

Mutual Alert



Date: May 10, 2011

To: America's Mutual Banks

Re: Recent Developments Regarding Federal Reserve Supervision of Simple MHCs, Proposed Amendment to Dodd-Frank for Mutuals, and Salem Five's Commitment to Mutuality

A. Members and Representatives of America's Mutual Banks meet with the Fed

On May 6, 2011, members and representatives of America's Mutual Banks ("AMB") met with senior staff of the Board of Governors of the Federal Reserve System (the "Fed"). AMB members in attendance included Frederick E. Schea, Raymond G. Hallock and Douglas P. Faucette. Mr. Schea is President and Chief Executive Officer of First Savings Bank of Perkasio, an institution with over \$1 Billion in total assets. Mr. Hallock is President and Chief Executive Officer of Columbia Bank, the second largest mutual holding company with no public stockholders in the country, with over \$4.6 Billion in total assets. Mr. Faucette is a banking partner at Locke Lord Bissell & Liddell LLP and an advocate for America's Mutual Banks.

The meeting was called by AMB for the purpose of receiving guidance from the Fed staff as to how the Fed would apply its new authorities from Dodd-Frank to mutual holding companies. AMB includes mutual holding companies with no public stockholders ("Simple MHC's") such as First Savings Bank of Perkasio and Columbia Bank among its membership, but does not include mutual holding companies with public stockholders. While many Simple MHC's are already regulated by the Fed, other Simple MHC's are currently regulated by the OTS and will be regulated by the Fed after the transfer of powers from the OTS. Part of AMB's initiative is to elevate the mutual profile among regulators and policymakers. As you may recall, on April 15, 2011, the Fed issued a notice (the "Notice") regarding the regulation of saving and loan holding companies ("SLHC"), but at no point in that notice were mutual holding companies mentioned.

AMB started the meeting by thanking all of the members of the Fed staff for taking the time to attend a meeting with a small, but important segment of the savings and loan holding company population. As of December 31, 2010, there were 116 Simple MHCs with total assets of \$79.2 billion. These companies had an average leverage capital ratio of 10.38% and an average nonperforming assets to total assets ratio of 2.13%. Of these Simple MHCs, 37 with assets totaling \$17.1 billion are currently regulated by the OTS. The remaining 79 Simple

MHCs with total assets of \$62.1 are currently regulated by the Fed. Most Simple MHCs have no operations at the holding company level. In addition many state chartered mutuals are seriously considering becoming Fed members

AMB explained that its area of concern is only on those issues which uniquely effect Simple MHCs. AMB representatives voiced some of their concerns and questions. It explained that it deferred to its national and state trade groups in areas of general industry concern. Currently, the Fed's approach to supervision is based on size and complexity. Will the Fed use the same size criteria for SLHCs as is used for bank holding companies ("BHCs")? And would the Fed classify a Simple MHC as complex merely because it is an unusual form of corporate organization? AMB inquired on whether the Fed anticipated that most Simple MHCs would be categorized as "community banking organizations" given that only 18 of 116 Simple MHCs have total assets greater than \$1 billion and the largest Simple MHC has total assets less than \$8 billion. The Notice provides guidance on Small, Noncomplex Holding Companies and for Small Shell BHCs (assets less than \$1 billion). Will Simple MHCs that would otherwise meet the definitions of a Small Noncomplex BHC or a Small Shell BHC qualify for treatment under those guidelines? The Notice stated that for BHCs with consolidated assets of \$1-10 billion and a satisfactory composite rating, a limited scope on site inspection is required every two years. Will the Fed accept the current composite ratings from the OTS or will the Fed require new rating from the OCC?

Mr. Faucette explained that mutuals are sensing that the playing field is increasingly tilting in an unfair direction. While not intentional, the actions taken by Congress and the regulators are putting mutuals in a position of disadvantage. Mr. Faucette cited the Collins Amendment as a prime example. He explained that while the purpose of the amendment was to standardize minimum capital requirements for BHCs and SLHCs, the few exemptions contained in the amendment allowing certain elements to be grandfathered did not treat all institutions equally. For example, the language regarding the small bank exemption, as well as the Fed discussion in the Notice, indicates that small SHLCs may not fall under the traditional community bank exemption. This will have a profound effect on Simple MHCs in that a Simple MHC does not have the same sources of capital since they have no common stock. This is particularly onerous on a Simple MHC with a federal thrift in that it must forfeit its federal charter and flip to a state savings bank. Only then could the Simple MHC become a BHC and arguably fall under the small bank exemption of the Collins Amendment. He stated that he is confident that Congress did not intend this provision to deplete the ranks of federal thrifts by forcing conversion to state charters. Indeed he anticipated the OCC would be particularly concerned if the Collins Amendment had such a consequence. An interpretation of the Collins Amendment which denies small SLHCs an exemption would hasten the demise of the federal charter. The Fed staff acknowledged that this is a serious issue involving a significant interpretation of the statute.

Mr. Hallock then explained the difficulties he has experienced with the banking agencies and their appreciation of the mutual structure. On numerous occasions, the banking agencies have displayed a lack of understanding on the differences between the stock form and mutual form. He also raised concerns to what extent the Fed would defer to previous OTS examinations or whether full, several day onsite examinations would initially be necessary. Mr. Hallock explained how Columbia has utilized the benefits of a Simple MHC structure to raise capital

through subordinated debt and trust preferred securities. Mr. Faucette emphasized that unlike BHCs which have an incentive to increase leverage through borrowing, trust preferred securities or other hybrid securities in order to maximize returns on equity, Simple MHCs do not have pressure to enhance stockholders returns through leverage. Under Basel III, there are issues on whether Simple MHCs would be able to use the five year Dodd-Frank grandfather for trust preferred securities. A brief discussion on Basel III ensued and its ultimately unforeseeable outcome at this point. Additionally, Mr. Faucette emphasized the need for Simple MHCs to have access to hybrid capital instruments, such as mutual capital certificates.

