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CONVERSION OF MUTUAL SAVINGS AND LOAN ASSOCIATIONS TO STOCK OWNERSHIP

TONIGHT I WANT TO TALK TO YOU ABOUT A MATTER THAT GIVES ME GREAT CONCERN OVER THE FUTURE OF THE SAVINGS AND LOAN INDUSTRY. I WANT TO TALK TO YOU ABOUT THE CONVERSION OF MUTUAL SAVINGS AND LOAN ASSOCIATIONS TO THE STOCK FORM OF OWNERSHIP.

THE SAVINGS AND LOAN INDUSTRY IS ONE WHICH HAS A SPECIAL CHARACTERISTIC. IT IS THAT SEGMENT OF THE FINANCIAL INDUSTRY WHICH MAKES THE BULK OF HOME MORTGAGE LOANS. SAVINGS AND LOAN ASSOCIATIONS HAVE EXPERIENCED TREMENDOUS GROWTH SINCE THE END OF WORLD WAR II. FROM AN INFANT INDUSTRY IN 1945, SAVINGS AND LOAN ASSETS HAVE GROWN TO OVER $500 BILLION TODAY. THIS GROWTH CHANNELED INTO THE HOME BUILDING MARKET HAS ENABLED THIS NATION TO PROVIDE HOUSING FOR AN EXPANDING POPULATION IN ALL AREAS AND PARTICULARLY IN THE SUBURBAN AND RURAL COMMUNITIES. THE RECORD OF ACHIEVEMENT OF SAVINGS AND LOAN ASSOCIATIONS IN COMMUNITY SERVICE IS ONE THAT WE CAN ALL BE JUSTIFIABLY PROUD. ONE WAY OR ANOTHER, SAVINGS INSTITUTIONS TOUCH THE LIVES OF ALL OF US AND, TO MY MIND, THEY HELP PRESERVE THE TWO MOST VALUED IDEALS OF OUR AMERICAN WAY OF LIFE--OWNERSHIP IN PRIVATE PROPERTY AND ADVANCEMENT OF A STRONG COMMUNITY LIFE.

A DISTINCTIVE FEATURE OF THE SAVINGS AND LOAN INDUSTRY IS ITS ORIGIN AS A MUTUAL INDUSTRY. THE DRIVING FORCE BEHIND THE ESTABLISHMENT OF MANY SAVINGS AND LOAN INSTITUTIONS WERE COMMUNITY SPIRITED CITIZENS

WHO DESIRED TO FORM FINANCIAL INSTITUTIONS WHICH WOULD TAKE LOCAL SAVINGS AND CHANNEL THOSE SAVINGS BACK INTO COMMUNITY GROWTH AND HOME OWNERSHIP BY LOCAL CITIZENS. THE FACT THAT THESE INSTITUTIONS WERE MUTUALLY OWNED -- OR TO PUT IT ANOTHER WAY, OWNED BY ALL OF THE MEMBERS OF THE INSTITUTIONS -- IN MY JUDGMENT ENHANCED THE SENSE OF COMMUNITY ORIENTATION OF SAVINGS AND LOAN INSTITUTIONS.

MUTUAL SAVINGS AND LOAN INSTITUTIONS HAVE GROWN TO THE POINT WHERE THEIR NET WORTH AMOUNTS TO OVER $25 BILLION. THIS NET WORTH AMOUNTS TO A HUGE PUBLIC RESOURCE WHICH ENABLES THE SAVINGS AND LOAN INDUSTRY TO MAINTAIN ITS SAFETY AND SOUNDNESS AND ITS COMMITMENT TO COMMUNITY GROWTH AND HOME OWNERSHIP.

I DO NOT THINK THAT THERE SHOULD BE ANY QUESTION THAT THE NET WORTH OF THE MUTUAL SAVINGS AND LOAN INDUSTRY IS A PUBLIC RESOURCE. LET ME TELL YOU WHY I THINK THIS IS THE CASE.

