P-99-4-A

Date: March 11, 1999.

Summary Conclusion: Section 10(o)(5)(C) of the HOLA and OTS Mutual Holding Company Regulations authorize the merger of two mutual holding companies and the merger of two mid-tier mutual holding companies where the state chartered savings bank subsidiary of the mid-tier holding company that would be acquired would elect treatment as a savings association pursuant to section 10(l) of the HOLA prior to the transaction. The resulting mid-tier stock holding company would have the legal authority to hold the acquired state-chartered savings bank as a separate institution.

Subjects: Home Owners' Loan Act/Savings Association Powers; Savings and Loan Holding Companies/Change in Control.

Office of Thrift Supervision
Department of the Treasury
1700 G Street, N.W., Washington, DC 20552 • (202) 906-6000

P-99-4-A

Chief Counsel

March 11, 1999

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Dear [ ]:

In your letter of November 18, 1998, you request confirmation that a proposed transaction, involving the merger of two mutual holding companies and two mid-tier stock holding companies, as more fully described below, is consistent with the regulations of the Office of Thrift Supervision ("OTS"), and may be approved subject to conditions. In addition, you request OTS confirmation that the resulting Federal mutual mid-tier stock holding company may, after the transaction, hold the acquired state-chartered savings bank, which would elect treatment as a savings association pursuant to section 10(l) of the Home Owners' Loan Act ("HOLA"), as a separate institution.

We apologize for the delay in our response. With respect to your first request, it is our view that section 10(o)(5)(C) of the HOLA and the OTS Mutual Holding Company ("MHC") Regulations authorize the proposed merger of the two mutual holding companies and the merger of the two mid-tier mutual holding companies, given that the state chartered savings bank would elect treatment as a savings association pursuant to section 10(l) of the HOLA immediately prior to the transaction. As discussed below, because this is a novel transaction and no application has been filed, we cannot confirm that the OTS would approve the specific transaction contemplated in your letter nor can we confirm what conditions may be imposed if the transaction were approved. With respect to your second request, in our opinion, the resulting mid-tier stock holding company would have the legal authority to hold the acquired state-chartered savings bank (which would have elected to be treated as a savings association pursuant to section 10(l) of the HOLA) as a separate institution.

Background

The acquiror in the proposed transaction is a Federal mutual holding company, [ ]("FMHC"), which holds 67 percent of the

common stock of a Federal mid-tier stock holding company, [ ] ("FMT"). Minority shareholders hold the remaining 33 percent of the FMT's common stock. The FMT holds all of the common stock of its subsidiary [ ] ("FSB").

The target in the proposed transaction is a state-chartered mutual holding company, [ ] ("SMHC"), which holds 54 percent of the common stock of a state-chartered mid-tier holding company, [ ] ("SMT"). The remaining 46 percent of the SMT's common stock is held by minority stockholders. The SMT holds all of the common stock of its subsidiary state-chartered savings bank, [ ] ("SSB").

You have advised us telephonically that, immediately prior to the proposed transaction, the SSB would elect to be treated as a savings association for purposes of section 10 of the HOLA, pursuant to section 10(l) of the HOLA.[1] In the proposed transaction, the SMHC would merge into the FMHC, with the FMHC being the survivor. Simultaneously, the SMT would merge into the FMT, with the FMT being the survivor. You state that no premium would be paid for the shares of either mid-tier holding company, and that each stockholder group would hold a percentage of the resulting FMT's stock in proportion to their relative contribution of earnings, book value and market capitalization. Further, you state that the exchange ratio would be negotiated on an arm's-length basis. The merger would be effected as a tax-free transaction to the merging holding companies and their stockholders. Upon consummation of the proposed transaction, the FMT would hold the FSB and the SSB as separate subsidiaries.

Discussion

Section 10(o)(5)(C) of the HOLA provides that a mutual holding company may, subject to section 10(o)(6) of the HOLA, merge with or acquire "another holding company, one of whose subsidiaries is a savings association." At the time of the proposed mergers, the SSB will have elected to be treated as a savings association for purposes of section 10 of the HOLA pursuant to section 10(l) of the HOLA, and therefore, both the SMHC and the SMT will be holding companies with a subsidiary savings association.[2]

The MHC Regulations do not specifically address the merger of the SMHC into the FMHC or the merger of the SMT into the FMT. Section 575.10(a)(3) of the MHC Regulations provides that "A mutual holding company that is not a subsidiary holding

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[1] 12 U.S.C. § 1467a(l).

[2] Given that the holding companies in question are either MHCs that are already subject to section 10(o)(6) of the HOLA, or bank holding companies that are subject to bank holding company activities restrictions, it is our understanding that the proposed mergers would not raise any issues under section 10(o)(6) of the HOLA.

company may acquire control of another mutual holding company, including a subsidiary holding company, by merging with or into such company, provided the necessary approvals are obtained from OTS . . . ."[3] The regulations, however, define the term "mutual holding company" as a mutual holding company organized under 12 C.F.R. Part 575.[4] Accordingly, neither the SMHC nor the SMT is a mutual holding company within the scope of the regulations.

