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SAVINGS AND LOAN ASSOCIATIONS — MUTUAL TO STOCK CONVERSIONS UNDER THE REVISED REGULATIONS

by

PETER B. SABA* AND ROBERT B. ROBBINS**

I. HISTORICAL SUMMARY

Traditionally, SAVINGS AND LOAN ASSOCIATIONS have been organized as mutual corporations. In 1933, Congress enacted the Home Owners’ Loan Act (HOLA), which adopted this form of organization for the federal system of savings and loans. HOLA authorized the formation of federal mutual savings and loan associations chartered by the Federal Home Loan Bank Board (FHLBB) and allowed previously chartered state associations to convert to federal associations. Shortly thereafter, states began passing legislation permitting the formation of state-chartered stock associations and the conversion of state-chartered mutual associations to stock associations. In 1948, Congress amended HOLA to allow federal mutual savings and loans to convert to state stock associations. The erosion of the federal system and other undesirable consequences resulting from these conversions led to the imposition of an administrative moratorium on federal-to-state conversions from June 1955 to December 1961. Another administrative moratorium was invoked in December 1963 in order to permit the FHLBB to study the conversion process and develop a practical and equitable system.

This administrative moratorium was adopted by the legislature in 1973 with the passage of Public Law 93-100, amending the National Housing Act of 1934. Public Law 93-495, passed in 1974, extended the moratorium on all

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1See generally the historical summaries in York v. FHLBB, 624 F.2d 495, 497-98 (4th Cir. 1980), cert. denied, 449 U.S. 1043 (1980); Leibold & Wilfand, The Conversion Process; Mutual to Stock Savings and Loan Associations, 30 BUS. LAW. 129, 131-32 (1974); Lucarelli & Teague, Converting into a Stock Company, FED. HOME LOAN BANK BOARD, Sept. 1979, at 3, 5.


4The consequences of a number of conversions were less than ideal. Some of them were characterized by very few people owning most of the stock of the resulting stock association and having paid relatively little to the former members who had received warrants, rights, or stock representing their ownership interests in the association upon conversion.” Leibold & Wilfand, supra note 1, at 131 (footnote omitted).

conversions until June 30, 1976, with the exception of previously filed applications and a limited number of test cases. Moreover, this amendment to the National Housing Act gave the Bank Board authority to approve conversions of federal mutual associations to federal stock associations. While there had been some question as to whether the Bank Board’s authority to approve federal mutual to federal stock conversions expired in 1976, both the U.S. District Court for the District of Columbia and the Fourth Circuit upheld the continued legal authority of the Bank Board to approve such conversions. Furthermore, the Garn-St. Germain Depository Institutions Act of 1982 provides the Bank Board with clear authority to regulate such conversions.

The conversion from mutual to stock form of an institution, the accounts of which are insured by the Federal Savings and Loan Insurance Corporation (FSLIC), is governed by regulations promulgated by the Bank Board. These regulations have been extensively amended, most recently in May 1982, February and April 1983, and February 1984. These amendments provide increased flexibility to converting insured institutions in structuring their conversion and substantially reduce the time and expense of conversion. This simplified conversion process, the deregulation of financial institutions, and a favorable market for the stocks of converted institutions have led to a dramatic increase in the number of conversions.

The relevant sections are:

Section 313 which amends § 5(i) of the Home Owners’ Loan Act of 1933 (12 U.S.C. § 1464(i)) to read as follows:

(i)(2) Subject to the rules and regulations of the Board, any Federal association may convert itself from the mutual form to the stock form of organization, or from the stock form to the mutual form, and any Federal association may change its designation from a Federal savings and loan association to a Federal savings bank, or the reverse.

Section 314 which amends § 402(j) of the National Housing Act (12 U.S.C. § 1725(f)) to read as follows:

(1) Except as provided in section 5 of the Home Owners’ Loan Act of 1933, no insured institution may convert from the mutual to the stock form except in accordance with the rules and regulations of the Corporation.

12 C.F.R. § 563b (1984). The FHLBB is the operating head of the FSLIC, 12 U.S.C. § 1725(a) (1982), and the FHLBB and FSLIC have a common governing board and essentially the same staff. This article uniformly refers to the FHLBB while the regulations make references to both.

The provisions of Part 563b shall exclusively govern the conversion of mutual insured institutions to capital stock institutions, and no mutual insured institution shall convert to the capital stock form without the prior written consent of the FHLBB. Id. at 563b.1(a).

Moreover, the provisions of Part 563b shall supersede all inconsistent charter and bylaw provisions of federally chartered associations converting to the stock form. Id. at 563b.3(k).
The new rules provide for four types of conversions: (1) standard conversions; (2) sale-of-control conversions; (3) voluntary supervisory conversions; and (4) modified conversions. In a standard conversion, association members receive, without payment, nontransferable subscription rights to purchase shares on a preemptive basis according to the categories of eligibility and in amounts set in the regulations. Any shares of the converting institution not sold to persons with subscription rights must be sold in an underwritten public offering or in a direct community offering. A sale-of-control conversion allows association members to vote to sell a controlling stock interest in the institution to one or more third parties.\(^\text{12}\) A voluntary supervisory conversion entails the conversion of a technically insolvent institution without the consent of or participation by the mutual members. The modified conversion regulations allow, on a test-case basis for qualifying institutions, conversions resembling sale-of-control conversions, without bidding or member consent, but with member participation through preemptive rights.

II. THE MUTUAL FORM OF ORGANIZATION AND CONVERSIONS

Under the mutual form of organization, the savings and loan association is "owned" by its members.\(^\text{13}\) Members are usually defined as all holders of the association’s savings accounts and all borrowers therefrom. Among their rights and privileges as owners is the right of control. Generally, borrowers are entitled to cast one vote in their capacity as borrowers, while savers are entitled to cast votes based upon the amount deposited and often subject to a statutory maximum. In practice, many associations solicit a continuous proxy at the time a savings account is opened which allows the officers or directors of the association to cast the depositor’s votes. Other attributes of ownership are circumscribed by statute and regulation. The members are not allowed to share in the profits of the association through dividends, but are entitled only to an established rate of interest that is often limited by regulation. The depositors do not share in the risk of loss to the extent that their accounts are insured. While the saving members with existing accounts have the right to participate on a pro rata basis in any assets remaining after dissolution or liquidation, federal regulations prohibit dissolution without Bank Board approval\(^\text{14}\) and no solvent association has ever secured such approval. The status of these ownership interests has led to the conclusion that "[d]epositors will not be deprived of property rights by conversion to a federal stock organization. Depositors’ only actual rights, their rights as creditors of the association, will remain unchanged by the conversion."\(^\text{15}\)

\(^{12}\)But see infra note 10.


\(^{15}\)York, 624 F.2d at 500 (Footnote omitted) (holding that the approval of the conversion of First Federal Savings and Loan Association of Raleigh was within the discretion of the Bank Board and was neither arbitrary nor capricious).
The corporate existence of a mutual association converting to a federal stock association does not terminate and the converted association is deemed to be a continuation of the mutual entity. An account holder continues to have the same account in the converted stock association as (s)he had before the conversion. The conversion does not affect FSLIC insurance, savings account balances, certificate maturities, loan account balances, or the rights and obligations of borrowers. Voting and liquidation rights, however, are modified. After the conversion, voting rights vest exclusively in the shareholders of the converted association. Furthermore, a converting association must create a liquidation account in an amount equal to its net worth before conversion. 

