

OFFICE OF THRIFT SUPERVISION

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

Order No.: 2006-22
Date: May 24, 2006
Docket Nos.: 4410, H-1154, and H-2919

Sovereign Bancorp, Inc., Wyomissing, Pennsylvania (Bancorp), and Sovereign Bank, Wyomissing, Pennsylvania (Savings Bank) (collectively, the Applicants), have applied to the Office of Thrift Supervision (OTS) for approval pursuant to section 10(e) of the Home Owners' Loan Act (HOLA), the OTS Acquisition of Control Regulations (Control Regulations), and the Bank Merger Act (BMA), 12 U.S.C. § 1828(c), and 12 C.F.R. § 563.22(a), to acquire Independence Community Bank, Brooklyn, New York (State Bank). In addition, the Savings Bank has requested approval, pursuant to section 10(f) of the HOLA, and 12 C.F.R. § 563.143(b), to make a capital distribution to Bancorp in connection with the proposed transaction. The Savings Bank also has requested approval, pursuant to 12 C.F.R. §§ 552.4 and 552.5, to amend its charter and bylaws to increase the size of its board of directors to 18 members.

The Proposed Transaction

The Savings Bank is a wholly owned subsidiary of Bancorp. The State Bank, a wholly owned subsidiary of Independence Community Bank Corp., Brooklyn, New York (Target Holding Company), previously elected to be treated as a savings association under section 10 of the HOLA, pursuant to section 10(l) of the HOLA.

In the first step of the proposed transaction, the Target Holding Company will merge with an interim corporation, Iceland Acquisition Corp., established by Bancorp to facilitate the transaction. The Target Holding Company will survive the transaction. As a result of the merger, the State Bank will become an indirect, wholly owned subsidiary of Bancorp. In the second step of the proposed transaction, which will occur several months after the initial acquisition, the State Bank will merge into the Savings Bank, with the Savings Bank as the surviving entity. The Savings Bank has no current plans to close any of the State Bank's offices. The Savings Bank will establish an advisory board, which will provide advice regarding the State Bank's former area of operations.

Public Comments

OTS received four comment letters on the applications. The comments opposed the transactions, and alleged, among other things, that Bancorp engages in high-risk practices, and has relatively low capital, that the proposed transaction and matters related to the funding of the transaction will have a negative impact on Bancorp and the Savings Bank, that Bancorp's managerial resources are inconsistent with approval of the applications, that Bancorp violated certain regulatory provisions in connection with the transaction and otherwise, and that the Savings Bank would not fulfill its Community Reinvestment Act (CRA) obligations after the transaction.

Holding Company Application

Section 10(e)(2) of the HOLA and the Control Regulations provide that in reviewing the proposed acquisition of a savings association by a savings and loan holding company, OTS must consider the managerial and financial resources and future prospects of the company and associations involved, the effect of the acquisition on the associations, the insurance risk to the Deposit Insurance Fund (DIF), and the convenience and needs of the community to be served. Consideration of the managerial resources of a company or savings association must include consideration of the competence, experience, and integrity of the officers, directors, and principal shareholders of the company or savings association. OTS must consider the impact of any acquisition on competition. Also, 12 C.F.R. § 563e.29 requires that OTS take into account assessments under the CRA when approving holding company acquisitions.

As for managerial resources, OTS, in its role as the regulator of Bancorp, the Savings Bank, and the Target Holding Company, is familiar with their managerial resources. The board of directors and the executive officers of Bancorp and the Savings Bank will consist of the present directors and executive officers of these entities, and other persons with experience in financial institutions. The current president of the State Bank will become the Savings Bank's President and Chief Operating Officer and the chairman of the New York Division Advisory Board and chief executive officer of the New York Division. The other senior officers and board members of the State Bank will continue in their respective capacities until the State Bank is merged into the Savings Bank. Bancorp will add five persons to its board of directors in connection with the proposed transaction; not all of those persons have submitted background information, and two persons have not yet been identified. In addition, certain persons will be added to the Savings Bank's board of directors. Furthermore, certain directors of Bancorp and the Savings Bank have served for less than one year. OTS is imposing condition number 6, regarding the submission of pertinent background information from these individuals, in order to ensure that the managerial resources of Bancorp and the Savings Bank are consistent with approval. OTS concludes that, with the imposition of condition 6, the managerial resources of Bancorp, the Savings Bank, the Target Holding Company and the State Bank are consistent with approval.

