

# COMPTROLLER'S LICENSING MANUAL



# Contents

---

|   |          |
|---|----------|
| <b>Introduction.....</b>  | <b>1</b> |
| General .....   | 1        |
| National Banks and FSAs Are Subject to Different Requirements .....                           | 1        |
| Heightened Requirements Apply for Subordinated Debt to Qualify<br>for Regulatory Capital..... | 2        |
| <b>Specific Requirements and Procedures .....</b>   | <b>3</b> |
| General Requirements for National Banks .....   | 3        |
| Prior Approval for Issuance .....   | 3        |
| Minimum Terms .....   | 4        |
| Required Disclosures .....  | 4        |
| Prohibition on Certain Restrictive Provisions and Covenants .....                             | 5        |
| Prior Approval for Prepayment.....  | 6        |
| General Requirements for FSAs .....   | 7        |
| Prior Approval for Issuance .....   | 7        |
| Required Disclosures .....  | 7        |
| Other Restrictions .....  | 8        |
| Regulatory Capital Requirements for National Banks.....                                       | 8        |
| Notice.....   | 8        |
| Prior Approval for Prepayment.....  | 8        |
| Regulatory Capital Requirements for FSAs .....  | 9        |
| Required Disclosures .....  | 9        |
| Trust Indenture Requirement .....   | 10       |
| Application for Approval.....   | 10       |
| Timeline for Issuance.....  | 11       |
| Prior Approval for Prepayment.....  | 11       |
| OCC Review of Notices and Applications .....  | 12       |
| Additional Regulatory Capital Requirements for National Banks and FSAs.....                   | 12       |
| Basic Requirements .....  | 13       |
| Disclosures .....   | 13       |
| Acceleration and Prepayment .....   | 13       |
| Call Option.....  | 13       |
| Credit Sensitivity .....  | 14       |
| Funding and Issuing Entity .....  | 14       |
| Other Requirements for National Banks and FSAs .....  | 14       |
| Lending Limits and Other Statutory Limits.....  | 14       |
| Mandatory Convertible Debt .....  | 15       |
| Reciprocal Holdings.....  | 15       |
| Shareholders' Approval .....  | 15       |
| Securities Disclosure Requirements .....  | 15       |
| Limitations on Inclusion in Regulatory Capital.....   | 16       |

|   |           |
|---|-----------|
| <b>General Policies, Receivership Concerns, and Guidance for Subordinated Debt</b>    |           |
| <b>Included in Regulatory Capital .....</b>   | <b>17</b> |
| General Policies .....  | 17        |
| Representations and Warranties.....   | 17        |
| Affirmative Covenants.....  | 17        |
| Negative Covenants .....  | 18        |
| Events of Default .....   | 18        |
| Contemporaneous Loan Agreements .....   | 19        |
| Novel, Untested, or Extraordinary Provisions .....                                    | 19        |
| Receivership Concerns.....  | 20        |
| Pre-Failure and Post-Failure Claims by the FDIC, Depositors, and Senior Creditors     | 20        |
| ‘General’ Rights of Offset .....  | 20        |
| Guidance for Subordinated Debt Included in Regulatory Capital .....                   | 21        |
| Significant Incentive to Redeem Prior to Maturity.....                                | 21        |
| Credit-Sensitive Features .....   | 22        |
| No Expectation That a Call Option Will Be Exercised .....                             | 22        |
| Funding Purchases of Subordinated Debt.....   | 22        |
| <b>Appendix A: Sample Provisions .....</b>  | <b>23</b> |
| <b>Appendix B: Sample Certificate of Accredited Investor Status .....</b>             | <b>27</b> |
| <b>Appendix C: Sample Certificate of Compliance With 12 CFR 3.20(d)(1)(viii).....</b> | <b>30</b> |
| <b>Appendix D: Sample Certificates of Compliance With 12 CFR 3.20(d)(1)(iii) and</b>  |           |
| <b>12 CFR 5.47(d)(1)(iv) [National Bank]/ 12 CFR 5.56(d)(1)(i)(C) [FSA] .....</b>     | <b>32</b> |
| <b>Appendix E: Sample Subordinated Debt Notes .....</b>                               | <b>34</b> |
| <b>Glossary .....</b>   | <b>44</b> |
| <b>References .....</b>   | <b>46</b> |

# Introduction

---

## General

Subordinated debt is a financing tool available to national banks and federal savings associations (FSA) (collectively, banks). This *Comptroller's Licensing Manual* booklet describes the licensing requirements, key policies, and other guidance adopted by the Office of the Comptroller of the Currency (OCC) that apply to subordinated debt issued by banks.

The requirements and policy that apply to issuances of subordinated debt differ based on (1) whether the issuing bank is a national bank or FSA and (2) whether the issuance is intended to qualify for regulatory capital. In reviewing the regulatory requirements described in this booklet, banks should pay special attention to the following items and the extent to which they apply:

- Whether OCC approval is necessary before issuing or prepaying subordinated debt.
- What minimum terms must be included in the subordinated debt note or note agreement, paying agent, or trust indenture documents, as applicable.
- What disclosures must be made in connection with the issuance.
- What additional requirements apply before a bank can include subordinated debt in regulatory capital.
- Whether any provisions unduly restrict the authority of a bank, interfere with the OCC's supervisory authority, or otherwise raise safety and soundness concerns.

The “Specific Requirements and Procedures” section of this booklet describes the regulatory requirements that apply to issuances of subordinated debt. The section titled “Key Policies” provides OCC guidance and policies relevant to the requirements described in this booklet. In addition, this booklet provides sample provisions (appendix A), a sample certificate for accredited investors (appendix B), a sample certificate of compliance with 12 CFR 3.20(d)(1)(viii) (appendix C), a sample certificate of compliance with 12 CFR 3.20(d)(1)(iii) (appendix D), sample subordinated debt notes (appendix E), a glossary of terms, and a reference section that includes applicable laws and regulations. Banks should use this booklet with other booklets of the *Comptroller's Licensing Manual*, such as the “[General Policies and Procedures](#)” booklet, which includes a discussion of general filing instructions and procedures. Throughout the booklet, there are hyperlinks to related booklets and filing samples.

A bank generally may enter into any type of agreement, provided the agreement does not violate a law, regulation, or OCC policy or constitute an unsafe or unsound banking practice. Banks with questions regarding subordinated debt are encouraged to contact the appropriate OCC district licensing office.

## National Banks and FSAs Are Subject to Different Requirements

There are separate procedures and requirements for subordinated debt issued by national banks and FSAs. While there is some overlap, these rules have different statutory bases, and banks

should take care to address the requirements that apply specifically to them. Fundamentally, all national banks issuing subordinated debt must satisfy the requirements set forth in 12 CFR 5.47. FSAs issuing subordinated debt (or other types of debt) must at a minimum satisfy the requirements in 12 CFR 163.80.

### **Heightened Requirements Apply for Subordinated Debt to Qualify for Regulatory Capital**

In addition to the general requirements that apply to all issuances of subordinated debt, banks must satisfy certain heightened requirements when seeking to include subordinated debt in tier 2 capital or prepay subordinated debt included in tier 2 capital. For national banks, 12 CFR 5.47 includes certain provisions that must be satisfied. FSAs must meet the requirements in 12 CFR 5.56. Additionally, banks must satisfy the regulatory capital requirements of 12 CFR 3 and in particular 12 CFR 3.20(d).

# Specific Requirements and Procedures

---

## General Requirements for National Banks

### Prior Approval for Issuance

Pursuant to 12 CFR 5.47(f)(1)(i), a national bank that is not an “eligible bank”<sup>1</sup> must obtain OCC approval from the appropriate district licensing office before issuing subordinated debt. A national bank that is an eligible bank must obtain OCC approval from the appropriate district licensing office before issuing subordinated debt when

- the national bank will not continue to be an “eligible bank” following the transaction.
- the OCC has notified the national bank that prior approval is required.
- the law otherwise requires prior OCC approval.

The application for prior approval must include

- a description of the terms and amount of the proposed issuance.
- a statement of whether the national bank is subject to a capital plan, as defined in 12 CFR 5.47(c), or required to file a capital plan with the OCC and, if so, how the proposed change conforms to the capital plan.<sup>2</sup>
- a copy of the proposed subordinated debt note and subordinated debt agreement.
- a statement that the subordinated debt issuance complies with all applicable laws and regulations.

In addition to these requirements, a national bank should submit a copy of any other subordinated debt documents pertaining to the issuance.<sup>3</sup>

---

<sup>1</sup> An eligible bank or eligible savings association is a national bank or FSA that (1) is well capitalized as defined in 12 CFR 6.4; (2) has a composite CAMELS rating of 1 or 2; (3) has a Community Reinvestment Act (CRA) rating of “Outstanding” or “Satisfactory,” if applicable; (4) has a consumer compliance rating of 1 or 2 under the Uniform Interagency Consumer Compliance Rating System; and (5) is not subject to a cease-and-desist order, consent order, formal written agreement, or prompt corrective action directive or, if subject to any such order, agreement, or directive, is informed in writing by the OCC that the bank or savings association may be treated as an “eligible bank or eligible savings association” for purposes of 12 CFR 5. Refer to 12 CFR 5.3(g).

<sup>2</sup> If subject to a capital plan, the national bank should demonstrate how the proposed issuance will assist the national bank in achieving its capital plan and, more specifically, how the proceeds of the issuance will be deployed in conformity with the capital plan. If the proposed subordinated debt issuance represents a significant deviation from the present capital plan, the applicant must demonstrate how the revised capital plan is more realistic and achievable in light of the national bank’s financial condition.

<sup>3</sup> Such additional documents may include a trust indenture, a note agreement, a paying agent agreement, or an underwriting agreement.

## Specific Requirements and Procedures

A national bank's application for prior approval is considered approved as of the 30th calendar day after the OCC's receipt of the application or notice, unless the OCC notifies the national bank otherwise. The subordinated debt should be issued within one year of approval.

### Minimum Terms

Pursuant to 12 CFR 5.47(d)(1), all subordinated debt notes issued by a national bank must satisfy the following minimum requirements:

- Have a minimum original maturity of at least five years.
- Not be a deposit and not be insured by the Federal Deposit Insurance Corporation (FDIC).
- Be subordinated to the claims of depositors.
- Be unsecured, which includes prohibiting the establishment of any legally enforceable fund earmarked for payment of the subordinated debt note through (1) a sinking fund or (2) a compensating balance or any other funds or assets subject to a legal right of offset, as defined by applicable state law.
- Be ineligible as collateral for a loan by the issuing national bank.
- Provide that after any scheduled payments of principal begin, all scheduled payments shall be made at least annually and the amount repaid in each year shall be no less than in the prior year.
- Provide that, when applicable, no payment (including payment pursuant to an acceleration clause, redemption prior to maturity, or repurchase or the exercising of a call option) shall be made without prior OCC approval.

National banks should ensure that these requirements are satisfied in any other subordinated debt documents, as appropriate.

### Required Disclosures

Pursuant to 12 CFR 5.47(d)(3), a national bank must disclose clearly on the face of any subordinated debt note the following language in all capital letters:

- THIS OBLIGATION IS NOT A DEPOSIT AND IS NOT INSURED BY THE FEDERAL DEPOSIT INSURANCE CORPORATION.
- THIS OBLIGATION IS SUBORDINATED TO CLAIMS OF DEPOSITORS AND GENERAL CREDITORS, IS UNSECURED, AND IS INELIGIBLE AS COLLATERAL FOR A LOAN BY [*NAME OF ISSUING BANK*].

A national bank must also disclose clearly and accurately certain items, summarized below, in the subordinated debt note. National banks should review 12 CFR 5.47(d)(3) for the full requirements.

