

# Capital and Dividends

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Introduction.....	1
Key Policies.....	1
Application Process.....	2
Prior Approval.....	2
Prior Approval Not Required.....	3
Securities Disclosure Requirements.....	4
Lending Limit Calculation.....	5
Specific Requirements for Increases.....	5
Sale of Common Stock for Cash.....	5
Sale of Preferred Stock for Cash.....	5
Blank Check Preferred Stock.....	6
Sale of Capital Stock for Other than Cash.....	6
Receipt of Cash Contribution.....	6
Receiving Noncash Contribution.....	6
Specific Requirements for Decreases.....	7
Reduction in Capital by Distributing Cash or Assets.....	7
Reduction in Capital by a Quasi-reorganization.....	8
Specific Requirements for Other Changes.....	9
Stock Split.....	9
Change in Par Value of Capital Stock.....	9
Retirement of Capital Stock.....	10
Employee Stock Option Plans.....	10
Acquisition of Treasury Stock.....	11
Reverse Stock Split.....	12
Innovative Capital Instruments Included in Tier 1 Capital.....	13
Hybrid Capital Instruments Included in Tier 2 Capital.....	15
Dividends.....	15
Stock Dividends.....	15
Dividends-In-Kind.....	16
Dividends Exceeding the Limits of 12 USC 60.....	16
Procedures: Filing the Application.....	18
Procedures: Notice.....	23
Appendix A: Changes in Capital.....	25
Appendix B: Payment of Dividends.....	26
Glossary.....	27
References.....	29

# Capital and Dividends

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## Introduction

A national bank must obtain OCC prior approval for any decrease and for certain increases in permanent capital (the sum of a bank's capital stock and capital surplus accounts). National banks may make some increases to permanent capital by sending the OCC an after-the-fact notice. Other changes require the OCC's prior approval. Additionally, the OCC must certify to increases in a bank's permanent capital before the bank can issue additional capital or reflect the capital change on its financial statements.

This booklet provides guidance and instructions to banks intending to change permanent capital. It also describes key policies, summarizes both the prior approval and the after-the-fact processes, and details specific requirements for increases and decreases in permanent capital. Additionally, this booklet describes innovative and so-called hybrid capital instruments that the OCC has determined qualify as capital, subject to various limitations. The booklet also discusses dividends, including the process that banks must follow to obtain OCC approval for dividends that exceed the earnings limits of 12 USC 60.

There is a step-by-step procedure section for applicants and the OCC to follow and a glossary of terms used in this booklet. The reference section includes applicable laws, regulations, and OCC issuances to assist applicants in completing the capital and dividend process. This booklet is to be used together with other booklets of the *Comptroller's Licensing Manual*. You should review the "[General Policies and Procedures](#)" booklet prior to completing the application for filing instructions and to the "[Charters](#)" booklet for sample corporate documents. Throughout this booklet there are hyperlinks to related corporate decisions and to filing samples.

## Key Policies

Generally, the OCC will approve a change in permanent capital that:

- Is consistent with applicable law, regulation, and OCC policy.
- Provides an adequate capital structure.
- Complies with the capital plan filed by the bank under either 12 CFR 3.7 or 12 USC 1831o and 12 CFR 6.5, if appropriate.
- Complies with applicable securities disclosure requirements.

The OCC regulations permit national banks to follow the corporate governance procedures of the laws of the state in which the main office of the bank is located; the law of the state in which the bank's holding company is incorporated; the Delaware General Corporation Law; or the Model Business Corporation Act. National banks, however, may follow those laws only to the extent that they are not inconsistent with applicable federal banking statutes or regulations and safe and sound banking practices. The bank must designate in its bylaws the body of law selected. (Refer to section 8.4 of the model [Bylaws](#) and 12 CFR 7.2000.)

The OCC generally does not approve dividend requests that:

- Would reduce capital to less than regulatory minimums, as required by 12 CFR 5.65, "Restrictions on undercapitalized institutions," or below levels specified in an enforcement action.
- Are intended to specifically service shareholder debt, protect stock value, or to continue a trend of paying dividends.

There are various arrangements a bank may adopt to avoid complicated recordkeeping for fractional shares. Some acceptable alternatives are detailed in 12 CFR 5.67, Fractional shares, and the OCC has approved alternative means. A bank considering an option not discussed in the regulation should consult with the appropriate director for district licensing.

## Application Process

Certain changes in permanent capital do not require OCC approval or certification, although they are subject to other legal requirements. Such changes include a change in the amount of authorized, but unissued, capital stock; and a stock split or other adjustment that does not change the amount in the common stock account. These changes are effective upon shareholder approval (see Appendix A). Other changes in permanent capital do require OCC approval or notice as follows.

## Prior Approval

The OCC must review and approve certain changes in capital before the transaction can be completed. Once the bank has requested and received prior OCC approval, the bank then notifies the OCC when the change is made and that it complies with legal requirements. Upon receipt of the bank's notification, the OCC will certify or acknowledge the change.

A national bank must obtain the OCC's prior approval for:

- The sale of common or preferred stock for consideration other than cash.
- The receipt of a material<sup>1</sup> noncash contribution to capital surplus.
- The reduction in capital stock or capital surplus through a distribution of cash or assets, or a transfer to undivided profits or to any other noncapital account.
- Acquisition of a bank's own shares to be held as treasury stock. However, shares of the bank's own stock taken to satisfy a debt previously contracted, while accounted for as treasury stock, are not subject to this prior approval procedure. (See 12 USC 83 for specific requirements in this situation.)

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<sup>1</sup> A contribution to capital surplus will be considered material if the fair value of the noncash item represents 3 percent or more of Tier 1 capital prior to the contribution.

- Any change in permanent capital if the bank seeking to make the change is required to receive prior OCC approval pursuant to letter, order, directive, written agreement, or similar communication.
- The planned use of innovative capital instruments if the bank wants such instruments to be considered Tier 1<sup>2</sup> capital.

For changes requiring prior approval, the bank must submit an application to the OCC to change permanent capital. The application must describe the proposed change and explain the reason(s) for it. The OCC will review the change to determine that it:

- Conforms to the terms of any capital adequacy agreement.
- Can be considered capital for regulatory and accounting purposes.
- Complies with laws and regulations.
- Satisfies any related supervisory concerns.

Unless the OCC notifies the bank to the contrary, an eligible bank (see Glossary) may consider a proposed change in capital approved and certified 30 days after the OCC receives the application. The OCC will advise the applicant if any additional steps or information are required to complete the change.

Under 12 USC 51b, the OCC must review the terms of preferred stock concerning dividends, voting and conversion rights, rights to exercise control over management, and retirement of preferred stock. All banks must submit provisions in the Articles of Association about those terms prior to the sale of the preferred stock. A bank may consider the provisions approved by the OCC on the 30<sup>th</sup> day after the day of receipt by the OCC, unless otherwise notified in writing. Any OCC notification will include the reason for the delay.

## Prior Approval Not Required

The following changes in capital do not require the OCC's prior approval. However, these changes do not become effective until the OCC certifies or acknowledges that they comply with legal requirements.

The following changes require the bank to notify the OCC:

- Sale of common or preferred stock for cash.
- Stock issued either in accordance with an Employee Stock Option Plan or as a form of compensation to bank employees (refer to the "Specific Requirements for Increases" discussion for details).
- Conversion of preferred stock to common stock.

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<sup>2</sup> See 12 CFR 3.2 describing the various Tier 1 and Tier 2 components of capital.

- Payment of stock dividends that do not exceed the 12 USC 56 earnings limitations.
- A stock split, other than a reverse stock split, involving a change in the par value of capital stock when the change in the capital stock account is offset by an equal change in the capital surplus account.
- Receiving cash contributions to capital surplus.
- Receiving immaterial noncash contributions to capital surplus (see footnote 1).

