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August 29, 2006

Christopher Cox, Chairman
The Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Mr. Cox:

On July 20, 2006, the Office of Thrift Supervision (OTS) proposed rulemaking to amend the present voting requirements for mutual holding company (MHC) stock benefit plans. The present rule requires an affirmative vote of a majority of the minority shareholders; i.e. the public shareholders. The OTS now wants to permit the MHC, after one year, to vote its controlling shares on benefit plan proposals. This makes the vote a farce since an MHC, by regulation, must own greater than 51% of the outstanding shares and the directors of the MHC would be voting to approve a benefit plan that benefits themselves and dilutes shareholders.

On August 20, 2006, the Wall Street Journal reported that Brazil's stock market regulator issued a ruling that "prevents controlling shareholders, who own voting stock, to vote their shares on matters that could benefit themselves at the expense of other shareholders."[1] Shareholders in companies traded on United States stock exchanges should expect a corporate governance standard that is at least equal to Brazil's corporate governance standard.

The OTS' position as to why the proposed rule is proper is that public shareholders who do not like being subject to dilution can sell their MHC stock. Using this logic, the Securities and Exchange Commission (SEC) should do away with its proxy rules and the Sarbanes-Oxley requirements because the shareholders, who are not satisfied with what a public company is doing, have the option of selling their stock.

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[1] Many Brazilian companies have two classes of stock.

I have enclosed the following information for your review:

1) 2006 Proposed Rule
2) 1995 Final Rule and Comments
3) OTS September 17, 2004 Interpretive Letter
4) August 20, 2006 Wall Street Journal Article
5) OTS Response to Senate Banking Committee Questions Regulatory Burden Relief Hearing (March 1, 2006)
   (Specifically see questions 4 – 6.)

I would appreciate an opportunity to discuss this matter with your staff and the staff of the appropriate stock exchanges. The SEC and the exchanges should consider adopting rules to address, and to prevent, this situation that the new OTS rule creates.

Very truly yours,

Lawrence B. Seidman

cc: Robert Greifeld, President and Chief Executive Officer
The NASDAQ Stock Market, Inc.
One Liberty Plaza
New York, NY 10006

Marshall N. Carter, Chairman
Noreen Culhane, Senior Vice-President
NYSE Group, Inc.
20 Broad Street
New York, NY 10005

John M. Reich, Director
Office of Thrift Supervision
1700 G Street NW
Washington, D.C. 20552

WSJ JOURNAL AUG 2006 Section C

you did not receive the Notice or the accompanying Proof of Claim form, you may obtain them at www.Gilardi.com or by writing to *In re CR Antitrust Litigation (Bayer)*, c/o Gilardi & Co., LLC, P.O. Box 1110, Corte Madera, California 94976-1100.

You may direct questions about the lawsuit or the settlement in writing to Class Counsel at the following addresses:

Paul F. Bennett, Esq.
Gold Bennett Cera & Sidener LLP
595 Market Street, Suite 2300
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Levin Fishbein Sedran & Berman
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Philadelphia, PA 19106

Please do not contact the Court.

Dated: July 19, 2006

BY ORDER OF:
Clerk of the United States District Court
for the District of Connecticut

Brazil's Regulator Strengthens Minority Investors' Protection

Ruling Blocks Telemar Plan To Eliminate Share Classes; A Predetermined Outcome

By Geraldo Samor

SÃO PAULO—Brazil's stock-market regulator issued a ruling that significantly enhances minority shareholders' protection.

A response to longtime complaints that the Brazilian market is marked by abuse on the part of controlling shareholders, the regulator's decision, issued late Friday, is designed to make it safer to invest in nonvoting shares of Brazilian companies. The ruling prevents controlling shareholders, who own voting stock, to vote their shares on matters that could benefit themselves at the expense of other shareholders.

The decision all but kills a plan proposed in April by controlling shareholders in Tele Norte Leste Participações SA to eliminate different classes of stock in the company.

The telecommunications group, known as Telemar, is widely held among international and Latin American stock funds run by companies such as Brandes Investment Partners LP, Emerging Markets Management LLC and Fidelity Investments.

In a filing with the U.S. Securities and Exchange Commission, Brandes, a San Diego money manager that owns 8.75% of Telemar's American depositary shares, had complained the plan would heavily dilute its interest in Telemar and said it had asked Brazilian authorities to look into the matter.

As part of the plan, investors who hold nonvoting shares in the company's several units would tender their shares in exchange for voting stock in a new company. While the plan would lead to a simpler corporate structure, the exchange terms would double controlling shareholders' stake in the company at the expense of minority investors, whose interest in the company would shrink.

"If the deal is not good for everybody involved, it won't get done," said Marcos Duarte, a partner at Polo Capital Ltda., a Rio de Janeiro-based hedge fund. He believes Telemar will have to modify the exchange terms to win shareholders' approval for the plan.

Telemar declined to comment.

The power of controlling shareholders is an issue that arises frequently because most Brazilian companies have two classes of stock. An increasing number of companies are switching to a single-class share structure. Food producer Perdigao SA and aircraft maker Empresa Brasileira de Aeronáutica SA, or Embraer, have already done so.

"We want more and more companies to simplify their share structures, but we want it to be done in a legal and fair way," Marcelo Trindade, head of the regulatory commission, said.

The Comissão de Válores Mobiliarios ruled that controlling shareholders must abstain from voting in the shareholder meeting that will be called to approve the reorganization plan because of conflicting interests. The commission added that shareholders who own both voting and nonvoting shares would also have to abstain from voting.

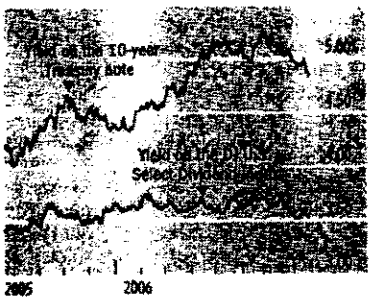
Finally, the CVM said the plan to switch to a single class of shares must be approved through an "affirmative" vote of shareholders polled. Before the ruling, Telemar said its plan would be approved so long as shareholders didn't object.

Before the CVM weighed in, "the outcome of the shareholders' meeting was almost predetermined," because odds were stacked up against minority shareholders, Luiz Guilherme Sauerbronn, a senior research analyst at Brandes, said.

In 4 p.m. trading Friday on the New York Stock Exchange, Telemar's American depositary shares were up 48 cents, or 3.5%, to $14.25.

Dividend Yields...

Yield on the DJ U.S. Select Dividend Index, which tracks the top 100 dividend-paying companies in the DJ U.S. Total Market Index, versus the yield on the 10-year Treasury note



Some Stocks That Could Offer Both

Dividend investors look for high yields and low price-t
Here are some stocks with the highest dividend yields
performed best last week.

Dividend	Annual yield	SECTOR/Company (Symbol)
	0.63%	**TECHNOLOGY**
$0.80	7.27	United Online (UNTD)
1.28	3.02	Pitney Bowes (PBI)
0.94	2.82	Microchip Technology (MCHP)
0.40	2.27	Amer Power Conversion (APCC)
0.64	2.27	Analog Devices (ADI)
	1.01%	**TRAVEL & LEISURE**
$0.62	2.29	Lone Star Steakhouse (STAR)
1.60	2.52	Harrah's Entertain (HET)
1.00	2.51	Carnival (CCL)
0.36	2.47	Triarc Cos. B (TRYB)
1.00	2.06	IHOP (IHP)
	1.63%	**INDUSTRIAL GOODS & SVCS**
$4.34	11.02	General Maritime (GMR)
4.00	7.10	Anixter Intl (AXE)
0.88	6.03	Chesapeake (CSK)
1.00	5.75	Deluxe (DLX)
1.00	4.40	Packaging of Am (PKG)
	2.36%	**CHEMICALS**
$0.20	7.58	Wellman (WLM)
1.50	3.98	Dow Chemical (DOW)
1.48	3.67	DuPont (DD)
0.90	3.57	Lyondell Chemical (LYO)
1.76	3.45	Eastman Chemical (EMN)
	2.00%	**AUTOMOBILE**
$0.42	4.96	Cooper Tire & Rubber (CTB)
0.64	*3.23*	*Superior Inds Intl (SUP)*
0.60	3.00	Amer Axle & Mfg Hldgs (AXL)
1.00	2.78	General Motors (GM)
1.35	2.75	Genuine Parts (GPC)

*Posted a loss for the past 12 months

unpublished

OTS Response to Senate Banking Committee Questions Regulatory Burden Relief Hearing (March 1, 2006)

Follow Up Questions Submitted by Senator Shelby

Question 1: The agencies have devoted considerable time and resources to developing the matrix and have sought input from consumer groups as well as industry representatives. As regulators you bring a unique perspective to the process. Based on that perspective, why do you feel regulatory relief is necessary now?

Answer: The federal banking agencies have promulgated more than 850 regulations and modifications since the passage in 1989 of the Financial Institutions Reform, Recovery, and Enforcement Act. While regulatory requirements add up, little is done to eliminate outdated, no longer necessary, or unduly onerous provisions.

The vast majority of existing laws and regulations are appropriate and beneficial to a strong and effective federal regulatory oversight system, but over time some provisions lose their utility. Five federal agencies (including the NCUA) have reviewed the 187 regulatory-relief proposals and determined that the vast majority of the provisions no longer serve a useful purpose or can be modified to be less burdensome.

When Congress passed the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) in 1996, Federal banking regulators were given a mandate to review their regulations to reduce the regulatory burden imposed on financial institutions. We have taken this mandate seriously. Over the past three years the agencies have opened more than 125 regulations for comment, received more than 1,000 comment letters, and held 16 banker and consumer group outreach meetings around the country.

All institutions bear regulatory burden, but the impact on smaller ones is disproportionate. The future of many of our nation's smaller community banks, and the thousands of communities they serve, depends on Congress enacting meaningful regulatory relief legislation. This is the best opportunity we have had in many years to achieve this goal.

Question 2: We have received several proposals designed to give regulators additional flexibility in conducting examinations (#42, 68, 112 and 169). Do these types of proposals pose a safety and soundness concern?

Answer: Current law requires the federal banking agencies (FBAs) to conduct a full-scope, on-site examination for the depository institutions under their jurisdiction at least every 12 months. There is an exception for small institutions that are well-capitalized and managed and have total assets of less than $250 million, and meet other criteria. Examinations of these small institutions are required at least every 18 months.

When originally enacted in 1991, the small institution examination exception was available to institutions with assets less than $100 million (assuming the other statutory criteria were satisfied). This statutory threshold was raised to $250 million in 1994 for institutions in outstanding condition and meeting the other statutory criteria. In 1996, the FBAs were authorized to extend the $250 million threshold to institutions in good condition. Given the fact that the current threshold has been in place for almost 10 years, OTS believes it is appropriate to consider whether the $250 million cap should be raised. OTS supports increasing the small institution threshold to $1 billion for well-capitalized, well-managed institutions. We believe this provision would reduce regulatory burden on low-risk, small institutions and permit the FBAs to more effectively focus their resources on the highest risk institutions.

With respect to matrix number 112, OTS is unable to take a position on this proposal without reviewing the legislative language.

Question 3: Prior to the Gramm-Leach-Bliley Act, banks engaging in traditional banking services such as trust and fiduciary activities were exempt from the definitions of broker and dealer under the Securities Exchange Act of 1934.
A) What protections were in place prior to the Gramm-Leach-Bliley Act to ensure that these activities were conducted in an appropriate manner?
B) Is there any evidence that banks were abusing this exemption or that these activities posed a risk to the system?
C) The SEC has attempted to implement the amendments made to the definitions of broker and dealer by issuing its Regulation B. What is the status of Regulation B?

Answer: While it is true that banks engaging in traditional banking services prior to the enactment of the Gramm-Leach-Bliley Act (GLB Act) were exempt from the definitions of broker and dealer under the Securities Exchange Act of 1934 (Exchange Act) - savings associations do not now, and have never had, a similar statutory exemption.

The Exchange Act requires any broker or dealer to register with the Securities and Exchange Commission (SEC) if it uses the mail or any instrumentality of interstate commerce to effect transactions in, or induce the purchase or sale of, any security (Section 15(a)(1)). Section 201 and 202 of the GLB Act amended Section 3(a)(4)(B) and 3(a)(5)(C) of the Exchange Act to conditionally exempt banks from registration as a broker or dealer if they engaged in certain banking activities. The definition of "bank" in the Exchange Act (Section 3(a)(6)) has been interpreted by the SEC to include state chartered banks and national banks, but never savings associations. The GLB Act did not change the definition of bank in the Exchange Act. The SEC, utilizing its broad exemptive authority in Section 36 of the Exchange Act, has provided a temporary

exemption from the definitions of "broker" for savings associations on the same terms and under the same conditions that banks are excepted (17 C.F.R. 242.733). This exemption is in effect until September 30, 2006.

The legislative history of the Exchange Act indicates that banks were excluded from the definition of "broker" and "dealer" because Congress recognized at that time (1934) that banks engaging in securities transactions were already subject to the scrutiny of bank regulators. Banks have provided securities services for many years, largely through their trust departments, with few problems. Trust department services are subject to strict and well-developed mandates of state trust and fiduciary law. Trust services also receive strict scrutiny by bank supervisors and examiners that specialize in these activities.

Savings associations engage in the same securities transactions, largely through their trust departments. The authority for savings associations to engage in trust activities has been in place since 1980. Since then, savings associations have been providing the same trust department services to their customers as banks. Savings associations engaging in securities transactions through their trust department are subject to the same state trust and fiduciary laws as banks and receive similar federal regulatory oversight by trained supervisors and examiners.

Other securities services have long been provided by banks and savings associations as an integral part of their normal banking functions without generating any significant securities-related concerns. Custodial and safekeeping activities, which may involve certain securities transactions, are core banking functions. These activities are provided as an accommodation to customers or offered to particular customers such as employee benefit 401(k) plans or bank-offered custodial IRAs. Other "broker" or "dealer" securities transactions that occur in the course of providing customers common bank and savings association products and services, such as networking (depository institution customers purchasing securities products through a third party brokerage arrangement) or sweeps of deposit funds into certain money market funds, are common banking practices.

The history of banks and savings associations engaging in these activities without any significant concerns is true of all of the securities transactions detailed in Section 201 and 202 of the GLB Act. All of these activities receive constant scrutiny by bank supervisors and examiners. These protections were in place prior to the enactment of the GLB Act and will remain in place in the future. The exceptions provided to banks in the GLB Act, and to savings associations through the SEC's temporary exemption, meet the exemption test in Sections 15 and 36 of the Exchange Act in that they are in the interest of the public and consistent with the protection of investors.

The SEC issued interim final broker-dealer rules on May 11, 2001 to implement sections 201 and 202 of the GLB Act. As part of these rules, the SEC exercised its authority to include savings associations within the bank exceptions. This treated savings associations the same as banks for the first time for purposes of broker-dealer registration. In the interim broker-dealer rule, the SEC recognized it would be wrong to continue disparate, anomalous treatment between savings associations and banks. The SEC postponed the effective date of the interim rule several times. On June 30, 2004, the SEC published in the Federal Register a new proposed broker rule (Regulation B). Unlike the interim final rules, savings associations are not treated the same as banks in all respects.

Savings associations are treated the same as banks for the 11 statutory activities they may engage in without registering as a broker with the SEC, as provided by the GLB Act. However, three non-statutory exemptions provided banks would not be extended to savings associations. The SEC describes the three non-statutory exemptions as targeted exemptions that recognize the existing business practices of some banks. We understand that the SEC does not believe savings associations are engaged in the exempted securities activities and will only extend relief for savings associations to the securities activities they are currently performing. A separate analysis conducted by OTS indicates that savings associations engage in all of the securities activities covered by the three additional exemptions. Pursuant to its request, this information was forwarded to the SEC in October 2004.

Since the publication of the proposed Regulation B rules, OTS met with several SEC Commissioners, filed a comment letter on September 1, 2004 objecting to the unequal treatment of savings associations, and held conversations with staff from the Division of Market Regulation. The SEC has not indicated that it is willing to reverse its position with regard to the inequitable treatment of savings associations. A temporary exemption for savings associations from having to register as a broker is in place until September 30, 2006.

Follow Up Questions Submitted by Senator Santorum

Question 4: Under current regulations of mutual holding companies, public shareholders have a right to approve the compensation package of executives and provide direction to a foundation, which might be created by the Initial Public Offering (IPO). Should they also have a say in determining the Board? Why or why not?

Answer: Typically, minority public shareholders of a depository institution in a mutual holding company (MHC) structure have dual interests in the MHC structure—as mutual

members of the MHC and as shareholders of the institution. As minority public shareholders of the depository institution in a MHC structure, they have the same rights as any public shareholder to nominate directors and to vote in the election of directors of the underlying stock depository institution.

It is important to clarify that under current regulations, while minority shareholders of stock subsidiaries of MHCs have the right to vote on the establishment of management stock benefit plans, minority shareholders do not have the ability to vote on the compensation package of executives. Similarly, while minority shareholders have the ability to vote regarding the establishment of a foundation, they do not have the ability to provide direction to a charitable foundation established by the MHC. Minority shareholders are informed of these rights and restrictions via offering materials provided to them prior to their purchase of stock in the subsidiary stock institution.

While minority public shareholders do not typically have preferential voting rights vis-à-vis a majority and controlling shareholder (such as a MHC), OTS established certain separate voting rights for minority shareholders in the MHC context. Specifically, minority shareholders have separate voting rights in connection with stock benefit plans and foundations because both types of transactions may dilute the percentage of stock held by existing minority shareholders. That is, in the case of both the implementation of employee plans and the establishment of charitable foundations, the company may issue additional stock. Such issuances of stock would have a direct dilutive effect on minority interests, thus, separate voting rights are extended to minority shareholders to protect their existing percentage interest in an institution subsidiary of a MHC. Other corporate actions, including the election of members of the board of directors, do not dilute the minority stockholders' interest, and therefore do not merit the extension of separate voting rights to minority stockholders.

