



15 March 2022

SEC-OGC Opinion No. 22-03
Re: Preferred Shares; Rural Banks

PUYAT JACINTO & SANTOS LAW
10/F 8 Rockwell, Hidalgo cor. Plaza Drives,
Rockwell Center, Makati City, 1200

Attention : ATTY. MARIA RAQUEL S. CHAVEZ
Partner

ATTY. MA. CHRISTINE P. DE VERA
Senior Associate

Gentlemen:

This refers to your letter dated 13 September 2021 requesting for the Commission's confirmation of your opinion on the following matters: (1) the distribution of dividends and liquidation made on the basis of the par value is not inconsistent with Section 42 of the Revised Corporation Code ("RCC"); and (2) the provisions of the Anti-Dummy Law¹ will not apply to rural banks in relation to the Rural Bank Act of 1992².

Based on your letter, the relevant facts are as follows:

1. X Rural Bank is a banking corporation duly organized under Philippine laws and licensed by the Bangko Sentral ng Pilipinas (BSP) as a rural bank.
2. Based on a redacted copy of its 2021 General Information Sheet (GIS)³, X Rural Bank's capital structure is as follows:

Nationality	No. of Stockholders	Type of Shares	No. of Shares	Par/ Stated Value	Amount (Php)	% of Ownership
Filipino	3	Common	4,000,000	10.00	40,000,000.00	40%
Korean	3	Common	3	10.00	30.00	60%
Singaporean	1	Common	5,999,997	10.00	59,999,970.00	
			10,000,000.00		100,000,000.00	100%

¹ Commonwealth Act No. 108, as amended by Republic Act (RA) No. 421, R.A. No. 134, R.A. No. 6084, and Presidential Decree No. 715.

² R.A. No. 7353, as amended by R.A. No. 10574

³ Annex A of your letter



Accordingly, X Rural Bank is: (i) 60% owned by a Singaporean holding company which is ultimately and beneficially owned by Korean Nationals; and (ii) 40% owned by a Filipino corporate stockholder, which is wholly-owned by Filipino citizens.

3. X Rural Bank proposes the following amendments to its Articles of Incorporation (AOI):

- a. Increase its authorized capital stock (ACS) from Php100,000,000.00 divided into 10,000,00 common shares to Php314,000,000.00 divided into the following:

Share Type	No. of Shares	Par Value	Amount
Common	10,000,000	10	100,000,000.00
Voting Preferred A (New)	2,000,000	100	200,000,000.00
Voting Preferred B(New)	10,000,000	1.40	14,000,000.00
TOTAL	22,000,000		314,000,000.00

- b. In view of the increase of ACS, the new capital structure of X Rural Bank shall be:

Shareholder	Nationality	Type of Shares	No. of Shares	Amount Subscribed in Php	Amount Paid in Php	% of Ownership
Foreign Corporate Stockholder (and nominees)	Foreign	Common	6,000,000	60,000,000.00	60,000,000.00	37.46 %
		Voting Preferred A	649,999	64,999,900.00	64,999,900.00	
Filipino Corporate Stockholder (and nominees)	Filipino	Common	4,000,000	40,000,000.00	40,000,000.00	62.54 %
		Voting Preferred B	7,099,996	9,939,994.40	9,939,994.40	
			17,749,995	174,939,894.40	174,939,894.40	100%

- c. The proposed features, rights and restrictions of the shares are as follows:

i. **Voting Rights.** Holders of each share shall have one (1) vote each, regardless of its classification and par value.

ii. **Dividends and Liquidation.** The distribution of dividends and liquidated value or a similar value shall be **made in**



proportionate(sic) to the par value of each share regardless of its classification. Each Preferred Share shall have preferences in dividends and liquidation *as may be fixed and approved by the Board of Directors, including the determination of the rate and manner of distribution of dividends* and such other terms and conditions upon which such dividends or liquidation shall be payable, subject to existing regulations of the BSP applicable to the declaration of the dividends and liquidation.

- iii. Dividends shall be declared and paid out of the unrestricted retained earnings which shall be payable in cash, property or stock to the stockholders in accordance with its AOI and By-Laws, on the basis of the par value of the shares, as often and at such times as the Board of Directors may determine and ratified by the resolution of the stockholders approved in a stockholders' meeting duly called for the purpose, in accordance with the law and applicable rules and regulations.