MUTUAL INSTITUTIONS ORIGINATED AS COMMUNITY ENTERPRISES OWNED BY THEIR MEMBERS. AS THE YEARS PASSED THE MUTUAL INSTITUTIONS GREW AND CONTINUED TO SERVE THEIR COMMUNITIES AND MEMBERS, BUT THEIR MEMBERSHIP NATURALLY CHANGED. DEPOSITORS DIED OR WITHDREW SAVINGS AND THEY WERE REPLACED BY OTHER DEPOSITING MEMBERS OF THE COMMUNITY. IT WOULD BE IMPRACTICAL TO TRY TO TRACE THE PRECISE LINEAGE OF MEMBERSHIP IN MUTUAL SAVINGS AND LOAN ASSOCIATIONS. NEVERTHELESS, OVER THE YEARS, DESPITE MEMBERSHIP CHANGES, THE MUTUAL INSTITUTIONS REMAINED AS AN INSTITUTION FULFILLING THEIR INTENDED PURPOSES. IN THESE CIRCUMSTANCES,

THE MUTUAL INSTITUTION I BELIEVE HAS TAKEN ON THE CHARACTERISTIC OF A PUBLIC RESOURCE.

IN THE PAST SEVERAL YEARS, ANOTHER GROWTH PATTERN HAS EMERGED IN THE SAVINGS AND LOAN INDUSTRY. SIDE BY SIDE WITH THE GROWTH OF MUTUAL INSTITUTIONS HAS BEEN THE GROWTH OF STATE-CHARTERED STOCK SAVINGS AND LOAN INSTITUTIONS. THERE ARE NOW some 700 STATE STOCK SAVINGS AND LOANS ASSOCIATIONS WITH ASSETS OF over $100 billion. THESE INSTITUTIONS ARE OWNED BY STOCKHOLDER ENTREPRENUERS WHO HAVE CHANNELED THEIR OWN FUNDS INTO THESE INSTITUTIONS AS AN INVESTMENT. THIS IS A HEALTHY DEVELOPMENT. IN ANY DYNAMIC SOCIETY THERE SHOULD BE PLENTY OF ROOM FOR INDIVIDUALS PUTTING UP THEIR OWN MONEY TO RUN THEIR OWN BUSINESS. IT IS PARTICULARLY GRATIFYING TO SEE THE HOUSING MARKET ATTRACT CAPITAL INVESTMENT FUNDS, PARTICULARLY IF INVESTMENT HOLDS OUT THE POSSIBILITY OF FLATENING OUT THE WIDE SWINGS IN THE HOMEBUILDING MARKET WHICH OCCUR DURING EVERY PERIOD OF HIGH INTEREST RATES AND TIGHT MONEY.

IF THIS WERE THE END OF MY TALK TONIGHT EVERYONE WOULD GO HOME WITH THE FEELING THAT WITH RESPECT TO THE OWNERSHIP OF SAVINGS AND LOAN INSTITUTIONS EVERYTHING WAS JUST SWEETNESS AND LIGHT. UNFORTUNATELY, THIS IS NOT THE CASE.

IT IS NOT THE CASE BECAUSE THERE HAS BEEN A VERY DISTURBING TREND TOWARD THE CONVERSION OF EXISTING MUTUAL SAVINGS AND LOAN INSTITUTIONS TO THE STOCK FORM OF OWNERSHIP. UNFORTUNATELY, A LONG TRAIN OF ABUSES HAS ATTENDED SUCH CONVERSIONS THAT I QUESTION WHETHER THERE IS ANY VALID

PUBLIC PURPOSE TO BE SERVED BY PLACING THE HUGE RESOURCES OF THE MUTUAL INDUSTRY INTO PRIVATE HANDS BY CONVERSION TO STOCK OWNERSHIP AS AGAINST COMMUNITY OWNERSHIP.

LETS TAKE A LOOK AT THE RECORD OF CONVERSIONS.

IN 1974 IN ORDER TO FORESTALL THE WHOLESALE CONVERSION OF MUTUAL SAVINGS AND LOAN ASSOCIATIONS TO PRIVATE STOCK OWNERSHIP THE CONGRESS AUTHORIZED THE CONVERSION OF 30 MUTUAL INSTITUTIONS AS ON EXPERIMENTAL BASIS UNDER THE AUTHORITY OF THE FEDERAL HOME LOAN BANK BOARD DURING A LIMITED PERIOD OF TIME.

