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First Federal Lakewood plots expansion under new mutual holding company structure

By Jeremy Nobile

First Federal Lakewood CEO Tom Fraser

First Federal Lakewood is putting its money where its mouth is.

The largest independent mutual bank in Ohio reinforced its commitment to the mutual concept and true depositor ownership by converting its parent corporation to a mutual holding company. The change, which established the no-stock First Mutual Holding Co., was announced in the spring and completed in mid-July. Mutual banks, which issue no stock themselves, have been around since 1816. But the mutual holding company structure is a relatively recent concept.

They were first created on the federal level with the Competitive Equality Banking Act of 1987 largely to preserve the interests of mutual banks while also providing some additional flexibility as an operation.

Unlike a mutual bank, the mutual holding company can issue stock to raise additional capital, if it chooses to, and hold additional charters, for example.

The 80-year-old parent company of First Federal Lakewood has every intention of remaining independent, said president and CEO Tom Fraser, underscoring a commitment to mutual banking's founding tenet — valuing members and communities over the enrichment of a company.

It also positions the bank for targeted growth. With $1.6 billion in assets, the bank isn't starving for capital. It clearly has no immediate plans of pursuing a lucrative payday through a stock offering. And there aren't major tax incentives to leverage.

“In today's environment, we looked at this because it gives us some added flexibility,” Fraser said.

The flexibility comes with opening up the company for acquisitions of other institutions that want a partner to affiliate with because of the rising costs of banking, but also want to retain their own no-stock, independent structures.

It also allows the company the option to acquire or create other non-bank financial service companies.

Those things couldn't happen under the previous ownership structure.

No plans are concrete yet, Fraser said, and no acquisitions are in the immediate pipeline, but now the company is prepped for that activity.

Notably, the conversion is among the first of its particular kind since the passage of the sweeping financial reform act that has squeezed bank margins with expensive and rigorous compliance requirements.

“The business reality is a lot of other mutual banks, smaller banks over time are struggling to stay profitable and manage expenses,” Fraser said.

“The banking landscape has changed, and this creates a more modern form of corporate ownership.”

A "courageous commitment'

In addition to retaining a mutual structure, members made it more difficult for the bank to convert to stock in the future, if it wants to.

Any issuance of stock, for instance, now requires approval by two-thirds of voters instead of just a basic majority. If that should happen, an anti-enrichment provision prohibits directors and junior management from benefiting financially.

“It is a very rare thing when people make it tougher to raise common equity in the open market,” said Don Musso, founder and president of FinPro Financial Services Inc., a New Jersey financial industry consultant with a specialty focus on mutual banks.

But that same move could, potentially, create some risk if the bank *does* find itself growing too fast or famished for capital.

“What Lakewood is saying is we're content to grow without any public stockholders, and that's a fairly courageous commitment,” said Douglas Faucette, a partner in the Washington office of Locke Lord LLP and counsel to America's Mutual Banks, a lobbying trade group. “It says through earnings and profitability they can manage their growth. That's a very confident move by them.”

However, it makes the most sense for a well-capitalized bank like First Federal operating in a relatively stable market, Faucette said.

“It's an enviable position to be in because they can potentially do a lot for the community, and there are no stockholders to complain about it,” Faucette said.

“This says this is a group of individuals dedicated to higher principles than the pure profit motive.”

Blazing a trail

While financially strong, Fraser said the bank is certainly looking to grow.

Fraser said the goal is to exceed $2 billion in assets through the coming years.

A bank combining with First Mutual Holding Co. would create synergies through the benefit of additional scale — something that has become increasingly imperative with the regulatory costs stemming from Dodd

Frank. More scale means an additional spread to cover costs while creating pooled buying power for items benefiting depositors like modern tech-based services.

“For all those reasons, costs of running a bank are going up,” said Jeff Quayle, general counsel for the Ohio Bankers League trade association.

“This holding company presents a thoughtful approach to managing costs.”

“It's absolutely the right strategic play by Lakewood because the whole reason we're seeing this consolidation (in the banking industry) is because of fear by small banks that they can't compete unless they get some size and the efficiency that comes with size,” Musso said.

And a deal with First Mutual would create an affiliate relationship, so it won't resemble a traditional bank acquisition.

Staffs, in theory, would not be affected. Their name would stay the same.

Beyond a level of control passed to the holding company itself and the marrying of balance sheets, the typical depositor at an institution merged with First Mutual probably won't notice any immediate difference in day-to-day banking.

Fraser expects that to appeal to strugglers who want to retain their independent status.

The company could potentially acquire traditional community banks, but it would have to pay in cash. It could also make deals outside of Ohio.

But Fraser said the company's focus remains predominantly on mutual banks in its home state in new or existing markets. And no deals are being sought simply to grow for growth's sake.

Analysts expect others will be watching First Mutual to see how its transition plays out.

The reason more mutual banks haven't taken the steps the Lakewood entity has, experts say, is largely because of the high-pressure environment and treatment by regulators and legislators that make operating as a mutual bank cumbersome.

“It's interesting because I think the whole market was waiting for a trailblazer,” Musso said.

“I think the whole market will let a quarter or two go by. And in 2016, you will start to see more companies go to the mutual holding company structure with and without stock.”