Upon receipt of the bank's notice of a permanent capital change, the OCC will review the notice and certify an increase in permanent capital; or if a reduction, it will acknowledge the bank has completed the transaction.

Upon the OCC's certification of a permanent capital increase, a bank may issue shares and reflect the capital on financial statements and the Consolidated Reports of Condition and Income (Call Report).

Changes in capital must be completed within one year of OCC's approval. If the approval time runs out and the transaction is not consummated, the OCC's approval ends automatically. The OCC normally does not grant extensions of time.

## Securities Disclosure Requirements

A national bank offering its securities for sale must comply with 12 CFR 16, Securities Offering Disclosure Rules. Part 16 prohibits the offer or sale of bank securities unless:

- The bank has filed a registration statement with the OCC and the OCC has declared it effective, and the securities have been sold through the use of a prospectus filed as part of that registration statement; or
- The transaction is exempt from the registration statement requirement or qualifies for an abbreviated registration requirement, such as a private placement, for nonconvertible debt, or a limited offering. Banks proposing to offer and sell securities should consult with legal counsel for the appropriate registration requirement or exemption under the Securities Act of 1933 and its rules and regulations.

Under the Securities and Exchange Act of 1934, banks that have securities registered on a national securities exchange, or with more than 500 shareholders, must register those securities with the OCC. Banks with registered securities also must file certain periodic and current reports with the OCC. These reports include, among others, quarterly reports, annual reports, and proxy or information statements for shareholder meetings.

The filing requirements for banks that have securities registered under the Securities and Exchange Act of 1934 are set forth in 12 CFR 11, Securities Exchange Act Disclosure Rules. This regulation incorporates Securities Exchange Commission rules, regulations, and forms, except where otherwise provided.

## Lending Limit Calculation

When a capital transaction results in a change in capital category under 12 USC 1831o, and 12 CFR 6 (prompt corrective action), the OCC will confirm in writing that the bank should begin to calculate its lending limit based on the resulting capital and will note the effective date of such change. In addition, on a case-by-case basis, the OCC can require recalculation of a bank's lending limit when a capital transaction causes a change to capital but does not result in a change in capital category. Further, a bank may request permission from the OCC to recalculate its lending limit when a capital transaction causes a material change to capital but does not result in a change in capital category.

## Specific Requirements for Increases

Shareholders must approve by two-thirds vote any changes to the Articles of Association that increase the amount of authorized, but unissued, common stock. A majority of shareholders must approve other changes to the Articles of Association including authorized, but unissued, preferred stock. Changes to the Articles of Association are not required if the existing articles authorize unissued shares of common or preferred stock.

## Sale of Common Stock for Cash

Generally national banks have only one class of common stock. National banks may not create classes of common stock with different or no voting rights. Federal banking law provides, without exception, that common shareholders are entitled to one vote per share in all matters, except the election of directors for which the common shareholders have cumulative voting rights. If a bank proposes to issue more than one class of common stock, legal, supervisory, and policy issues must be considered. A bank should consult with the OCC prior to issuing more than one class of common stock.

Common stock may be par value stock or no par stock. Banks should consult with the OCC prior to considering a sale of common stock at a price below par value. If the stock is no par stock, the stock may have a stated value so that the bank will have capital surplus and capital stock. Prior to issuing no par common stock, a bank should consider the relationship between capital surplus and restrictions on dividends contained in 12 USC 60 and 12 CFR 5.64. For a more complete explanation of these issues, see Corporate Decision 2003-3 (March 3, 2003).

Once the shares of common stock are sold, the bank must notify the OCC (refer to Notice: Increase in Stock for Cash for details). Upon receipt of the notice, the OCC certifies the increase in outstanding capital if it meets legal requirements (Capital Increase Certification Letter).

## Sale of Preferred Stock for Cash

Generally, the Articles of Association define the terms, rights, privileges, and authorized amount of a bank's preferred stock. Once the sale of the preferred stock is completed, the bank notifies the OCC (refer to Notice: Reduction of Permanent Capital for sample). Upon receipt of the notification, the OCC certifies the increase in preferred stock.

Although cash sales of preferred stock do not require prior OCC approval, 12 USC 51b requires the agency to review terms of preferred stock for dividends, voting and conversion rights, control of management, and retirement. A bank must submit to the director for district licensing, the provisions in the Articles of Association about those terms at least 30 days prior to the sale of the preferred stock (refer to Notice: Preferred Stock Terms for sample).

## Blank Check Preferred Stock

Blank check preferred stock enables banks to respond more quickly to market conditions to meet their capital needs and is consistent with 12 USC 51a and 51b. This flexibility comes from shareholders providing in the Articles of Association an overall authorized amount of preferred stock and delegating to the board the ability to determine the timing and specific terms of one or more series of preferred stock. When the board decides that an opportune time to issue the preferred stock exists, it passes resolutions defining and approving the terms of the preferred stock.

A bank must take several steps to use the blank check preferred stock option. First, under 12 CFR 7.2000(b), the board designates in its bylaws corporate governance procedures that permit blank check preferred stock to be issued. Second, shareholders adopt Articles of Association containing a provision authorizing the board to issue preferred stock using the blank check procedure. The shareholder-approved articles also provide that a board resolution that specifies the exact terms of the preferred stock will be incorporated by reference into the Articles of Association. Third, the articles are filed with the OCC. Fourth, when determined by the board, and before issuing any of the preferred shares, the terms of the sale of the preferred stock are submitted to the OCC for its review. Finally, when issued, the OCC certifies the preferred stock as capital.

## Sale of Capital Stock for Other than Cash

The bank must submit to the OCC an application to change its permanent capital and receive its approval prior to trading or exchanging common or preferred stock for assets. The bank should be prepared to provide documentation supporting the fair value of any asset to be exchanged or traded for its capital stock. Refer to Application: Increase in Capital for Other Than Cash for sample. Also 12 CFR 34.42(g) if a real estate-related transaction.

## Receipt of Cash Contribution

A bank may be the recipient of a capital contribution, typically either from its holding company or controlling owner. The cash contribution is recorded as an increase in the bank's capital surplus account. No shareholder approval is required. The bank should inform the OCC of receipt of the contribution within 10 days of receiving it (refer to Notice: Increase in Stock for Cash). At that time the OCC will authorize inclusion of the contribution as capital.

## Receiving Noncash Contribution

A bank must submit an application for prior OCC approval if it will receive a noncash contribution that has a fair value that represents 3 percent or more of Tier 1



capital prior to the contribution (refer to sample application). The bank must submit documentation that describes the property and valuation method. Also refer to 12 CFR 34.41-34.47 if the property is a real estate-related transaction to determine the market value. The bank also must notify the OCC upon receipt of the property (refer to sample Notice: Noncash Contribution to Surplus).

If the bank's noncash contribution to capital surplus has a fair value of less than 3 percent of Tier 1 capital prior to the contribution, it need not seek prior OCC approval; however, the bank must notify the OCC.

## Specific Requirements for Decreases

A bank must submit to the OCC an application and receive its approval for any reduction in permanent capital that results in a distribution of either cash or assets or a transfer to undivided profits or any other noncapital account. This includes the retirement of outstanding shares or the acquisition of outstanding shares that will be held by the bank as treasury stock. Transfers of so-called "surplus-surplus" into undivided profits for the payment of dividends do not require OCC prior approval, or notification if they meet the earnings criteria of 12 CFR 5.64(c) and if the board of directors of the bank approves the transfer. However, any subsequent dividends must satisfy the requirements of 12 USC 56 and 60.

