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Regulation Comments, Chief Counsel's Office
Office of Thrift Supervision
1700 G Street NW
Washington, DC 20552
Attention: OTS Docket No. 2006-29

Via Facsimile (202) 906-6518 and e-mail (regs.comments@ots.treas.gov)

Re: No. 2006-29: Comments on Proposed Rulemaking: "Stock Benefit Plans in Mutual-to-Stock Conversions and Mutual Holding Company Structures (12 CFR Parts 563b and 575)

Dear Sir or Madam;

I am writing to comment on the above referenced rule proposals, with suggestions for change and serious discussion about this proposal. I believe it is important to be approached from a much different direction.

The Specifics that I will try to present:

- Among regulators, those involving the banking industry have been exemplary in trying to always aim to take the "high ground" on legal and ethical issues, and somehow this issue has created a quagmire where an unethical approach would be accepted as a legally acceptable approach. Whether the banking industry somehow feels they have been blackmailed into needing to do this, or it is considered expedient for the near future, in the short or long term it is improper and wrong to do.

- Generally unsaid, there is a dollar and time cost factor that is behind some of the banks' support for this otherwise embarrassing proposal. There are several other alternatives. Even approval of Plans within the initial conversion prospectus should still be an option, but changed slightly – and meaningfully.

- There are various opinions about the regulatory acceptance of the proposed rule which are unmentioned in the summation of minimal impact statements on paperwork, etc. As proposed, such a poorly contrived approach will surely continue to be a contentious issue that will drag through courts and security industry oversight hearings and committees for some time. This is additional evidence that this proposal needs to be changed significantly.

- Shareholder voting should be expanded

- For various reasons, the previous Mutual Holding Company rule change proposals in November 2000 under Dockets 2000-56 and 2000-57 requesting comments for making this structure more attractive was delayed, and the formal opportunity for addressing basic issues was not significantly implemented. Re-visiting of that agenda would be appropriate now.

- Option pricing methods would be better if changed somewhat.

- In a Conversion offering, the ability to reduce maximum share allocation is fair and reasonable, and should be allowed.

The ethical and legal high ground:

Let's make things simpler. Let's start with the premise that should in life precede Ethics 101 – a kind of rule to always live by. In my mind, it runs something like this: When I am spending my own money, I only need to answer "Do I want to do it?" When spending someone else's money, though, it's very different. I need to answer "Would they want to do this if they were here deciding?" AND "Is doing this completely consistent with my fiduciary, ethical, and legal 'hats'?"

While I would consider this a simple business re-work of pretty much the exact wording of the "Golden Rule," it also suggests some better business practices than sometimes are practiced. Unfortunately, doing the "right thing" is not always the easiest, as we know. It can be very challenging for a board to be independent in hiring, retaining, or even replacing management people when typically that management has had a role in having them come to the institution for the board. For the issue at hand here, a board's compensation committee should be able to independently determine management's compensation. This becomes even more difficult when it comes to a board determining extraordinary compensation. In situations where a person would lack independence, that person should remove themselves from the process. Add to that the awkward situation that comes about when a board just effectively determines its own ordinary compensation, and board tasks become hard. It is only reasonable to have issues of extraordinary compensation for management be removed from this process whenever possible, and any issues of extraordinary compensation to board members never be decided by board members. The answer of course is to have such issues posed to and answered directly by the business owners directly, and as specifically as possible, whenever they arise. Of course, that does not mean using the business owners' previously obtained proxy to appear to get their vote or opinion.

Going a step further, I feel this means that not only should directors not be able to vote to approve their own extraordinary compensation, but as a class along with management and employees and parties related to them, they should all be prohibited from voting their own proxies for such compensation. There is not only the conflict of interest issue, but also there is even the real or imagined pressure on employees from a management. This includes their proxies as depositors as well as their proxies as shareholders!

[As "harsh" as this might seem, it is an interesting sidelight to consider the extremes. It turns out that our tax laws and stock market valuation of a business do encourage an aspect of this. There are examples where once personal ownership gets into say the 30%+ range, a management owner will decline all but minimal job compensation because his participation in stock or business value appreciation is often more valuable.]

In recent years we have seen an explosion in publicity and challenges to board and management compensation decisions, from the NYSE board challenged by the New York State Attorney General to company challenges by Class Action lawyers and so-called activist shareholders. An industry has been created with a small army of Compensation Advisors and Corporate Governance & Proxy Advising firms. They all have idealized agendas they represent, and they also have shortcomings and conflicts of interest. Compensation advisors advertise themselves to corporate managements and boards, who are of course the ones who seek to hire them, and who pay them. They offer information on the "best" pay packages currently popular within an industry, etc. [as opposed to what shareholders might pick – the "lowest"]. "Shareholder Service" firms evaluate proxy issues, but they seek consultant and guidance fees and retainers from the companies they evaluate. Etc.

