

New Capital Instruments for Mutual Holding Companies

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Biography

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Dory A. Wiley is President & CEO of Commerce Street Holdings, LLC, the holding company for Commerce Street Capital, LLC ("CSC"), a FINRA-regulated broker/dealer and Commerce Street Investment Management, LLC ("CSIM"), an SEC-registered investment advisor. Since co-founding the firm in 2007, his primary focus has been the creation and management of investment funds that specialize in financial institutions and related derivatives. Mr. Wiley serves on the Boards and Investment Committees of CSIM's investment funds. He formerly served as a member of the Board of Trustees of the Teacher Retirement System of Texas, an approximately \$100 billion pension fund where he was Chairman of the Investment Committee. Mr. Wiley has over 20 years of experience in commercial and investment banking and investment management. Prior to his current position with Commerce Street, Mr. Wiley was President of SAMCO Capital Markets, LLC, which he joined in August, 1996. Prior to SAMCO, he was Vice President and Manager of the Financial Institutions Group at Rauscher Pierce Refsnes, now RBC Capital Markets. Mr. Wiley often lectures on bank-related topics for universities, seminars and conferences. He has testified as an expert witness on bank and securities valuations, has written articles for various banking periodicals and has been quoted extensively in the media. He is a member of the AICPA, Texas Society of CPAs, the Dallas Society of Financial Analysts, the National Association of Certified Valuation Analysts, and the CFA Institute. He also serves on several charitable boards. Mr. Wiley received a BBA in Finance and Accounting from Texas Tech University, and an MBA from Southern Methodist University.

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Mutual Saving Banks – Current Issues for Growth and Acquisition

- Mutuals are non-stock companies, so **capital raising and growth by acquisition** can be more difficult than for standard stock-based companies – for example, bidding for stock-based banks.
- There may be **restrictions** on lending areas and business activities for Federal savings banks per QTL and other guidelines, compared to full-line commercial banks.
- A stock-based banking company's board may enter the newest business sectors seeking higher returns. Mutuals are perceived as **more cautious** and careful in entering new business lines, and this caution may be attractive to new investors.
- Trend toward embracing **state charters** seen as more attractive, esp. in New England – specifically Massachusetts, whose state banking regulators have loosened the reins on state chartered mutuals' business activity.
- **Capital infusions by government** actions in times of national banking distress may be hampered by mutuals' non-stock nature.
- **Need for more capital for growth and acquisitions** – to keep pace with standard stock-based commercial banks. Most mutuals have enough capital to operate, but not enough excess capital for acquisitions.

Proposed Capital Growth Instrument:

The Mutual Investment Certificate (MIC)

- “Non-Withdrawal MIC” is not a deposit, because it is not withdrawable.
- **Ranks junior** to all creditor and account liabilities on liquidation.
- Viewed as **hybrid capital**: combination of a bond-like interest payment feature with an equity-like component (regular payments are lesser of stated rate or 50% of net income).
- **No regulatory permission required** for regular payments (unlike Trust Preferreds).
- **Perpetual instrument**; no fixed maturity (unlike Trust Preferreds with their 30-year maturity).
- Interest payments are **tax-deductible to issuer**, cutting net cost of capital to issuer.
- **Redeemable** at issuer’s option.
- Capital Status: **Tier 1 capital treatment** for mutual banks and MHCs.
- **Rate**: Fixed or floating payment rate, payable periodically. **Cumulative** income payments.
- **Payments must be lesser of: stated rate or 50% of issuer’s net income** provided the issuer remains adequately capitalized after payment.
- **No voting rights**, except holders would be able to elect board directors after missed payments.

The Mutual Investment Certificate: *Benefits and Considerations*

- Will allow MSBs and MHCs to **expand business activities** to lend in their communities for consumer and business loans, and thus better compete with commercial banks
- Can help with **acquisitions and possibly mergers** especially in MHC forms. Can pay cash (or use MICs as currency) for stock acquisitions.
- MICs are somewhat similar in nature to allowable Tier 1 instruments that **already exist** at US corporate credit unions (non-withdrawable instruments).
- MICs allow growth in lending while **retaining the mutual form**, and preserve the capital ratios.
- In the event of needed **government capital infusions** into the banking systems, MICs are a practical instrument.
- **Legislative status:** No current House bills in process in the 2015-16 session for MICs, after previous bills in 2014-15 session.

MICs: Investors and Markets

Liquidity for MICs:

- Need to develop secondary trading markets to provide investors with exit / liquidity/ trading information for valuations.
- Initial thought is that issuers can create markets in their own instruments.
- Likelihood that specialized trading desks will develop markets for their institutional clientele, as is the case for single-issuer and securitized Trust Preferreds.
- Will be different from existing Perpetual Preferred, as MICs are not preferreds.

Potential Investors in MICS include:

- Credit / Private Equity Funds / Specialty lenders that specialize in Bank/ Financial institution-focused investments.
- If rated investment-grade by credit ratings agencies, insurance companies may be interested especially given long-term investment horizon.
- Other banks or financial institutions may be interested in a steady dividend payer.

Additional Features/ Considerations: Investors will likely need to see:

- A secondary market should develop for this hybrid instrument.
- Some form of call protection may be needed in early years, with a call premium.
- Valuation and pricing will develop along with trading markets.

Subordinated Debt – An Alternative Capital Instruments for Mutuals?

Is Subordinated Debt an alternative?

- Mutual Holding Company may issue Sub Debt, downstream proceeds to MSB, and have it be viewed as capital
- A Sub Debt issue will have a maturity date – how would it be repaid at maturity?
- Compare to MICs, which would be perpetual
- Holding Company Sub Debt issuances recently seen for smaller commercial banks
- Market may or may not be receptive to Sub Debt from a MHC vs. bank
- But investment in the form of debt may be attractive to other banks

The Mutual Investment Certificate in the Marketplace:

Q&A / Discussion