OFFICE OF THRIFT SUPERVISION

Approval of Holding Company Application,
Bank Merger Act Application, And Related Filings

Order No.: 2004-22
Date: April 23, 2004
Docket Nos.: H-3730, H-3731, 01272, H-2809, H-3202

Northwest Bancorp, MHC, Warren, Pennsylvania (Holding Company) has applied pursuant to 12 U.S.C. § 1467a(e) and 12 C.F.R. § 574.3, for approval of the Office of Thrift Supervision (OTS) to acquire First Carnegie Deposit, Carnegie, Pennsylvania (Association). In addition, the Association has applied pursuant to 12 U.S.C. § 1828(c) and 12 C.F.R. § 563.22(a), for OTS approval of the merger of an interim federal savings association (Interim) with and into the Association. The Association has also applied to OTS to make a capital distribution under the OTS Capital Distribution Regulations. (The foregoing filings are collectively referred to as the Applications.)

The Applications

The Holding Company, the top-tier holding company in a federally chartered mutual holding company structure, owns approximately 59 percent of Northwest Bancorp, Inc., Warren, Pennsylvania (Mid-Tier 1), a mid-tier, federally chartered mutual holding company, which owns all of the common stock of two state-chartered savings banks, Northwest Savings Bank, Warren, Pennsylvania (Savings Bank) and Jamestown Savings Bank, Jamestown, New York (Jamestown). In addition, the Holding Company owns all of the common stock of Leeds Federal Savings Bank, Baltimore, Maryland (Leeds). The Savings Bank and Jamestown elected to be treated as savings associations under section 10(l) of the Home Owners' Loan Act (HOLA), in June 2001.

The Holding Company proposes to acquire by merger Skibo Financial, M.H.C., Carnegie, Pennsylvania (MHC-2). MHC-2 is the parent of Skibo Financial Corporation, Carnegie, Pennsylvania (Mid-Tier 2), a mid-tier federally chartered mutual holding company. MHC-2 owns 60.17 percent of Mid-Tier 2, with the remaining shares held by minority shareholders (Minority Shareholders).

In order to consummate the transaction, Mid-Tier 2 will convert into the Interim, which will merge with and into the Association, with the Association being the resulting entity. Immediately thereafter, MHC-2 will merge with and into the Holding Company, with the Holding Company being the resulting entity, and the Association will become a wholly owned direct subsidiary of the Holding Company. The Holding Company will then contribute $10 million to the Association, and after the Holding Company's contribution the Association will

pay Mid-Tier 2's former minority shareholders $17.00 in cash per share (and cash out certain options), and pay certain transactional expenses, for an aggregate amount of $23.8 million. As a result of the transaction, the interests of the Association's depositors as members of MHC-2 will cease to exist and will be converted into interests of the Holding Company.

Holding Company Application

The Holding Company's acquisition of the Association requires OTS approval under section 10(e) of the HOLA, and the OTS regulations thereunder (Control Regulations).

Section 10(e) of the HOLA and the Control Regulations require that OTS consider, with respect to the Holding Company's acquisition of the Association, the financial and managerial resources and future prospects of the Holding Company, the Savings Bank, Jamestown, Leeds, and the Association, the effect of the acquisition on the savings associations, the insurance risk to the Savings Association Insurance Fund (SAIF) and Bank Insurance Fund (BIF), and the convenience and needs of the community to be served. OTS also must consider the impact of the acquisition on competition. Further, 12 C.F.R. § 563e.29(a) requires that the OTS take into account assessments under the Community Reinvestment Act (CRA) when approving holding company acquisitions.

As for managerial resources, OTS, in its role as the regulator of the Holding Company and the Association, is familiar with their managerial resources. Upon consummation of the transaction, there will be no changes in the board of directors of the Holding Company or the Association. OTS also has considered the managerial resources of the Savings Bank, Jamestown, and Leeds, which will not change as a result of the proposed transaction. Based on its experience with the managerial resources of the Holding Company and the four savings associations, OTS concludes that the managerial resources of the Holding Company and the four savings associations are consistent with approval.