- The order and level of subordination. At a minimum, the disclosure language must provide that, in addition to being subordinated to the claims of depositors, the subordinated debt note is subordinate and junior in its right of payment to the obligations of all creditors, except

## Specific Requirements and Procedures

those specifically designated as ranking on a parity with, or subordinated to, the subordinated debt note. The subordinated debt note must be subordinated to both secured and unsecured or general creditors.

- A general description of the OCC’s regulatory authority with respect to a national bank in danger of insolvency. The description should include (1) the OCC’s and FDIC’s receivership authority, (2) the OCC’s authority to impose restrictions and requirements on “undercapitalized” national banks,<sup>4</sup> and (3) the OCC’s authority under 12 CFR 3.11 to limit certain discretionary distributions.<sup>5</sup>

Though not required by 12 CFR 5.47, national banks should consider adding a statement about or reference to the following prohibitions within the subordinated debt note:

- The 12 USC 1828(b) prohibition on the payment of dividends or interest for national banks in default in the payment of any assessment due to the FDIC.
- Any other relevant, material restrictions.

National banks must also comply with the securities offering disclosure rules in 12 CFR 16, as described in the “Other Requirements for National Banks and FSAs” subsection of this booklet. National banks should consider including the above disclosures in any other subordinated debt documents as appropriate.

## Prohibition on Certain Restrictive Provisions and Covenants

Pursuant to 12 CFR 5.47(d)(2), a subordinated debt note issued by a national bank must not include any provision or covenant that unduly limits the authority of a national bank or that interferes with the OCC’s supervision of a national bank. Specifically, this would include any provision or covenant that

- requires a national bank to maintain a certain minimum amount in the national bank’s capital accounts or other metric, such as capital assets, liquidity, or loan ratios.
- unreasonably restricts a national bank’s ability to raise additional capital through the issuance of additional subordinated debt or other regulatory capital instruments.
- provides for default and acceleration of the subordinated debt as the result of a change in control, if such change in control results from the OCC’s exercise of its statutory authority to require a national bank to sell stock in that national bank, enter into a merger or consolidation, or be acquired by a bank holding company.
- requires the prior approval of a purchaser or holder of the subordinated debt note in the case of a voluntary merger by a national bank in which the resulting institution

---

<sup>4</sup> National banks must include a statement or refer to 12 USC 1831o(h); specifically, the 12 USC 1831o(h)(2) prohibition on the payment of principal and interest for critically undercapitalized institutions.

<sup>5</sup> The capital conservation buffer and the countercyclical capital buffer requirements described at 12 CFR 3.11 may restrict the ability of a bank to make certain discretionary payments and distributions (including by repurchase or redemption of a capital instrument) absent OCC approval (1) if the national bank fails to meet certain capital conservation requirements or (2) at certain OCC-determined periods.

## Specific Requirements and Procedures

- assumes the due and punctual performance of all conditions of the subordinated debt note and agreement, and
- is not in default of the various covenants of the subordinated debt.
- provides for default and acceleration of the subordinated debt as the result of a default by a subsidiary (including a limited liability company) of the national bank,<sup>6</sup> unless
  - there is a separate agreement between the subsidiary and the purchaser of the national bank’s subordinated debt note, and
  - such agreement has been reviewed and approved by the OCC.

National banks should ensure that these provisions do not appear in other subordinated debt documents pertaining to the issuance.

## Prior Approval for Prepayment

Pursuant to 12 CFR 5.47(f)(2) and (g)(1)(ii), for subordinated debt not included in tier 2 capital, a national bank that is not an eligible bank must seek prior approval from the appropriate OCC district licensing office to prepay subordinated debt. An eligible national bank must seek prior approval to prepay such subordinated debt if (1) the national bank meets any of the conditions that would require it to seek prior approval before issuing subordinated debt<sup>7</sup> or (2) the amount of the proposed prepayment is equal to or greater than 1 percent of the national bank’s total capital. All national banks must obtain prior OCC approval to prepay subordinated debt if the subordinated debt is included in tier 2 capital.

An application for prior approval for prepayment must include

- a description of the terms and amount of the proposed prepayment.
- a statement of whether the national bank is subject to a capital plan or required to file a capital plan with the OCC and, if so, how the proposed change conforms to the capital plan.
- a copy of the subordinated debt instrument the national bank is proposing to prepay.

Pursuant to 12 CFR 5.47(g)(1)(ii)(B), if the prepayment is in the form of a call option, a national bank must provide either (1) a statement explaining why the national bank believes that after the proposed prepayment the national bank would continue to hold an amount of capital commensurate with its risk or (2) a description of the replacement capital instrument that meets the criteria for regulatory capital under 12 CFR 3.20.

The description of the replacement capital instrument must include the amount of such instrument and the time frame for issuance. In addition to providing the statement or description and before exercising the call option, or immediately thereafter, the national bank must also (1) demonstrate to the satisfaction of the OCC that the national bank will continue to hold capital

---

<sup>6</sup> A national bank should also avoid any provision or covenant that provides for default and acceleration of the subordinated debt as the result of a default by an affiliate, including a holding company.

<sup>7</sup> That is, the eligible bank (1) would not continue to be an eligible bank following the transaction, (2) the OCC has notified the eligible bank that prior approval is required, or (3) the law otherwise requires prior approval.

## Specific Requirements and Procedures

that is commensurate with its risk or (2) replace the called amount with an equivalent amount of an instrument that meets the criteria for regulatory capital.

A national bank's application for prepayment is deemed approved as of the 30th calendar day after the OCC receives the filing, unless the OCC notifies the national bank that the filing presents a supervisory, compliance, legal, or policy issue. If the national bank's application is for prepayment in the form of a call option, however, the national bank must receive affirmative approval from the OCC to exercise the call option. If the OCC requires the national bank to replace the subordinated debt, the replacement capital instrument must satisfy the regulatory capital requirements in 12 CFR 3. Approval expires if the national bank does not complete the sale of the subordinated debt within one year of approval.

## General Requirements for FSAs

### Prior Approval for Issuance

Pursuant to 12 CFR 163.80(e), FSAs are required to provide notice to the appropriate OCC district licensing office before issuing subordinated debt if (1) the FSA does not meet its capital requirements under 12 CFR 3, and (2) the maturity of the note exceeds one year. The notice must be made at least 10 business days before issuance and must contain a summary of the items of the security, including

- principal amount of the securities.
- anticipated interest rate range and price range at which the securities are to be sold.
- minimum denomination.
- stated and average effective maturity.
- mandatory and optional prepayment provisions, if any.
- description, amount, and maintenance of collateral, if any.
- trustee provisions, if any.
- paying agent provisions, if any.
- events of default and remedies of default, if any.
- any provisions that restrict, conditionally or otherwise, the FSA's operations.

The OCC has 10 business days after receipt of the notice to object to the issuance. The OCC will object if the terms or covenants of the proposed issuance place unreasonable burdens on, or control over, the operations of the FSA. If the OCC does not object, the FSA has 120 calendar days to issue the securities.

### Required Disclosures

Pursuant to 12 CFR 163.80(d) and 12 CFR 5.56(d)(1), a subordinated debt note must include the following legend in a prominent place and in bold type on the face of the note:

This security is *not* a savings account or a deposit and it is *not* insured by the United States or any agency or fund of the United States.

FSAs must comply with the securities offering disclosure rules in 12 CFR 16, as described in the “Other Requirements for National Banks and FSAs” section of this booklet. FSAs are subject to the requirements under 12 CFR 3.11.<sup>8</sup>

### Other Restrictions

Pursuant to 12 CFR 163.76(a), FSAs are not permitted to offer or sell debt securities issued by the FSA or its affiliates at an office of the FSA.

## Regulatory Capital Requirements for National Banks

### Notice

Pursuant to 12 CFR 5.47(f)(1)(ii), if the national bank intends to include the subordinated debt instrument in tier 2 capital, the national bank must notify the OCC in writing within 10 days after issuing the subordinated debt, regardless of whether the national bank was required to seek prior approval.<sup>9</sup> Pursuant to 12 CFR 5.47(h)(2), the notice must include

- the terms of the issuance.
- the amount and date of receipt of funds.
- a copy of the final subordinated note instrument and note agreement.
- a statement that the issuance complies with all applicable laws and regulations.

In addition, a national bank should also provide any other subordinated debt documents, including any indenture, pertaining to the issuance.

The national bank may not include the subordinated debt in tier 2 capital unless it has received notification from the OCC that the subordinated debt qualifies as tier 2 capital.

### Prior Approval for Prepayment

National banks are required to obtain prior approval from the appropriate OCC district licensing office to prepay subordinated debt if the subordinated debt is included in tier 2 capital. The specific requirements related to the application for prior approval are provided in the “General Requirements for National Banks” subsection of this booklet.

---

<sup>8</sup> The capital conservation buffer and the countercyclical capital buffer requirements described at 12 CFR 3.11 may restrict the ability of a bank to make certain discretionary payments and distributions (including by repurchase or redemption of a capital instrument) absent OCC approval (1) if the bank fails to meet certain capital conservation requirements or (2) at certain OCC-determined periods.

<sup>9</sup> Though not required by 12 CFR 5.47, in practice national banks typically state their intent to include subordinated debt in tier 2 capital as part of the application for prior approval. The national bank can then satisfy the remaining requirements provided in 12 CFR 5.47(h)(2) in the notice filed after issuing the subordinated debt.

## Regulatory Capital Requirements for FSAs

In addition to the general requirements (12 CFR 163.80) described above, FSAs must satisfy the requirements of 12 CFR 5.56 for subordinated debt to be included in tier 2 capital. These requirements are described in this section. When an inconsistency arises between the requirements of 12 CFR 163.80(d) and 12 CFR 5.56, the requirements of 12 CFR 5.56 apply.

FSAs must also satisfy the regulatory capital requirements of 12 CFR 3.20(d), which apply to all banks.

## Required Disclosures

Pursuant to 12 CFR 5.56(d)(1), to be included in tier 2 capital, the subordinated debt note must state the following:

- The security is subordinated on liquidation as to principal, interest, and premium to all claims against the FSA that have the same or higher priority as savings accounts.
- The security is not secured by the FSA's assets or the assets of any affiliate of the FSA. An affiliate means any person or company that controls, is controlled by, or is under common control with the FSA.
- The security is not eligible collateral for a loan by the FSA.

The subordinated debt note must also state or refer to the following prohibitions:

- The 12 USC 1828(b) prohibition on the payment of dividends or interest for banks in default in the payment of any assessment due to the FDIC.
- The 12 USC 1831o(h) and 12 CFR 3.11 prohibition on the payment of principal and interest for critically undercapitalized institutions.<sup>10</sup>
- Any other relevant, material restrictions.

The subordinated debt note must also state the following or refer to documents that state the following:

- The terms under which the FSA may prepay the obligation.
- That the FSA must obtain the OCC's prior approval before (1) the acceleration of payment of principal or interest, (2) redemption prior to maturity, (3) repurchase, or (4) exercising a call option in connection with the security.

An FSA must also include any additional statements that the OCC requests be included in the subordinated debt note, agreement, indenture, or other subordinated debt document. FSAs should ensure that the requirements described above are satisfied in any other subordinated debt documents, as appropriate. In this regard, the subordinated debt note should include a general description of the OCC's regulatory authority with respect to an FSA in danger of insolvency.

---

<sup>10</sup> Refer to footnote 11.

## Specific Requirements and Procedures

The description should include (1) the OCC's and FDIC's receivership authority, (2) the OCC's authority to impose restrictions and requirements on "undercapitalized" FSAs,<sup>11</sup> and (3) the OCC's authority under 12 CFR 3.11 to limit certain discretionary distributions.<sup>12</sup>

### Trust Indenture Requirement

For the subordinated debt to be included in tier 2 capital, pursuant to 12 CFR 5.56(d)(2), an FSA generally must use an indenture as part of the transaction.