Again, while minority shareholders are unable to control the election of directors to the institution's board of directors, minority shareholders do have a role in determining the board. Like a minority shareholder of any publicly traded company, minority shareholders in a MHC structure have the right to nominate directors and the right to vote in the election of directors.

Question 5: Because shareholders are prohibited from challenging the Board slate, it is my understanding that they are therefore effectively blocked from firing the management of an under-performing mutual holding company. Could this structure increase the risk that OTS may have more troubled mutual holding companies?

Answer: Rather than increasing the risks to the institution, there is considerable factual and anecdotal evidence suggesting that mutuality insulates a depository institution from

the types of shareholder and market pressures than can sometimes cause a stock institution to take unsound business risks.

In any MHC structure, the top-tier entity is a MHC that has no shareholders. The subsidiary savings association's depositors are the voting members of the MHC. The corporate governance provisions for federal MHCs are similar to the corporate governance provisions regarding federal mutual savings associations. OTS has found the mutual form of organization to be at least as conducive to safe and sound operations as the stock form of organization for savings associations. Similarly, OTS examinations of MHCs suggest that such entities are less likely to be troubled than stock holding companies.

Question 6: In a recent speech to the Exchequer Club in mid-February, you noted that OTS has petitioned Congress for a number of statutory changes for the thrift charter including "parity for savings banks" on the issues of investor advisor and broker-dealer activities, saying there should be "equal footing." It is my understanding that while asking for these changes to put thrifts on "equal footing" in these areas, OTS staff maintains that shareholdings in mutual savings banks and mutual holding companies should not have the same rights on governance and operations issues as do shareholders in other financial institutions. Could you explain these two seemingly divergent positions?

Answer: Minority shareholders in MHC structures already have the same rights as minority shareholders in other stock corporations. They may present issues for shareholder votes, nominate directors, and vote on all appropriate matters. As with any minority shareholder in a corporation where a single shareholder controls the majority of the voting shares, minority shareholders in a MHC structure cannot control the outcome of the vote unless they are able to convince the MHC majority shareholder that their recommendation should be adopted.

It is also important to note that the interests of depositors in a MHC or mutual thrift are not comparable to the interests of stockholders in a stock form depository institution or holding company. Due to the confidentiality of the deposit relationship and the privacy rights of member depositors, depositor lists cannot be provided in the same manner that stock institutions can provide shareholder lists. MHCs and stock form depository institutions or holding companies are different forms of ownership. Based on the differences in mutual and stock form of organization, it follows that their corporate governance structures will be different. However, the form of ownership should not be confused with the separate and unrelated issue of providing for a fair and competitive marketplace among financial institutions in the offering of investment, advisory and broker dealer services to consumers.

Question 7: Recently, in a response to a letter from a member of this committee, OTS responded that it believes increasing shareholders' rights would "significantly disadvantage the rights and interests of the depositors of a mutual savings bank that reorganizes into a mutual holding company structure." OTS further stated that minority shareholders in a mutual holding company structure are aware of the lack of corporate governance at the outset and to try to give these members "greater rights" than the majority would undermine the "basic principles of sound corporate governance and corporate ownership rights." Do you agree with this opinion? If so, please explain why.

Answer: It is important to correct a mischaracterization of OTS's response suggested by the question. OTS made no statement in the letter referenced in the question regarding a "lack of corporate governance" with respect to minority shareholders in a MHC structure or otherwise; nor has the agency suggested in any other context that there is a lack of corporate governance with MHC structures. The point that was made in the letter was that providing minority shareholders with the ability to control a depository institution in a MHC structure would undermine basic principles of sound corporate governance and corporate ownership rights. Sound corporate governance requires that shareholders' interests and rights be reflective of their relative ownership interests and rights.

The letter stated that investors in minority stock in a MHC structure are aware at the outset that minority shareholders receive a minority interest. They should also understand that the MHC, as the majority shareholder, controls the institution and makes the business decisions regarding it. Corporate governance principles regarding any stock entity enable the majority shareholder (in the case of MHC structures, the MHC) to control the operations of the entity.

We maintain that the proposal to which OTS's previous letter responded would significantly disadvantage the rights and interests of the depositors of a mutual savings bank that reorganizes into a MHC structure. That letter proposed to provide the minority shareholders with the sole voting rights in the depository institution controlled by the MHC. In our view, this proposal would cause the mutual accountholders of the MHC to lose their rights in the underlying institution, without the protections provided under the OTS mutual-to-stock conversion regulations. Such an action would also provide an inappropriate windfall to minority shareholders, given that they would have control in excess of the amount of their capital contribution to the subsidiary depository institution.

P-2004-6

Office of Thrift Supervision
Department of the Treasury
1700 G Street, N.W., Washington, DC 20552 • (202) 906-6372

John E. Bowman
Chief Counsel

September 17, 2004

[ ]

Re: Voting Requirements for Benefit Plans Implemented After a Minority Stock Issuance in a Mutual Holding Company Structure

Dear [ ]:

This letter responds to your inquiry on behalf of [ ](Mid-tier), the sole stockholder of [ ] (Savings Association), a [chartered savings association that reorganized into a mutual holding company structure effective and contemporaneously engaged in a minority stock issuance. The majority stockholder of the Mid-tier is

Specifically, the Mid-tier has requested that the Office of Thrift Supervision (OTS) opine as to whether the voting requirements contained in 12 C.F.R. § 563b.500(a)(7) apply to management and employee stock benefit plans implemented more than one year after a subsidiary holding company conducts an initial public offering of stock. In brief, we conclude that, by virtue of 12 C.F.R. § 575.7(b)(1), the voting requirements contained in subsection 563b.500(a)(7) apply to proposed management and employee stock benefit plans that are to be implemented by subsidiary holding companies in a mutual holding company structure, regardless of the length of time that has elapsed after a public offering. However, OTS is prepared to consider, on a case by case basis, requests for partial waivers of the 12 C.F.R. § 563b.500(a)(7) voting requirement pertaining to minority shareholders in mutual holding company structures to permit plans to be approved by a majority of the minority shares present and voting on the plan.

Section 575.7 of OTS's mutual holding company regulations governs issuances of stock by savings association subsidiaries of mutual holding companies. Subsection 575.7(a) provides that such savings associations may not issue stock to persons other than their respective mutual holding companies unless OTS gives the association approval in advance of the stock issuance. Subsection 575.7(b)(1) states:

> All of the provisions of part 563b of this chapter shall apply to a stock issuance applied for pursuant to this section, unless otherwise provided for in this part [575] or clearly inapplicable, as determined by the OTS. For purposes of this paragraph (b)(1), the term *conversion* as it appears in the provisions of part 563b of this chapter shall be deemed to refer to *the stock issuance*, and the term *converted* or *converting savings association* shall be deemed to refer to the savings association undertaking the stock issuance.

Moreover, 12 C.F.R. § 575.14(b) provides that, for purposes of section 575.7 of OTS's regulations, a mid-tier holding company in a mutual holding company structure is treated as a savings association issuing stock and is subject to the same requirements under section 575.7. See also, 12 C.F.R. § 575.7(e).

Thus, reading the provisions of sections 563b.500, 575.7 and 575.14 together, each issuance of stock by a mid-tier holding company or savings association in a mutual holding company structure constitutes a distinct "conversion" for purposes of determining the periods governing approvals of management and employee benefit plans under section 563b.500. Significantly, the issuance of shares pursuant to a stock benefit plan itself is a "conversion" for purposes of the section 563b.500 requirement.[1] Accordingly, subsection 563b.500(a)(7) requires that the shareholders of a mid-tier holding company approve each management or employee benefit plan by a majority of the total votes eligible to be cast and by the majority of the total votes eligible to be cast, other than those of the parent mutual holding company.

Section 563b.500(a)(7)'s general requirement of approval of a plan by the majority of the votes eligible to be cast is consistent both with the charter-based approval requirements for stock issuances to insiders of federal stock savings associations[2] and for stock issuances to insiders of federal mid-tier mutual holding companies.[3] Significantly, however, the model charter for federal mid-tier mutual holding companies does not require, in addition, the vote of a majority of the outstanding minority shares. Furthermore, in other contexts, which may have significant ramifications to minority shareholders' interests, the model charter for federal mid-tier mutual holding companies does not require a vote of the majority of the minority shares in order to amend the charter.[4] Even though it otherwise exceeds the general charter requirements, requiring approval by a majority of the minority shares prevents the mutual holding company from

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[1] OTS has routinely required MHC-2 filings in connection with stock issuances for benefit plans. The only exception to the requirement of filing a separate MHC-2 application has been where the plans have been addressed in a minority stock offering application that contemplated the issuance of shares in accordance with the mutual-to-stock conversion priorities. In such situations, in our view, it is clear notwithstanding the lack of a separate application, that issuances pursuant to plans are "stock issuances."

[2] See, section 5 of the model federal stock savings association charter, 12 C.F.R. § 552.3 (2004).

[3] See, section 5 of the model federal mid-tier mutual holding company charter, 12 C.F.R. § 575.14(c)(1) (2004).

[4] See, section 8 of the model federal mid-tier mutual holding company charter, 12 C.F.R. § 575.14(c)(1) (2004).

controlling the outcome of every such vote.[5] Nevertheless, the requirement that the majority of the minority be of the total minority votes eligible to be cast as opposed to those actually cast is not needed to prevent the parent mutual holding company from controlling the outcome of every vote. Given that the requirement for affirmation by the majority of eligible votes exceeds the requirements in the model charter and is not generally necessary to prevent the mutual holding company or the insiders who determine the way the mutual holding company votes its shares from controlling the outcome of each vote, OTS is willing to consider, on a case by case basis, requests for a waiver of that provision.

In reaching the foregoing conclusions, we have relied on the factual representations made in the material you submitted to us. Our conclusions depend in part on the accuracy and completeness of those facts. Any material difference in facts or circumstances from those described herein could result in different conclusions.

If you have questions regarding these matters, please feel free to contact Aaron B. Kahn, Special Counsel, at (202) 906-6263.

Sincerely,

John E. Bowman
Chief Counsel

cc: All Regional Directors
All Regional Counsel

[5] A parent mutual holding company is required to maintain ownership of more than 50% of the stock in any subsidiary holding company. See, 12 C.F.R. § 575.7(a)(5) (2004).

[Federal Register: November 30, 1994]

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

12 CFR Parts 563b and 575

[No. 94-253]
RIN 1550-AA73

Conversions From **Mutual** to Stock Form; **Mutual** Savings and Loan **Holding** Companies

AGENCY: Office of Thrift Supervision, Treasury.

ACTION: Final rule.

SUMMARY: The Office of Thrift Supervision (OTS or Agency), is issuing a final rule to revise its regulations governing conversions from **mutual**-to-stock form and **mutual** savings and loan **holding** companies. On May 3, 1994, the OTS issued an interim final rule with request for comment and a proposed rule with request for comment. The interim final rule contained amendments to the OTS's **mutual**-to-stock conversion regulations (conversion regulations) designed to strengthen the standards governing conversions and to ensure the integrity of the conversion process. The proposed rule contained a new ``convenience and needs'' test to be added to the approval standards for conversion transactions.

This final rule includes revisions made to the interim final rule that reflect OTS's consideration of the comments it received during the 45-day comment period following publication of the interim final rule. In addition, this final rule also addresses the comments received by the OTS during the 75-day comment period following publication of the proposed rule and adopts the proposed rule without modification. Finally, this final rule incorporates certain technical changes to the regulations governing **mutual**-to-stock conversions and **mutual** savings and loan **holding** companies.

EFFECTIVE DATE: January 1, 1995.

FOR FURTHER INFORMATION CONTACT: Teri M. Valocchi, Counsel (Banking and Finance) (202/906-7299), Michael P. Vallely, Counsel (Banking and Finance) (202/906-6241), J. Larry Fleck, Assistant Chief Counsel (202/906-6413), Business Transactions Division, Chief Counsel's Office; Diana L. Garmus, Deputy Assistant Director (202/906-5683), Corporate Activities Division, Office of Thrift Supervision, 1700 G Street, NW., Washington, D.C. 20552.

SUPPLEMENTARY INFORMATION:

I. Summary of Interim Final and Proposed Rules

On May 3, 1994, the OTS published an interim final rule with request for public comment.<SUP>1 The interim final rule amended the OTS regulations governing **mutual**-to-stock conversions of savings associations to strengthen the conversion standards and ensure the integrity of the conversion process. Specifically, the amendments:

\1\See 59 FR 22725 (May 3, 1994).

(A) revised and clarified the appraisal standards;
(B) prohibited the use of ``running'' proxies by management of converting associations;
(C) placed the current tax-qualified employee stock ownership plan (ESOP) stock purchase priority after those of eligible depositors;
(D) provided stock purchase priority to core depositors;
(E) required that a stock purchase preference be given to account holders and voting members residing in the association's local community;
(F) prohibited management stock benefit plans in a conversion;
(G) limited merger conversions to institutions that qualify for a conversion, i.e., financially-weak institutions;
(H) lengthened the conversion public comment period;
(I) required converting associations to submit business plans in support of the conversion; and
(J) prohibited the repurchase of a converted association's stock within one year of conversion.

The interim final rule did not propose any changes to the prohibition in the OTS conversion regulations on the transfer or sale of subscription rights or similar ``free distribution'' schemes, but did request comment on whether subscription rights should continue to be nontransferable, or if transferability is recommended, the reasons for, and the manner in which to allow for, such transfer. Finally, the interim final rule made preliminary conversion proxy materials available to the public and incorporated certain technical changes to the OTS's regulations governing **mutual** savings and loan **holding** companies.

Separately, the OTS published a proposal to amend the conversion regulations and the regulations governing stock offerings by savings association subsidiaries of **mutual holding** companies (MHC stock offerings) by adding a new ``convenience and needs'' standard to existing approval standards for such transactions.<SUP>2 Under the proposed standard, the OTS would consider the extent to which the transaction would affect the convenience and needs of the communities served by the applicant.

\2\See 59 FR 22764 (May 3, 1994).

In evaluating transactions under this standard, the OTS would review the applicant's performance under the Community Reinvestment Act (CRA),<SUP>3 the contents of the business plan submitted in support of the conversion, and other factors relating to the applicant's performance in meeting the convenience and needs of its delineated community. Under the proposal, the OTS could deny an application or approve it on the condition that the applicant improve certain aspects of its CRA performance record or address particular credit or lending needs of the communities that it serves.

\3\See 12 U.S.C. 2901-2907.

The OTS worked with the Federal Deposit Insurance Corporation (FDIC) on the interim final rule and this final rule to ensure greater consistency in the regulatory standards and policies in this area.

II. Summary of Comments and Analysis of Issues

The public comment period for the interim final rule closed on June 17, 1994. The OTS received 75 comment letters. Twenty-seven comment letters were submitted by financial institutions or their **holding** companies, including 20 letters from federally-chartered savings associations and seven letters from other financial institutions and **holding** companies. Of the remaining 48 comment letters, persons in their individual capacity submitted 15, law firms submitted 13, state trade associations submitted six, a national trade association submitted one, city and state banking commissioners submitted three, various groups representing financial institutions submitted seven, a financial regulatory ``shadow'' group submitted one and certified public accountants submitted two.

The comment period on the proposed convenience and needs rule closed on July 18, 1994. The OTS received 12 comment letters, including five from trade associations and similar groups representing financial institutions, two from law firms representing thrifts, two from persons in their individual capacity, one from a state thrift regulatory authority, one from an association of state thrift regulatory authorities and one from a federally-chartered savings bank.

The following is a discussion of the major issues raised by the commenters and a brief analysis and resolution of the issues.

A. Revisions to the Appraisal Standards

As noted in the preamble to the interim final rule, the integrity of the OTS' current conversion program rests, in large part, on the existence of independent and accurate appraisals of converting associations.<SUP>4 When the initial conversion regulations were adopted in 1974, the Federal Home Loan Bank Board, the predecessor agency to the OTS, expressed concerns about underpricing conversion stock and stated that no method of conversion could be considered equitable unless the conversion stock was accurately appraised and sold at its pro forma market value.<SUP>5

\4\See 59 FR 22725, 22726 (May 3, 1994).

\5\See 39 FR 9142 (March 7, 1974).

The OTS believes that the appraisal process has adequately addressed conversion valuation issues during most of the period since 1974. As also noted in the preamble to the interim final rule, however, the OTS has been concerned that some recent appraisals were setting pro forma market values that were significantly below the market value of the converting association. In response to these concerns, the OTS, in the interim final rule, revised the conversion regulations to formalize the current practice of requiring a full appraisal report and justification for the methodology employed. The OTS also clarified the provision in the conversion regulations that requires that the conversion applicant submit information demonstrating, to the

satisfaction of the OTS, the independence and expertise of the appraiser. The revised regulations allow the OTS to censure, suspend or bar an appraiser from practicing before the OTS in egregious cases of consistent undervaluation on the part of an appraiser.

OTS further revised the appraisal rules to provide that in those instances where the initial appraisal report is deemed to be materially deficient and/or substantially incomplete, the OTS may deem the entire conversion application materially deficient and/or substantially incomplete, and require the filing of a new application.<SUP>6

\6\The OTS has recently issued updated staff guidance for conversion appraisers that provides specific details on appraisal methodology as well as report content, and also incorporates provisions 9 and 10 of the Uniform Standards of Professional Appraisal Practice. In adopting the guidelines, the OTS consulted with the FDIC to ensure uniform appraisal standards.

Finally, the OTS requested public comment on whether it should amend its regulations to prohibit an appraiser or its affiliates from also serving as an underwriter or selling agent.

Approximately 25% of the comments addressing appraisal standards affirmatively supported the requirement that a full appraisal report and justification for methodology employed be required to insure a ``fair value'' assessment of an institution. One commenter cautioned against an attempt to eliminate any ``pop'' or ``post conversion windfall,'' and suggested management of such price increases instead, by limiting them to a reasonable percentage. Eleven commenters expressed concern that market forces cannot be regulated, that appraisals and pricing of stock are not exact sciences, and that the revisions may force the stock to be overvalued. One of the eleven stated that the stock market is not predictable enough to institutionalize an expectation that the stock of every institution will trade within a fixed parameter following conversion.

