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Conversion of a Savings Association from the Mutual to the Stock Form of Ownership: Current Legal Process

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Summary

A savings association is permitted by statute to convert from the mutual to the stock form of ownership. Regulations issued by the Director of the Office of Thrift Supervision provide the procedures by which a conversion may occur. This report summarizes major portions of these regulations. This report will be updated as warranted.

A savings association¹ may convert from the mutual² to the stock form of ownership.³ The conversion is subject to the regulations issued by the Director of the Office of Thrift Supervision.⁴ The applicable regulations are located primarily in 12 C.F.R. Part 563b.

Before passing a plan of conversion, the savings association must have its board or a subcommittee of its board meet with the Office of Thrift Supervision (OTS) for the purpose of providing OTS with a written strategic plan outlining the objectives of the

¹ A “savings association” is defined as:

(A) any Federal savings association;

(B) any State savings association; and

(C) any corporation (other than a bank) that the Board of Directors [of the Federal Deposit Insurance Corporation] and the Director of the Office of Thrift Supervision jointly determine to be operating in substantially the same manner as a savings association. 12 U.S.C. § 1462(4), referencing 12 U.S.C. § 1813(b)(1).

² A mutual savings association is a savings association owned by the members of the association. If a mutual savings association converts to the stock form of ownership, the organization is owned by the shareholders.

³ 12 U.S.C. § 1464(i)(1).

⁴ *Id.*

proposed conversion and the intended use of the conversion proceeds.⁵ The business plan is required to contain at least the following information: 1. projected operations and activities for three years following the conversion; 2. a provision that the converted savings association must retain at least 50% of the net conversion proceeds or a larger percentage if required by OTS; 3. its plan for deploying conversion proceeds to meet credit and lending needs in the proposed market areas; 4. the risks associated with the plan for deployment of conversion proceeds and the effect of the plan on management resources, staffing, and facilities; and 4. the expertise of the management and board of directors or proof that plans have been made for adequate staffing and controls to manage prudently the growth, expansion, new investment, and other operations and activities proposed in the business plan.⁶ The savings association is prohibited from projecting returns of capital or special dividends in any part of the business plan.⁷

The chief executive officer and members of the board of directors of the savings association must review the business plan, and at least two thirds of the board of directors must approve the plan. Certifications as to the accuracy of the business plan must be made by the chief executive officer and at least two thirds of the board of directors.⁸ OTS will review the business plan to determine that it demonstrates a safe and sound deployment of conversion proceeds.⁹

Members of a savings association must be notified promptly when the board of directors has adopted a plan of conversion and has made the plan available for inspection. The board is required to send a letter to each member or publish a notice in the local newspaper in every local community where the savings association has an office. The Internal Revenue Service must issue a favorable tax ruling or a tax expert must issue an appropriate tax opinion on the tax consequences of the conversion before OTS will approve the conversion. The ruling or opinion must indicate that the conversion will be a tax-free reorganization.¹⁰

OTS is allowed to approve the application for conversion only if the application complies with the issued regulations, the regulatory capital requirements will be met after the conversion, and the conversion will not result in a taxable reorganization.¹¹ Any person aggrieved by OTS's final action on the application for conversion may ask the court of appeals of the United States for the circuit in which the principal office of the association or residence of the person is located or the United States Court of Appeals for the District of Columbia Circuit to review the action.¹²

⁵ 12 C.F.R. § 563b.100(a).

⁶ 12 C.F.R. § 563b.105(a).

⁷ 12 C.F.R. § 563b.105(b).

⁸ 12 C.F.R. § 563b.110.

⁹ 12 C.F.R. § 563b.115(a).

¹⁰ 12 C.F.R. § 563b.135.

¹¹ 12 C.F.R. § 563b.200(a).

¹² 12 C.F.R. § 563b.205(a).

The plan of conversion, after approval by OTS, must be submitted to the members of the savings association for approval. The members must approve the plan of conversion by a majority of the total outstanding votes, unless the association is state-chartered and state law prescribes a higher percentage.¹³

The members must be notified of the meeting to consider the conversion by being sent a proxy statement authorized by OTS 20 to 45 days before the meeting.¹⁴ After the members' meeting, the converting mutual savings bank must file with OTS: 1. a certified copy of each adopted resolution on the conversion; 2. the total votes eligible to be cast; 3. the total votes represented in person or by proxy; 4. the total votes cast in favor of and against each matter; 5. the percentage of votes necessary to approve each matter; and 6. an opinion of counsel that the meeting was conducted in compliance with all applicable state or federal laws or regulations.¹⁵ Proxy solicitation requirements are specified.¹⁶

Before filing with OTS a plan of conversion from the mutual to the stock form, the board of directors by a two thirds vote must adopt a plan of conversion in compliance with OTS regulations concerning offers and sales of stock and trading of shares by officers, directors, and their associates.¹⁷ Offers of sales of shares must be made in the following order: 1. eligible account holders; 2. tax-qualified employee stock ownership plans; 3. supplemental eligible account holders; 4. other voting members who have subscription rights; and 5. the savings association's community or the general public.¹⁸ The conversion shares may be offered for sale after OTS approves the conversion, authorizes the proxy statement, and declares the offering circular effective.¹⁹

