Heritage, MHC, Albany, Georgia (MHC), a federal mutual holding company, filed with the Office of Thrift Supervision (OTS), on August 19, 2004, a notice under 12 C.F.R. § 575.10(b)(1) (Notice), for the MHC’s proposed disposition of stock of its subsidiary holding company, Heritage Financial Group (Mid-tier), and its subsidiary federal stock savings bank, HeritageBank of the South, Albany, Georgia (Savings Bank).

Background

The Savings Bank is a federal savings bank. In May 2002, the Savings Bank reorganized into a federal mutual holding company structure. Currently, the MHC owns all the stock of the Mid-tier, which owns all the stock of the Savings Bank. As of June 30, 2004, the Savings Bank had approximately $328.9 million in assets, $296.4 million in liabilities, $32.4 million in equity capital, and was well capitalized.

On June 28, 2004, the Savings Bank filed an application with the Georgia Department of Banking and Finance (Department) for the charter conversion of the Savings Bank to a Georgia-chartered commercial bank. On September 10, 2004, the Department approved the Savings Bank’s articles of conversion and its application to convert to a Georgia state-chartered commercial bank, subject to certain conditions.

On October 4, 2004, the MHC filed a bank holding company application with the Board of Governors of the Federal Reserve System (FRB) in connection with the proposed transactions. That application is pending.

The MHC filed the Notice with OTS on August 19, 2004. The MHC is prohibited from consummating its proposed disposition of the stock of the Mid-tier and the Savings Bank, unless OTS approves the Notice under 12 C.F.R. § 575.10(b)(1).¹

Proposed Transaction

The Savings Bank proposes to convert its charter from that of a federal stock savings bank to a Georgia-chartered commercial bank (Commercial Bank). In connection with the proposed charter conversion, the MHC and the Mid-tier have each adopted plans

¹ On June 29, 2004, the Savings Bank provided notification to OTS of its intention to convert to a Georgia-chartered commercial bank, pursuant to 12 C.F.R. § 563.22(b). The Savings Bank supplemented that notification on July 22, 2004.
of reorganization and merger pursuant to which they propose to reorganize, respectively, into a Maryland non-stock corporation (MNSC) and a Maryland stock corporation (MSC). The MHC and Mid-Tier propose to accomplish the reorganizations and charter conversions by creating, respectively, the MNSC and the MSC, and then merging into these entities immediately prior to the charter conversion of the Savings Bank. According to the Notice, the former members of the MHC will become the members of the MNSC.

The Notice includes, as an exhibit, seven proposed commitments to be provided by the MHC, the Mid-tier, the MNSC, and the MSC, to the FRB. The MHC claims that the proposed commitments are sufficient to protect the rights of the members of the MHC, after the MHC merges with and into the MNSC. The first three commitments, in summary, would require: (1) the MNSC and the MSC to obtain the FRB’s prior approval (a) for the sale, transfer, or other disposition of any of the MNSC’s stock holdings of the MSC or the Commercial Bank, and the MSC’s stock holdings of the Commercial Bank, and (b) for any issuance by the MSC, the Commercial Bank or any other direct or indirect subsidiary of the MNSC, of equity securities or any securities providing a right to acquire equity securities, among other things, to persons other than the MNSC; (2) the MNSC to file an application with the FRB in connection with any conversion of MNSC to the stock form of organization; and (3) the MNSC and the MSC, in connection with the circumstances described in (1) and (2), to provide depositors of the Commercial Bank the same stock purchase priorities given under OTS regulations in a minority stock offering or mutual to stock conversion, unless the FRB waives the requirement. The third commitment provides that the FRB, in considering such requests, would “take into account the extent to which the proposed transactions” conform with the provisions and purposes of the OTS Mutual to Stock Conversion Regulations and Mutual Holding Company Regulations, and certain regulations of the Federal Deposit Insurance Corporation.\(^2\)

Commitments four through seven, in summary, would require: the FRB’s prior approval for any MSC stock repurchases and that such repurchases be at the market price; the FRB’s prior approval of any pledge of MSC stock; the FRB’s prior approval of any waiver of dividends by the MNSC; and the MNSC to address certain MNSC restructuring and waiver of dividend issues.

