Comments as Submitted, May 9, 2002

Attention: Docket No. 2000-11

"Mutual Savings Associations, Mutual Holding Company Reorganizations, and Conversions From Mutual to Stock Form"

From: Ed Fraser
195 Marine Street
Farmingdale, NY 11735
Tel: 631-293-7393
E-mail: efraser@msn.com
May 9, 2002

To:
regs.comment@ots.treas.gov
Attention Docket No. 2002-11
[submitted by e-mail]
or FAX Number (202) 906-6518,
Attention Same Docket No. 2002-11
Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
General E-mail: public.info@ots.treas.gov

Dear Sirs:

After reading through the new Proposed Rules, it is easy to feel a bit of a step backward after 18 months since the last comment period closed. It is often quite disappointing to read at the end of small sections through the document "After considering the comments ... OTS is re-proposing the regulation as originally proposed." This is disappointing when some of the comment letters submitted for Dockets 2000-56 and 2000-57 addressed several additional shortcomings that are truly shortcomings. Additionally, subsequent conversations with OTS publicly and privately indicated their intention to correct or at least address some of those problems. My immediate reaction is that basically only conflicts between regulatory agencies, and mis-statements of detail, where actually changed. However, I realize that other changes have been put into place and routinely followed. Also, to be fair, this is a big task, and there also is at least one exception. It was marketplace created, not regulator created, but it is new. Since July 2000, there have been several re-mutualization transactions, and dealing with this fairly is now addressed.

I note that the earlier enthusiastic call for comments that surrounded release of Dockets 2000-56 and 2000-57 is not in 2002-11, either. Perhaps it was viewed as too big an agenda, although comment on some of the thoughts would have been of interest. Especially disappointing is that there is no reference now to any request for comments from "Investors" specifically, even though many of the issues the OTS addresses here relate more to that aspect than to banking "safety and soundness" issues.

While perhaps it is perceived that all bank stocks have had strong investor demand and good price appreciation since July 2000 when the original Docket requests were made, and therefore this is an issue that has taken care of itself and doesn't need to be addressed, that would be a serious mistake. A major part of that appreciation was recovery, in part certainly helped initially by the proposals for a few new OTS rules [about stock buyback and dividend waivers]. There are still issues that need to be addressed that might help maintain a more investor friendly perception. That might also help preclude the loss of confidence in these stocks for the 2 years preceding July 2000 when so many investors "lost heart" and lost money investing in their local community bank stock offerings – and sold out at losses.

I would add that referencing the 46 comment letters for Dockets 2000-56 and 2000-57 of course offers additional thoughts not referenced currently. This includes comments I also have submitted, and still feel relate to this topic.

One final request, which would require a change in current procedure and requirements: It would be wonderful if an agency requesting comment, and receiving comment [in this case back in November 2000] could acknowledge that, especially to notify those who submitted the 46 comment letters that the result of that effort has been published, and that there will be a new comment period running from April 6, 2002 through May 9, 2002.

I greatly appreciate your consideration.

Sincerely,

Ed Fraser

Additional Comments by Section:

IV. Item-by-item Summary, sections A to D concerning Business Plans.

There are two philosophical views that I think are against the currently described business plan.

First, from an investor's view, common stock or equity must be viewed as high-cost capital. Selling stock to raise equity capital for an already well-capitalized institution is not going to be justifiable in all but the absolutely most extreme cases. This is not an industry with a large need for capital to expand, restructure, or modernize. Hence, ROE and ROA justifications are not an honest criteria, so the resulting conclusions will of course be forced or contrived, just to satisfy the regulatory requirement.

Second, trying to have a fair overview, a depository institution can choose to operate in one of three forms.

