



**Bureau of Residential Finance  
Thrift Division**

**[Mutual to Stock Conversions  
Purpose, Business Plan, Community Offering]**

To: Illinois State-Chartered Mutual Savings Banks

Date: July 12, 2001

Re: Applications for Conversion from Mutual to Stock Form of Ownership  
Guidelines Regarding the Purpose of the Conversion, Post-Conversion Business Plan, and Community Offering of Conversion Shares

Mutually-owned Illinois state-chartered savings banks may convert to stock form of ownership by application to the Office of Banks and Real Estate Thrift Division. The decision to convert to stock form is a business decision largely within the discretion of the savings bank's board of directors. However, a savings bank does not possess an absolute right to convert. The conversion must be consistent with the purposes of the Saving Bank Act (205 ILCS 205), safe and sound operation of the savings bank, the fiduciary obligations of the savings bank's directors, and the provisions of Subpart O of the Savings Bank Rules (38 IAC 1075.1800-.2580) (as well as applicable federal law).

The first mutual savings bank converted to stock form in the early 1990's. Since that time the Agency has reviewed and approved numerous applications for conversion. Based on this experience, the Agency seeks to provide general guidance in selected areas for mutual savings banks considering whether to convert to stock form. To that end, this memorandum addresses three important aspects of a mutual to stock conversion, namely:

- the identification and analysis by the savings bank of its reasons for converting to stock form,
- the formulation of a post-conversion business plan, and
- the formulation of a stock marketing and sales plan for a community offering to local residents of conversion stock.

The savings bank is not required to submit its reasons for seeking to convert, its business plan, nor its community stock offering plan prior to filing the its conversion application. However, the Agency is available for pre-filing consultation and review of draft documents.

If you have any questions regarding the matters discussed in this memorandum, please contact Roger Copley, Manager of Thrift Supervision, at (312) 793-1456 or [rcopley@bre.state.il.us](mailto:rcopley@bre.state.il.us) or Robert Stearn, Senior Counsel, at

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## **I. IDENTIFICATION OF THE BUSINESS PURPOSES FOR CONVERTING**

The most obvious consequence of converting to stock form is an immediate and substantial infusion of capital into the savings bank – potentially a near doubling of capital. A capital infusion of this kind may be entirely appropriate for a mutual savings bank. However, a large capital infusion may not necessarily benefit every institution, especially ones that are already highly capitalized. For this reason, thrift institutions and their legal and business advisers, in general discussions of conversions, have cited other benefits of converting. For example, conversion to stock form permits the implementation of stock-based compensation arrangements and merger and acquisition strategies.

Given the possibility that a savings bank may seek to convert to stock form for a variety of reasons, and in recognition of the authority of the savings bank's management to exercise its business judgment, the Agency does not at this time seek to adopt a general rule that delimits acceptable reasons for converting. Rather, the Agency shall review the reasons for and objectives of the proposed conversion (as identified by management) for consistency with the purposes and requirements of the Saving Bank Act, safe and sound operation of the savings bank, the fiduciary obligations of the savings bank's directors, and the provisions of Subpart O of the Savings Bank Rules.

Generally, in evaluating the reasons for converting, management should heed its fundamental obligations to the savings bank. Clearly, the reasons for and objectives of the conversion must be consistent with safe and sound operation of the institution. Furthermore, these reasons and objectives must arise from informed deliberation and must evidence sound business judgment. Equally important, conversion must be motivated by a regard for the interests of the savings bank. Directors must be guided by their fiduciary duty of loyalty to the institution and should not act in their personal interest without considering or at the expense of the institution's interests. No conversion can be approved if these basic requirements are not met.

In order to provide the Agency with adequate information to determine whether the conversion complies with these fundamental requirements and other applicable law and regulation, the application to convert should include the information described below (discussions should include detailed information and institution-specific analysis):

\*Identify the specific reasons that motivate the savings bank to seek to convert.

\*Identify the purposes and the benefits of the conversion for the savings bank.

\*Describe the manner in which the directors deliberated on the decision to convert and the information upon which the decision was based.

\*Discuss how the reasons for converting are consistent with the directors' fiduciary duties. Include discussion of how directors and officers may personally benefit from the conversion.

\*If primary objective of proposed conversion is not to raise capital, provide a detailed, institution-specific explanation why a mutual holding company reorganization (whether it involves no stock offering or a minority offering) is not a viable alternative to a mutual to stock conversion.

\*If the reasons for converting include the possibility of positioning the savings bank for sale as part of an "exit strategy" for management or directors, describe this strategy and provide a detailed, institution-specific discussion of why that strategy is consistent with the purposes of the Savings Bank Act (205 ILCS 205/1002) and why conventional management succession is not a viable alternative. Also, discuss why merger of the mutual savings with another mutual institution resulting in a mutual savings bank is not a viable alternative.

\*If the reasons for converting include the possibility of positioning the savings bank for sale for other reasons, describe the reason(s) and provide a detailed, institution-specific discussion of how a sale is consistent with the purposes of the Savings Bank Act and how a sale may benefit management and may effect customers of the savings bank and community access to financial services. Also, discuss whether any merger, combination, or acquisition transaction that would result in a mutual savings bank or stock savings bank is viable.