Discussion

**OTS Has Authority To Deny The Notice**

Section 575.10(b)(1) of OTS’ Mutual Holding Company Regulations (MHC Regulations) requires a mutual holding company to “provide written notice to the OTS” prior to disposing of stock it holds in a mid-tier mutual holding company or former

\(^2\) The third commitment further provides that conformity with the OTS and FDIC requirements will not be sufficient for FRB regulatory approval if the FRB determines that the proposed transaction would pose a risk to the institution’s safety and soundness, violate any law or regulations, or present a breach of fiduciary duty.
mutual savings association. The OTS Applications Processing Procedures Regulations define a “notice” as an application and subject it to OTS procedures for processing applications. Under those procedures OTS may approve or deny an application.

Moreover, the preamble to the 1993 final MHC Regulation discussed the § 575.10(b) notice requirement, and stated: “the transaction in which the mutual holding company disposes of the association would be subject to OTS oversight.” OTS used that language to inform the public that the regulation contemplates that OTS will exercise its judgment when reviewing a notice under § 575.10(b)(1) and may approve, approve with conditions or deny such a notice. Therefore, OTS’ regulations provide authority for the agency to approve or deny the notice filed by the MHC here.

The Proposed Transaction Involves a Disposition Under 12 C.F.R. § 575.10(b)(1)

Section 575.10(b)(1) requires a mutual holding company to provide written notice to OTS at least 30 days prior to the effective date of any direct or indirect transfer of any of the stock it holds in a “subsidiary holding company” or a savings association that was formerly in the mutual form.

Currently, the MHC directly owns all of the stock of a subsidiary holding company, the Mid-tier, and indirectly owns all of the stock of the Savings Bank, a savings association that was in mutual form before it reorganized into the mutual holding company structure. After the transaction, the successor to the MHC, the MNMC, will not own a subsidiary holding company, as the term is defined in the MHC Regulations because that mid-tier federal mutual holding company will have been merged into a state-chartered stock corporation. Similarly, the MHC will no longer hold the stock of a savings association because there will not be any savings association remaining after the conversion is completed. Therefore, because the MHC proposes to dispose of the stock of the subsidiary holding company and the savings association in the proposed transaction it must first obtain OTS’ approval of the transaction.

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4 Section 516.1(b)(4) provides an exception from those procedures for applications filed under an OTS regulation that prescribes other application processing procedures and time frames. Section 516.1(c), however, provides that if an OTS regulation for a specific type of application prescribes some application processing procedures, or time frames, OTS will apply 12 C.F.R. Part 516 to the extent necessary to process the application.
7 12 C.F.R. § 575.2(q) defines a “subsidiary holding company” as a federally chartered stock holding company, controlled by a mutual holding company, which owns the stock of a savings association whose depositors have membership rights in the parent mutual holding company.
8 Regardless of whether the MHC and Mid-tier merge with the proposed Maryland-chartered corporations first and then the Savings Bank converts its charter to that of a Georgia-chartered commercial bank, as is currently proposed, or the Savings Bank converts its charter first and then the MHC and Mid-tier merge with the proposed Maryland-chartered corporations, the end result is the same, in that there is no federal mutual holding company, subsidiary holding company, or savings association in the organizational
Moreover, OTS review of the proposed transaction is consistent with the purposes underlying § 575.10(b). The regulation states that any stock disposition shall comply with the requirements of Part 575 or with Part 563b of OTS’ regulations, as appropriate, and with any other applicable statute or regulation including, without limitation, 12 C.F.R. Parts 546, 563 and 574. The MHC Regulations include extensive provisions governing minority stock issuances by savings association subsidiaries of mutual holding companies, and by subsidiary holding companies. If mutual holding companies were able to dispose of their interests in subsidiary holding companies or their savings association subsidiaries without complying with § 575.10(b), the §§ 575.7 and 575.8 limitations on minority stock issuances would be meaningless, because the mutual holding companies could simply transfer the stock they own in the manner they wished. The goal of both §§ 575.7 and 575.8, and § 575.10(b), is the protection of the interests of the subsidiary institution’s depositors. That protection is the reason why § 575.10(b) provides that the disposition must comply with the provisions of 12 C.F.R. Part 563b, as appropriate, and the preamble to the 1993 final MHC Regulations mentions the OTS conversion regulations when discussing § 575.10(b). As discussed in further detail below, OTS is denying the Notice because the proposed transaction will be detrimental to the interests of the Savings Bank’s depositors.