Under 12 USC 59, shareholders must approve any reduction in permanent capital and related distribution of cash or assets.

The OCC generally approves reductions in permanent capital for banks in satisfactory condition, unless the proposed capital structure is not considered adequate under OCC policies. The OCC will approve applications for capital reductions from eligible banks that contemplate up to four consecutive quarterly distributions. However, approval of such distribution plans is contingent upon the bank maintaining its eligible bank status before and after each decrease.

The OCC may deny, or conditionally approve, any reduction in capital for:

- Failure to comply with a capital plan submitted to the OCC.
- A capital structure that the OCC considers inadequate.
- Use of treasury stock as a means to speculate in the bank's own stock or bypass a requirement or obligation under federal banking laws.
- A violation of laws or regulations.
- Conditions that threaten the safety and soundness of a bank.
- Failure to provide adequate information.

## Reduction in Capital by Distributing Cash or Assets

A bank must submit an application and receive OCC's prior approval to reduce its capital stock or capital surplus through a distribution of cash or assets. When a bank distributes assets in this manner, it must record the assets at fair value. The

OCC has allowed banks to reduce permanent capital through a "return of capital." This accounting method will allow a bank to return excess funds to their shareholders. Moreover, because a return of capital does not constitute a dividend, the reduction will not affect a bank's future dividend paying capacity.

## Reduction in Capital by a Quasi-reorganization

A quasi-reorganization is an accounting procedure that allows a bank to restructure its capital accounts to remove a deficit in undivided profits without undergoing legal reorganization. This procedure allows a bank that has previously suffered losses, but subsequently corrected its problems, to restate its records as if it were reorganized.

The bank can accomplish the restructuring by transferring amounts from capital stock and capital surplus to the undivided profits account to remove the deficit. Upon OCC approval, a quasi-reorganization is recognized as a recapitalization. Following the quasi-reorganization, a bank may pay dividends from future earnings without regard to the prior deficit in undivided profits and the limitation under 12 USC 56.

A quasi-reorganization is available only to banks that meet certain legal and accounting requirements. To satisfy legal requirements, the shareholders must approve by a two-thirds vote the quasi-reorganization and any related reduction in capital stock and capital surplus. The bank must provide shareholders with full disclosure of the material aspects of the proposal, including the appraisal process.<sup>3</sup> In addition, the bank must meet the following accounting requirements:

- The bank's financial records should reflect the fair value of all assets and liabilities based on an appropriate appraisal or evaluation process. The bank should never recognize new intangible assets because of the quasi-reorganization. Further, existing intangible assets should be reviewed for impairment.
- The bank's undivided profits account must be adjusted to a zero balance.
- If the net effect of the fair value adjustments results in decreased capital, the bank must charge this amount to the existing deficit in undivided profits.
- Total capital cannot be increased as the result of a quasi-reorganization. If the fair value adjustments would result in increased capital, the bank must reduce proportionately the fair value of any noncurrent, nonmarketable assets, so that capital is not increased.
- Any resulting deficit in undivided profits should be eliminated against the bank's capital surplus account. If the capital surplus account is not sufficient, the bank should reduce the par value of existing capital stock to increase the surplus account.

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<sup>3</sup> National banks with securities registered under the Securities Exchange Act of 1934 should submit proposed shareholder disclosures to the Securities and Corporate Practices Division for review.

- Following the quasi-reorganization, the bank should be accounted for as a new entity. Anticipated or planned changes in accounting principles should be adopted before, or at the same time with, the quasi-reorganization. The bank must report any unrecognized tax benefits of deductible temporary differences and carry-forwards existing as of the date of the quasi-reorganization as an increase to capital surplus when recognized in subsequent years.
- The effective date of the quasi-reorganization is generally the date upon which the bank receives shareholder approval or OCC approval, if later. However, the bank may use the first day of the quarter in which approval is obtained as the effective date.

To use this procedure, the bank must submit an application and receive the OCC's prior approval. The application must describe how the bank satisfies the various requirements and provide a schedule of the proposed changes in capital, including the fair value adjustments. If the OCC determines that a bank's circumstances warrant a "fresh start" and it satisfies the applicable requirements, the OCC generally will approve the proposal. The bank must notify the OCC of completion of the change.

## Specific Requirements for Other Changes

### Stock Split

Shareholders must approve by a two-thirds vote any increase in authorized, but unissued, shares of stock. No prior OCC approval of a stock split is required, because the dollar amount in the capital stock account does not change. However, once the stock split occurs, the bank must notify the OCC. Upon receipt of the notice, the OCC will certify the increase in the number of shares of stock outstanding in capital stock.

A stock split typically increases the number of shares of stock outstanding and reduces the par value and the market price of the shares. For example, one million shares of \$10 par with a \$12 market price might split 2 for 1. This would result in two million shares of \$5 par with a \$6 market price for the stock. The shareholders must approve by a majority vote an amendment to the Articles of Association to change the par value of the stock.

A stock split also can be affected by declaring a stock dividend. A stock dividend exceeding 20 percent of issued shares is classified as a stock split and accounted for by transferring to permanent capital an amount not less than the par value of the additional shares issued. A stock dividend classified as a stock split is considered a realignment of capital accounts according to generally accepted accounting principles. Consistent with 12 CFR 5.60, it is subject to the restrictions of 12 USC 56, but not 12 USC 60.

### Change in Par Value of Capital Stock

Shareholders must approve any amendment to the Articles of Association to change the par value of capital stock. Par value cannot exceed \$100 and there is no minimum par value. Shareholders also must approve any reduction in the bank's permanent capital by a two-thirds vote as required under 12 USC 59. Upon

completion of the change, the bank must notify the OCC and certify that the change meets legal requirements, providing a copy of any amendment to the Articles. Upon receipt of the notice, the OCC will certify any increase.

## Retirement of Capital Stock

A bank may buy back any portion of its outstanding common stock consistent with 12 USC 59. The bank must receive prior approval from the OCC and a vote of shareholders owning two-thirds of the shares of outstanding common stock. A bank deciding to retire capital stock, or hold it as treasury stock, is cautioned to ensure full and adequate disclosure to shareholders under the federal securities laws, and to consider the interest of remaining shareholders under applicable fiduciary principles. Directors have a fiduciary relationship to their bank and are responsible for certain fiduciary duties. These duties include ensuring that legitimate business reasons exist for entering into the transaction; that any conflict of interest has been minimized appropriately; and that the actions taken are in the best interest of the bank. The value per share offered to individual shareholders is a board decision, and shareholders have a right to reject any offer for purchase of their shares.

## Employee Stock Option Plans

A national bank should account for employee stock compensation in accordance with generally accepted accounting principles (GAAP). The bank should consider the effect of the Statement of Financial Accounting Standards Number 123 (Revised 2004): *Shared-Based Payment* (FAS 123R) in developing and implementing stock benefit plans. (Refer to the Glossary for the definition of employee stock option plan.)

FAS 123R generally requires a company to recognize in its financial statements the cost of employee services received in exchange for stock compensation. The accounting treatment applies regardless of whether the shares awarded to the employee, for services rendered to the bank, are shares of bank stock or shares of the bank's parent holding company. This accounting treatment represents a change from previous guidance under Accounting Principles Board (APB) Number 25: *Accounting for Stock Issued to Employees* that generally resulted in recognition of no compensation cost.

The cost of employee services is based on the grant-date fair value of the stock award. Usually fair value (refer to Glossary for definition) is determined by either observable market value or calculated value based on option-pricing models, such as Black-Scholes. A nonpublic bank's stock with no observable market value may require expert assistance to determine the calculated value of the stock compensation. The compensation cost is recognized usually over the vesting period with a corresponding credit to equity (generally, paid-in capital). Recording the compensation cost also gives rise to deferred tax consequences; that is, a deferred tax asset that must be recognized and evaluated for realizability.