THE RESULTS OF THE CONVERSION CONDUCTED PURSUANT TO THE EXPERIMENT HAVE SHOWN THAT INSIDERS -- OFFICERS AND DIRECTORS OF THE CONVERTING INSTITUTION -- HAVE BEEN THE CHIEF BENEFICIARIES OF THE CONVERSIONS. IN MAY 1977 GAO ISSUED A REPORT OF ITS AUDIT OF 8 OF THE FIRST CONVERSIONS UNDER THE EXPERIMENTAL PROGRAM. THAT REPORT SHOWS THAT THE CONVERSION OBJECTIVE OF BROAD PARTICIPATION BY DEPOSITORS WITH NO WINDFALL BENEFITS TO INSIDERS WAS SYSTEMATICALLY UNDERMINED.

INSIDERS AND THEIR ASSOCIATES MANIPULATED THEIR SAVINGS ACCOUNT BALANCES JUST BEFORE THE ELEGIBILITY DATE SO AS TO INCREASE THE NUMBER OF SHARES OF STOCK THEY COULD PURCHASE. FOR EXAMPLE, THE GAO REPORT STATES THAT:

"AT ONE ASSOCIATION, SIX ACCOUNTS HELD BY MEMBERS OF MANAGEMENT OR MANAGEMENT-RELATED INTERESTS WERE INCREASED SIGNIFICANTLY THUS ALLOWING THESE INDIVIDUALS TO ACTUALLY PURCHASE 7,030 MORE SHARES THAN WITHOUT THE INCREASES.

"AT A SECOND ASSOCIATION, ONE ACCOUNT IN THE NAME OF A DIRECTOR'S BUSINESS WAS INCREASED SIGNIFICANTLY WHICH ALLOWED THE BUSINESS TO ACTUALLY PURCHASE AN ADDITIONAL 4,365 SHARES.

"AT A THIRD ASSOCIATION, ONE ACCOUNT IN THE NAME OF A DIRECTOR'S BUSINESS WAS OPENED WHICH ENTITLED THE DIRECTOR TO PURCHASE 4,482 MORE SHARES THAN WITHOUT THE ACCOUNT. THE DIRECTOR DID NOT PURCHASE HIS FULL ENTITLEMENT BUT DID BUY AN ADDITIONAL 1,300 SHARES. THE SIGNIFICANCE OF THIS TRANSACTION IS THAT THE ACCOUNT WAS OPENED 2 MONTHS BEFORE THE ELIGIBILITY RECORD DATE AND CLOSED 2 MONTHS LATER."

ANOTHER INSIDER ABUSES CITED IN THE GAO REPORT WAS THAT INSIDERS AND THEIR ASSOCIATES USED DUMMY PARTIES TO PURCHASE STOCK WHICH WAS TRANSFERRED TO THEM SOON AFTER CONVERSION. THE GAO REPORT STATES:

"AT SOME ASSOCIATIONS, MEMBERS OF MANAGEMENT AND THEIR ASSOCIATES SIGNIFICANTLY INCREASED THEIR HOLDING THROUGH STOCK TRANSFERS SOON AFTER CONVERSION. IN TWO ASSOCIATIONS WE REVIEWED, THERE WAS ACTIVITY WHICH SUGGESTS THAT PRE-ARRANGEMENTS COULD HAVE BEEN MADE WHICH WERE PROHIBITED BY THE REGULATIONS AND WHICH WERE NOT DISCOVERED BY THE FEDERAL HOME LOAN BANK BOARD."

" AT ONE ASSOCIATION, 25,854 SHARES WERE TRANSFERRED ON THE STOCK ISSUANCE DATE. MEMBERS OF MANAGEMENT ACQUIRED 21,592 SHARES, OR 84 PERCENT OF THE TOTAL TRANSFERRED. SOME OF THESE TRANSFERS TO MANAGEMENT CAN BE TRACED TO FOUR INDIVIDUALS WHO, DURING THE INITIAL SUBSCRIPTION OFFERING, PLACED TWO SEPARATE ORDERS. ONE STOCKHOLDER TRANSFERRED 80 PERCENT OF HIS SECOND ORDER AND THREE OTHER STOCKHOLDERS TRANSFERRED ALL OF THEIR SECOND ORDERS TO MEMBERS OF MANAGEMENT. THE ACQUISITION ON THE STOCK

ISSUANCE DATE INCREASED MANAGEMENT'S HOLDINGS FROM 5 TO 31 PERCENT."