The function of the liquidation account is to establish a priority in the event of a complete liquidation, but otherwise not to restrict the use of the capital of the converted association, except for a restriction on dividends. Each eligible account holder and supplemental eligible account holder has a pro rata inchoate interest in a portion of the liquidation account ("subaccount"). Such initial subaccount balances may not be increased and are adjusted downward each year as balances in the related accounts decrease or as the related accounts are closed.

III. Advantages and Disadvantages of Converting

The major advantage gained by converting from mutual to stock form is the immediate infusion of low-cost equity capital. This additional capital can be used to satisfy both federal insurance reserve and net worth requirements. Through the multiplier effect, such capital can support a magnified increase in deposits. The larger capital base enables an institution to expand and diversify its services and thereby compete more effectively in an increasingly deregulated financial industry environment. Moreover, the stock form will facilitate growth through acquisition and mergers and will provide additional opportunities to diversify operations through the formation of a holding company. A converted institution also has the option of reentering the capital

13 Id. at § 563b.3(c)(12).
14 Id. at § 563b.3(c)(15). Under FHLBB regulations, stockholders in federal stock associations exclusively possess all voting power. Id. at § 552.3. The laws of most states also provide that stockholders in state-chartered stock associations exclusively hold all voting power. In the case of a state-chartered converted insured institution, should state law require that savings account holders and/or borrowers also have voting rights, the FHLBB’s regulations require that the converted association’s charter “limit such voting rights to the minimum required by State law” and provide for the solicitation of proxies. Id. at § 563b.3(c)(15).
15 Id. at § 563b.3(b)(13), § 563b.3(f).
16 Id. at § 563b.3(g)(2), which provides: “No converted insured institution shall declare or pay a cash dividend on, or repurchase any of, its capital stock if the effect thereof would cause the net worth of the converted insured institution to be reduced below (i) the amount required for the liquidation account or (ii) the net worth requirements contained in § 563.13(b) of this subchapter.”
17 Id. at § 563b.3(f).
18 For a discussion of the advantages of converting see Allen, Stock Conversions Under the Amended Regulations, 13 AKRON L. REV. 463, 465-69 (1980); Lee, supra note 13, at 29-31; Leibold & Wilfand, supra note 1, at 129; Lucarelli & Teague, supra note 1, at 4. For the arguments against permitting conversions see Note, Mutual-to-Stock Conversions and the Federal Home Loan Bank Board, 82 YALE L.J. 559 (1973).
markets to sell additional stock and thus further enlarge its capital base.

In addition to the direct financial benefits associated with converting, particularly the increase in income as a result of revenue earned on funds raised through conversion, the stock form of ownership allows management and other personnel to participate on an equity basis in the growth and profitability of the institution through stock option and other equity-based programs. These programs can be effectively utilized to create performance incentives and as a means of retaining, attracting and compensating qualified personnel. Even without such programs, the issuance of stock and the attendant emphasis on institution and stock performance create their own psychological incentives.

The conversion places the institution in the same form of ownership as all commercial banks and most business organizations and is not without disadvantages. From a management perspective, the greatest disadvantage associated with converting is the threat of takeover. While somewhat diminished by regulatory restrictions and the inclusion of "shark-repellent" devices in the charter or bylaws, the possibility of an unfriendly takeover remains quite real. Furthermore, conversion entails additional expenses in the form of the cost of the conversion itself and the continuing additional costs of the stock form of organization. Also, stock associations may no longer use Regulatory Accounting Principles, but must use Generally Accepted Accounting Principles which treat certain items less favorably and may have an adverse effect on reported earnings.

IV. STANDARD CONVERSIONS

Standard conversions must comply with the requirements of Subpart A of the conversion regulations. In addition, "the provisions of [that] Subpart shall govern conversions undertaken pursuant to any other Subpart... unless clearly inapplicable." A standard conversion must be approved by the insured institution's board of directors, by the FHLBB and by the association members. The FHLBB will not approve a conversion application if, as a result: (1) the institution would fail to meet the reserve or net worth requirements;

1Previous, the FHLBB permitted converting institutions to adopt stock option plans as part of the plan of conversion. In the April 1983 amendments to the conversion regulations, the FHLBB concluded that a stock option plan is a matter for future stockholders and deleted this authority. The converting institution is still required under general disclosure principles to make full disclosure in the proxy statement and offering circulars of any stock option plans that will be proposed to the stockholders following completion of the conversion. 48 Fed. Reg. 15,592 (1983).


3Id. See also Lucarelli & Teague, supra note 1, at 4-5.

4See infra notes 98-102 and accompanying text.

5These continuing costs include such items as transfer agent fees, additional costs due to public reporting, and the time and expense of public and shareholder relation programs. Frank, supra note 24, at 54-55.

6Id. at 51-52.


8Id. at § 563b.3(a).
(2) the conversion would be a taxable event under the Internal Revenue Code of 1954, as amended; or (3) the institution would lose its federal account insurance.31

The process begins with adoption of a plan of conversion by at least two-thirds of the association’s board of directors.32 The FHLBB regulations contain a list of twenty-two mandatory and fourteen optional provisions for the plan of conversion.33 The intention to convert should be kept in the strictest confidence prior to adoption of the plan by the directors. Promptly after adoption of the plan of conversion by the board of directors, the association must (i) notify its members of such action by publication or letter and (ii) make copies of the plan available for inspection at each of its offices. In addition, the association may issue a press release.34

After director approval and member notification, the association files ten copies of an application for conversion on Form AC as set forth in the regulations.35 The application consists primarily of the plan of conversion, a preliminary proxy statement with signed financial statements, a preliminary form of proxy, the proposed offering circulars, the appraisal report and the proposed stock charter and bylaws.36 In addition, the association must apply to amend its charter and bylaws to read in the form of a charter and bylaws

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31Id. at § 563b.3(b).

32The FHLBB requires either favorable rulings from the Internal Revenue Service and the appropriate state taxing authority or a favorable opinion of counsel as to the income tax consequences of the plan of conversion for the applicant and those receiving subscription rights (Exhibit 4 of Form AC).

33The IRS in Rev. Rul 80-105 1980-1 C.B. 78 and numerous private rulings has held that mutual-to-stock conversions conforming with the FHLBB conversion regulations are nontaxable reorganizations under the provisions of § 368(a)(1)(F) of the Internal Revenue Code. Generally, most state income tax laws define state taxable income in terms of federal taxable income. Accordingly, most conversions are also nontaxable under state tax laws.

34Id. at § 563b.4(a)(3) (1984).

35Id. at § 563b.3(c), (d).

36The plan of conversion may be substantively amended by the board of directors prior to the solicitation of proxies from members and at any time thereafter with the concurrence of the FHLLB; the conversion may be terminated by the board of directors prior to the meeting of members and at any time thereafter with the concurrence of the FHLBB. Id. at § 563b.3(c)(16).

37Id. at § 563b.4(a). The contents of the publication, letter and press release are limited by § 563b.4(a)(4). Copies of the proposed publication, letter and press release are not required to be filed with the FHLBB, but may be submitted for comment. Copies of the definitive statement, letter and press release, however, must be filed with the FHLBB as part of the application for conversion. Id. at § 563b.4(a)(3)(ii).

38Three copies shall be filed with the Supervisory Agent and the remaining copies with the Securities Division, Office of the General Counsel of the FHLBB. Id. at § 563b.8(a), (e). The Supervisory Agent is defined as (i) the President of the Board of the Federal Home Loan Bank district in which the applicant has its principal office, or (ii) any other person who is specifically designated as an agent by FSLIC to act on its behalf in the administration of this part. Id. at § 563b.2(a)(33). Under the regulations the General Counsel has the authority to approve, but not to deny applications. Id. at § 563b.8(w)(2).