The accounting entries likely will result in an increase in permanent capital with an offsetting decrease to retained earnings. Such an increase requires an after-the-fact notice or an application to the OCC. If the bank is an eligible bank, it may file its notice on a quarterly basis, as it files its call report. The proposed change is deemed approved and certified seven days after the date on which the OCC

receives the notice. If the bank does not qualify for the notice process, it must obtain the OCC's prior approval by filing an application.

In rare instances, the accounting entries may result in a reduction in capital. In that case, the bank must submit an application and obtain the OCC's prior approval before making any reduction to its permanent capital (refer to the Specific Requirements for Decreases section of this booklet for detailed information).

NOTE: Shares held in an employee stock ownership plan (ESOP) are exempt from FAS 123R and should be accounted for in accordance with the American Institute of Certified Public Accountants' Statement of Position No. 93-6, Employers' Accounting for Employee Stock Ownership Plans (SOP 93-6).

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## Acquisition of Treasury Stock

Twelve USC 24(Seventh) and 12 CFR 7.2020 allow banks to acquire and hold treasury stock to fulfill a legitimate corporate need, as long as the repurchase of outstanding shares and consequent reduction in capital complies with 12 USC 59. A bank may not acquire, or hold, treasury stock for speculation.

Examples of legitimate corporate purposes include the acquisition and holding of treasury stock to:

- Have shares available for use in connection with employee stock option, bonus, purchase, or similar plans.
- Sell to a director for the purpose of acquiring qualifying shares.
- Purchase a director's qualifying shares upon cessation of the director's service in that capacity if there is no ready market for the shares.
- Reduce the number of shareholders to qualify as a Subchapter S corporation.
- Reduce costs associated with shareholder communications and meetings.
- Repurchasing bank stock to facilitate a bank's shareholder dividend reinvestment plan.

To acquire and hold treasury stock, the bank must receive prior approval from the OCC and a vote of shareholders owning two-thirds of the outstanding shares of common stock. However, shares of a bank's own stock acquired as a debt previously contracted, while accounted for as treasury stock, are not subject to prior OCC or shareholder approval.

A bank whose securities are not actively traded must disclose in its application to the OCC the method used to establish a price or valuation of the treasury stock. If a bank's board determines that the treasury stock should be repurchased for a consideration that exceeds the fair value, it must provide an opinion as to why the proposed consideration is fair to the bank and minority shareholders.

## Reverse Stock Split

A reverse stock split is a restructuring of ownership interests by which a bank reduces the number of its outstanding shares and, frequently, the number of its shareholders. To reduce the number of shares, a bank exchanges one share of a new stock issuance for a predetermined number of existing shares, and pays cash to shareholders who would have held fractional shares after the exchange.

To effect a reverse stock split, national banks generally complete the following five-step process:

- The bank adopts a corporate governance system that permits reverse stock splits and designates it within its bylaws as permitted by 12 CFR 7.2000(b) and safe and sound banking practices. If adequate protections are provided for dissenting shareholders, a bank may elect to follow corporate governance procedures of the law of the state in which the main office of the bank is located; the law of the state in which the holding company of the bank is incorporated; the Delaware General Corporation Law; or the Model Business Corporation Act. (Refer to section 8.4 of the model Bylaws.)
- The bank sets an exchange ratio for the transaction and obtains shareholder approval for the proposal. The holders of two-thirds of the bank's outstanding shares must vote in favor of the change.
- The bank reduces the par value of its outstanding shares so it does not exceed the \$100 statutory maximum par value at any time.
- The bank effects the reverse stock split at the established ratio and pays cash for fractional shares.
- Upon completion, the bank's capital accounts change only by the amount paid to fractional shareholders.

A bank must submit an application and obtain the OCC's approval prior to completing a reverse stock split. A bank must provide a legitimate business purpose for the transaction; offer sufficient dissenting shareholder's rights; and pay the cash equivalent of the fractional shares of stock repurchased consistent with 12 CFR 7.2023.

The OCC has approved reverse stock splits conducted under the corporate governance procedures of the following states: Alabama, Arkansas, California, Colorado, Delaware, Iowa, Kansas, Kentucky, Michigan, Minnesota, Mississippi, Missouri, New Mexico, New York, Oklahoma, Pennsylvania, and Texas. This booklet will be updated as other states are added.

## Innovative Capital Instruments Included in Tier 1 Capital

In addition to capital instruments a bank may issue directly, certain minority interests in the equity accounts of its consolidated subsidiaries are eligible for inclusion in Tier 1 capital. A number of banks have established subsidiaries with the sole purpose of raising additional Tier 1 capital. The minority interest results from the issuance of noncumulative, perpetual preferred stock by the subsidiary of the bank to outside investors or an affiliated company.

To qualify as Tier 1 capital, the instrument issued by the subsidiary must meet the same criteria as an instrument issued directly by a bank. These types of instruments are generally considered "innovative capital instruments." The OCC has approved two different types of innovative capital instruments that are eligible as Tier 1 capital; (1) preferred stock issued by its Real Estate Investment Trust (REIT) subsidiary, and (2) noncumulative, perpetual trust preferred stock issued by a subsidiary to investors. The OCC does not certify these instruments as permanent capital.

### **REIT Structure**

In Corporate Decision 97-109, the OCC determined that the minority interest resulting from the preferred stock issued by a REIT subsidiary of a national bank would be eligible for inclusion in Tier 1 capital of the bank, up to a limit of 25 percent of Tier 1 capital. REITs are tax-advantaged companies that invest in real estate assets. The dividends paid to shareholders by the REIT are taxable to the shareholders but the REIT itself does not pay taxes on its income if the assets and income are primarily real estate related, and it pays out at least 90 percent of its taxable income to shareholders.

National banks are permitted to establish REITs as long as the REIT only invests in bank eligible assets. Although in most cases, well-capitalized banks do not need prior OCC approval to establish a REIT, prior OCC approval of the capital instrument's inclusion in Tier 1 capital is required. Banks considering such a capital instrument should consult with the director for district licensing to ensure that the proposed REIT preferred securities qualify for inclusion as Tier 1 capital.

### **Trust Preferred Structure**

In Interpretative Letter No. 894, the OCC approved a structure whereby a subsidiary of the bank issued noncumulative, perpetual preferred stock to investors. The proceeds from the issuance were lent to the bank in the form of a 30-year subordinated debenture. Upon redemption of the subordinated debenture, the subsidiary will invest the proceeds in earning assets. This structure is very similar to trust preferred securities often issued by bank holding companies and included in Tier 1 capital of the holding company. However, the structure approved by the OCC has two features that differ from typical bank holding company trust preferred.

The OCC-approved security is noncumulative and perpetual—the proceeds are reinvested upon the redemption of the underlying subordinated debt—while bank holding company trust preferred issues are usually cumulative and have an effective term of 30 years. Banks must receive prior OCC approval before it can consider as Tier 1 capital the preferred stock described in Interpretative Letter 894. The

minority interest in the subsidiary is eligible for inclusion in Tier 1 capital up to a limit of 15 percent of Tier 1 capital.

### **Requirements for REIT and Trust Preferred Structure**

In both the REIT and trust preferred structures, the instrument the subsidiary issues must be exchangeable automatically into noncumulative perpetual preferred stock of the bank in the event that the OCC directs the bank in writing to make a conversion because the bank is:

- Undercapitalized under the prompt corrective action regulations, 12 CFR 6.4(b);
- Placed into conservatorship or receivership; or
- Expected to become undercapitalized in the near term.