## **II. BUSINESS PLAN FOR CONVERSION PROCEEDS**

As stated, a savings bank may seek to convert for a variety of reasons and raising capital may not be the primary motivation. Regardless of the savings bank's objectives, the conversion will result in an immediate, massive infusion of capital. Upon conversion, a savings bank can expect a 70 to 100% increase in its capital. For a marginally capitalized savings bank, a large capital infusion usually immediately bolsters safety and soundness and otherwise benefits the institution. For a well-capitalized savings bank, however, the capital infusion may be detrimental to the institution's safety and soundness if the new capital is not properly managed and deployed.

Accordingly, applications to convert from mutual to stock form of ownership must include a post-conversion business plan for the savings bank. Specifically:

\*The business plan should:

- cover at least the three years following the conversion;
- provide a detailed, quantitative, and institution-specific discussion of the proposed use of the conversion proceeds as measured at the minimum, mid-point, and super-maximum;

- include pro forma financial statements (balance sheet, statement of income, statement of stockholders equity, and statement of cash flows); and
- discuss all significant assumptions used in formulating the plan

\*If the operations of the mutual savings bank currently result in a return on assets (ROA) that is at or above the average for similar thrift institutions, the business plan should discuss the impact of the conversion on ROA. If the conversion will have an adverse impact on ROA, the business plan should explain how and over what period this will be ameliorated or why the reduction is not significant to the safety and soundness of the savings bank. Also, the business plan should explain why management concludes the benefits of conversion on the whole outweigh the adverse impact on ROA.

\*The business plan should identify and discuss the financial performance standards (for example, ROA, return on equity, return on investment) by which the management will assess the savings bank's success in deploying the conversion proceeds and success of the conversion generally.

\*The business plan should explain when the savings bank expects its return on equity (ROE) to attain a level that is equal to or above the average for similarly situated thrift institutions.

\*The business plan should discuss what the savings bank's policies will be regarding stock repurchases, distributions, share price targets, and related matters.

\*The business plan should discuss how the conversion proceeds will be deployed to benefit the savings bank's customers and community.

### **III. COMMUNITY STOCK OFFERING**

Under the stock conversion regulations, any shares of the converting savings bank not sold in the subscription offering to eligible members may be sold by the savings bank in a direct community offering. The community offering must give preference in the offering to natural persons residing in the counties in which the converting savings bank has an office (local residents). This requirement reflects both the Savings Bank Act's express purpose of providing a "...system of financial institutions in Illinois...owned by Illinois citizens and corporations..." and the local, community-oriented focus of independent thrift institutions. A conversion to stock form must consider the local nature of the savings bank charter. As such, local ownership can be an effective way for the converted savings bank to retain community-oriented local character after the conversion.

In this connection, the conversion regulations require that the converting savings bank (and its agents) demonstrate the

feasibility of the proposed method of sale of the conversion stock in the community offering and the feasibility of the methods of giving preference to local residents. For the local resident preference to have any meaning, the savings bank's offering, marketing, and sales efforts in the community offering must attempt to maximize sales of stock to local residents. The savings bank must conduct the community offering in a manner that is reasonably certain to give local residents adequate notice of the offering and opportunity to purchase conversion stock prior to the stock being offered/sold to any nonresident. No nonresident should be able to purchase stock while local residents' demand for stock remains unfilled.

In order to meet the local resident preference, a savings bank conversion application should include a stock marketing and sales plan that addresses in detail the following issues:

\*What policies and procedures will be adopted to attempt to maximize the sale of stock to local residents? How will the savings bank verify and document adherence to the policies and procedures?

\*What policies and procedures will be adopted to emphasize stock marketing and sales efforts to local residents? How will the savings bank verify and document adherence to the policies and procedures?

\*How will the savings bank ensure that the sales incentive of the underwriter, investment banker, or sales agent is consistent with the objectives of maximizing local ownership and retaining independence?

\*If the savings bank exceeds the minimum subscription amount, will the savings bank pursue further stock sales that would have the effect of diluting local ownership?

\*Will the savings bank use its ability to accept and reject subscriptions to achieve the objective of local ownership? How?

\*How will the savings bank ensure that subscriptions of local residents are executed before those of any nonresident subscriber?

\*In the event that the savings bank obtains the required Agency approvals and proceeds with the stock offering, the savings bank should provide a list of all persons contacted (by whatever means) by the savings bank or its agents and persons who contact the savings bank or its agents regarding the offer or purchase of conversion stock. This list should include the contact's name and county and state of residence. The list should not include persons who are eligible account holders, supplemental eligible account holders, or other voting members of the savings bank. In

Mutual to Stock Conversions

July 12, 2001

Page 6 of 5

addition, the agency requests the list of conversion stock subscribers. This list should indicate each subscriber's name, county and state of residence, and number of shares ordered. The savings bank should submit both lists before any stock orders are executed.