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STOCK CONVERSIONS UNDER THE AMENDED REGULATIONS

CHARLES E. ALLEN*

INTRODUCTION

CONVERSIONS from the mutual to stock form of organization on a sale-of-stock basis have been permitted by the Federal Savings and Loan Insurance Corporation (hereafter referred to as the "FSLIC") since its conversion regulations became effective in June 1975.¹ The regulations as amended in March 1979 change various subscription priorities and place additional limitations on management purchases while reaffirming the basic FSLIC sale-of-stock approach to conversions.² There is no change in the FSLIC policy of prohibiting "give-away" or "free distribution" conversions.³ The

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¹ Amendments to these regulations were subsequently adopted by the Federal Home Loan Bank Board (the "FHLBB" or "Bank Board") on March 21, 1979 and became effective on May 1, 1979 (44 Fed. Reg. 18880 (March 29, 1979)). All references to the amended regulations are to the sections of the Code of Federal Regulations in which such material will appear.

By way of background, a sale of stock conversion is one in which the converting association sells its capital stock at its estimated pro forma market value, with eligible depositors of the association having priority rights to subscribe for the purchase of the conversion stock issue.

The Bank Board, as operating head of the FSLIC, adopted its initial sale-of-stock conversion regulations on February 28, 1974 (39 Fed. Reg. 9142 (March 7, 1974)). However, the regulations became effective during a temporary statutory moratorium imposed by Public Law 93-100, which in 1973 amended section 402 of the National Housing Act by adding thereto subsection (j) 12 U.S.C. § 1725(j)), which prohibited conversions of all insured institutions (except for certain "study applications") until June 30, 1974. As a consequence, the Board's regulations were not effectively operative until the enactment of Public Law 93-495 on October 28, 1974, which reaffirmed the Board's authority governing conversions of all insured institutions, but continued the existing moratorium on all conversions until June 30, 1976, with the exception of a limited number of conversions (12 U.S.C. § 1725(j)(1)). A historical summary of the Board's initial conversion regulations can be found in Liebold & Wilfand, *The Conversion Process - Mutual Stock Savings and Loan Associations*, 30 BUS. LAW. 129 (1974).

² As discussed *infra*, important regulation changes include 1) limiting the subscription by any person or group of persons acting in concert to five percent of the total shares offered, 2) limiting the total shares purchased by officers and directors in the subscription offering to twenty-five percent of the total offering, and 3) requiring an association to go to the community to sell any shares left over from the subscription offering. A report issued by the Comptroller General of the United States dated October 1, 1979, and titled *Converting Savings and Loan Associations from Mutual to Stock Ownership - a National Policy Needed* (hereinafter referred to in the text as the "1979 Comptroller General's Report"), has commended the Board for these changes. See Comp. Gen. Rep. at 10. (on file with the AKRON LAW REVIEW)

³ A "give-away" or "free distribution" conversion is one in which the stock of the converting association is distributed, without payment, to the eligible account holders of the association. Although the Board once considered inclusion of free-stock distributions in its conversion regulations (see 38 Fed. Reg. 1334 (1973)), it has since decided otherwise. The basis for the Board's decision is its belief that distribution of free stock would be inequitable and constitute what would be, in essence, a "windfall." In turn, such a distribution "would create strong incentives for significant shifts in savings funds among insured

amended regulations also reaffirm the FSLIC authority to permit Federal associations to retain their Federal charter after conversion to the stock form.⁴

The amended regulations continue the basic requirements of full public disclosure⁵ by the converting association and a sale of stock in an amount equal to its pro forma market value as determined by an independent valuation.⁶ Conversions under the new subscription and purchase provisions will also continue to be the most effective means of substantially increasing an association's net worth. This in many cases is essential in order to support increased savings growth and expanded home mortgage lending. In some cases, conversion may be a requisite for further branching.

Under the amended regulations, savings account members as of a specified eligibility record date have first priority to purchase the stock of the converting association in an amount equal to not less than the greater of fifteen times their pro rata portion of the shares being sold, 200 shares, or one-tenth of one percent of the total number of shares being sold.⁷ Thereafter other voting members have subscription rights on a second priority basis to purchase not less than 200 shares per member.⁸ Management purchases under the management set aside third priority are limited to a maximum of fifteen percent to twenty-five percent of the issue depending upon the size of the converting association.⁹ Management purchases in all categories are subject to various special restrictions.¹⁰ Shares remaining

institutions and other financial institutions . . . [which] would unacceptably threaten the financial stability of such institutions." 12 C.F.R. § 563b.3(a)(2). See Allen, *The Board's New Proposed Conversion Regulations*, 6 FED. HOME LOAN BANK BOARD J. 2 (Dec. 1973).

⁴ The question regarding whether or not the Board and the FSLIC have the statutory authority to permit federal associations to retain their federal charter after conversion to the stock form is presently a subject of controversy. See Comp. Gen. Rep. *supra* note 2, at 7. A brief discussion of this issue and a summary of the litigation which has ensued appear *infra*.

⁵ The regulations encourage disclosure by virtue of the requirement that unless otherwise provided, a proxy statement be furnished to each association member whose vote is solicited in connection with a meeting at which a plan of conversion will be voted upon. The proxy statement must meet the requirements of Form PS which, although comparable in many ways to Schedule 14A under the Securities Exchange Act of 1934 (the "1934 Act"), has been specifically designed for conversion transactions. See 12 C.F.R. § 563b.5 and Form PS. The regulations also provide for distribution of an offering circular for the subscription offering and any subsequent public or direct community offering. See Form OC.

As noted by this author in a prior article concerning the former conversion regulations, in formulating the disclosure requirements it was the intent of the Board "to give association members the information needed for intelligent voting on the plan of conversion and to provide information which can be incorporated into offering circulars to enable eligible account holders and others to make informed investment decisions with respect to the purchase of the converted institution's capital stock." Allen, *supra* note 3, at 5.

⁶ 12 C.F.R. § 563b.3(c)(1).

⁷ 12 C.F.R. § 563b.3(c)(2).

⁸ 12 C.F.R. § 563b.3(c)(5).

⁹ 12 C.F.R. § 563b.3(d)(1).