Shareholder approval generally is required for a bank's subsidiary to issue preferred stock. If a bank does not have sufficient preferred shares authorized for such an exchange, shareholder approval is required to amend the Articles of Association to authorize preferred shares. OCC policy is to require the amendment prior to issuance of the innovative instrument.

The dividends paid by the subsidiary are treated as bank dividends for purposes of 12 USC 60, 12 CFR 5.63(b), and the safety and soundness protections provided by the prompt corrective action statute pursuant to 12 USC 1831o and 12 CFR 6. Before the subsidiary declares a dividend, the bank should confirm that payment of such a dividend is permissible. The bank should determine that it has sufficient dividend capacity under 12 USC 60(b) and undivided profits to cover the dividend. If the total of a bank's retained net income from the prior two years plus earnings for the current year is less than the planned dividend on the innovative instrument, the bank must seek the OCC's approval under 12 USC 60(b) before the subsidiary can declare and pay the dividend. Similarly, if the planned subsidiary dividend is greater than the bank's undivided profits, the dividend would be considered a reduction in capital for which the bank must comply with 12 USC 59 (refer to the Dividends section of this booklet).

Each of the two types of eligible innovative instruments may be included in Tier 1 capital up to the specified limit, and the total amount of innovative instruments that may be included in Tier 1 capital is limited to 25 percent of Tier 1 capital, including the eligible innovative instrument(s). A bank may include the proceeds from the issuance of innovative instruments that exceed the Tier 1 limit in Tier 2 capital (subject to limits on "lower" Tier 2 capital).<sup>4</sup> The OCC does not certify these instruments as permanent capital. Any dividends paid on such innovative instruments included in Tier 2 are subject to the same dividend treatment as described above.

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<sup>4</sup> Lower Tier 2 includes term subordinated debt and limited life preferred stock and is limited to a maximum of 50 percent of Tier 1 capital. (Section 2(b)(4) of Appendix A of 12 CFR 3.)



## Hybrid Capital Instruments Included in Tier 2 Capital

Hybrid capital instruments have features of both equity and debt instruments. To be eligible for inclusion in Tier 2 capital, a hybrid instrument must be unsecured, subordinated to the claims of depositors and general creditors, and fully paid-up. The instrument may be redeemable prior to maturity at the option of the investor only on the condition that prior OCC approval is required for such redemption. The proceeds must be available to the bank to cover losses, that is, the instrument must automatically convert to common stock or perpetual preferred stock of the bank if the sum of the retained earnings and capital surplus of the bank fall below zero. Finally, the bank must be able to defer principal and interest payments in the event that the bank does not report a net profit for the most recent four quarters and has eliminated cash dividends on common and preferred stock. As with other nontraditional capital instruments, a bank should consult the director for district licensing prior to issuing a hybrid capital instrument to ensure Tier 2 capital eligibility.

### Dividends

The OCC's prior approval must be obtained for:

- Dividends paid in something other than cash (that is, dividends-in-kind).
- Dividends that exceed the limitations established by 12 USC 60.

No dividend may be declared from permanent capital unless the bank follows procedures for decreasing permanent capital. Any payment, described as a dividend or otherwise, by a bank that results in a reduction of its permanent capital requires the OCC's prior approval as a reduction of capital under 12 USC 59 and 12 CFR 5.46. A bank may obtain prior OCC approval to reduce permanent capital or pay dividends in advance of the period(s) in which the capital reduction or dividend would occur. Notwithstanding any such approval, a bank is prohibited from reducing permanent capital or declaring or paying a dividend if, following the action, it would become an undercapitalized institution as defined in 12 CFR 6.4. (Refer to the sample dividend documents before filing.)

### Stock Dividends

A stock dividend is an issuance of shares of stock that reflect the current owners' share of accumulated earnings. Stock dividends (other than stock splits in the form of a dividend) are accounted for by transferring an amount equal to the fair value of the additional shares issued from undivided profits to a category of permanent capital (capital stock and capital surplus). The amount transferred from undivided profits shall be no less than the par value of the additional shares being issued. After a stock dividend, undivided profits must be zero or greater. Stock dividends are subject to 12 USC 56, but not 12 USC 60.

Fractional shares sometimes arise together with stock dividends, stock splits, reverse stock splits, and other transactions. Methods for dealing with fractional shares are described in 12 CFR 5.67 and 12 CFR 7.2023.

Shareholders must approve by a two-thirds vote any necessary increase in authorized, but unissued shares. Upon payment of the dividend, the bank must notify the OCC attesting that the change meets legal requirements. Upon receipt of the notification, the OCC certifies the increase in capital.

## Dividends-In-Kind

With prior OCC approval, a bank may declare dividends payable in property or in a form other than cash (together "property"), not including stock dividends. Dividends-in-kind are subject to OCC approval regardless of whether they are paid on common or preferred stock. Before the dividend is declared, the property must be written up or down to reflect its current fair value. The bank should record any write-up or write-down in the income statement as if the bank had disposed of the property through a sale. The dividend is recorded at an amount equal to the current fair value of the property and reduces undivided profits by that amount. The bank may need to use an independent appraisal to substantiate the value of the property. A bank seeking to declare dividends-in-kind must submit an application to the appropriate Licensing office. (See Appendix B for a summary of requirements.)

## Dividends Exceeding the Limits of 12 USC 60

Under 12 USC 60, a national bank must obtain prior OCC approval from the appropriate supervisory office to declare a dividend if the total of all dividends (common and preferred), including the proposed dividend, declared by a bank in any calendar year will exceed its net retained income of that year to date plus the retained net income of the preceding two calendar years.

A bank that declares a dividend in excess of its current year net income may attribute dividends in excess of the current year's net income to each of the prior two years, *to the extent that there is sufficient undistributed net income in those years*. The bank must attribute the excess first to the earlier of the two years and then to the immediately preceding year.

If the dividend in any year exceeds the bank's net income for that year plus the previously undistributed net income of the preceding two years, the bank would carry forward a negative amount to compute its dividend paying capacity in future years. This situation would arise only if the amount of the dividend exceeds the limitation in 12 USC 60, and, therefore, would require prior OCC approval. In determining any such request for approval, the OCC's appropriate supervisory office could consider any request for different treatment of the excess dividend amount, including advance waivers for future periods. Also, this attribution method applies only to the treatment of earning deficits that result from dividends declared in excess of a single year's earnings and not to other types of current earnings deficits. See Interpretive Letter No. 816.

Notwithstanding the permissibility of any particular dividend payment under 12 USC 56 and 12 USC 60, national banks are subject to the safety and soundness protections provided by the prompt corrective action statute. Accordingly, under prompt corrective action [12 USC 1831o(d)(1)(A); 12 CFR 5.65], a national bank may not pay a dividend if the bank would be undercapitalized after the dividend payment is made.

An eligible bank may request advance approval to cover several anticipated dividend payments, provided that the bank projects sufficient current net income during those periods to support the amount of the dividends declared. In determining whether to grant advance approval, the supervisory office will consider:

- The reasonableness of the bank's request, including its historical dividend payout ratio and projected dividend payments.
  - The bank's historical trends and current projections for capital growth through earnings retention.
  - The overall condition of the institution, with particular emphasis on current and projected capital adequacy.
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- The reason(s) for which the bank became subject to the restrictions of 12 USC 60(b).
  - Any other information that the supervisory office deems pertinent to reviewing the bank's request.

After considering these standards, the OCC may grant prior approval for a bank's dividend request in advance of the period(s) in which the dividend(s) will be declared. Notwithstanding any such approval, a bank may not declare or pay a dividend if, after making the dividend payment, the bank would be "undercapitalized" as defined in 12 CFR 6.4(b)(3).

