AMERICA'S MUTUAL BANKS
701 8TH STREET, NW. SUITE 700 . WASHINGTON, D.C. 20001

February 8, 2019

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC, 20429
ATTN: Comments, Federal Deposit Insurance Corporation

Re: FDIC's Request for Information
RIN 3064-ZA03

America's Mutual Banks ("AMB") welcomes the opportunity to respond to the FDIC's Request for Information on the FDIC's Deposit Insurance Application Process,("RFI") RIN 3064-ZA03, 83 F.R. 63868, dated December 12, 2018. The request seeks comments regarding the "deposit insurance process, including with respect to the transparency and efficiency of the process and any unnecessary burdens that have become part of the process."

America's Mutual Banks

AMB is an unincorporated association whose membership consists of mutually chartered FDIC insured institutions and mutual holding companies. AMB's membership consists entirely of community based institutions dedicated to serving their communities and fostering the economic growth of those communities. Community based, mutual form institutions or holding companies are a historically vital part of the fabric of many communities and their future viability must be protected and enhanced.

Mutual form institutions have been a bedrock for generations and have been and are community based and community focused. As far back as 1852, with the publishing of the treatise "Mutual Benefit Building and Loan Association: their History, Principles, and Plan of Operation; together with a Statement of the Benefits Attending Them, and of the Distinction between American and English Societies" by Joseph Walker and S. K. Cox, mutual form banks have been integral to the local communities of America and even longer in Great Britain and other European nations. Mutual form institutions do not have permanent capital stock like stock form institutions and, therefore, do not have permanent stockholders. The depositors and borrowers of a mutual institution have only inchoate rights in that they are the residual "owners" of the institution with rights to any surplus remaining in liquidation.

The Dearth of De Novo Mutual Charters

Depending upon market conditions, investor demand and other factors, stock form institutions may have access to capital markets via, among other things, the sale of common equity securities in the marketplace by a public offering or private placement. However, this avenue for capital formation, by definition, has not been, is not now and will not be available to mutual institutions. Members of mutual institutions are not stockholders. They possess none of the important incidents of ownership. Their interests cannot be bought or sold. Mutual institutions have historically enhanced their capital positions primarily through retained earnings. With the inherent volatility of general and local economies, market conditions and the valuation and nature of assets germane to each banking institution to name a few of the variables, the ability to maintain compliance not only with regulatory minimum capital requirements but also the higher levels which undoubtedly will be required by the examiners is paramount to an institution's ability to serve its community. Unnecessarily restricting a mutual institution's ability to raise additional capital or apply historically available sources of capital because not enough attention was paid to the unique nature of the mutual form of organization would be in direct conflict with the Home Owners' Loan Act, which expressly provides for the formation and continued existence of federal mutual institutions. AMB notes that de novo formation of stock banks and FDIC insurance of accounts reached its peak with 203 new banks insured in 2005. This number plummeted with only four new charters and concomitant insurance of accounts approved between 2012 and 2016. Since that time there has been a small increase in number but the trend line remains at the low point in the historical range. Recent testimony in 2016 by then FDIC Chairman Martin Gruenberg suggested a correlation between the federal funds rate with new charter formation at least through 2013. He also testified as to the FDIC imposition in August 2009 of nonstandard conditions in extending from three to seven years the period during which *de novo* banks were subject to capital maintenance requirements and increased requirements on the state level. He stated:

> The FDIC also required *de novo* state nonmember banks to obtain prior approval from the FDIC for material changes in business plans (FIL 50-2009). These nonstandard conditions were put into place at that time because institutions insured less than seven years were overrepresented among the bank failures that began in 2008, with many of the failures occurring during the fourth through seventh years. Out of 1,042 *de novo* institutions chartered between 2000 and 2008, 133 (12.8 percent) failed, representing more than double the failure rate of 4.9 percent for established small banks. Moreover, a number of *de novo* institutions pursued business plan changes during the first few years that led to increased risk and financial problems while failing to have adequate controls and risk management practices. Given the ongoing improvement in post-crisis industry performance, the FDIC recently rescinded this policy, returning to a three-year *de novo* period in April 2016.

AMB believes that as to stock institutions, all of the factors mentioned above have had a negative effect. However, it is startling when one realizes that no new mutual has been insured since the 1960s. The FDIC's Handbook issued in 2018 which consists of 38 pages of discussion makes no mention of mutual banks other than in a footnote on page 2, *Applying for Deposit Insurance – A Handbook for Organizers of De Novo Institutions*. Similarly the FDIC *Statement of Policy on Applications for Deposit Insurance* makes only a single reference to mutual banks solely in the context of an interim bank. It should be no surprise that organizing groups are discouraged or frustrated in developing a plan for a new mutual when the insuring agency offers no guidance whatsoever.

