OFFICE OF THRIFT SUPERVISION

Denial of Applications to Amend Bylaws

Order No.: 2008-34
Date: September 26, 2008
Docket Nos.: 02454, H-2730, H-2811

Columbia Bank, Fair Lawn, New Jersey (Association), and its holding companies, Columbia Bank MHC (MHC) and Columbia Financial, Inc. (Company) (collectively, Columbia) have submitted applications to the Office of Thrift Supervision (OTS), pursuant to 12 C.F.R. §§ 575.9(a)(4) and 575.14(c)(3), and Condition 12 of OTS Order No. 97-14 (March 3, 1997), proposing the following changes to each of their bylaws: (i) a perpetual prohibition on service as a director if a person has been subject to a cease and desist order related to certain matters, issued by a banking agency, and a related provision prohibiting a person who is not qualified to serve as a director from nominating a director; and (ii) a provision requiring that each director be a resident of New Jersey.

Background

The Association is a federally chartered stock savings association that completed its reorganization into a mutual holding company structure in 1997. The Company, a state-chartered stock corporation, holds all of the Association’s stock. The MHC, a federally chartered mutual holding company, owns all of the Company’s common stock.

Discussion

Sections 575.9(a)(4) and 575.14(c)(3) require, respectively, that mutual holding companies and subsidiary mutual holding companies have bylaws that conform to sections 12 C.F.R. § 544.5 (the bylaw provisions that are applicable to federal mutual savings associations), and 12 C.F.R. § 552.5 (the bylaw provisions that are applicable to federal stock savings associations), respectively. In addition, an underlying federal savings association in an MHC structure must have bylaws that conform to section 552.5, except where otherwise approved by OTS. Sections 544.5 and 552.5 permit deviations from the model bylaws in certain circumstances, with OTS approval. OTS has discretion to disapprove bylaws that would render more difficult or discourage a merger, proxy contest, the assumption of control by an account holder of a mutual association or a holder of a large block of a stock association’s stock, the removal of incumbent

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1 As a condition to approving the Company’s acquisition of the Association, OTS required that the Company receive OTS’s non-objection to any proposed amendments to its bylaws. See Condition 12 of OTS Order No. 97-14 (March 3, 1997). Because the Company is comparable to a subsidiary mutual holding company, OTS is reviewing its proposed bylaw amendments on the same basis as OTS would review proposed bylaw amendments by a federally chartered subsidiary mutual holding company.

2 See also 12 C.F.R. § 575.9(b) (2008).
management, and to disapprove bylaws that are inconsistent with the requirements of applicable laws, rules, regulations, or an association’s charter.\(^3\)

In this case, OTS must determine whether or not to permit the MHC, the Company, and the Association to impose director qualification requirements of the type they have proposed. The proposed bylaws include director integrity requirements that are more restrictive than are currently permitted pursuant to OTS’s pre-approved optional integrity bylaw.\(^4\) The OTS’s pre-approved optional bylaw does not prohibit persons who are subject to the integrity factors set forth from nominating qualified persons for director positions, while the proposed bylaw includes such a restriction. In addition, the pre-approved optional bylaw contains a ten-year restriction prohibiting service on a board of directors if a person has been subjected to certain cease and desist orders issued by a banking agency. The proposed bylaw would make that restriction perennial. Furthermore, the proposed bylaws would restrict service on the board of directors of each of the Columbia entities only to residents of New Jersey.

Management can choose not to nominate any particular person for a seat on the board of directors. Therefore, even without adoption of the proposed bylaws, management may choose not to nominate a person who it finds unacceptable. Thus, the proposed bylaws would have the effect of limiting the ability of persons who are not aligned with management from being nominated or from nominating persons in opposition to management. Accordingly, it is appropriate to treat the proposed bylaws as antitakeover provisions. In doing so, the agency may consider the proper balance between the management and the owners of the respective companies.

Columbia has asserted that OTS should approve the two proposed bylaws because: (1) OTS proposed the same expanded integrity bylaw provision as a pre-approved bylaw provision,\(^5\) although the proposal was subsequently withdrawn,\(^6\) and such a provision is not prohibited under either Delaware or New Jersey law; and (2) the proposed geographic limitation is less restrictive than many OTS has previously approved, and would help ensure Columbia that its directors are familiar with its market.

We have analyzed the justifications provided by Columbia for the proposed bylaws and are not persuaded by those arguments. OTS has discretion to deny adoption of any proposed bylaw for a mutual holding company that is inconsistent with OTS’s regulations. Similarly, OTS has discretion to deny applications to adopt proposed bylaws by stock companies for policy reasons, when the agency has already set forth what is permissible by regulation or other written opinion, or for reasons of safety and soundness,

\(^3\) See 12 C.F.R. §§ 544.5(c)(1) and 552.5(b)(1)(i) (2008).
\(^4\) See Section 410 of the Applications Handbook.
\(^5\) 71 FR 7695, February 14, 2006.
\(^6\) 72 FR 72264, December 20, 2007.
or because the proposed bylaws are inconsistent with the purposes underlying OTS’s regulations.

**Integrity Bylaw**

Federal savings associations and federally chartered mutual holding companies already may adopt a pre-approved bylaw that addresses the integrity of directors. The proposed bylaw differs from the pre-approved optional bylaw in two significant ways. First, the bylaw that Columbia has proposed would prohibit persons who are themselves prohibited from serving as a director from nominating an otherwise-qualified person to serve. Second, the bylaw that Columbia has proposed would establish a lifetime prohibition on director service, rather than a ten-year prohibition.

