Capital Distributions

Institution: SCD:

This workpaper covers regulatory requirements **only** for capital distributions that are cash patronage, cash dividends, and retirements of common cooperative equity. Areas that are not covered in this workpaper include the following:

- Retirements of preferred stock and subordinated debt, as well as restrictions on any capital distributions resulting from capital buffer requirements (these are covered in the Capital Regulatory Compliance workpaper).
- Retirement of protected borrower stock (called "eligible borrower stock" in 615.5260) because almost all has been retired.

Prior Approval Requirements

Institutions must obtain FCA prior approval for capital distributions. There are three types of approval: (1) deemed prior approval (the "safe harbor"); (2) 30-day prior approval; and (3) advance prior approval. Capital distributions that comply with the "safe harbor" provisions of 628.20(f)(5) are deemed to have FCA prior approval, and the institution does not have to submit a request to FCA. The institution must submit a 30-day prior approval request to FCA for a capital distribution that does not comply with the "safe harbor" provisions of 628.20(f)(5). An institution may also request advance prior approval for several planned distributions, and there is no deadline by which FCA must respond. For the following questions, the examiner should review Call Report Schedule RI-D to identify the various forms of capital distributions and then determine if the institution complied with prior approval requirements. If distributions were made under "safe harbor," the examiner should review documentation from the institution evidencing compliance with "safe harbor" requirements, particularly documentation tracking the life (holding period) of common cooperative equities.

Question	Response	Comment
1. If a capital distribution was made under the "safe harbor" provisions of 628.20(f)(5) (i.e., deemed prior approval): *Note: If the answer to any of these questions is "No," then the capital distribution was not permitted under "safe harbor" provisions and required submission of a request to FCA for prior approval.*		
a. Was the distribution in the form of a cash patronage payment, cash dividend payment, or common cooperative equity retirement?		
b. Were common cooperative equities that were retired and included in common equity tier 1 (CET1) capital issued at least 7 years prior to retirement (i.e., the minimum holding period for CET1 capital)? And, were common cooperative		

Capital Distributions

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equities that were retired and included in tier 2 capital issued at least 5 years prior to retirement (i.e., the minimum holding period for tier 2 capital)? *Exceptions: The following equities may be retired under the "safe harbor" provisions prior to satisfying the minimum applicable holding period, provided the additional requirements in rows c and d below are met: 628.20(f)(5) and (6)* 　○ *Equities mandated to be redeemed or retired by a final court order* 　○ *Equities held by the estate of deceased former borrowers* 　○ *Equities required to be canceled under 615.5290 in connection with a restructuring under part 617* *Note 1: Retirements of the statutory minimum stock and additional amounts of required minimum stock up to $1,000 are not subject to a holding period or FCA prior approval requirements. Therefore, "safe harbor" requirements are not applicable when an institution retires the statutory minimum borrower stock (and additional amounts up to $1,000). 628.20(b)(1)(xiv)* *Note 2: Compliance with the applicable minimum required holding period is determined relative to the common cooperative equity issuance date as defined in 628.2.*		
c. After capital distributions, did the dollar amount of CET1 capital as of the quarter-end date in which the distribution occurred, equal or exceed the amount of CET1 capital as of the same quarter-end date the prior year?		
d. Did the institution continue to comply with all regulatory capital requirements and any supervisory or enforcement actions?		
2. For capital distributions that did not qualify under the "safe harbor" provisions, did the institution submit a request to FCA for prior approval at least 30 days prior to the intended action? 628.20(f)(2) *Note: As noted in FCA Bookletter BL-068 (number 11), this includes "loans in default" in which borrower stock (excluding statutory minimum borrower stock) or allocated equity that did*		