In view of the foregoing, you hereby seek the opinion of the Commission on the following matters:

1. The distribution of dividends made on the basis of par value, is not inconsistent with Section 42 of the RCC;
2. Liquidation value can be distributed on the basis of par value instead of number of shares held by each shareholder;
3. There is no doubt as to the actual control and ownership of X Rural Bank since foreign equity threshold under the Rural Bank Act of 1992, as amended, is met; and
4. The Anti-Dummy Law is not applicable to rural banks pursuant to the Rural Bank Act of 1992, as amended.

DISCUSSION

Distribution of dividends on the basis of par value

Paragraph 6 of Section 6 of the RCC states that “[p]referred shares of stock issued by a corporation may be given preference in the distribution of dividends and in the



distribution of corporate assets in case of liquidation, **or such other preferences: Provided, That preferred shares of stock may be issued only with a stated par value.** The board of directors, **where authorized in the articles of incorporation, may fix the terms and conditions of preferred shares of stock or any series thereof:** *Provided, further,* That such terms and conditions shall be effective upon filing of a certificate thereof with the Securities Exchange Commission, herein referred to as the "Commission." (*Emphasis and underscoring supplied*)

Section 42 of the RCC provides that stockholders participation in the declaration of dividends shall be based on the outstanding capital stock being held by them, to wit:

Section 42. Power to Declare Dividends. – The board of directors of a stock corporation may declare dividends out of the unrestricted retained earnings which shall be payable in cash, property, or in stock to all stockholders **on the basis of outstanding stock held by them:** *Provided, X X X*" (*Underscoring supplied*)

Meanwhile, in Section 173 of the RCC, the term "Outstanding Capital Stock" is defined as:

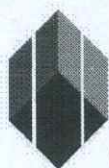
Section 173. Outstanding Capital Stock Defined. – The term "outstanding capital stock", as used in this Code, shall mean **the total shares of stock issued under binding subscription contracts to subscribers or stockholders, whether fully or partially paid, except treasury shares.**" (*Emphasis supplied*)

In view of the above cited provisions, the Commission has opined that "the stockholder's participation in dividends is based on his total subscription and not on the amount paid by him on account thereof."⁴

In *SEC Opinion addressed to Mr. Mitsuhiro Otsuki, dated 16 July 1996*, the Commission explained that "dividends shall be declared on the basis of the number of shares held by the stockholders, not on the amount paid in consideration thereof. However, holders of preferred shares may be given preference over common shares in the distribution of dividends and the extent of their preference depends upon the terms indicated in the AOI, but the distribution of dividends to preferred shareholders must always be based on the number of shares held by them."

In *SEC Opinion No. 45-03 addressed to Atty. Maria Zarah R. Villanueva dated 24 September 2003*, the Commission was asked to provide an opinion on the legality of the

⁴ SEC Opinion dated 1 February 1991 addressed to Romulo, Mabanta, Buenaventura Sayoc & De Los Angeles.



dividend declaration made by the board of directors of an undisclosed corporation in favor of the cumulative preferred shareholders. Accordingly, sometime in 2002, the company declared dividends in favor of all preferred cumulative shareholders **at the rate of 10% of par value payable out of surplus or net profits**. The Commission opined that the foregoing *subject terms and conditions stated in the AOI and By-Laws of the company with respect to the dividend declaration* may be considered legally valid.

However, the Commission has previously stated that giving the board of directors a *blanket authority* to fix the terms and conditions of preferred shares might result to an abuse of such authority that might adversely affect the rights of shares already issued. Thus, in order to protect the interest of the stockholders, the Commission does not allow a provision giving the Board a blanket authority to determine the terms of preferred shares, *unless certain features, guidelines or standards to be followed in the issuance of preferred shares are spelled out in the AOI*.⁵

Relative to the new capital structure of X Rural Bank whereby the preferred shares shall have preference in the dividends on the basis of the par value of such shares held by the stockholders, we are of the opinion that this is allowed under Section 42, in relation to Section 6 of the RCC. However, this is subject to the condition that the board of directors will not be given a blanket authority to determine the terms of such preferred shares, unless certain features, guidelines or standards to be followed in the issuance of preferred shares are clearly spelled out in the AOI. Moreover, since the corporation is a bank, the dividend rate shall be subject to the rules and regulations of the BSP.⁶

Distribution of the liquidated value of preferred shares on the basis of par value

As stated in your letter, apart from preference in dividends, the preferred shares shall have preference as to the distribution of the assets of the corporation in case of liquidation.