39Other items required to be furnished in Form AC include a timetable for the conversion, data with respect to establishment of the eligibility record date, an estimate of the expenses of conversion, information concerning indemnification arrangements, and a variety of exhibits, such as the board of directors’ resolution, opinions of counsel, contracts with management, the valuation materials (unless the offering will not commence before the meeting of association members), and tax rulings.
for a Charter S or Charter T Association. Upon determination that an application for conversion is properly executed and is not materially incomplete, the FHLBB will advise the applicant, in writing, to publish a notice of the filing of the application and will commence processing of the application.

There is a tripartite staff review of the application, involving the legal, appraisal and accounting staffs of the FHLBB: legal (Securities Division, Office of General Counsel), for adequacy of proxy statement disclosures and compliance with regulations; accounting (Office of Chief Accountant [of the Office of Examinations and Supervision]), for compliance with FHLBB accounting regulations; and appraisal (Office of Policy and Economic Research), for adequacy of appraisal methodology and fairness of the proposed appraisal price range.

Following FHLBB approval of an application for conversion, the plan of conversion must be submitted for approval to a special meeting of the association members. The plan must be approved by at least a majority of the total outstanding votes of the association members. The record date for determining those members eligible to vote at the special meeting cannot be more than sixty nor less than ten days prior to the date of such meeting. Notice of the meeting must be given to voting members by means of the proxy statement.

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12 C.F.R. § 563b.8(d)(2) (1984). The effective date of such amendments shall be stated in the FHLBB resolution approving the conversion. See also Id. at § 552.2-5.

In September 1983, the FHLBB adopted revisions to the regulations regarding the charters and bylaws of federally chartered mutual and stock savings and loan associations and savings banks. 48 Fed. Reg. 44,174 (1983). The amendments establish a single charter requirement for federal stock institutions, whether they are savings and loan associations or savings banks. 12 C.F.R. §§ 552.3-4. Formerly, federal stock savings and loan associations charters were in the form of Charter S and federal stock savings banks charters were in the form of Charter T. The Bank Board also eliminated prescribed bylaws and instead adopted regulatory standards governing internal management. 12 C.F.R. §§ 552.5-6.4. The FHLBB retained updated versions of the previously required bylaws as model bylaws which are deemed to meet the regulatory standards. Id. at § 552.5(b), 552 appendix.

The charters and bylaws of existing institutions are not affected by these amendments to the regulations unless an institution chooses to amend its charter or bylaws to conform to the revised regulations. Converting associations, however, must adopt the new form of charter. It is anticipated that technical amendments to 12 C.F.R. §§ 563b.8(d)(2), 552.2-5, eliminating the references to Charter S and Charter T, soon will be forthcoming.

Under 12 C.F.R. § 563b.4(b) the applicant must post notice of the filing in each of its offices and publish such notice in a newspaper. The contents of the notice, including the procedure for filing objections to the plan, are specified in paragraph b.4(b)(1). Copies of the notice and affidavits of publication must be filed under paragraph b.4(b)(3).

Generally, applications are processed in chronological sequence once they have been accepted for filing. On written request under § 563b.8(b)(3), an application which contains at least a materially complete plan of conversion will be accepted for filing but will not be reviewed until additional materials are accepted for filing and the applicant so requests. On the other hand, under § 563b.3(j), the FHLBB will process for approval on a priority basis applications which include in the plan of conversion the optional provision of § 563b.3(d)(2) that the subscription offering shall commence within forty-five days after the date of the meeting of association members held to vote on the plan of conversion.

Goldberg and Marcotte, Mutual to Stock Conversions by Savings and Loan Associations: An Update, 37 BUS. LAW. 856, 866 (1982).
authorized for use by the FHLBB. Proxies must be solicited specifically for a vote on the conversion and previously solicited proxies may not be used. In lieu of the 100+ page proxy statement generally issued in a conversion, converting institutions are now permitted to issue a summary proxy statement provided that members can obtain the full proxy statement or offering circular by returning an enclosed postage-paid postcard. The summary proxy statement procedure is intended to reduce the paperwork and cost burdens on institutions, while still providing members with the information material to their consideration of a decision whether to convert.

Normally, plans of conversion receive the requisite member support. After member approval, notice of the result and an opinion of counsel must be filed in accordance with section 563b.8(c). The conversion must then be completed within the time period established in the plan. This time period cannot be more than twenty-four months from the date the association members approve the plan and cannot be extended.

12 C.F.R. § 563b.6 (1984). The solicitation of proxies, proxy statement and form of proxy are governed by § 563b.5 and Form PS. These regulations are based on Regulation 14A, Schedule 14A and Form 10 of the Securities and Exchange Commission (pursuant to the 1934 Act).

The proxy statement contains an extensive description of the association’s business, management, and plan of conversion. A list of the items included in Form PS follows:

- Item 1. Notice of Meeting
- Item 2. Revocability of Proxy
- Item 3. Persons Making Solicitation
- Item 4. Voting Rights and Vote Required for Approval
- Item 5. Directors and Executive Officers
- Item 6. Management Remuneration
- Item 7. Business of the Applicant
- Item 8. Description of the Applicant’s Plan of Conversion
- Item 9. Description of Capital Stock
- Item 10. Capitalization
- Item 11. Use of New Capital
- Item 12. New Charter, Bylaws or Other Documents
- Item 13. Other Matters
- Item 14. Financial Statements
- Item 15. Consents of Experts and Reports
- Item 16. Attachments

Notice of the meeting must be given to association members not more than 45 nor less than 20 days prior to the date of the meeting. Id. at § 563b.6(c).

An alternative means of notice to eligible account holders and supplemental account holders who are not voting members is allowed under § 563b.6(d).

The summary proxy statement can be approximately twelve pages in length and:
(a) eliminates (1) Item 6 Management Remuneration, (2) most of Item 7 Business of the Applicant (except items concerning the organization of the association, a summary of selected financial data, and material pending litigation), (3) Item 14 Financial Statements, (4) most of Item 15 Consents of Experts and Reports;
(b) allows summary form disclosure of Item 8(j) director and officer purchase of capital stock, Item 9 Description of Capital Stock, and Item 13 Other Matters;
(c) requires only the disclosure of the names, ages and present occupations of all directors and executive officers under Item 5;
(d) eliminates the attachment of the plan requirement of Item 16; and
(e) provides for the inclusion of the statement contained in § 563b.8(u) Review of Board (FHLBB) action.

The summary proxy statement procedure entails a longer notice requirement so that those persons requesting the supplemental information statement will have sufficient time to respond. Id. at § 563b.3(d)(14)(i)(b).
Securities issued by savings and loan associations are exempt from the registration requirements of the Securities Act of 1933.\(^4\) Instead, the offering of conversion stock is governed by the FHLBB conversion regulations.\(^4\) The association must issue and sell its capital stock at a total price equal to the estimated pro forma market value of the stock of the converted institution based on an independent valuation.\(^4\) The purchase price per share must be the same for all purchasers, except for an underwriters’ discount in the case of an underwritten public offering.\(^4\) An applicant may not make any offer to sell securities prior to FHLBB approval of the application for conversion and authorization for use of the proxy statement. No sale of securities may be made except by means of a final offering circular which has been declared effective by the FHLBB.\(^4\) In addition, the converting institution is prohibited from loaning funds or otherwise extending credit to any person in connection with the purchase of the institution’s stock.\(^4\)

In a standard conversion, stock must first be offered for purchase to association members according to the categories of eligibility and in amounts set by the regulations. Eligible account holders (i.e., those savings account holders with qualifying deposits as of the eligibility record date set by the board of directors)\(^5\) have first priority. They receive subscription rights to purchase the greater of (i) the maximum purchase limitation established for the public offering or direct community offering, (ii) one-tenth of one percent of the total offering of shares, or (iii) fifteen times their pro rata portion based on qualifying deposit balances.\(^5\) In the event of an oversubscription pursuant to this section, shares are allocated to permit subscribing eligible account holders to purchase, to the extent possible, 100 shares each and thereafter on an equitable

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While most state blue-sky laws exempt the offering of a federal association from registration requirements, the blue-sky laws vary and should be checked on a state-by-state basis.

