LUSE GORMAN

August 16, 2011

LEGAL UPDATES AND NEWS

Regulatory Policies Regarding Capital Distributions by Bank and Savings and Loan Holding Companies

In the context of the regulatory restructuring occasioned by the Dodd-Frank Wall Street Reform Act and Consumer Protection Act of 2010, we have received questions from both bank and savings and loan holding company clients concerning regulatory policies applicable to capital distributions (including dividends and capital redemptions and repurchases). This legal update summarizes regulatory guidance applicable to bank holding companies, which now applies to savings and loan holding companies by virtue of a Federal Reserve Board ("FRB") Supervision and Regulation Letter issued on July 21, 2011.

In 2009, the FRB issued a Supervision and Regulation Letter titled "Applying Supervisory Guidance and Regulations on the Payment of Dividends, Stock Redemptions and Stock Repurchases at Bank Holding Companies" (SR 09-4, February 24, 2009, amended March 27, 2009) ("SR 09-4" or the "Letter"). That Letter "reiterates longstanding….supervisory policies and guidance." It notes that a fundamental principle of FRB supervision of bank holding companies is that the bank holding company should serve as a source of managerial and financial strength to its subsidiary bank. Consistent with that premise, the FRB anticipates that a holding company will hold capital commensurate with its overall risk profile.

SR 09-4 says that regulatory assessment of holding company capital adequacy includes a review of the comprehensiveness and effectiveness of capital planning, and that a company's level of common stock dividends is an integral part of that capital planning. Bank holding companies are expected to have dividend policies that account for the effect of cash dividends on the company's capital resources. Dividend levels are expected to be prudent relative to the company's financial condition and not based on overly optimistic earnings projections.

SR 09-4 urges boards of directors to consider eliminating, deferring or reducing dividends when the quality and quantity of earnings have declined, the company is experiencing other financial problems or the outlook for the company's primary profit centers has deteriorated. The Letter notes that bank holding companies should inform the FRB and eliminate, defer or significantly reduce dividends if: (i) the company's net income available to the shareholders for the past four quarters, net of dividends previously paid over that period, is insufficient to fully fund the dividends; (ii) the company's overall rate of earnings retention is inconsistent with the company's capital needs and overall current and financial condition; or (iii) the company will not meet, or is in danger of not meeting, applicable regulatory capital requirements. Failure to do so, according to the Letter, could result in a regulatory finding that the company is operating in an unsafe and unsound manner.

SR 09-4 also indicates that a bank holding company should inform the FRB "reasonably in advance of declaring or paying a dividend that exceeds earnings for the period (e.g., the quarter) for which the dividend is being paid" or that could cause a material adverse change to the organization's capital structure. The Letter also says that the FRB should be notified "reasonably in advance" of a bank holding company declaring any material increase in its common stock dividend to ensure that it does not raise safety and soundness concerns.

SR 09-4 also discusses stock redemptions/repurchases. It notes that such transactions need to be consistent with the bank holding company's current and prospective capital needs. The Letter mentions regulations applicable to bank holding companies that require FRB approval of a redemptions/repurchases in certain circumstances, such as where a bank holding company that is not well-capitalized and well-managed is paying 10% or more of its consolidated net worth on redemptions over a twelve-month period. Aside from such regulations, the Letter indicates that a company should advise the FRB in advance of redemptions/repurchases that result in a net reduction of the company's outstanding common or perpetual preferred stock below the amount outstanding at the beginning of the quarter in which the redemption/repurchase occurs. SR 09-4 notes that such notice should be sufficiently in advance of the redemption/repurchase to provide reasonable opportunity for supervisory review and possible objection if the proposal is deemed to raise safety and soundness concerns.

On July 21, 2011, the date that jurisdiction over savings and loan holding companies transferred to the FRB from the Office of Thrift Supervision, the FRB issued a Supervision and Regulation Letter concerning its anticipated supervision of savings and loan holding companies (SR 11-11 (July 21, 2011)). SR 9-04 is among the FRB's previous bank holding company supervisory issuances that are specifically listed as being applicable to savings and loan holding companies. Saving and loan holding companies should, therefore, consider the aforementioned guidance regarding dividends and stock repurchases/redemption applicable immediately. That means that savings and loan holding companies that contemplate dividends and stock repurchases/redemptions under circumstances requiring prior consultation with the FRB by a bank holding company should similarly give prior notice to their supervisory contact at the applicable Federal Reserve Bank.

None of the FRB releases require any formal procedures for providing such notice, where required. If the notice is in the form of a telephone call, we recommend that a follow-up e-mail be sent to the Federal Reserve Bank staff member to document the call and the subjects discussed and confirm the response given by the staff member. Certainly, the supervisory staff is free to require more substantial written submissions in particular cases as they deem warranted. In order to allow sufficient time for any necessary give and take with the supervisory staff, we suggest that notice be provided at least 30 days before the declaration of a dividend or adoption of a stock repurchase plan. Allowing sufficient time is particularly important given that the staff is in process of familiarizing themselves with the savings and loan holding companies that the FRB now regulates and may not be in a position to render quick clearances for capital distributions that require notice under the FRB guidance.

Please contact us if you have any questions or would like a copy of the pertinent FRB Supervision and Regulation letters.

* * *

Luse Gorman is one of the leading firms nationally in advising financial institutions on capital-raising, mergers and acquisitions, corporate and securities, regulatory and executive compensation/employee benefits matters. Please contact any of the attorneys listed below for if you would like to discuss any information contained in this newsletter.

Eric Luse	■	(202) 274-2002
John J. Gorman	■	(202) 274-2001
Joe Daly	■	(202) 274-2034
Richard S. Garabedian	■	(202) 274-2030
Lawrence M.F. Spaccasi	■	(202) 274-2037
Gary Lax	■	(202) 274-2031