¹⁰ For example, purchases in the public offering phase by each officer, director or their associates are limited to one-tenth of one percent of the total offering of shares (12 C.F.R.

unsold may then be offered on a fourth priority basis up to one percent of the issue to eligible savings account members and other voting members.¹¹ Thereafter, unsubscribed shares are then sold in an underwritten public offering or in a direct community marketing depending upon the size of the converting association and the number of unsubscribed shares.¹²

The conversion regulations continue to contain various provisions designed to protect the converted association from a hostile takeover both during and after conversion.¹³ The entire conversion process is carefully regulated and monitored by the FSLIC to assure fairness and equitability and to avoid "windfall" profits by any group. There is, nonetheless, some controversy surrounding conversions, a discussion of which appears later in this article.

I. ADVANTAGES OF CONVERTING

Former Bank Board Chairman McKinney in his June 9, 1978 letter submitting the FSLIC's annual report on conversions to the Congress summarized the advantages of converting as follows:

The annual report demonstrates a most compelling reason to continue the conversion program, specifically, an increase in home mortgage lending of 1.6 billion dollars by converted associations — this represents growth at twice the average rate for all insured institutions.

In the savings and loan industry, equity capital is critical because of its capacity to provide leverage for increased savings growth. The new equity capital infused through conversions has been used to support dramatic increases in savings growth and branching, thereby enabling converted associations to expand significantly their mortgage lending and service to the community.

A. *Substantial Increase in Net Worth; FIR Solution*

Conversion to the stock form is the most effective means for a mutual association to raise a significant amount of equity capital, and thereby substantially increase its net worth. Since a converting association is required to sell stock equal to its pro forma market value upon conversion, conversion has the immediate effect of dramatically expanding the converting association's equity capital base.¹⁴

§ 563b.3(c)(6)(i)), and, by all such persons, to twenty-five percent in all phases of the conversion (12 C.F.R. § 563b.3(c)(8)). Moreover, shares purchased by directors and officers on original issue in the conversion are restricted for resale purposes for a period of not less than three years following the date of purchase except in the event of death (12 C.F.R. § 563b.3(c)(16)). See discussion, *infra*.

¹¹ 12 C.F.R. § 563b.3(d)(2).

¹² 12 C.F.R. § 563b.3(c)(6).

¹³ 12 C.F.R. § 563b.3(i).

¹⁴ This effect was recently confirmed in the April 15, 1978 Report of the Federal Home Loan Bank Board to the Congress of the United States of America on Mutual to Stock Conversion of Savings and Loan Associations (the "1978 FHLBB Report") which contained a section analyzing the effects of sale of stock conversions. Concluding that, on the

Based on the five percent federal insurance reserve requirement¹⁵ each dollar in new equity capital supports twenty dollars in additional savings deposits. A converted association's new equity capital can be used to satisfy both the federal insurance reserve and net worth requirements. In contrast, an association remaining mutual must rely solely on its earnings to meet the federal insurance reserve requirement. Since the federal insurance reserve is an account against which losses may be charged, the FSLIC does not allow subordinated debentures as debt securities to be used to satisfy any part of the federal insurance reserve requirement.¹⁶ A converted association also acquires the capability of further increasing its net worth in the future by selling additional stock or convertible securities when needed to satisfy this requirement as its savings growth continues.

B. Branch Expansion

The substantial increase in net worth resulting from the conversion will facilitate branch expansion.¹⁷ In some cases, associations have been required to curtail their branching or to delay initiating a branching program because of low net worth.

C. Increased Home Mortgage Lending

The equity capital raised in the conversion supports future savings growth and branching, which in turn substantially increase an association's home mortgage lending capability. In addition, the funds raised in the con-

average, insured associations have experienced net worth erosion in the recent past, the 1978 Report concluded at 23 that "[s]ale of stock conversions provide an immediate and substantial increment to an association's net worth accounts." The 1979 Comptroller General's Report acknowledged this fact, but suggested that alternatives other than conversion may be possible. *See* Comp. Gen. Rep., *supra* note 2, at 24.

¹⁵ 12 U.S.C. § 1726(b) (Supp. 1979). *See also* 12 C.F.R. § 563.13.

¹⁶ However, legislation recently enacted by Congress and signed into law by the President on March 31, 1980 authorizes federal savings and loan associations to issue mutual capital certificates which would constitute part of the general reserve and net worth of the issuing association and against which losses could be charged. Such certificates would be subordinate to all savings accounts, savings certificates, and debt obligations. After that, they would constitute a claim in any liquidation on the remaining general reserve, surplus and undivided profits. The certificates are entitled to the payment of dividends at a fixed or a variable rate. No dividends would be paid without FSLIC approval during any period of Federal insurance reserve/net worth non-compliance. *See generally*, The Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221 amending 12 U.S.C. §§ 1464(b) and 1726(b). For further background regarding this legislation, *see* 125 CONG. REC. 15,673 (daily ed. November 1, 1979) (remarks of Sen. Stone).

It has been suggested that the use of subordinated debt as net worth could reduce the need for conversion by providing additional net worth. Comp. Gen. Rep., *supra* note 2, at 24.

¹⁷ The 1978 FHLBB Report, *supra* note 14, at 38 pointed out its discussion of branch network expansion that:

The expansive action has been fueled by the infusion into capital of conversion generated funds and the knowledge that returns to the marketplace for capital augmentation are possible. *In other words, the addition of the conversion proceeds to the equity base allowed investment in new branch offices and gave converting associations the potential to institute other services.* (Emphasis added.)

version are primarily invested in local home mortgage lending by most converting associations.¹⁸

D. *Expanded Lending Authority*

The increased net worth of the converted association may have the effect of expanding the lending authority of the association since certain lending powers of associations¹⁹ (*e.g.*, prudent man loans, non-conforming loans, land development loans, developed building lot loans, and service corporation conforming loans in excess of the one percent limitation) are either not allowed or are more restricted for a federal association having a net worth of less than five percent of its savings deposits.

E. *Stock Ownership Opportunity for Savers*

Conversion provides savings account members with an opportunity to purchase stock in the conversion, and thereby benefit from the converted association's earnings and successful operation. Stock ownership should increase the loyalty of many savers.

F. *Appropriate Increase in Community Control*

Conversion appropriately increases community control since in most cases the stock will be purchased primarily by the converting association's savings account members and other persons residing in the communities served by the association. Unlike passive savings account members in a mutual association, stockholders can be expected to exercise their voting rights and many will attend annual meetings of the converted association. Since their equity capital investment will be at risk, stockholders will have a financial interest in how the converted association is managed and in its operating results. This should make its management more responsive since proxies will no longer be obtained at the time a savings account is opened and then voted each year exclusively by the managing officer of the directors as is the case in most mutual associations. At the same time, the converted association will continue to respond to the needs of its savers and borrowers in competing for their business.