Pursuant to 12 CFR 5.56(d)(2), if the aggregate amount of subordinated debt securities publicly offered and sold in any consecutive 12-month or 36-month period exceeds \$5 million or \$10 million, respectively, the indenture must provide for the appointment of a trustee other than the FSA or an affiliate of the FSA and for collective enforcement of the security holders' rights and remedies.

An FSA is not required to use an indenture if the subordinated debt note that is intended to be included in tier 2 capital is sold only to accredited investors; however, these securities may not be transferred to any non-accredited investor unless the FSA has an indenture in place that meets the requirements described above. If an FSA claims an exemption to the indenture requirement, it must place a legend on the appropriate subordinated debt documents indicating that an indenture must be in place before the debt securities are transferred to any non-accredited investor.

FSAs should consider incorporating certain suggested subordination provisions and revised American Bar Association Model Simplified Indenture provisions, available at appendix A in this booklet, in the indenture and other appropriate subordinated debt documents.<sup>13</sup>

### Application for Approval

Pursuant to 12 CFR 5.56, an FSA that intends to include subordinated debt in tier 2 capital must file an application seeking the OCC's approval. This application may be filed before or after the

---

<sup>11</sup> FSAs must include a statement or refer to 12 USC 1831o(h), specifically, the 12 USC 1831o(h)(2) prohibition on the payment of principal and interest for critically undercapitalized institutions.

<sup>12</sup> The capital conservation buffer and the countercyclical capital buffer requirements described at 12 CFR 3.11 may restrict the ability of an FSA to make certain discretionary payments and distributions (including by repurchase or redemption of a capital instrument) absent OCC approval if the FSA fails to meet certain capital conservation requirements or at certain OCC-determined periods.

<sup>13</sup> References to the Model Simplified Indenture are to specific sections of the American Bar Association's revisions (May 2000) to the 1983 Model Simplified Indenture (Model Simplified Indenture). See 55 Bus. Law. 1115 (May 2000). The Model Simplified Indenture is a general purpose indenture for commercial companies and should be revised for the specific circumstances of a financial institution. See appendix A for the specific provisions with citations for those recommended provisions. The suggested provisions in appendix A reflect suggested revisions by the OCC to tailor the provisions to a bank. The bank and its advisors should review carefully the suggested provisions to help ensure their applicability to the bank's proposed subordinated debt issuance.

## Specific Requirements and Procedures

issuance. If the FSA is an eligible savings association,<sup>14</sup> it can file a notice subject to expedited review. The FSA may not include subordinated debt in tier 2 capital until the OCC approves the application. Under expedited review, the notice is deemed to have been approved by the OCC upon the expiration of 30 calendar days after the filing date of the notice unless, before the expiration of that time period, the OCC notifies the FSA that (1) additional information is required to supplement the notice; (2) the notice is not eligible for expedited review, or the expedited review process is extended; or (3) the OCC denies the notice. Pursuant to 12 CFR 5.56(f), if the FSA amends the subordinated debt note or related subordinated debt documents following completion of the OCC's review, it must obtain the OCC's approval before it may include the amended subordinated debt note in tier 2 capital.

An FSA must file the following information with the OCC within 30 calendar days after the FSA completes the sale of subordinated debt includable as tier 2 capital. If the FSA filed its application or notice following the completion of the sale, it must submit this information with its application or notice:

- A written report indicating the number of purchasers, the total dollar amount of securities sold, the net proceeds received by the FSA from the issuance, and the amount of subordinated debt, net of all expenses, to be included as tier 2 capital.
- Three copies of the executed subordinated debt note and a copy of all other relevant subordinated debt documents governing the issuance or administration of the securities.
- A certification by the appropriate executive officer indicating that the FSA complied with all applicable laws and regulations in connection with the offering, issuance, and sale of the securities.

## Timeline for Issuance

The FSA must complete the sale of subordinated debt within one year after the OCC's approval under 12 CFR 5.56. An FSA may request an extension of the offering period by filing a written request with the OCC. The FSA must demonstrate good cause for the extension and file the request at least 30 days before the expiration of the offering period or any extension of the offering period. For any potential extension of the offering period, the FSA should consider whether there are any securities offering disclosure implications.

## Prior Approval for Prepayment

FSAs are required to obtain prior approval from the appropriate OCC district licensing office to prepay subordinated debt if the subordinated debt is included in tier 2 capital.

In reviewing an FSA's prepayment application, the OCC considers the same criteria and conditions used in reviewing an FSA's applications to issue subordinated debt or include subordinated debt in tier 2 capital. See 12 CFR 5.56(e).

---

<sup>14</sup> The term "eligible savings association" is defined at 12 CFR 5.3(g). Refer to footnote 2.

## Specific Requirements and Procedures

If the prepayment is in the form of a call option, FSAs must provide either (1) a statement explaining why the FSA believes that following the proposed prepayment the FSA would continue to hold an amount of capital commensurate with its risk or (2) a description of the replacement capital instrument that meets the criteria for regulatory capital under 12 CFR 3.20. The description of the replacement capital instrument must include the amount of such instrument and the time frame for issuance. In addition to providing the statement or description, and before or immediately after exercising the call option, the FSA must also (1) demonstrate to the OCC's satisfaction that the FSA will continue to hold capital that is commensurate with its risk or (2) replace the called amount with an equivalent amount of an instrument that meets the criteria for regulatory capital.

## OCC Review of Notices and Applications

Pursuant to 12 CFR 5.56(e), in reviewing an FSA's (1) application to issue subordinated debt that is intended to qualify for tier 2 capital, (2) notice of intent to include subordinated debt in tier 2 capital, or (3) application to prepay subordinated debt that is included in tier 2 capital, the OCC considers whether

- the issuance of subordinated debt is authorized under applicable laws and regulations and is consistent with the FSA's charter and bylaws,
- the FSA is at least adequately capitalized under 12 CFR 6.4 and meets the regulatory capital requirements at 12 CFR 3.10,
- the FSA is or will be able to service the subordinated debt,
- the subordinated debt is consistent with the requirements of 12 CFR 5.56,
- the subordinated debt and related transactions sufficiently transfer risk from the Deposit Insurance Fund, and
- the OCC has no objection to the issuance based on the FSA's overall policies, condition, and operations.

The OCC's approval is conditioned upon no material changes to the information disclosed in the application or notice submitted to the OCC. The OCC may impose such additional requirements or conditions as it may deem necessary to protect purchasers, the FSA, or the Deposit Insurance Fund.

## Additional Regulatory Capital Requirements for National Banks and FSAs

In addition to the general requirements and regulatory capital requirements described above, 12 CFR 3 sets additional requirements that banks must satisfy for the subordinated debt to be included in tier 2 capital. The requirements in 12 CFR 3 apply to subordinated debt issued by national banks and FSAs. The requirements of 12 CFR 3.20(d) set forth the criteria for an instrument to be included in tier 2 capital, whereas other sections of 12 CFR 3, such as 12 CFR 3.11 (capital conservation buffer and countercyclical capital buffer), include other relevant requirements applicable to capital instruments. As discussed elsewhere, banks must also

satisfy the requirements in 12 CFR 5.47 (for national banks) and 12 CFR 5.56 (for FSAs) for subordinated debt to be included in tier 2 capital.

### Basic Requirements

- The instrument must be issued and paid-in.
- The instrument must be subordinated to depositors and general creditors of the bank.
- The instrument must not be secured, covered by a guarantee of the bank or an affiliate of the bank, or subject to any other arrangement that legally or economically enhances the seniority of the instrument in relation to more senior claims.
- The instrument must have a minimum original maturity of at least five years.<sup>15</sup>

### Disclosures

- For an advanced approaches bank, a subordinated debt note must disclose that the holders of the instrument may be fully subordinated to interests held by the U.S. government in the event that the bank enters into a receivership, insolvency, liquidation, or similar proceeding.

### Acceleration and Prepayment

- The instrument must not have any terms or features that require, or create significant incentives for, the bank to redeem the instrument prior to maturity.
- The instrument, by its terms, may be called by the bank only after a minimum of five years following issuance, except that the terms of the instrument may allow it to be called sooner upon the occurrence of an event that would preclude the instrument from being included in tier 2 capital, a tax event, or if the issuing entity is required to register as an investment company pursuant to the Investment Company Act of 1940 (15 USC 80a-1 et seq.).<sup>16</sup>
- The holder of the instrument must have no contractual right to accelerate payment of principal or interest on the instrument, except in the event of a receivership, insolvency, liquidation, or similar proceeding of the bank.
- Redemption of the instrument prior to maturity or repurchase requires prior OCC approval.

### Call Option

- The instrument must require prior approval from the OCC before the bank can exercise a call option on the instrument.
- The bank must not create at issuance, through action or communication, an expectation that the call option will be exercised.

---

<sup>15</sup> An instrument that by its terms automatically converts to a tier 1 capital instrument less than five years after issuance complies with the five-year maturity requirement of this criterion.

<sup>16</sup> The OCC interprets 12 CFR 3.20(d)(v) to require a final (and not proposed) action, such as (1) an amendment to or change in the laws or regulations or treaties of the United States or any political subdivision thereof or therein, or (2) an official or administrative action (including an audit of the issuer or any affiliate thereof) or judicial decision interpreting or applying such laws or regulations or treaties.

## Specific Requirements and Procedures

- Before or immediately after exercising a call option, the bank must (1) demonstrate to the OCC's satisfaction that the bank will continue to hold capital that is commensurate with its risk or (2) replace the called amount with an equivalent amount of an instrument that meets the criteria for regulatory capital.

### Credit Sensitivity

- The instrument must have no credit-sensitive feature, such as a dividend or interest rate that is reset periodically based in whole or in part on the bank's credit standing, but may have a dividend rate that is adjusted periodically independent of the bank's credit standing in relation to general market interest rates or similar adjustments.

### Funding and Issuing Entity

- The bank, or an entity controlled by the bank, must not have purchased or directly or indirectly funded the purchase of the instrument.
- If the instrument is not issued directly by the bank or by a subsidiary of the bank that is an operating entity, the only asset of the issuing entity must be its investment in the capital of the bank, and proceeds must be immediately available without limitation to the bank or the bank's top-tier holding company in a form that meets or exceeds all the other criteria for tier 2 capital instruments under 12 CFR 3.20. A bank may disregard de minimis assets related to the operation of the issuing entity for purposes of this criterion. Banks should be aware that, for purposes of the regulatory capital rules, an "operating entity" is not an "operating subsidiary." For regulatory capital purposes, an "operating entity" is defined as "a company established to conduct business with clients with the intention of earning a profit in its own right." See 12 CFR 3.2.

## Other Requirements for National Banks and FSAs

### Lending Limits and Other Statutory Limits

Issuance or prepayment of a subordinated debt instrument may result in a change in a bank's capital level for purposes of its lending limits, pursuant to 12 USC 84 and 12 CFR 32, and its capital category, pursuant to 12 USC 1831o and 12 CFR 6 ("Prompt Corrective Action"). In addition to 12 USC 84, 12 USC 1464(u)(2)(b) imposes additional special rules on FSAs for lending limits.

Unless the OCC determines for safety and soundness reasons that a bank should calculate its lending limits more frequently and provides written notice to that effect, a bank shall determine its lending limits as of (1) the most recent of the last day of the preceding calendar quarter or (2) the date on which there is a change in capital category for purposes of 12 USC 1831o and 12 CFR 6.3.