As for financial resources, OTS is familiar with the financial resources of the Holding Company and the Association. As of December 31, 2003, the Holding Company's shareholders' equity equaled 5.1 percent of its assets and its tangible capital ratio was 2.35 percent. The Savings Bank, Jamestown and Leeds are all well-capitalized. Upon consummation of the transaction, the Association will have core capital of 5.51 percent and risk-based capital of 13.17 percent. The Holding Company intends to make a capital contribution of $10.0 million to the Association at the conclusion of the transaction. The Holding Company will fund the $10.0 million infusion with a $10.0 million loan from Mid-Tier 1. Based on the foregoing, OTS concludes that the financial resources of the Holding Company and the four savings associations are consistent with approval.

With respect to the future prospects of the Holding Company and the associations, OTS has considered the managerial and financial resources of the Holding Company and the four savings associations. OTS has also considered the debts of the Holding Company, and the fact that the Association will pay dividends to the Holding Company to service the debt from the loan. To ensure that the Holding Company continues to have adequate financial resources, OTS

is imposing condition 6 below, which requires the Holding Company to notify OTS prior to issuing additional debt securities or trust preferred securities, or similar hybrid instruments, or obtaining any other term financing. OTS concludes that the future prospects of the Holding Company and the associations, and the effect of the transaction on the SAIF and BIF are consistent with approval, provided that OTS imposes the conditions set forth below.

As for the competitive impact of the transaction, there is a slight overlap in the market areas of the Association and that of the Savings Bank. Both the Association and the Savings Bank have offices in Pennsylvania counties of Allegheny and Washington. Both institutions are relatively small in comparison to the major banks that operate in these markets. The Savings Bank has a market share of deposits of under five percent, while the Association's market share is less than one percent. Based on the relatively small size of their market shares and the number of competitors in these markets in which they operations, the acquisition should have no detrimental effect on competition. In addition, there is no overlap in the market area of the Association, and those of Jamestown, and Leeds. The Department of Justice's competitive factors report has not objected to the transaction. Accordingly, OTS concludes that the transaction is not objectionable on competitive grounds.

As for convenience and needs, the operations of the Association's existing offices and the existing services to the Association's customers and communities will continue. Accordingly, OTS concludes that approval of the transaction is not objectionable based on convenience and needs considerations.

As for CRA considerations in connection with the holding company application, the Savings Bank's, Jamestown's, and Leeds' most recent CRA ratings are "Satisfactory." No comments objecting to the Applications on the basis of the CRA have been filed. Accordingly, OTS concludes that approval of the holding company application is consistent with the CRA.

Formation of Interim Association, and Merger Application

The formation of the Interim requires OTS approval under 12 C.F.R. § 552.2-2. The merger of the Interim into the Association requires OTS approval under section 18(c) of the Federal Deposit Insurance Act (FDIA) (Bank Merger Act or BMA), and 12 C.F.R. § 563.22(a).

With respect to formation of the Interim, 12 C.F.R. § 552.2-2 provides that approval of an application to organize an interim federal stock savings association shall be conditioned upon approval by OTS of an application to merge the interim, or upon approval of another transaction that the interim was designed to facilitate. OTS has previously approved several transactions involving the conversion of federal mutual holding companies into interim associations, and concludes that the proposed transaction is consistent with 12 C.F.R. § 552.2-2.