G. *Competitive Structure*

Conversion will structure the association in the form used by all commercial banks, an increasing number of savings and loan associations and almost all business corporations in the United States. The ability to issue stock increases the operating flexibility of a converted association, thereby lessening its competitive disadvantage in competing against commercial banks and improving its competitive position with respect to other associations.

¹⁸ 1978 FHLBB Report, *supra* note 14, at 50.

¹⁹ 12 U.S.C. § 1464(c) (Supp. 1979).

H. *Increased Flexibility in Compensating and Attracting Management Discourages Insider Transactions*

Stock ownership is an effective performance incentive and a means of attracting, retaining and compensating qualified management and other personnel.²⁰ Directors, officers and employees in that capacity have an opportunity of purchasing stock of the converting association as part of the conversion after the subscriptions of savings account and borrower members have been satisfied.²¹ The converting association's pension and profit sharing plans may also invest a portion of their assets in the converting association's stock both as part of the conversion and thereafter. In addition, stock option or other stock purchase plans are available after conversion.²²

I. *Makes More Costly Annual Report Disclosure Unnecessary*

In view of the annual and interim reporting and proxy soliciting requirements under the 1934 Act applicable to publicly-owned stock associations,²³ there is an exemption for converted associations under the FSLIC's annual report disclosure requirements.²⁴ Thus a converted association would not be required to send annual reports to its savers or borrowers, thereby significantly reducing disclosure costs. At the same time, the converted association would be making public disclosure and soliciting proxies from its stockholders, who with their equity capital invested and at risk in the converted association are the appropriate group to whom disclosure should be made and from whom proxies should be solicited.

J. *Forestalling Supervisory Action*

The ability to raise equity capital may be critical in forestalling supervisory action.²⁵ In some cases, this ability may avoid supervisory mergers and provide both the FSLIC and the association's management more flexibility in dealing with operating and net worth problems.

²⁰ Advocates of conversion are consistent in their views on this point. See e.g., Chairman of the Board of Citizens Federal Savings and Loan Association of San Francisco, cited prior to that association's conversion to stock form, in Donahoe, *Conversion to a Stock Association*, 4 FED. HOME LOAN BANK BOARD J. 21 (Aug. 1971).

²¹ 12 C.F.R. § 563b.3(d)(1).

²² 12 C.F.R. § 563b.3(d)(6).

²³ In this connection, Public Law 93-495 transferred to the FHLBB the powers, functions and duties of the SEC to administer the provisions of sections 12, 13, 14(a), 14(c), 14(d), 14(f) and 16 of the 1934 Act (15 U.S.C. 78a et. seq.) with respect to securities issued by institutions which are insured by the FSLIC. Such duties encompass review of documents required to be filed under these sections such as registration statements, annual, quarterly and periodic reports, proxy soliciting materials and beneficial ownership reports. See 12 C.F.R. § 563d.1.

²⁴ 12 C.F.R. § 563.45.

²⁵ The importance of equity capital in forestalling supervisory action was emphasized in the statement by former Board Chairman Thomas R. Bomar during early congressional hearings on the matter. *Conversion of Savings and Loan Associations from Mutual To Stock Form: Hearings on S. 3132 and S. 3224 Before the Subcomm. on Financial Institutions of the Senate Comm. on Banking, Housing and Urban Affairs, 93rd Cong., 2d Sess. 115-94 (1974)*. The relevant portion of Mr. Bomar's testimony has been reprinted in 7 FED. HOME LOAN BANK BOARD J. 2 (May, 1974).

K. *Holding Company Structure Available*

If an association prefers to operate in a holding company structure, such a change is possible subsequent to conversion. This may facilitate future mergers where the association being acquired desires to continue operating as a separate entity with its own board of directors and officers. Further, a holding company structure permits substantial business activity diversity through affiliates.

II. STATUS OF CONVERSION APPLICATIONS

As of May 9, 1980, there were 170 conversion applications with the FSLIC, including sixty-three applications which have been approved, leaving one hundred seven pending. Of the sixty-three approved conversions, fifty-three have been fully completed. A substantial number of additional approvals are expected in the near future. The 170 applications involve thirteen minority associations, four of which are among the approved conversions.

The 170 applications are from 111 federally chartered associations and fifty-nine state-chartered associations. Of the sixty-three approved conversions, thirty-four involve federal mutual to federal stock charter including sixteen of those approved since April 1979, nine are federal mutual to state charter, and twenty are state mutual to state stock charter.

The 170 conversion applications are from associations in the following states: Thirty-two from North Carolina; twenty-one from Florida; eighteen from Texas; sixteen from California; twelve from Illinois; eight from Virginia; seven from Maryland; six each from New Jersey and Oklahoma; five each from Kansas and New Mexico; four from Indiana; three each from Colorado, Connecticut, Mississippi, Tennessee and Wisconsin; two each from Arkansas, the District of Columbia, Massachusetts, Michigan and Ohio; and one each from Arizona, Puerto Rico, Utah, Washington and Wyoming. Based on total asset size, fourteen converting associations have assets in excess of \$500 million, sixty between \$100 million and \$500 million, thirty-seven between \$50 million and \$100 million, and the remaining fifty-nine less than \$50 million. As shown, converting associations have broad geographic diversity with the largest number of conversions coming from geographic areas having rapid savings growth. In addition, the statistics make it clear that large as well as small associations can utilize the conversion process to raise equity capital.²⁶

III. CONVERSION REQUIREMENTS

A. *Approval of Plan*

The plan of conversion is required to be adopted by at least a two-thirds vote of the board of directors of the converting association before a con-

²⁶ The information furnished in this section has been furnished by members of the staff of the FHLBB.

version application is filed with the FSLIC.²⁷ In the case of Federal associations, conversion under the plan is accomplished by amending the converting association's charter and by-laws in their entirety to read in the form prescribed for Federal stock associations.²⁸ The conversion application includes the plan of conversion, proposed stock charter and by-laws, proxy statement and form of proxy to be used to obtain member approval of the plan, and an independent valuation of the appraised aggregate pro forma market value of the association after giving effect to the conversion.²⁹

Conversion applications are filed currently with the appropriate Federal Home Loan Bank and with the Securities Division, Office of General Counsel, at the FSLIC in Washington, D.C.³⁰ The plan of conversion, charter and by-laws, and nonfinancial statement portions of the proxy statement are primarily reviewed by the Office of General Counsel. The financial statements are reviewed by the Chief Accountant, who is in the Office of the District Banks. The independent appraisal is reviewed by the Office of Economic Research.