### Mandatory Convertible Debt

Mandatory convertible debt refers to a subordinated debt instrument that requires without qualification that the issuer exchange either common or perpetual preferred stock for such instruments by a date at or before the maturity of the instrument. Mandatory convertible debt is eligible to be included in tier 2 capital without limitation if it meets all of the requirements described in this booklet, including the requirements provided in 12 CFR 3.20 (for all banks), 12 CFR 5.47 (for national banks), and 12 CFR 5.56 (for FSAs), as applicable.<sup>17</sup>

### Reciprocal Holdings

Pursuant to 12 CFR 3.22(c)(3), if there is a formal or informal arrangement in which (1) Bank X purchases, exchanges, swaps, or otherwise agrees to hold the subordinated debt of Bank Y; and (2) Bank Y agrees to hold any capital instrument of Bank X; then (3) Bank X must deduct the amount of its investment in Bank Y's subordinated debt from the component of capital for which the underlying capital instrument would qualify if it were issued by Bank X. The deduction should follow the "corresponding deduction approach" set forth at 12 CFR 3.22(c)(2). A bank that issues subordinated debt must disclose in any application or notice to the OCC whether another bank that holds any capital instruments of the bank will purchase or has purchased the subordinated debt.

### Shareholders' Approval

The OCC does not require a bank to obtain approval from shareholders or members (in the case of mutual savings associations) for the issuance or prepayment of subordinated debt. The OCC also does not require a national bank to amend its articles of association or an FSA to amend its charter to authorize the issuance or prepayment of the subordinated debt.

### Securities Disclosure Requirements

When selling subordinated debt securities, a bank must comply with the registration requirements or otherwise qualify for an exemption under 12 CFR 16. These requirements apply even if the bank is not required to obtain prior approval to issue subordinated debt.

12 CFR 16.17 requires that all registration statements, offering documents, amendments, notices, or other documents relating to a securities offering by a bank be filed electronically with the OCC's Securities and Corporate Practices Division and the appropriate district office at [www.banknet.gov](http://www.banknet.gov). Documents may be signed electronically using the signature provision in SEC Rule 402 (17 CFR 230.402).

---

<sup>17</sup> For purposes of determining any statutory limits that are based on the amount of a national bank's surplus, national banks should consult the definition of and requirements for "mandatory convertible debt" provided at 12 CFR 3.701.

## Limitations on Inclusion in Regulatory Capital

The amount of subordinated debt eligible for inclusion as tier 2 capital is reduced by 20 percent of the original amount of the instrument (net of any redemptions) at the beginning of each of the last five years of the instrument's life. See 12 CFR 3.20(d)(1)(iv). Thus, subordinated debt with less than one year to maturity is not included in regulatory capital.

# **General Policies, Receivership Concerns, and Guidance for Subordinated Debt Included in Regulatory Capital**

---

## **General Policies**

The policies in this section of the booklet apply to all subordinated debt issued by a bank, regardless of whether it is intended to be included in tier 2 capital, unless otherwise noted.

Banks should be aware that, for subordinated debt that is intended to be included in tier 2 capital, 12 CFR 3.20(d)(1)(vi) provides that the holder of a subordinated debt note must not have a contractual right to accelerate payment of principal or interest on the note except in the event of a receivership, insolvency, liquidation, or similar proceeding of the bank.

## **Representations and Warranties**

As a policy matter, the OCC is concerned that subordinated debt documents might contain representations and warranties that might unduly interfere with the management of a bank and could result in unsafe or unsound banking practices. For example, banks should pay special attention to warranties asserting that (1) there has been no material change in the issuing bank's condition, (2) the bank is not in default with respect to any agreement, or (3) the bank is not in violation of its articles of association (for a national bank), charter (for an FSA), or bylaws. These types of broad contract provisions could result in a violation of the contract or be an event of default that leads to acceleration of the subordinated debt note, even when the violation is based on a reasonable legal dispute or is immaterial in nature. A representation or warranty that requires acceleration and repayment of the subordinated debt note because of an immaterial contract violation that does not reflect underlying credit issues could be contrary to safe and sound banking practices.

Accordingly, any representation or warranty should be worded to avoid the undue or otherwise unreasonable operation of any default clause when the default clause is based on a change in the bank's status, the bank's default on any other agreement, or any violation of the national bank's articles of association or the FSA's charter or bylaws.

## **Affirmative Covenants**

In an affirmative covenant, a bank promises to perform certain actions, and the bank's failure to do so may constitute an event of default. The OCC generally does not object to a covenant permitting the purchaser to inspect the books and records of a bank, provided the covenant does not violate applicable laws and regulations. The OCC pays special attention, however, to any affirmative covenant that may unduly restrict a bank's operations or potentially require a bank to violate a law, regulation, or OCC policy. Two areas of specific concern are the following:

# **General Policies, Receivership Concerns, and Guidance for Subordinated Debt Included in Regulatory Capital**

## **Report of Examination and Nonpublic OCC Information**

Pursuant to 12 CFR 4, subpart C, a bank is prohibited from disseminating nonpublic OCC information. Nonpublic OCC information includes a bank's confidential correspondence with the OCC, reports of examination, or reports of supervisory activity. Thus, the subordinated debt note must not include any clause that would require a bank to share any nonpublic OCC information in violation of 12 CFR 4, subpart C.

## **Financial Statements**

A prospective purchaser or holder of subordinated debt may require a bank to provide financial information. While such a request by a prospective purchaser or holder is reasonable and the bank may provide such information, the bank might consider executing a confidentiality agreement before providing any information that the bank considers sensitive.

## **Negative Covenants**

The OCC also pays special attention to negative covenants. In a negative covenant, a bank promises to refrain from performing certain actions or agrees that the occurrence of a certain event may or will give rise to an event of default. Pursuant to 12 USC 1818, the OCC is concerned that a negative covenant that unduly interferes with the management of a bank could result in unsafe or unsound banking practices. Accordingly, a bank should not include in any subordinated debt document any negative covenant that unreasonably impairs the bank's flexibility in conducting its operations or interferes unduly with management. See 12 CFR 5.47(d)(2) for examples of specific negative covenants that the OCC prohibits for national banks. FSAs should consult these examples when preparing subordinated debt documents.

## **Events of Default**

A subordinated debt note generally includes a section that specifies events of default. Because a subordinated debt note or related subordinated debt document may make failure to abide by an affirmative or negative covenant an event of default, banks should be aware that there may be some overlap between the concerns raised by affirmative and negative covenants and events of default. If an event of default occurs, a subordinated debt note may provide that the note holder, at its option, may declare the note to be due and payable. In other words, payment of the principal and interest and premium, if any, due on the subordinated debt note would be accelerated and due and payable immediately.

As discussed previously, pursuant to 12 CFR 3.20(d)(1)(vi), the holder of a subordinated debt note included in tier 2 capital must not have the ability to accelerate payment of principal or interest on the note except in the event of a receivership, insolvency, liquidation, or similar proceeding of the bank.

The OCC is aware that default triggers can cover a variety of circumstances. As with general representations and warranties, however, default triggers should not be based on immaterial

## **General Policies, Receivership Concerns, and Guidance for Subordinated Debt Included in Regulatory Capital**

events. In particular, with respect to such events of default, a bank should have a reasonable opportunity to cure the default.

The following are examples of default triggers that the OCC has concluded to be reasonable:

- With respect to default triggered by nonpayment of the interest or principal when due, a reasonable minimum period to cure the default would be the later of 30 days or the next due date.
- With respect to default in performance or observance of certain other covenants, the note generally should provide for a reasonable grace period of the later of 30 days or the next due date.
- With respect to a trigger based on the bank's having defaulted on other debts, the subordinated debt note or other related subordinated debt documents generally should establish a threshold for the amount of defaulted debt. A reasonable threshold generally would be 3 percent of a bank's common equity tier 1 capital at the time of the default.
- With respect to a default trigger based on a bank's insolvency, a reasonable indication of that insolvency would be (1) that the bank admitted in writing that it was unable to pay its debts or (2) that the bank's liabilities exceeded its assets.

### **Contemporaneous Loan Agreements**

The OCC has found, on occasion, that a bank's parent holding company will fund the purchase of a subordinated debt note issued by its subsidiary bank by a contemporaneous loan agreement with a third-party lender. The terms and conditions of these loan agreements can place significant and unacceptable restrictions on the bank's parent holding company with respect to the operations of the bank issuing subordinated debt. For example, if the parent holding company's ability to repay the loan is solely dependent on dividends upstreamed by the subsidiary bank, the holding company may be asked to agree to restrict the operations of the subsidiary bank in a manner that is not consistent with these guidelines. Accordingly, a bank should make all reasonable efforts to determine whether its parent holding company has executed such a third-party loan agreement and, if such an agreement exists, to review that agreement for compliance with the requirements and policies discussed in this booklet.

### **Novel, Untested, or Extraordinary Provisions**

If a subordinated debt note includes novel, untested, or extraordinary provisions, additional review by the OCC may be required, particularly for any provisions that raise policy or safety and soundness concerns.

## **Receivership Concerns**

### **Pre-Failure and Post-Failure Claims by the FDIC, Depositors, and Senior Creditors**

As required by 12 CFR 3.20(d)(1), 5.47(d)(1), and 5.56(d)(1), depositors and senior creditors are generally a higher priority in liquidation than subordinated debt holders.<sup>18</sup> Accordingly, transactions should be structured so that a failed bank will pay out any post-insolvency interest to the depositors<sup>19</sup> and senior creditors before the failed bank makes any payment toward a subordinated debt claim, regardless of when the subordinated debt claim accrued.

Banks should be aware that courts have recognized a “rule of explicitness” in determining the order of liquidation payments and, in some cases, have ruled that terms such as “payment in full” are insufficient to require that depositors and senior creditors receive post-insolvency interest before subordinated debt holders receive anything. If the terms of the subordinated debt note are not sufficiently explicit, the court may require payment for the pre-failure claims (for principal and interest accruing before insolvency) of subordinated debt holders before allowing the payment of post-insolvency interest to depositors and senior creditors.

Banks need to pay close attention to the potential problems raised by the rule of explicitness to ensure that this issue does not arise. Banks should take appropriate measures in drafting subordination provisions in the subordinated debt note and any other appropriate subordinated debt documents. Although indentures are not generally required by the OCC for banks to issue subordinated debt (except for subordinated debt issued by an FSA that is intended to be included in regulatory capital), banks should consider the use of certain Model Simplified Indenture provisions (available in appendix A) in the appropriate subordinated debt documents. The explicitness language in the Model Simplified Indenture is supported by the definitions for “debt” and “senior debt.” In addition, banks should strongly consider defining other terms, such as “depositors” and “senior unsubordinated creditors,” as applicable. These terms are not defined in the OCC’s sample subordinated debt notes at this time. The definitions should be provided in the appropriate subordinated debt document.

### **‘General’ Rights of Offset**

The FDIC has encountered problems assembling all of the assets of a failed bank in cases in which a third-party bank that owns subordinated debt of the failed bank has claimed a legal right of offset. For example, the third-party bank may attempt to use funds deposited by the failed bank at the third-party bank to offset amounts due on the subordinated debt. The third-party bank may also argue that it does not have to pay off debt that is owed to the failed bank because of its right of offset. Other types of transactions between a failed bank and a third-party bank that holds its subordinated debt may also result in the third-party bank attempting to withhold funds from the failed bank’s receiver.

---

<sup>18</sup> See also 12 USC 1821(d)(II)(A) and 12 CFR 360.3(a)(9).

<sup>19</sup> See 12 CFR 360.7.

## **General Policies, Receivership Concerns, and Guidance for Subordinated Debt Included in Regulatory Capital**

OCC regulations provide that a national bank's subordinated debt cannot be secured. See 12 CFR 5.47(d)(1)(iv)(B). In addition, subordinated debt of an FSA that is included in tier 2 capital cannot be secured by the FSA's assets or the assets of any affiliate of the FSA. See 12 CFR 3.20(d)(1)(iii) (for national banks and FSAs) and 12 CFR 5.56(d)(1)(i)(C) (for FSAs). To help ensure compliance with these regulations, a bank may consider obtaining a certification of compliance with respect to 12 CFR 3.20(d)(1)(iii) and the applicable regulation for a national bank (12 CFR 5.47) or FSA (12 CFR 5.56) from prospective subordinated debt purchasers (see appendix D for a sample certificate).