As for financial resources, OTS is familiar with the financial resources of Bancorp, the Savings Bank and the Target Holding Company. As of December 31, 2005, the Savings Bank's tangible, core, and risk-based capital ratios were 6.84 percent, 6.84 percent, and 10.66 percent, respectively. As of the same date, the State Bank had Tier 1, Tier 1 Risk-Based and Total Risk-Based capital ratios of 6.98, 8.82, and 12.59 percent, respectively. The Savings Bank will continue to be "well capitalized" pursuant to the OTS Prompt Corrective Action regulation upon consummation of the transaction. OTS has considered the funding of the transaction, and is familiar with and has considered the financial resources of Bancorp and the Target Holding Company. Bancorp has not provided a final term sheet regarding a planned issuance of up to \$440 million of trust preferred securities. In order to ensure that the terms of such securities do not have an adverse effect on the financial resources and future prospects of Bancorp or the Savings Bank, OTS is imposing condition number 7, below, requiring submission of a term sheet regarding such securities. Based on the foregoing, OTS concludes that, with the imposition of condition 7, the financial resources of Bancorp, the Savings Bank and the State Bank are consistent with approval.

Both the Savings Bank and the State Bank are operating profitably. As discussed above, the managerial and financial resources of the parties are consistent with approval. Bancorp and the Savings Bank propose to enter into employment contracts with certain individuals. In order to ensure that such agreements do not have an adverse effect on the future prospects of Bancorp or the Savings Bank, OTS is imposing condition 8, below, requiring prior OTS non-objection to such contracts. OTS concludes that the future prospects of Bancorp, the Savings Bank and the State Bank, and the effect of the transaction on the DIF are consistent with approval, provided that Bancorp and the Savings Bank satisfy the conditions set forth below.

As for the competitive impact of the transaction, the Savings Bank and State Bank operate in two separate markets, with the exception of certain counties in the New York-Northern New Jersey-Long Island, NY-NJ-PA Metropolitan Statistical Area (New York MSA). The impact on the New York MSA is minimal. On a combined basis, the Savings Bank would control approximately 2.10 percent of the deposits in the New York MSA. The *pro forma* Herfindahl-Hirschman Index (HHI) would increase 2.01 points to 1004.98. 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 the CRA, the Savings Bank's most recent rating was "Outstanding." The State Bank's most recent rating was "Satisfactory." OTS considered the comments received, as discussed more fully below, and believes the Savings Bank's CRA plan adequately and properly addresses the concerns. Accordingly, OTS concludes that approval is consistent with the CRA.

As for the convenience and needs of the community, the Savings Bank will be assuming the operations of the State Bank's existing offices and continuing services to

the offices' customers and communities. No offices are being closed as a result of the transaction. Accordingly, OTS concludes that approval of the transaction is not objectionable based on convenience and needs.

Bank Merger Act

The BMA and OTS regulations impose approval standards that are substantially similar to the approval standards set forth under section 10(e) of the HOLA, which have been discussed previously. The BMA also requires that OTS consider the Savings Bank's and the State Bank's records of compliance with anti-money laundering statutes in analyzing the BMA transaction. In addition, OTS must consider the CRA record of the Savings Bank and the State Bank in evaluating the BMA application, and must also consider whether the transaction conforms to applicable laws, regulatory policies, and factors relating to fairness and disclosure.

As discussed above, OTS concludes that the Savings Bank's managerial and financial resources and future prospects are consistent with approval, subject to the imposition of the conditions set forth below. The Savings Bank and the State Bank are well-capitalized and are expected to remain well-capitalized after the proposed merger.