The Disposition Will Be Detrimental to the Interest of the Savings Bank’s Depositors

At present, the interests of the MHC’s members (that is, the depositors of the Savings Bank) are protected under an extensive system of laws (section 10(o) of the Home Owners’ Loan Act (HOLA)), and regulations (12 C.F.R. Parts 575 and 563b). If the proposed transactions are consummated, the mutual nature of the MNSC will not be governed by a system of federal or state statutes or regulations designed to protect depositor members’ rights. Instead, the MNSC’s members will have the rights granted by the MNSC’s charter. However, unlike under the federal regulatory framework established by HOLA and the MHC Regulations, amendments to the MNSC’s charter will not be subject to any regulatory review or approval that will consider the interests of the MNSC’s members. Maryland will not provide any financial regulation of the MNSC or the MSC, because there will be no subsidiary depository institution in Maryland. Accordingly, if the MHC and the Mid-tier are permitted to convert to a Maryland-chartered, for-profit, non-stock, corporation, and to a Maryland stock corporation, respectively, there will be no body of federal or state laws or regulations that will govern their charters, operations, activities, and member rights, that are equivalent to the OTS regulations to which the MHC and the Mid-tier are currently subject. OTS finds that the absence of a system of state or Federal statutes and regulations that would protect the interests of depositors as members is a sufficient basis to deny the Notice.

structure of the resulting entities. Accordingly, OTS approval is required under § 575.10(b) regardless of the order of the steps in the transaction.

The proposed commitments illustrate the inadequacy of mere commitments to protect the depositor members' rights in lieu of a federal or state statutory and regulatory framework. The proposed commitments by the MHC, the Mid-tier, the MNSC, and the MSC, to the FRB address certain possible transactions that involve a sale or disposition of stock of the MSC or Commercial Bank, a minority stock issuance by the MSC or Commercial Bank or another subsidiary of the MNSC, a mutual to stock conversion of the MNSC, certain stock repurchases, a pledge of the MSC's stock, dividend waivers by the MNSC, and certain reorganization issues. However, the proposed commitments do not address or provide a framework for considering all the types of activities, mergers, acquisitions, or other proposed transactions for which there are relevant statutes or regulations administered by OTS. For example, novel transactions could be proposed that might not be covered by any commitments offered by the MHC, Mid-tier, MNSC and MSC. Such transactions might involve, among others: (1) amending the MNSC's charter to eliminate depositor members' rights or to significantly reduce them; (2) the MNSC and the MSC taking steps to dissolve, with the result that they are no longer regulated by the FRB; and (3) the MNSC and the MSC seeking to engage in a merger with another non-stock corporation or other entity, with the other entity being the survivor.

Conclusion

Based on the foregoing, OTS concludes that the proposed transaction fails to adequately protect the interests of the members of the MHC. Accordingly, the Notice is hereby denied.

By order of the Director of the Office of Thrift Supervision, or his designee, effective October 27th, 2004.

Richard M. Riccobono
Deputy Director