The Legislative History of The relationship of the FDIC to The Federal Bank Chartering Agencies

AMB recognizes that the FDIC is not a chartering authority. Indeed with respect to mutual savings institutions only the states and the OCC can issue a mutual form charter eligible for FDIC insurance. However, FDIC deposit insurance is a condition of the issuance of a federal charter under OCC regulations which was not always the case. The legislative history of section 5 of the Federal Deposit Insurance Act demonstrates the weakening of the Congressional emphasis on the duty of the deposit insurer to give deference in its consideration of applications for insurance of accounts to the primary Federal chartering authority. Prior to 1989, the Federal Savings and Loan Insurance Corporation (the FSLIC) was the primary insurer for savings associations. Its governing statute, Section 403 of the National Housing Act, provided that “It shall be the duty of the Corporation (FSLIC) to insure the accounts of all Federal savings and loan associations and all Federal savings banks....”. Deposit insurance was not linked unconditionally to the federal charter as Section 403 of the National Housing Act provided the Corporation could reject an application if it found impaired capital, unsafe financial or management policies or character deficiencies in the management. Similar language existed with respect to insurance for national banks. Thus, the statutory scheme in stating a duty created a legislative deference to newly issued national bank and federal savings institution charters with respect to their eligibility for insurance. The passage of FIRREA, PL 101-73, in 1989 abolished the FSLIC, transferring its functions to the FDIC.

In abolishing the FSLIC, Congress amended section 5 of the Federal Deposit Insurance Act to specify that the FDIC give deference to the decision of the Office of Thrift Supervision in considering applications for insurance by new charters. Section 206 of that law provided:

> (6) NOTICE OF DENIAL OF APPLICATION - If the Board of Directors, after giving due deference to the determination of the Director of the Office of Thrift Supervision with respect to such factors, does not concur in the determination of the Director, the Board of Directors shall promptly notify the Director that insurance has been denied, giving specific reasons in writing for the Corporation's determination with reference to the factors described in paragraphs (1), (2), (3), (4), and (5) of section 6, and no insurance shall be granted.

Notwithstanding the independence of the FDIC to make the final determination the law imposed a supermajority vote of the FDIC Board to sustain a denial of insurance of accounts. Section 206 provided:

> (7) VOTING REQUIREMENTS - The authority of the Board of Directors to make any determination to deny insurance under this subsection may not be delegated by the Board of Directors and any such determination may be made only upon a vote of 3/4 of all members of the Board of Directors (excluding the Director of the Office of Thrift Supervision).

The provisions mandating deference and requiring a 3/4 vote were eliminated by Public Law 102-242, The Federal Deposit Insurance Corporation Improvement Act of 1991 which simplified the agency review and decision process.

The elimination by statutory amendment to the requirement that the FDIC defer to the federal chartering authority has created a chicken or egg problem for prospective applicants and superseded the role of the OCC in determining the soundness and probability of success of a newly formed institution. Congress has effectively but unintentionally put the FDIC in the position to deny any new charter - an entity which is naturally adverse to increased risk. FDIC Insurance is also a precondition for the operation of a state chartered mutual savings bank, cooperative bank or savings association. This change in the relationship of the two federal regulators in administering the chartering process may have had a profound effect on new charter issuance.

Capital Requirements

Part 143 of the OCC's regulations entitled Federal Mutual Savings Associations prescribes the procedures for organizing a Federal Mutual institution but like too many regulations consolidates most of its references to apply to formation of stock associations. Those Sections which are mutual specific are apparently out of date. For example, Section 143.3 (12 C.F.R. § 143.3), relating to the chartering of a de novo mutual federal savings association, provides that a de novo association must have an initial capitalization of at least $2.0 million of "pledged savings accounts." Pledged savings accounts are accounts that are pledged by the institution's founders and act as the initial capital. The OCC's regulations at 12 C.F.R. § 167.5 include pledged accounts as "core capital." That section provides that the definition of core capital includes "non-withdrawable accounts and pledged deposits of mutual savings associations (excluding any treasury shares held by the savings association) meeting the criteria of regulations and memoranda of the OCC to the extent that such accounts or deposits have no fixed maturity date, cannot be withdrawn at the option of the accountholder, and do not earn interest that carries over to subsequent periods." Thus, historically, interest paying instruments with certain debt like features but no claim by the holder for withdrawal have been included in the definition of core capital.

