

The word is out on conversion profits, but will the sector see an influx of new activist players?

The push and pull of depositor activism

By Matthew Squire

Dealing with troublesome depositors has always been part and parcel of the mutual thrift experience. But as the investing community is slowly catching on to the potentially massive profits to be made in mutual conversions, the sector is running the risk of new players entering the fray.

Converting mutual thrifts have often been a magnet for activists. One of the most notable examples of such activism occurred with the conversion of New Haven Savings Bank in 2004, which caused a firestorm among community groups in its hometown of New Haven, Conn. Although a deal was struck to resolve the matter, the New Haven Savings transaction also sparked New England state legislatures to attempt to place additional conditions on conversions, although with limited success.

Attorneys, however, now say that community and governmental activism has generally been placed on the back burner, replaced with individual depositors looking to push mutuals into high-profit conversion transactions.

Speaking at the America's Community Bankers 2005 Mutual Community Bank Conference on March 14, Lord Bissell & Brook Partner Doug Faucette said that the threats to mutuality from Congress and community and consumer groups have largely been overcome, but have been replaced.

"Today, the kinds of profits we see being made are such now that it is not the masses that are coming after you, it is well-heeled investors," Faucette told his audience.

A new breed of activist?

Attorneys we spoke with were mixed as to whether depositor activism has increased.

Stradley Ronon Stevens & Young LLP Partner David Scranton, for instance, told *ThriftInvestor* that he does not believe that activism has increased in any significant degree.

While he acknowledged that certain jurisdictions have experienced some action, "The fears and concerns about it are somewhat overblown if taken in light of the amount of activity."

There is also evidence that the well-known stable of perennial activists may have been reduced. Activist Larry Seidman still has his irons in the fire with companies such as Elmwood Park, N.J.-based **Spencer Savings Bank SLA**. But in an interview with SNL Financial back in June 2004, fellow activist Barrett Rochman indicated that his days as an activist were over after being stung by his proxy battle with Silver Spring, Md.-based **American Bank Holding Inc. (ABKD)** in 2002. "There has to be a better way to make money, so let somebody else do it," Barrett said in the interview.

Still, the potential for new activists is growing as conversions, such as **Hudson City Bancorp Inc.'s (HCBK)** massive deal, become more publicized and shine light on an otherwise little understood area of investing. In fact, with conversion profits becoming more publicized, there is an increased risk of activism towards mutuals with no intention of converting.

"I think that what's probably increased is the number of people that understand what the potential benefit of a conversion or minority stock offering may provide to potential investors," Silver Freedman & Taff LLP Partner Martin Meyrowitz said in an interview with *ThriftInvestor*.

Not your father's proxy battle

Furthermore, proxy battle tactics have changed for activists, as technology has significantly lowered the cost barriers and opened the door to relatively inexpensive campaigns.

"Forget about the 1955 proxy contest; it's not going to happen," Faucette told conference attendees. "The kind of proxy contest you are going to encounter today is the

2005 proxy contest."

The information age has bred new strategies, and conversion rules and regulations are becoming hard pressed to keep up, said Faucette. "If I'm a depositor and I know what I'm doing, I'm going to set up a negative Web site, I'm going to set up Webcasts and then I'm going to solicit my proxies on the Web, and it's not going to cost me a whole lot. I don't have to mail a darn thing; I don't have to go to print; I don't have to pay postage; I don't have to pay handling."

An example of these approaches can be found in California. **First Federal Savings & Loan Association of San Rafael** is currently squaring off with activist depositor Joe Garrett, who is attempting to make his case to convert through media outlets. Garrett told SNL in September 2004, "We'll fight it not in the real courts, but in the court of public opinion."

Garrett argues that First Federal's growth has been anemic and a conversion would provide it with needed capital for expansion and increased lending. First Federal, on the other hand, has countered that Garrett's motivation is purely based on self-enrichment.

What's a mutual to do?