Capital Distributions

Question	Response	Comment
not qualify for "safe harbor" was retired and applied to the loan. Also, as noted in 628.20(f)(1), term equities retired on their maturity date do not require FCA prior approval (although they must be phased out of regulatory capital as they approach maturity).		
3. If FCA responded to the prior approval request within 30 days of receiving the request, did the institution comply with any special requirements in the FCA response?		
4. If FCA did not respond to the prior approval request, did the institution wait at least 30 days after FCA received the institution's completed request before proceeding with the capital distribution? 628.20(f)(2) and (3)		
5. If the institution requested advance approval for several anticipated capital distributions, did the institution: 628.20(f)(4)		
a. Wait for an FCA response and approval before proceeding with a distribution?		
b. Comply with any special requirements in the FCA response?		
c. Continue to comply with minimum regulatory capital requirements after the capital distribution?		
6. Did the institution refrain from distributing allocated equities that are treated in CET1 capital as "unallocated retained earnings (URE) equivalents," and also refrain from offsetting URE equivalents against a loan in default (except as required by a final court order, approved by FCA, or required under 615.5290 in connection with a restructuring under 617)? 615.5200(d)(4) *Note: URE equivalents are defined in 628.2 and include nonqualified allocated equities not subject to revolvement (other than equities allocated to other System institutions) and paid-in capital.*		

Other Requirements

Examiner responses to these questions should generally be based on a review of board minutes and materials, board resolutions, capital bylaws, capital distribution policies and procedures, related accounting records, and transaction testing.

Question	Response	Comment
7. Did the institution continue to comply with minimum regulatory capital requirements after the declaration and recognition of capital distributions? 628.20(f)(4)(ii), 615.5270(b), 615.5295(b), 615.5215 *Exceptions: This limit does not apply to term equities*		

Question	Response	Comment
retired on their maturity date, or borrower stock retired in accordance with 615.5280 (loans in default) or 615.5290 (restructuring). Also, under the definition of term preferred stock in 615.5201 and under the tier 2 criteria in 628.20(d)(1)(iv), term preferred stock and subordinated debt must be gradually phased out of regulatory capital when they approach maturity. *Note: If capital is near minimum regulatory requirements, management should have internal controls to ensure compliance with these regulations.*		
8. Determine if capital distributions were consistent with cooperative principles. More specifically: 615.5230(c)(2) and (3)		
a. Were patronage distributions paid on an equitable and nondiscriminatory basis and in accordance with capitalization bylaws? *Note: If separate earnings pools are established for the payment of patronage, they must be rational and equitable and ensure each patron receives a fair share of earnings and bears a fair share of the institution's expenses.*		
b. Were dividends paid to common stock and participation certificate holders paid on a per share basis, without preference as to rate or priority of payment within the same class or between different classes of common stock or participation certificates? *Exception: Any class of common stock or participation certificate that results from a conversion of allocated surplus may be subordinated to other classes of common stock or participation certificates for dividend distributions.*		
9. Were borrower stock and allocated equity retired at par value or less? 615.5270(a), 615.5280 *Note: This includes "loans in default" and "direct loans in default" in which borrower stock or allocated equity was retired and applied to the loan (615.5280). The examiner should ensure bylaws, policies, and procedures are consistent with this regulatory requirement, and may need to test loan transaction histories or general ledger entries to validate conclusions.*		
10. If the board delegated authority to retire at-risk borrower stock to management: 615.5270(c)		

Capital Distributions

Question	Response	Comment
a. Did the board determine the institution's capital is adequate?		
b. Were all retirements in accordance with applicable provisions of part 628 and the institution's capital adequacy plan (or capital restoration plan, if applicable)?		
c. After retirements, was the institution's permanent capital ratio greater than 9 percent, the capital conservation buffer greater than 2.5 percent, and the leverage buffer greater than 1 percent?		
d. Did the institution continue to satisfy all applicable regulatory standards after retirements?		
e. Did management report the aggregate amount and net effect of stock purchases and retirements to the board at least quarterly?		
11. Did the board declare dividends before they were paid to stockholders? 615.5295(a)		

Other Comments:

This workpaper is not intended to create any rights, substantive or procedural, enforceable at law or in any administrative proceeding. While the workpaper was carefully reviewed for applicability and accuracy, changes may occur in the wording or interpretation of laws and regulations. If a situation arises where the workpaper becomes inconsistent with applicable laws or regulations, the requirement of the laws or regulations will prevail. Examination scope may vary between institutions. On a particular examination activity, the workpaper may not pertain to all factual situations or interpretations, additional concerns or issues may be addressed that are not covered in the workpaper, and some portions of the workpaper may not be used.