## Procedures: Filing the Application

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### Licensing Staff

1. Refers a bank that requests filing instructions to the "General Policies and Procedures" booklet, sample corporate documents to the "Charters" booklet, and capital and dividend information to this booklet of the *Comptroller's Licensing Manual*. Generally, a bank needs only to submit a notice to increase its permanent capital. Prior approval is required if: the OCC requires a bank to obtain prior approval; the bank plans to sell common or preferred stock for consideration other than cash; it will receive a material noncash contribution; or it will decrease capital stock or capital surplus through a distribution of cash or assets, or a transfer to undivided profits or to any other noncapital account.

Applications to pay cash dividends pursuant to 12 USC 60(b) and 12 CFR 5.64 are filed with the appropriate supervisory office, which will acknowledge and act on the filing. All other applications and notices are filed with the appropriate director for district licensing.

### Bank

2. Submits a complete application (see sample) and filing fee to the director for district licensing at the appropriate district office.

If reducing permanent capital, submits information about the planned method of reduction (that is, quasi-reorganization, treasury stock, reverse stock split, dividends-in-kind); and

- For treasury stock, provides the business purpose for the capital reduction.
- For all transactions involving the repurchase of equity securities, provides the method of valuation used to determine fair value.
- For transfer of assets other than cash, provides the method of valuation.
- For transactions involving the distribution of an entire legal entity or business, contacts the appropriate district accountant for guidance.
- For reverse stock splits,
  - Within its bylaws, the bank adopts a corporate governance system that permits reverse stock splits. Cites the authority to conduct reverse stock splits under state law and dissenters rights for shareholders.
  - The bank sets an exchange ratio for the transaction and obtains shareholder approval for the proposal. The holders of two-thirds of the bank's outstanding shares must vote in favor of the change.

- The bank reduces the par value of its outstanding shares so it does not exceed the \$100 statutory maximum par value at any time.
  - The bank effects the reverse stock split at the established ratio and pays cash for fractional shares.
  - Upon completion, the bank's capital accounts change only by the amount paid to fractional shareholders.
3. If the bank is subject to 12 CFR 11 and the change requires shareholders' approval, submits preliminary proxy materials or information statement to Securities and Corporate Practices Division (SCP), Washington, DC, for review and clearance.
  4. Before commencing the sale of securities, prepares and files with SCP a registration statement or other document that may be required under 12 CFR 16. *NOTE: SCP will send the bank a letter of effectiveness or a comment letter detailing deficiencies in the registration statement or its amendment. SCP will notify the district licensing staff of the action.*
  5. If issuing preferred stock, submits information to the director for district licensing about the preferred stock's dividends, voting and conversion rights, retirement terms, and rights to exercise control over management. This information must be submitted 30 days prior to issuance.

## Review

### Licensing Staff

6. Sends an e-mail to notify the appropriate assistant deputy comptroller (ADC) and ADC analyst or large bank examiner-in-charge (EIC) of receipt of the application. Sends SCP a copy of the bank's corporate governance legal opinion (analysis) if it elects procedures from a state not previously approved (refer to Reverse Stock Split section of this booklet for listing of approved states).
7. Initiates and enters required information into the Corporate Activities Information System (CAIS).
8. Establishes the official file to maintain all original documents.
9. If a filing fee is submitted, forwards it and the deposit memorandum (Form 6043-01) to the Comptroller of the Currency, Attention: Accounts Receivable, 250 E Street, S.W., MS 4-8, Washington, DC 20219. Retains a copy of the memorandum. Contacts the bank if the filing fee is not received or is inaccurate.
10. Within five business days of receipt:
  - Reviews the application and other relevant information about the bank to determine whether the application contains a detailed description of the change, all information required in the sample application, and the

required enclosures. For a capital reduction, reviews the proposed terms, verifying that no reasons exist to object to the terms.

- With the issuance of preferred stock, verifies that no reason exists to object by reviewing sample Articles of Association within the "Charters" booklet for appropriate terms.
- If a reverse stock split is proposed, considers whether the national bank:
  - Will perform each step of the reverse stock split process in compliance with legal requirements governing its capital structure.
  - Has adopted corporate governance provisions that authorize reverse stock splits under 12 CFR 7.2000(b) and if those provisions are in a state previously approved (refer to Reverse Stock Split section for listing).
  - Has a legitimate corporate purpose for undertaking the reverse stock split.
  - Has provided to its shareholders adequate dissenters' rights.

11. Solicits comments from the ADC and ADC analyst or large bank EIC and from other OCC divisions (supervisory, compliance, economic, accounting), as appropriate, with a preliminary response required within 15 days after receipt. For undercapitalized banks, contacts the supervisory office staff for capital plan status.

- If the transaction involves the distribution of an entire legal entity or business, sends a copy of the bank's financials to the district accountant to ensure compliance with generally accepted accounting principles (GAAP).
- If a legal question is identified or a legal opinion submitted, forwards the question and application to the district counsel with a preliminary response required within 15 days after receipt.
- Verify whether or not SCP reviewed securities disclosures and any analysis discussing corporate governance provisions. Refer to Step 6.
- If the filing contains all the information needed to reach a decision, sends the bank an acknowledgment letter or an e-mail providing the target date for decision and the CAIS Control Number.
- If additional information is needed, requests the missing information from the bank, specifying a response date (sample letter). Also determines if the bank is eligible for expedited review and informs the bank whether the 30-day automatic approval date remains in effect.

12. If at any time the application presents significant policy, legal, or supervisory issues, contacts Headquarters Licensing (HQ LIC) to decide:

- If the application should be forwarded to HQ LIC for processing, or

- If specific issues should be carved out for Washington action, while the application continues to be processed in the appropriate district office.

## Decision

### Licensing Staff

13. For a bank that is eligible for expedited review, verifies before expiration of the 30-day processing period, that no reasons exist to disqualify the bank from expedited review.
  - If the bank remains qualified, proceeds to the next step.
  - If the bank is disqualified, immediately notifies the bank that it no longer qualifies for expedited review, identifies the specific reason(s), and requests any necessary information from the bank, specifying a response date.
14. Prepares the confidential memorandum and decision letter, recommending a decision to the delegated official.
15. Decides the application under delegated authority or forwards the official file to HQ LIC for decision. If referred to HQ LIC, go to step 21.
16. Notifies bank and, if appropriate, any interested parties. Sends the bank the decision letter and a satisfaction survey.
17. Notifies the appropriate ADC and ADC analyst or large bank EIC of the decision by forwarding updated CAIS comments and an electronic copy of the decision letter.
18. If the decision is either a denial or conditional approval, forwards a copy of the confidential memorandum, decision letter to the director, licensing activities.
19. Makes appropriate CAIS entries.
20. When the change requires the bank to file information with SCP, under 12 CFR 11 and 16, sends a copy of the approval letter to SCP.
21. If the application is denied, goes to step 34.

### HQ LIC

22. Makes appropriate CAIS entries.
23. Reviews the file, draft decision documents, and all relevant information; solicits comments from other OCC divisions as appropriate; makes a recommendation; and forwards the official file to the appropriate official for decision.
24. Once decided, notifies the bank. Notifies the appropriate ADC and ADC analyst or large bank EIC of the decision by forwarding updated CAIS comments and an electronic copy of the decision letter.

25. Sends the bank the decision letter and, if appropriate, a satisfaction survey and notifies any interested parties.
26. If the decision is either denial or conditional approval, forwards a copy of the confidential memorandum and decision letter to the director, licensing activities.
27. Sends a copy of the decision letter to SCP, if the change requires the bank to file with SCP under 12 CFR 16.
28. Makes appropriate CAIS entries.
29. If either approved or conditionally approved, returns the official file to the appropriate district office. If denied, goes to step 34.