"AT ANOTHER ASSOCIATION, A BUSINESS ASSOCIATE OF MANAGEMENT AND AN ESTATE FOR WHICH A DIRECTOR WAS A CO-EXECUTOR TRANSFERRED 20,901 SHARES TO A MEMBER OF MANAGEMENT WITHIN 3 MONTHS OF THE STOCK ISSURANCE DATE. THIS ACTION INCREASED TOTAL MANAGEMENT HOLDINGS IN THE ASSOCIATION FROM 16 TO 20 PERCENT."

INSIDERS UTILIZED THE INFORMATION GAINED AS STOCK TRANSFER AGENTS TO PURCHASE UNAUTHORIZED SHARES IN CONVERTING INSTITUTIONS. AGAIN THE GAO REPORT STATES:

"THE ASSOCIATION ACTING AS ITS OWN TRANSFER AGENT, CAN OBTAIN INFORMATION ABOUT POTENTIAL TRANSFERS AND DIRECT SUCH ACTIVITY TO ITS MANAGEMENT.

***BY ACTING AS ITS OWN STOCK TRANSFER AGENT MANAGEMENT COULD BE THE FIRST TO RECEIVE INFORMATION OF OFFERS TO SEEL STOCKS, THUS ENABLING IT TO INCREASE PERCENT HOLDINGS. *** MANAGEMENT IS ACQUIRING THE MAJORITY OF SHARES TRADED IN THE SECONDARY MARKET, AND THOSE TRADES ENABLE THEM TO GAIN CONTROL OF THE ASSOCIATION."

IN MY VIEW, INSIDER ABUSES HAVE ENABLED THEM TO PURCHASE MORE STOCK THAN THEY ARE ENTITLED TO AND THEREBY GAIN CONTROL OVER THE CONVERTING INSTITUTIONS. AT STAKE IS OF COURSE, THE MILLIONS IN EQUITY CAPITAL BUILT UP OVER MANY YEARS BY THE SAVINGS PUBLIC.

ACCORDING TO THE FEDERAL HOME LOAN BANK BOARD, OFFICERS AND DIRECTORS OF CONVERTING INSTITUTIONS PURCHASED AN AVERAGE OF 34.1 PERCENT OF THE STOCK FOR CONVERSIONS COMPLETED AS OF THE END OF 1977.

According to a study conducted by the Council of Mutual Savings Institutions, insiders tend to gain control of the converted institutions. Of 28 conversions examined, insiders acquired as much as 72 percent of the stock and in only three cases did insiders purchase less than 20 percent. While insiders purchased control of the converting institutions, only 3.5 percent of the mutual savings and loan members purchased stock.

This evidence gives me concern that the community orientation of mutual institutions will give way when they convert to ownership by a few insiders.

Yet another aspect of conversions gives me great concern. That is the method and the price at which insiders are able to convert the mutual institutions for their own benefit.

There is an inherent windfall in conversions as they have been conducted. The windfall arises because when insiders purchase control of converting institutions, they thereafter control not only the capital of the institution before conversion but also the amount of capital added to the institution from the purchase of stock. Thus the insiders get back what they paid-in plus more.

There might be an argument that a few institutions should be allowed to convert if that is the only way they can augment their capital and continue to serve the communities needs. But the results of the experimental conversions shows that conversions just don't work that way.

MOST SAVERS ARE PRIMARILY INTERESTED IN A SAFE PLACE FOR THEIR MONEY AND A FAIR RATE OF RETURN. CONVERSIONS ARE COMPLICATED AND NOT EASILY UNDERSTOOD BY SAVERS. MOREOVER, OBSTACLES ARE PLACED IN THE WAY OF SAVERS WHO WISH TO BE INFORMED OF THE DETAILS OF CONVERSIONS. I KNOW OF ONE INSTANCE IN WHICH A CONVERTING INSTITUTION REFUSED TO PERMIT THE PLAN OF CONVERSION TO BE REPRODUCED ON A TIMELY BASIS EVEN AT THE EXPENSE OF THE MEMBER, REQUIRING THE PLAN TO BE REVIEWED AT THE INSTITUTION'S OFFICE. NO WONDER SAVERS PARTICIPATION IN CONVERSIONS IS SO LOW.

CONVERSIONS ARE DEFENDED ON THE GROUND THAT INCREASED CAPITAL IS NEEDED FOR INSTITUTION GROWTH. HOWEVER, THIS RATIONALE DOES NOT STAND UP UNDER CLOSE SCRUTINY. ACCORDING TO A RECENT REPORT OF THE FEDERAL HOME LOAN BANK BOARD ON 32 CONVERSIONS STUDIED, ONLY TWO WERE BELOW THE PRESCRIBED NET WORTH REQUIREMENT. TEN WOULD NOT HAVE FALLEN BELOW SUCH REQUIREMENT FOR AT LEAST FIVE YEARS OR MORE AND ANOTHER TEN NOT FOR A PERIOD OF THREE TO FIVE YEARS.