With respect to the merger of the Interim into the Association, the Bank Merger Act and the OTS regulations thereunder impose standards of approval that are substantially similar to the holding company approval standards.[1] In addition, the Bank Merger Act requires the responsible agency to take into consideration, in its evaluation of a BMA application, the effectiveness of any insured depository institution in combating money laundering activities. Also, under OTS regulations, OTS must consider whether the merger is equitable to all concerned, whether full disclosure has been provided regarding written or oral agreements through which any person will receive anything of value in connection with the transaction, whether compensation to officers, directors, and controlling persons of the disappearing association is reasonable, and whether provisions regarding advisory boards are consistent with the regulations.[2] The CRA requires, in the context of the merger transaction, that OTS consider the CRA performance of the Association.[3]

Because the Interim would be a shell entity, the merger of the Interim into the Association will have no material effect on the managerial and financial resources and future prospects of the Association and the Interim, nor will the merger have any effect on competition or on the convenience and needs of the community.

As for equitable treatment, the merger transaction itself is an internal reorganization. With respect to full disclosure regarding written or oral agreements or understandings through which any person or company will receive anything of value in connection with the proposed transaction, materials distributed in the context of the minority shareholder and depositor votes provided relevant information. As for employment contracts and advisory boards, the merger of the Interim and the Association will not result in any employment contracts or advisory boards.

With respect to compliance with money laundering statutes and regulations, OTS examines savings associations for compliance with such statutes and regulations. OTS' review of the Association's compliance with money laundering statutes and regulations has not revealed any matters that are inconsistent with approval of the merger application.

With respect to the CRA, the Association received a "Satisfactory" rating at its latest CRA examination. No commenters have objected to the merger on CRA grounds. Accordingly, OTS concludes that approval of the merger application is consistent with the CRA.

Capital Distribution Notice

The Association seeks OTS approval to make a capital distribution of $23.8 million to pay the Minority Shareholders for their common stock and to pay certain transaction expenses. The OTS Capital Distribution Regulations require OTS to consider a savings association's capital position upon completion of the capital distribution, the effects of the capital distribution on the safety and soundness of the savings association, and the conformity of the capital distribution with applicable statutes, regulations, and other limitations. Based on the

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1 12 U.S.C. § 1828(c)(5)(B); 12 C.F.R. § 563.22(d) (2003).
2 12 C.F.R. § 563.22(d)(1)(vi) (2003).
3 See 12 C.F.R. § 563e.29(a)(2003).

Association's capital position after the transaction, relevant safety and soundness considerations, and the fact that the distribution does not violate any relevant statute, regulations, or other provision, OTS concludes that the Association's proposed capital distribution in connection with the proposed transaction is consistent with approval.

Mutual Holding Company Considerations

Authority

Section 575.10(a)(3) of OTS' regulations provides authority for the transaction. The regulation explicitly authorizes a federal mutual holding company to acquire another mutual holding company by merger.

Depositor and Borrower Rights

OTS regulations, at 12 C.F.R. §§ 575.5(a)(2) and (a)(4), require, under these circumstances, that depositors and borrowers of the Association who currently have membership rights in MHC-2, receive, after the transaction, the same membership rights in the Holding Company that they had in MHC-2 immediately prior to the transaction.

In this case, the members of MHC-2 currently have voting rights, but members of the Holding Company do not. Although the Holding Company will draw members from the Association after the transaction, depositors and borrowers of the Association will no longer have voting rights, except in the event of a second-step stock conversion of the Holding Company, placing them in the same position as depositors and borrowers of the Savings Bank and Jamestown. The proposed arrangement regarding the rights of depositor and borrower members of MHC-2, therefore, is not consistent with 12 C.F.R. §§ 575.5(a)(2) and (a)(4).

OTS regulations, at 12 C.F.R. § 575.1(b), provide that OTS may waive (non-statutory) requirements of the Mutual Holding Company Regulations for good cause. Section 10(o) of the HOLA does not address post-acquisition membership rights in this type of transaction. In the absence of a waiver, MHC-2's depositor and borrower members (Members), alone among those of the three depository institution subsidiaries of the Holding Company, would have voting rights. The Holding Company proposes to treat Members the same as depositors and member borrowers of the Holding Company's other depository institution subsidiaries. The Members have voted to approve the proposed transaction, after having been provided with a proxy statement that explicitly describes the loss of voting rights. Based on the foregoing, OTS has concluded that good cause to grant the waivers exists.