For the reasons discussed above, the proposed transaction will have no significant effect on competition. Further, the Savings Bank has an "Outstanding" CRA rating and the State Bank has a "Satisfactory" CRA rating. OTS has no objection to the Savings Bank's CRA plan. OTS received four comments objecting to the proposed transactions, which are discussed below. With respect to convenience and needs of the community, the Savings Bank will continue to operate all of the State Bank's offices and will not close any of Savings Bank's existing offices in the market area. In our opinion, there is an adequate legal basis to conclude that the proposed transaction meets the convenience and needs of the community and is consistent with the CRA.

In addition, pursuant to section 563.22, OTS must consider whether the proposed transaction is equitable to all of the parties, provides full disclosure of the agreements and understandings among the parties, meets regulatory guidelines regarding compensation to the officers, directors and controlling persons of the disappearing savings association, and meets certain guidelines for advisory boards.

The Target Holding Company received a fairness opinion that the transaction is fair to the shareholders of the Target Holding Company. Bancorp has submitted information demonstrating that the price is within the range of consideration paid by other bank and savings and loan holding companies in similar transactions. Compensation being paid to the State Bank's officers and directors remains the same and is considered to be reasonable. The applications and related materials provide full disclosure of the terms of the proposed transactions and the understandings of the parties to the proposed transaction. With the exception of a requested waiver, the proposed advisory board meets the regulatory guidelines.

The Applicants have requested a waiver of 12 C.F.R. § 563.22(d)(1)(vi)(D) to permit members of an advisory board to be elected to a three year term. OTS may waive the applicability of any regulation for good cause, to the extent permitted by statute. The purpose of the advisory board is to assist the Savings Bank in the effective and profitable operation of the New York Division, and thereby enhance the future prospects of the Savings Bank. The size of the acquisition is significant and it will take some time for the State Bank's operations to be fully integrated into the Savings Bank and operated in a manner satisfactory to Bancorp. Considering the size of the acquired institution, the relative compensation of the advisory board to the compensation of Bancorp's board and the size of the resulting entity, we conclude that it is reasonable to appoint the advisory board for a three-year term. Therefore, OTS concludes that there is good cause to waive the regulation.

As for compliance with money laundering statutes and regulations, OTS has reviewed the Savings Bank's Bank Secrecy Act (BSA) policies and believes the Savings Bank has adequate BSA policies in place. The State Bank has had certain BSA compliance violations. OTS has reviewed the nature of the violations and has concluded that the Savings Bank will be able to address anti-money laundering activities conducted by the State Bank in the context of the subject transaction. Based on these considerations, OTS has concluded that there is no reason to believe the Savings Bank, as the resulting entity, will fail to comply with the BSA and anti-money laundering requirements in the future. Accordingly, OTS concludes that the anti-money laundering activities of the institutions do not warrant rejection of the BMA application.

Public Comments

OTS received comments objecting to the applications on CRA and other grounds.¹ Commenters alleged that Bancorp has: (i) weak capital ratios, especially a low tangible capital ratio; (ii) low debt ratings for such a large holding company; (iii) a low return on assets; and (iv) significant reliance on wholesale borrowing at higher interest rates creating significant interest rate risk. In addition, certain of the comments alleged that the Savings Bank has a high loan to deposit ratio.

OTS has reviewed the capital of Bancorp and the Savings Bank. The Savings Bank is "well-capitalized" as defined under OTS' Prompt Corrective Action Regulations. Bancorp's capital ratios and return on assets are consistent with approval, particularly in light of the Savings Bank's projected operations, and Bancorp's debt ratings do not provide a basis for denial of the application. Although wholesale borrowings result in slightly higher interest rate costs, OTS concludes that such costs will not be a material

¹ Some comments raised irrelevant issues that do not provide a basis to deny the applications. These comments included allegations regarding Banco Santander Central Hispano, S.A., a bank holding company that does not have an application pending before OTS, and speculations regarding Bancorp's potential ability to engage in certain activities under the applicable regulatory framework.

concern. The Savings Bank's loan to deposit ratio does not raise significant supervisory concerns.

Commenters asserted that the funding of the proposed transaction raise concerns. OTS has considered the funding of the transaction, and has concluded that the financial resources and future prospects of the applicants are consistent with approval after taking the source of funds for the transaction into account.