That said, banks that are mutuals, or have a mutual component, espouse that fact but even as one bank commenter for this 2006-29 very ethically alludes, they all too often seem to have lost touch

with the responsibility that puts on them. We successfully operate in a capitalistic system that we have continually tweeked to get it to work better and better. Things that don't fit into that structure such as charitable and fraternal organizations, surely can have an important social role, but are often run much more informally – and that can be a source of problem. There is a huge advantage to the corporate stock form of ownership, and it is not just allowing for higher and more elegant compensation packages. These advantages are rather the discipline that has to be put in place and maintained for good management practices of an enterprise. The transparency, the public accounting, the guidelines for board committees, and the rigor of shareholder meetings, proxies, etc., have been judged invaluable by many businesses that had a choice to be public or private, and attribute the choice to be public as meaningful for their successful development through past years.

The Cost is an Issue:

It is amazing to see the waste in producing the volume of mailings, follow-ups, and even phone calls from brokers, proxy solicitors, and even banks themselves to ensure passage of these plans six months or a year after a conversion offering. Trees lost, dollars lost, etc. However, as one of the early 2006-29 commenters points out, the dollars involved in these plan packages are huge, and these costs are diminutive in any comparison. While the regulators were rightly concerned about the size of these packages being built into and getting automatically approved with the conversion offering enthusiasm, it did put the issue out front for a defined constituency to see and evaluate. To me, it calls for more presentation on the history and meaningful role of management and directors in the institution's past success, and more disclosure about the way such compensation will be used to incentivize.

[I will digress here to express an opinion that appears at odds with words used by many of the commentators on 2006-29. Options can incentivize people. Free stock grants have a much more questionable record. A person getting free stock is not "in the same boat" with shareholders getting their shares by buying them. We are not speaking of 100 or 200 shares here. There is ample body of study to show that huge free stock compensation programs very often related to stocks that wound up underperforming their peers, and I for one question having them at all. I am also bothered by the recent years' disappearance of a separate proxy item for free stock grants and for options, which allowed a shareholder to vote for or against each item separately. Now they are almost always combined, probably because there was an observed trend that people were voting only for the option part.]

To compare apples and apples, it seems to me that the real cost comparison should be between what it costs to mail, call, and remail all the multiple packages to every account registration title for both the shareholders and all the depositors. While I would exclude from that are those few that are employees, management, directors, and their families, since I wouldn't want them voting, this looks like the potential cost. Because the dollar numbers in these Plans are huge, it also can make embarrassing press. I would think that bringing this up as a separate issue 6 months or a year after an offering would be the last thing a management would want to do if there were any alternative at all. Add to that the current possibility of litigation from an unhappy shareholder or depositor, and a bank's management is effectively "blackmailed" into supporting a totally unreasonable approach of the current proposal to not require approval of this for an MHC structure. Additionally, I surely doubt some of the commenting letters would be worded as they are if the regulators specified that the same material sent to stockholders must also be sent to depositors and depositors' old proxies could not be used for this issue. It should be the same as in many jurisdictions now where the individual depositors need to vote directly for a conversion to take place – or for even a no-public-stock conversion to an MHC structure – but where a response in required as it is for stockholders.

This all suggests that having this as part of the original conversion prospectus would be far easier. Having the requirement that nothing happen before a date 12 months after the initial offering closes would be logical. Having options priced after this same 12 month date would likewise be logical. [See comments later about option price setting.] However, I would like to see that managements and related persons could either not be able to vote for the conversion if it included a Compensation and/or Option plan other than an ESOP, or not be able to vote on a separate item for any Compensation and/or Option plan. Maybe some conversions as proposed wouldn't happen. However, it would improve governance standards and avoid the mistakes the proposed rule change will bring.

The Impact Statements are Incomplete:

The proposed changes are described as being "minimal" and in fact in many ways this is correct. These plans, and most issues involving management and corporate governance, are routine and low profile, involve minimal paperwork changes, and are treated with disinterest by voters. There should be an additional Impact item, though: the risk that this proposal will be litigated because it goes against other regulators' practices or changes prior legal rights, and it goes against popular rights issues. This needs to be considered for this case, and its impact may well not be minimal. The proposal here reverses rules and guidelines put in place following high profile government hearings, etc., to keep possible abuse of management and insider compensation in check.

Commentors have said that approval of the proposed rules on MHC plans will be litigated, and it surely will. The OTS will face this cost. Individual banks in different jurisdictions may face this cost and risk as well. Although different people read the NYSE and SEC rules on shareholder rights differently, this will be an ongoing issue to be adjudicated. I cannot imagine other regulators not being pulled into the picture with the hot-button issue corporate governance has become.

It goes back to the necessity of the first item: be sure to try to take the ethical and legal high road. That also should minimize these costs as well.