## **Shareholders' Approval**

### **Bank**

30. If required, obtains shareholders' approval of the change in capital.
31. Amends the Articles of Association, if necessary, and executes the secretary's certificate.
32. Files amended Articles of Association with appropriate director for district licensing (refer to Instructions and Articles for guidance).
33. Notifies OCC when capital change occurs (see sample Notice).

## **Close Out**

### **Licensing Staff or HQ LIC**

34. Reviews Articles of Association (if amended), secretary's certification, and notice of capital change completion. Reviews the file for completeness and forwards it to Central Records.
35. Makes appropriate CAIS entries.



## Procedures: Notice

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### Licensing Staff

1. Refers a bank that requests instructions to the "General Policies and Procedures" booklet and this booklet of the *Comptroller's Licensing Manual*.

### Bank

2. If required, obtains shareholders' approval of the change in capital.
3. Amends the Articles of Association, if necessary, and executes the secretary's certificate. Files amended Articles with appropriate director for district licensing.
4. If the bank is subject to 12 CFR 11 and the change requires shareholders' approval, submits preliminary proxy materials or information statement to Securities and Corporate Practices Division (SCP), Washington, DC, for review and clearance.
5. Before commencing the sale of securities, prepares and files with SCP a registration statement or other document that may be required under 12 CFR 16. *NOTE: SCP will send the bank a letter of effectiveness or a comment letter detailing deficiencies in the registration statement or its amendment. SCP will notify the district licensing staff of the action.*
6. If issuing preferred stock, submits information to the director for district licensing about the preferred stock's dividends, voting and conversion rights, retirement terms, and rights to exercise control over management. This information must be submitted 30 days prior to the stock's issuance.
7. Notice of Completed Changes. Using the specific notice applicable to the particular type of change, sends a letter to the director for district licensing providing the amount and effective date of the change in capital, along with amended Articles of Association (if applicable). Refer to the appropriate sample Notice for specific filing requirements.
8. Considers an increase in capital approved and certified seven days after the day on which the OCC receives the Notice.

### Licensing Staff

9. Reviews the bank's Notice; and when prior approval was granted, reviews the official file to determine that all required actions have occurred.
10. Notifies the bank by telephone, and e-mail or letter, if necessary, of any problems.
11. Notifies the bank by telephone, e-mail, or letter (certification or acknowledgment) of the date the OCC received the Notice.

12. Notifies the appropriate assistant deputy comptroller (ADC) and ADC analyst if the bank's capital category changed.

## **Close Out**

### Licensing Staff

13. Makes appropriate CAIS entries.
  14. Reviews the file for completeness and forwards it to Central Records.
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## Appendix A: Changes in Capital

	Prior Approval Required	Notice Only	Shareholder Approval Required	Expedited Review	Law(s)	Regulation(s)
Sale of common stock for cash or issued for employee stock ownership plan	no	yes	Two-thirds*	yes	12 USC 51a 12 USC 51b 12 USC 57	12 CFR 5.46(i)(3)
Sale of preferred stock for cash or issued for employee stock ownership plan <sup>1</sup>	no	yes	Majority**	yes	12 USC 51a 12 USC 51b	12 CFR 5.46(i)(3)
Sale common stock for other than cash	yes	na	Two-thirds*	yes	12 USC 57	12 CFR 5.46(g)(1)(i)(B)
Sale of preferred stock for other than cash	yes	na	Majority **	yes	12 USC 51a	12 CFR 5.46(g)(1)(i)(B)
Receiving material (3% or more) noncash contribution to capital surplus	yes	na	Two-thirds*	yes	12 USC 57	12 CFR 5.46(g)(1)(i)(C)
Receiving nonmaterial (less than 3%) noncash contribution to capital surplus	no	yes	Two-thirds*	na	12 USC 57	12 CFR 5.46(g)(1)(i)(C)
Receiving cash contribution to surplus	No	Yes	No	na		12 CFR 5.46(i)(3)
Acquire treasury stock	yes	na	Two-thirds	yes	12 USC 24(7) 12 USC 59	12 CFR 5.46(h) 12 CFR 7.2020
Change to permanent capital if under any form of agreement with OCC	yes	na	Yes	no	12 USC 57 12 USC 59	12 CFR 5.46(g)(1)(i)(A) 12 CFR 5.46(h)
Change par value when offset by an equal change in the surplus account	no	yes	Majority	yes	12 USC 52	12 CFR 5.46(i)(3)
Reduction in capital stock or capital surplus	yes	na	Two-thirds	yes	12 USC 59	12 CFR 5.46(h)
Change amount of authorized but unissued capital stock <sup>2</sup>	no	no	Two-thirds	na	12 USC 57	
Stock split or other adjustment that does not change amount in common stock account	no	no	Two-thirds	na	12 USC 21a	
Quasi-reorganization <sup>3</sup>	yes	na	Two-thirds	yes	12 USC 56 12 USC 59	12 CFR 5.47
Reverse stock split	yes	na	Two-thirds	yes	12 USC 52 12 USC 215	12 CFR 7.2000(b) 12 CFR 7.2023(b)

<sup>1</sup>In the case of the sale of preferred stock, the national bank shall also submit provisions in the Articles of Association concerning preferred stock dividends, voting and conversion rights, retirement of the stock, and rights to exercise control over management to the appropriate district office prior to the sale of the preferred stock. The provisions will be deemed approved by the OCC within 30 days of its receipt, unless the OCC notifies the applicant otherwise.

<sup>2</sup>A national bank need not obtain prior OCC approval to increase its permanent capital unless the bank is:

- Required by OCC to receive prior approval.
- Selling common or preferred for consideration other than cash.
- Receiving a material noncash contribution.

<sup>3</sup>A quasi-reorganization allows a bank to restructure its capital accounts without legal reorganization by transferring amounts from capital stock and surplus to the undivided profits account to remove a deficit. It is available to banks that meet legal and accounting requirements.

\*Two-thirds approval is needed if the shares have not been authorized previously.

\*\* A majority approval is needed if the shares have not been authorized previously.

## Appendix B: Payment of Dividends

	Prior OCC Approval Required	Notice Only	Shareholder Approval Required	Expedited Review	Law(s)	Regulation(s)
Dividend-in-kind <sup>1</sup>	yes	na	no	yes	12 USC 56 12 USC 60	12 CFR 5.63 12 CFR 5.66
Dividend in excess of 12 USC 56 and 60	yes	na	no	yes	12 USC 56 12 USC 60	12 CFR 5.63 12 CFR 5.64 12 CFR 5.65
Stock dividend	no	yes	Two-thirds*	yes	12 USC 57 12 USC 60	12 CFR 5.66 12 CFR 5.67
Earnings limitations <sup>2</sup>	no <sup>2</sup>	no	no	na	12 USC 60	12 CFR 5.64
Undercapitalized institutions <sup>3</sup>	n/a	na	n/a	na	12 USC 1831o(d)	12 CFR 5.65
Fractional shares	no	na	Two-thirds*	na	12 USC 56	12 CFR 5.67 12 CFR 7.2023
Transfer from surplus surplus	no <sup>4</sup>	na	na	na	12 USC 56 12 USC 60	12 CFR 5.64(c)
Transfer from surplus surplus not meeting the criteria in 5.64(c)	yes	na	Two-thirds	yes	12 USC 56 12 USC 60	12 CFR 5.64(c)
Issue a nondividend dividend <sup>5</sup>	no	na	Two-thirds*	yes	12 USC 60	12 CFR 5.67

<sup>1</sup>Assets must be written up or down to reflect current fair value.