After the FSLIC has approved the plan of conversion³¹ and authorized the use of the proxy material, the converting association must then obtain approval of the plan by not less than a majority vote of its members entitled to vote on the plan at a meeting called for such purpose.³² Existing proxies cannot be voted to approve the plan. Only proxies obtained through the use of the proxy statement may be voted by the converting association.³³

Approval of the appropriate State Commissioner is also required where a state-chartered association is converting or in the case of a Federal mutual converting to state stock charter.

B. *Subscription Offering-Priorities*

1. **First Priority** — a. **Eligible Account Holders.** The FSLIC regulations require that all of the stock being issued in the conversion must be offered

²⁷ The amended regulations also impose certain notice requirements on insured institutions after the plan of conversion has been adopted. *See* 12 C.F.R. § 563b.4(a)(3).

²⁸ 12 C.F.R. § 563b.8(d).

The amended regulations require that the converted association apply to amend its charter and bylaws to read in the form of a charter and bylaws for a Charter S Association, the form specified for stock associations. *See* 12 C.F.R. Part 552.

²⁹ An Application for Conversion is made on Form AC, which sets forth the information required to be furnished at this stage of the transaction.

³⁰ 12 C.F.R. § 563b.8(e). *See also* 12 C.F.R. § 563b.2(a)(33).

³¹ Upon determination that the application for conversion is not materially incomplete, the amended regulations provide for written notice from the FSLIC to the applicant. Upon receipt of such notice, the applicant, in turn, is required to publish its own notice in accordance with the provisions of 12 C.F.R. § 563b.4(b). This provision also establishes a public comment period.

³² 12 C.F.R. § 563b.6(a).

³³ Moreover, no proxy soliciting material required to be filed with the FSLIC prior to its use shall be furnished to association members or otherwise released for distribution until the use of such material has been authorized in writing by the FSLIC. 12 C.F.R. § 563b.5(b).

for purchase on a first-priority basis to eligible account holders (i.e., savings account holders as of a date at least ninety days prior to the date of adoption of the plan of conversion by the board of directors).³⁴ Under the amended regulations, eligible account holders must receive subscription rights to purchase the greater of 200 shares, one-tenth of one percent of the total number of shares being issued in the conversion, or fifteen times their pro rata portion.³⁵ Pro rata portion is calculated by multiplying the total number of conversion shares by a fraction the numerator of which is the qualifying deposit of the eligible account holder and the denominator of which is the total qualifying deposits of all eligible account holders. In the event of oversubscription, shares are allocated first to permit each subscribing eligible account holder to purchase 100 shares and thereafter pro rata based on qualifying deposit balances.³⁶ These first priority subscription rights are prescribed by the FSLIC without a converting association having the option of offering its account holders greater first priority subscription rights. To the extent that a director, officer or associate has increased his account balances during the one-year period prior to the eligibility record date, subscriptions based on such increase are filled only after all other subscriptions under the first priority have been satisfied in full.³⁷

As an optional provision, the amended regulations permit an association to use a limitation as low as one percent on the maximum number of shares which any person or group of persons affiliated with each other or otherwise acting in concert may purchase in the subscription offering.³⁸ In determining whether to use this optional provision, a converting association should consider the maximum percentage up to five expected to be purchased by a director or officer in the subscription offering including the management set aside discussed below. The association may then want to set a subscription offering purchase limitation at that maximum percentage.

b. **Supplemental Eligible Account Holders.** In the case of plans of conversion approved by the FSLIC more than fifteen months after the eligibility record date, the amended regulations provide that savings account holders as of the end of the calendar quarter immediately preceding FSLIC approval of the plan are to be granted supplemental subscription rights on a similar basis as eligible account holders on the eligibility record date.³⁹ Supplemental subscription rights are the greater of 200 shares, one-tenth of one percent of the

³⁴ 12 C.F.R. § 563b.3(c)(13).

³⁵ The first priority classification is established under 12 C.F.R. § 563b.3(c)(2).

³⁶ *Id.*

³⁷ 12 C.F.R. § 563b.3(c)(3).

³⁸ 12 C.F.R. § 563b.3(d)(4).

³⁹ 12 C.F.R. § 563b.3(c)(4).

The supplemental eligibility record date is determined in accordance with the provisions of 12 C.F.R. § 563b.2(34).

total number of shares, or fifteen times the pro rata portion based on qualifying deposits on the supplemental record date. Supplemental subscription rights are reduced by any subscription rights which the supplemental eligible account holder has based on qualifying deposits on the eligibility record date.⁴⁰ In the event of oversubscription, subscriptions based on qualifying deposits on the eligibility record date are satisfied in full before subscriptions based on qualifying deposits on the supplemental record date.⁴¹ Directors, officers and their associates have no subscription rights based on their qualifying deposits on the supplemental record date.

2. Second Priority — Other Members

Under the amended regulations, other 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) are required to receive subscription rights to purchase 200 shares per member on a second priority basis after eligible account holders (and supplemental eligible account holders if applicable).⁴² A converting association would not be permitted by the FSLIC to offer its other members subscription rights to purchase more than 200 shares under this second priority.

3. Third Priority — Management Set Aside

The FSLIC regulations continue to permit directors, officers and employees of converting associations to purchase at the subscription price a limited number of shares remaining unsold after all subscriptions under the first and second priorities have been satisfied in full.⁴³ Under the amended regulations, the number of shares which may be purchased under this management set aside priority is limited to a range of fifteen percent to twenty-five percent depending upon the size of the converting association. The fifteen percent limit applies to an association having assets of \$500 million or more with a corresponding percentage increase up to twenty-five percent for associations of under fifty million dollars in assets. Purchases under the management set aside would be made prior to the sale of unsubscribed shares in an underwritten public offering or in a direct community marketing to the general public.

4. Fourth Priority — Additional Subscription Rights of Members

Under the amended regulations, an optional provision allows eligible account holders (supplemental eligible account holders if applicable) and other members to purchase up to one percent of the total number of shares being

⁴⁰ 12 C.F.R. § 563b.3(c)(4)(ii).