- It can operate as a non-profit, like the Salvation Army, and even be run by people working for no pay or modest pay. In that form, efficiently run, it can be a wonderful community institution – like some of the original building societies in this country over 150 years ago. However, they are a volunteer effort pretty much unaffected by tax incentives [they don't earn much money] or other regulatory encouragement.
- It can operate as a mutual institution that seeks to be efficiently run and provide lower cost services by deliberately having a low return on equity.
- It can operate as either a stock or mutual institution, seek to be efficiently run, and seek to earn a proper ROE. In our society, capital and risk always flow in the long term to where that capital has

the best risk-adjusted return, the basic definition of capitalism. An institution seeking the best long-term business approach is certainly justified in trying to do this.

I would wonder about an Institution in the first or second case converting to stock form – kind of like the Salvation Army selling stock. However, in the third case, I see mutuality as an historic anachronism. As time goes along, the buildup in "un-owned" equity also builds up contentiousness about how it is used, who can benefit from it, etc., etc. The conversion rules of decades past tried to focus on converting by distributing ownership in a fair way. Realistically, I prefer to say "a somewhat fair way," because that is the best we can achieve. I think this is the real approach. The Regulators' role should not be to require "business" reasons for conversion. Sometimes it helps to look from the other extreme. In some cases perhaps it could be asked if there should be a "business plan" for an institution to stay as a mutual – perhaps demonstrate a low ROE goal, full disclosure of all management perks, etc.?

Conclusion: There should be no plan or need required to change to an MHC or stockholder owned institution.

IV. Item-by-item Summary, section E concerning MHC's and Mutuality

Enhancing the attractiveness of the MHC structure does require enhancing its attractiveness to the investor – whether employee, depositor, or outside investor. This not only includes making the structure more transparent, but also having fewer things undefined. Some specific needs:

1. Currently, stock is sold to the public and significant capital raised. Frequently the market price of these shares has later been far below their replacement value, significantly below a price other institutions would be willing to sell their similar assets at, and sometimes even below their original price. It is an easy decision to see the value in buying shares back. However, buying them back in the current MHC owned intermediate holding company is odd. By buying these shares using money raised from public investors but "assigned" to the MHC, the majority percentage of any benefit of the stock repurchase accrues to enhancing the value of the non-subscribing depositors' shares. Not only do I view this as happening at the subscribing depositors [or stockholders'] expense, but the current procedure for a second step effectively calls for reselling that majority portion of these shares in the second step. Depending on the market climate at that time, there can wind up being an actual loss because those shares effectively wind up being resold cheaper than they were bought back at. The effect is to create uncertainty in what should be a real value in stock buyback. Conceptually this can be easily solved, but not without some legal work for the lawyers.

   Currently, the Intermediate Mutual Holding Company is in the wrong place! There should instead – or in addition – be an intermediate holding company owned by the minority shareholders. The minority shares issued by the MHC represent a fixed percentage established at conversion or when this intermediate holding company is set up, and shares are issued by it to the public stockholders. Initially the shares might be exactly equivalent to MHC shares, but as the intermediate holding company bought back shares, this ratio would change. The constant would be that the same percentage of the MHC would always be owned by the minority shareholders – it would not drop due to stock buybacks.

   Consider the problem another way. If an MHC is 40% publicly owned and they pay a $1.00 cash dividend, after even 40% in income taxes a stockholder would have $.60 left that could be used to buy stock personally. If this same MHC instead pays no dividend and used the $1.00 to buy stock, the stockholder's portion is really only $.40, as that's the stockholders' 40% interest in the $1.00. Hence, a stockholder in this MHC gets $.60, or 50% more value out of a cash dividend, after tax at a top rate, than out of the $.40 worth of stock from a buyback.

Whether this new Intermediate Mutual Holding Company is set up after the stock offering, or as part of the stock offering, it should correct another one of the shortcomings of the structure. I could add that if it were set up with the initial stock offering, there can be additional ways that offering proceeds can be handled and retained that could further enhance the MHC idea.

