The Rights of Federal Mutual Savings Association Members to Distributions of Capital

Summary Conclusion: Federal law does not give the members of federal mutual savings associations any right to dividends or other distributions of the capital of such savings associations except if (1) the board of directors of the savings association has exercised its discretion to declare a dividend and complied with applicable OTS regulations, or (2) there is an OTS authorized solvent liquidation of the institution.

Date: June 21, 2002

Subjects: Home Owners' Loan Act/Savings Association Powers

P-2002-7
June 21, 2002

Re: The Rights of Federal Mutual Savings Association Members to Distributions of Capital

Dear [ ]:

This letter responds to your inquiry on behalf of [ ] (the Association). The Association is a federally chartered mutual savings association that as of December 31, 2001, had more capital than was required to be “well capitalized” under the Office of Thrift Supervision’s (OTS) prompt corrective action regulations, 12 C.F.R. Part 565. The Association pays interest on the balances in interest-bearing accounts but, at least for many years, the Association has not paid dividends or other distributions of capital to its members. The Association considers the retention of earnings important because, as a mutual savings association, its ability to raise capital by other means is limited.

The Association has requested that OTS opine as to whether members of a federal mutual savings association have any entitlement to dividends or other distributions of capital other than in the course of a solvent liquidation of the savings association. For purposes of the letter, we consider capital distributions to be distributions of cash or property to the owners of a federal mutual savings association on account of their ownership interests and to exclude payments that the association is required to make under the terms of a deposit instrument. See, 12 C.F.R. § 563.141. In brief, we conclude that federal law does not give the members of federal mutual savings associations any right to dividends or other distributions of the capital of such savings associations, with two exceptions. Those exceptions are: (a) if the board of directors of the savings association has exercised its discretion to declare a dividend and complied with applicable OTS regulations; and (b) if there is an OTS authorized solvent liquidation of the institution.
Section 5(a) of the Home Owners’ Loan Act (HOLA), 12 U.S.C. § 1464(a), gives the Director of OTS the authority to organize, charter and regulate the operations of federal savings associations. Section 5(b) of the HOLA, 12 U.S.C. § 1464(b), provides that the holders of savings and demand accounts, as members of a federal savings association, have “voting rights and such other rights” as provided in the association’s charter and OTS regulations. However, no regulation or provision of the standard form of federal savings association charter gives members of such an institution the right to demand distributions of such an institution’s capital. In addition, the relevant statutes and regulations place limitations on the ability of savings associations to make capital distributions.

OTS has issued a regulation prescribing a form of charter for federal mutual savings associations.1 Section 7 of the current form of prescribed charter provides that the savings association shall be under the direction of its board of directors.2 Implicit in that provision is authority for the board of directors to exercise discretion to determine whether or not to authorize dividends or other capital distributions.3 However, that discretion is not complete. The first paragraph of section 8 of the current form of the prescribed charter limits the savings association’s ability to make capital distributions.4 That section requires that the savings association must maintain sufficient capital to meet all capital requirements contained in section 5 of the HOLA and OTS’s regulations.5 Section 8 further limits the ability to distribute capital by requiring that any capital distributions be made on such basis and in accordance with such terms and conditions as OTS may authorize.6

Other statutory and regulatory provisions also circumscribe the discretion otherwise exercisable by the board of directors. Section 38(d)(1)(A) of the Federal Deposit Insurance Act (FDIA), 12 U.S.C. § 1831o(d)(1)(A), generally prohibits any capital distribution if, after making the distribution, the institution would be undercapitalized as defined in OTS’s regulations, 12 C.F.R. § 565.4. Moreover, in certain circumstances a savings association must file with OTS a notice of intent or application for permission to make a capital distribution and, if OTS denies

---

1 See, 12 C.F.R. § 544.1. Savings associations must submit nonconfoming charter amendments to OTS and the agency may choose to permit or reject any such amendments. See, 12 C.F.R. § 544.2.
2 See, 12 C.F.R. § 544.1, Federal Mutual Charter, section 7. The Association’s charter also provides for it to be under the direction of its board of directors.
3 See also, 12 C.F.R. § 544.5(b)(12)(iii). (Unless otherwise authorized by OTS, a federal mutual savings association’s bylaws must empower the association’s board of directors to exercise all of its powers not expressly reserved in the charter to the members. None of the prescribed charter provisions expressly reserves the right to declare dividends or other capital distributions to the members of a federal savings association.)
4 See, 12 C.F.R. § 544.1, Federal Mutual Charter, section 8. The Association’s charter contains the same provision as section 8 of the currently prescribed OTS form of federal mutual association charter.
5 Capital requirements are contained in section 5(t) of the HOLA, 12 U.S.C. § 1464(t), and parts 565 and 567 of OTS’s regulations, 12 C.F.R. Parts 565, 567. In addition, OTS may set individual capital requirements for particular savings associations pursuant to section 5(s) of the HOLA, 12 U.S.C. § 1464(s), and section 567.3 of OTS’s regulations, 12 C.F.R. § 567.3.
6 The charter provision also provides a savings association’s board of directors with authority to set minimum balance requirements for members to receive any otherwise authorized capital distribution.
the application or objects to the notice, the distribution cannot properly be made. See, 12 C.F.R. Part 563, Subpart E.