Remutualization Considerations

OTS has stated that transactions such as the proposed transaction (a "remutualization transaction") raise significant issues concerning disparate treatment of minority shareholders and mutual members of the target entity, and also raise issues concerning the effect on the mutual

members of the target entity.[4] OTS has stated that where such transactions exceed certain parameters, OTS will give the transaction special scrutiny, from the perspective of the members of the acquired entity, the minority shareholders of the acquired entity, and the members of the acquiring entity, and OTS will reject the application unless the applicant can demonstrate that OTS' concerns are not warranted in a particular case.[5] These parameters are addressed below.

With respect to members of the acquired entity, OTS applies special scrutiny to remutualization transactions in which the members of the acquired entity either: (i) obtain a right to a distribution in liquidation that is less in value than the corresponding right that they had in the acquired entity; or (ii) receive subscription rights less than those they had in the acquired entity.

The record indicates that as of June 30,2003, the ratio of majority-owned tangible equity per $1000 in deposits was $172.26 for MHC-2 and $48.21 for the Holding Company, and that after the transaction, the Holding Company's tangible equity per $1000 in deposits will be reduced to $47.06. The reduction triggers special scrutiny for the application.

Although the extent of the proposed dilution of the interests of MHC-2's members raises concerns under OTS' policy regarding remutualization transactions, OTS has analyzed the relevant facts, and has concluded that the transaction is consistent with OTS policy. The primary concern underlying the factor regarding dilution of the majority interest is that minority stockholders may receive windfall profits in a remutualization transaction, and may do so to the detriment of the mutual, majority interest. The Prior Order states that:

> Finally, because the account holders in the acquired institution become members of the acquiring savings association or mutual holding company they dilute the inchoate interest of the other mutual members to the extent that the stockholders are paid a disproportionate sum for their interest in the acquired institution. (Emphasis added.)

In this case, the dilution to the majority interest is not caused by disproportionate payments to minority shareholders of Mid-Tier 2. The Holding Company, before the transaction, had stockholders' equity of $318.4 million. The proposed payment of approximately $23.7 million to Mid-Tier 2's minority stockholders represents only a small portion of the Holding Company's equity. Even if the payment to the minority shareholders were significantly reduced, the proposed transaction would result in significant dilution to the equity interest of MHC-2's mutual members.

Accordingly, OTS concludes that the dilution to MHC-2's mutual members does not result in the proposed transaction becoming objectionable under OTS' policy regarding remutualization transactions.

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[4] See, OTS Order No. 2003-24 (June 24, 2003) (Prior Order), at p. 3.

[5] Id.

As for subscription rights, MHC-2's members' subscription rights will not change as a result of the proposed transaction.

With respect to minority stockholders of the acquired entity, OTS stated that it will closely scrutinize remutualization transactions in which any of five specified conditions exist.[6]

With respect to the first of these factors, minority shareholders own slightly less than 40 percent of the target entity. Although this level of minority ownership triggers special scrutiny, the level of minority ownership is not significantly below the 40 percent threshold. With respect to the factors pertaining to the ratio of the aggregate purchase price to book value of the minority interest, and to the tangible book value of the minority interest, as well as the factor pertaining to the price to return on average assets, OTS has concluded that the transaction does not trigger special scrutiny.

With regard to the ratio of price to earnings per share, the record indicates that the price to earnings per share ratio is 212.5x for the proposed transaction and 39.26x for the third quartile for all transactions announced during the preceding four quarters. The transaction is subject to special scrutiny based on this factor. However, the ratio for the transaction reflects the target entities' relatively weak earnings. In order for the transaction to meet this parameter, the purchase price would have to be well below the stock's book value, and less than 25% of Mid-Tier 2's trading price before announcement of the proposed transaction. Accordingly, we conclude that this factor should not prevent approval of the transaction.