⁴¹ 12 C.F.R. § 563b.3(c)(4)(i).

⁴² 12 C.F.R. § 563b.3(c)(5).

⁴³ 12 C.F.R. § 563b.3(d)(1).

It should be noted that this is merely an optional provision.

issued in the conversion in addition to their purchases in the first and second priorities, respectively.⁴⁴ The plan may provide for these additional subscription rights to be satisfied on a fourth-priority basis after the management set aside third priority.

C. *Public Underwritten Offering*

After the subscription offering (i.e., first four priorities), the FSLIC requires that all shares remaining unsold must then be sold in an underwritten public offering if the size of the association and the number of unsubscribed shares is sufficient to permit such an offering.⁴⁵ The FSLIC has informally determined that a public underwritten offering will normally be required where the pro forma market value of the converting association is in excess of four million dollars.

Under the amended regulations, a two percent limitation is required on the total number of shares which may be purchased by any person or associate in the public offering, with a lower percentage permitted at the option of the converting association.⁴⁶ Purchases by a director, officer or associate in the public offering are limited to one-tenth of one percent of the total number of shares being issued.⁴⁷

The underwriters may be reimbursed for their standby underwriting legal and other expenses, but are not allowed by the FSLIC to charge a standby underwriting fee. The unsubscribed shares are purchased by the underwriters at an underwriters' discount which normally does not exceed eight percent of the aggregate offering price of the unsubscribed shares to be sold by the underwriters to the general public.⁴⁸ The public offering price and the subscription offering price are the same.⁴⁹

D. *Direct Community Marketing*

Where because of size a public underwritten offering is not feasible, the unsubscribed shares are required by the amended regulations to be sold to the general public in a direct community marketing. Preference is required to be given to individuals resident in any county in which the converting association has an office.⁵⁰ Savings account and borrower members of the association may purchase shares in the direct community marketing but are not given special preference as members. The percent limita-

⁴⁴ 12 C.F.R. § 563b.3(d)(2).

⁴⁵ 12 C.F.R. § 563b.3(c)(6).

⁴⁶ 12 C.F.R. § 563b.3(c)(6)(ii).

⁴⁷ 12 C.F.R. § 563b.3(c)(6)(i).

⁴⁸ See 12 C.F.R. § 563b.7(e).

⁴⁹ In this regard, the plan of conversion must provide that the sales price of the shares of capital stock to be sold in the conversion should be a "uniform" price determined in accordance with § 563b.7. See 12 C.F.R. § 563b.3(c)(10). The amended regulations provide appropriate procedures for adjustment of the price in the event necessary. See e.g., 12 C.F.R. § 563b.7(g)(3).

⁵⁰ 12 C.F.R. § 563b.3(c)(6)(iii).

tions discussed above with respect to purchases in an underwritten public offering also apply to purchases in a direct community marketing.

The FSLIC no longer requires or permits the use of a management syndicate to purchase unsubscribed shares, except for the optional management set aside third priority discussed above. While reducing management purchases, this change eliminates the need to provide assurance in advance that there are persons committed to purchase all unsubscribed shares, as previously required by the FSLIC. It is expected that except in unusual circumstances the direct community marketing will enable a smaller to medium size association to sell all unsubscribed shares. However, if shares still remain unsold, purchase arrangements satisfactory to the FSLIC will have to be made since the amended regulations continue to require that shares be sold in the conversion equal to the pro forma market valuation of the association upon conversion.⁵¹

E. *Additional Requirements*

1. **Purchase Limitations.** In addition to the various purchase limitations as to particular priorities discussed above, the amended regulations contain maximum limitations applicable to total purchases under all priorities. No director, officer or other person, including an associate of any person and persons acting in concert, may purchase in the aggregate more than five percent of the total number of shares being issued in the conversion.⁵² Further, purchases by directors, officers and their associates are limited in the aggregate to twenty-five percent of the total number of shares being issued in the conversion.⁵³ With respect to minimum purchases under each priority, the FSLIC regulations continue to permit the use of twenty-five shares as a minimum purchase limitation.⁵⁴

2. **Associate.** The use of the associate concept in the various purchase limitations is new in the amended regulations. In some cases this will substantially lessen the number of shares which can be purchased by a person. An "associate" includes (i) a company (other than the association or a subsidiary) in which a person is an officer, partner or ten percent stockholder, (ii) a trust in which a person is a trustee or significant beneficiary, or (iii) a relative or spouse of a person or a relative of such spouse, if living in the same home or if the relative is a director or officer of the association or a subsidiary.⁵⁵

3. **Special restrictions on management resale and purchase after con-**

⁵¹ 12 C.F.R. § 563b.3(c)(1). See also 12 C.F.R. § 563b.3(d)(3), which permits the sale of an "insignificant residue of shares" in such other manner as provided in the plan with Board approval.

⁵² 12 C.F.R. § 563b.3(c)(7).

⁵³ 12 C.F.R. § 563b.3(c)(8).

⁵⁴ 12 C.F.R. § 563b.3(d)(5).

⁵⁵ 12 C.F.R. § 563b.2(a)(4).

version. Under the amended regulations, the plan must contain provisions restricting for three years the sale of any shares purchased under any priority by directors and officers in the conversion, except upon their death or in connection with a merger or acquisition.⁵⁶ These provisions include a legend on each stock certificate so restricted and instructions to the transfer agent.⁵⁷ Purchases in the market after conversion for three years by directors, officers and their associates are required by the amended regulations to be made only through a dealer or broker registered with the Securities and Exchange Commission, except for larger purchases exceeding one percent.⁵⁸

4. Independent appraisal. The amended regulations continue to require that the plan provide for a purchase price per share based on the aggregate pro forma market value of the converted association as determined by an independent appraisal.⁵⁹ Shares having an aggregate purchase price equal to such aggregate pro forma market value must all be sold in the conversion. 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. The price paid for shares sold in the subscription offering is required to be the same as the public offering price. The FSLIC regulations do not permit any shares to be issued on a "give-away" or free distribution basis.⁶⁰ The independent appraisal assures that fair market value is paid by each purchaser, thereby avoiding a "windfall" to any group including management. In reviewing a conversion application, the FSLIC extensively tests the appropriateness of the independent appraisal and where necessary requires changes. The independent appraisal is updated several times during the conversion process so as to be current upon completion of the conversion.