### **Guidance for Subordinated Debt Included in Regulatory Capital**

This section of the booklet describes policies that apply to subordinated debt that is intended for inclusion in tier 2 capital. These policies supplement the heightened requirements provided in 12 CFR 3.20(d) (for national banks and FSAs), 12 CFR 5.47 (for national banks), and 12 CFR 5.56 (for FSAs). The following guidance applies to both national banks and FSAs unless otherwise noted.

#### **Significant Incentive to Redeem Prior to Maturity**

Pursuant to 12 CFR 3.20(d)(1)(iv), a subordinated debt note (and any relevant subordinated debt documents) may not include terms or features that require, or create significant incentives for, a bank to redeem the subordinated debt note prior to maturity. The OCC believes a significant incentive to redeem can take any number of forms; thus, it would be impossible to list all the possibilities. The OCC's experience, however, is that repricing clauses may create significant incentives to redeem the bank's subordinated debt.

For this reason, a bank should pay particular attention to provisions that include periodic contractual increases in the interest rates, or "step-ups," that may create significant incentives to redeem. For this discussion, a step-up is a change in coupon rate that occurs at a specific time after issuance of subordinated debt when (1) the new coupon rate is explicitly higher than the original coupon rate or (2) there is an implied increase in the original reference credit spread rate. An explicitly higher coupon rate would occur, for example, if the coupon rate increased from a fixed 4 percent for the first five years to a fixed 6 percent for years six through maturity. An implied increase in the original reference credit spread rate would occur in a subordinated debt note that has a fixed coupon for an initial period followed by a floating rate coupon when the credit spread over the second reference rate is greater than the initial coupon rate less the swap rate—that is, the fixed rate paid to the call date to receive the second reference rate. For example, if the initial reference rate is 0.9 percent, the credit spread over the initial reference rate is 2 percent (that is, the initial coupon rate is 2.9 percent), and the swap rate to the call date is 1.2 percent, then a credit spread over the second reference rate greater than 1.7 percent (2.9 percent minus 1.2 percent) would be considered an incentive to redeem.

The subordinated debt note is permitted to include an interest rate that is adjusted periodically in relation to general market interest rates or similar adjustments, so long as the adjustments are independent of a bank's credit standing (as previously discussed in this section).

## **General Policies, Receivership Concerns, and Guidance for Subordinated Debt Included in Regulatory Capital**

### **Credit-Sensitive Features**

Pursuant to 12 CFR 3.20(d)(1)(vii), a subordinated debt note (and any relevant subordinated debt documents) must not have a credit-sensitive feature, such as an interest rate that is reset periodically based in whole or in part on a bank's credit standing. A bank should pay special attention to the mechanics for determining the interest rate of the subordinated debt note to ensure that it is not based directly or indirectly on the bank's credit standing, which is prohibited.

### **No Expectation That a Call Option Will Be Exercised**

Pursuant to 12 CFR 3.20(d)(1)(v), a subordinated debt note with a call option, by its terms, generally may be called by the bank only after a minimum of five years following issuance. At the time a bank issues the subordinated debt, however, the bank must not create an expectation, whether through actions or communications, that the call option will be exercised. In this regard, a bank, consistent with all applicable laws and regulations, should pay special attention to any communication made contemporaneously with the marketing or sale of subordinated debt, particularly with respect to the bank's future expectations regarding its regulatory capital and debt structure.

### **Funding Purchases of Subordinated Debt**

The OCC's capital rules (12 CFR 3.20(d)(1)(viii)) do not permit a bank, or any entity controlled by the bank, to fund, directly or indirectly, the purchase of its subordinated debt if the subordinated debt is to be included in regulatory capital. A bank should make reasonable efforts to ensure that the source of funds does not violate 12 CFR 3.20(d)(1)(viii). If the bank has concerns with the investor's source of funds, the bank might consider obtaining some form of certification from the prospective subordinated debt purchaser to help ensure compliance. A Sample Certificate of Compliance with 12 CFR 3.20(d)(1)(viii) is included in appendix C as a resource.

## Appendix A: Sample Provisions

This appendix contains sample provisions—divided into “Suggested Subordination Provisions” and “Selected Revised ABA Model Simplified Indenture Provisions”—that banks should consider incorporating into a subordinated debt note or other appropriate subordinated debt document, even when the transaction does not involve an indenture. These sample provisions are intended to be used together and should be appropriately tailored to the circumstances of the particular transaction. The sample provisions are intended to help ensure that the rule of explicitness requirement and other concerns discussed in this booklet are addressed. Banks should pay particular attention to terms that are presented in brackets, which should be modified or defined as appropriate.

### Suggested Subordination Provisions

**Senior Claims.** The following expenses, obligations, and liabilities of the [Bank] are Senior Claims:

- (1) obligations for administrative expenses of any receiver, conservator, or similar representative appointed for the [Bank];
- (2) all deposit liabilities; and
- (3) all other general or senior liabilities other than: (A) claims arising from [Bank] obligations that are subordinated to the [Bank]’s depositors or creditors by contract or applicable statute; and (B) obligations owed to the [Bank]’s shareholders, members, and equity holders in their capacity as such.

In a [Proceeding], [as defined within this Note], Senior Claims include, without limitation:

- (1) the proven or allowed amount of Senior Claims;
- (2) any interest legally payable on the Senior Claims accruing before the commencement of the [Proceeding]; and
- (3) interest accruing on and after the commencement of the [Proceeding], assessed at the post-insolvency interest rate provided by 12 C.F.R. § 360.7 as that regulation may be amended from time to time (“Post-Commencement Interest”), whether or not claims for such Post-Commencement Interest are allowable or provable claims in such [Proceeding], and regardless of what the priority or treatment of Post-Commencement Interest would have been absent the subordination provisions in this [Note].

As to Senior Claims, “payment in full” and “paid in full” as used in this [Note] include the payment of all Post-Commencement Interest. The holders of Senior Claims, in their capacity as such, are referred to as “Senior Creditors.”

**Note is Unsecured.** Payment of this [Note] is not directly or indirectly secured by any assets of the [Bank] or its affiliates or subsidiaries, and none of their assets have been designated or segregated to provide for repayment of this [Note].

**Waiver of setoff, recoupment, and counterclaim.** The obligations under this [Note] are not subject to the exercise of setoff, recoupment, counterclaim, or any similar remedy by the [Purchaser] against any claim or obligation it may owe to the [Bank] or any of its subsidiaries or affiliates, now or in the future, and [Purchaser] waives any and all such present or future rights.

**Subordination.** Regardless of any default under this [Note] at any time, or the [Purchaser's] exercise of any rights hereunder, the [Purchaser]'s right to any payment from the [Bank] and its estate are subordinated to the payment in full of Senior Claims to the extent and in the manner provided in this section.

- (1) If the [Bank] goes into a [Proceeding], no payment will be made to the [Purchaser] under this [Note] until all Senior Claims are paid in full (including Post-Commencement Interest);
- (2) Until all Senior Claims are paid in full, any distribution in respect of any obligation evidenced by this [Note] to which the [Purchaser] would be entitled but for the provisions of this Subordination section shall be paid to the Senior Creditors; and
- (3) [Purchaser] shall not have any subrogation or other rights of recourse to any security in respect of any Senior Claims until such time as all Senior Debt shall have been paid in full as provided above.

### Selected Revised ABA Model Simplified Indenture Provisions

**Revised Model Simplified Indenture Section 1.01. Definitions. (“Debt,” “Proceeding,” “Senior Debt”).**

**Debt.** “Debt” means, with respect to the [Bank]:

- (1) any obligation of the [Bank] to pay the principal, premium, interest (including interest accruing on or after the filing of any petition in bankruptcy or for reorganization relating to the [Bank], whether or not a claim for such post-petition interest is allowed in such proceeding), penalties, reimbursement or indemnification amounts, fees, expenses, or other amounts relating to any indebtedness;
- (2) any other liability, contingent or otherwise, of the [Bank]: (A) for borrowed money (including instances where the recourse of the lender is to the whole of the assets of the [Bank] or to a portion thereof), (B) evidenced by a note, debenture, or similar instrument (including a purchase money obligation), including securities, (C) for any letter of credit or performance bond in favor of the [Bank], or (D) for the payment of money relating to a capitalized lease obligation;

- (3) any liability of others of the kind described in the preceding clauses (1) or (2), which the [Bank] has guaranteed or which is otherwise its legal liability;
- (4) any obligation of the type described in clauses (1) - (3) secured by a lien to which the property or assets of the [Bank] are subject, whether or not the obligations secured thereby shall have been assumed by or shall otherwise be the [Bank]'s legal liability; and
- (5) any and all deferrals, renewals, extensions, and refunding of, or amendments, modifications, or supplements to, any liability of the kind described in any of the preceding clauses (1) – (4).

**Proceeding.** Any insolvency, receivership, conservatorship, liquidation, reorganization, or similar proceeding, whether voluntary or involuntary.

**Senior Debt.** Debt of the [Bank] whenever incurred, outstanding at any time except (i) Debt that by its terms is not senior in right of payment to the [Securities], (ii) Debt held by the [Bank] or any affiliate of the [Bank], and (iii) Debt excluded by [Model Simplified Indenture Section 12.09 Variable Provisions] [*addressing several administrative matters including, inter alia, identifying which debts are not considered as Senior Debts, if any*].

**Revised Model Simplified Indenture Section 6.08. Priorities.**

After an [Event of Default], any money or other property distributable in respect of the [Bank]'s obligations under this [Indenture] shall be paid in the following order:

First: to the [Trustee] (including any predecessor [Trustee]) for amounts due under [Model Simplified Indenture Section 7.07 Compensation and Indemnity] [of the Trustee];

Second: to holders of Senior Debt to the extent required by [Model Simplified Indenture Article 11 Subordination or the above Subordination Provisions];

Third: to [Security holders] for amounts due and unpaid on the [Securities] for principal and interest, ratably, without preference or priority of any kind, according to the amounts due and payable on the [Securities] for principal and interest, respectively; and

Fourth: to the [Bank].

**Revised Model Simplified Indenture Section 11.02. Distributions.**

Upon any [Distribution] in any Proceeding,

- (1) any [Distribution] to which the [Holders] are entitled shall be paid directly to the holders of Senior Debt to the extent necessary to make payment in full of all Senior Debt remaining unpaid after giving effect to all other [Distributions] to or for the benefit of the holders of Senior Debt; and

- (2) in the event that any [Distribution] is received by the [Trustee] before all Senior Debt is paid in full, such [Distribution] shall be applied by the [Trustee] in accordance with part (1).

## Appendix B: Sample Certificate of Accredited Investor Status

This appendix contains a sample Certificate of Accredited Investor Status. Banks often issue subordinated debt instruments in reliance on an exemption from the securities registration provisions of 12 CFR 16, such as 12 CFR 16.7. One of the specific exemptions relies on sales of securities to individuals or entities that meet the definition of accredited investor, as that term is defined in the U.S. Securities and Exchange Commission's rules. See also the Glossary following these Appendixes. The issuer of a security is responsible for ensuring that the terms of the offering, the conduct of the offering, and the persons investing meet the various regulatory criteria for taking advantage of the exemption from registration. This includes, if applicable, that an investor meets the accredited investor definition. To aid in ensuring compliance with this regulatory accredited investor requirement, issuers may use a Certificate of Compliance executed by the investors to seek to ensure that an investor is aware of the accredited investor criteria and the investor certifies that they meet the criteria. The OCC offers the below sample certification to assist issuers in seeking to ensure compliance with the requirements for the exemption from registration.