\(^{4}\)For example, the regulations contain a general anti-fraud provision covering the offer, sale or purchase of securities issued incident to a conversion. 12 C.F.R. § 563b.3(h) (1984).

\(^{4}\)Id. at §§ 563b.3(c)(1), 563b.7.

In lieu of shares of its capital stock, the converting institution may issue and sell units of securities consisting of capital stock and long-term warrants or other equity securities. Id. at § 563b.3(d)(11).

Converting institutions are now authorized to convert mutual capital certificates into preferred stock issued in connection with the conversion. The regulations preserve for the preferred stock the relative liquidation priorities and other rights that the mutual capital certificates had at the time of conversion. Id. at § 563.7-4(1)(2)(ix). See also id. at § 563b.3(f)(3) (relating to the liquidation account).

\(^{5}\)Id. at § 563b.3(c)(10). Sales price of the shares shall be a uniform price determined in accordance with § 563b.7.

Section 563b.7(e) regulates underwriting expenses. More generally, § 563b.3(c)(20) provides that expenses incurred in the conversion shall be "reasonable."

\(^{4}\)Id. at § 563b.7(a). The provisions of this paragraph do not apply to negotiations or agreements with underwriters.

\(^{4}\)Id. at § 563b.3(c)(22).

The eligibility record date must be at least 90 days prior to the date of adoption of the plan by the board of directors. Id. at § 563b.3(c)(14).

The plan may provide that any savings accounts with total deposit balances of less than $50 (or any lesser amount) shall not constitute a qualifying deposit. Id. at § 563b.3(e).

\(^{5}\)Id. at § 563b.3(c)(2). See infra notes 85-86, and accompanying text.
basis related to their qualifying deposit balances. The subscription rights of officers and directors and their associates — to the extent that such rights are based on their increased deposits during the one-year period prior to the eligibility record date — are subordinated to the subscription rights of all other eligible account holders.

In the case of plans involving an eligibility record date that is more than fifteen months prior to the date of the latest amendment to the application filed prior to FHLBB approval, the regulations require that supplemental eligible account holders be granted subscription rights subordinated to the rights received by eligible account holders. In addition, the regulations require that third priority subscription rights be provided to other association voting members (i.e., borrowers and savings account holders as of the voting record date who are not eligible account holders or supplemental eligible account holders).

Under an optional provision, a management set-aside category may be established in which directors, officers and employees receive rights to purchase shares remaining after all subscriptions in preceding categories have been satisfied. The FHLBB permits between fifteen and twenty-five percent of the total number of shares issued to be placed in this category (twenty-five percent for associations with total assets of less than $50 million, fifteen percent for associations with total assets of $500 million or more, with a sliding scale in between). The allocation of shares under this category must be on an equitable basis, such as by giving weight to period of service, compensation, and position. Under another optional provision, account holders receiving subscription rights may be given rights to purchase up to an additional one percent of the total offering of shares, to the extent that such shares are available after exercise of the subscription rights under the preceding categories. On the other hand, a provision may be included in the plan which limits to not less than one percent of the total offering the number of shares which any person, or

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*Id. at § 563b.3(c)(3).

*Supplemental eligible account holders are defined as those savings account holders with qualifying deposits as of the last day of the calendar quarter preceding FHLBB approval of the application for conversion (the supplemental eligibility record date). Officers, directors and their associates are excluded from this category. *Id. at § 563b.2(a)(34), (35).

*Id. at § 563b.3(c)(4). These subscription rights are subject to similar provisions as to purchase amounts and as to the allocation of shares in the event of an oversubscription. The subscription rights received by eligible account holders shall be applied in partial satisfaction of the rights to be distributed pursuant to this section. *Id.

*Id. at § 563b.3(c)(5). These are rights to purchase stock in an amount equal to the greater of (i) the maximum purchase limitation established for the public offering or direct community offering, or (ii) one-tenth of one percent of the total offering of shares. In the event of an oversubscription pursuant to this section, shares shall be allocated among the subscribing voting members on an equitable basis as provided in the plan. One possible method is to allocate the shares in the same proportion that the subscription of each member bears to the total subscription of all members under the third priority.

*Id. at § 563b.3(d)(3). *Cf. infra note 89 and accompanying text (limit on total management purchases in the conversion).

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A group of persons affiliated with each other or otherwise acting in concert, may subscribe for in the subscription offering. The regulations also permit the use of a minimum purchase requirement for the exercise of subscription rights.

Traditionally, subscription rights were exercised in a separate subscription offering following member approval of the plan. Under the amended regulations, the subscription offering of conversion stock may commence concurrently with or at any time after the mailing of the proxy statement. Furthermore, if the offering is conditioned upon member approval of the plan, it may be closed before the special meeting of the association members. In either case, each offering circular must be prepared in accordance with Form OC. Form OC contains substantially the same information required to be included in the proxy statement, plus additional current information and information concerning the exercise of subscription rights and the public offering or direct community offering. Any preliminary offering circular which has been filed with the FHLBB may be distributed in connection with the offering at the same time as or after the proxy statement is mailed to association members. No final offering circular may be distributed until it has been declared effective by the FHLBB. Any preliminary offering circular and, if the offering is to commence prior to the special meeting, the proxy statement shall set forth the estimated price range.

The association is also required to submit certain price information. The pricing materials must be prepared by independent experts acceptable to the FHLBB and must contain data which support the conclusions. This data should include information as to the independent expert, the methodology employed and any additional information requested by the FHLBB staff. The requirements as to the pricing material have been amended recently in order to reduce the length and detail of the appraisals. As a result, the FHLBB expects that appraisal fees will be either substantially reduced or, in the case of conversions involving a public offering, eliminated by submitting the pricing material developed by the underwriters. The price information is reviewed in determining whether to grant approval to conversion applications when the offering is to commence prior to the meeting of association members. The pricing

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9 Id. at § 563b.3(d)(9).
10 Id. at § 563b.3(d)(10). The minimum may be set up to twenty-five shares, provided that the aggregate price for any minimum share purchase shall not exceed $500.
11 In an optional provision, the plan may provide that the subscription offering shall commence within 45 days after the date of the meeting of association members. Id. at § 563b.3(d)(2). See supra note 39.
13 Id. at § 563b.8(c)(3).
14 Id. at § 563b.7(b).
15 Id. at § 563b.7(c). The maximum and minimum price should be within 15% of the average of the price range, and the maximum should normally be no more than $50 per share and the minimum no less than $5 per share. Id.
16 Id. at § 563b.7(f).
material is also reviewed in determining whether to declare a final offering circular effective. 68

Promptly after the Bank Board has declared effective the offering circular for the subscription offering, the applicant shall distribute order forms for purchasing shares to all persons with subscription rights. 69 Each order form must be accompanied or preceded by the final offering circular and a set of detailed instructions explaining how to complete such order forms. 70 The specific requirements of the order form, including maximum subscription price, maximum number of shares that may be purchased, and exercise period, are contained in section 563.7(g)(4). 71 Upon the occurrence of any material event, circumstance or change of circumstance after the expiration of subscription rights, the association must file and distribute a post-effective amendment to the offering circular to each subscriber and, if applicable, each person who has ordered stock in the direct community offering. Each subscriber and ordering person then shall be granted the opportunity to increase, decrease or rescind their subscription or order. 72