One commenter requested that the terms ``materially deficient'' and ``consistently undervalued'' be defined and another commenter requested that the term ``independence'' be defined and that the OTS provide guidance as to the appropriate degree of participation by management in the appraisal process.

One commenter stated that the OTS should deal with the appraiser directly when an initial appraisal report is materially deficient or substantially incomplete and should not penalize the thrift; another commenter stated that the OTS should give institutions time to correct inappropriate appraisals without the need to file costly new conversion applications.

Eleven commenters addressed the issue of whether to prohibit appraisers or their affiliates from also serving as underwriters or selling agents. Six stated that appraisal firms should be separate from firms that market conversion stock so as to avoid all potential conflicts of interest. One of the six further stated that underwriters or selling agents in one situation may not be able to be objective as appraisers in another situation and that if an attorney continually uses the same appraiser, that appraiser becomes a quasi-affiliate of the attorney, with questionable independence. Five expressed the view that there was no evidence of abuse where the appraiser and selling agent are the same parties, that the two functions can be impartially carried out and that to require different parties is costly and detrimental to small thrifts.

In implementing revisions to the appraisal regulations, the OTS was

not attempting to create an appraisal system that would result in precise conformity between appraisal values and post-conversion stock prices. The OTS, however, remains concerned about significant discrepancies between appraisal values and immediate post-conversion trading prices. The OTS also recognizes that there will be circumstances that could not reasonably have been foreseen by an appraiser that may result in pricing discrepancies in a particular transaction. As noted in the preamble to the interim final rule, however, when there is a consistent pattern of discrepancies by a particular appraisal firm, the independence and competence of the appraiser is called into question.

The terms ``materially deficient'' and ``consistently undervalued'' as used in the regulation are heavily dependent upon the facts and circumstances of each transaction or group of transactions. Because there is no ``bright-line'' test that can be applied to these terms, the OTS does not believe that it would be useful to further define these terms.

With respect to the comment that the converting association should not be penalized for a materially deficient or substantially incomplete appraisal and the comment that the converting association should be given the opportunity to correct the faulty appraisal, the OTS does not believe that any change to the interim final rule is warranted. While management of a converting association may properly rely on the opinion of an independent appraiser in valuing conversion stock, it is ultimately the fiduciary responsibility of management to ensure that the converting association is properly priced for sale. The converting association also is ultimately responsible for the quality of the work of all of its agents, including its attorneys, accountants and selling agent, as well as its appraiser, and thus, should exercise due care in the hiring of such parties to ensure that qualified advisors and experts have been retained on behalf of the association. In any instance where a materially deficient conversion application is submitted, whether as a result of significant legal, accounting, appraisal or other deficiencies, the OTS retains the right to deem the application materially deficient and reject it.

As to the issue of permitting ``corrections'' to inadequate appraisals submitted to the OTS, the purpose of rejecting conversion applications containing faulty appraisals is to encourage applicants to file applications that are substantially complete and that comply with regulatory requirements. If there are no consequences of filing an application that is substantially incomplete, there is less incentive to submit an adequate appraisal. In addition, given limited OTS staff resources, it is unfair to delay review of complete conversion applications with adequate appraisals by devoting inordinate amounts of OTS staff time to multiple reviews of applications with inadequate appraisals.

The OTS believes that there is an appropriate role for officers of a converting association in the preparation of an appraisal. The OTS expects that the appraiser will consult with officers of the association in preparing the appraisal because the officers will often be the sole source of information about certain aspects of the current and future business operations of the association. It is not appropriate, however, for the officers to attempt to influence or to interfere with the independence of the appraiser. Similarly, appraisers seeking engagement with a converting institution should not in any manner suggest that they can provide a ``lower'' valuation than other appraisers.

The board of directors has a primary responsibility to hire the appraiser and to review the appraisal report. The board of directors is entitled to rely on the appraiser's expertise. As with officers, it

would be inappropriate for the board of directors to influence or interfere with the independence of the appraiser.

The board of directors also retains the authority to reject an appraisal or to dismiss an appraiser. In such a case, the OTS would conduct the same type of review that it does when a savings association dismisses its accounting firm or rejects an accounting firm's opinion.<SUP>7

\7\17 CFR 229.304 (March 8, 1989).

The interim final rule requested comment on whether appraisers or their affiliates should be prohibited from also serving as underwriters or selling agents in a conversion. A majority, albeit a narrow one, of those who commented on this aspect of the interim final rule were in favor of a prohibition on firms serving in both roles. Upon review of the comments, the OTS has determined that, as discussed in the interim final rule, the appraisal process and the independence of the appraiser should not be tainted by even the appearance of a conflict of interest. Although the same firm infrequently performs both these services and the OTS is not aware of any serious problems when it has, the final rule generally prohibits a firm from this dual service, except where procedures are followed and representations made to ensure that an appraiser is separate from the underwriter or selling agent affiliate and the underwriter or selling agent affiliate does not make recommendations or in any way impact the appraisal. Additionally, the final rule prohibits the appraiser from receiving any fees other than the fees for services rendered in connection with the appraisal.

B. Prohibition on Use of ``Running'' Proxies

The conversion regulations have been revised to prohibit the use of ``running'' proxies and to require the use of a proxy specifically designated for the conversion.

The majority of commenters addressing the revision supported the prohibition of ``running'' proxies because it better ensures that members understand the proposed change in the association's organization. A few commenters expressed concern for the high costs of using professional proxy solicitation firms but none thought the costs were overly burdensome. Those commenters who opposed the prohibition asserted that there were already sufficient safeguards, that the old rule worked well since ``running'' proxies were only used if a member did not send a proxy or vote in person, that detailed disclosure was included in the proxy statements, and that the prohibition is an added expense for converting institutions.

One commenter recommended adoption of a requirement that 50% of those voting approve the conversion, rather than the existing requirement that the conversion be approved by a 50% vote of all depositors.

The OTS agrees with the majority of commenters and continues to believe that the prohibition of ``running'' proxies is the most effective manner in which to assure an increased role for an association's membership in the conversion process. Accordingly, no change has been made to the interim final rule. Thus, 12 CFR 563b.6(e) will continue to require approval of the plan of conversion by at least a majority of the total outstanding votes of the association's members, unless state law requires a higher percentage for a state-chartered converting savings association, in which case the higher percentage will be used. Finally, the final rule revises section 575.13(a)(4) of

the **mutual** savings and loan **holding** companies regulation to clarify the prohibition on the use of ``running'' proxies and the requirement for the use of a specifically designated proxy for a **mutual holding company** reorganization, **mutual**-to-stock conversion undertaken either by a **mutual** savings association or a **mutual holding company**, or any other material transactions.

C. Re-Prioritize Stock Purchase by Tax-Qualified Employee Stock Ownership Plans

In its interim final rule, the OTS revised the stock purchase priorities so as to give eligible account holders first priority and tax-qualified employee stock benefit plans second priority. The conversion regulations continue to give supplemental eligible account holders third priority and all other voting members who have subscription rights fourth priority.

A majority of the commenters recommended that the ESOP be given first priority; a few commenters affirmatively supported giving the ESOP second priority. The commenters that recommended giving the ESOP first priority asserted that employees make the organization successful and should have the first stake in the **company**'s performance, that the plans do not favor higher paid officers, but promote greater productivity and motivation, that the plans do not prevent long-term depositors from purchasing conversion stock, and that they protect institutions from hostile takeover situations. These commenters further asserted that if the ESOP is not established in the conversion, it will be established later and will dilute shareholders' ownership interest.

A few commenters requested that the methodology for distribution of shares in the event of oversubscription be clarified. The commenters requested that the regulation be written to make clear the intent that the ESOP would be able to purchase stock through open market purchases or through authorized but unissued shares in the event of an oversubscription. If this was not the intent of the regulation, one commenter requested that the OTS clarify that it will grant a waiver or no-action letter to permit the ESOP or any other tax-qualified plan to purchase shares in the open market immediately following conversion.

As stated in the preamble to the interim final rule, although the OTS believes that it is still appropriate to provide management incentives and to encourage employee stock ownership in the converted association, these interests have been overshadowed by other factors. The former provision which granted a first priority to tax-qualified employee benefit plans was a means to afford undercapitalized **mutual** savings associations a measure of anti-takeover protection through the opportunity to place a significant block of conversion stock in friendly hands, and thus, encourage capital raising through conversion. Because most **mutual** savings associations are now healthy, there is a need to balance the interests of management and employees against those of account holders by providing core depositors at **mutual** savings associations the first opportunity to buy conversion stock. The final rule will continue to give eligible account holders first priority. The wording of 12 CFR 563b.3(c)(23) has been revised to clarify that eligible account holders have first priority to purchase conversion stock, tax-qualified employee stock benefit plans have second priority, supplemental eligible account holders have third priority, and other voting members who have subscription rights have fourth priority.

Also, as prescribed by 12 CFR 563b.3(c)(23), and further clarified in the final rule, if the final conversion stock valuation exceeds the maximum conversion stock offering range, up to ten percent of the total offering of shares may be sold to the tax-qualified employee stock benefit plans. This provision generally will allow ESOPs to be

allocated stock during periods of an active and strong thrift securities market; however, such allocation generally will not be available when the final pro forma market value as approved by the OTS and disclosed in the stock offering materials does not exceed the maximum conversion stock offering range.\8\ If the ESOP is not able to purchase conversion stock, the ESOP or any other tax-qualified plan may purchase shares in the open market or utilize authorized but unissued shares only with prior OTS approval. Disclosure must be made in the conversion stock offering materials of the potential open market purchases or use of authorized but unissued shares to fund the ESOP and its effect on the association and its shareholders. The final rule reflects these clarifications.

\8\In the nearly 1,000 conversions completed since 1983, a majority were sold for a conversion price that did not exceed the maximum conversion stock offering range.

D. Revision to Eligibility Record Date

The OTS currently requires that the eligibility record date (ERD) be set at a date no less than one year prior to board of director approval of the plan of conversion. In the interim final rule, the OTS also requested public comment as to whether a longer minimum time period would be appropriate.

The majority of commenters supported the revision to the ERD based on the reasoning that it properly protects the legitimate interests of core depositors and provides sufficient assurance that long-term supporters of an institution are given priority. A couple of commenters recommended setting a maximum time limit of two years and one recommended not extending beyond one year; one requested that ``depositor'' be defined as one who has ``savings in any type of a deposit account of at least $100 continuously during the eligibility period.''

Two commenters disagreed with the revision because it eliminates legitimate local depositors and is impractical since accurate records about depositors are not readily available. One commenter noted that directors and executive officers will have to plan further ahead, maintaining records for longer periods of time. Two commenters stated that the revision has no effect since professional investors are in place for a considerable period. One commenter recommended waivers for institutions of $100 million or less that can demonstrate that information is not available.

A few commenters suggested eliminating the supplemental eligible account holder category, because the date for determining such account holders is close to the record date, and therefore duplicative, or in the alternative, setting a supplemental eligibility record date (SERD) only if the ERD is more than 18 months prior to the date of the latest application amendment filed before OTS approval. One commenter suggested moving the SERD from the current 15 month period to a 24 month period; and also noted that the ERD revision and the local community depositor preference create three additional categories, making for extraordinary processing difficulties.

One commenter suggested: (1) giving purchase preference to both depositors and borrowers as of the ERD; (2) giving preference to the eligible and supplemental eligible account holders whose accounts remain open at the voting record date over those who terminated their account relationship; and (3) amending the regulation to replace the 100 share initial allocation\9\ with a provision that the initial

allocation may be tailored to the circumstances of the thrift's offering.

\9\See 12 CFR 563b.3(c) (2)(ii) and (4)(iv).

The interim final rule will continue in effect without change for the reason stated by most commenters and supported by OTS: it properly protects the legitimate interests of core depositors and provides sufficient assurance that these depositors are given priority. ``Eligible account holders'' are defined as those holders with savings accounts in place for a minimum of one year prior to board of director adoption of the plan of conversion. The OTS also believes there is no compelling reason to set a maximum time limit for an ERD. As stated in the interim final rule, the one year period is a minimum time period. Converting associations may designate such longer time periods as they may deem appropriate to encompass longer term depositors in the local communities served by the institution.

The definition of qualifying deposit will continue as stated in 12 CFR 563b.3(e). Also, the OTS believes that there is no compelling reason to eliminate or revise the current supplemental eligibility record date. Thus, supplemental eligible account holders, as currently defined in the regulation, will continue to be a category with a priority immediately following that of tax-qualified employee benefit plans. In addition, the OTS believes that there is no compelling reason to revise the current regulation that: 1) gives a purchase preference to all depositors (but not borrowers); 2) does not differentiate between eligible and supplemental eligible account holders whose accounts remain open at the voting record date over those who terminated their account relationship after board of director approval of the plan of conversion; and 3) requires the 100 share initial allocation.

E. Preference for Depositors in Local Community

Prior to promulgation of the interim final rule, the OTS conversion regulations required a converting association to conduct a community offering of conversion stock in the local community, prior to a general public offering,\10\ but did not permit converting associations to give account holders and voting members in those local communities a priority to purchase stock in the initial subscription offering.\11\ However, to minimize conversion expenses, the OTS permitted converting associations to not register under state blue sky laws in those states where there was a relatively small number of depositors compared to the overall depositor base, even though this resulted in some depositors being precluded from purchasing stock in the conversion offering. In addition, the OTS has, on a case by case basis, permitted thrift subsidiaries of **mutual holding** companies to prioritize stock purchases by account holders and voting members in the local communities.\12\

\10\See 12 CFR 563b.3(c)(6)(iv).
\11\See 12 CFR 563b.3(c)(2), (4), (5).
\12\See 12 CFR 575.7(d)(6)(ii).

The interim final rule required that a stock purchase preference be given to eligible account holders, supplemental eligible account holders and voting members residing in the association's local

community. Those having preference in each priority group (i.e., eligible account holder, supplemental eligible account holder and voting member) are persons who reside in the association's ``local community'' or within 100 miles of a home or branch office of the converting association. The interim final rule defined ``local community'' to include all counties in which the converting association has a home or branch office, each county's standard metropolitan statistical area or the general metropolitan area of each of these counties and such other similar area(s) as provided for in the converting association's plan of conversion, as approved by the OTS.

Over one-half of the commenters on the interim final rule expressed views on the local depositor preference (LDP) provision. Approximately one-half of those commenters supported the LDP provision for various reasons such as: it promotes local control and involvement and is more sensitive to the community's needs; it serves the community first and gives depositors in the local community a more meaningful opportunity to participate; it is a good way to maintain local control of community-oriented associations; and it deals with the problem of outside investors who tend to put undue pressure on management to achieve a higher stock value more rapidly than may be feasible through safe and sound operations.

A majority of the supporters of the LDP provision also suggested various changes to the interim final rule. Three suggested eliminating the 100 mile rule; one suggested using 50 instead of 100 miles; and three requested that the OTS clarify the parameters of 100 miles, i.e., from headquarters or branch, to residence or town of residence, within certain counties, etc. One commenter noted that the standard metropolitan statistical area (SMSA) is no longer in general use in delineating communities and markets and has been replaced by ``metropolitan statistical area'' and ``consolidated metropolitan statistical area.'' The same commenter also noted that the term ``general metropolitan area'' is not a term of general usage nor is it explained in the interim final rule. This commenter suggested eliminating the 100 mile priority and restricting priority to persons living within the local community defined by reference to counties.

Two commenters suggested using zip codes corresponding to delineated CRA service areas, and three commenters suggested allowing each institution voluntarily to establish a local priority and identify local depositors. Four commenters requested that the rule be clarified to include, as local depositors, long-term account holders who lived in the area and kept accounts open but have retired and moved from the area, and long-term account holders who work or regularly vacation in the local community but do not reside there.

One selling agent had concerns with the definition of ``local community'' and concerns with the word ``reside,'' including the problem with multiple residences. This commenter suggested that the test for the geographic area for the domicile of an account include the whole of any zip code that is partially within the geographic area. The commenter also suggested developing an affidavit to accompany the stock order form and requested that OTS not require any independent verification by the selling agents.

Commenters that opposed the LDP provision asserted that all association members, regardless of location, should be treated the same and be allowed to participate in the conversion process on an equal basis. The objections raised by commenters opposing the LDP provision included the following: all depositors have ownership, voting and liquidation rights, deposits are used indiscriminately, and the definition of customer should not be related to location; the LDP provision is an artificial distinction between depositors based upon geography; non-local persons with long-term accounts and/or more money

in accounts would have a lower priority than local persons with shorter-term accounts and/or less money; the LDP is arbitrary, capricious, unfairly discriminatory, ill-suited to advancing any legitimate public policy objective, and in violation of the Administrative Procedure Act;<SUP>13 the LDP deprives non-locals, who have had long-term accounts with significant amounts of money and who maintain banking relationships, of rightful opportunity to participate in attractive conversions; it is unconscionable for a federal agency to require U.S. citizens to be treated differently based on their residence; and the LDP provision conflicts with the takings, due process and equal protection clause of the United States Constitution.

\1\3One of the most detailed comment letters came from counsel representing Thrift Depositors of America, Inc. (TDA), a trade association of **mutual** savings association depositors. A lawsuit by TDA (TDA vs. OTS, Civil Action No. 94-1008, U.S. District Court for the District of Columbia) alleged that the OTS's implementation of the LDP in the interim final rule without a notice and comment period violated the APA. On September 29, 1994, the Court ruled that because the OTS had failed to adequately justify waiving notice and comment for the LDP, it would enjoin the OTS from proceeding with **mutual**-to-stock conversions containing the LDP provision until a new rule was finalized in accordance with the notice and comment procedures of the APA.

Several of the commenters objected to the LDP provision because they believe that it violates federal and state policies and laws that prohibit discrimination. The OTS acknowledges that the effect of the rule is to authorize a preference to a certain type of depositor. The LDP rule, however, does not discriminate against any person based on age, race, sex, ethnic background, religion or any other impermissible category. Its purpose is to reward those who have and will maintain a banking relationship with the institution. While using residency as the basis for determining this category of depositors is inexact, it is valid to assume that generally local depositors fall into that category and non-local depositors do not. The OTS believes that providing for a LDP provision will assist in achieving the goals of (1) recognizing those depositors who have maintained long-term banking relationships with the converting institution and thereby contributed to its financial success, and who are likely to continue to do so in the future,<SUP>14 and (2) promoting ownership by persons who have close ties to the community. Thus, in the OTS's view, the rule does not violate federal or state policies against discrimination.