The Fed staff recognized there might be situations where initial onsite examinations were more lengthy than a Simple MHC would anticipate, but once initial examinations were concluded as to an absence of any issues, its unlikely that further onsite examinations will be necessary for Simple MHCs. The Fed emphasized they were talking about Simple MHCs only, and not any other savings and loan holding companies.

Mr. Schea indicated he is currently regulated by the Fed as a three-tiered Simple MHC. He shared his bank's personal experiences. Anecdotally, he talked about his first experiences with various examiners and their unfamiliarity with the MHC structure and mutual governance. Once his bank grew beyond \$1 billion, it triggered an onsite exam, which was acknowledged as a threshold for closer examination. He noted that the MHC had no transaction during the year examined. Mr. Schea stated when his MHC structure was formed it was not for personal gain. Rather, the simple structure and business model was designed to give his bank a greater array of instruments to raise capital.

Mr. Hallock added that mutuals in general are very involved in their communities and are not motivated by personal gain. In fact, the qualifications to become a member of the board of directors of his MHC and bank include business acumen, community involvement and integrity (i.e. not on board for personal gain). Mr. Hallock then spoke about the Small Business Lending Program and TARP, two programs where mutuals were neglected. He related the irony of his experience with the Treasury's Small Business Lending Program explaining that he received a call from the US Treasury soliciting his bank's participation in the program which was not permitted by the Treasury because of the bank's mutual structure. Mr. Hallock explained that his MHC was first formed as a legal defense against any attempts resulting from the FDIC's whitepaper to divert capital from members.

AMB representatives discussed Simple MHCs more conservative nature and greater emphasis on safety and soundness due to the absence of pressure to leverage returns on equity. Therefore Simple MHCs tend to have higher capital ratios. The point was also made that Simple MHCs, as a group, were not responsible for the crisis, but are still subject to the burdens of Dodd-Frank, in some cases to a greater degree than other institutions. Then a discussion ensued about the view that because Simple MHCs have no stockholders, Simple MHCs have less market discipline. However, Mr. Hallock stated that Simple MHCs are susceptible to market discipline in their daily operations. If Simple MHCs were not disciplined, it would result in ratios and financial metrics inferior to other financial institutions. He emphasized that as an industry, that was not the case. Simple MHCs, on average, enjoy better ratios and financial metrics than other institutions.

Kathleen O'Day, Deputy General Counsel of the Fed, stated that there is much to do in the implementation of Dodd-Frank and mutuals are not always at the top of consciousness during this process. Ms. O'Day stated that if mutuality has been left out of regulations or releases, please let the Fed know. She told AMB that she was very appreciative of this meeting and urged AMB to maintain a dialogue with the Fed. Ms. O'Day explained that the Fed is conscience of community banks, and they are constantly reminded by senior members of the Fed the important role that community banks play in the banking system.. She stated the oversight and treatment of community banks is important to the Fed.

There was also a discussion that, while there is a thrift advisory board, there is no formal group recognizing Simple MHCs. Therefore, this type of dialogue is helpful in sensitizing the Fed staff to the structure of Simple MHCs, as well as to unique mutual issues. A Fed staff member encouraged meeting with each local Fed bank to help the Fed staff become better educated on mutuals. A Fed staff member stated the Fed has been designing its own training regimen to educate staff that do not have significant exposure to mutual issues. The more experienced Fed staff from the Boston Fed, New York Fed and Philadelphia Fed share their mutual experience and knowledge with other Fed banks.

B. Regulatory Relief Bill

House Financial Services Committee Member Blaine Luetkemeyer (R-Mo.) formally introduced ICBA-advocated legislation ([H.R. 1697](#)) to reduce regulatory, tax and paperwork burdens on community banks and customers they serve. The bill does not address matters of specific concern to mutuals.

America's Mutual Banks will be meeting with members of the House Financial Services Committee to obtain additional relief. It has also pledged to work with the ICBA and ABA to insert provisions relating to issues uniquely affecting mutuals.

C. Massachusetts Mutual Savings Bank Commits to Mutuality

On April 17, 2011, Salem Five Cents Savings Bank, Salem, Massachusetts released a press release regarding recent action of its board of trustees. Salem Five Cents Savings Bank, is a state chartered savings bank held by Salem Five Bancorp, a mutual holding company with no public stockholders. The Salem Five Board of Trustees approved changes to the Bank's By-Laws, deepening Salem Five's commitment to its mutual bank status, preserving this status for the bank's future and preventing any Salem Five employee or Board member from benefiting financially should a future change in structure occur.

By-law changes included three primary actions:

1. A clear statement that Salem Five will not consider any conversion proposal unless there is a compelling reason to do so.
2. Prohibits any Director, Officer, Trustee or employee of Salem Five or its affiliates from profiting from a conversion proposal.

3. If the new By-Law amendments are repealed or amended in the future, the prohibition shall continue to apply to all persons who were Officers, Directors, Trustees or employees at the time of such repeal or amendment.

For a copy of the full press release, [click here](#).