Section 6 of the RCC also provides that preferred shares of stock issued by a corporation may be given preference in the distribution of corporate assets **in case of liquidation** provided that preferred shares of stock may be issued only with a stated par value.

The Commission opined in *SEC Opinion addressed to Col. Daniel V. dela Cruz dated 11 April 1980* that certain preferences that may be granted to preferred shares may refer

⁵ SEC Opinion addressed to Mr. Ismael Seferino dated 24 May 1994 citing Ltr to Sabido, Sabido & Associates dated 17 January 1983 and Ltr to Jose C. Vitug dated 11 January 1982.

⁶ *Ibid.*



to the distribution of the assets of the corporation upon dissolution to the extent of the par value of the preferred shares together with all the accrued dividends thereof.

Similarly, in *SEC Opinion addressed to Mr. Rolando A. Olegario dated 14 December 1981*, the Commission affirmed the privileges and/or preferences granted to the holders of preferred shares of Volcano Lakeview Resort, Inc. whereby in case of liquidation and/or dissolution, the holders of preferred shares shall be entitled to be paid on the basis of the par value or ratably in so far as the assets of the corporation will permit, together with the accrued unpaid dividends.

Based on the foregoing, the liquidated value of preferred shares of X Rural Bank may be distributed on the basis of the par value, provided that the terms and conditions in the distribution shall be clearly spelled out in its AOI which must be approved by the Commission. Similar to the above, this shall also be subject to the rules and regulations of the BSP on liquidation of banks.

The proposed capital structure of the X Rural Bank X vis-a-vis foreign equity threshold under the Rural Bank Act of 1992

Section 4 of Republic Act (R.A.) No. 7353, otherwise known as the Rural Bank Act of 1992, was amended by R.A. No. 10574 which allows foreign citizens to own, acquire or purchase up to sixty percent (60%) of voting stocks in a rural bank, to wit:

“Section 4. No rural bank shall be operated without a Certificate of Authority from the Monetary Board of the *Bangko Sentral ng Pilipinas*. Rural banks shall be organized in the form of stock corporations. No less than forty percent (40%) of the voting stocks of a rural bank shall be owned by citizens of the Philippines or corporations or associations organized under the laws of the Philippines at least sixty percent (60%) of whose capital is owned by such citizens. **Non-Filipino citizens may own, acquire or purchase up to sixty percent (60%) of the voting stocks in a rural bank. The percentage of foreign-owned voting stocks shall be determined by the citizenship of the individual or corporate stockholders of the rural bank.** Provided, x x x.”
(Underscoring supplied)

Subsection X126.1. of the Manual of Regulations for Banks (MORB) particularly provides for the guidelines with respect to the limits of stockholdings, to wit:

“Subsection X126.1. *Limit of stockholdings in a single bank.* – The stockholdings of an individual, corporation, family group or same group



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of persons in any bank shall be subject to the limits prescribed in Sections 11, 12, and 13 of R.A. No. 8791, R.A. No. 7906, **R.A. No. 7353, as amended by R.A. No. 10574**, R.A. No. 7721 and other relevant laws.

a. Any foreign individuals and non-bank corporations may each own or control up to forty percent (40%) of the voting stock of a universal, commercial, or thrift bank. *Provided*, That the aggregate foreign-owned voting stock owned by foreign individuals and non-bank corporations shall not exceed forty percent (40) of the outstanding voting stock of the universal or commercial bank, and sixty percent (60%) in the case of thrift banks.

For rural banks, non-Filipino citizens, excluding foreign banks, may each or in the aggregate, own, acquire or purchase, up to sixty (60%) of the voting stocks in a rural bank.

