

Banking/Employee Benefits

March 16, 2010

Use Your Existing ESOP to Increase Bank Capital

According to recent filings with the Securities and Exchange Commission, at least one bank has found an opportunity to improve its capital position through changes to its employee stock ownership plan (ESOP). A similar opportunity may be available to other banks to do the same thing under the right circumstances.

The bank in question maintained both a leveraged ESOP and a 401(k) plan for its eligible employees. While a majority of the shares of bank stock in its leveraged ESOP were allocated to participants' accounts, the ESOP still had indebtedness for shares that were not yet allocated to participants' accounts. In this respect, the existing ESOP loan was reflected on the right side of the bank's balance sheet as both a liability and a contra-equity amount ("Unearned Compensation") in accordance with generally accepted accounting principles (GAAP).

As part of a benefit plan restructuring and in order to generate capital, the bank terminated the ESOP and merged the accounts of ESOP participants into the bank's 401(k) plan, with the unallocated shares of the ESOP being redeemed by the bank in exchange for cancellation of the ESOP's debt to the bank.

While the termination of the ESOP had no material impact on the bank's earnings, the Unearned Compensation contra-account amount was reduced to zero, thereby improving the bank's capital position by the amount of the reduction (\$3.1 million), which represents the amount of the unpaid ESOP loan.

For banks that maintain ESOPs with outstanding leverage, including many mutual thrifts that converted to stock organizations using a leveraged ESOP as a part of such conversion, this may present an opportunity to improve their capital position. Before doing so, however, careful analysis of all implications of terminating a leveraged ESOP should be undertaken to ensure that the best interests of the bank and its shareholders are served, and that there are no inadvertent violations of the fiduciary provisions of the Employee Retirement Income Security Act of 1974.

For more information on how you might use your ESOP to improve your capital position, please contact one of the Katten Muchin Rosenman LLP attorneys listed below:

Gregory K. Brown
312.902.5404 / gregory.brown@kattenlaw.com

Jeffrey M. Werthan
202.625.3569 / jeff.werthan@kattenlaw.com

Christina Grigorian
202.625.3541 / christina.grigorian@kattenlaw.com

Robert J. Wild
312.902.5567 / robert.wild@kattenlaw.com

Kathleen Sheil Scheidt
312.902.5335 / kathleen.scheidt@kattenlaw.com

www.kattenlaw.com

CHARLOTTE

CHICAGO

IRVING

LONDON

LOS ANGELES

NEW YORK

WASHINGTON, DC

Published as a source of information only. The material contained herein is not to be construed as legal advice or opinion.

©2010 Katten Muchin Rosenman LLP. All rights reserved.

Circular 230 Disclosure: Pursuant to regulations governing practice before the Internal Revenue Service, any tax advice contained herein is not intended or written to be used and cannot be used by a taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer. Katten Muchin Rosenman LLP is an Illinois limited liability partnership including professional corporations that has elected to be governed by the Illinois Uniform Partnership Act (1997). London affiliate: Katten Muchin Rosenman Cornish LLP.