Bank Mutual Corporation, Brown Deer, Wisconsin (Holding Company), the holding company for Bank Mutual, Milwaukee, Wisconsin (Savings Association), submitted a written notice (Notice) to the Office of Thrift Supervision (OTS), pursuant to 12 C.F.R. §§ 563b.510 and 563b.515, regarding its proposed repurchase, in the open market, of up to 3,938,788 shares (five percent) of its common stock. The Holding Company proposes to commence the repurchases after April 29, 2004.

Background

The Savings Association completed a mutual holding company reorganization on November 1, 2000. In the reorganization, the Savings Association formed a mid-tier holding company (Mid-Tier), which completed a minority stock issuance in connection with the reorganization. The Mid-Tier adopted the Bank Mutual 2001 Stock Incentive Plan (2001 Plan), and the Mid-Tier’s shareholders approved the 2001 Plan in 2001.

The Savings Association and its mutual holding company (MHC) completed a “second-step” conversion to stock form on October 29, 2003, pursuant to the OTS Mutual Holding Company Regulations and the OTS Mutual to Stock Conversion Regulations. In approving the second-step stock conversion, OTS imposed a condition requiring that following the conversion, the Holding Company be subject to the OTS stock repurchase regulations as if it were the Savings Association. The Holding Company’s common stock was initially issued and sold at $10.00 per share. As of April 1, 2004, the common stock traded at approximately $11.24 per share.

The Notice states that the Holding Company proposes to engage in the repurchases in order to fund its obligations under the 2001 Plan. After the conversion, the Holding Company assumed the obligations of the Mid-Tier, including the 2001 Plan. Without the requested repurchases, the Holding Company would have to issue new shares of stock in order to honor exercises of stock options issued under the 2001 Plan, and the Holding Company notes that such stock issuances would dilute the value of existing outstanding shares.

The Holding Company has requested permission pursuant to 12 C.F.R. §§ 563b.510 and 563b.515 to repurchase up to 3,938,788 shares of its common stock, which represents five percent of the 78,775,779 shares outstanding on December 31, 2003. The Holding Company proposes to commence the repurchases after April 29, 2004. The Holding Company has stated it intends to use the repurchased shares to fund any potential exercises of stock options under the 2001 Plan. Specifically, the Holding Company states
that it intends to repurchase up to 1,870,025 shares, after April 29, 2004 and prior to October 29, 2004, to hold as treasury shares in the event any stock options are exercised under the 2001 Plan.

At December 31, 2003, the Holding Company had outstanding 3,298,590 options to purchase shares of its common stock under the 2001 Plan. Of these options, 1,159,799 are currently exercisable, 710,226 will become exercisable before the one-year anniversary date of the conversion, October 29, 2004, and the remaining options will become exercisable thereafter.

In addition, the Notice provides information regarding a proposed management recognition plan, named the 2004 Stock Incentive Plan (2004 Plan), which is being submitted to the Holding Company’s shareholders for approval in May. The Holding Company indicates that it intends to repurchase up to 1,642,521 shares of its common stock to fund the awards under the 2004 Plan.¹

Discussion

Section 563b.510 provides that recently converted savings associations may not repurchase any of their stock during the first year after conversion, subject to certain exceptions.² One exception, set forth at 12 C.F.R. § 563b.510(a)(1), provides that a converted savings association (or its holding company) may, in extraordinary circumstances, make open market repurchases of up to five percent of the outstanding stock in the first year following conversion, provided the party files a notice with OTS, and OTS does not disapprove the repurchase. Section 563b.510(a)(1) provides that OTS will not approve such repurchases unless the repurchases meet the standards set forth at 12 C.F.R. § 563b.515.

Section 563b.515(c) provides that OTS will not object to a repurchase program if: (i) the repurchase program will not adversely affect the financial condition of the savings association; (ii) the information submitted is sufficient for OTS to evaluate the repurchases; (iii) the association demonstrates extraordinary circumstances and a compelling and valid business purpose for the repurchases; and (iv) the repurchase program would not be contrary to other applicable regulations.