<sup>2</sup>Yes, if capital surplus is less than capital stock of the bank, except when the bank has:

- In the case of ANNUAL dividends transferred 10 percent of its net income for the preceding four quarters to capital surplus, or
- In the case of QUARTERLY or SEMIANNUAL dividends transferred 10 percent of its net income for the preceding two quarters to capital surplus.

<sup>3</sup>A national bank may NOT declare or pay any dividend if, after making the dividend, the national bank would be undercapitalized (12 CFR 5.65).

<sup>4</sup>For the payment of dividends provided: 1) the bank can demonstrate that the surplus came from earnings of prior periods, EXCLUDING the effect of any stock dividend, and 2) the board of directors approves the transfer of the surplus from capital surplus to undivided profits.

<sup>5</sup>A nondividend dividend occurs when a bank pays a dividend (within the limitations of 12 USC 56 and 60) to its parent holding company to acquire another bank entity that will be merged ultimately with the original bank.

\*Needed if shares have not been authorized previously.

## Glossary

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**Blank check preferred stock** is preferred stock where the shareholders approve Articles of Association that grant the board of directors' authority to establish specific terms of the preferred stock rather than providing the specific terms in the Articles of Association.

**Capital plan** means a plan describing the manner and schedule by which a bank will attain specified capital levels or ratios filed with the OCC under 12 CFR 3.7 or a capital restoration plan filed with the OCC under 12 USC 1831o and 12 CFR 6.5.

**Capital stock** means common and preferred stock.

**Capital surplus** means the total of:

- The amount paid in on capital stock in excess of the par or stated value.
- Direct capital contributions representing the amount paid in other than capital stock.
- Amounts transferred from undivided profits as a result of stock dividends.
- Amounts transferred from undivided profits required by 12 USC 60.

**Cash dividends** are payments of cash to stockholders in proportion to the number of shares they own.

**Dividend-in-kind**, also known as property dividend, means a distribution to stockholders paid in something other than cash.

An **eligible bank** is a national bank that:

- Has a composite CAMELS rating of 1 or 2.
- Has an "outstanding" or "satisfactory" Community Reinvestment Act (CRA) rating. (This factor does not apply to an uninsured bank or branch, or a special purpose bank covered by 12 CFR 25.11(c)(3).)
- Is well capitalized as defined in 12 CFR 6.4(b)(1).
- Is not subject to a cease and desist order, consent order, formal written agreement, or prompt corrective action directive or, if subject to any such order, agreement or directive, is informed in writing by the OCC that the bank still may be treated as an "eligible bank."

**Employee Stock Option Plans** are contracts between a company and its employees that give employees the right to buy a specific number of the company's shares at a fixed price within a certain period of time. Employee Stock Option Plans should not be confused with "ESOPs," or Employee Stock Ownership Plans, which are retirement plans.

**Employee Stock Ownership Plans (ESOPs)** is a retirement plan in which the company contributes its stock to the plan for the benefit of the company's employees. With an ESOP, you never buy or hold the stock directly. This type of plan should not be confused with employee stock option plans (see above), which are not retirement plans.

**Expedited review** means that an application to change permanent capital from an eligible bank is approved by the OCC 30 days after the receipt date, unless the bank is notified within the 30-day period that the application is not eligible for expedited processing.

**Fair value** is the amount at which an asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, other than in a forced or liquidation sale.

**Legal lending limit** means the limit on the aggregate amount of credit that a bank can extend to a single customer or a group of affiliated customers. The limit is a function of the bank's capital structure.

**Market value** means the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Refer to 12 CFR 34.42(g) for additional discussion.

**Permanent capital** means the sum of capital stock and capital surplus. See 12 CFR 5.46(4) and 12 CFR 5.61.

**Retained net income** means the net income of a specified period less the total amount of all dividends declared in that period.

**Stock dividends** are distributions of additional shares to stockholders in proportion to the number of shares they own.

**Tier 1 and Tier 2 Capital** are defined in 12 CFR 3.2, Components of Capital.

## References

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<b>Approval by Comptroller—Capital Regulation</b>	12 CFR 5.46
<b>Approval by Comptroller—Dividends Regulation</b>	12 CFR 5.60-5.67
<b>Articles of Association Law</b>	12 USC 21a
<b>Assessment – Capital Stock Deficiency Law</b>	12 USC 55
<b>Blank Check Preferred Stock Issuance</b>	Interpretive Letter 921
<b>Capital Category Law Regulation Issuances</b>	12 USC 1831o 12 CFR 6 Interpretive Letter 894 Bank Accounting Advisory Series
<b>Capital Requirements and Minimum Ratios Regulation</b>	12 CFR 3
<b>Capital Stock Deficiency Law</b>	12 USC 55
<b>Capital Stock—Par Value Law</b>	12 USC 52
<b>Capital Stock—Paid In Law</b>	12 USC 53
<b>Changes in Permanent Capital Regulation</b>	12 CFR 5.46
<b>Corporate Governance Regulation</b>	12 CFR 7.2000
<b>Decrease in Capital Law</b>	12 USC 59
<b>Dividends—Capital Limit Law Regulation</b>	12 USC 56 12 CFR 5.63
<b>Dividends—Earnings Limit Law Regulation Issuance</b>	12 USC 60 12 CFR 5.64 OCC Bulletin 94-41

<b>Dividends-In-Kind</b>	Interpretative Letter 816
Regulation	12 CFR 5.66
<b>Dividends—Undercapitalized Banks</b>	
Regulation	12 CFR 5.65
<b>Fractional Shares</b>	
Regulations	12 CFR 5.67, 7.2023
<b>Hybrid Capital Instruments</b>	
Regulation	12 CFR Part 3, App. A, Sec. 2(b)(3)
Issuance	Interpretative Letter 894 Corporate Decision 87-109
<b>Impairment</b>	
Laws	12 USC 51b-1, 56
<b>Increase in Capital</b>	
Law	12 USC 57
<b>Legal Lending Limit Calculation</b>	
Law	12 USC 84
Regulation	12 CFR 3, 6, 32
<b>Market Value</b>	
Regulation	12 CFR 34.42(g)
<b>Offering Circular</b>	
Regulation	12 CFR 16
<b>Par Value</b>	
Law	12 USC 52
<b>Preemptive Rights</b>	
Regulation	12 CFR 7.2021
<b>Preferred Stock</b>	
Laws	12 USC 51a, 51b
Regulation	12 CFR 5.46
Issuance	Interpretive Letter 894
<b>Prompt Corrective Action</b>	
Law	12 USC 1831o
Regulation	12 CFR 6
<b>Proxy Materials, Rules</b>	
Regulation	12 CFR 11
<b>Quasi-reorganization</b>	
Issuance	Bank Accounting Advisory Series (Topic 8C)



<b>Reduction in Capital</b>	
Law	12 USC 59
Regulation	12 CFR 5.46
<b>Reverse Stock Split</b>	
Regulation	12 CFR 7.2023
<b>Risk-based Capital</b>	
Regulation	12 CFR 3 Appendices A and B
<b>Securities Offering Disclosures Rules</b>	
Regulation	12 CFR 16
<b>Shareholder Approval</b>	
Law	12 USC 21a, 51a, 57, 59
<b>Stock Dividend</b>	
Law	12 USC 57
Regulation	12 CFR 5.66, 5.67
<b>Tier 1 and 2 Capital</b>	
Regulation	12 CFR 3, Appendix A, Section 2(a), (b)
<b>Treasury Stock</b>	
Regulation	12 CFR 7.2020