Finally, the Prior Order states that OTS will apply special scrutiny to a remutualization transaction in which the interests of members of the acquiring entity are diluted in excess of certain levels. The record indicates that, based on June 30, 2003, data, the Holding Company's ratio of tangible equity per $1000 of deposits will decrease from $48.21 to $47.06 as a result of the transaction. OTS concludes that this minimal reduction is does not cause the transaction to be objectionable.

Conclusions

Based on the foregoing analysis and the substance of the Applications, OTS concludes that the Applications meet the applicable approval criteria, with the exception of 12 C.F.R. §§ 575.5(a)(2) and 575.5(a)(4), provided that the relevant parties comply with the conditions set forth below. For the reasons discussed above, OTS hereby waives 12 C.F.R. §§ 575.5(a)(2) and 575.5(a)(4) to the extent necessary to permit the depositor and borrower members of MHC-2 to

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[6] OTS Order No. 2003-24, at 2-3.

have the same rights, after the transaction, as members of the Holding Company whose rights with the Holding Company are derived from the Holding Company's other depository institution subsidiaries. Accordingly, the Applications are hereby approved, provided that the following conditions are complied with in a manner satisfactory to the Northeast Regional Director, or his designee (Regional Director):

1. The Holding Company, the Savings Bank, MHC-2, Mid-Tier 1, Mid-Tier 2, and the Association must receive all required regulatory and shareholder approvals for the proposed transaction and submit copies of such approvals to the Regional Director prior to the consummation of the proposed transaction;

2. The proposed transaction must be consummated no later than 120 days from the date of this Order;

3. No more than 30 days following the consummation of the proposed transaction, a final executed tax opinion addressing the tax consequences of the transaction to the Association must be submitted to the Regional Director;

4. On the business day prior to the date of consummation of the proposed transactions, the chief financial officers of the Holding Company, the Savings Bank, MHC-2, Mid-Tier 1, Mid-Tier 2, and the Association must certify in writing to the Regional Director that no material adverse events or material adverse changes have occurred with respect to the financial condition or operations of their respective entities, since the date of the financial statements submitted with the applications. If additional information having a material adverse bearing on any feature of the applications is brought to the attention of the Holding Company, the Savings Bank, MHC-2, Mid-Tier 1, Mid-Tier 2, the Association or OTS since the date of the financial statements submitted with the Applications, the transaction must not be consummated unless the information is presented to the Regional Director, and the Regional Director provides written non-objection to consummation of the transaction;

5. The Holding Company and the Savings Bank must advise the Regional Director in writing within five calendar days after the effective date of the proposed transaction (a) of the effective date of the transaction and (b) that the transaction was consummated in accordance with all applicable laws, regulations, the Applications and this Order;

6. The Holding Company and Mid-Tier 1 must submit written notification to the Regional Director prior to issuing any debt securities or trust preferred securities, or similar hybrid instruments that possess debt and equity characteristics, or obtaining any other term financing;

7. Should the Holding Company and the Association establish a tax sharing arrangement with a written tax sharing agreement, such an agreement must first be submitted to the Regional Director for non-objection;

8. Upon completion of the organization of the Interim federal savings association, the boards of directors of the Association and the Interim federal savings association must ratify the agreement and plan of merger; and

9. Not later than 5 calendar days after the date of consummation of the merger of the Interim and the Association, the Association must submit a certification of legal counsel stating: (a) the effective date of the merger; (b) that the Interim federal savings association never opened for business; and (c) that the merger has been consummated in accordance with the Application, applicable state law, applicable federal law, and this Order.

Any time period set forth herein may be extended for up to 120 calendar days, for good cause, by the Regional Director.

By order of the Director of the Office of Thrift Supervision, or his designee, effective April 23, 2004.

Scott M. Albinson
Managing Director,
Examinations, Supervision, and Consumer Protection