With the cat out of the bag on conversion profits, cheaper proxy contests, and more investor attention affecting the conversion process, attorneys agree that mutuals with no intention of going public need to take the necessary precautions to avoid the unwanted attention of activist depositors.

To begin with, one of the biggest risks that mutuals run in attracting activists is unused capital, said Scranton. A large cash position can open the door to arguments that idle capital should be used to benefit depositors, through higher interest on savings accounts or giving more back to the community, for example.

"Any mutual thrift that's got excessive

capital, really needs to think about what they are doing with it," said Scranton.

The attorney added that mutuals can guard against claims of mismanagement simply by having a capital plan on record. "If the mutual is heavily capitalized, it's not hard for them to come up with a strategic plan that is profitable for it and includes actions that promote friendly relations with members of the community while not necessarily pushing it towards conversion," he said.

Having plans related to community reinvestment or even branch expansion could make the all the difference, Scranton said. "Just having in your corporate records a plan, for example, that the institution is considering branch expansions can be useful because branch expansions take a lot of capital."

A mutual blindsided by an activist attack can use such documentation as evidence that they do have plans for excess capital, said Scranton. "You strengthen your response if you have some documentation."

Keeping corporate documents, depositor policies and corporate governance procedures up to date can also go a long way to defend against activists, say attorneys.

While mutuals are not legally required to do so, legal experts suggest that they adopt the stringent corporate governance principles of the Sarbanes-Oxley Act.

"Most mutual institutions, to be perfectly honest, have very outdated governing documents," said Scranton. As such, mutuals should review such documents, including proxies, "just be sure that they don't present potential issues or difficulties if [the

company] gets in any dispute with a member," he said.

Establishing a clearly stated policy on depositors could also go a long way in discouraging activists, said Meyrowitz. "Clearly there are a number of institutions out there that are adopting more restrictive provisions for who their true depositor market is and trying to stay within that. I see a lot of companies doing that."

Meyrowitz noted that many mutuals still adhere to outdated rules governing the voting rights of depositors, which can put them at a disadvantage. "It helps to have the full voting power that the newer charters provide," he said.

Creating rules that keep out certain depositors can be tricky, however, and can run the risk of discrimination. As Faucette told his audience, "The trick is to adopt exclusionary tactics that at the same time are going to preserve the independent prerogative of your board."

Faucette further recommended that mutuals conduct a risk analysis to find out if they would be a likely activist target, based on factors such as location, financial characteristics, community reputation and corporate governance.

When to drop a depositor

But what if it's too late to adopt a depositor policy and an activist has already gained a foothold at a mutual?

Scranton said that mutuals should avoid a public firefight as it could poorly reflect on the institution's relations with its members and its community. "Usually those fights have gotten out of hand because the

fights were mismanaged or relationships with members got mismanaged."

Faucette agreed and said during his presentation. "Don't be heavy-handed because that's exactly what they want you to do."

Meyrowitz said that his firm also advises its mutual clients to take a proactive role. "Not necessarily seek out these people, but never duck them."

Scranton also said that dropping an account can be a legitimate option to dealing with certain troublesome depositors, but stressed that the institution should first have a stated depositor policy in order to avoid more trouble than it bargained for.

Meyrowitz cautioned that it's more difficult to drop an activist depositor retroactively once you have established a policy. "I think that's where you tend to find the so called 'activist depositors' get a little bit more up in arms and upset than if they simply come and are advised that 'I'm sorry but we just don't accept out of state deposits or out of area deposits.'"

Summary

While the more influential activist depositors usually focus their attention on larger, well capitalized mutuals, smaller institutions can also be vulnerable. Scranton said that while smaller institutions are not generally singled out for conversion, they can still run the risk from "off the wall members" that are more driven by principle than profit.

So no matter what the mutual's size, keeping the next Larry Seidman or Joe Garret at bay may require a little foresight and preemptive action. **TI**

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