The applicant may allow payment for stock pursuant to the exercise of subscription rights by withdrawal from certificate accounts without the assessment of early withdrawal penalties, notwithstanding any regulatory provision regarding such penalties. 73 The institution must pay interest on payments received in the subscription offering or direct community offering from the date payment is received until the conversion is completed or terminated. 74 The sale of all shares to be made under the plan of conversion, including any sale in a public offering or direct community marketing, must be completed as promptly as possible and within forty-five days after the last day of the subscription period, unless extended by the FHLBB. 75

6812 C.F.R. § 563b.7(d) (1984). This section also prohibits the making of certain representations.
69Id. at § 563b.7(g)(1).
70Id. at § 563b.7(g)(2).
71The maximum subscription price stated on the order form shall be the amount to be paid when the order form is returned. If the actual public offering price is less than the maximum subscription price stated, the actual subscription price shall be correspondingly reduced and the difference refunded, unless the subscriber affirmatively elects to have the difference applied to the purchase of additional shares. Id. at § 563b.7(g)(3).

The period of time within which subscription rights must be exercised shall be no less than 20 days and no more than 45 days following the date of the mailing of the subscription offering order form. Id. at § 563b.7(g)(4)(ii).
73Id. at § 563b.7(k)(4), (5).
74Id. at § 563b.7(h). If the applicable minimum balance requirement ceases to be met, the certificate evidencing such account must be cancelled and the remaining balance will earn interest at the passbook rate. Id.
75Id. at § 563b.7(j).
76Id. at § 563b.7(l).

If an extension is granted, the institution must immediately file and distribute a post-effective amendment to the offering circular to each subscriber and, if applicable, each person who has ordered stock in the direct community offering. Whether or not a material event has occurred, each subscriber and ordering person must be given the opportunity to increase, decrease or rescind their subscription or order. Id. at § 563b.7(k)(1), (2).
The recent amendments to the regulations provide a converting institution with increased flexibility in structuring its offering. The amendments allow the converting institution to reduce the time and expense involved, while still preserving the members' rights to participate equitably, on a priority basis, in the conversion. As previously noted, the subscription offering may commence concurrently with or at any time after the mailing of the proxy statement. Moreover, the offering circular can be combined with the proxy statement as a "wrap around" document. While this combined document enables a converting institution to complete a conversion more rapidly, the costs of printing and mailing this document to all association members can be significant. Accordingly, the institution is given the alternative to utilize an optional request card provision. Under this provision, the association may require persons with subscription rights to return, by a certain date, a postage-paid written communication provided by the association in order to receive an offering circular. If the plan of conversion includes this optional procedure, order forms need be distributed only to those who requested receipt of the offering circular. Additional printing and mailing cost savings can be achieved by utilizing both the request card and summary proxy statement procedures. If the subscription offering is commenced concurrently with or during the proxy solicitation period, the supplemental statement required to be furnished to members under the summary proxy statement section can be combined with Form OC. Thus, the request card can be used to provide additional information to voting members in the proxy solicitation and to commence the subscription offering, with the same document serving both purposes and being sent only to those who specifically request it.

Any of the converting institution's shares not sold to persons with subscription rights must be sold either in a public offering through an underwriter or directly by the converting institution in a community offering. The stock must be offered and sold in a manner that will achieve the widest distribution of shares. The new regulations permit the association to commence both the direct

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14See supra note 62, and accompanying text.
1512 C.F.R. § 563b.3(d)(6), (7) (1984). The offering may not be closed until thirty days after the association mails the postage-paid written communication to those entitled to subscription rights. If the offering is not commenced within 45 days after the meeting of association members, these provisions require written notice of the commencement of the offering and of the offering circular request procedure. Id.
16Id. at § 563b.7(g)(1).
17Id. at § 563b.3(d)(14)(i)(c).
18Id. at § 563b.3(c)(6). The applicant must demonstrate the feasibility of the method of sale to the FHLBB, id., and must disclose the underwriting and/or other marketing arrangements in the plan of conversion. Id. at § 563b.3(c)(10). See also Form PS, Item 8 and Form OC, Item 6.
19Id. at § 563b.3(c)(6)(iii).
20Orders must first be filled up to a maximum of two percent of the conversion stock and, thereafter, remaining shares must be allocated equally per order until all orders have been filled. Id. at § 563b.3(c)(6)(ii).

In any direct community offering, preference is required to be given to natural persons residing in the counties in which the institution has an office. Id. at § 563b.3(c)(6)(iv).
community offering and the public offering, concurrently with or at any time during the subscription offering. Moreover, the April 1983 amendments enable the converting institution to eliminate the separate subscription offering provided that the subscription rights issued in connection with the conversion can be exercised on a priority basis in the public or direct community offering. To date, no institution has taken advantage of the opportunity to combine the public and subscription offerings. Several recent conversions have been conducted, however, in which the public offering has commenced during the pendency of the subscription offering. While the combined subscription and public offering procedure might result in some practical difficulties for underwriters (caused by the inability to determine the number of shares which will be subscribed for by members), this procedure has the advantage of eliminating the costs inherent in preparing two different offering circulars.

Subject to an optional provision, purchases in the public offering or the direct community offering by any person together with any associate or group of persons acting in concert must be limited to a maximum of five percent of the total offering. Adoption of the optional provision permits this limit to be raised to less than ten percent of the total offering, provided that orders for stock exceeding five percent of the total offering do not exceed ten percent of the total offering. In addition, the regulations place a general limitation of five percent of the total offering, subject to the optional provision of paragraph (d)(5), on the number of shares which any person together with any associate or group of persons acting in concert may subscribe for or purchase in the conversion. It should be noted that the members of the converting institution's board of directors are not deemed to be associates or a group of persons acting in concert solely as a result of their board membership. Rather, the total number of shares which officers and directors of the converting institution and their associates may purchase in the conversion may not exceed

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1Id. at § 563b.3(d)(1).
2Id. at § 563b.3(d)(12). A combined subscription and public offering would most likely involve the exercise of subscription rights by delivery of properly completed and executed order forms to the underwriters or selling group, instead of to the association as is done in the traditional conversion. The request card procedure can still be utilized in an offering pursuant to paragraph (d)(12) to distribute offering circulars to persons with subscription rights. Id. at §§ 563b.3(d)(6), (7).
3If the plan contains the optional provision permitted by section 563b.3(d)(12), underwriting commissions with respect to shares of stock sold in the subscription offering are allowed. Id. at § 563b.7(e) (1983). Although this option would increase the conversion underwriting commissions and fees since they would be applicable to all shares sold in the conversion, and not just those sold in the public offering phase, it is anticipated that converting institutions will negotiate for substantially lower underwriting commissions and fees for shares sold to members exercising subscription rights compared to those for shares sold to the public, since members are likely to have more loyalty to the institution than unrelated investors, and are more likely to purchase shares of the conversion stock.
512 C.F.R. § 563b.3(c)(6)(i) (1984). This allows the association to adopt a percentage limit less than five, if it so desires.
6Id. at § 563b.3(d)(5).
7Id. at § 563b.3(c)(7).
8Id.
thirty-five percent of the total offering for associations with total assets of less than $50 million, or twenty-five percent for associations with total assets of $500 million or more, with a sliding scale for those associations with assets in between the above-described limitations.89

