Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

December 22, 1997

Interpretive Letter #816
January 1998
12 U.S.C. 60

Dear [ ]:

This letter replies to your request earlier this year concerning how the OCC determines a bank's dividend paying capacity under 12 U.S.C. § 60(b). Section 60(b) limits the amount of dividends a national bank may pay in any calendar year without obtaining OCC approval. You suggested that § 60(b) should be interpreted in a way that avoids the requirement that a national bank create an earnings deficit when a dividend is declared in excess of current net income. For the reasons explained in this letter, we conclude that neither § 60(b) nor the OCC's implementing regulations require a national bank to carry forward negative amounts that result from dividends in excess of a single year's earnings.[1] Instead, the bank may attribute such excess dividends to each of the prior two years, attributing the excess first to the earlier of the two years and then to the immediately preceding year.

Statutory Background

Twelve U.S.C. § 60(b) provides:

> The approval of the Comptroller of the Currency shall be required if the total of all dividends declared by such association in any calendar year shall exceed the total of its net income of that year combined with its retained net income of the preceding two years, less any required transfers to surplus or a fund for the retirement of any preferred stock.

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[1]This opinion addresses only the treatment of earning deficits that result from dividends declared in excess of a single year's earnings and does not apply to other types of current earnings deficits.

Thus, the total amount of dividends that a bank may declare in any one year is limited to the sum of the net income of the current year plus the retained net income of the prior two years.[2]

Discussion

In instances where a bank declares dividends in excess of its current year net income, the OCC's practice has been to require the bank to carry a negative amount in retained net income for determining future dividend paying capacity. You propose an alternate method to this calculation under which a bank would not carry forward a negative amount in retained net income; instead, the portion of the dividend in excess of the net income of the current year would be attributed to prior periods, as the statute contemplates.

Section 60(b) establishes a three-year window, or reference period, by which a national bank is to gauge the permissibility of a dividend payment without prior OCC approval. Neither the plain language of § 60(b) nor the OCC's implementing regulations requires the carry-forward of *negative* retained net income, a concept that is, as your letter points out, at odds with both general corporate law and generally accepted accounting principles (GAAP). Accordingly, pursuant to § 60(b) and 12 C.F.R. § 5.64, we conclude that national banks 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 net income in those years*, attributing the excess first to the earlier of the two years and then to the immediately preceding year.[3]

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[2]The dividend restrictions in section 60(b) have been implemented by regulations promulgated at 12 C.F.R. Part 5, Subpart E. Section 5.64 contains a slightly more detailed version of the statutory earnings restriction and, in pertinent part, provides:

> (b) *Earnings limitation*. For purposes of 12 U.S.C. 60, a national bank may not declare a dividend if the total amount of all dividends (common and preferred), including the proposed dividend, declared by the national bank in any calendar year exceeds the total of the national bank's retained net income of that year to date, combined with its retained net income of the preceding two years, unless the dividend is approved by the OCC. * * *

12 C.F.R. § 5.64(b) (1997). Retained net income is defined at § 5.61(b) as "the net income of a specified period less the total amount of all dividends declared in that period." Additionally, § 5.62 provides that "[a] national bank shall use the date a dividend is declared for the purposes of determining compliance with this subpart."

[3]If the dividend in any year exceeds the bank's net income for that year plus previously undistributed net income of the preceding two years, a negative amount would be carried forward in the future year dividend calculations. This situation, however, would only arise if the amount of the dividend exceeds the limitation in § 60(b), and therefore would require prior OCC approval. In determining any such request for approval, the OCC could consider any request for different treatment of the excess dividend amount, including advance waivers for future period. *See* OCC Bulletin 94-41 (June 24, 1994).

This interpretation is consistent with the purpose of the earning limitations in § 60(b). As explained in the legislative history:

> [Section 60(b)] is designed to restrict the payment of dividends by national banks where such payments would result in dissipating needed capital funds. This provision strengthens the regulatory authority of the Comptroller. Under it, he will be able to prevent the declaration of dividends which are not justified by *current and recent accumulated earnings*, and which would result in a weakened and under-capitalized bank and violate safe and sound banking practice. It is not anticipated, however, that this provision will interfere in any measure with the normal dividend policies of national banks.

S. Rep. No. 730, 86th Cong., 1st Sess. -- (1959), *reprinted in* 1957 U.S.C.C.A.N. 2232, 2238 (emphasis added). This interpretation is consistent with the dividend limitation under § 60(b) because the total amount of dividends that a bank may declare remains limited to "current and recent accumulated earnings" based on the current and the prior two years. Any bank dividend in excess of § 60(b) is still subject to OCC approval. As a result, this change in the dividend calculation is consistent with the purpose of § 60(b) to prevent the dissipation of capital through excessive dividends.

This result also is consistent with the Federal Financial Institutions Examination Council's (FFIEC) policy of moving toward GAAP for regulatory reporting purposes. *See* FFIEC Press Release, dated November 3, 1995. Under GAAP, dividends are treated as distributions from surplus and not as specific reductions from earnings for the period in which the dividend is declared. Absent specific statutory restrictions, the total amount of undivided profits would be available for the payment of dividends; GAAP does not segregate undivided profits by source or income period.

Finally, it is important to note that, notwithstanding the permissibility of a particular dividend payment under § 60(b), national banks (and other types of insured depository institutions) may not pay dividends, if, after payment of the dividend, the bank would be undercapitalized. 12 U.S.C. § 1831o(d)(1)(A). Thus, the flexibility for dividend payments allowed under § 60(b) is at all times subject to the safety and soundness protections provided by § 1831o(d)(1)(A).

Should you have further questions, please feel free to contact Ron Shimabukuro, Senior Attorney, Legislative and Regulatory Activities Division, at (202) 874-5090.

Sincerely,

/s/

Julie L. Williams
Chief Counsel