

## Frequently Asked Questions re: SR letter 09-4

### **Q1: Does SR 09-4 change the priorities of payment of dividends on various capital instruments?**

**A:** No. As indicated in the revised SR letter, the priority of payment of dividends is based on the payment seniority of the capital instruments as established by contract between an issuer and its investors. This letter does not change the payment seniority of a BHC's capital instruments, which typically require the deferral of dividends on more junior instruments before dividends can be deferred on more senior instruments. Specifically, a BHC must eliminate its common stock dividend before deferring dividends on more senior instruments, and must defer payment of dividends on perpetual preferred stock before dividends may be deferred on trust preferred securities.

### **Q2: Is this letter specifically targeted at trust preferred securities?**

**A:** No. The letter applies to the payment of dividends or interest on all tier 1 instruments in the capital structure, consistent with safety and soundness and the instruments' contractual seniority as noted in the preceding answer.

### **Q3: By issuing SR letter 09-4, is it the Federal Reserve's intention to halt the payment of all dividends by all BHCs in the current economic environment?**

**A:** No. It may be appropriate for the boards of directors of many BHCs in the current environment to decide to reduce, defer, or eliminate dividends on at least some capital instruments in light of those BHCs' or subsidiary depository institutions' deteriorating financial condition and potential vulnerability to further macroeconomic weakness. Supervisory assessments of such decisions, however, will be made based on the specific circumstances at individual BHCs.

### **Q4. Does a BHC need to get the approval of the Federal Reserve every time it plans to pay a dividend?**

**A:** No. As indicated in the guidance, a BHC should consult with supervisory staff in circumstances where the declaration and payment of a dividend could raise supervisory concerns about the safe and sound operation of the BHC and its depository institution subsidiaries, where the dividend declared for a period is not supported by earnings for that period, and where a BHC plans to declare a material increase in its common stock dividend. Routine payment of dividends from earnings that can be sustained on a recurring basis would not typically require consultation with supervisory staff.

### **Q5. If a BHC has an unusual loss in one period but projects profits for the year, should supervisors expect that the BHC will reduce, defer, or eliminate its dividend?**

**A:** Assessments should be made on a case-by-case basis. There is no requirement that a BHC reduce or cease paying a dividend based solely on one quarter or more of losses, particularly

where such losses are of a nonrecurring nature. In such a situation, the BHC should inform supervisory staff reasonably in advance of declaring a dividend, and staff should assess whether the BHC's future earnings projections are reasonable and whether the payment of a dividend, in light of the BHC's current and prospective capital needs, raises supervisory concerns.

**Q6. Will BHCs be allowed to continue paying a de minimis dividend (e.g., \$0.01) per share of common stock to avoid market consequences of full deferral?**

**A:** A primary criterion for instruments included in tier 1 capital is that a BHC's board of directors must have the discretion not to pay dividends on such instruments. Earnings that are not paid out as a dividend shore up a BHC's capital base by increasing retained earnings; conversely, earnings that are distributed through dividends are not available to augment the BHC's capital base, and reduce its cash reserves. Thus, it is important that a BHC's board of directors take care when determining dividend levels to ensure that the BHC retains capital commensurate with its risk exposure and overall capital needs and that any dividend actions do not adversely affect the BHC's financial condition or its continued safe and sound operation. A board of directors that elects to pay a dividend on its common shares, however small, forestalls the possibility of deferring dividends on more senior capital instruments such as preferred stock for which, by contract, the full amount of dividends must be paid unless all dividends on the more junior capital instruments are eliminated. In some cases, the financial condition of a BHC may be such that paying dividends on the more senior instruments would result in an excessive drain on the BHC's cash resources or materially impair its capital base. In such cases, a BHC as a general matter should not pay even a de minimis common stock dividend and should defer or reduce dividends on more senior instruments. In other instances, a BHC that may have experienced less serious deterioration may choose to husband its resources by reducing its common stock dividend to a de minimis amount, rather than eliminating it, in order to avoid potential adverse market consequences (e.g., the possibility that some institutional investors may not be able to continue holding the BHC's stock). In this latter case, the decision to pay a de minimis common stock dividend is not necessarily imprudent, but it should be made only after a careful assessment of the BHC's capital needs and a balancing of the desire to avoid negative market signals with the merits of taking further dividend actions to shore up the BHC's capital base.

**Q7. If a BHC has declared, but not yet paid, a dividend, and supervisory staff believe such a dividend would be inappropriate, should the BHC be prevented from paying the dividend?**

**A:** As indicated in the SR letter, as a general matter, the declaration of a dividend by a BHC's board of directors establishes a legal obligation to its shareholders to pay that dividend, which is recorded as a liability on the BHC's balance sheet. Therefore, if supervisory staff has strong concern about the impact on BHC safety and soundness of a dividend that has been declared but not yet paid, staff should consult with Board staff in the Banking Supervision & Regulation and Legal Divisions before taking any action regarding the BHC's dividend. On the other hand, dividends on trust preferred securities are legal obligations to pay unless a BHC's board of directors gives timely notice that the BHC will not pay the dividend. Under the existing rule for components of tier 1 capital, this notification cannot exceed 15 days before the payment date.

Consultation with Board and Reserve Bank staff is recommended for issues relating to a BHC's deferral of payments on trust preferred securities.

**Q8. Does the letter apply to the redemption of tier 2 capital instruments (e.g., subordinated debt)?**

**A:** Yes. As indicated in the section of the letter on stock redemptions and repurchases, the guidance applies to "other regulatory capital instruments." The same principles and considerations that apply to repurchases or redemption of tier 1 capital instruments should also be applied to tier 2 capital instruments. The guidance on payment of dividends, however, does not apply to tier 2 capital instruments such as subordinated debt because an interest payment on such instruments may not be waived or deferred without triggering an event of default.

**Q9: Are recipients of government investments (e.g., through the Treasury's Capital Purchase Program) expected to suspend payment of dividends on any or all capital instruments?**

**A:** As a generally matter, dividends should be paid out of current earnings. To the extent a BHC that is participating in a government investment program has sufficient earnings to pay a dividend, this should not generally be construed as using government funds to pay the dividend. Where such a BHC or its subsidiary depository institution subsidiaries are experiencing financial difficulties or the payment of dividends would not be prudent in the absence of receiving public funds, however, the BHC generally should eliminate, reduce, or defer dividends on tier 1 capital instruments as appropriate.

**Q10. Under what conditions would it be appropriate for a recipient of government investment to defer payment of the dividend on this investment?**

**A:** A board of directors' decision to defer a dividend on a government investment—as with all other instruments in the capital structure—should be based primarily on the extent to which deferral is necessary for the BHC to preserve capital to continue operating in a safe and sound manner and serving as a source of strength to its depository institution subsidiaries. As a general matter, dividends on government investments may not be deferred unless all dividends have been deferred or waived on more junior instruments.

**Q11. Why was language on the use of CPP funds removed from the revised SR letter?**

**A:** The focus of this letter is on safety and soundness issues related to payment of dividends, stock redemptions, and stock repurchases. A recipient of government funds should, of course, use those funds in a manner that is consistent with program objectives and requirements, as well as the safety and soundness of the BHC and its depository institution subsidiaries.

**Q12. When the letter states that a BHC should inform or consult with supervisory staff, whom should the BHC contact?**

**A:** The BHC should contact supervisory staff at the Reserve Bank who are responsible for supervision of the holding company. Unless otherwise indicated, such consultation does not require any application.

**Q13. Was the SR letter effective immediately upon publication?**

**A:** Yes. Unless indicated otherwise, all SR letters are effective when they are published.