All shares purchased by directors and officers on original issue in the conversion are subject to the restriction that the shares may not be sold for a period of not less than one year following the date of the purchase, except in the event of death of the director or officer.90 This restriction also applies to any shares issued as a stock dividend, stock split or otherwise with respect to such restricted stock.91 In addition, for a period of three years following the conversion without the prior written approval of the FHLBB, no officer, director or their associates may purchase the stock of the converted institution except from a broker or dealer registered with the Securities and Exchange Commission. This provision does not apply to negotiated transactions involving more than one percent of the outstanding capital stock of the converted institution.92

Promptly after conversion, the association must register its securities with the FHLBB under the Securities Exchange Act of 193493 and undertake not to deregister for a period of three years thereafter.94 Upon registration the proxy and tender offer rules, insider trading reporting and restrictions, annual and periodic reporting, and other requirements of the 1934 Act are applicable. Under the conversion regulations, the converted association must use its best efforts to encourage and assist a market maker to establish and maintain a market for its securities and to list those securities on a national or regional securities exchange or on the NASDAQ quotation system.95

For a period of three years after the date of conversion, the association may not repurchase any of its stock from any person, with two exceptions. First, the association may repurchase shares on a pro rata basis pursuant to an offer to all shareholders approved by the FHLBB. Second, the association

89Id. at § 563b.3(c)(8). Cf. supra note 57 and accompanying text (optional management set-aside).
91Id. at § 563b.3(c)(18)(iii). Sections 563b.3(c)(18)(i) and (ii) provide for a legend on each certificate of stock so restricted and for instructions to the transfer agent.
92Id. at § 563b.3(c)(9).
93Securities Exchange Act of 1934, § 12(i), U.S.C. § 781(i) (1982). This section of the 1934 Act vests in the FHLBB the powers, functions and duties vested in the SEC to administer and enforce §§ 12, 13, 14(a), 14(c), 14(d), 14(f) and 16 of the 1934 Act with respect to any securities issued by an institution the accounts of which are insured by the FSLIC.
94The FHLBB has adopted as its regulations all SEC rules, regulations and forms applicable as a result of the registration by an institution of its securities with the FHLBB under the 1934 Act, and not only those regulations adopted by the SEC under the enumerated sections set forth in 12(i). No filing fees are required. 12 C.F.R. § 563d.1 (1984).
95The information generated by Form PS should enable the converted association to meet the registration requirement without substantial additional expense.
96Id. at § 563b.3(c)(19)(i). This registration requirement supplements the 12(g) requirement of the 1934 Act.
97Id. at § 563b.3(c)(19)(ii), (iii).
may repurchase qualifying shares of directors. Furthermore, during this three-year period the association may not, without prior approval of the FHLBB, declare or pay a cash dividend on, or repurchase any of its stock in an amount greater than one half of its post-conversion annual net income.

The conversion regulations also restrict the acquisition of the securities of the association both prior to and for one year after the completion of the conversion. Prior to the completion of the conversion, no person may transfer or enter into an agreement to transfer the legal or beneficial ownership of subscription rights or the underlying securities to the account of another. This prohibition extends to the making of an offer or the announcement of an offer for any security issued in connection with the conversion. In addition, the regulations provide that no person shall acquire or offer to acquire the beneficial ownership of more than ten percent of any class of equity securities of a converted institution for a period of one year following the completion of the conversion without the prior written approval of the FHLBB. To the extent permitted by applicable federal or state law, an unconditional ten percent limitation on acquisitions may be included in the plan of conversion as an optional

Id. at § 563b.3(g)(1).

Id. at § 563b.3(g)(2). Specifically, the limit is one half the greater of (i) the institution's net income for the current fiscal year; or (ii) the average of the institution's net income for the current fiscal year and not more than two of the immediately preceding fiscal years. Id. See also supra note 20 for the dividend and repurchase restrictions contained in § 563b.3(g)(2).

12 C.F.R. § 563b.3(i)(1), (2) (1984). These provisions are subject to the exceptions contained in § 563b.3(i)(5) relating to underwriters and the public or direct community offering.

Id. at § 563b.3(i)(3). This prohibition, unless made applicable by the FHLBB by prior advice in writing, does not apply to acquisitions by a person during the preceding twelve months totaling not more than 1% of a class of securities. Id. at § 563b.3(i)(5)(iii).

Section 563b.3(i)(6) sets forth the criteria for FHLBB denial of applications submitted under § 563b.3(i)(3).

On February 23, 1984, the FHLBB adopted a temporary final rule that extended this regulatory restriction on acquisitions from one year to three years following conversion. 49 Fed. Reg. 7358 (1984) (to be codified at 12 C.F.R. § 563b.3(i)(3)). The FHLBB also adopted a provision for self-enforcement of the restriction. Under this provision, shares acquired in violation of paragraph (i)(3) "shall not be counted as shares entitled to vote and shall not be voted by any person or counted as voting shares in connection with any matter submitted to the stockholders for a vote." Id. "Under § 563b.3(k), this sterilization procedure would take precedence over the one-share-per-vote requirement of section 5 of the federal stock charter." 49 Fed. Reg. 7357 (1984).

In addition, the Bank Board expanded the definitional provisions of § 563b.3(i)(8), 49 Fed. Reg. 7359 (1984) (to be codified at 12 C.F.R. § 563b.3(i)(8)), which apply to all associations subject to § 563b.3(i)(3) and its predecessor versions. "A solicitation of revocable proxies to vote on a matter at an upcoming meeting, however, would not of itself fall within the § 563b.3(i)(3) proscription [as a group acting in concert]." 49 Fed. Reg. 7357 (1984).

The new § 563b.3(i)(3) became effective on February 29, 1984 and will expire of its own terms on August 31, 1984, unless extended or made permanent. The three year acquisition restriction applies only to insured institutions that had not commenced subscription offerings prior to the effective date. 49 Fed. Reg. 7358 (1984) (to be codified at 12 C.F.R. § 563b.3(i)(3)). A converting institution that had commenced its subscription offering, but had not completed its conversion prior to the effective date may opt for coverage by the new rule by distributing to each subscriber a post-effective amendment to the subscription offering circular, in accordance with § 563b.7(k), describing the effect of the regulatory amendment and giving subscribers the right to increase, decrease, or rescind their subscriptions. 49 Fed. Reg. 7358 (1984) (to be codified at 12 C.F.R. § 563b.3(i)(4)).

The new restriction does not apply to the formation of a holding company after one year from the date of completion of the conversion, provided that the ownership of the holding company is substantially the same as the ownership of the insured institution. 49 Fed. Reg. 7359 (1984) (to be codified at 12 C.F.R.
The association may also adopt, at any annual or special meeting of the shareholders, any charter provision regarding the acquisition of securities that would be permitted to be adopted by a corporation chartered by the state in which the principal office of the association is located. The association, however, must file an opinion of independent counsel that such charter provision is permissible under the law of the applicable state. The various restrictions on acquisitions, both during and after the conversion, serve to protect the converted institution from hostile takeovers.

V. HOLDING COMPANY AND MERGER CONVERSIONS

Section 563b.9 authorizes an insured institution to convert to stock form pursuant to Subpart A as part of a transaction in which a holding company

§ 563b.3(i)(iv). The FHLBB will consider proposals for the formation of a holding company within one year of conversion on a case-by-case basis. See 49 Fed. Reg. 7357 (1984) (listing factors that will be examined). A holding company may be organized as part of the conversion to stock form. § 563b.9; see infra notes 103-108 and accompanying text. The acquisition of more than ten percent of the shares of the holding company is considered to be the acquisition of more than ten percent of the insured institution's shares. 49 Fed. Reg. 7357 (1984).