A concern might be that there is a requirement to protect the interests of the depositors, and this may be unfair to them in some way. Definition of this responsibility would be in everyone's interest. *Inserting the comment from my #2000-56 comments:*

I think it is a questionable agenda to have to accrue earnings, book value, and other enhancements to increase the value of the unsold shares of the MHC, for the supposed benefit of those who freely elected not to buy shares in the first offering. To incentivise investors to own the stock, and management to apply focused diligence to make the institution more valuable, the issued stock has to get, or have the potential to get, more underlying value. While it is specified that there is a fiduciary duty to "protect the interests of the depositors", this is a nebulous concept. It is not clear that there really must be any obligation to preserve depositors' equity in an MHC institution indefinitely after they have had that opportunity to buy stock. More importantly, I think **it should be specifically spelled out that *there should be absolutely no* requirement *to grow or enhance that equity amount attributed to the unsold shares.* That would then be in the offering prospectus, would clarify a board's obligations, and would define the understanding for the regulators as well.**

2. Mutual institutions have by free choice established good charitable endeavors in their communities over the years, some being "institutionalized" by setting up specific trust funds and charitable foundations. However, once capital is raised by selling shares to stockholders, this creates a new constituency with some interest in the conservancy of any asset. Currently these stockholders have provided part of the capital in the majority owned MHC part, and that adds a problem. A solution would be to expressly state that an MHC with minority stockholders cannot in any case establish or donate funds to set up a charitable foundation or trust as part of a full conversion, or "second step", even should the shares or funds be supposedly solely out of the MHC itself [because that isn't fully the actual case]. There is a serious fiduciary responsibility to minority shareholders that would come into question, and a regulatory statement about that would eliminate any pressures inside or outside the institution to so distribute capital. It would also save likely litigation costs that could arise from efforts to set up such a charity.

Item-by-item Summary, section I concerning Charitable Organizations:

In addition to the comments immediately above specifically about MHC "second step" Charitable Foundations", the following would be a most important change for any MHC or Standard Conversion offering. In this section, OTS wording provides for the creation of a charitable foundation using cash or company stock. **It is very desirable for this to be also possible using instead specific assets the bank may currently have – in particular current securities holdings.** There are many benefits to doing that instead of cash or bank shares. In the current theme of diversification being politically correct, have different securities not related to the bank's stock should be acceptable. More importantly, however, it allows the use of appreciated securities that the bank might already own. It also dilutes the other stockholder's shares less for the exact same stated "dollar value" of the gift. In some cases, appreciated securities had been used by an institution to fund a charitable foundation in prior years as a mutual, so the idea is not a new philosophy in giving.

Item-by-item Summary, section N concerning Mutual Holding Company Revisions:
Part 3. Second Step Conversions of MHC's:

Existing MHC stock, and the stockholders themselves, are given extra uncertainty and true second-class rights to participate in a "second step" offering. Also, the amount of that ownership should not be regulated beyond the current rules already in place in other regulations.

Currently, stockholder capital forms some of the capital of the majority owned portion of the MHC, and the sale of stock represents both a market risk and a dilution of the outstanding stock. For both these reasons, it would be fair to give existing stockholders priority rights to buy additional stock, not rights below everyone else except community [and in some cases worse than community]

Additionally, **a stockholder's right to buy stock should not be reduced by the number of shares already owned**. This happens whether the shareholder is an employee, depositor, or outside investor. It also creates offerings where the management may have a different agenda in the stock sale because they are precluding from buying shares because of their existing holdings. While it might seem a well-meaning goal to offer as many people as possible a chance to buy stock, this should not be at the expense of existing holders who have had their money at risk when others chose not to. Also, whether management chooses to buy stock or not is usually a meaningful criteria for the average investor to consider -- yet, here that information may well be lacking for an arbitrary reason. Of course, any regulatory limits envisioned in the conversion rules from the 1970's and 1980's are not generally involved at all here. They still can apply, of course, but the current "deduction for existing shares held" probably precludes just about any institution from reaching group ownership of even a fraction of that amount.