### Suggested Sample Certificate

#### CERTIFICATE OF ACCREDITED INVESTOR STATUS

Except as may be indicated by the undersigned below, the undersigned is an individual accredited investor, as that term is defined in Regulation D under the Securities Act of 1933, as amended (the "Act"). In order to demonstrate the basis on which it is representing its status as an accredited investor, the undersigned has checked one of the boxes below indicating that the undersigned is:

a bank as defined in Section 3(a)(2) of the Act, or any savings and loan association or other institution as defined in Section 3(a)(5)(A) of the Act whether acting in its individual or fiduciary capacity; a broker or dealer registered pursuant to Section 15 of the Securities Exchange Act of 1934; an insurance company as defined in Section 2(a)(13) of the Act; an investment company registered under the Investment Company Act of 1940 or a business development company as defined in Section 2(a)(48) of that act; a small business investment company licensed by the U.S. Small Business Administration under Section 301(c) or (d) of the Small Business Investment Act of 1958; a plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if such plan has total assets in excess of \$5,000,000; an employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974, if the investment decision is made by a plan fiduciary, as defined in Section 3(21) of such act, which is either a bank, savings and loan association, insurance company, or registered investment adviser, or if the employee benefit plan has total assets in excess of \$5,000,000 or, if a self-directed plan, with investment decisions made solely by persons that are accredited investors;

a private business development company as defined in Section 202(a)(22) of the Investment Advisers Act of 1940;

- an organization described in Section 501(c)(3) of the Internal Revenue Code; a corporation; a Massachusetts or similar business trust; or a partnership, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of \$5,000,000;
- a natural person whose individual net worth, or joint net worth with the undersigned's spouse, at the time of this purchase exceeds \$1,000,000 (excluding the value of the person's primary residence);
- a natural person who had individual income in excess of \$200,000 in each of the two most recent years or joint income with the undersigned's spouse in excess of \$300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year;
- a trust with total assets in excess of \$5,000,000, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a person who has such knowledge and experience in financial and business matters that he or she is capable of evaluating the merits and risks of the prospective investment;
- an entity in which all of the equity holders are accredited investors by virtue of their meeting one or more of the above standards; or
- an individual who is a director or executive officer of [NAME OF BANK].

The undersigned understands that [NAME OF BANK] (the "Bank") is required to verify the undersigned's accredited investor status AND ELECTS TO DO ONE OF THE FOLLOWING:

- allow the Bank's representative to review the undersigned's tax returns for the two most recently completed years and provide a written representation of the undersigned's reasonable expectation of reaching the income level necessary to qualify as an accredited investor during the current year;
- allow the Bank's representative to: (1) obtain a written representation from the undersigned that states that all liabilities necessary to make a determination of net worth have been disclosed; and (2) review one or more of the following types of documentation dated within the past three months: bank statements, brokerage statements, tax assessments, appraisal reports as to assets, or a consumer report from a nationwide consumer reporting agency;
- provide the Bank with a written confirmation from one of the following persons or entities that such person or entity has taken reasonable steps to verify that the undersigned is an accredited investor within the prior three months and has determined that the undersigned is an accredited investor:
  - a registered broker-dealer;
  - an investment adviser registered with the Securities Exchange Commission;
  - a licensed attorney who is in good standing under the laws of the jurisdictions in which such attorney is admitted to practice law; or
  - a certified public accountant who is duly registered and in good standing under the laws of the place of such accountant's residence or principal office.

IN WITNESS WHEREOF, the undersigned has executed this Certificate of Accredited Investor Status effective as of \_\_\_\_\_, 20\_\_\_\_\_.

\_\_\_\_\_  
Name of Subscriber

\_\_\_\_\_  
Name of Signatory

\_\_\_\_\_  
Title of Signatory

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Address

\_\_\_\_\_  
Address

\_\_\_\_\_  
Phone Number

\_\_\_\_\_  
Email Address

## Appendix C: Sample Certificate of Compliance With 12 CFR 3.20(d)(1)(viii)

### SAMPLE CERTIFICATE OF COMPLIANCE With 12 C.F.R. § 3.20(d)(1)(viii)

On \_\_\_\_\_ (date), \_\_\_\_\_ (name) the undersigned subscriber (Subscriber) submitted a Subscription Form/Agreement to acquire \$\_\_\_\_\_ of the \_\_\_\_\_ (dollar amount and name of note) (Note), an issuance of subordinated debt offered by \_\_\_\_\_ (Bank).

The Subscriber understands that the Bank intends to include the value of the Note in its tier 2 regulatory capital pursuant to the Office of the Comptroller of the Currency's (OCC) regulatory capital regulation, which includes the requirement at 12 C.F.R. § 3.20(d)(1)(viii) that states:

(viii) The national bank or federal savings association, or an entity that the national bank or federal savings association controls, has not purchased and has not directly or indirectly funded the purchase of the instrument.

The Subscriber hereby certifies that:

1. The undersigned Subscriber has not obtained any funds through a loan or other means, directly or indirectly, from the Bank, or any entity that the Bank controls for the purpose of acquiring all or a portion of the Note.
2. The undersigned Subscriber has not entered into any written or oral agreement, understanding, or arrangement under which the Subscriber would directly or indirectly sell or transfer by any means all or any portion of the Note the Subscriber intends to purchase to the Bank or any entity that the Bank controls.
3. The undersigned Subscriber understands that if any statement herein contained is false, the Bank may not be permitted to include the full value of the Note in its tier 2 regulatory capital, which may result in a reduction in the Bank's regulatory capital and may cause non-compliance with the OCC's regulatory capital requirements.

The foregoing is a true and accurate statement, made of the Subscriber's own free will and volition.

Date: \_\_\_\_\_

Print Name: \_\_\_\_\_

Subscriber Signature: \_\_\_\_\_

Title: \_\_\_\_\_

Company: \_\_\_\_\_

**Appendix D: Sample Certificates of Compliance With  
12 CFR 3.20(d)(1)(iii) and 12 CFR 5.47(d)(1)(iv) [National Bank]/  
12 CFR 5.56(d)(1)(i)(C) [FSA]**

**SAMPLE CERTIFICATE OF COMPLIANCE**

**With 12 C.F.R. § 3.20(d)(1)(iii) and [12 C.F.R. § 5.47(d)(1)(iv) OR  
12 C.F.R. § 5.56(d)(1)(i)(C)]**

On \_\_\_\_\_ (date), \_\_\_\_\_ (“Bank”) intends to issue  
\$ \_\_\_\_\_ of the \_\_\_\_\_ (dollar amount and name of note) (“Note”),  
an issuance of subordinated debt offered by the Bank.

**[IF THE BANK IS A NATIONAL BANK]**

The Bank understands that the Note must meet the requirement at 12 C.F.R. § 5.47(d)(1)(iv) that states that the Note must:

- (iv) Be unsecured, which would include prohibiting the establishment of any legally enforceable fund earmarked for payment of the subordinated debt note through:
  - (A) A sinking fund; or
  - (B) A compensating balance or any other funds or assets subject to a legal right of offset, as defined by applicable state law.

**[IF THE BANK IS AN FSA]**

The Bank understands that the Note must meet the requirement at 12 C.F.R. § 5.56(d)(1)(i)(C) that states that the Note must:

- (C) State that the security is not secured by the savings association's assets or the assets of any affiliate of the savings association. An affiliate means any person or company that controls, is controlled by, or is under common control with the savings association

**[FOR ALL BANKS]**

The Bank understands that for it to include the value of the Note in its tier 2 regulatory capital pursuant to the applicable regulations of the Office of the Comptroller of the Currency (“OCC”), the Note must comply with the requirement at 12 C.F.R. § 3.20(d)(1)(iii) that states:

- (iii) The instrument is not secured, not covered by a guarantee of the national bank or federal savings association or of an affiliate of the national bank or federal savings association, and not subject to any other arrangement that legally or economically enhances the seniority of the instrument in relation to more senior claims.

The Bank, by its authorized officer, hereby certifies that:

The Note, by its terms and the terms of any other documents relating to the issuance and administration of the Note, complies with these provisions; and

The Bank understands, as represented by its undersigned authorized officer, that if any statement herein contained is false, the Bank may not be permitted to issue the Note or to include the full value of the Note in its tier 2 regulatory capital, which may result in a reduction in the Bank’s regulatory capital and may cause non-compliance with the OCC’s regulatory capital requirements.

The foregoing are true and accurate statements made of the Bank’s free will and volition by its authorized officer.

Date: \_\_\_\_\_

Print Name: \_\_\_\_\_

Authorized Signature: \_\_\_\_\_

Title: \_\_\_\_\_

Bank: \_\_\_\_\_

## Appendix E: Sample Subordinated Debt Notes

### SAMPLE NATIONAL BANK SUBORDINATED NOTE NOT INCLUDED IN TIER 2 CAPITAL

THIS OBLIGATION IS NOT A DEPOSIT AND IS NOT INSURED BY THE FEDERAL DEPOSIT INSURANCE CORPORATION. THIS OBLIGATION IS SUBORDINATED TO THE CLAIMS OF DEPOSITORS AND GENERAL CREDITORS, IS UNSECURED, AND IS INELIGIBLE AS COLLATERAL FOR A LOAN BY [BANK NAME].

\$ \_\_\_\_\_

Date: \_\_\_\_\_

[Bank Name] \_\_\_\_\_, a national banking association (“Bank”), promises to pay to the order of \_\_\_\_\_ [Purchaser Name] \_\_\_\_\_ (“Purchaser”) the principal amount of \$ \_\_\_\_\_, together with the interest on the part of the principal amount from time to time remaining unpaid from this date until such principal is paid at the rate of \_\_\_\_\_ [Percent] \_\_\_\_\_ annually (the “Note”).

The entire unpaid principal of this Note and any accrued interest then unpaid shall be due and payable on or before \_\_\_\_\_ [Date not less than five years from date of execution] \_\_\_\_\_. The interest on this Note shall be due and payable \_\_\_\_\_ [Payment Period] \_\_\_\_\_ as it accrues on \_\_\_\_\_ [Accrual Period] \_\_\_\_\_ until this Note is paid in full, commencing on the first such date following the date of this Note. Once any scheduled payments of principal begin, all scheduled payments shall be made at least annually and the amount repaid in each year shall be no less than in the prior year. The Bank shall have the right and privilege of prepaying all or any part of this Note at any time without notice or penalty from the Purchaser. However, the Bank may be prohibited from prepaying this Note (including, where applicable, payment pursuant to an acceleration clause, redemption prior to maturity, repurchase, or exercising a call option) without prior approval of the Office of the Comptroller of the Currency (“OCC”). All payments on this Note shall be applied first to accrued interest and the balance, if any, to principal. The Bank shall not pay any interest on the Note (if such interest is required to be paid only out of net profits) while the Bank remains in default in the payment of any assessment due to the Federal Deposit Insurance Corporation (“FDIC”).

**Subordination.** The indebtedness of the Bank evidenced by this Note, including the principal and premium, if any, and interest is unsecured and shall be subordinate and junior in right of payment to its obligations to its depositors, its obligations under bankers’ acceptances and letters of credit, obligations owed to all creditors, including both secured and unsecured or general creditors, including its obligations to the Federal Reserve Bank, FDIC, and any rights acquired by the FDIC as a result of loans made by the FDIC to the Bank or the purchase or guarantee of

any of its assets by the FDIC pursuant to the provisions of 12 U.S.C. § 1823, whether now outstanding or hereafter incurred.

In the event of any insolvency, receivership, conservatorship, reorganization, readjustment of debt, marshaling of assets and liabilities, liquidation, winding up, or similar proceedings relating to the Bank, whether voluntary or involuntary, all such obligations shall be entitled to be paid in full before any payment shall be made on account of the principal of or premium, if any, or interest on the Note. In the event of any such proceedings, after payment in full of all sums owing on such prior obligations, the holder of this Note, together with any obligations of the Bank ranking on a parity with this Note, shall be entitled to be paid from the remaining assets of the Bank the unpaid principal thereof and any unpaid premium, if any, and interest before any payment or other distribution, whether in cash, property, or otherwise, shall be made on account of any capital stock or any obligations of the Bank ranking junior to this Note.