5. Effect on savings accounts. Conversion has no effect on FSLIC insurance of savings accounts, nor does it affect account balances, interest rates or certificate maturities. The plan must provide that a savings account holder will continue to have the same account in the converted association as he had before the conversion.⁶¹ The only differences are with respect to voting and liquidation rights.

6. Voting rights. In a converted association, exclusive voting rights are vested in the stockholders unless, in the case of state-chartered associations, state law requires that account holders and/or borrowers have voting rights in a stock association.⁶² Since all or substantially all of the votes cast by savings account holders at each annual meeting of a mutual

⁵⁶ 12 C.F.R. § 563b.3(c)(16).

⁵⁷ 12 C.F.R. § 563b.3(c)(17).

⁵⁸ 12 C.F.R. § 563b.3(c)(9).

⁵⁹ 12 C.F.R. § 563b.3(c)(1).

⁶⁰ See *supra* note 3.

⁶¹ 12 C.F.R. § 563b.3(c)(11).

⁶² 12 C.F.R. § 563b.3(c)(14).

association are by continuous proxies obtained by management when the accounts were opened, the loss of voting rights has little effect on most account holders.

7. Liquidation account. The plan is required to provide for the creation of a liquidation account by the converting association in an amount equal to its net worth as of the latest practicable date before conversion.⁶³ Each eligible account holder has a pro rata inchoate interest in the liquidation account, which interest cannot increase, but is reduced by a subsequent decrease in the savings account balance.⁶⁴ As in the case of liquidation rights in a mutual association, the function of the liquidation account in a converted association is to establish a priority in the event of a complete liquidation not involving a merger or similar acquisition, but not otherwise restrict the use of the capital of the converted association. Similarly to a mutual association, no payment to the account holder would be made except in the case of such a complete liquidation. Thus, the liquidation account created in the conversion preserves the liquidation rights of eligible account holders to the net worth of the association existing at the time of conversion. As a practicable matter it is highly unlikely that a solvent association would be involved in such a complete liquidation either before or after conversion.

In the case of a conversion approved by the FSLIC more than fifteen months after the eligibility record date, the amended regulations provide that savings account holders having supplemental subscription rights will also have a similar pro rata inchoate interest in the liquidation account based on their qualifying deposits on the supplemental record date.⁶⁵

8. Cash dividends. The amended regulations limit cash dividends on stock of a converted association for ten years to fifty percent of current earnings subsequent to conversion.⁶⁶ Previously, the limitation was two-thirds. This change should not create a problem in paying a five percent dividend for most converting associations. Whether any dividend is to be paid to stockholders is a management decision, but the proposed dividend policy must be specifically disclosed in the offering circular.

9. Post conversion market and registration requirements. The amended regulations continue the FSLIC policy of requiring the converted association promptly after conversion to register its stock with the Federal Home Loan Bank Board under the Securities Exchange Act of 1934 and to agree not to deregister for three years.⁶⁷ A new requirement is that the converted association use its best efforts to establish a trading market by obtaining

⁶³ 12 C.F.R. § 563b.3(c)(12) and (f).

⁶⁴ 12 C.F.R. § 563b.3(f).

⁶⁵ *Id.*

⁶⁶ 12 C.F.R. § 563b.3(g)(3).

⁶⁷ 12 C.F.R. § 563b.3(c)(18).

one or more securities dealers as "market makers" and where practicable seek quotation of the stock by the NASDAQ over-the-counter system or listing on a national or regional stock exchange.⁶⁸

10. Stock options. The FSLIC, apart from the proposed regulatory amendments discussed herein, on November 15, 1978 proposed limitations on stock option and purchase plans of Federal stock associations, which limitations would also apply to all converted associations for three years following conversion.⁶⁹ In general, the proposed limitations would limit total shares under such plans to an amount equal to 10 percent of the outstanding stock and preclude purchases by a person holding five percent or more of the outstanding stock after giving effect to the purchase.

F. *Management Control; Anti-Takeover Provisions*

An important concern to management of an association considering conversion is the possibility of a hostile takeover attempt after conversion.⁷⁰ In a mutual association, there is complete control by management (whether by the managing officer alone, a limited number of directors or the full board) based on the continuous proxies obtained from savings account holders at the time their accounts are opened. These proxies normally constitute all or substantially all the votes cast at an annual meeting of a mutual association. Conversion appropriately reduces management control by cancelling these continuous proxies and requiring an annual solicitation of proxies from the stockholders to the converted association, which solicitation is subject to the proxy requirements of the Securities Exchange Act of 1934.

By purchasing a reasonable portion of the conversion stock and controlling the annual proxy solicitation, management of a converted association will normally have effective working control. As a general rule the more diversified the stock ownership of the converted association the smaller the management ownership percentage needed for effective working control. However, a management which fails properly to operate a converted association may lose the support of many of its stockholders and become vulnerable to takeover. There are also takeover possibilities in the case of successful associations whose stock is undervalued by the market as well as from dissension within the existing management group. However, in only one conversion has the existing management group lost effective

⁶⁸ *Id.*

⁶⁹ 43 Fed. Reg. 54,663 (1978).

⁷⁰ Speaking to this concern, the amended regulations state:

[T]hat the new capital to be received by converted insured institutions upon the sale of capital stock will cause such insured institutions, during an initial period following conversion, to be specially vulnerable to attempts by other companies to acquire control of such insured institutions.

12 C.F.R. § 563b.3(i)(1).

working control, and in that case management purchased only three percent of the conversion stock.

The FSLIC regulations contain various provisions that may be used to deter, resist and substantially delay a hostile takeover attempt. These provisions include:

1). fifteen percent to twenty-five percent management set aside permitted in plans of conversion;⁷¹

2). mandatory agreement with the FSLIC that for three years after conversion no company significantly engaged in an unrelated business activity may directly or through an affiliate acquire control (twenty-five percent test) of the converted association;⁷²

3). similar anti-takeover provision, without limit as to time, which may be included in the stock charter, with such charter provision being subject to amendment only by a seventy-five percent vote of stockholders;⁷³ alternatively, the FSLIC has recently approved a ten percent ownership limitation for five years to be included in the stock charter;

4). regulatory prohibition against any person prior to completion of a conversion from transferring, or entering into an agreement or understanding to transfer, the legal or beneficial ownership of subscription rights or conversion stock;⁷⁴

5). regulatory prohibition prior to completion of the conversion against offering, or making an announcement of an offer or intent to make an offer, to purchase subscription rights or conversion stock;⁷⁵

6). three-year regulatory prohibition against any person, without prior FSLIC approval from acquiring, or offering to acquire, more than ten percent of the stock of the converted association;⁷⁶

7). various optional and mandatory limitations in plans of conversion on the maximum number of shares which any person and his associates may purchase under the different subscription offering priorities and in the public offering or direct community marketing;

⁷¹ 12 C.F.R. § 563b.3(d)(1).