OTS has reviewed the Notice, and concludes that the Notice fails to demonstrate extraordinary circumstances and a compelling and valid business purpose for the repurchases. The Holding Company has provided the following reasons as to why it believes there are extraordinary circumstances and a compelling business purpose: (1) the Holding Company currently has no treasury shares, and therefore will need to use authorized and unissued shares to satisfy any exercises of options under the 2001 Plan,

¹ The Notice separately advised OTS, under 12 C.F.R. § 563b.515(c)(4), that it proposes to repurchase shares for the 2004 Plan. This order does not address that notification.
² OTS conditioned approval of the Savings Association’s and MHC’s second-step mutual to stock conversion on the Holding Company being subject to 12 C.F.R. § 563b.510 as if it were a savings association.
which will result in a dilution of ownership to its existing shareholders and a decrease in earnings per share; (2) OTS has approved previous notices filed by other savings associations or their holding companies, to make purchases for similar plans that existed before a second-step conversion, based on the potential for dilution; (3) there have been significant changes in equity market conditions, including additional volatility resulting from recent acts of terrorism, that have caused the Holding Company’s stock to trade at approximately 8 percent below its high following its conversion; (4) in order to comply with Securities and Exchange Commission (SEC) Regulation 17 C.F.R. § 240.10b-18, as recently amended, the Holding Company may need a longer period of time to make its stock repurchases; (5) the Holding Company’s tangible net worth as a percentage of assets is over 22.0 percent and because of the current low interest rate/investment return environment, it believes that repurchases will provide the best improvement in its financial performance ratios; and (6) the Holding Company plans to have shareholders vote on the 2004 Plan in May 2004, which would lead to the need for up to approximately an additional 5.7 million shares and possible additional dilution.

As an initial matter, although the Notice addresses the proposed repurchase of up to 3,938,788 shares of the Holding Company’s stock, the Notice explicitly states that the Holding Company does not intend to purchase more than 1,870,025 shares of common stock before October 29, 2004. Because the regulatory restriction is inapplicable after October 29, 2004, approval is not needed for repurchases effected after that date. Accordingly, based on this fact alone, the Holding Company has not demonstrated extraordinary circumstances or compelling business reasons for any repurchase exceeding 1,870,025 shares. With respect to the proposed repurchase of up to 1,870,025 shares, we address each of the Holding Company’s assertions below.

Dilution and Expense; Prior Approvals

The Holding Company’s claim that existing shareholders will suffer dilution in their ownership from the use of authorized and unissued shares does not constitute either extraordinary circumstances or result in a compelling business purpose for the repurchases. All employee stock benefit plans have the potential to result in dilution. The Holding Company’s prospectus, dated July 31, 2003, for the mutual to stock conversion disclosed the possibility of dilution and a reduction in earnings per share. Further, because: (i) the options do not expire in the near future, (ii) the Holding Company’s common stock was sold in the conversion at $10.00 per share, and (iii) the stock is currently trading at approximately $11.24 per share, it is highly unlikely that a significant amount of options will be exercised before October 29, 2004. The Holding Company has provided no evidence that it has received any pending requests for exercise by any of its directors, executive officers, other officers, and key employees, who hold options granted under the 2001 Plan. In addition, when the staff called counsel on April 6, 2004, and asked the Holding Company’s counsel whether or not there were any pending requests for exercise, counsel responded that he was not aware of any such requests.

The Holding Company indicates that OTS did not object to certain other applications for stock repurchases made in the first year following a conversion (OTS Order Nos. 2003-13, 2003-26, and 2003-29), which involved stock repurchases to fund exercises under a stock option plan adopted before the conversion.

When OTS considered the other applications, during 2003, those applicants indicated that they did not have notice, before their mutual-to-stock conversions, of the fact that the existence of a pre-existing stock plan and the lack of any existing treasury shares after completion of the second step conversion would not provide extraordinary circumstances and a compelling business justification for repurchases. Because of this lack of notice and for the reasons set forth in those approval orders, OTS approved those applications.