\1\4OTS cannot, in a regulation, identify with exactitude every single instance in which a depositor has maintained a long-term banking relationship with a converting institution and thereby contributed to its financial success. However, it is both rational and convenient, for reasons discussed elsewhere in this preamble, to identify this group as the local depositors. Moreover, as discussed more fully below, the OTS has provided a mechanism to enable converting institutions, in applying the LDP, to take account of unique and compelling circumstances posed by persons who are not local depositors.

The OTS also believes that the constitutional arguments raised by

certain commenters are without merit. As has been recognized by a number of courts, the property rights of **mutual** account holders are extremely limited.<SUP>15 In the OTS conversion regulations, the limited rights that depositors have to share pro rata in the surplus of a liquidated **mutual** savings association is recognized by the establishment of a liquidation account in the converted association. No distinction is made between local and non-local depositors in the establishment of these accounts and nothing in the interim rule or this final rule would diminish a depositor's interest in his or her liquidation account. Similarly, the OTS does not believe that authorizing the LDP provision violates the Equal Protection Clause of the Constitution. Although the LDP provision does make a distinction between depositors, the OTS believes, for the reasons discussed above, that there is a rational basis for authorizing an institution to make the distinction and that the provision reasonably relates to legitimate policy objectives.

\1\5See, e.g., Paulsen v. C.I.R., 469 U.S. 131 (1985); Ordower v. Bell Fed. Sav. & Loan Ass'n, 999 F.2d 1183 (7th Cir. 1993); York v. Federal Home Loan Bank Board, 624 F.2d 495 (4th Cir.), cert. denied, 449 U.S. 1043 (1980); Lovell v. The One Bancorp, 614 A.2d 56 (Me. 1992).

The OTS instituted the LDP rule in the interim final rule to promote local community ownership of converting institutions, and to reward a group that, collectively, typically has made significant contributions to the financial success of the institution. The LDP rule sought to provide the opportunity for local depositors to participate more fully in the subscription offering without competition from large purchases by out-of-area depositors. The OTS has become aware in recent years of the evolution of a class of depositors, sometimes referred to as ``professional depositors'' or ``flippers,'' who have opened accounts in a large number of **mutual** associations.<SUP>16 These ``professional depositors,'' who often reside outside the local community of the **mutual** savings association, make deposits in anticipation of the **mutual** savings association converting to stock form. Often, these depositors subscribe for a significant number of shares in the subscription offering phase with the intent of selling all or a significant number of the shares in a short period of time following the conversion to take advantage of a lucrative after-market. Once a conversion is complete, these depositors often withdraw their deposits and have no further relationship with the converted savings association.

\1\6See, e.g., Peter Lynch, Beating the Street (1993), p. 220.

As discussed below, OTS continues to believe that local depositors should be given preference over out-of-area depositors in purchasing stock of a converting **mutual** savings association. Upon further consideration of the issues presented in this area and review of the comment letters, however, OTS has determined in the final rule to authorize, but not require, a savings association to give a conversion stock purchase preference to account holders residing in the local community.

The OTS has taken this position, i.e., making the LDP provision optional, for a number of reasons. First, the OTS does not oppose the

full participation of those other than local depositors in the conversion process. The nationwide interest in thrift stock has enabled many thrifts to recapitalize, thereby preventing thrift failures and a burden on the taxpayers. In addition, the OTS notes that the conversion eligibility record date, the primary determinant for prioritized eligibility to purchase conversion stock, has always been keyed to the length of time a depositor has had an account with a converting institution, not to geographic location. Also, as noted below, many **mutual** associations have exercised their authority to accept deposit accounts only from persons residing in the association's local community.

In light of the foregoing, and in response to the comments noted above, the OTS believes that the LDP provision need not be a requirement of conversion; rather it should be at the option of each converting savings association which will decide whether its particular situation warrants its use. A savings association may conclude that an LDP for stock purchases is important to ensure ownership by local depositors who made significant long-term contributions to the financial success of the institution by virtue of their deposit and borrowing relationships, and who, it expects, will continue to maintain financial relationships with the institution after the conversion. The final rule includes the LDP provision as an optional provision in the subscription phase of the conversion.

To assist converting institutions who elect to include the LDP provision, the final rule continues to provide a definition of the ``local community.'' In response to comments, however, the final rule substantially revises the definition. First, the 100-mile standard is eliminated. In addition, the definition of local community has been revised to delete the reference to the ``standard metropolitan statistical area'' and the ``general metropolitan area.'' Finally, the definition also has been revised to include ``metropolitan statistical area'' (which replaced the SMSA), all zip code areas corresponding to the converting institution's delineated CRA service area, and such other area(s) or category as designated by the institution and provided for in the plan of conversion.\17\ In this regard, the OTS will review, on a case by case basis, the proposals by converting associations to define local community other than as defined in the final rule.

\17\For example, a number of commenters suggested other categories of depositors, such as retirees, who may be equivalent to local depositors in terms of their long-term relationship with the institution.

OTS also specifically solicited comments as to whether a savings association, in anticipation of conversion, should be permitted to: (1) refuse to open accounts for potential depositors residing outside the local community, or (2) close accounts of depositors residing outside the local community.

Of 18 commenters addressing this issue, 13 stated that a savings association should be able to refuse to open accounts for non-local depositors, with three of the 13 requesting that OTS confirm the association's right to refuse to accept deposits. Five commenters believed that associations should not be allowed to refuse to open accounts, with two of the five stating that OTS should prohibit associations from refusing to open or maintain accounts of non-local depositors.

Of 18 commenters, 10 stated that savings associations should be allowed to close accounts of non-local depositors, with one commenter

stating that an account should be required to be closed at least 6 months prior to the adoption of a plan of conversion. Two of the 10 stated that OTS should confirm an association's right, as a general matter, to close accounts of, and return monies to, depositors who do not reside in the community served by the association. Eight commenters opposed the closing of accounts in contemplation of conversion, with one stating that the closing would violate fundamental fairness and deprive valid property rights without due process.

In the interim final rule, the OTS noted that federal associations generally have the authority to open and maintain savings accounts within their discretion.\18\ State chartered savings associations are subject to state laws governing the opening and closing of deposit accounts. Based upon its review of the comments, the OTS has determined not to make any changes to the conversion rules in this area. It is the opinion of the OTS that federal associations have the authority to open and close deposit accounts, including those accounts of non-local depositors, provided they do not violate applicable laws that prohibit discrimination on the basis of age, race, sex, ethnic background, religion or any other impermissible category.

\18\See 12 U.S.C. 1464(b) and 12 CFR 545.11(b); see also Appendix to 12 CFR Part 544 (model bylaws for federal associations provide that the board of directors has the explicit power to reject any application for a savings account).

The OTS, however, would not consider it to be a legitimate exercise of that authority if a savings association, in anticipation of conversion, closed an account for the purpose of preventing a depositor from participating in a conversion as an account holder. The OTS believes that this could result in the perception that insiders were acting out of self-interest and not in the interests of the savings association.

F. Revision to Policy Regarding Management Stock Benefit Plans

In the interim final rule, the OTS substantially revised and codified its policies regarding the establishment of management recognition plans (MRPs) and stock option plans (SOPs) during the conversion process. The new provisions require that any decision to implement MRPs and SOPs after conversion be voted on and approved by a majority of the shareholders no earlier than the first annual meeting following the conversion, and that prior to implementation, all such plans be reviewed and approved by the Regional Director. The provisions also prohibit the use of conversion stock to fund MRPs, require that MRPs be awarded and stock options be granted only after shareholder approval is received and require that stock options be granted at the market price at which the stock is trading at the time of grant. The regulation also codifies the OTS's policies regarding permissible amounts that may be included in SOPs and MRPs formed within one year of conversion.

Approximately 17 commenters recommended allowance of a reasonable amount of stock benefits at the time of conversion, rather than a flat prohibition. A majority of the 17 commenters stated that the level of stock benefit plans should be tailored to the size, health and performance of the association, the business plan objectives and needs, the size of the offering, and the specific contribution and tenure of management. One commenter suggested 1% for MRPs and 5% for stock options, subject to the normal five-year vesting period. Another

commenter suggested allowing a small MRP amount at the time of conversion with the remainder reserved for future performance-based awards and a SOP that is structured so that the exercise price is based on an averaging formula or an indexed price.

Four commenters supported the prohibition of stock benefit plans at conversion.

Of eight commenters addressing the issue, six supported the requirement for shareholder approval of management plans. One of the six supported the delaying of implementation until approval is received and two commenters stated that shares should be allocated at the time of conversion but contingent on shareholder approval. One commenter requested a revision in the wording of the regulation to clarify that plans must be approved by an affirmative vote of the holders of a majority of the securities of the issuer present, or represented and entitled to vote, at the meeting.

Of ten commenters addressing the issue, two supported the provision that shareholder approval be at the first annual meeting, and eight requested that the timing aspect be revised to allow approval at any duly called meeting of shareholders, either annual or special. One commenter suggested that the regulation require that a meeting be at least two months after completion of the conversion. One commenter expressed concern for differences in flexibility with annual meeting dates for state **holding** companies and federal savings associations. One of the eight commenters stated that by waiting for the first annual meeting, awards are expensed based upon the fair market value of common stock on the date of the meeting which increases the financial accounting expenses for the institution. This same commenter also noted that the date the MRPs are implemented is inconsequential to officers and directors, because the financial benefit of the MRPs is in the full value of the shares, not in their appreciation as in stock options.

Three commenters stated that associations should be given flexibility to obtain a reasonable and appropriate number of shares to fund stock plans through open market purchases or through authorized but unissued shares. Another commenter requested that the regional office review and act upon stock plans at the time of conversion, that no conditional approval be allowed, and that plans not acted upon within a certain time be deemed approved automatically.

Consistent with the discussion in the preamble to the interim final rule, the OTS believes that while there are valid business reasons for thrifts to adopt stock benefit plans in order to attract and retain qualified management, these plans are now more appropriately implemented subsequent to the conversion and with shareholder approval. A waiting period allows shareholders to decide whether to permit dilution of their interests after reviewing management's performance. Moreover, the stock price stabilizes once the marketplace has sufficiently digested the financial data of the association.

The interim final rule required that stock options be granted at the market price at which the stock is trading at the time of grant. The OTS has revised the interim final rule so as to require that stock options be granted at no less than the market price at which the stock is trading at the time of grant. This revision is consistent with the current practices and rules relating to the granting of stock options.

The shareholder vote required by the final rule will be uniform for both savings associations and **holding** companies, i.e., the affirmative votes of the holders of a majority of the total votes eligible to be cast at a legal meeting.\19\

\19\This voting requirement coincides with the voting requirement of Section 5 of 12 CFR 552.3, the Federal Stock Charter

provision. As noted, it will apply to savings and loan **holding** companies formed in the conversion process that implement management stock benefit plans within one year following conversion.

Shareholder approval is required prior to implementation of MRPs or stock option plans within the first year of conversion. In response to the comments and mindful that a uniform meeting time may be justifiable for the reasons cited by the commenters, the timing aspect in the interim final rule is being revised to allow approval at any duly called meeting of shareholders, either annual or special, to be held no earlier than six months after completion of the conversion. The OTS believes a six-month ``cooling off'' period will give the marketplace sufficient time to digest the financial data and the shareholders sufficient time to become familiar with the finances and operations of the converted association in order to make an informed investment decision in considering whether to vote to adopt such plans.

The interim final rule did not specify the vesting schedule of the management stock benefit and stock option plans. As a matter of policy under both the conversion regulations and the safety and soundness authority governing management compensation, the OTS has generally required such plans to vest beginning one year from the date the plans are approved by shareholders, and at a rate not in excess of 20% a year. A provision has been added to the final rule codifying these policies. Also, in furtherance of the foregoing policy, an additional provision in the final rule generally prohibits accelerated vesting except in the case of disability or death.

The OTS agrees with the commenters that savings associations should be given flexibility to obtain a reasonable and appropriate number of shares to fund stock plans through open market purchases or through authorized but unissued shares. In funding these plans, the board of directors and the compensation committees are reminded of their fiduciary duties to the association or **holding company**, its shareholders and the association's members.

Finally, the interim final rule required that management and stock option plans be subject to approval of the appropriate OTS Regional Director prior to plan implementation. The final rule removes the requirement for OTS Regional Director approval in advance of a stockholder vote and implementation. The final rule provides that management stock benefit plans and stock option plans comply with all of the regulatory requirements. Disclosure in all proxy and related material distributed to the shareholders shall indicate that the plans in no way have been approved or endorsed by the OTS, and no written or oral representation to the contrary shall be made by the association, its management, employees or professional advisors. The final rule also adds the requirement that subsequent to shareholder approval of the plans, the association will be required to file with the OTS a copy of the plans approved by shareholders and written certification that the plans approved by shareholders are the same plans submitted to the OTS in the proxy materials.

G. Merger Conversions

In the interim final rule, the OTS amended its conversion regulations to limit merger conversions to institutions that qualify for a supervisory conversion, i.e., financially-weak institutions. OTS also solicited comment as to whether merger conversions involving healthy savings associations should be permitted in the future, and if so, under what circumstances. The OTS was particularly interested in how merger conversions should be structured to avoid the safety and

soundness concerns raised by such transactions that were discussed in the preamble to the interim final rule.

Of approximately 43 commenters addressing merger conversions, approximately 33 expressed the view that merger conversions should be permitted for healthy thrifts. Of these 33 commenters, 13 proposed a small savings association exception, with ``small'' being defined as anywhere from $5 million to $300 million in assets. The bases for the exception were the cost of doing two transactions (a standard **mutual**-to-stock conversion followed by a merger transaction) in order to accomplish a merger; the business reasons (access to capital markets, choice of partner, long-term survival, technological advancement, access to a strong management team and enhancement of service to communities); and the economic necessity for market-driven consolidations to occur.

Those commenters who favored authorization of merger conversions involving healthy thrifts believed that the OTS should regulate and supervise these transactions and address concerns over insider abuse, excessive management compensation and stock incentive packages. They argued that OTS could set narrow approval guidelines but should not ban or eliminate merger conversions. One commenter stated that merger conversions should be allowed on a case-by-case basis taking into account the size and strategic needs of the institution. Another commenter stated that OTS should allow submission on a test case basis so as to develop a structure that would address the issues.

A few commenters thought that depositors should be able to vote on whether a stand-alone or merger conversion would be in the best interest of the association. Several commenters stated that the board of directors should decide whether to undertake a merger conversion based on their business judgment. Two commenters thought that for a merger conversion to be approved, an institution would have to document specific business, economic and fiscal reasons and be required to demonstrate that the transaction would provide opportunities for customers and depositors to participate in the institution's value. Another commenter stated that the prohibition punishes forward-thinking thrift managers and further endangers the health of the industry by closing off avenues for generating capital.

Another commenter stated that the institution should be free to negotiate the terms of a merger conversion, including reasonable compensation arrangements and purchase discount percentages.

Some suggestions regarding the windfall gains and other problems and the valuation issue included: allow subscribers to subscribe to the stock of the acquiring association at a 15% to 20% discount, based on the stock price either at the time of acquisition or at the time the transaction is announced; require the acquiring entity to pay a control premium; assure that value is made available to appropriate constituencies through community foundations, special interest payments on deposits, and/or a special class of preferred stock made available to depositors without cost; make bonus interest payments equal to a certain percentage of principal on all eligible account holder deposits maintained at resulting institution for a specific time period after the acquisition is consummated\20\; require the acquiror to hold the thrift as a separate subsidiary or be an OTS-regulated institution itself; require all net conversion proceeds to go to the association; allow compensation only to the extent allowed in stand alone conversions; or require a CRA rating of outstanding or satisfactory.

\20\The OTS notes that a fundamental premise of the conversion regulations prohibits free distribution schemes in connection with a conversion. See 39 FR 9142 (March 7, 1974).

One commenter recommended using a two-step approach, allowing the **mutual** to enter into a definitive merger conversion agreement prior to doing a stand-alone conversion, disclosing the intended transaction in the stand-alone conversion, and then requiring a 90-day period between completion of the stand-alone conversion and consummation of the merger.

Of the approximately ten commenters that supported the prohibition against merger conversions, two did so only until guidelines can be drawn to protect the rights of members of the disappearing association and to prevent insider abuse. One of the ten stated that merger conversions should be prohibited except in cases of undercapitalized institutions or at the discretion of the regulators on a case by case basis. A fourth supporter noted that what is beneficial to the board of directors and insiders may not always be in the best interest of the institution or the community it serves. A fifth supporter stated that depositors are best served by forcing acquiring entities to bid for a converted institution's stock in the open market. A sixth commenter supported the prohibition because of the windfall and valuation problems.

Upon review of the comments, the OTS has determined to continue to generally limit merger conversions to cases involving financially weak institutions. Although several commenters made suggestions that attempted to address the concerns raised in the interim final rule, including the valuation problem and accrual of ``windfall gains'' by the acquiror, the OTS remains concerned with the problems raised by merger conversions of healthy institutions.

In line with the commenter who suggested that the OTS allow test case submissions in order to develop a structure that would address the issues, the OTS emphasizes that it retains its general waiver authority under part 563b to permit a merger conversion transaction under appropriate circumstances.<SUP>21 An institution seeking a waiver of the merger conversion limitation will bear the burden of demonstrating how a proposed transaction specifically addresses the concerns set forth above and in the interim final rule, and will also be required to document specific business, economic and corporate reasons for a merger conversion. As discussed in the interim final rule, however, the OTS has identified a number of significant structural abuses and regulatory problems inherent in merger conversions.<SUP>22 Thus, while the OTS continues to remain open to the development of a transaction structure that addresses these problems, a healthy institution faces significant hurdles in demonstrating its transaction will resolve these problems.

