Republic of the Philippines
Department of Finance
SECURITIES AND EXCHANGE COMMISSION
SEC Building, EDSA, Greenhills
Mandaluyong City Metro Manila
Philippines

20 January 2006

SEC Opinion No. 06-05
Re: Amendment of a rural bank's articles to reflect conversion of shares from preferred to common.

WILLIAM RUSSELL L. SOBREPENA
President/Manager
Rural Bank of Caba (La Union), Inc.
Sobrepena Building, National Highway, Poblacion Sur,
Caba 2502, La Union

Sir:

This refers to your letter dated 12 October 2005 requesting opinion on the query posed therein relative to the need for an amendment of the articles of incorporation of the Rural Bank of Caba (La Union), Inc. ("the Bank" for brevity).

Paragraph (b), Article Seven, of the Bank's articles of incorporation reads:

> *"**SEVENTH.** That the capital stock of the corporation is TEN MILLION PESOS (Php 10,000,000.00), Philippine Currency, divided into 975,000 shares of Common Stock with voting rights and 25,000 shares of Preferred Stock, both at the par value of TEN PESOS (Php 10.00) each.*
>
> *xxx xxx xxx.*
>
> *b.) Only one kind of common stock that is with voting rights shall be provided for the Bank. Preferred stock shall be non-voting;* ***but in case of sale by the government of its preferred stocks to private shareholders, such stocks automatically become common stocks with voting rights, thereby reducing the number of outstanding preferred stocks and increasing the number of outstanding common stocks."***

(16)

You thus inquire whether said provision would be enough legal basis to convert the government preferred shares to private common shares, without having to amend the existing amended articles of incorporation of the Bank.

To answer your query, resort must be had primarily to the provisions of **Republic Act (RA) No. 7353 or the Rural Banks Act of 1992. Section 8 of RA 7353** reads:

> " Sec. 8. xxx xxx xxx.
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> Stocks held by the Landbank of the Philippines (LBP), Development Bank of the Philippines (DBP) or by any government-owned or controlled bank or financial institution, under the terms of this Section, shall be made preferred only as to assets upon liquidation and without the power to vote and shall share in dividend distributions from date of issuance in the amount of two percent (2%) without preference xxx xxx xxx: Provided, however, That if such stock of the LBP xxx xxx xxx is sold to private shareholders, the same may be converted into common stock of the class provided for in Section 10 hereof. **Provided, further, That pending the amendment of the Articles of Incorporation of the rural bank, *if necessary*, for the purpose of reflecting the conversion into common stock of preferred stock sold to private stockholders,** the transfer shall be recorded by the rural bank in the stock and transfer book and such shareholders shall thereafter enjoy all the rights and privileges of common stockholders. xxx xxx xxx.
>
> xxx. **When all the preferred shares of stock of a rural bank have been sold to private shareholders, the Articles of Incorporation of the rural bank shall be amended to reflect conversion of the preferred shares of stock into common stock.** xxx xxx xxx."

Implementing said provision, the **BSP Manual of Regulations for Banks ("the Manual"),** updated as of 31 December 2004, provides:

> "**Subsection 3127.4. Convertibility of preferred stock to common.-** RBs (rural banks) may convert their unissued preferred shares into common stock. In the case of sale by the DBP, LBP, or any government-owned or controlled bank or financial institution of preferred stock to private persons, such stock may be converted to common stock: Provided, That pending amendment of the bank's articles of incorporation, if necessary for the purpose of reflecting the conversion, the transfer shall be recorded by the bank in its stock and transfer book and such shareholders shall thereafter enjoy all the rights and privileges appurtenant to the converted stock. xxx xxx xxx. **The corporate secretary of the bank shall submit to the appropriate supervising and examining department and the SEC a report of every transfer of preferred stock from the LBP, etc., within five (5) banking days from the date of such transfer.**

(15)

When **all the preferred shares** of stocks held by the LBP, DBP or any government-owned and controlled bank or financial institution have been sold to private shareholders, **the bank's articles of incorporation shall be amended to reflect the conversion**, if any, of the preferred shares of stock into common stock.

For this purpose, a certificate that all preferred shares have been sold and transferred to private shareholders shall be issued, duly signed by the president, the corporate secretary, and a majority of the board of directors. **The bank shall submit copies of such certificate and the amended articles of incorporation to the BSP for the issuance of a certificate of authority for the purpose of registering the amended articles with the SEC."**

It is clear from **Section 8 of RA 7353** that amendment of a rural bank's articles of incorporation for the purpose of reflecting such conversion should only be done ***"if necessary".*** According to the second sentence of its next paragraph, the amendment is necessary **"when all the preferred shares of stock of a rural bank have been sold to private shareholders",** in view of the use thereof of the word "SHALL" preceding the said phrase.

The Manual confirms said construction. Note that when all the government preferred shares have been sold to private shareholders, a certification of such fact should be executed and filed with the BSP for the issuance of a certificate of authority for the purpose of registering the amended articles with the SEC. This is not the case when all the preferred shares are not yet sold to private shareholders. What the Manual requires in such a scenario is a mere report to the BSP and the SEC of every transfer of preferred stock within five (5) banking days from the date of such transfer.

There is a presumption that the legislature does not intend an absurdity or that its enactments produce absurd results.[1] Congress could not have contemplated a situation wherein every sale of the government's preferred stocks would entail amendment of the articles of incorporation. Otherwise, we would be witnessing the spectacle of a possible amendment five, even ten, times in a row within a span of one year or worse, half-year. Such a construction would be cumbersome on the part of the corporation, thereby wasting its time and resources and thus defeating the very purpose and intent of the law to establish a rural banking system designed to make needed credit available and readily accessible in the rural area on reasonable terms.

The foregoing discussion may also be supported by analyzing certain provisions of the Code, specifically Sections 14 and 6 thereof, which read, respectively:

"Section 14. Contents of articles of incorporation.- xxx xxx xxx.

8. If it be a stock corporation, the amount of its authorized capital stock in lawful money of the Philippines, the number of shares into which

[1] Martin, Statutory Construction, p. 133

it is divided, and in case the shares are par value shares, the par value of each, xxx xxx xxx."

"Section 6. Classification of shares. – The shares of stock in corporations may be divided into classes or series of shares, or both, any of which classes or series of shares may have such rights, privileges or restrictions as may be stated in the articles of incorporation. xxx xxx xxx."

Following RA 7353's logic, there is no material change in the afore-quoted contents of the Bank's articles of incorporation when all the government's preferred shares are not yet sold to private shareholders. The authorized capital stock, as well as the number of shares into which it is divided, remain the same. The conversion, as per articles of incorporation, does not entail a change in the par value of each share but only in the class of shares. **It is to be noted that in such situation, the current classification of stocks into common and preferred may remain unchanged for practical considerations and to avoid the tedious amendment process.** When all the preferred shares shall have been sold to private shareholders, such a classification disappears and amendment should thus be effected.

Accordingly, the answer to your query is qualified. When the sale by the government involves all, or would eventually result in the disposition of the entire preferred shares, then amendment of the Bank's articles of incorporation is necessary. Otherwise, it is not.

For your information and guidance.

VERNETTE G. UMALI-PACO
General Counsel

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