100 12 C.F.R. § 563b.3(i)(7) (1984). The February 1984 amendments permit this optional, unconditional ten percent limitation to extend for a specified period of not more than five years following the date of completion of the conversion. 49 Fed. Reg. 7359 (1984) (to be codified at 12 C.F.R. § 563b.3(i)(7)); see also 49 Fed. Reg. 7357-58 (1984). In addition, notwithstanding the provisions of 12 C.F.R. § 552 and to the extent otherwise permitted by applicable federal or state law, the plan of conversion may include charter provisions that, for the specified period, (i) sterilize any shares beneficially owned in violation of the optional, unconditional ten percent limitation; (ii) eliminate cumulative voting; and (iii) remove the right of shareholders to call special shareholder meetings relating to changes in control or amendment of the charter. 49 Fed. Reg. 7359 (1984) (to be codified at 12 C.F.R. § 563b.3(i)(7)); see also 49 Fed. Reg. 7357-58 (1984).

While restrictions on the acquisition of recently converted associations might be necessary in order to protect the integrity of the conversion process and to prevent costly takeover battles, see 49 Fed. Reg. 7356-57 (1984), permitting the managers of an institution contemplating conversion to include these optional five year charter provisions in the plan unduly interferes with the ability of the true owners — the shareholders — to decide whether or not to sell their investment and distorts the market for corporate control thereby protecting inefficient management. See Gilson, A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers, 33 STAN. L. REV. 819 (1981). Certainly, it should not take five years for the management of a converted institution to deploy conversion proceeds into productive assets. Moreover, after the initial post-conversion stage, there is no reason to provide greater protection to management of converted institutions than is provided to insured institutions generally by the pre-existing regulatory and statutory framework. See infra note 102 and accompanying text.

Permitting these charter provisions to be included as part of the plan of conversion is particularly unjustified since it presents members of the converting organization with the Hobson's choice of either rejecting the conversion plan altogether or accepting a plan in which they would receive subscription rights to purchase shares whose ownership interests have been severely diminished. In addition, the adoption of a flat five year prohibition in the charter would restrict the FHLBB's power to approve acquisitions. See supra note 99 and accompanying text.

Other deterrents to hostile takeovers include: (1) management control through the proxy machinery and through purchase of stock in the conversion; (2) provisions of the National Housing Act including the savings and loan holding company provisions requiring FHLBB approval before any company may acquire control of an insured institution (12 U.S.C. § 1730a (1982)); (3) the Change in Savings and Loan Control Act of 1978 which requires persons intending to acquire control of an insured association to give 60 days prior written notice to the FHLBB which can then disapprove the proposed acquisition on certain specified grounds (12 U.S.C. § 1730(q) (1982), 12 C.F.R. § 563.18-2 (1984)); (4) the tender offer and disclosure requirements of the Securities Exchange Act of 1934; and (5) staggered terms of the board of directors, long-term management employment contracts, and other "shark repellent" charter and by-laws provisions. See Goldberg & Marcotte, supra note 40, at 862-63; Pitt & Williams, Thrift Institution Acquisitions: Selected Offensive and Defensive Considerations, 39 BUS. LAW. 171 (1983).
is organized to acquire all the capital stock of the converted institution upon issuance.\textsuperscript{103} Similarly, section 563b.10 permits a conversion in which an existing holding company acquires all of the capital of the converted institution or in which the converting institution merges with an existing insured stock institution.\textsuperscript{104} A merger conversion may involve the merger of the converting institution either with an existing insured stock institution which is a wholly-owned subsidiary of a holding company\textsuperscript{105} or with an existing insured stock institution as part of a transaction in which the equity securities of the existing insured stock institution or the converting insured institution are issued.\textsuperscript{106} In a holding company conversion, the eligible account holders, supplemental eligible account holders and voting members of the converting institution receive, without payment, nontransferable subscription rights under sections 563b.3(c)(2), (c)(4) and (c)(5) to purchase the stock of the holding company in lieu of the stock of the converting institution.\textsuperscript{107} In a merger conversion, they receive subscription rights to purchase the stock of the surviving institution.\textsuperscript{108} The April 1983 amendments to the conversion regulations removed the test-case restriction on these holding company and merger conversions, and all of the requirements of Part 563b are applicable to such conversions, unless clearly inapplicable.

\textbf{VI. SALE-OF-CONTROL CONVERSIONS}

Under the new sale-of-control conversion regulations, Subpart B, a converting institution is permitted to sell a controlling block of stock to a third party or parties in connection with the conversion.\textsuperscript{109} The control block of shares must be sold at a price per share equal to the estimated pro forma market value of the stock plus a premium to reflect the fair market value of the control represented by such shares.\textsuperscript{110} The major advantages of a sale-of-control con-

\textsuperscript{101}12 C.F.R. § 563b.9 (1984).
\textsuperscript{102}Id. at § 563b.10.
\textsuperscript{103}Id. at § 563b.10(b).
\textsuperscript{104}Id. at § 563b.10(c). This provision was amended recently "to confirm that a merger conversion may be structured as a type of reverse merger, i.e., the merger of a stock institution into a converting mutual institution." 48 Fed. Reg. 15,593 (1983).
\textsuperscript{105}The securities of a holding company are not exempt from the registration requirements of the Securities Act of 1933. \textit{Cf. supra} note 44 and accompanying text.
\textsuperscript{106}In a merger conversion in which the converting institution merges into an existing insured stock institution which is a wholly-owned subsidiary of a holding company, the subscription rights are for the purchase of the stock of the holding company. 12 C.F.R. § 563b.10(b) (1984).
\textsuperscript{107}Id. at § 563b.11-b.19. On January 4, 1984, the FHLBB proposed to rescind its regulations governing the sale-of-control conversions contained in Subpart B. If adopted, the rescission would be effective as of January 4, 1984. \textit{See} 49 Fed. Reg. 415 (1984).
\textsuperscript{108}12 C.F.R. § 563b.13(a)(1) (1984). The converting institution enters into an agreement with the acquiring person pursuant to which such person agrees to purchase a specified percentage or specified dollar amount of the institution's capital stock. Nontransferable subscription rights, if any, are subordinated to the rights of any acquiring person, and no acquiring person or any affiliate thereof shall receive, or be entitled to, subscription rights in connection with the conversion. No acquiring person may purchase any shares in connection with the conversion other than the shares required to be issued to the acquiring person pursuant to the conversion plan. \textit{Id.} at §§ 563b.12, 563b.13.
version are that it expands the potential sources of capital for converting institutions by attracting investors who are only interested in making a controlling investment and are prohibited from doing so in a standard conversion and, through the control premium, increases the amount of capital received by the converting institution. Additionally, a sale-of-control conversion allows management to buy control of the institution. In order to protect the institution and to ensure that a substantial control premium is received in the event of a sale-of-control conversion, a series of checks and balances are incorporated within the conversion regulations.

First, no sale-of-control conversion may be initiated unless an offer has been made to and approved by two-thirds of the insured institution's board of directors. If a sale-of-control offer is approved by the board of directors, the institution is required to immediately and widely distribute a press release setting forth the principal terms of the proposed sale-of-control conversion. Thereafter, any person may make a competing offer to acquire control of the converting institution. The offer approved by the board of directors and any competing offers must be submitted to and approved by the FHLBB and the members of the association. Once a competitive bid has been accepted for filing by the FHLBB, the management of the converting institution is prohibited from cancelling or otherwise postponing the meeting of association members originally called to vote on management's proposal. In order for the conversion to be approved by the association members, a majority of the votes eligible to be cast must be voted in favor of one of the competing bids.