In the case of an application for the incorporation of a mutual association, the laws of the various states where mutual formation was encouraged generally required as a condition to the approval of any such application, that the incorporators execute an agreement to subscribe to, and upon the commencement of business pay into, an account of the State association to be known by various names oftentimes "guaranty account". The guaranty account would be subordinate to the other deposit accounts and was to be used as a guaranty against the impairment of the capital of the State association. To the extent that it might be necessary, losses and expenses of the State association would be charged to it. The account would not be released to the owners thereof, for some minimum number of years from the date upon which payment was made into the account. If thereafter, the chartering and supervisory authority found that the reserves established to absorb losses and the undivided profits account of the State association plus the amount remaining in the guaranty account exceeded a minimum capital level -- the greater of a fixed dollar amount or a ratio of insured accounts, any excess amount would be released to the owners, proportionate to their respective interests in the guaranty account.

Dividends or interest could be paid to the guaranty account holder, but not in excess of the maximum rate of dividend rate declared or interest paid to savings accounts or deposits in the association for the same period. Each holder of a guaranty account would have the same voting rights, restrictions and limitations as set forth in the bylaws of the association.

The difficulty with complying with these requirements by an organizing group became more complicated with the increase in the minimum capital required by the FDIC for a de novo charter and the redefinition of capital by the agencies in 2018 as part of Basel III regulatory capital changes. The agencies seriously compounded the difficulty of a de novo mutual to meet minimum capital requirement as part of the organization process. One could argue that the agencies exceeded their statutory mandate by practically outlawing the formation of de novo mutuals. The regulatory scheme of Reg Q is based on the fundamentally flawed assumption that all insured institutions issue capital stock. It prescribes a minimum Tier 1 common equity requirement of generally 4%. As a last minute revision and partly as a result of communications by AMB to the Federal Reserve Board ("FRB") staff, the rule was modified to recognize certain instruments issued by mutual banks as equivalent to Tier 1 common equity. Section 217.20 defines common equity Tier 1 capital and contains the criteria or "common equity Tier 1 capital elements" for a mutual instrument that qualifies. The criteria are stated in § 217.20 of the FRB rules. It states:

> (i) The instrument is paid-in, issued directly by the Board-regulated institution, and represents the most subordinated claim in a receivership, insolvency, liquidation, or similar proceeding of the Board-regulated institution; (ii) The holder of the instrument is entitled to a claim on the residual assets of the Board-regulated institution that is proportional with the holder's share of the Board-regulated institution's issued capital after all senior claims have been satisfied in a receivership, insolvency, liquidation, or similar proceeding; (iii) The instrument has no maturity date, can only be redeemed via discretionary repurchases with the prior approval of the Board, and does not contain any term or feature that creates an incentive to redeem; (iv) The Board-regulated institution did not create at issuance of the instrument through any action or communication an expectation that it will buy back, cancel, or redeem the instrument, and the instrument does not include any term or feature that might give rise to such an expectation; (v) Any cash dividend payments on the instrument are paid out of the Board-regulated institution's net income, retained earnings, or surplus related to common stock, and are not subject to a limit imposed by the contractual terms governing the instrument. State member banks are subject to other legal restrictions on reductions in capital resulting from cash dividends, including out of the capital surplus account, under 12 U.S.C. 324 and 12 CFR 208.5; (vi) The Board-regulated institution has full discretion at all times to refrain from paying any dividends and making any other distributions on the instrument without triggering an event of default, a requirement to make a payment-in-kind, or an imposition of any other restrictions on the Board-regulated institution; (vii) Dividend payments and any other distributions on the instrument may be paid only after all legal and contractual obligations of the Board-regulated institution have been satisfied, including payments due on more senior claims; (viii) The holders of the instrument bear losses as they occur equally, proportionately, and simultaneously with the holders of all other common stock instruments before any losses are borne by holders of claims on the Board-regulated institution with greater priority in a receivership, insolvency, liquidation, or similar proceeding;

> (ix) The paid-in amount is classified as equity under GAAP; (x) The Board-regulated institution, or an entity that the Board-regulated institution controls, did not purchase or directly or indirectly fund the purchase of the instrument; (xi) The instrument is not secured, not covered by a guarantee of the Board-regulated institution or of an affiliate of the Board-regulated institution, and is not subject to any other arrangement that legally or economically enhances the seniority of the instrument; (xii) The instrument has been issued in accordance with applicable laws and regulations; and (xiii) The instrument is reported on the Board-regulated institution's regulatory financial statements separately from other capital instruments.