Nothing herein shall impair the obligation of the Bank, which is absolute and unconditional, to pay the principal of and any premium and interest on this Note according to its terms.

**Office of the Comptroller of the Currency Regulatory Authority.** Notwithstanding any other provisions of this Note and related documents, including specifically those set forth in the sections relating to subordination, events of default, and covenants of the Bank, it is expressly understood and agreed that the Bank is subject to 12 C.F.R. § 5.47. In the event the Bank is considered “undercapitalized,” as defined under applicable law, and fails to satisfactorily implement a required capital restoration plan, the Bank may be subject to restrictions and requirements applicable to “significantly undercapitalized” institutions, as defined in applicable law. If the Bank is considered “significantly undercapitalized,” the OCC has the legal authority to require the Bank to sell shares in the Bank, enter into a merger or consolidation, or be acquired by a depository institution or a depository institution holding company. This authority supersedes and voids any default that may result from such OCC action. In addition, if the Bank is considered “critically undercapitalized,” as defined under applicable law, the Bank will be prohibited from making principal or interest payments on this Note without prior OCC approval.

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

**SAMPLE NATIONAL BANK SUBORDINATED NOTE INCLUDED IN TIER 2 CAPITAL**

THIS OBLIGATION IS NOT A DEPOSIT AND IS NOT INSURED BY THE FEDERAL DEPOSIT INSURANCE CORPORATION. THIS OBLIGATION IS SUBORDINATED TO THE CLAIMS OF DEPOSITORS AND GENERAL CREDITORS, IS UNSECURED, AND IS INELIGIBLE AS COLLATERAL FOR A LOAN BY [BANK NAME].

\$ \_\_\_\_\_

Date: \_\_\_\_\_

\_[Bank Name] \_\_\_\_\_, a national banking association (“Bank”), promises to pay to the order of \_\_\_\_\_ [Purchaser Name] \_\_\_\_\_ (“Purchaser”) the principal amount of \$ \_\_\_\_\_, together with the interest on the part of the principal amount from time to time remaining unpaid from this date until such principal is paid at the rate of \_\_\_\_\_ [Percent] \_\_\_\_\_ annually (the Note).

The entire unpaid principal of this Note and any accrued interest then unpaid shall be due and payable on or before \_\_\_\_\_ [Date not less than five years from date of execution] \_\_\_\_\_. The interest on this Note shall be due and payable \_\_\_\_\_ [Payment Period] \_\_\_\_\_ as it accrues on \_\_\_\_\_ [Accrual Period] \_\_\_\_\_ until this Note is paid in full, commencing on the first such date following the date of this Note. Once any scheduled payments of principal begin, all scheduled payments shall be made at least annually and the amount repaid in each year shall be no less than in the prior year. The Bank shall have the right and privilege of prepaying all or any part of this Note at any time without notice or penalty from the Purchaser. However, the Bank is prohibited from prepaying this Note (including, where applicable, payment pursuant to an acceleration clause, redemption prior to maturity, repurchase, or exercising a call option) without prior approval from the Office of the Comptroller of the Currency (“OCC”). The holder of this Note may not accelerate payment of principal or interest on this Note except in the event of receivership, insolvency, liquidation, or similar proceeding of the Bank. All payments on this Note shall be applied first to accrued interest and the balance, if any, to principal. The Bank shall not pay any interest on the Note (if such interest is required to be paid only out of net profits) while it remains in default in the payment of any assessment due to the Federal Deposit Insurance Corporation (“FDIC”).

**Subordination.** The indebtedness of the Bank evidenced by this Note, including the principal and premium, if any, and interest is unsecured and shall be subordinate and junior in right of payment to its obligations to its depositors, its obligations under bankers’ acceptances and letters of credit, obligations owed to all creditors, including both secured and unsecured or general creditors, including its obligations to the Federal Reserve Bank, FDIC, and any rights acquired by the FDIC as a result of loans made by the FDIC to the Bank or the purchase or guarantee of any of its assets by the FDIC pursuant to the provisions of 12 U.S.C. § 1823, whether now outstanding or hereafter incurred.

In the event of any insolvency, receivership, conservatorship, reorganization, readjustment of debt, marshaling of assets and liabilities, liquidation, winding up, or similar proceedings relating to the Bank, whether voluntary or involuntary, all such obligations shall be entitled to be paid in full before any payment shall be made on account of the principal of or premium, if any, or interest on the Note. In the event of any such proceedings, after payment in full of all sums owing on such prior obligations, the holder of this Note, together with any obligations of the Bank ranking on a parity with this Note, shall be entitled to be paid from the remaining assets of the Bank the unpaid principal thereof and any unpaid premium, if any, and interest before any payment or other distribution, whether in cash, property, or otherwise, shall be made on account of any capital stock or any obligations of the Bank ranking junior to this Note.

Nothing herein shall impair the obligation of the Bank, which is absolute and unconditional, to pay the principal of, and any premium and interest on, this Note according to its terms.

**Office of the Comptroller of the Currency Regulatory Authority.** Notwithstanding any other provisions of this Note and related documents, including specifically those provisions set forth in the sections relating to subordination, events of default, and covenants of the Bank, it is expressly understood and agreed that the Bank is subject to 12 C.F.R. §§ 3.20(d) and 5.47. In the event the Bank is considered “undercapitalized,” as defined under applicable law, and fails to satisfactorily implement a required capital restoration plan, the Bank may be subject to restrictions and requirements applicable to “significantly undercapitalized” institutions, as defined in applicable law. If the Bank is considered “significantly undercapitalized,” the OCC has the legal authority to require the Bank to sell shares in the Bank, enter into a merger or consolidation, or be acquired by a depository institution or a depository institution holding company. This authority supersedes and voids any default that may result from such OCC action. In addition, if the Bank is considered “critically undercapitalized” as defined under applicable law, the Bank will be prohibited from making principal or interest payments on this Note without prior OCC approval.

The Bank must obtain prior OCC approval to prepay this subordinated debt Note, including through a redemption prior to maturity, repurchase, or exercising a call option. In addition, if the Note is callable, the Bank may call the instrument only after a minimum of five years following issuance, except that the instrument may be called sooner than five years upon the occurrence of an event that would preclude the instrument from being included in tier 2 capital, a tax event, or if the issuing entity is required to register as an investment company pursuant to the Investment Company Act of 1940 (15 U.S.C. § 80a-1, et seq.).

[INCLUDE THE FOLLOWING PARAGRAPH IF THE BANK HAS DISCRETION TO SUSPEND INTEREST PAYMENTS WITHOUT TRIGGERING EVENT OF DEFAULT.

SEE 12 C.F.R. § 3.11 AND PARAGRAPH (4) OF THE DEFINITION OF “DISTRIBUTION” IN 12 C.F.R. § 3.2.

Consistent with the requirements for the capital conservation buffer at 12 C.F.R. § 3.11, the Bank may be prohibited from making a distribution under this Note, or creating an obligation to make

such a distribution, if such distribution, in the aggregate, would exceed the maximum payout amount, unless the Bank receives prior OCC approval.]

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

**SAMPLE FEDERAL SAVINGS ASSOCIATION SUBORDINATED NOTE NOT INCLUDED IN TIER 2 CAPITAL**

THIS OBLIGATION IS NOT A DEPOSIT AND IS NOT INSURED BY THE FEDERAL DEPOSIT INSURANCE CORPORATION. THIS OBLIGATION IS SUBORDINATED TO THE CLAIMS OF DEPOSITORS AND GENERAL CREDITORS, IS UNSECURED, AND IS INELIGIBLE AS COLLATERAL FOR A LOAN BY [SAVINGS ASSOCIATION NAME].

\$ \_\_\_\_\_

Date: \_\_\_\_\_

\_[Savings Association Name]\_\_\_\_\_, a federal savings association (“Savings Association”), promises to pay to the order of \_\_\_\_\_ [Purchaser] (“Purchaser”) the principal amount of \$\_\_\_\_\_, together with the interest on the part of the principal amount from time to time remaining unpaid from this date until such principal is paid at the rate of \_\_\_\_\_ [Percent]\_\_\_\_\_ annually (the “Note”).

The entire unpaid principal of this Note and any accrued interest then unpaid shall be due and payable on or before \_\_\_\_\_ [Date not less than five years from date of execution]\_\_\_\_\_. The interest on this Note shall be due and payable \_\_\_\_\_ [Payment Period]\_\_\_\_\_ as it accrues on \_\_\_\_\_ [Accrual Period]\_\_\_\_\_ until this Note is paid in full, commencing on the first such date following the date of this Note. The Savings Association shall have the right and privilege of prepaying all or any part of this Note at any time without notice or penalty from the Purchaser. However, the Savings Association may be prohibited from prepaying this Note (including, where applicable, payment pursuant to an acceleration clause, redemption prior to maturity, repurchase, or exercising a call option) without prior approval of the Office of the Comptroller of the Currency (“OCC”). All payments on this Note shall be applied first to accrued interest and the balance, if any, to principal. The Savings Association shall not pay any interest on the Note (if such interest is required to be paid only out of net profits) while the Savings Association remains in default in the payment of any assessment due to the Federal Deposit Insurance Corporation (“FDIC”).

**Subordination.** The indebtedness of the Savings Association evidenced by this Note, including the principal and premium, if any, and interest is unsecured and shall be subordinate and junior in right of payment to its obligations to its depositors, its obligations under bankers’ acceptances and letters of credit, all obligations owed to creditors, including both secured and unsecured or general creditors, including its obligations to the Federal Reserve Bank, FDIC, and any rights acquired by the FDIC as a result of loans made by the FDIC to the Savings Association or the purchase or guarantee of any of its assets by the FDIC pursuant to the provisions of 12 U.S.C. § 1823, whether now outstanding or hereafter incurred.

In the event of any insolvency, receivership, conservatorship, liquidation, reorganization, readjustment of debt, marshaling of assets and liabilities, liquidation, winding up, or similar

proceedings relating to the Savings Association, whether voluntary or involuntary, all obligations owed to creditors, including both secured and unsecured or general creditors, shall be entitled to be paid in full before any payment shall be made on account of the principal of or premium, if any, or interest on the Note. In the event of any such proceedings, after payment in full of all sums owing on such prior obligations, the holder, of this Note, together with any obligations of the Savings Association ranking on a parity with this Note, shall be entitled to be paid from the remaining assets of the Savings Association the unpaid principal thereof and any unpaid premium, if any, and interest before any payment or other distribution, whether in cash, property, or otherwise, shall be made on account of any capital stock or any obligations of the Savings Association ranking junior to this Note.

Nothing herein shall impair the obligation of the Savings Association, which is absolute and unconditional, to pay the principal of and any premium and interest on this Note according to its terms.

**Office of the Comptroller of the Currency Regulatory Authority.** Notwithstanding any other provisions of this Note and related documents, including specifically those set forth in the sections relating to subordination, events of default, and covenants of the Savings Association, it is expressly understood and agreed that the Savings Association is subject to 12 C.F.R. § 163.80, and in the event the Savings Association is considered “undercapitalized,” as defined under applicable law, and fails to satisfactorily implement a required capital restoration plan, the Savings Association may be subject to restrictions and requirements applicable to “significantly undercapitalized” institutions, as defined in applicable law, or if the Savings Association is considered “significantly undercapitalized,” the OCC has the legal authority to require the Savings Association to sell shares in the Savings Association, enter into a merger or consolidation, or be acquired by a depository institution or a depository institution holding company. This authority supersedes and voids any default that may have occurred resulting from such OCC action. In addition, if the Savings Association is considered “critically undercapitalized,” as defined under applicable law, the Savings Association will be prohibited from making principal or interest payments on this subordinated debt Note without prior OCC approval.

Notwithstanding the foregoing, however, any interest and principal previously due, other than by reason of acceleration, and not paid, shall be deemed to be immediately due and payable as of the date of such transfer and assumption, together with the interest from its original due date at the rate provided for herein, unless the holder of this Note has made an agreement to the contrary.