The sale-of-control conversion regulations contain detailed provisions that are designed to achieve full and fair disclosure to association members regarding all material facts relating to each sale-of-control offer and each competing offeror. The regulations also provide procedures for the inclusion of competing offers in management's proxy form and the institution's proxy statement and for the distribution of the proxy statement, proxy form or other communication from the proponents of competing offers. Another provision requires each offeror to submit a fairness opinion signed by an independent expert. The sale-of-control conversion must comply with the additional requirements contained in Subpart B and, unless clearly inapplicable, all of the

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111 This requirement (1) protects the institution against inadequate or inappropriate offers; (2) gives the board of directors an opportunity to negotiate for the highest possible control premium; and (3) preserves the absolute right of the board of directors to determine in its sole discretion whether to convert from the mutual to stock form. 48 Fed. Reg. 15,595 (1983).

112 C.F.R. § 563b.14 (1984). This is in addition to an augmented § 563b.4(a)(3), (4) notice to members.

113 Id. at § 563b.16.

114 Id. at § 563b.16(d)(2).

115 Id. at § 563b.16(a).

116 Id. at § 563b.18. The optional summary proxy procedure contained in § 563b.3(d)(14) may not be used in a sale-of-control conversion. Id. at § 563b.13(b).

117 Id. at § 563b.17.

118 Id. at § 563b.19(e).
requirements of Subpart A. For a period of three years following the conversion, no acquiring person or affiliate or associate thereof may purchase more than one percent of the outstanding capital stock of the converted institution in any three month period without the prior written approval of the FHLBB.

VII. VOLUNTARY SUPERVISORY AND MODIFIED CONVERSIONS

Subpart C of the regulations specifies the qualifications for and procedures applicable to voluntary supervisory stock conversions. Generally, an institution must be technically insolvent in order to qualify for a supervisory conversion. In a supervisory conversion, the association members have no right of approval or participation. Furthermore, upon completion of the conversion, the association members have no continuing legal or beneficial ownership interest in the converted institution.

Finally, for those institutions that are facing severe financial difficulties, but do not qualify for supervisory conversions, the FHLBB has set down guidelines for modified conversions in Subpart D. Under these guidelines, the FHLBB will permit, on a test-case basis, conversions in which association members have no right of approval but in which they have a right of participation through preemptive subscription rights. It is anticipated that most modified conversions will be structured as takeout conversions, in which management will find a purchaser who will agree to purchase all of the stock remaining after the exercise of subscription rights by members.

VIII. REGULATORY OUTLOOK

The recent revisions to the conversion regulations have substantially achieved their objectives of increasing the flexibility and reducing the time and expense of the conversion process. As a result of these revisions and the enhanced attractiveness of investing in thrift institution stock, the number of approved conversions increased from thirty-nine in 1981 and thirty-four in 1982 to over 100 in 1983. On the other hand, the FHLBB is presently considering rescin-
The proposed rescission would reduce the options available to institutions contemplating conversion and would remove a potentially less expensive alternative method of conversion.

As stated in the preamble to the regulations and reiterated in the FHLBB’s proposal to rescind the rules, the objectives of the sale-of-control regulations are: (1) to increase the flexibility of the conversion process, (2) to grant to mutual members rights of corporate governance similar to those of stockholders in a stock corporation, and (3) to substantially increase the potential sources of capital for converting institutions and the capital received by those institutions. Since the adoption of these regulations, however, no association has submitted an application for a sale-of-control conversion. Furthermore, the Bank Board has concluded that the sale-of-control regulations “do not provide a workable method of capital-raising and do not accomplish the objectives established by the Board.”

The comments received by the FHLBB in response to the proposed rule indicate that a major obstacle to the utilization of the sale-of-control conversion process has been the prospect of a competitive bidding procedure. The possibility that a competing offer may prevail presents to management the risk of unknown and potentially hostile owners. Moreover, prospective acquirers face the increased risk of investing time and money in structuring a deal which may not come to fruition. Some of the comments recommended using outside appraisals and FHLBB approval of the price to be paid in order to protect the institution and its members and to ensure an adequate control premium. Nevertheless, it does not seem likely that the FHLBB will adopt the recommendations to replace the competitive bidding procedure.

Rescinding the sale-of-control regulations will not promote any of the Bank Board’s objectives, especially in the absence of any evidence that retention of the regulations could be injurious to the institutions, mutual members or the public. To the contrary, retention of the current regulations, while studying alternatives that would facilitate sale-of-control conversions and still achieve the FHLBB’s objectives, would enable the management of an institution and

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126See supra note 109.
129Id.
130Cf. 12 C.F.R. § 563b.19(e) (fairness opinion). Alternatively, the regulations could be amended to require a minimum percentage premium for the control block over the pro forma market value. Moreover, any changes to the regulations could be adopted on a temporary test case basis.
131For example, the regulations may be amended (1) to explicitly permit management to include in management’s proxy statement a management recommendation as to the competing proposals or (2) to give priority to the initial proposal accepted by management if the offeror matches the competing bid or if the board of directors of the converting institution determines that the proposal of the initial offeror is essentially equivalent to the competing proposal.

In addition, a sale-of-control conversion can be made more attractive to potential acquirers by reducing the restrictions on purchase of the capital stock of the converted institution from the present period of three years following the conversion to one year. This one year period would still ensure the integrity
any prospective acquirers that are willing to risk a contested bid to structure such a transaction. Moreover, sale-of-control conversions are likely to become a more attractive option as the increased number and dollar volume of conversions and of outstanding shares of previously converted institutions leads to increased competition for public market equity funds and as the supply of such funds directed towards investment in savings and loans diminishes. Also, as more institutions contemplate conversion, this conversion method may be viewed as more desirable compared to other alternatives depending upon the mix of size, market, and business plans of a particular institution. In sum, it would be premature to rescind Subpart B of the regulations and thereby prohibit sale-of-control conversions solely because no institution has utilized this procedure in the nine months since its adoption. The proposed rule would decrease rather than increase the potential sources of capital available to converting institutions and the capital received in the conversion process and, therefore, should not be adopted.\footnote{131} 

of the conversion process, while permitting the acquiring person to subsequently buttress his control position and make investment decisions based on prevailing market conditions. \textit{Cf. supra} note 120 and accompanying text.

\footnote{131}{A person or group of persons who control a savings and loan holding company or another savings and loan may be able to effectively achieve a sale-of-control conversion through the merger and holding company conversion regulations \textit{(see supra} notes 103-108 and accompanying text), if they control a sufficiently large block of a significantly larger institution or holding company so that the conversion does not dilute their control position. See Pitt & Williams, \textit{supra} note 102, at 196-197.

\textit{[T]he holding company and merger conversion statutes do present intriguing potential alternatives to the new sale-of-control conversion rules. It remains to be seen, for example, whether a potential acquiror will be permitted to create an S&L or S&L holding company for the purpose of effecting a conversion that would result in the acquiror assuming control of a converting institution. \textit{Id.} at 197 (footnote omitted).} 

\footnote{132}{While this article was in publication, the FHLBB finalized its proposed rule rescinding the sale-of-control conversion regulations, Subpart B of 12 C.F.R. Part 563b. The rescission is effective as of January 4, 1984. \textit{See 49 Fed. Reg.} 19,003-04 (1984). 

In addition, to prevent evasion of the conversion regulations, the FHLBB adopted temporary final rules that clarify the applicability of the conversion regulations to mutual insured institutions that leave the FSLIC's insurance system. The new rules also provide safeguards in such conversions. \textit{See Id.} at 19,000-03. The FHLBB also amended the conversion regulations to clarify that annual computations of the liquidation account and subaccount balances are not required provided that the institution maintains the documentation necessary for making such computations. \textit{Id.} at 19,003 (to be codified at 12 C.F.R. § 563b.3(f)(5).}