⁷² 12 C.F.R. § 563b.3(i)(2).

For purposes of this section, a company shall be deemed to be "significantly engaged" in an unrelated business activity if its unrelated business activities would represent, on either an actual or a pro forma basis, *more than fifteen percent* of its consolidated net worth at the close of its preceding fiscal year or of its consolidated net earnings for such fiscal year. 12 C.F.R. § 563b.3(i)(4)(iii). An "unrelated business activity" means any business activity not authorized for a multiple savings and loan holding company under section 408(c)(2) of the National Housing Act, as amended, or under regulations adopted pursuant thereto. 12 C.F.R. § 563b.3(i)(4)(iv).

⁷³ 12 C.F.R. § 563b.3(i)(3).

⁷⁴ 12 C.F.R. § 563b.9(b).

⁷⁵ 12 C.F.R. § 563b.9(c).

⁷⁶ 12 C.F.R. § 563b.9(d).

8). three-year management employment contracts⁷⁷ and three-year staggered director terms;⁷⁸

9). The use of stock option and other stock purchase plans after conversion for up to ten percent of the outstanding stock as part of an executive compensation and incentive program, which plans permit a reasonable increase in management holdings;

10). the need for prior FSLIC approval under the holding company provisions of the National Housing Act for the acquisition of control by any company⁷⁹ together with the various statutory and regulatory restrictions on holding companies including debt approval in the case of nondiversified holding companies;

11). the recently enacted statutory provision requiring sixty days prior notice to the FSLIC by an individual seeking to acquire control, and allowing the FSLIC to block the acquisition if various standards are not met;⁸⁰ and

12). the tender offer and disclosure requirements applicable to five percent or more stockholders of companies registered under the 1934 Act.⁸¹

V. TAX CONSEQUENCES OF CONVERSION

The amended regulations require that a plan of conversion not be approved by the FSLIC if it may result in a taxable reorganization of the applicant under the Internal Revenue Code of 1954, as amended (the "Code").⁸² As a non-taxable reorganization within the relevant provisions of the Code,⁸³ the conversion generally would not result in recognition of any gain or loss by the converting association or its accountholders, and would not alter the tax basis of the account holders' savings accounts. Similarly, the tax basis of interests in the liquidation account would be zero and that of the common stock purchased in the conversion would be the amount paid therefor. As indicated in Form AC, Exhibit 4, an association can satisfy the regulatory requirement by furnishing an opinion of its tax counsel or an Internal Revenue Service Ruling as to the federal income tax consequences of the plan.

The Internal Revenue Service has issued numerous private rulings to the effect that mutual to stock conversions under the FSLIC regulations are non-taxable reorganizations under the provisions of section 368(a)(1)(F) of the Code. However, in the early part of 1978 the Service suspended

⁷⁷ 12 C.F.R. § 545.25-1.

⁷⁸ See 12 C.F.R. § 552.5 for bylaws of a Charter S Association, which include a staggered board provision.

⁷⁹ 12 U.S.C. 1730(a).

⁸⁰ 12 U.S.C. 1730(q) (Supp. 1979).

⁸¹ 15 U.S.C. 78m, 78n.

⁸² 12 C.F.R. § 563b.3(b)(3).

⁸³ Int. Rev. Code of 1954 §§ 368(a)(1)(F) and/or 368(a)(1)(E).

issuing private rulings on conversions while it reexamined its ruling position. The Service on March 31, 1980 indicated that it would resume issuing private rulings on conversions. On April 2, 1980, the Service announced the publication of a public revenue ruling holding that a conversion of a mutual savings and loan association to a stock association qualifies as a tax-free reorganization under section 368(a)(1)(F) of the Code.⁸⁴ This public ruling applies to all three types of stock conversions — federal mutual to federal stock, federal mutual to state stock and state mutual to state stock.

VI. CONTROVERSY SURROUNDING CONVERSION

In response to requests from Senator William Proxmire, Chairman of the Senate Committee on Banking, Housing and Urban Affairs,⁸⁵ the Comptroller General of the United States has issued two reports regarding the conversion process. The first report⁸⁶ concluded that additional time was needed to monitor the conversion process, refine regulations, and assess further the impact of conversion on the savings and loan industry.

Subsequent to the first report, at the request of Senator Proxmire, the Comptroller General reviewed the differing legal opinions⁸⁷ surrounding the retention of federal stock charters by converting mutual associations. The issue arose as a result of legislation enacted in 1974 amending Section 402(j) of the National Housing Act which established, among other things, a statutory moratorium on stock conversions except for a limited number of test conversions.⁸⁸ The moratorium expired on June 30, 1976. As a result, a controversy developed as to whether the entire statutory provision granting the Bank Board authority to approve such conversions expired as of that date, or merely the limitation on the number of test conversions authorized. The Bank Board concluded that the historical development of its conversion program and the purposes of Public Law 93-495 supported its position that this 1974 legislation as well as prior legislation⁸⁹ was enacted to give the Bank Board permanent authority to regulate and permit conversion of federally chartered mutual to federally chartered stock as-

⁸⁴ Rev. Rul. 80-105, 1980-16 I.R.B. 5 (Apr. 21, 1980).

⁸⁵ Letter from William Proxmire to Elmer Staats (July 13, 1976); Letter from William Proxmire to Elmer Staats (May 17, 1978).

⁸⁶ See Comptroller General's Conversion Rep't to Senate Committee on Banking, Housing and Urban Affairs (May 26, 1977) (on file with the AKRON LAW REVIEW).

⁸⁷ As stated in the 1979 Comp. Gen. Rep., *supra* note 2, at 7:

On the one hand, the Board claimed it had the authority to convert Federal savings and loan associations and allow them to retain their Federal charters. On the other hand, the Senate Office of the Legislative Counsel to the Committee stated the Board did not have that authority.