Commenters asserted that terms of the funding arrangements for the transaction have an unacceptable "fiduciary out" provision, serve to entrench Bancorp's board and management, and impose severe constraints on acquisition transactions between Bancorp and any third party for 5 years. The "fiduciary out" provisions and other terms of the financing appear permissible under applicable law. The constraints on acquisition transactions do not appear unreasonable, and are intended to protect investors.

Commenters allege that Bancorp's managerial resources are inconsistent with approval due to: (i) certain statements made by management that commenters allege have been inconsistent with management's subsequent actions; (ii) alleged corporate governance weaknesses that resulted in excessive board compensation, insider dealings, and delay of Bancorp's annual meeting; (iii) alleged incorrect disclosure regarding the circumstances under which directors could be removed and related filings with the Securities and Exchange Commission (SEC); and (v) constructing the funding arrangements for the transaction to avoid a shareholder vote on the transactions.

As to statements by Bancorp's management, Bancorp's management asserts that Bancorp has always stated that it would pursue acquisitions if and when such transactions were within Bancorp's guidelines for expansion, and that all transactions have been within its guidelines. Bancorp's board compensation arrangements were reviewed by an outside consultant in recent years and adjusted to better comport with industry practices and to tie compensation to Bancorp's stock performance. Transactions with a particular director were reviewed by OTS and not found to be improper. OTS does not consider Bancorp's actions with respect to the annual meeting to cause Bancorp's managerial resources to be inconsistent with approval. Bancorp states that the disclosures concerning removal of directors were inadvertent. Bancorp has now made appropriate disclosures in SEC filings concerning the ability of shareholders to remove its directors. As for constructing the proposed transaction to avoid shareholder approval, management of companies typically structure transactions under applicable statutory and regulatory requirements to achieve business and legal objectives, and OTS finds nothing inappropriate in management's doing so here.

Commenters contended that certain of the matters expressed in the above comments may constitute breaches of Bancorp's board of directors' fiduciary duties. The Commenters have not demonstrated that Bancorp has engaged in material violations of statutes, rules or regulations, and therefore, they do not appear to constitute breaches of Bancorp's board of directors' fiduciary duties.

Commenters expressed concern that the Savings Bank may not be in compliance with certain HOLA lending requirements or the Qualified Thrift Lender (QTL) test. OTS staff reviewed the Savings Bank's lending and QTL compliance in connection with the application, and has found no basis to conclude that the Savings Bank is in violation of its lending requirements or has failed to meet the QTL test.

Commenters expressed several CRA concerns: (i) that the State Bank has retrenched its community development activities in recent years; (ii) some of the State Bank's branch closures have been in low-income areas, while most branch openings have been in middle and high income census tracts; (iii) the State Bank's multi-family lending is in substandard housing; (iv) the State Bank has made almost no mortgage loans to non-profit developers; and (v) the State Bank's lending does not support the credit needs of low-income neighborhoods. One of the Commenters urges the Savings Bank to increase lending to nonprofit community developers in the New York City market after the transaction. Concern was expressed that, based on 2004 Home Mortgage Disclosure Act (HMDA) data, the Savings Bank denies mortgages to minorities more frequently than to non-minorities and confines minorities to higher cost loans more frequently than non-minorities.

The Savings Bank has committed to address the various lending-related matters raised by Commenters. The Savings Bank's commitment to CRA-related activities is demonstrated by its "Outstanding" rating. Bancorp has committed to maintaining the present State Bank branches and the application states that the Savings Bank will consider placing branches in low- and moderate-income areas. The Savings Bank lends to a variety of housing lenders and will review its lending activities to ensure that nonprofit organizations are among those organizations receiving loans to better serve the credit needs of low-income neighborhoods.

The use of raw HMDA data does not reflect all factors necessary to determine whether a financial institution is improperly discriminating in its lending with respect to denial rates or interest rates charged. OTS recently reviewed the Savings Bank's lending activities in light of the most recent HMDA data and considered additional relevant factors appropriately considered by the Savings Bank for granting loans. OTS concludes, based on this more detailed review, that there was no evidence of discriminatory credit practices on any prohibited basis with respect to denial or pricing of loans in 2004 by the Savings Bank. The Savings Bank aggressively offers lending products in low- and moderate-income areas and may, therefore, attract more unqualified applicants than some other lenders; hence, it may have more loan denials than other lenders.