Share prices in the offering are strictly regulated. The shares must be sold at a uniform price per share and at a total price equal to the estimated market value of the shares after conversion. The maximum and minimum prices of the shares must be no more than 15% above or 15% below the mid-point of the estimated price range. The maximum share price must be between \$5 and \$50.²⁰

Various sales practices are prohibited. Among these are any device, scheme, or artifice to defraud; obtaining money or property by means of an untrue statement of a material fact or omission of a material fact necessary to make the statements not misleading; engaging in an act, transaction, practice, or course of business that operates or would operate as a fraud or deceit upon a purchaser or seller; transferring the legal right or beneficial ownership of subscription rights for conversion shares or the underlying

¹³ 12 C.F.R. § 563b.225.

¹⁴ 12 C.F.R. § 563b.225.

¹⁵ 12 C.F.R. § 563b.240.

¹⁶ 12 C.F.R. §§ 563b.250–563b.295.

¹⁷ 12 C.F.R. § 563b.125.

¹⁸ 12 C.F.R. § 563b.320.

¹⁹ 12 C.F.R. § 563b.325.

²⁰ 12 C.F.R. § 563b.330.

securities to the account of another; or knowingly acquiring more than the maximum purchase allowable under the plan of conversion.²¹

The regulations specify formulas for the amount of subscription rights which must be given to each eligible account holder and each supplemental eligible account holder.²²

Officers, directors, their associates, and other voting members may be given subscription rights, but there are specific limits placed on aggregate purchases by officers, directors, and their associates and on allocation of conversion shares if the shares are oversubscribed.²³

Other purchase limitations may be imposed. A tax-qualified employee stock ownership plan may purchase up to 10% of the total offering of the conversion shares.²⁴ The number of shares sold to any person, group of associated persons, or persons otherwise acting in concert may be limited to between 1% and 5% of the total stock sold.²⁵ In the subscription offering a purchase preference may be given to eligible account holders, supplemental eligible account holders, and voting members residing in the local community. In the community offering, a purchase preference must be given to natural persons residing in the local community.²⁶

The sale of the stock must be completed within 45 calendar days after the last day of the subscription period, unless the offering is extended.²⁷ OTS may grant extensions if a request is made in writing, but no single extension may be for longer than 90 days.²⁸

A conversion must be completed within 24 months from the date that the members have approved the plan of conversion. If the date for conversion has been set, it cannot be extended. If the conversion has not been completed by that date, it must be terminated.²⁹ The conversion may also be terminated by the members by failing to approve the conversion at the members' meeting, by the board before the members' meeting, or by the board after the members' meeting if OTS concurs.³⁰

²¹ 12 C.F.R. § 563b.340.

²² 12 C.F.R. § 563b.355.

²³ 12 C.F.R. §§ 563b.360–563b.375.

²⁴ 12 C.F.R. § 563b.380.

²⁵ 12 C.F.R. § 563b.385.

²⁶ 12 C.F.R. § 563b.390.

²⁷ 12 C.F.R. § 563b.400.

²⁸ 12 C.F.R. § 563b.405.

²⁹ 12 C.F.R. § 563b.420.

³⁰ 12 C.F.R. § 563b.425.

Stockholders must be provided with exclusive voting rights,³¹ unless the savings association is state-chartered and state law requires that voting rights shall be provided to savings account holders or borrowers.³²

Each savings account holder must be provided a withdrawable savings account in the same amount and under the same terms and conditions as accounts before the conversion.³³ A liquidation account³⁴ must be provided for each eligible and supplemental eligible account holder.³⁵ Directions for determining the balance of the liquidation account are provided.³⁶

Post-conversion, a stock option plan or management or employee stock benefit plan may be implemented within 12 months after the conversion.³⁷ Directors and officers who purchase conversion shares may not sell the shares for one year after the date of purchase.³⁸ For three years after the conversion, the officers, directors, and their associates may purchase stock only from a broker or dealer registered with the Securities and Exchange Commission. Officers, directors, and their associates may engage in a negotiated transaction involving more than one percent of the outstanding stock and may purchase stock through any of the management or employee stock benefit plans.³⁹ Dividends may be declared or paid after conversion if certain criteria are met.⁴⁰ Some of the conversion shares or proceeds may be contributed to a charitable organization.⁴¹

³¹ 12 C.F.R. § 563b.440.

³² 12 C.F.R. § 563b.445(c).

³³ 12 C.F.R. § 563b.445(a).

³⁴ A “liquidation account” represents the potential interest of eligible account holders and supplemental eligible account holders in the net worth of the savings association at the time of conversion. 12 C.F.R. § 563b.450(a).

³⁵ 12 C.F.R. § 563b.445(b).

³⁶ 12 C.F.R. §§ 563b.445–563b.485.

³⁷ 12 C.F.R. § 563b.500(a).

³⁸ 12 C.F.R. § 563b.505(a).

³⁹ 12 C.F.R. § 563b.505(d).

⁴⁰ 12 C.F.R. § 563b.520.

⁴¹ 12 C.F.R. § 563b.550.

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