Shareholder Voting should be expanded, not reduced:

It is a reasonable purpose that any capital structure, including an MHC one, should be structured, if possible, to not have to be an interim form. Anything otherwise is seriously flawed. Currently, too many of the MHC specifics are not suited to the long tern, and this is correctly recognized by many as necessitating a second step transaction. Part of the problem was the effort made to make this form attractive to mutual bankers, but unfortunately not enough consideration was given to making this form attractive to investors. The result is apparent in the stock market pricing, where at times MHC securities have languished for years until a second step was proposed. Even today a number of newer MHC's regularly trade below their issue price in an otherwise strong market for bank securities. Changes could be made to make the structure more acceptable as a long term vehicle attractive to investors.

Part of the problem is that the new money brought in from stock buyers often is very important in providing growth capital for the bank, and focusing a bank's business model on a more market driven agenda. Unfortunately as structured, the majority of any success with this does not accrue to these investing shareholders' equity, but like the infused funds themselves, the majority accrues to the non-risk- taking MHC majority side. Additionally, when looking to invest those funds in franchise acquisition ways, one's own underperforming MHC stock price can often be a far more attractive investment. The value enhancement can be greater this way, but like all value

enhancements made with this shareholder capital, currently only a minority of it accrues to those at-risk stockholders. These are serious shortcomings with the structure. One answer would be to consider an MHC conversion as a conversion, which it is, but one where shareholders' rights are enhanced over time – much as depositors "liquidation account" rights are depreciated over time in a standard conversion. There could be many arguments in favor of increasing shareholders rights over time, where eventually it would get to 100%. This could be irrespective of whether the MHC itself still has a majority of unissued shares. The benefits would be that corporate governance would eventually operate normally, without the current serious ethical and legal issues. Overall, the benefits of the American system would be part of the structure, and we would all benefit in the long term.

The MHC enhancement efforts of November 2000 under Dockets 2000-56 and 2000-57:

An extremely ambitious effort was made prior to November 2000 for the OTS to create an even better MHC structure that would enhance its attractiveness for mutual savings banks, and perhaps even credit unions looking for a more business involved vehicle. Whether done to preserve or expand the regulatory role of the OTS doesn't matter if they fulfill an important unmet need in the marketplace – and this structure probably can do that. Currently it only offers this in a very short term way – and I consider a three to six year outlook short term. The 6 year ago effort did little to enhance attractiveness to investors, and my guess is that the comments and ideas all pretty much dropped off the table due to management changes in the OTS or elsewhere in the Government. Part of the difficulty with this strange proposal here for MHC Plans comes about because of this earlier lack of clarification of roles, and responsibilities to investors.

Option pricing methods would be better if changed somewhat:

When something gets reduced to a price that exists in the market on a single day, and, worse yet, the security involved may even trade minimally, there will always be questions of fairness in pricing. Add to that the current frequent abuse of backdating, and there is a fair mess. I have not understood why option pricing should not be done at a premium to the current market price – say 10% would be a fair number – and where the HIGHER of either the average price of the last 30 days trading or the last closing price on the day the option price is set would be used. That still does not prevent abuses and outright fraudulent behavior, but it does make things simpler to appear somewhat fair.

It is Fair to Reduce Maximum Share Allocation in a Conversion:

The purposes of a conversion should be an effort to try to reasonably distribute stock ownership and I suppose to allow depositors and management to buy about as many shares as they want or can afford. The money gathering function is most important, the literature also suggests, in reducing self-dealing and helping for a fairer distribution of the ownership. The best reference I know of about this is still the "Legal Bulletin" of May 1987. It is an 80 page article entitled "Mutual to Stock Conversions" by Julie L. Williams, J. Larry Fleck, and V. Gerard Comizio.

Although it is not in the interests of Wall Street underwriters and institutional investors, and does complicate the role of market makers in the stock, having a smaller maximum order size can provide for a fairer distribution of ownership. Personally, I still prefer the "old rules" that allowed management its own priority subscription tier, so they were not in direct competition for the same stock pool that others would participate in.

Other Brief Comments combining the above categories:

- Additionally, if management and depositors are able to buy all the shares they want and can afford, and perhaps even in cases where shares are offered more widely as well in filling the offering, why isn't that enough to be viewed as a full and complete conversion even if it is an MHC where less than 50% of the shares have been sold? It would not be unreasonable to structure things for this to be the fair and final effect.
- It is sad that there may be a bias, regulatory or otherwise, toward maintaining mutuality where the institution has long ago made the choice to accumulate profits, build capital, and increase enterprise scope and value without there ever being a clear definition of whom should own entitlement for compensation for past management contribution and the true amount of initial risk capital compensation, and who has entitlement to various rewards from the business success. In the meantime, as the value of the equity expands, the opinions about any entitlement become more contentious, and the goal of conversion to effect a somewhat fair distribution of ownership becomes more difficult.

  An MHC structure continues the problem, and an approach that "freezes" or separates the Majority equity would seem meaningful and not unreasonable. It does appear that ways of doing this could involve additional holding companies, and a consideration would again become having a meaningful voting right attached to the shareholders' stock. Addressing that issue and having a workable philosophy about it would be a wonderful step forward.

Thanking you for your consideration of these comments, I would be glad to discuss any of them further or have any misinformation corrected.

Sincerely,

Ed Fraser