The percentage of foreign-owned voting stock in a bank shall be determined by the citizenship of the individual or corporate stockholders in that bank.

b. XXX

c. A Filipino individual and a domestic non-bank corporation may each own up to forty percent (40%) of the voting stock of a universal, commercial or thrift bank, and up to sixty percent (60%) of the voting stock of a rural bank. There shall be no ceiling on the aggregate ownership by such individuals and non-bank corporations in a domestic bank.

d. XXX

XXX XXX XXX

(2) The citizenship of the corporation, which is a stockholder of a bank shall follow the citizenship of the controlling stockholders of the corporation, irrespective of the place of incorporation. For purposes hereof, the term "controlling stockholders" shall refer to stockholders holding more than fifty percent (50%) of the voting stock of the corporate stockholders of the bank.

In the case of rural banks, a corporate stockholder thereof shall be deemed Filipino-owned if it is organized under the laws of the Philippines at least sixty percent (60%) of its capital is owned by Filipino citizens.⁷ (*Underscoring supplied*)

⁷ BSP Circular No. 809-13 dated 23 August 2013



Relative thereto, the Commission issued *Memorandum Circular No. 8, s. 2013* ("*SEC-MC No. 8*")⁸, or the *Guidelines on Compliance with the Filipino-Foreign Ownership Requirements Prescribed in the Constitution and/or Laws* which provides for the two-tiered test in determining nationality requirements, where we find in paragraph 2 of Section 2 thereof, an exemption, to wit:

"Section 2. All covered corporations shall, at all times, observe the constitutional or statutory ownership requirement. For purposes of determining compliance therewith, the required percentage of Filipino ownership shall be applied to BOTH (a) the total number of outstanding shares of stock entitle to vote in the election of directors; AND (b) the total number of outstanding shares of stock, whether or not entitle to vote in the election of directors

Corporations covered by special laws⁹ which provide citizenship requirements shall comply with the provision of said law" (emphasis and underscoring supplied)

Based on your letter, the proposed capital structure of X Rural Bank is divided into: (1) 10 Million common shares with par value of Php10.00, (2) 649,999 preferred shares "A" with par value of Php100.00 each, and (3) 7,099,996 preferred shares "B" with par value of Php1.40 each. It also shows that all shares issued by X Rural Bank are all granted voting rights, regardless of their classification as to whether they are common or preferred, and their corresponding par value. Thus, all subscribed shares shall be considered to be in the same footing and shall be used in computing the Filipino-Foreign equity in accordance with R.A. No. 7353, as amended by R.A. No. 10574.

Shareholder	Nationality	Type of Shares	No. of Shares	% of Ownership
Foreign Corporate Stockholder (and nominees)	Foreign	Common	6,000,000	37.46%
		Voting Preferred A	649,999	
Filipino Corporate Stockholder (and nominees)	Filipino	Common	4,000,000	62.54%
		Voting Preferred B	7,099,996	
			17,749,995	100%

⁸ Dated 20 May 2013

⁹ For example, R.A. 9374, also known as the Lending Company Regulation Act of 2007, R.A. 8556, also known as the Financing Company Act of 1998 and P.D. 129, also known as The Investment Houses Law.



Since 62.54% (4,000,000 common shares + 7,099,996 = 11,099,996 divided by 17,749,995 or the total number of shares) of the voting stocks of X Rural Bank is owned by Filipinos, it is therefore compliant with the Rural Bank Act of 1992. However, it is worthy to note that the right to operate rural banks is subject to the regulation and supervision of the BSP. In which case, we recommend that you seek the guidance and/or opinion of the BSP on the matter.

The proposed capital structure of the X Rural Bank X vis-a-vis Anti-Dummy Law

Section 2-A of the Anti-Dummy Law provides for the rule with respect to the unlawful use, exploitation or enjoyment of rights, interests and/or business which the Constitution and/or other laws have expressly reserved in favor of Filipinos, to wit:

“Section 2-A. Unlawful Use, Exploitation or Enjoyment. – Any person, corporation, or association which, having in its name or under its control, a right, franchise, privilege, property or business, the exercise or enjoyment of which is expressly reserved by the Constitution or the laws to citizens of the Philippines or of any other specific country, or to corporations or associations at least sixty per centum of the capital of which is owned by such citizens, permits or allows the use, exploitation or enjoyment thereof by a person, corporation or association not possessing the requisites prescribed by the Constitution or the laws of the Philippines; or leases, or in any other way, transfers or conveys said right, franchise, privilege, property or business to a person, corporation or association not otherwise qualified under the Constitution, or the provisions of the existing laws; or in any manner permits or allows any person, not possessing the qualifications required by the Constitution, or existing laws to acquire, use, exploit or enjoy a right, franchise, privilege, property or business, the exercise and enjoyment of which are expressly reserved by the Constitution or existing laws to citizens of the Philippines or of any other specific country, to intervene in the management, operation, administration or control thereof, whether as an officer, employee or laborer therein with or without remuneration except technical personnel whose employment may be specifically authorized by the Secretary of Justice, and any person who knowingly aids, assists or abets in the planning consummation or perpetration of any of the acts herein above enumerated shall be punished by imprisonment for not less than five nor more than fifteen years and by a fine of not less than the value of the right, franchise or privilege enjoyed or acquired in violation of the provisions hereof but in no case less than five thousand pesos: x x x” (Underscoring supplied)



The Department of Justice (DOJ) stated in its *Opinion No. 016, Series of 2004 dated January 26, 2004* that the very essence of the Anti-Dummy Law was to limit a certain economic activity, or the exercise or enjoyment of a certain right, franchise, privilege, property or business only to Filipino citizens, or to corporations or associations at least sixty (60%) percent of the capital of which is owned by Filipino citizens. The law was intended to prevent the circumvention of the nationalization laws of the country.

In its *Opinion No. 054, Series of 2010 dated 23 November 2010*, the DOJ opined that the Financing Company Act of 1998¹⁰ (R.A. No. 8556) effectively removed the limitation imposed under Section 6 of the Financing Company Act (R.A. No. 5980), the original law, such that up to sixty percent (60%) of the voting stock of financing companies may now be owned by foreign nationals. Hence, the amendment may be construed to have taken out financing companies from the coverage of Section 2-A of the Anti-Dummy Law.

R.A. No. 7353, as amended by R.A. No. 10574, particularly provides that rural banks are now allowed to own, acquire and purchase at least sixty percent (60%) voting shares from the rural bank.

By the same logic, we are of the opinion that rural banks are likewise deemed to have been taken out of the coverage of Section 2-A of the Anti-Dummy Law.

This is consistent with the above mentioned *DOJ Opinion No. 016 dated January 26, 2004* which stated that in light of the subsequent passage of several amendatory laws, which eventually allowed foreign banks to own or acquire 100% or 60% of voting stock of a domestic bank, certain banking activities involving the entry and operation of

¹⁰ This was further amended by Section 6 of R.A. No. 10881 dated 17 July 2016 which states as follows:

“Section 6. Financing Companies. – Section 6 of Republic Act No. 8556, otherwise known as the “Financing Company Act of 1998”, is hereby amended to read as follow:

“Section 6. *Form of Organization and Capital Requirements.* – **Financing companies shall be organized in the form of stock corporations, may be owned up to one hundred percent (100%) by foreign nationals,** and shall have a paid-up capital of not less than ten million pesos (P10,000,000.00) in case the financing company is located in Metro Manila and other first class cities, five million pesos (P5,000,000.00) in other classes of cities and two million five hundred thousand pesos (P2,500,000.00) in municipalities: *Provided,* That the Securities and Exchange Commission may adjust said minimum paid-up levels as it deems warranted by its prudential oversight requirements and consistent with the objectives of this Act: *Provided, however,* That financing companies duly existing and in operation before the effectivity of this Act shall comply with the minimum capital requirement within one (1) year from the date of the said effectivity: and *Provided, further,* That where land is concerned, the financing company shall comply with the constitutional provision on foreign ownership of land.”(emphasis and underscoring supplied)




foreign banks into the Philippine banking system may now be deemed to have been taken out of the coverage of the Anti-Dummy Law.

It shall be understood that the foregoing opinion is rendered solely on the basis of the facts, circumstances and documents disclosed/submitted, and should be considered relevant solely to the particular issue raised therein. It shall not be used in the nature of a standing rule binding upon the Commission in other cases or upon the courts whether of similar or dissimilar circumstances¹¹. If, upon further inquiry or investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered void.

Please be guided accordingly.

Respectfully yours,


ROMUALD C. PADILLA
General Counsel

¹¹ SEC Memorandum Circular No. 15 series of 2003 dated 16 December 2003.