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

**SAMPLE FEDERAL SAVINGS ASSOCIATION SUBORDINATED NOTE INCLUDED  
IN TIER 2 CAPITAL**

THIS OBLIGATION IS NOT A DEPOSIT AND IS NOT INSURED BY THE FEDERAL DEPOSIT INSURANCE CORPORATION. THIS OBLIGATION IS SUBORDINATED TO THE CLAIMS OF DEPOSITORS AND GENERAL CREDITORS, IS UNSECURED, AND IS INELIGIBLE AS COLLATERAL FOR A LOAN BY [SAVINGS ASSOCIATION NAME].

\$ \_\_\_\_\_

Date: \_\_\_\_\_

\_[Savings Association Name]\_\_\_\_\_, a federal savings association (“Savings Association”), promises to pay to the order of \_\_\_\_\_[Purchaser]\_\_\_\_\_ (“Purchaser”) the principal amount of \$\_\_\_\_\_, together with the interest on the part of the principal amount from time to time remaining unpaid from this date until such principal is paid at the rate of \_\_\_\_\_[Percent]\_\_\_\_\_ annually (the “Note”).

The entire unpaid principal of this Note and any accrued interest then unpaid shall be due and payable on or before \_\_\_\_\_[Date not less than five years from date of execution]\_\_\_\_\_. The interest on this note shall be due and payable \_\_\_\_\_[Payment Period]\_\_\_\_\_ as it accrues on \_\_\_\_\_[Accrual Period]\_\_\_\_\_ until this Note is paid in full, commencing on the first such date following the date of this Note. The Savings Association shall have the right and privilege of prepaying all or any part of this Note at any time without notice or penalty from the Purchaser. However, the Savings Association is prohibited from prepaying this Note (including, where applicable, payment pursuant to an acceleration clause, redemption prior to maturity, repurchase, or exercising a call option) without prior approval from the Office of the Comptroller of the Currency (“OCC”). The holder of this Note may not accelerate payment of principal or interest on this Note except in the event of receivership, insolvency, liquidation, or similar proceeding of the Savings Association. All payments on this Note shall be applied first to accrued interest and the balance, if any, to principal. The Savings Association shall not pay any interest on the Note (if such interest is required to be paid only out of net profits) while the Savings Association remains in default in the payment of any assessment due to the Federal Deposit Insurance Corporation (“FDIC”).

**Subordination.** The indebtedness of the Savings Association evidenced by this Note, including the principal and premium, if any, and interest is unsecured and shall be subordinate and junior in right of payment to its obligations to its depositors, its obligations under bankers’ acceptances and letters of credit, and obligations to all creditors, including both secured and unsecured or general creditors including its obligations to the Federal Reserve Bank, FDIC, and any rights acquired by the FDIC as a result of loans made by the FDIC to the Savings Association or the purchase or guarantee of any of its assets by the FDIC pursuant to the provisions of 12 U.S.C. § 1823, whether now outstanding or hereafter incurred.

In the event of any insolvency, receivership, conservatorship, reorganization, readjustment of debt, marshaling of assets and liabilities, liquidation, winding up, or similar proceedings relating to the Savings Association, whether voluntary or involuntary, all such obligations shall be entitled to be paid in full before any payment shall be made on account of the principal of or premium, if any, or interest on the Note. In the event of any such proceedings, after payment in full of all sums owing on such prior obligations, the holder of this Note, together with any obligations of the Savings Association ranking on a parity with this Note, shall be entitled to be paid from the remaining assets of the Savings Association the unpaid principal thereof and any unpaid premium, if any, and interest before any payment or other distribution, whether in cash, property, or otherwise, shall be made on account of any capital stock or any obligations of the Savings Association ranking junior to the Note.

Nothing herein shall impair the obligation of the Savings Association, which is absolute and unconditional, to pay the principal of, and any premium and interest on, this Note according to its terms.

**Office of the Comptroller of the Currency Regulatory Authority.** Notwithstanding any other provisions of this Note and related documents, including specifically those provisions set forth in the sections relating to subordination, events of default, and covenants of the Savings Association, it is expressly understood and agreed that the Savings Association is subject to 12 C.F.R. §§ 3.20(d) and 5.56. In the event the Savings Association is considered “undercapitalized,” as defined under applicable law, and fails to satisfactorily implement a required capital restoration plan, the Savings Association may be subject to restrictions and requirements applicable to “significantly undercapitalized” institutions, as defined in applicable law. If the Savings Association is considered “significantly undercapitalized,” the OCC has the legal authority to require the Savings Association to sell shares in the Savings Association, enter into a merger or consolidation, or be acquired by a depository institution or a depository institution holding company. This authority supersedes and voids any default that may result from such OCC action. In addition, if the Savings Association is considered “critically undercapitalized” as defined under applicable law, the Savings Association will be prohibited from making principal or interest payments on this Note without prior OCC approval.

The Savings Association must obtain prior OCC approval to prepay this Note, including through a redemption prior to maturity, repurchase, or exercising a call option. In addition, if the Note is callable, the Savings Association may call the instrument only after a minimum of five years following issuance, except that the instrument may be called sooner than five years upon the occurrence of an event that would preclude the instrument from being included in tier 2 capital, a tax event, or if the issuing entity is required to register as an investment company pursuant to the Investment Company Act of 1940 (15 U.S.C. § 80a-1, et seq.).

[INCLUDE THE FOLLOWING PARAGRAPH IF BANK HAS DISCRETION TO SUSPEND INTEREST PAYMENTS WITHOUT TRIGGERING EVENT OF DEFAULT. SEE 12 C.F.R. § 3.11 AND PARAGRAPH (4) OF THE DEFINITION OF “DISTRIBUTION” IN 12 C.F.R. § 3.2.

Consistent with the requirements for the capital conservation buffer at 12 C.F.R. § 3.11, the Savings Association may be prohibited from making a distribution under this Note, or creating an obligation to make such a distribution, if such distribution, in the aggregate, would exceed the maximum payout amount, unless the Savings Association receives prior OCC approval.]

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

## Glossary

---

**Accredited investor:** As stated in 17 CFR 230.501(a), the accredited investor definition attempts to identify those persons whose financial sophistication and ability to sustain the risk of loss of investment and fend for themselves render the protections of the Securities Act of 1933’s registration process unnecessary.<sup>20</sup> Accredited investors generally include high-net-worth individuals, banks, financial institutions, and other large corporations with access to complex and higher-risk investments, such as venture capital, hedge funds, and angel investments.

**Advanced approaches bank:** A national bank or FSA as described in 12 CFR 3.100(b)(1).

**Capital restoration plan:** A plan that must be filed by a bank that is undercapitalized, significantly undercapitalized, or critically undercapitalized. The plan must meet the requirements set forth at 12 USC 1831o and 12 CFR 6.5, including describing steps that the bank plans take to attain the minimum required capital levels or ratios.

**Eligible bank and eligible savings association:** Pursuant to 12 CFR 5.3, an eligible bank or eligible savings association is a bank that

- is well capitalized as defined in 12 CFR 6.4;
- has a composite rating of 1 or 2 under CAMELS;
- has a CRA (12 USC 2901 et seq.) rating of “Outstanding” or “Satisfactory,” if applicable;
- has a consumer compliance rating of 1 or 2 under the Uniform Interagency Consumer Compliance Rating System; and
- is not subject to a cease-and-desist order, consent order, formal written agreement, or prompt corrective action directive (see 12 CFR 6, subpart B) or, if subject to any such order, agreement, or directive, is informed in writing by the OCC that the bank or FSA may be treated as an eligible bank or eligible savings association for purposes of 12 CFR 5.

**Indenture:** An agreement made between a bond issuer and a trustee that represents the bondholders’ interests by governing the obligations of each party. The indenture specifies all the important features of a bond, such as its maturity date, timing, manner and place of interest payments, method of interest calculation, and callable/convertible features, if applicable, and specifies each of the parties’ responsibilities under the indenture. It may also delineate other consequences concerning a default. For specific types of bonds, the indenture may also indicate the source of the income stream for repayment of the bond. Underwriters and other parties involved in a subordinated debt issuance often may require the use of an indenture or paying agent agreement. For other requirements, refer to the Trust Indenture Act of 1939, 15 USC 77aaa–77bbbb.

---

<sup>20</sup> “Regulation D Revisions; Exemption for Certain Employee Benefit Plans,” Release No. 33-6683 (January 16, 1987) [52 Fed. Reg. 3015] (the “Regulation D Revisions Proposing Release”). See also “Report on the Review of the Definition of ‘Accredited Investor,’ ” Staff Report, U.S. Securities and Exchange Commission, December 18, 2015.

**Paying agent agreement:** A contract between the parties to a subordinated debt transaction detailing the terms of appointment of a paying agent. Paying agents generally act as an exchange agent between the bond issuer and bondholder for payments of principal and interest, to verify ownership, to collect shareholder payment instructions, and to receive W-9 or W-8 tax forms. A paying agent accepts payments from the issuer of a security and then distributes the payments to the holders of the security. The paying agent may also delineate other circumstances and processes surrounding the bond, such as a default.

**Perpetual preferred stock:** A stock that, pursuant to 12 CFR 3.701(e)(8), is a preferred stock that does not have a stated maturity date and cannot be redeemed at the option of the holder. Additionally, perpetual preferred stock issued by FSAs may not have any “other provisions that will require future redemption of the issue.”

**Subordinated debt agreement or note agreement:** A contract that governs the relationship between parties to the subordinated debt transaction.

**Subordinated debt document:** A subordinate debt note or instrument, subordinated debt agreement or note agreement, indenture, paying agent agreement, or any other such document or instrument prepared in connection with a subordinated debt transaction. Banks should take care to ensure that the terms required by the regulations described in this booklet are included in the appropriate subordinated debt documents, as appropriate.

**Subordinated debt note:** A financial instrument whereby the subordinated issuer promises to make specified payments under specified terms. A subordinated debt agreement may be used in connection with a subordinated debt note.

**Tier 2 capital and tier 2 regulatory capital:** The sum of tier 2 elements in 12 CFR 3.20(d) and any related surplus, after accounting for the regulatory adjustments and deductions in 12 CFR 3.22.

## References

---

In this section, “NB” denotes that the referenced law or regulation applies to national banks, and “FSA” denotes that the reference applies to federal savings associations.

### **Borrowing Limitations for FSAs**

Regulation 12 CFR 163.80 (FSA)

### **Capital Deficiency**

Law 12 USC 55 (NB)

### **Capital Requirements and Minimum Ratios**

Law 12 USC 1464(t) (FSA)

12 USC 3907 (NB)

Regulation 12 CFR 3 (NB and FSA)

### **Filing Fee**

Regulation 12 CFR 5.5 (NB and FSA)

### **Impairment**

Law 12 USC 51b-1, 56 (NB)

### **Legal Lending Limits Calculation**

Laws 12 USC 84 (NB and FSA)

12 USC 1464(u) (FSA)

Regulation 12 CFR 32.4 (NB and FSA)

### **Mandatory Convertible Debt**

Regulation 12 CFR 3.701(e)(5), (f) (NB)

### **Perpetual Preferred Stock**

Regulation 12 CFR 3.701(e)(8) (NB)

### **Prompt Corrective Action**

Law 12 USC 1831o (NB and FSA)

Regulation 12 CFR 6 (NB and FSA)

### **Reduction of Capital**

Law 12 USC 59 (NB)

Regulation 12 CFR 5.46 (NB)

12 CFR 5.55 (FSA)

### **Securities Offering Disclosure Rules**

Regulation 12 CFR 16 (NB and FSA)

## References

### **Subordinated Debt Issued by National Banks**

Regulation

12 CFR 5.47 (NB)

### **Subordinated Debt Issued by FSAs as Regulatory Capital**

Regulation

12 CFR 5.56 (FSA)