IT IS APPARENT FROM THESE STATISTICS THAT THERE IS NO NEED TO RUSH CONVERSIONS AND THAT GIVEN THE ABSUES INHERENT IN CONVERSIONS, THE FEDERAL HOME LOAN BANK BOARD SHOULD PAY GREATER ATTENTION TO ALTERNATIVES TO CONVERSIONS TO INCREASE CAPITAL.

ONE OF THE MOST CRITICAL ASPECTS OF CONVERSIONS IS THE APPRAISAL OF THE WORTH OF THE INSTITUTION FOR THE PURPOSE OF DETERMINING THE PRICE AT WHICH SHARES IN THE CONVERTING INSTITUTION WILL BE SOLD TO INVESTORS.

THE PRICE OF CONVERTING INSTITUTION SHARES IS BASED PRIMARILY ON THE PRICE/EARNINGS RATIO AND COMPARISON OF COMPARABLE SAVINGS AND LOAN ASSOCIATION STOCK ALREADY BEING TRADED. I HAVE GRAVE DOUBTS WHETHER THIS METHOD OF VALUATION TURLY REFLECTS THE WORTH OF THE INSTITUTION.

FIRST OF ALL, IN A DEPRESSED STOCK MARKET THE LEVEL AT WHICH A STOCK TRADES MAY NOT AT ALL RELFECT THE WORTH OF AN INSTITUTION. AT DEPRESSED PRICES INSIDERS HAVE AN INCENTIVE TO CONVERT SO THAT THE STOCK MARKET RISES THEY WILL BE THE BENEFICIARIES OF SPECULATIVE GAINS. SECONDLY, SUCH CONVERSION PRICES TO NOT REFLECT AT ALL THE FACT THAT CONTROL BY A GROUP OF INSIDERS WHICH THEY CAN IN TURN SELL TO OTHERS PLACES A HIGHER VALUE ON OUTSTANDING STOCK. ONE INSTITUTION WAS APPRAISED AT A VALUE OF $11.3 MILLION AT THE TIME OF CONVERSION. FIFTEEN MONTHS LATER IN CONNECTION WITH AN OFFER BY A HOLDING COMPANY TO PURCHASE THE INSTITUTION IT WAS APPRAISED AT $34.2 MILLION. THIS KIND OF UNCONSCIONABLE PROFIETEERING IS FUNDAMENTALLY DESTRUCTIVE OF A GREAT MUTUAL INDUSTRY WITH A FINE RECORD OF SERVING COMMUNITY NEEDS.

THE FEDERAL HOME LOAN BANK BOARD RECENTLY ISSUED NEW REGULATIONS AND DECLARED ITS INTENT TO PERMIT FURTHER CONVERSIONS. THIS POLICY IS MOST UNFORTUNATE. GAO HAS ISSUED A LEGAL OPINION WHICH HOLDS THAT THE BOARD'S AUTHORITY TO PERMIT THE CONVERSION OF FEDERAL MUTUAL TO FEDERAL STOCK CONVERSIONS EXPANDED IN JUNE 30, 1976. MOREOVER, THE BOARD'S REGULATIONS WILL NOT PREVENT INSIDERS FROM TAKING CONTROL OF CONVERTED INSTITUTIONS OR TO CONVERT AT LOW PRICES.

CHAIRMAN PROXMIRE INTRODUCED LEGISLATION IN THE LAST CONGRESS WHICH WOULD ALLOW THE BOARD TO COMPLETE ITS CONVERSION EXPERIMENT UNDER STANDARDS WHICH WOULD PUT A STOP TO THE KIND OF ABUSES I HAVE DETAILED TONIGHT. I SUPPORT THAT CONCEPT. AT THE END OF THE EXPERIMENT ALL CONVERSIONS SHOULD BE PROHIBITED UNLESS CONGRESS FINDS CLEAR AND CONVINCING EVIDENCE THAT CONTINUATION OF CONVERSIONS WILL BEST SERVE THE PUBLIC INTEREST.