\2\1One situation suggested by some commenters and to which the OTS would give serious consideration is where a converting association could demonstrate by clear and convincing evidence that a standard conversion would not be economically feasible, based on the ratio of expenses to gross proceeds, because of the asset size of an institution. Very small institutions, i.e. those with assets under $25 million are more likely to be able to establish such a justification.

\2\2See 59 FR 22725, 22729 (May 3, 1994); *see also testimony of* a House Financial Institutions Subcommittee Hearing on **Mutual**-to-Stock Conversions dated January 26, 1994.

In the interim final rule, the OTS stated that merger conversions could be done as a two-step process in which the **mutual** account holders

are initially granted an opportunity to purchase stock of a converting savings association or its **holding company** and then following the conversion, vote to merge with or be acquired by another institution, subject to certain limitations. One of the limitations is 12 CFR 563b.3(i)(2), under which no person is permitted to make an offer for any security of a converting savings association issued in connection with the conversion. The other limitation is 12 CFR 563b.3(i)(3), under which no person is permitted for a period of three years following the conversion, to make an offer to acquire or acquire more than 10% of any class of equity security of a converted savings association without the prior written approval of the OTS.<SUP>23

\2\3Clearly, with respect to the latter limitation, the opportunity is present for converted institutions contemplating a merger to seek approval from the OTS to undertake such a transaction even within the first year following conversion.

In addition, the OTS has generally imposed a condition in connection with approval of a conversion transaction that prohibits, without prior OTS approval, the converting association or its **holding company** from taking any action within the first year following conversion that could lead to a transaction that would require stockholder approval if such transaction were subject to 12 CFR 552.13. These provisions are intended to preserve the integrity of the independent appraisal process, deter manipulation of the conversion process by insiders or other sophisticated third parties to the detriment of the account holders, and permit the OTS to monitor post-conversion acquisition activities of recently converted associations. By this regulatory oversight of merger and acquisition activities following the conversion, a converting institution is provided with a reasonable period of time to implement its post-conversion business plan and to invest the conversion proceeds. With respect to the appraisal issue, the pro forma valuation of converting institutions assumes that no acquisition of the converting association will take place for a reasonable period of time following the conversion. If there are ongoing discussions about a takeover of a converting thrift during the conversion process, the ability of an appraiser to prepare an appraisal that satisfies the requirements of 12 CFR 563b.7 is severely diminished because of the uncertainty that such takeover speculation would generate.

H. Extension of the Conversion Public Comment Period

OTS revised the conversion regulations to conform the public comment period with the longer twenty calendar day public comment period provided under the acquisition of control regulations.<SUP>24

\2\412 CFR 574.6(e).

Eight of ten commenters endorsed the new requirement, with one of the eight suggesting that OTS include a requirement for wider distribution, in a timely manner, of the conversion notices contemporaneously with the filing of the conversion application. One of the eight noted that too long a comment period may cause significant delays and related inappropriate costs to the converting associations.

One commenter stated that the ten day comment period provided ample

time for any person desiring to comment on an application, and if the 20-day period is used, suggested that an association be permitted to publish the 4(b) notice immediately upon filing the application with OTS, without waiting for OTS authorization. Another commenter stated that the revision served no useful purpose, but if kept, also suggested that the 4(b) notice should be able to be given immediately after the filing to ensure no delay due to the longer public comment period.

The OTS continues to believe that the longer public comment period will give sufficient time for interested parties to review and comment on a detailed conversion application. In order to accommodate the concern noted by some commenters, the final rule requires that the 4(b) notice be given immediately after the filing of the application with the OTS. However, the final rule also clarifies that if a conversion application is later deemed not properly executed or is materially deficient or substantially incomplete, the applicant may be required to refile the application, republish the accompanying 4(b) notice, and provide for another 20-day public comment period.

I. Submission of Business Plans for All Conversion Transactions

OTS now requires that all conversion transactions, with or without **holding company** formations, include a business plan, and that the business plan address in detail how the capital acquired in the conversion will be utilized.

All commenters addressing this issue affirmatively supported the provision. Two wanted assurance of confidentiality of the business plan to protect associations from unfair competition. One of the commenters stated that the business plans should not be used to deny a conversion application, unless the plan raises significant safety and soundness concerns, and two urged OTS not to put itself in the position of deciding how much capital a business may need in future years, nor to require a converting institution to justify the need for capital in order to be able to convert.

The interim final rule will continue in effect without change. As noted in the preamble to the interim final rule, in order to ensure that a business plan is given confidential treatment, the applicant should follow the procedures set forth at 12 CFR 563b.4(c).

Applicants for conversions must submit their business plans to the Regional Director prior to the filing of the conversion application. OTS may deny a conversion application where the business plan does not sufficiently address the deployment of conversion proceeds, raises significant safety and soundness concerns, or does not otherwise address convenience and needs standards as required in the final regulation.

J. Revision to Post-Conversion Stock Repurchase Rules

In its interim final rule, the OTS revised the conversion regulations to prohibit stock repurchases by the converting association for one year following conversion. After one year, a converted association may file with the appropriate Regional Director an open market repurchase program in which it may propose stock repurchases of no more than 5% of the outstanding capital stock during any twelve month period in the second and third years after the conversion. The Regional Director also may disapprove repurchases if the association does not demonstrate a valid business purpose for the stock repurchase; and also may approve amounts greater than 5% in the second and third years if there are circumstances that would justify such repurchases.

A majority of the commenters addressing this issue disagreed with the revisions, six commenters proposed alternative revisions, and one

commenter supported the prohibition of stock repurchases for one year following conversion. The majority felt the blanket prohibition was not sound public policy, was not justified or necessary, was detrimental to thrift stock prices, and reduced the ability of thrifts to compete in capital markets. Most stated that the repurchase of stock is standard corporate practice that should be left to the decision of the board of directors (consistent with fiduciary responsibilities), subject to safety and soundness concerns. Most also felt that thrifts need to retain flexibility in using repurchase programs because markets are fluid and subject to change due to various forces. Most viewed the prohibition on stock repurchases as taking away the institution's and the OTS's ability to follow market dictates and react to stock price fluctuations and other market conditions. A few commenters stated that by limiting repurchases, the regulation may cause institutions to use excess capital unwisely, to engage in unsound and risky ventures in an attempt to provide better returns for shareholders, and could unintentionally increase pressure on thrift management to produce better returns on equity by taking greater risks in daily operations. A few commenters found no valid justification for distinguishing newly converted thrifts and stated that, in deciding whether a repurchase is for valid business reasons, the OTS should look at whether the association has excess capital, whether the stock is trading below book value, and whether the repurchase is an attractive investment given the association's business prospects.

One commenter requested that the rule specify in greater detail the circumstances that would warrant repurchase amounts greater than the 5% repurchase limit in the second and third years following conversion. Another commenter requested that the rule require all regions to be uniform in permitting repurchases greater than 5% during that time.

Eight commenters stated that recently converted thrifts should be allowed to operate under the regulations in place at the time they converted, and that the OTS should grandfather all associations that converted prior to the effective date of the interim final rule.

While the OTS continues to believe that stock repurchase programs may serve valid business purposes, e.g., maintaining the value of a converting association's stock in an active trading market, the OTS also continues to have concerns with substantial buyback programs that commence immediately after conversion and are not based on a valid business purpose. In addition, and as noted in the preamble to the interim final rule, repurchases commenced immediately after conversion raise substantial issues regarding whether conversion stock has been appropriately valued.

To address these concerns, but also to allow for some flexibility for repurchase programs, the final rule continues to discourage stock repurchases for one year after conversion, but gives the OTS discretion to allow limited stock repurchases in the first year where exceptional circumstances are established.<SUP>25 This would give the OTS the ability to permit repurchases where it may be in the best interests of the association and its shareholders; however, such repurchases will be allowed in the first year only when deemed necessary by the OTS.

\2\5We note, for example, that typically public companies may repurchase stock in the open market where there is a prolonged period of a downward trend in the stock price.

The interim final rule stated that repurchases within two years after the conversion must be part of an open-market stock repurchase program that does not allow for a repurchase of more than 5% of the

association's outstanding capital stock during a twelve month period. The final rule has been revised to clarify that repurchases in years two and three after conversion must be part of an open-market stock repurchase program and generally will be limited to no more than 5% of the association's outstanding capital stock. However, the final rule allows the OTS to approve repurchase programs in amounts greater than 5% in the second and third years, if exceptional circumstances are established. As stated above, this would give the OTS the ability to permit additional repurchases where it may be in the best interests of the association and its shareholders; however, such repurchases will be allowed only when deemed necessary by the OTS.

The OTS continues to believe that ensuring an equitable conversion process and consistency in that process require that the final rule apply to all associations that converted in the three years preceding the May 3, 1994 effective date of the interim final rule. Any previous repurchases that occurred prior to May 3, 1994 will be grandfathered, however, grandfathered repurchases will count toward compliance with the current requirements.

K. Convenience and Needs Considerations

The proposed rule would add a new ``convenience and needs'' standard to existing approval standards applicable to conversions and MHC stock offerings. Under the proposal, the OTS would review the applicant's performance under the CRA,<SUP>26 the contents of the business plan submitted in support of the application, and other factors relating to the applicant's performance in meeting the convenience and needs of its delineated community.

\2\6The OTS recently reproposed revisions to its regulations implementing the CRA. See 59 FR 51232 (October 7, 1994).

Three commenters favored adoption of the new standard and nine opposed the new standard. Favorable comments expressed the view that the proposal would serve a valid public purpose and adequately respond to community and Congressional concerns regarding allocation of conversion proceeds. Comments opposed to the proposal focused primarily on the OTS' authority to adopt the proposal and on questions relating to implementation, such as whether the proposal is necessary or appropriate given existing laws and regulations; whether the OTS will consider CRA-related protests during application processing; and whether the OTS would mandate allocation of transaction proceeds to specific community credit or lending programs.

1. OTS Authority to Adopt the Proposal

As noted in the preamble to the convenience and needs proposal, a convenience and needs standard has not, to date, been applied to **mutual**-to-stock conversions of savings associations. Similarly, a convenience and needs standard generally has not been applied to MHC stock offerings.<SUP>27 Upon review of this area, however, the OTS proposed amendments to its regulations to impose a convenience and needs standard on these transactions. The proposal was issued, among other reasons, to enhance the OTS' ability to ensure that savings associations undertaking these transactions recognize their responsibility to consider their community's credit needs.

\2\7A convenience and needs standard has been applied to **mutual holding company** reorganizations because these transactions require

the OTS' approval under the Bank Merger Act (BMA). See 58 FR 44105 (August 19, 1993) (adopting part 575 governing **mutual holding company** reorganizations and related stock issuances). The BMA requires that the responsible agency consider the convenience and needs of the community to be served in acting on any BMA application. See 12 U.S.C. 1828(c)(5).

In the notice of the proposed amendments, the OTS explained its authority to adopt and implement the proposal.<SUP>28 Some commenters argued that the proposal goes beyond OTS authority under the Home Owners' Loan Act (HOLA)<SUP>29 and the CRA. These commenters stated that the CRA limits the types of applications that may be subject to review under the CRA; that Congress intended the CRA to cover only those transactions resulting in new charters or expanded facilities, not conversions and MHC stock offerings. On this point, these commenters asserted that a convenience and needs standard is not appropriate in conversions because conversions are fundamentally a capital-raising technique, not an expansion of operations. One commenter believed that section 5(c) is the only provision of the HOLA<SUP>30 that enumerates thrift powers and authorities, and that no affirmative housing credit obligation exists in section 5(c) that would permit the OTS to direct the allocation of conversion proceeds to community lending programs.

\2\8See 59 FR 22764, 22765 (May 3, 1994).
\2\912 U.S.C. 1461.
\3\012 U.S.C. 1464(c).

The OTS has concluded that it has ample statutory authority for the amendments. As noted in the proposal, the OTS has broad authority under sections 5(i)(1) and 5(i)(2) of the HOLA to regulate **mutual**-to-stock conversions, and under section 10(o)(7) of the HOLA to regulate **mutual holding** companies.<SUP>31 Inherent in this broad grant of authority is the ability to assess the impact of a proposed transaction on the convenience and needs of the communities to be served by a savings association.

\3\112 U.S.C. 1464(i)(1), 1464(i)(2) and 1467a(o)(7). See also Charter Federal S.&L. Ass'n. v. Office of Thrift Supervision, 912 F.2d 1569 (11th Cir. 1990).

In addition, section 4(a)(3) of the HOLA provides that the Director ``shall exercise all powers granted to the Director under this chapter so as to encourage savings associations to provide credit for housing safely and soundly.''<SUP>32 For federal associations, in particular, the OTS is directed to exercise its regulatory powers in order to provide thrift institutions ``* * * for the extension of credit for homes and other goods and services.''<SUP>33 The powers granted to the Director include the general regulatory authority under sections 5(i)(1), 5(i)(2), and 10(o)(7) of the HOLA mentioned above. The admonitions in the HOLA that the Director use his or her statutory powers to encourage savings associations to provide credit provides a substantial additional basis for the Director to assess community needs when reviewing applications.

\3\212 U.S.C. 1463(a)(3).
\3\3See section 5(a) of the HOLA, 12 U.S.C. 1464(a).

Thus, the OTS' authority to address convenience and needs concerns in the context of applications is not limited to the applications specifically mentioned in the CRA. While the application review sections of the CRA arguably focus primarily on transactions that involve some type of expansion of operations in a geographical market, e.g., new charters or branch facilities,<SUP>34 the CRA does not limit agency authority under other statutes or regulations to consider convenience and needs factors during the review of applications that do not necessarily involve an expansion of operations.

\3\4See 12 U.S.C. 2902(3), 2903.

Finally, the amendments are consistent with section 5(c) of the HOLA. Section 5(c) of the HOLA generally sets forth permissible investments and investment limitations for federal savings associations, but in no way limits the OTS' authority to ensure that these investment powers are exercised in a manner that is consistent with the convenience and needs of the community.

2. Appropriateness of a Convenience and Needs Standard

As stated in the proposal, the amendments are intended to enhance the OTS' ability to ensure that savings associations undertaking conversions and MHC stock offerings recognize their responsibility to consider their community's credit needs.

A number of commenters questioned the wisdom of a convenience and needs standard, suggesting the OTS has sufficient regulations and policies to implement the CRA and ensure that the convenience and needs of the community are met by all thrifts.

For the reasons stated above in support of the OTS' authority to adopt the amendments, the OTS believes it is appropriate to impose a convenience and needs standard on applications for conversions and MHC stock offerings. In addition, the OTS believes the amendments will enhance current regulations and policies designed to ensure that thrifts meet their community's credit needs.

3. Consideration of CRA-Related Protests During Application Review

The proposal did not address whether the OTS would consider CRA-related protests during agency review of conversion and MHC stock offering applications.

Some commenters objected to OTS consideration of CRA protests during the public comment period. These commenters emphasized that the timing of a conversion, in particular, is critical to stock pricing and appraisal considerations. The mere prospect of a delay due to a CRA protest may unfairly subject an institution to pressure to make concessions to protestants, according to these commenters. They suggested limiting public comments on applications subject to the rule to issues relating to eligibility of purchasers and fairness of the appraisal.

The OTS realizes that conversions and MHC stock offerings are time-sensitive transactions and that protests may affect their success. Nevertheless, the OTS does not believe it is appropriate to preclude the public from commenting on a savings association's performance in meeting a community's convenience and needs. Accordingly, the OTS will consider these types of comments filed as part of a public comment period on conversion and MHC stock offering applications. The OTS

emphasizes that it will address these comments as promptly as possible. The CRA protest and oral argument procedures at 12 CFR 543.2 will not apply, however.<SUP>35 The OTS believes the public comment period will provide a full and fair opportunity for interested persons to express their views regarding an applicant's performance in meeting the convenience and needs of the community.

\3\5As a matter of policy the OTS has applied these procedures to certain conversion transactions and other applications, although neither the HOLA nor the CRA require the OTS to follow any specific procedures.

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4. Allocation of Transaction Proceeds to Specific Lending Programs or Services

The preamble to the proposal specifically solicited comment on whether the proceeds from conversions or MHC stock offerings should be directed to specific types of activities, and, if so, what portion should be used for what types of activities.<SUP>36

\3\6See 59 FR 22764, 22766 (May 3, 1994).

A few commenters objected to any regulation or policy that would impose an allocation scheme on transaction proceeds. They argued that the OTS has no statutory authority for such action; that a regulatory allocation scheme would place artificial limits on capital planning and business strategy; and that specific allocations should be within the discretion of the management of the applicant, consistent with safety and soundness.

The OTS agrees with many of the comments on this issue. In proposing the amendments, the OTS did not intend to impose any specific allocation scheme on proceeds from conversions or MHC stock offerings. The OTS agrees that the allocation of transaction proceeds is largely a matter within the discretion of the converting association, consistent with the safety and soundness of the savings association. Nevertheless, as suggested in the proposal, the OTS will require applicants to submit business plans that demonstrate how transaction proceeds will be used to further the convenience and needs of the community. Business plans should describe specifically the lending and credit programs to which transaction proceeds will be directed. OTS policies encourage savings associations to consider traditional lending programs as well as more innovative methods to meet the credit needs of the communities they serve.<SUP>37

\3\7See, e.g., ``Community Development Investment Authority'' (OTS guide to the federal laws and regulations governing community development activities of savings associations).

Where an applicant's business plan does not adequately address how transaction proceeds will help meet the credit and lending needs of its community, the OTS may deny the application or impose appropriate conditions of approval designed to ensure that the applicant will address these concerns. The OTS generally will not view commitments included in a savings association's business plan as remedying pre-existing CRA-related deficiencies. However, commitments may be

appropriate in addressing CRA performance in the context of the conversion of a troubled savings associations. The OTS intends to give substantial weight to an applicant's previous CRA record, consistent with long-standing policy of the OTS.<SUP>38

\3\8See 54 FR 13742 (April 5, 1989) (joint CRA policy statement of the federal financial supervisory agencies).