In 2005 OTS permitted a mid-tier mutual holding company to adopt a bylaw provision like the one sought by Columbia. See OTS Order 2005-13 (March 17, 2005). At the time, OTS indicated that it was approving the proposed bylaw because OTS believed that the institution should, in the first instance, make its own judgment concerning what was needed to protect it from risks that might be associated with persons of questionable integrity. Id. at 2. Such prior OTS action, however, does not compel the conclusion that Columbia’s proposed bylaw must be approved. Rather, OTS may change its view, provided that it explains its reasons for its change of approach. In this case, OTS subsequently received a number of requests for approvals of similar bylaw provisions, and OTS determined to undertake a broader review of the relevant issues. As Columbia has noted, in 2006, OTS proposed changing its regulations to permit savings associations to adopt an optional pre-approved bylaw that contained these same two features. With regard to the restriction on nominations, OTS in its 2006 proposal expressed concern that an institution might suffer reputational risk in such a scenario, since the tainted person might be thought to have chosen nominees who he or she believes will pursue the same objectives as their sponsor, and this might engender the same reaction from the public as would the election of the subject person himself.

After further consideration, including a review of the comments submitted on this proposal, OTS withdrew its 2006 proposal in December 2007.

The prohibition on nominating a director diminishes the property rights that stockholders otherwise obtain when they acquire stock or that members obtain when they become members of a federal savings association or mutual holding company. Such a diminution raises serious questions, particularly where the stock registration or membership-related documents do not reveal that those persons might be deprived of their right to nominate persons to serve on the board of directors. OTS is not persuaded

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7 See National Home Equity Mortgage Ass’n v. OTS, 373 F.3d 1355, 1360 (D.C. Cir. 2004); Michigan v. Thomas, 805 F.2d 176, 184 (6th Cir. 1986).
that imposing this restriction is consistent with affording stockholders and members a fair opportunity to nominate candidates for the board.

In addition, it appears that the proposed restriction on nominations would not be effective in preventing a stockholder or member from presenting a nominee for election to the board. All the stockholder or member would have to do is get any other stockholder or member to make the nomination.

Furthermore, it is doubtful that a stockholder or member with “bad” character would, simply by nominating a person of “good” character, damage the reputation or otherwise adversely affect the Company or the Bank. It appears that adoption of a prohibition regarding nominations exhibits management’s lack of trust of stockholders or members, and we must be cognizant of the fact that management is supposed to serve the interests of the institution and its stockholders or members, not their own interests.

The other change from the pre-approved integrity bylaw is the removal of the ten-year limitation on the provision restricting service on the board of directors for a person who had been subjected to certain cease and desist orders issued by a banking agency. As noted above, OTS proposed in 2006 (and later withdrew) an optional bylaw containing this same perpetual prohibition. At that time, OTS noted that the perpetual prohibition was partly derived from OTS regulations at 12 C.F.R. § 563.39(b)(1), which permit a thrift’s board to terminate an officer for cause, including personal dishonesty or breach of a fiduciary duty involving personal profit, and that it seemed reasonable to hold board members to at least a comparable standard of integrity. The agency observed that people need to be able to trust the institution that holds their money, and that a director whose reputation is tainted may injure an institution simply by being a member of the board.

The common law recognizes a corporation’s right to impose reasonable qualifications on those who stand as candidates for a position on the board of directors. OTS now believes, however, that such a perpetual prohibition precludes the possibility of rehabilitation and ignores the fact that over time the governmental sanctions may become less relevant to a person’s suitability as a director. Therefore, in our view, OTS may conclude that a perpetual prohibition is inappropriate to protect the institution or its holding companies.

Finally, while Columbia asserted that the proposed limitations on directors’ qualifications would be acceptable under either New Jersey law or Delaware law, Columbia did not provide a reasoned legal opinion to that effect or even any citations to relevant provisions. Therefore, it appears that while the laws of those states might not explicitly prohibit such a provision, they might not permit it either.
Based on the considerations discussed above, OTS concludes that the views the agency expressed when it issued OTS Order 2005-13 and the proposed rule were overstated, and that the proposed bylaw would, in any event, not be a particularly effective way to address those concerns.

There must be a balance between the need for a board of directors of suitable integrity and a provision that would tend to entrench management. In weighing that balance, OTS concludes that the proposed bylaw would not promote significantly greater integrity among potential board members than the already existing pre-approved optional bylaw provision. In addition, OTS concludes that the proposed bylaw inappropriately entrenches management.

**Geographic Limitation**

On a case-by-case basis, OTS has allowed geographic restrictions for board members that have been similar to the provision that Columbia has proposed. As noted above, prior OTS action does not compel the conclusion that Columbia’s proposed geographic restriction must be approved. In this regard, the current economic circumstances provide a strong reminder that institutions can and do run into business problems and may need assistance to overcome such events. A provision that excludes everyone who does not live in a particular state from board membership may prevent an entity from bringing on board members with the particular expertise necessary to deal with a business crisis and may impair the entity’s ability to raise capital from persons or entities that would want board representation to protect their investments.

Columbia’s desire to have persons on its boards who are familiar with its local market is not negated by OTS’s denial of the proposed bylaw amendment. Management and stockholders (or members) of the entities still have the ability to nominate and elect only persons who live in New Jersey. They cannot, however, present an absolute bar to service of persons who live elsewhere.

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8 Id.
Conclusion

Based on the foregoing, OTS concludes that denial of the applications is appropriate, and the applications are hereby denied.

By order of the Director of the Office of Thrift Supervision, or his designee, effective September 25, 2008.

Lori J. Quigley
Managing Director
Supervision