The nature of the components are arguably consistent with pledged deposits but only arguably. It is clear there was little or no thought given to pledged or guaranty accounts that would be the principal method of capitalizing a de novo mutual. Indeed, the FRB and other agency staff have made it clear that they have serious doubts that a pledged account would qualify as Tier 1 common equity. Indeed, if the agencies believe that statutorily they are bound to entertain impartially the chartering of de novo mutual savings institutions they could have easily prescribed the characteristics of pledged accounts in the regulation in terms that clearly apply to them.

In the discussion titled “Capital Instruments for Mutual Banking Organizations” in the agencies preamble to the joint Basel III capital rules it is stated:

> The agencies note that the qualifying criteria for regulatory capital instruments under the final rule permit mutual banking organizations to include in regulatory capital many of their existing regulatory capital instruments (for example, non-withdrawable accounts, pledged deposits, or mutual capital certificates). The agencies believe that the quality and quantity of regulatory capital currently maintained by most mutual banking organizations should be sufficient to satisfy the requirements of the final rule. For those organizations that do not currently hold enough capital to meet the revised minimum requirements, the transition arrangements are designed to ease the burden of increasing regulatory capital over time.

Thus, with little or no regard for the effect on de novo formation the agencies dismiss any concern for compliance on the basis that most existing mutual banks have sufficient capital. Further, they offer no illumination on what characteristics of non-withdrawable accounts, pledged accounts or mutual capital certificates would qualify as tier one common equity although stating emphatically that any cumulative feature would be disqualifying.

Recommendations

While the above discussion identifies some of the more significant reasons why there has been a dearth of mutual bank de novo formation since the 1960s, the one reason that would legally justify this situation is not present — a Congressional prohibition on new mutual bank formation. There is not a single shred of evidence, law, legislative history or Congressional pronouncements or even a wink and a nod that would support a conclusion that Congress intended to prohibit the formation of new mutual banks. To the contrary, the law still contemplates the agencies would promote their creation. It is clear that agency rules, policies, practices and perhaps laws have not kept pace with the changes in the business of banking as they effect mutual banks. AMB believes as a matter of public policy the FDIC should welcome new approaches to the consideration of insurance of accounts for mutual banks. We applaud the initiative the agency has taken in its RFI on the dearth of any de novo formation stock or mutual banks. Therefore, we propose some or all of the following measures be taken to attempt to reverse the current situation.

1. Issue an updated guidance for organizing groups seeking insurance for accounts for newly formed mutual banks providing practical advice of how to structure pledged accounts or guarantee account agreements that will qualify as Tier 1 capital;

2. Provide guidance with reduced minimum capitalization for insurance of accounts for de novo mutuals serving rural or limited geographic markets;

3. Encourage formation of de novo mutual banks by providing a pathway to insurance of accounts of banks whose business plan is to primarily serve affinity groups such as those with ethnic, religious or professional affiliations;

4. Encourage the formation and sponsorship of mutual banks by foundations, angel investors, community groups, go fund me groups and other charitable organizations to serve the needs of the unbanked and impoverished communities;

5. Establish an outreach program to contact various potential sponsors and affinity groups with a view to bringing them together to organize new mutual banks to serve the needs of the unbanked;

6. Direct the FDIC Division of Research to study and examine the root causes of the elimination of insurance accounts for de novo mutual banks since the 1960s with a view to revising rules and policies to reverse the absence of insurance of accounts for the de novo mutual banks;

7. Establish an interagency task force with the OCC and the state banking regulators to develop rules and policies that will revive the mutual banking form;

8. Work with HUD, SBA, the FHFA , the Department of Commerce and other Federal and state government agencies whose mission is to foster development of new businesses and organizations that will promote economic prosperity; and

9. Develop an alternative capital instrument that is saleable, protects the insurance fund, is gaap capital, carries tax deductible payments and qualifies as Tier 1 capital similar to the mutual investment certificate supported by AMB and contained in H.R. 1603 introduced in the 113th Congress.

Thank you for the opportunity to respond to the FDIC's RFI on this most important issue.

We look forward to working with the FDIC to explore new pathways to mutual bank formation. If you have any questions concerning our recommendations, please contact the undersigned at dfaucette@lockelord.com or (202) 220-6961.

Very truly yours,

[redacted]

Douglas P. Faucette
DC Director
America's Mutual Banks

cc: Thomas J. Fraser, Chairman, AMB
Leonard Stekol, Vice Chairman, AMB
Carlos P. Naudon, Second Vice Chairman, AMB
John Marvin, Treasurer, AMB