Based on the foregoing analysis, the application and related materials, and OTS' observations and examinations, OTS concludes that the comments do not provide a basis for denial of the applications.

Capital Distribution

OTS' regulations provide that a capital distribution filing may be denied if, generally, the proposed capital distribution would: (i) cause the institution to become undercapitalized; (ii) raise safety and soundness concerns; or (iii) violate any statute, regulation, agreement with OTS or condition of approval. The proposed distribution will not violate any prohibition contained in law, agreement with OTS, or condition of approval, and the Savings Bank will remain well capitalized after the distribution. Moreover, the proposed capital distribution does not raise safety and soundness concerns. Accordingly, OTS does not object to the Savings Bank's proposed capital distribution.

Charter and Bylaw Amendment

The Savings Bank has applied, pursuant to 12 C.F.R. §§ 552.4 and 552.5 to amend its charter and bylaws to provide for up to 18 members on its board of directors. In 1996, OTS amended its regulations to provide that charters and bylaws of federal associations could be amended to increase the size of the board to more than fifteen members, to allow OTS to respond to situations where an institution demonstrated the need for such flexibility.² OTS has previously permitted expansions of boards to accommodate a merger, and concludes that it is appropriate to permit the Savings Bank to expand its board in the manner proposed, in order to facilitate the integration of the State Bank into the Savings Bank.

Conclusions

Based on the foregoing analysis, OTS concludes that the applications meet the applicable approval criteria. For the reasons discussed above, OTS hereby waives 12 C.F.R. § 563.22(d)(1)(vi)(D) to permit members of an advisory board to be elected to a three year term. 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. Bancorp, the Savings Bank, the Target Holding Company, and the State Bank must receive all required regulatory and shareholder approvals and submit copies of such approvals to the Regional Director prior to the consummation of the proposed transaction;
2. The proposed BMA transaction must be consummated no earlier than 15 calendar days and no later than 120 calendar days from the date of this Order;

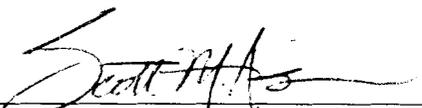
² 61 FR 64007 (Dec. 3, 1996).

3. On the business day prior to the date of consummation of the proposed transaction, the chief financial officers of Bancorp, the Savings Bank, the Target Holding Company, and the State Bank 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 as disclosed in the applications. If additional information having a material adverse bearing on any feature of the applications is brought to the attention of Bancorp, the Savings Bank, the Target Holding Company, the State Bank 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;
4. Bancorp, the Savings Bank, the Target Holding Company, and the State Bank must advise the Regional Director in writing within five calendar days after the effective date of the proposed holding company acquisition and merger: (a) of the effective date of the transaction; and (b) that the transaction was consummated in accordance with all applicable laws and regulations, the applications, and this Order;
5. No later than 30 calendar days after the merger of the State Bank with and into the Savings Bank, the Savings Bank must advise each accountholder, whose withdrawable accounts in the Savings Bank would increase above \$100,000 as a result of the merger, or whose uninsured balance would increase as a result of the merger, of the effect of the transaction on deposit insurance coverage, and submit a copy of such notice to the Regional Director;
6. The proposed new Bancorp board members and certain outside directors of Bancorp and the Savings Bank who have not submitted background information must submit such background information as required by the Regional Director and take such action as directed by the Regional Director if the background investigation of the individual reveals adverse information;
7. Bancorp must submit to the Regional Director for review the final term sheet for the second planned trust preferred securities issuance prior to the issuance date; and

8. The proposed employment agreements submitted in connection with the transaction must receive the written non-objection of the Regional Director prior to their execution.

The Regional Director may, for good cause, extend for up to 120 calendar days any time period set forth herein.

By order of the Director of the Office of Thrift Supervision, or his designee,
effective May 24, 2006.



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