The SMHC would clearly be authorized to merge into the FMHC under the MHC Regulations if the SMHC converted to a Federal charter.[5] The OTS has authorized conversions of state-chartered mutual holding companies to a Federal charter when such a conversion is accompanied by the conversion of a depository institution to a savings association.[6] Also, the preamble to the 1993 MHC regulations states both that state-chartered savings banks may elect to be treated as savings associations for purposes of section 10 of the HOLA, thus making the provisions of section 10(o) available,[7] and that mutual holding companies under section 10(o) of the HOLA must have a Federal charter.[8]

In an analogous situation, the Chief Counsel of the OTS addressed the direct conversion of a Federal association to a national bank, where the authority for a two-step conversion was clear. The Chief Counsel stated:

> It is plain that no legal barrier exists to the ultimate accomplishment of the proposed conversion. Federal statutes should be interpreted and applied in a manner consistent with their purpose. In doing so, the OTS has a responsibility to look beyond the form of transactions to their true substance. In this instance, the HOLA must not be read to exalt the form of the proposed transaction over its substance. To read HOLA as impliedly compelling a two step conversion would impose upon the Savings Bank unnecessary additional expenses and complications.[9]

In this situation, where the SMHC and the SMT could engage in the proposed mergers after having converted to Federal charters, requiring such a conversion where the two entities would exist as separate entities for only a moment in time would similarly exalt form over substance. Accordingly, in our opinion, in this situation, section 575.10(a)(3) should be read as encompassing the proposed mergers.

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3 See 12 C.F.R. § 575.10(a)(3), as amended by 63 Fed. Reg. 11361, 11365 (Mar. 9, 1998).

4 12 C.F.R. § 575.2(h), as amended by 63 Fed. Reg. 11365.

5 In addition, in our opinion, the MHC Regulations should be interpreted as permitting the SMT to merge into the FMT, if the SMT were to convert to a Federal charter. In drafting the 1998 revisions addressing mid-tier stock holding companies, the OTS did not intend to prevent the merger of two mid-tier holding companies. Further, interpreting section 575.10(a) as not permitting the merger of two mid-tier companies leads to an anomalous result, when OTS regulations explicitly permit the merger of the parent mutual holding companies (§ 575.10(a)(3)) and the subsidiary depository institutions (§ 552.13(c)).

6 See Op. BTD (Dec. 5, 1995) (Mascoma Mutual Holding Company).

7 See 58 Fed. Reg. 44105, 44107 (Aug. 19, 1993).

8 See 58 Fed. Reg. 44106.

9 Op. C.C. (Nov. 7, 1990), at 5.

Nevertheless, we cannot advise you that we would approve a particular transaction before receiving an application and reviewing all of the facts pertaining to the transaction. Your letter does not state how the entities in question would be valued, and we cannot determine if the proposal is fair to, and in the best interests of the mutual members, the shareholders and the mutual holding companies.[10]

Aside from the issue regarding the legal authority for the holding companies to engage in the proposed mergers, the proposed transaction raises an issue under the MHC Regulations due to the proposed issuance of stock of the FMT to shareholders of the SMT. The MHC Regulations, at 12 C.F.R. § 575.7(d)(6)(ii), require that a stock offering of a savings association subsidiary of a mutual holding company be structured in the same manner as a mutual to stock conversion subject to 12 C.F.R. Part 563b, including the stock purchase priorities. Section 575.14(b) of the MHC Regulations[11] provide that for purposes of the stock offering provisions of the MHC Regulations, mid-tier stock holding companies are treated as savings associations.

The proposed offering of shares of the FMT to stockholders of the SMT, therefore, is inconsistent with the MHC Regulations. The OTS has stated that it generally will require that mutual members be granted a first priority subscription interest for stock issued by subsidiary savings associations and stock mid-tier companies.[12] Nevertheless, the OTS, at the same time, stated that it believes that "properly structured merger transactions that do not grant priority subscription rights may qualify for approval and the OTS is willing to consider and approve such transactions on a case-by-case basis."[13] In order to determine whether to waive the requirement for priority subscriptions to mutual members, however, the OTS would need to receive an application and consider all of the relevant facts pertaining to the transaction.

With respect to the authority for the resulting mid-tier holding company, the FMT, to hold the SSB as a subsidiary, the SSB would have elected to be treated as a savings association for purposes of section 10 of the HOLA, pursuant to section 10(l) of the HOLA.[14] Section 575.10(a)(1) authorizes mutual holding companies to acquire control of savings associations in the stock form, subject to OTS approval. Accordingly,

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10 See 12 C.F.R. § 575.7(a)(3). See also 12 C.F.R. § 575.14(a).

11 See 12 C.F.R. § 575.14(b), as added at 63 Fed. Reg. 11366.

12 See 63 Fed. Reg. 11364.

13 Id.

14 12 U.S.C. § 1467a(l).

in our opinion, the resulting mid-tier stock holding company would have the legal authority to hold the SSB as a separate institution.

We hope that the foregoing is responsive to your requests. If you have any questions regarding the foregoing, please call David Permut, Counsel (Banking and Finance) at (202) 906-7505.

Sincerely,

Kevin A Corcoran

Kevin A. Corcoran
Acting Deputy Chief Counsel
for Business Transactions

cc: [

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