As stated above, applicants must submit business plans to OTS staff for their review prior to filing a formal application.

L. Other Issues

1. Subscription Rights

The conversion regulations require that prior to the completion of a conversion, no person may transfer, or enter into any agreement or understanding to transfer, the legal or beneficial ownership of conversion subscription rights, or the underlying securities to the account of another.<SUP>39 The OTS did not propose any change to the prohibition in the OTS conversion regulations on the transfer or sale of subscription rights or similar ``free distribution'' schemes, but did request comment on whether subscription rights should continue to be nontransferable, or if transferability is recommended, the reasons for, and the manner in which to allow for, such transfer.

\3\912 CFR 563b.3(i)(1).

Almost all of the commenters who commented on this issue stated that subscription rights should continue to be nontransferable. The commenters that opposed transferability asserted that transferability would place undue pressure on mutuals to convert; would place emphasis on ownership by depositors, a concept that is theoretical; would make the conversion process overly complex; would be dangerous to the long-term health of the industry; would be unworkable and not in the public interest; would increase the chances of fraud and abuse; would be difficult and costly in allocation of rights; would enable sophisticated and professional investors to take advantage of members; and would create a destabilizing effect on mutuals. One commenter suggested an alternative that would allow members to cause associations to redeem rights for a certain period of time, for payment of a special dividend, provided there is adequate capital.

Three commenters endorsed transferability of subscription rights, although one of the three stated that account holders should be allowed to transfer rights to another individual, but not a group of investors or another institution.

The OTS notes that the FDIC and others have suggested that it may be appropriate for depositors to be able to receive a gift of cash or stock or to transfer and sell their subscription rights so that any ``windfall'' value can be distributed directly to the depositors. The current OTS regulatory regimen specifically rejects any type of free distribution schemes as unsafe and unsound practice.<SUP>40 The OTS continues to believe that this type of change to the current conversion regulations would raise a number of complex legal and policy issues, many of which were taken into account previously by the FHLBB in determining to prohibit transferability.<SUP>41 These issues, as noted in the preamble to the interim final rule, include the possibility of

adverse federal tax consequences to depositors receiving such rights, undue pressure on **mutual** associations to convert that may evolve from significant shifts of savings funds by depositors into such associations, difficulties in equitably allocating such subscription rights among depositors, potential manipulation of the process by sophisticated third parties to the detriment of the depositors, incentives for manipulation by insiders, the continued need for establishment and maintenance of a liquidation account and significantly increased conversion costs due to compliance with securities law requirements for registering subscription rights for public distribution. For these reasons, the OTS conversion regulations continue in effect without any change relative to free distribution of stock or transfer of subscription rights.

\4\0See 39 FR 9142 (March 7, 1974).

\4\1See footnote 17 above.

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2. Availability of Conversion Documents

OTS rules now permit the public to have ready access to all relevant non-confidential materials regarding proposed conversion transactions.

Of five commenters addressing the issue of whether OTS should permit access to non-confidential preliminary conversion materials, three supported the revision allowing access, one opposed, claiming access to such materials would confuse members whose focus should be on the accuracy and adequacy of the final information disclosed to the public, and one stated that the prospectus and plan of conversion, as approved by the board of directors, provide adequate disclosure.

The OTS continues to believe that even though this information is preliminary in nature, it may be useful for account holders and the public to access it earlier in the conversion process, and therefore, the provision in the interim final rule will continue in effect without change. As noted above, business plans filed with, or in contemplation of, a conversion will continue to be treated confidentially so long as the applicant follows the procedures set forth in 12 CFR 563b.4(c).

3. Conforming Changes to **Mutual Holding Company** Regulations

The **mutual holding company** regulations, 12 CFR part 575, generally incorporate the substantive and procedural standards for conversion contained in the conversion regulation. To the extent the final rule addresses conversion standards, those same standards apply to **mutual holding company** reorganizations and minority stock issuances. The OTS is also revising 12 CFR part 575 to make clarifying and conforming changes to the **mutual**-to-stock conversion regulations.

III. Summary of Revisions to the Conversion Regulations

For the reasons set forth in the previous section, the following revisions have been made to the interim final rule. All other provisions of the interim final rule, and the proposed rule on convenience and needs, are adopted without change.

--The definition of ``Local Community'' in 12 CFR 563b.2(a)(19) is revised to include the generally used term ``metropolitan statistical area,'' all zip code areas corresponding to an association's delineated CRA service area, and any area(s) or category designated by the savings association and approved by the OTS.

--12 CFR 563b.3(c)(2)(i), (4)(i), (5)(i), which required the LDP in the subscription phase of the conversion, are deleted in the final rule and sections (2) (ii) and (iii), (4) (ii)-(v), and (5) (ii) and (iii)

are redesignated as sections (2) (i) and (ii), (4) (i)-(iv), and (5) (i) and (ii).

--12 CFR 563b.3(c)(6)(iv) is revised to delete the phrase ``or within 100 miles of the association's home or branch office(s).''

--12 CFR 563b.3(c)(23) is revised to clarify that eligible account holders have first priority to purchase conversion stock, tax-qualified employee stock benefit plans have second priority, supplemental eligible account holders have third priority, and other voting members who have subscription rights have fourth priority. Also the final rule clarifies that if the actual offering exceeds the proposed maximum offering price, up to ten percent of the total offering of shares may be sold to the tax-qualified employee stock benefit plans; if the ESOP is not able to purchase conversion stock, the ESOP or any other tax-qualified plan may purchase shares in the open market or utilize authorized by unissued shares only with prior OTS approval; and disclosure must be made in the conversion application and related documents as to the effects on the association and subscribers of shares of either open market purchases or use of authorized but unissued shares.

--12 CFR 563b.3(d)(12) is redesignated as 12 CFR 563b.3(d)(13) and a new 12 CFR 563b.3(d)(12) is added to give converting associations the authority to include a preference for eligible account holders, supplemental eligible account holders and other voting members residing in the association's local community.

--12 CFR 563b.3(g)(3)(i)(B) is revised to clarify that repurchases within year two and year three after conversion must be part of a repurchase program that does not allow for a repurchase of more than 5% of the association's outstanding capital stock during a twelve month period.

--12 CFR 563b.3(g)(3)(i)(D) revises the reference from Corporate and Securities Division to Business Transactions Division.

--12 CFR 563b.3(g)(3)(ii) is revised to give the OTS discretion to allow limited stock repurchases during the first three years in amounts exceeding those specified in (g)(3)(i), where exceptional circumstances are established.

--12 CFR 563b.3(g)(4) (vii) and (viii) are revised to require the affirmative vote of the holders of a majority of the total votes eligible to be cast at a shareholder meeting for the establishment and implementation of management stock benefit plans and stock option plans within one year of conversion.

--12 CFR 563b.3(g)(4) (vii) and (viii) also are revised to allow approval of stock option plans and management stock benefit plans at any duly called meeting of shareholders, either annual or special, to be held no earlier than six months after completion of the conversion.

--12 CFR 563b.3(g)(4)(ix) is revised to require stock options to be granted at not less than the market price at which the stock is trading at the time of grant.

--12 CFR 563b.3(g)(4)(xi) is revised to require strict compliance with the terms and provisions of (g)(4).

--12 CFR 563b.3(g)(4)(xii) is added to codify current OTS policy requiring that management benefit plans and stock option plans shall vest beginning one year from the date the plans are approved by shareholders, shall vest at a rate not in excess of 20% a year, and shall provide for accelerated vesting solely in the case of disability or death.

--12 CFR 563b.3(g)(4)(xiii) is added to require disclosure in all proxy and related material distributed to the shareholders, in connection with the meeting at which the stock option and benefit plans will be voted, to state that the plans comply with OTS regulations, have in no way been endorsed or approved by OTS; and no written and

oral representation to the contrary shall be made.

--12 CFR 563b.3(g)(4)(xiv) is added to require that no later than five calendar days from the date of shareholder approval, an association shall file with the OTS a copy of the approved plans and written certification that the plans approved by the shareholders are the same plans filed with the proxy materials.

--Newly-designated 12 CFR 563b.4(b)(1)(i) is revised so as to require the publication of notice immediately upon filing of a conversion application with the OTS.

--12 CFR 563b.4(b)(1)(i) also is revised to clarify that in the case where an application is not properly executed or is materially deficient or substantially incomplete, and where a new application is required to be filed, the applicant may be required to publish new notice upon filing of the revised application and may be required to consider written comments for an additional 20-day period.

--12 CFR 563b.7(f)(2) is revised to prohibit appraisers from also serving as underwriters or selling agents under the same plan of conversion except where procedures are followed and representations made to ensure that an appraiser is separate from the underwriter or selling agent affiliate and the underwriter or selling agent affiliate does not make recommendations or in any way impact the appraisal; and to prohibit the appraiser from receiving any fees other than the fees for services rendered in connection with the appraisal.

--12 CFR 563b.11 is added to the final rule to include a convenience and needs test to the approval requirements for conversion transactions.

--12 CFR 575.1 is revised to include a provision giving the OTS the ability to grant waivers in writing from any requirement of the **mutual holding company** regulations for good cause shown.

--12 CFR 575.7(a)(7) is added to include a convenience and needs test to the approval requirements for stock issuances of savings association subsidiaries of **mutual holding** companies.

--12 CFR 575.7(d)(2) is revised to provide that the sale of minority shares of capital stock of the savings association to be made under the plan of minority stock issuance, including any sale in a public offering or direct community marketing, shall be completed as promptly as possible and within 45 calendar days after the last day of the subscription period, unless extended by the OTS.

--12 CFR 575.13(a)(4) is revised to clarify the prohibition on the use of ``running'' proxies and the requirement for the use of a specifically designated proxy for a **mutual holding company** reorganization, **mutual**-to-stock conversion undertaken either by a **mutual** savings association or a **mutual holding company**, or any other material transactions.

IV. Paperwork Reduction Act

The reporting requirements contained in this final rule have been submitted to and approved by the Office of Management and Budget (OMB) under OMB Control Nos. 1550-0014, 1550-0071 and 1550-0072 in accordance with the Paperwork Reduction Act of 1980 (44 U.S.C. 3507). Comments on the collection of information should be sent to the Office of Management and Budget, Paperwork Reduction Project (1550-0014, 1550-0071, 1550-0072), Washington, DC 20503 with copies to the Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

The reporting requirements in this final rule are found in 12 CFR 563b.100 and 12 CFR Part 575. The information is needed by the OTS to further strengthen the standards governing the conversion process. The likely recordkeepers are savings associations.

V. Regulatory Flexibility Act

Pursuant to Section 605(b) of the Regulatory Flexibility Act, it is certified that this final rule will not have a significant economic impact on a substantial number of small entities. Accordingly, a final regulatory flexibility analysis is not required.

VI. Executive Order 12866

The OTS has determined that the final regulation does not constitute a ``significant regulatory action'' for purposes of E.O. 12866.

List of Subjects

12 CFR Part 563b

Reporting and recordkeeping requirements, Savings associations, Securities.

12 CFR Part 575

Capital, **Holding** companies, Reporting and recordkeeping requirements, Savings associations, Securities.

For the reasons set out in the preamble, the interim rule amending 12 CFR 563b.2, 563.b.3, 563b.4, 563b.5, 563b.7, 563b.8, 563b.10, 563b.100, 563b.101, and 12 CFR 575.7 and 575.13 which was published on May 3, 1994 at 59 FR 22725 is adopted as final with the following changes and parts 563b and 575 of subchapter D, chapter V, title 12 of the code of Federal Regulations are amended as follows:
Subchapter D--Regulations Applicable to All Savings Associations

PART 563b--CONVERSIONS FROM **MUTUAL** TO STOCK FORM

1. The authority citation for 12 CFR part 563b is revised to read as follows:

Authority: 12 U.S.C. 1462, 1462a, 1463, 1464, 1467a, 2901; 15 U.S.C. 78c, 78l, 78m, 78n, 78w.

2. Section 563b.2 is amended by revising paragraph (a)(19) to read as follows:

Sec. 563b.2 Definitions.

(a) * * *

(19) Local community. The term local community includes all counties in which the converting association has its home office or a branch office, all zip code areas corresponding to the converting association's delineated Community Reinvestment Act service area, each county's metropolitan statistical area and/or such other area or category as delineated by the savings association and provided for in the plan of conversion, as approved by the OTS.

* * * * *

3. Section 563b.3 is amended by:

a. Removing paragraphs (c)(2)(i), (c)(4)(i) and (c)(5)(i);

b. Redesignating paragraphs (c)(2) (ii) and (iii), (c)(4) (ii) through (v) and (c)(5) (ii) and (iii) as paragraphs (c)(2) (i) and

(ii), (c)(4) (i) through (iv) and (c)(5) (i) and (ii), respectively, and by redesignating paragraph (d)(12) as paragraph (d)(13);

c. Revising paragraphs (c)(6)(iv), (c)(23), (g)(3)(i)(B), (g)(3)(i)(D) introductory text, (g)(3)(ii), (g)(4)(vii), (g)(4)(viii), (g)(4)(ix), (g)(4)(x), and (g)(4)(xi); and

d. Adding paragraphs (d)(12), (g)(4)(xii), (g)(4)(xiii), and (g)(4)(xiv).

The revisions and additions read as follows:

Sec. 563b.3 General principles for conversions.

* * * * *

(c) * * *

(6) * * *

(iv) A condition that any direct community offering by the converting savings association shall give a preference to natural persons residing in the association's local community.

* * * * *

(23) Provide that eligible account holders with subscription rights have first priority to purchase conversion stock, tax-qualified employee stock benefit plans have second priority, supplemental eligible account holders have third priority, and other voting members who have subscription rights have fourth priority. If the final conversion stock valuation range exceeds the maximum conversion stock offering range, up to ten percent of the total offering of shares may be sold to the tax-qualified employee stock benefit plans. Furthermore, if the ESOP is not able to purchase conversion stock, the ESOP or any other tax-qualified plan may purchase shares in the open market or utilize authorized but unissued shares only with prior OTS approval; and disclosure must be made in the conversion stock offering materials of the potential open market purchases or use of authorized but unissued shares to fund the ESOP and its effects on the association and its shareholders.

* * * * *

(d) * * *

(12) That the offering of stock to be sold in the subscription offering may give a preference to eligible account holders, supplemental eligible account holders, and other voting members residing in the association's local community.

* * * * *

(g) * * *

(3) * * *

(i) * * *

(B) Repurchases within year two and year three after conversion are part of an open-market stock repurchase program that does not allow for a repurchase of more than 5% of the association's outstanding capital stock during a twelve month period;

* * * * *

(D) The association provides to the Regional Director, with a copy to the Chief Counsel's Office, Business Transactions Division, no later than ten days prior to the commencement of a repurchase program, written notice containing a full description of the repurchase program to be undertaken, the effect of such repurchases on its regulatory capital position, and a valid business purpose for the repurchase; and the Regional Director does not disapprove the repurchase program based upon a determination that:

* * * * *

(ii) During the first three years following conversion, the OTS, in accordance with the standards contained in this paragraph, may permit

stock repurchases in excess of the amounts specified in paragraph (g)(3)(i) of this section, where exceptional circumstances are established.

(4) * * *

(vii) All such plans, prior to establishment and implementation, are approved by the holders of a majority of the total votes eligible to be cast at any duly called meeting of shareholders of the association or its **holding company**, either annual or special, to be held not earlier than six months after completion of the conversion;

(viii) In the case of a savings association subsidiary of a **mutual holding company**, all such plans, prior to establishment and implementation, are approved by the holders (other than its parent **mutual holding company**) of a majority of the total votes eligible to be cast, at any duly called meeting of shareholders, either annual or special, to be held no earlier than six months after completion of the conversion;

(ix) For stock option plans, stock options are granted at no less than the market price at which the stock is trading at the time of grant;

(x) For management or employee stock benefit plans, no conversion stock is used to fund the plans;

(xi) The plans subject to this section must comply with the terms and amounts specified in paragraph (g)(4) of this section;

(xii) The plans subject to this section shall begin vesting no earlier than one year from the date the plans are approved by shareholders, shall not vest at a rate in excess of 20% a year, and shall not provide for accelerated vesting except in the case of disability or death;

(xiii) Disclosure in all proxy and related material distributed to shareholders in connection with the meeting at which the stock option plans and management stock benefit plans will be voted shall state that the plans comply with OTS regulations, that the OTS in no way endorses or approves the plans; and no written or oral representation to the contrary shall be made; and

(xiv) No later than five calendar days from the date of shareholder approval of any stock option or management benefit plans, the institution shall file with the OTS a copy of the approved plans and written certification that the plans approved by the shareholders are the same plans filed with and disclosed in the proxy materials.

* * * * *

4. Section 563b.4 is amended by designating the text of paragraph (b)(1) preceding the notice of filing as paragraph (b)(1)(i) and revising it, and designating the concluding text of paragraph (b)(1) following the notice of filing as paragraph (b)(1)(ii) to read as follows:

Sec. 563b.4 Notice of filing; public statements; confidentiality.

* * * * *

(b) Notice of filing. (1)(i) Immediately upon filing an application for conversion with the Office, the applicant shall publish a notice of the filing. If an application for conversion is not properly executed or is materially deficient or substantially incomplete, the Office may require a new application to be filed, publication of a new notice and an additional 20-day comment period. The applicant shall prominently post the notice in each of its offices and publish the notice in at least one newspaper printed in the English language and having a substantial general circulation in each community in which an office of the applicant is located, as follows:

* * * * *

5. Section 563b.7 is amended by removing the last sentence of paragraph (f)(2) and adding two new sentences in its place to read as follows:

Sec. 563b.7 Pricing and sale of securities.

* * * * *

(f) * * *

(2) * * * No appraiser shall serve as an underwriter or selling agent under the same plan of conversion. No affiliate of an appraiser may act as an underwriter or selling agent unless procedures are followed and representations made to ensure that an appraiser is separate from the underwriter or selling agent affiliate and the underwriter or selling agent affiliate does not make recommendations or in any way impact the appraisal. No appraiser shall receive any other fee except for the fee for services rendered in connection with such appraisal.

