Republic of the Philippines
Department of Finance
Securities and Exchange Commission
SEC Bldg. EDSA, Greenhills, Mandaluyong City

OFFICE OF THE GENERAL COUNSEL

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SEC-OGC Opinion No. 07-03
Sinking fund for preferred shares with mandatory redemption features

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Madam:

This refers to your letter dated 05 January 2007 requesting confirmation whether the Corporation Code of the Philippines (CCP) No. 1, the Rules Governing Redeemable and Treasury Shares (1982), is still in effect. If so, can banks and their financial allied subsidiaries be exempted from complying with the said requirements?

For easy reference, Section 5.4 of CCP No. 1 is quoted below:

> "Section 5.4. All corporations which have issued redeemable shares with mandatory redemption features are required to set up and maintain a sinking fund. The fund shall be deposited with a trustee bank and not be invested in risky or speculative ventures."

To raise funds for its business, a corporation is allowed to issue redeemable shares provided it is expressly so provided in the articles of incorporation.[1] Redeemable shares are shares usually preferred.[2] Preferred shares are designed as such to induce persons to subscribe for shares of a

1 Section 8, Corporation Code of the Philippines.
2 Republic Planters Bank v. Agana, et al., G.R. No. 51765, March 3, 1997.

corporation.[3] The compulsory or obligatory redeemable shares is one which requires the issuing corporation to redeem or repurchase its preferred shares at a fixed date or at the option of the holder; thus, giving the shareholder the right to demand a return of his investment.[4]

The issuance of redeemable shares may be likened to temporary borrowings which enables a corporation to adjust its capital structure to meet its varying conditions.[5] The Corporation Code likewise states that even if a corporation has no unrestricted earnings, it may purchase the redeemable shares at a fixed period. In order not to violate the trust fund doctrine, however, this Commission provides that the corporation must, after such redemption, have sufficient assets in its books to cover debts and liabilities inclusive of capital stock.[6]

Although the obligatory nature of the redeemable share is inconsistent with the nature of the shareholder status, which properly involves taking some risks of business, a corporation is allowed to issue mandatory redeemable shares.[7] In this case, a sinking fund is required to be established to protect the stockholders of a corporation.

The case of banks and their financial allied subsidiaries are no different from any other corporations. The creditors and the stockholders must not be put at a disadvantage vis-a-vis the holders of redeemable shares. Be that as it may, the *Bangko Sentral ng Pilipinas* (BSP) as the primary regulator of banks and their financial allied subsidiaries has sufficient power and authority to prohibit the redemption of preferred shares if such would result in the impairment of the required capital adequacy ratio.[8]

Further, the BSP may prescribe ratios, ceilings, limitations or other forms of regulation on different types and practices of banks and their financial allied subsidiaries.[9] With this, the BSP may suspend the redemption of preferred shares if the situation warrants such exercise of power but not totally exempt the banks and their financial allied subsidiaries from setting up a sinking fund for preferred shares with mandatory redemption features.

Very truly yours,

VERNETTE G. UMALI-PACO
General Counsel

3 Ibid.
4 Agbayani, Aguedo F. III COMMERICAL LAWS OF THE PHILIPPINES 99 (1990).
5 Campos, Jose C. and Maria Clara Campos. II THE CORPORATION CODE: COMMENTS, NOTES AND SELECTED CASES 32 (1990).
6 Section 5.4 of CCP No. 1.
7 Ibid, p. 109.
8 See Note 2.
9 Section 5, R.A. No. 8791.