To address the lack of notice, and to implement OTS' position that, for subsequently filed applications, funding of pre-conversion plans would not constitute extraordinary circumstances, OTS staff advised subsequent applicants for second-step conversions, during the application review process, of OTS' position that the need to provide shares for the exercise of a stock option plan adopted before a second-step conversion and the lack of treasury shares does not demonstrate extraordinary circumstances and a compelling business purpose. OTS staff explicitly advised the Holding Company's counsel of this position during its review of the application for conversion, in July 2003. The Holding Company was advised that: (a) the need to provide shares for the exercise of a stock option plan adopted before a second-step conversion and the lack of treasury shares does not demonstrate an extraordinary circumstances and a compelling business purpose; (b) the staff would recommend denial of any application for stock repurchase during the first year after a conversion to fund such stock options; and (c) the Holding Company must include disclosure regarding possible dilution to existing stockholders that may result from issuing authorized and unissued shares to provide shares for any options exercised under the 2001 Plan.

In response to the staff's comments, the Holding Company amended its preliminary prospectus filed with OTS and its registration statement filed with SEC to include new disclosure on pages 9 and 10, of the prospectus, dated July 31, 2003, which disclosed the effect of using authorized and unissued shares.

OTS makes the determination of whether an applicant has demonstrated extraordinary circumstances and a compelling business purpose, based on the evidence presented. In this case, the Holding Company was provided with notice that a prior stock option plan and a current lack of treasury shares would not by itself demonstrate extraordinary circumstances and a compelling business purpose. As discussed below, the Holding Company has not presented any other facts that demonstrate extraordinary circumstances exist or a compelling business purpose. The Holding Company, which has the option of using authorized and unissued shares, has provided no evidence that it has pending requests for exercise that it is unable to fill in a timely manner. Further, the
Holding Company is subject to the restrictions on repurchase only until October 29, 2004, which is approximately six months from now.

**Equity Market Conditions**

The Holding Company has not provided any evidence that there have been any significant changes in the equity markets that are extraordinary or that would provide a compelling business justification to engage in the proposed stock repurchase. An eight percent decrease from the high for the Holding Company’s stock, and current general market conditions do not provide sufficient evidence of extraordinary circumstances or a compelling business purpose.

**SEC Rule 10b-18**

The Holding Company has not provided any evidence that it would not be able to comply with the requirements of SEC Rule 10b-18. If OTS were to consider the amendments to the rule “extraordinary circumstances” or as providing valid and compelling business purposes, then every proposed repurchase would meet the approval criteria.

**Stock Repurchases Effect on Financial Condition**

The Holding Company has not provided any evidence that the proposed stock repurchases would have a significant effect on its financial condition as compared to other uses for its capital, which it described in its prospectus of July 31, 2003, and in its business plan filed with the OTS. Accordingly, this assertion by the Holding Company does not constitute extraordinary circumstances or a compelling business justification.

**Additional Dilution from Proposed 2004 Plan**

The Holding Company indicates that the shareholders will vote on the 2004 Plan in May 2004. If the existing shareholders object to the additional dilution that may result from the adoption of the 2004 Plan and any additional dilution that may result from the use of authorized and unissued shares during the first year after the conversion, then that concern should be reflected in the shareholder vote. Also, after the one-year anniversary period expires, on October 29, 2004, there will not be any restrictions on issuer repurchases under the OTS Conversion Regulations, at 12 C.F.R. Part 563b. Accordingly, the assertion by the Holding Company does not constitute extraordinary circumstances or a compelling business purpose.

Based on the facts presented, we conclude that the Holding Company has failed to provide evidence to OTS to demonstrate that “extraordinary circumstances” and a “compelling business purpose” exist with respect to the Notice. Accordingly, the Notice is hereby disapproved.
By order of the Director of the Office of Thrift Supervision, or his designee, effective April 12, 2004.

[Signature]

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