⁸⁸ See *supra* note 1.

⁸⁹ Public Law 93-100, which amended section 402 of the National Housing Act by adding thereto subsection (j) (12 U.S.C. 1725(j)), established the first statutory moratorium. One of the purposes of the original moratorium was evidently to provide the Board with time to revise its conversion regulations so as to enable federal mutual associations to convert to federal stock associations. S. REP. NO. 93-149, 93rd Cong., 1st Sess., 4 (1973).

sociations.⁹⁰ Thus, amended section 402(j) established this federal stock charter authority, and only limited until June 30, 1976 the full exercise of this authority by specifying a fixed number of conversions (both federal and state chartered) that could be approved prior to that date. The Bank Board has consistently stated that all other applicable provisions of section 402 apply and survive the June 30, 1976 cut-off date.⁹¹ Notwithstanding the Bank Board's position, on July 8, 1977, the Comptroller General expressed the view that the Bank Board's authority to approve conversions of federal mutual to federal stock associations lapsed on June 30, 1976.⁹²

The second report issued by the Comptroller General on October 1, 1979⁹³ examined several aspects of the conversion process including current FSLIC regulations, stock appraisals, conversion alternatives and the continuing controversy surrounding retention of federal stock charters. Although concluding that, in general, conversions have been both successful and financially rewarding⁹⁴ and that the FSLIC regulations were equitable,⁹⁵ the second report recommended certain revisions in the regulations.⁹⁶ On a broader scale, the report urged Congress to establish a national policy on conversions and to clarify the Board's authority to permit federal associations converting to the stock form to retain their federal charter.⁹⁷

Several lawsuits have recently been instituted based upon, among other things, the continuing controversy over the retention of federal stock charters.

The Council of Mutuals, a trade organization whose membership is comprised of 132 savings and loan associations in the United States, filed a lawsuit on August 28, 1978 in the United States District Court for the District of Columbia against the FHLBB challenging its authority to approve conversions. In a first count, the plaintiff contended that the FHLBB's

⁹⁰ The Bank Board's position in this regard has recently been articulated in the Brief of Respondents at 4-20, *W.C. York v. Federal Home Loan Bank Board and Federal Savings and Loan Insurance Corp.*, No. 79-13820 (4th Cir. 1979).

⁹¹ The author concurs in this view.

⁹² Comptroller General Opinion B-114827 (1977) (on file with the AKRON LAW REVIEW).

⁹³ See *supra* note 2.

⁹⁴ *Comp. Gen. Rep.*, *supra* note 2, at 6.

⁹⁵ In finding that the FSLIC regulations were equitable, particularly in terms of protecting depositor members' equity rights, the report points out that under the amended regulations, a converting association must establish a liquidation account, which provides existing depositors priority rights to the association's equity existing at the time of conversion. See *supra* note 63. In this regard, the report states:

The depositors' equity rights are thus protected since the liquidating account is reduced only when a depositor removes funds from the association. This method of relinquishing equity rights based upon removal of funds is consistent with mutual association operations.

Comp. Gen. Rep., *supra* note 2, at 4.

⁹⁶ The areas among which revisions were recommended relate to (i) using certificates of deposit to pay for stock and the waiver of penalties for early withdrawal (12 C.F.R. § 563b.7 (h)); (ii) reducing the supplemental eligible account holders' maximum allowable stock purchases from 5 percent to 2 percent of the subscription offering; and (iii) requiring further documentation in support of subjective judgments used in appraisals.

⁹⁷ *Comp. Gen. Rep.*, *supra* note 2, at 9.

authority in section 402(j) of the National Housing Act to approve conversions of federally-chartered mutual associations to federal stock charter had expired on June 30, 1976. In a second count, the plaintiff alleged that all approvals by the FHLBB of conversions of FSLIC-insured mutual associations to federal or state stock charter were arbitrary and capricious and that such conversions were an unconstitutional taking of property without due process of law. The plaintiff's position as to the first count was supported by the July 1977 opinion of the Comptroller General of the United States, who is the head of the General Accounting Office, which opinion is not, however legally binding. Despite this lawsuit, the FHLBB continued to approve conversions of FSLIC-insured mutual associations, including conversions of federally-chartered mutual associations to federal stock charter. The FHLBB described this lawsuit as being without merit, and moved to have it dismissed based on the pleadings. That motion and reciprocal motions for summary judgment were argued in the District Court on July 5, 1979. On January 10, 1980, the District Court granted the FHLBB's motion for summary judgment on the merits as to the first count affirming the FHLBB's continued federal stock charter authority and dismissed the lawsuit for lack of standing as to the second count.⁹⁸ The Court indicated that it was aided by legislative history lending support to the FHLBB's position. Specifically referring to the fact that section 402(j) refers to a "moratorium," which clearly indicated the temporary nature of the limitation, and the intent of the legislation to halt erosion of the federal system, the Court found support for the FHLBB's position which, coupled with the failure of Congress to act, was read to reasonably infer support for additional conversions. The plaintiff has appealed this decision.

On June 19, 1979, a lawsuit was filed in the United States District Court for the Eastern District of North Carolina by a savings account member of First Federal Savings and Loan Association of Raleigh ("First Federal") against the FHLBB, First Federal, and its directors challenging the legality of First Federal's pending conversion from federal mutual to federal stock charter as approved by the FHLBB in May 1979. The basic issues in this lawsuit are similar to those in the lawsuit filed by the Council of Mutuals. The FHLBB has similarly concluded that this lawsuit is without merit as to the FHLBB's authority to approve conversions and moved to have it dismissed.⁹⁹ A motion for partial summary judgment has been filed by the plaintiff. A petition for review of the FHLBB approval has also been filed by the plaintiff in the United States Court of Appeals for the Fourth Circuit.¹⁰⁰

⁹⁸ Council of Mutual Savings Inst. v. Fed. Home Loan Bank Bd., No. 78-1610 (D.D.C. Jan. 10, 1980) (memo op.).

⁹⁹ First Fed. Savings & Loan Assoc. of Raleigh v. Fed. Home Loan Bank Bd., No. 79-354 (E.D.N.C., filed June 19, 1979).

¹⁰⁰ First Fed. Savings & Loan Assoc. of Raleigh v. Fed. Home Loan Bank Bd., No. 79-1382 (4th Cir. filed June 27, 1979). Oral argument in this case was heard on May 8, 1980.