The second paragraph of section 8 of the prescribed federal mutual charter contains the only reference to a required distribution of assets to members. It provides that members of the savings association who hold accounts with the institution are entitled to a pro rata distribution of the net assets of the institution upon a voluntary or involuntary liquidation, dissolution or winding up of the affairs of the institution. However, OTS's regulations generally prohibit federally chartered mutual savings associations from voluntarily dissolving without OTS’s prior approval. See, 12 C.F.R. § 546.4. Therefore, the only right of members of federal mutual savings associations to receive dividends or distributions of the savings association's capital is when a liquidation occurs.

These conclusions are further supported by decisions of the Supreme Court and other federal courts. While the courts have found that federal mutual savings associations are owned by their depositors and, sometimes, also their borrowers (see e.g., Charter Fed. Sav. & Loan Ass’n v. OTS, 912 F.2d 1569, 1570 (11th Cir. 1990)), the courts have also consistently found that the member owners of federal mutual savings associations do not have a property interest in the equity of their institutions except in the case of a solvent liquidation.

In Society for Savings in the City of Cleveland v. Bowers, 349 U.S. 143 (1955), the Supreme Court considered whether depositor members in a federal mutual savings association and a state chartered mutual savings association would incur property tax liability for any interest they may have in the surplus of the institution. The Court held that the institutions' accumulated surplus was taxable as property of the institutions and not of the depositors. In reaching its decision, the Court reasoned:

So long as the bank remains solvent, depositors receive a return on [the surplus] fund only as an element of the interest paid on their deposits. To maintain their intangible ownership interest, they must maintain their deposits. If a depositor withdraws from the bank, he receives only his deposits and interest. If he continues, his only chance of getting anything more would be in the unlikely event of a solvent liquidation, a possibility that hardly rises to the level of expectancy. It stretches the imagination very far to attribute any real value to such a remote contingency.

349 U.S. at 150. See also, Paulsen v. Commissioner of Internal Revenue, 469 U.S. 131, 140 (1985), where the Supreme Court determined that the depositor members had only a negligible

---

8 The only situation we can envision where members of a federal mutual institution may demand payments from the institution's capital is as creditors of the institution and where the institution's current earnings are insufficient to meet its obligations to pay interest or repay the principal on their deposit accounts. However, as discussed above, such payments are not considered capital distributions under OTS’s regulations.
equity interest in a federal mutual savings association. The Supreme Court’s reasoning supports
the view that members of federal mutual savings associations lack the requisite interest in the
institutions’ capital that would generally entitle them to demand dividends or other distributions
of that capital.

A number of federal circuit courts have also expressed the opinion that members of
federal mutual savings associations generally do not have any entitlement to the capital of those
institutions. In Ordower v. OTS, 999 F.2d 1183 (7th Cir. 1993), the Seventh Circuit considered
the relationship of depositor members of a federal mutual savings association to the institution in
the context of a challenge to the conversion of the institution into the stock form of ownership.
The court found that:

Nominally the customers own the mutual, but it is ownership in name only. They
cannot sell what they “own”, and if they withdraw savings they receive only the
nominal value of the account rather than a portion of the mutual’s net worth,
which is valuable to them only to the extent it permits the bank to pay higher
interest.

999 F.2d at 1185. The court further concluded that, “[b]efore conversion, the account holders
can obtain a share of the institution’s net worth only if the mutual liquidates.” Ibid. The court
also noted that the depositors could not force such liquidation. Ordower, 999 F.2d at 1187.

Similarly, in York v. Federal Home Loan Bank Board, 624 F.2d 495, 499-500 (4th Cir.),
cert. denied, 449 U.S. 1043 (1980), another case involving a challenge to the conversion of a
federal mutual savings association to the stock form of organization, the Fourth Circuit stated
that:

Although the depositors are the legal “owners” of a mutual savings and loan
association, their interest is essentially that of creditors of the association and only
secondarily as equity owners. Depositors’ rights are circumscribed by statute and
regulation. They are not allowed to realize or share in the profits of the
association, but are entitled only to an established rate of interest. The depositors
do not share in the risk of loss since their deposits are federally insured, and their
only opportunity to realize a gain of any kind would be in the event the savings
and loan association dissolved or liquidated.

Moreover, the court in York, 624 F.2d at 500, also recognized that regulatory restrictions
prevented the owners of a federal mutual savings association from forcing the institution into
liquidation.
In sum, the federal courts have concluded that owners of federal mutual savings associations have only very limited equity interests in those institutions and those interests do not include any rights as owners to demand a distribution of the institutions' capital.9

In reaching the foregoing conclusions, we have relied on the factual representations made in the material you submitted to us. Our conclusions depend in part on the accuracy and completeness of those facts. Any material difference in facts or circumstances from those described herein could result in different conclusions.

If you have questions regarding these matters, please feel free to contact Aaron B. Kahn, Special Counsel, at (202) 906-6263.

Sincerely,

Carolyn J. Buck
Chief Counsel

cc: All Regional Directors
    All Regional Counsel

---

9 Indeed, one court has gone so far as to describe the ownership interests of members in a federal mutual savings association as a chimera. See, Reschini v. First Fed. Sav. and Loan Assn., 46 F.3d 246, 248 (3rd Cir. 1995).