enacted.

Very truly yours,

Lawrence B. Seidman