* * * * *

6. Section 563b.11 is added to subpart A of part 563b to read as follows:

Sec. 563b.11 Convenience and needs considerations.

In reviewing an application under this subpart, the Office will examine the extent to which the conversion will affect the convenience and needs of the communities to be served by the converted savings association. The Office will review the applicant's record under part 563e of this subchapter. In addition, the Office will scrutinize the business plan of the applicant. Each applicant must demonstrate that the proposed deployment of proceeds contained in its business plan will help meet the credit and lending needs of the communities served by the applicant. Also, the Office will consider other relevant factors relating to the association's performance in meeting the convenience and needs of the community. Based on an assessment of the applicant's record under part 563e of this subchapter, the applicant's business plan and other relevant factors, the Office may approve the application, deny the application, or approve the application on the condition that the applicant improve certain aspects of its CRA performance record or address particular credit or lending needs of the communities that it serves.

PART 575--**MUTUAL** SAVINGS AND LOAN **HOLDING** COMPANIES

7. The authority citation for 12 CFR part 575 is revised to read as follows:

Authority: 12 U.S.C. 1462, 1462a, 1463, 1464, 1467a, 1828, 2901.

8. Section 575.1 is amended by designating the existing text as paragraph (a), by adding a heading to newly-designated paragraph (a), and by adding a new paragraph (b) to read as follows:

Sec. 575.1 Scope.

(a) Purpose. * * *

(b) General. Except as the OTS may otherwise determine, the

Proposed Rules

Federal Register
Vol. 71, No. 139
Thursday, July 20, 2006

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

12 CFR Parts 563b and 575

[No. 2006–29]

RIN 1550–AC07

Stock Benefit Plans in Mutual-to-Stock Conversions and Mutual Holding Company Structures

AGENCY: Office of Thrift Supervision, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Office of Thrift Supervision (OTS) is proposing to clarify its regulations regarding stock benefit plans established after mutual-to-stock conversions or in mutual holding company structures. In addition, OTS proposes to reduce the voting requirements for the adoption of stock benefit plans in mutual holding company structures and to make several other minor changes to the regulations governing mutual-to-stock conversions and minority stock issuances.

DATES: Comments must be received on or before September 18, 2006.

ADDRESSES: You may submit comments, identified by No. 2006–29, by any of the following methods:

- *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments.
- *E-mail: regs.comments@ots.treas.gov.* Please include No. 2006–29 in the subject line of the message, and include your name and telephone number in the message.
- *Fax:* (202) 906–6518.
- *Mail:* Regulation Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552, Attention: No. 2006–29.
- *Hand Delivery/Courier:* Guard's Desk, East Lobby Entrance, 1700 G Street, NW., from 9 a.m. to 4 p.m. on business days, Attention: Regulation Comments, Chief Counsel's Office, Attention: No. 2006–29.

Instructions: All submissions received must include the agency name and docket number or Regulatory Information Number (RIN) for this rulemaking. All comments received will be posted without change to the OTS Internet site at: *http://www.ots.treas.gov/pagehtml.cfm?catNumber=67&an=1,* including any personal information provided.

Docket: For access to the docket to read background documents or comments received go to *http://www.ots.treas.gov/pagehtml.cfm?catNumber=67&an=1.* In addition, you may inspect comments at the Public Reading Room, 1700 G Street, NW., by appointment. To make an appointment for access, call (202) 906–5922, send an e-mail to *public.info@ots.treas.gov,* or send a facsimile transmission to (202) 906–7755. (Prior notice identifying the materials you will be requesting will assist us in serving you.) We schedule appointments on business days between 10 a.m. and 4 p.m. In most cases, appointments will be available the next business day following the date we receive a request.

FOR FURTHER INFORMATION CONTACT: Donald W. Dwyer, (202) 906–6414, Director, Applications, Examinations and Supervision—Operations; Aaron B. Kahn, (202) 906–6263, Assistant Chief Counsel, Business Transactions Division or David A. Permut, (202) 906–7505, Senior Attorney, Business Transactions Division, Office of Chief Counsel, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

SUPPLEMENTARY INFORMATION: Savings associations that propose to convert to stock form are subject to the OTS mutual-to-stock conversion regulations, 12 CFR part 563b (Conversion Regulations). Mutual holding companies (MHCs) are subject to OTS regulations at 12 CFR part 575 (MHC Regulations). Subsidiary mutual holding companies (Subsidiary MHCs) and savings associations (collectively, Subsidiary Companies) in MHC structures that propose to issue common stock in a minority stock issuance (Minority Stock Issuance) [1] are subject to both the Conversion Regulations and the MHC Regulations, including the provisions therein pertaining to stock benefit plans.[2]

OTS last changed the provisions of the Conversion Regulations addressing stock benefit plans in mutual-to-stock conversions or MHC structures in 2002 (2002 amendments).[3] The 2002 amendments revised the MHC Regulations to, among other things, permit the amount of stock includable in stock benefit plans established in MHC structures to be set as if 49.0 percent of the stock was issued to minority shareholders, and added a requirement that certain plans not exceed 25 percent of the stock actually offered in the Minority Stock Issuance. The 25 percent limitation was intended to ensure that insiders did not receive a disproportionate share of small Minority Stock Issuances.

OTS believes that confusion exists regarding the application of the stock benefit plan provisions in the Conversion Regulations and the MHC Regulations. OTS therefore proposes to clarify its regulations on stock benefit plans currently found at 12 CFR 563b.500 and 575.8. These clarifications are not intended to change existing OTS policies regarding stock benefit plans. In addition, OTS proposes to reduce regulatory burden by adjusting the voting requirements for the adoption of stock benefit plans in MHC structures. Also, OTS proposes to allow lower maximum purchase limitations in mutual-to-stock conversion offerings (Conversion Offerings) and in Minority Stock Issuances.

I. Stock Benefit Plans

OTS has permitted the establishment of three types of stock benefit plans in connection with mutual-to-stock conversions and Minority Stock Issuances. These stock benefit plans include: (i) Employee Stock Ownership Plans and similar plans (ESOPs), which must be tax-qualified;[4] (ii) Stock Option

[1] In a Minority Stock Issuance, the Subsidiary Company issues stock to entities other than the parent MHC. The parent MHC must hold more than 50 percent of the common stock of the Subsidiary MHC after the Minority Stock Issuance. See 12 U.S.C. 1467a(o)(8)(B) and 12 CFR 575.7(a)(5).

[2] The MHC Regulations currently include four separate provisions stating that the Conversion Regulations apply in the context of stock issuances by subsidiaries of MHCs. *See,* 12 CFR 575.7(a), 575.7(b)(1), 575.7(d)(6)(ii), and 575.7(e)(2006).

[3] See 67 FR 52010, at 52014 (August 9, 2002).

[4] These plans include 401(k) plans and plans defined at 12 CFR 563b.25 as tax-qualified

Continued

Plans (Option Plans), which are typically non-tax-qualified; and (iii) Management Recognition Plans (MRPs) (sometimes referred to as Retention and Recognition Plans), which are also typically non-tax-qualified.

Section 563b.500 of the Conversion Regulations sets forth certain limitations for stock benefit plans during the year following a Conversion Offering. For example, ESOPs and MRPs are generally limited to holding, in the aggregate, no more than ten percent of the number of shares issued in a mutual-to-stock conversion (§ 563b.500(a)(4)). However, if the converting institution has at least ten percent tangible capital following the completion of the conversion, then ESOPs and MRPs are permitted to hold up to an aggregate of 12 percent of the number of shares issued in the conversion (§ 563b.500(a)(4)). In addition, the Conversion Regulations (§ 563b.500(a)(3)) restrict MRPs to three percent of the number of shares issued in the conversion. If the institution has at least ten percent tangible capital following the completion of the conversion, however, MRPs may encompass four percent of the number of shares issued in the conversion. It has been OTS's experience that most converting associations implement an eight percent ESOP and a four percent MRP when they have at least ten percent tangible capital after the conversion.

In addition, converting associations may offer a separate Option Plan of up to ten percent of the number of shares issued in the conversion (§ 563b.500(a)(2)).

In MHC structures, Subsidiary Companies offer less than 50 percent of their stock to the public. This arrangement creates smaller stock benefit plans for companies in the MHC form. In order to make the MHC form of organization more reasonable, OTS expanded the permissible size of stock benefit plans in the 2002 amendments.[5] Prior to the 2002 amendments, the maximum size of plans was set in relation to the percentage of stock actually offered in the Minority Stock Issuance. For example, if the Subsidiary Company issued only 30 percent of its stock in the Minority Stock Issuance, it would have been restricted to an Option Plan encompassing three percent of total shares outstanding (ten percent of 30 percent) and a combined ESOP and MRP encompassing an aggregate of three percent of the total shares outstanding (or 3.6 percent, if the association's tangible capital exceeded ten percent). In the 2002 amendment, OTS set the maximum size for stock benefit plans as if the Minority Stock Issuance had been 49.0 percent of the Subsidiary Company's stock, regardless of the actual percentage of shares issued in the Minority Stock Issuance.[6]

The 2002 amendment also added an overall limitation, to prevent issuing an excessive amount of stock to management, particularly in small offerings. That restriction limited the aggregate amount of stock issued to all Option Plans and MRPs (but excluding ESOPs) in connection with any Minority Stock Issuance and all prior Minority Stock Issuances, to 25 percent of the outstanding stock of the association held by persons other than the parent MHC.[7] OTS has discovered that some persons incorrectly believed that the 25 percent limit was the only limit on the aggregate size of all Option Plans and MRPs, rather than one of several distinct limitations.

OTS believes that some confusion exists as to how the various limitations in the Conversion and MHC Regulations interact with each other. Therefore, OTS proposes to clarify several of the existing regulations at sections 563b.500, 575.7, and 575.8 to eliminate any confusion.

In addition, as discussed in more detail below, OTS believes that it is appropriate to adjust the shareholder vote requirements for the adoption of benefit plans in MHC structures.

A. Proposed Rule Changes at § 563b.500 Regarding Stock Benefit Plans

OTS proposes to clarify 12 CFR 563b.500 by referring to the specific type of plan addressed (that is, an ESOP, Option Plan, or MRP), rather than referring to plans in terms of their tax-qualified or non-tax-qualified nature. OTS proposes to revise § 563b.500(a)(1) to clarify that a shareholder vote is not required to establish an ESOP. OTS also proposes to move the provision addressing votes on Option Plans and MRPs in the context of MHCs from § 563b.500(a)(7) to the MHC Regulations, because it is more appropriate to locate provisions dealing exclusively with MHC structures in the MHC Regulations.

B. Proposed Rule Changes at § 575.7 Regarding Minority Stock Issuances

Section 575.7 sets forth the general requirements for Minority Stock Issuances by Subsidiary Companies. Section 575.7 provides, in four separate places, that some or all of the requirements of the Conversion Regulations are applicable to Minority Stock Issuances. OTS proposes to streamline the MHC Regulations by removing two of those references.

OTS proposes to retain the general provision at § 575.7(e), which would be redesignated as § 575.7(d), stating that the procedural and substantive requirements of the Conversion Regulations apply to Minority Stock Issuances unless clearly inapplicable. However, OTS proposes to add language to this section similar to the language in current § 575.7(b)(1) clarifying that OTS makes the determination whether a section is clearly inapplicable. OTS also proposes to relocate certain language from § 575.7(b)(1) to proposed § 575.7(d). The language in question states that for purposes of the provision the term "conversion" as it appears in the Conversion Regulations, refers to the Minority Stock Issuance, and the term "converted or converting savings association" as it appears in the Conversion Regulations, refers to the Subsidiary Company making the Minority Stock Issuance.

In light of these proposed changes, OTS proposes to eliminate the cross-references at §§ 575.7(a)[8] and

employee stock benefit plans. Because the only types of tax-qualified plans established in mutual-to-stock conversions in the recent past have been ESOPs, OTS proposes to define the tax-qualified plans as ESOPs, in order to simplify the regulations.

[5] 67 FR 52010, at 52014.

[6] Where a Subsidiary Company sets the size of a stock benefit plan as if it engaged in a 49 percent Minority Stock Issuance, a plan of the same type established in any second-step mutual-to-stock conversion of the relevant MHC must be based on not more than 51 percent of the resulting publicly held association's or holding company's issued and outstanding stock, following the consummation of the second-step conversion. See 12 CFR 563b.500(a). The stock issued and outstanding upon consummation of the second-step conversion includes both the stock issued in accordance with the mutual-to-stock conversion priorities for the second-step conversion and the shares issued in exchange for the shares held by the Subsidiary Company's minority stockholders.

If the Subsidiary Company sets the size of the stock benefit plan based on a percentage less than 49 percent (such as the actual percentage issued in the Minority Stock Issuance), then the same principle applies. For example, if a Subsidiary Company established plans based on an actual 40 percent Minority Stock Issuance, then the plans established in connection with the second-step conversion must be based on not more than 60 percent of the shares to be issued in the second-step conversion. This is the case regardless of whether, after the Minority Stock Issuance, the Subsidiary Company repurchased shares of its stock (and therefore more than 60 percent of the shares that will be issued and outstanding upon consummation of the second-step conversion would be issued in accordance with the mutual-to-stock conversion priorities).

[7] For example, the overall limitation for a 28 percent Minority Stock Issuance would be no more than seven percent for the Option Plan and MRP (25 percent of 28 percent equals seven percent) for the proposed issuance, plus all prior issuances.

[8] Eliminating the cross-reference in § 575.7(a) does not remove the requirement that MHCs must file business plans in connection with Minority

575.7(b)(1). OTS proposes to keep the reference at § 575.7(d)(6)(ii), however, because the cross-reference permits an applicant to engage in a Minority Stock Issuance that does not meet the mutual-to-stock conversion priorities if the applicant demonstrates that a non-conforming issuance is appropriate.

OTS proposes to revise and relocate § 575.7(b)(2). This section provides that, unless OTS determines otherwise, the limitations on the minimum and maximum amounts of the estimated price range required by 12 CFR 563b.330 do not apply. OTS has applied the limitations in 12 CFR 563b.330 in all Minority Stock Issuances, except in cases where the issuance involved only stock benefit plans or an acquisition. Accordingly, OTS proposes to revise this section to state that § 563b.330 will apply to Minority Stock Issuances, unless OTS determines otherwise, and to recodify this provision, as modified, at § 575.7(a)(9).

OTS proposes to eliminate 12 CFR 575.7(b)(3), which requires stock offering materials to disclose the amount of any discount on minority stock, and how the amount of the discount was determined. The general securities offering disclosure requirements, which require disclosure of material information, are sufficient to address the issue of disclosure of the amount and reasons for any discount on minority stock.

C. Proposed Rule Changes at § 575.8 Regarding Stock Benefit Plans

Section 575.8 contains the current limitations for stock benefit plans in MHC structures. OTS proposes to clarify the § 575.8 provisions pertaining to stock benefit plans in several respects. First, as with § 563b.500, OTS proposes to replace the references to tax-qualified and non-tax-qualified benefit plans in § 575.8(a) with references to a specific type of plan (that is, the ESOP, Option Plan, or MRP). Second, OTS proposes to include language in § 575.8 stating that the quantitative limitations regarding the size of ESOPs, Option Plans, and MRPs set forth in § 575.8 supersede the related quantitative limits in proposed sections 563b.500(a)(2) through 563b.500(a)(4). This change should reduce regulatory burden by eliminating the need for Subsidiary Companies to consider both the MHC Regulations and the Conversion Regulations to determine the permissible size of certain stock benefit plans. Third, in order to provide clarity and to reduce existing regulatory burdens, OTS proposes to amend § 575.8 to state that the restrictions set forth in proposed sections 563b.500(a)(4) through 563b.500(a)(14) apply in the context of a Minority Stock Issuance for only one year after the Subsidiary Company engages in a Minority Stock Issuance that is conducted in accordance with the purchase priorities set forth in the Conversion Regulations. Each such Minority Stock Issuance would start a new one-year period.

In order to further clarify the MHC Regulations and to eliminate certain unintended inconsistencies between the Conversion Regulations and the MHC Regulations, OTS is making three additional changes. First, the Conversion Regulations (at current § 563b.500(a)(3) and proposed § 563b.500(a)(3)(ii)) include a separate limitation regarding the size of MRPs. Notwithstanding the lack of a specific provision in the MHC Regulations addressing MRPs, OTS has consistently applied such a requirement in the context of Minority Stock Issuances, by applying the plan limits in the Conversion Regulations to Minority Stock Issuances.[9] Therefore, OTS proposes to include a corresponding limitation on the size of MRPs in § 575.8.

Second, the Conversion Regulations (at current § 563b.500(a)(4), and proposed § 563b.500(a)(3)(i)) include a limitation on the combined size of the ESOP and MRP. The current MHC Regulations do not include an aggregate limitation on ESOPs and MRPs. However, OTS has consistently applied such a restriction to Minority Stock Issuances, based on the cross-reference to the Conversion Regulations. In order to conform the MHC Regulations to the Conversion Regulations, OTS proposes to revise the MHC Regulations to explicitly include an aggregate limitation on ESOPs and MRPs. In addition to aggregate limitations on ESOPs and MRPs, OTS proposes to retain the existing aggregate limitation on the size of the Option Plans and MRPs set forth at § 575.8(a)(9) of the MHC Regulations.

Third, the Conversion Regulations impose a higher limitation on the size of MRPs and a higher aggregate limitation on the size of ESOPs and MRPs if the association in question has tangible capital exceeding ten percent. Again, OTS consistently has applied this provision of the Conversion Regulations to Minority Stock Issuances. The MHC Regulations do not include a corresponding provision, and OTS proposes to amend the MHC Regulations to eliminate this disparity.

Furthermore, OTS believes that the presence of language addressing individual purchase limitations (and those involving individuals and their associates) in sections 575.8(a)(3) and (a)(4) is confusing. These provisions, to the extent they pertain to individuals and their associates, are unnecessary because the Conversion Regulations provide the necessary limitations.[10] In addition, the usefulness of such provisions in the MHC regulations is limited, because the limitations in §§ 575.8(a)(3) and (a)(4) do not include shares acquired in the secondary market. Accordingly, OTS proposes to eliminate the reference to purchases by individuals and their associates presently set forth in sections 575.8(a)(3) and (a)(4) from the MHC Regulations.

In addition, OTS is clarifying sections 575.8(a)(3) through (a)(9) to make it clear that the limitations on benefit plans will be set in relation to the stock or equity outstanding at the close of the most recent Minority Stock Issuance made in conjunction with the promulgation of a benefit plan. Also, in sections 575.8(a)(7), OTS is clarifying that, when a plan is adopted or modified more than one year after a Minority Stock Issuance, the limitations in sections 575.8(a)(3) through (a)(6) may be exceeded to the extent that: (i) Awards in excess of those limitations are made with stock purchased in the secondary market; and (ii) such purchases take place at least one year after the most recent Minority Stock Issuance that is made in substantial conformity with the purchase priorities set out in part 563b.

Similarly, in § 575.8(a)(8)(ii), OTS proposes to clarify that when a plan is adopted or modified more than one year after a Minority Stock Issuance, the limitations in § 575.8(a)(8)(i) may be exceeded to the extent that: (i) Awards in excess of those limitations are made with stock purchased in the secondary market; and (ii) such purchases take place at least one year after the most recent Minority Stock Issuance that is made in substantial conformity with the purchase priorities set out in part 563b.

In addition, in § 575.8(a)(9), OTS proposes to clarify that the limitation therein presents a separate limitation on

Stock Issuances. Under proposed § 575.7(d), all procedural and substantive requirements in the Conversion Regulations apply to Minority Stock Issuances, unless clearly inapplicable.

[9] Because OTS proposes to simplify the MHC Regulations to provide that institutions proposing Minority Stock Issuances would need to look only at § 575.8 to determine the permissible size of their stock benefit plans, repeating this restriction, and the restrictions described below, in the MHC Regulations is necessary.

[10] See 12 CFR 563b.370 (2006).

Option Plans and MRPs that applies to each Minority Stock Issuance. However, that limitation does not require reductions in otherwise permissible awards under an existing plan when there is a subsequent Minority Stock Issuance where the excess results from intervening purchases by individuals in the secondary market.

As mentioned previously, OTS proposes to move the last sentence in current § 563b.500(a)(7), pertaining to mutual holding companies, to new § 575.8(c). This sentence currently requires that a majority of the outstanding minority shares approve any Option Plan and any MRP (in addition to the requirement that a majority of all shares approve any Option Plan and any MRP). Because OTS believes the current provisions are unduly restrictive, OTS proposes two changes to the minority vote requirement proposed at § 575.8(c). First, OTS proposes to revise the provision to require a vote of the minority shareholders only during the first year after a Minority Stock Issuance that was conducted in accordance with the mutual-to-stock conversion subscription priorities. Second, OTS proposes to revise the provision to require approval (during the first year after a Minority Stock Issuance) by a majority of the minority shares voting on the issue of adoption of the plan, rather than a majority of the outstanding minority shares.

II. Maximum Purchase Limitation

OTS proposes to increase an institution's choices regarding maximum purchase limitations. Section 563b.385 addresses maximum purchase limitations for subscriptions in mutual-to-stock conversions. Currently, converting savings associations are permitted to set a maximum purchase limitation between one and five percent of the stock sold. OTS has received many requests to waive the purchase limitations. This is particularly appropriate in the case of larger offerings, where a one percent limit would constitute a very large investment. Because OTS's policy is to achieve as widespread a distribution of stock as possible (see § 563b.395), the request for a waiver to set a smaller maximum purchase limitation is often granted. OTS proposes to amend this section to permit smaller purchase limitations.

III. Solicitation of Comments

A. Solicitation of Comments on the Proposed Amendments

OTS is requesting comment on all aspects of the proposed regulation. Specifically OTS seeks comment on:

(1) Does the proposed regulation accomplish its stated purposes?

(2) Does the proposed regulation eliminate ambiguities regarding stock benefit plans in mutual-to-stock conversions?

(3) Does the proposed regulation create any ambiguities that were not present in the current regulation?

(4) Does the proposed regulation impose unnecessary regulatory burdens?

B. Solicitation of Comments Regarding the Use of Plain Language

Section 722 of GLBA requires Federal banking agencies to use "plain language" in all proposed and final rules published after January 1, 2000. OTS invites comments on how to make this proposed rule easier to understand. For example:

(1) Have we organized the material to suit your needs? If not, how could we better organize it?

(2) Do we clearly state the requirements in the rule? If not, how could we state the rule more clearly?

(3) Does the rule contain technical language or jargon that is not clear? If so, what language requires clarification?

(4) Would a different format (grouping and order of sections, use of headings, paragraphing) make the rule easier to understand? If so, what changes to the format would make the rule easier to understand?

V. Regulatory Findings

A. Paperwork Reduction Act

OTS has determined that this proposed rule does not involve a change to collections of information previously approved under the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*).

B. Executive Order 12866

The Director of OTS has determined that this proposed rule does not constitute a "significant regulatory action" for purposes of Executive Order 12866.

C. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (RFA) (5 U.S.C. 601), the Director certifies that this proposed rule will not have a significant economic impact on a substantial number of small entities. The proposed rule would make certain changes that should reduce burdens on all savings associations, including small institutions. First, the proposed rule addresses the confusion surrounding compliance with OTS regulations regarding stock benefit plans in connection with mutual-to-stock conversions and Minority Stock Issuances. These clarifications will reduce the burden of complying with the OTS regulations on stock benefit plans. Second, OTS has reduced the voting requirement to adopt stock benefit plans in MHC structures, which reduces burden on institutions establishing stock benefit plans. Finally, the proposed rule will reduce burden by broadening the purchase limitations, thereby promoting a wider distribution of stock in a Conversion Offering or Minority Stock Issuance. All of the proposed changes are minor and should not have a significant impact on small institutions. Accordingly, OTS has determined that a Regulatory Flexibility Analysis is not required.

D. Unfunded Mandates Reform Act of 1995

OTS has determined that the proposed rule will not result in expenditures by state, local, or tribal governments or by the private sector of $100 million or more and that a budgetary impact statement is not required under section 202 of the Unfunded Mandates Reform Act of 1995, Public Law 104–4 (Unfunded Mandates Act). The proposed rule would make certain changes that should reduce burdens on savings associations. First, the proposed rule clarifies OTS regulations regarding stock benefit plans in connection with mutual-to-stock conversions and Minority Stock Issuances, which should reduce the burden of complying with the OTS regulations on stock benefit plans. Second, OTS has reduced the voting requirement to adopt stock benefit plans in MHC structures, which reduces burden on institutions establishing stock benefit plans. Finally, the proposed rule will reduce burden by broadening the purchase limitations, to promote a wider distribution of stock in a Conversion Offering or Minority Stock Issuance. All of the proposed changes are minor and should not have a significant impact on small institutions. Accordingly, a budgetary impact statement is not required under section 202 of the Unfunded Mandates Act.

List of Subjects

12 CFR Part 563b

Reporting and recordkeeping requirements, Savings associations, Securities.

12 CFR Part 575

Administrative practice and procedure, Capital, Holding companies, Reporting and recordkeeping requirements, Savings associations, Securities.

Accordingly, the Office of Thrift Supervision proposes to amend Chapter V of title 12 of the Code of Federal Regulations, as set forth below.

PART 563b—CONVERSIONS FROM MUTUAL TO STOCK FORM

1. The authority citation for part 563b continues to read as follows:

Authority: 12 U.S.C. 1462, 1462a, 1463, 1464, 1467a, 2901; 15 U.S.C. 78c, 78l, 78m, 78n, 78w.

§ 563b.385 [Amended]

2. Amend § 563b.385(a) by removing the phrase "between one percent and" and adding the words "up to" in place thereof.

3. Revise § 563b.500 to read as follows:

§ 563b.500. What management stock benefit plans may I implement?

(a) During the 12 months after your conversion, you may implement a stock option plan (Option Plan), an employee stock ownership plan or other tax-qualified employee stock benefit plan (collectively, ESOP), and a management recognition plan (MRP), provided you meet all of the following requirements.

(1) You disclose the plans in your proxy statement and offering circular and indicate in your offering circular that there will be a separate shareholder vote on the Option Plan and the MRP at least six months after the conversion. No shareholder vote is required to implement the ESOP. Your ESOP must be tax-qualified.

(2) Your Option Plan does not encompass more than ten percent of the number of shares that you issued in the conversion.

(3)(i) Your ESOP and MRP do not encompass, in the aggregate, more than ten percent of the number of shares that you issued in the conversion. If you have tangible capital of ten percent or more following the conversion, OTS may permit your ESOP and MRP to encompass, in the aggregate, up to 12 percent of the number of shares issued in the conversion; and

(ii) Your MRP does not encompass more than three percent of the number of shares that you issued in the conversion. If you have tangible capital of ten percent or more after the conversion, OTS may permit your MRP to encompass up to four percent of the number of shares that you issued in the conversion.

(4) No individual receives more than 25 percent of the shares under your ESOP, MRP, or Option Plan.

(5) Your directors who are not your officers do not receive more than five percent of the shares of your MRP or Option Plan individually, or 30 percent of any such plan in the aggregate.

(6) Your shareholders approve each of the Option Plan and the MRP by a majority of the total votes eligible to be cast at a duly called meeting before you establish or implement the plan. You may not hold this meeting until six months after your conversion.

(7) When you distribute proxies or related material to shareholders in connection with the vote on a plan, you state that the plan complies with OTS regulations and that OTS does not endorse or approve the plan in any way. You may not make any written or oral representations to the contrary.

(8) You do not grant stock options at less than the market price at the time of grant.

(9) You do not fund the Option Plan or the MRP at the time of the conversion.

(10) Your plan does not begin to vest earlier than one year after shareholders approve the plan, and does not vest at a rate exceeding 20 percent per year.

(11) Your plan permits accelerated vesting only for disability or death, or if you undergo a change of control.

(12) Your plan provides that your executive officers or directors must exercise or forfeit their options in the event the institution becomes critically undercapitalized (as defined in § 565.4 of this chapter), is subject to OTS enforcement action, or receives a capital directive under § 565.7 of this chapter.

(13) You file a copy of the proposed Option Plan or MRP with OTS and certify to OTS that the plan approved by the shareholders is the same plan that you filed with, and disclosed in, the proxy materials distributed to shareholders in connection with the vote on the plan.

(14) You file the plan and the certification with OTS within five calendar days after your shareholders approve the plan.

(b) You may provide dividend equivalent rights or dividend adjustment rights to allow for stock splits or other adjustments to your stock in your ESOP, MRP, and Option Plan.

(c) The restrictions in paragraph (a) do not apply to plans implemented more than 12 months after the conversion, provided that materials pertaining to any shareholder vote regarding such plans are not distributed within the 12 months after the conversion. If a plan adopted in conformity with paragraph (a) is amended more than 12 months following your conversion, your shareholders must ratify any material deviations to the requirements in paragraph (a) of this section.

PART 575—MUTUAL HOLDING COMPANIES

4. The authority citation for part 575 continues to read as follows:

Authority: 12 U.S.C. 1462, 1462a, 1463, 1464, 1467a, 1828, 2901.

§ 575.7 [Amended]

5. Amend § 575.7(a) by removing the first sentence.

6. In § 575.7(b), redesignate paragraph (b)(2) as (a)(9) and remove the word "not" in that paragraph, remove the remaining text in paragraph (b), redesignate paragraphs (c), (d), and (e) as paragraphs (b), (c), and (d), and revise newly designated paragraph (d) to read as follows:

(d) *Procedural and substantive requirements.* The procedural and substantive requirements of 12 CFR part 563b shall apply to all mutual holding company stock issuances under this section, unless clearly inapplicable, as determined by OTS. For purposes of this paragraph (d), the term *conversion* as it appears in the provisions of part 563b of this chapter shall refer to the stock issuance, and the term *converted* or *converting savings association* shall refer to the savings association undertaking the stock issuance.

7. Revise paragraphs (a)(3) through (a)(9) of § 575.8 to read as follows:

§ 575.8 Contents of stock issuance plans.

(a) Mandatory provisions. * * *

* * * * *

(3) Provide that all employee stock ownership plans (ESOPs) must not encompass, in the aggregate, more than either 4.9 percent of the outstanding shares of the savings association's common stock or 4.9 percent of the savings association's stockholders' equity at the close the proposed issuance.

(4) Provide that all ESOPs and management recognition plans (MRPs) must not encompass, in the aggregate, more than either 4.9 percent of the outstanding shares of the savings association's common stock or 4.9 percent of the savings association's stockholders' equity at the close of the proposed issuance. However, if the savings association's tangible capital equals at least ten percent at the time of implementation of the plan, OTS may permit such ESOPs and MRPs to

encompass, in the aggregate, up to 5.88 percent of the outstanding common stock or stockholders' equity at the close of the proposed issuance.

(5) Provide that all MRPs must not encompass, in the aggregate, more than either 1.47 percent of the common stock of the savings association or 1.47 percent of the savings association's stockholders' equity at the close of the proposed issuance. However, if the savings association's tangible capital is at least ten percent at the time of implementation of the plan, OTS may permit MRPs to encompass, in the aggregate, up to 1.96 percent of the outstanding shares of the savings association's common stock or 1.96 percent of the savings association's stockholders' equity at the close of the proposed issuance.

(6) Provide that all stock option plans (Option Plans) must not encompass, in the aggregate, more than either 4.9 percent of the savings association's outstanding common stock at the close of the proposed issuance or 4.9 percent of the savings association's stockholders' equity at the close of the proposed issuance.

(7) A plan modified or adopted no earlier than one year after the close of the proposed issuance, or any subsequent issuance that is made in substantial conformity with the purchase priorities set forth in Part 563b, may exceed the percentage limitations contained in paragraphs 3 through 6 (plan expansion), subject to the following two requirements. First, all common stock awarded in connection with any plan expansion must be acquired for such awards in the secondary market. Second, such acquisitions must begin no earlier than when such plan expansion is permitted to be made.

(8)(i) Provide that the aggregate amount of common stock that may be encompassed under all Option Plans and MRPs, or acquired by all insiders of the association and associates of insiders of the association, must not exceed the following percentages of common stock or stockholders' equity of the savings association, held by persons other than the savings association's mutual holding company parent at the close of the proposed issuance:

Institution size	Officer and director purchases (percent)
$50,000,000 or less	35
$50,000,001–100,000,000	34
$100,000,001–150,000,000	33
$150,000,001–200,000,000	32
$200,000,001–250,000,000	31
$250,000,001–300,000,000	30
$300,000,001–350,000,000	29
$350,000,001–400,000,000	28
$400,000,001–450,000,000	27
$450,000,001–500,000,000	26
Over $500,000,000	25

(ii) The percentage limitations contained in paragraph 8(i) may be exceeded provided that all stock acquired by insiders and associates of insiders or awarded under all MRPs and Option Plans in excess of those limitations is acquired in the secondary market. If acquired for such awards on the secondary market, such acquisitions must begin no earlier than one year after the close of the proposed issuance or any subsequent issuance that is made in substantial conformity with the purchase priorities set forth in part 563b.

(iii) In calculating the number of shares held by insiders and their associates under this provision, shares awarded but not delivered under an ESOP, MRP, or Option Plan that are attributable to such persons shall not be counted as being acquired by such persons.

(9) Provide that the amount of common stock that may be encompassed under all Option Plans and MRPs must not exceed, in the aggregate, 25 percent of the outstanding common stock held by persons other than the savings association's mutual holding company parent at the close of the proposed issuance.

8. Add a new paragraph (c) to § 575.8, to read as follows.

(c) *Applicability of provisions of § 563b.500(a) to minority stock issuances.* Notwithstanding § 575.7(d) of this part, §§ 563b.500(a)(2) and (3) do not apply to minority stock issuances, because the permissible sizes of ESOPs, MRPs, and Option Plans in minority stock issuances are subject to each of the requirements set forth at paragraphs (a)(3) through (a)(9) of this section. Sections 563b.500(a)(4) though (a)(14) apply for one year after the savings association engages in a minority stock issuance that is conducted in accordance with the purchase priorities set forth in part 563b. In addition to the shareholder vote requirement for Option Plans and MRPs set forth at § 563b.500(a)(6), any Option Plans and MRPs put to a shareholder vote during the year after a minority stock issuance that is conducted in accordance with the purchase priorities set forth in part 563b must be approved by a majority of the votes cast by stockholders other than the mutual holding company.

Dated: July 11, 2006.

By the Office of Thrift Supervision.

John M. Reich,

Director.

[FR Doc. E6–11278 Filed 7–19–06; 8:45 am]

BILLING CODE 6720–01–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 33

[Docket No. FAA–2006–25375; Notice No. 06–09]

RIN 2120–AI73

Airworthiness Standards; Engine Bird Ingestion

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Notice of proposed rulemaking (NPRM).

SUMMARY: The FAA is proposing to amend the aircraft turbine engine type certification standards to reflect recent analysis of the threat flocking birds present to turbine engine aircraft. These proposed changes would also harmonize FAA, Joint Aviation Authority (JAA), and European Aviation Safety Agency (EASA) bird ingestion standards for aircraft turbine engines type certificated by the United States and the JAA/EASA countries, and simplify airworthiness approvals for import and export. These proposed changes are necessary to establish uniform international standards that provide an adequate level of safety for aircraft turbine engines with respect to the current large flocking bird threat.

DATES: Send your comments on or before September 18, 2006.

ADDRESSES: You may send comments [identified by Docket Number FAA–2006–25375] using any of the following methods:

- DOT Docket Web site: Go to *http://dms.dot.gov* and follow the instructions for sending your comments electronically.
- Government-wide rulemaking Web site: Go to *http://www.regulations.gov* and follow the instructions for sending your comments electronically.
- Mail: Docket Management Facility; U.S. Department of Transportation, 400 Seventh Street, SW., Nassif Building, Room PL–401, Washington, DC 20590–0001.
- Fax: 1–202–493–2251.
- Hand Delivery: Room PL–401 on the plaza level of the Nassif Building,