FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 71-277
November 18, 1971

To the Chief Executive Officer
State Member Banks:

Pursuant to Executive Order No. 11627 of October 15, the President's Committee on Interest and Dividends has issued guidelines covering payment of dividends by corporations of all kinds. A copy of those guidelines, together with a supplementary statement furnished by the Committee, is enclosed for your information.

While a large majority of the nation's banks are not specifically covered by dividend limitations, it would be highly desirable--in view of the public interest vested in the banks and the strategic role of banking in the economy--that all banks adhere to the spirit of the guidelines.

Dividends payable before December 31, 1971, remain subject to the President's request to extend the wage-price freeze to all dividends. Dividends payable after December 31, 1971, should be within the limits of the formulas described in the guidelines.

If adherence to the guidelines will result in special problems for your bank, please discuss the matter with me or with Vice President Ralph T. Green. We shall be glad to answer any questions you may have.

Yours very truly,

P. E. Coldwell

President

Enclosures (2)

COMMITTEE ON INTEREST
AND DIVIDENDS
Washington, D. C. 20551

Arthur F. Burns, Chairman
John B. Connally
Maurice H. Stans

George W. Romney
Preston Martin
Frank Wille

November 15, 1971

Statement on Dividend Guidelines for 1972

The Committee on Interest and Dividends has issued Guidelines, effective November 15, 1971, for the payment of corporate dividends as part of a program for dividend restraint pursuant to the President's Executive Order 11627, dated October 15, 1971.

The Guidelines for Dividend Payments are the core of a program for dividend restraint that will also include (a) communications with corporations and the public, (b) monitoring of cooperation, and (c) analysis and reporting of results. This Statement discusses important aspects of the Guidelines.

Dividend payments conforming to the Program

The General Guideline sets forth the basic principle that dividend increases are limited to 4 per cent in 1972. The Committee believes that such a principle will be administratively feasible, is consistent with the goals of the President's stabilization program, and, though it calls for restraint, is sufficiently realistic not to discourage voluntary compliance or disrupt the orderly flow of funds into equity securities.

In selecting the base period against which the allowable increase applies, the Committee noted that, for many companies, earnings and dividends vary substantially from year to year. It concluded that, in order to be fair and provide reasonable flexibility, the base period should be any one of a corporation's most recent three fiscal years.

The payments per share in each year of the base period must be adjusted to reflect all stock splits and issuances of stock dividends through December 31, 1971. For example, if a company with a fiscal year ending March 31 paid $1.00 per share on March 31, 1969, $.60 on March 31, 1970, and $.40 on March 31, 1971, and split the stock 2 for 1 on each following September 30, the rate per share adjusted through December 31, 1971 would be $.125 for 1969, $.15 for 1970, and $.20 for 1971.

The "Guideline adjustment" provides for situations in which a company paid no dividends in the base years, or could pay out as dividends, in 1972, only a very small percentage of earnings on the basis of the General Guideline. Such a company may pay dividends in 1972 totalling not more than 15 per cent of its net income (after taking into account all taxes and dividends on preferred stock) in the company's prior fiscal year.

The Guideline limits on dividend payments are applicable to the year as a whole and not to each quarterly or semi-annual dividend payment. However, the Committee expects that corporations will not depart substantially from their previous patterns of dividend disbursements over the year. In any event, corporate dividend payments will be monitored throughout the year in order to ascertain whether the annual rate will conform to the Guidelines.

Stock dividends and stock splits as such are not restricted by the Guidelines. Of course, when stock is split or a stock dividend is issued, accompanying and subsequent cash dividends should be adjusted for the split or stock dividend in order to avoid exceeding the Guideline limits. For example, the maximum permissible dividend on a share of stock whose dividend was $1.00 per year in the highest year of the base period should be no more than $.52 in 1972 after a 2 for 1 split on January 1, 1972. If, instead, a stock dividend of 4 per cent was issued on that day, the aggregate cash dividends in 1972 should be no higher than $1.00.

<u>Coverage of the Guidelines</u>

Broadly stated, the Guidelines cover almost all companies that are listed on any U.S. stock exchange, and unlisted companies that have 500 or more stockholders and over $1 million in assets. With few exceptions, these are the corporations that are required to file financial reports under the Securities Exchange Act of 1934.

Although this coverage excludes a large number of small firms, and some with special characteristics, such as "Subchapter S" corporations and wholly-owned subsidiaries, it includes almost 10,000 of the largest corporations, which account for all but a small portion of the dividends paid each year. The Committee expects, however, that many small companies will comply with the spirit of the Guidelines.

Some types of companies have been exempted because of special characteristics that call for such treatment:

1. <u>Regulated Investment Companies</u> (such as "mutual funds") are companies whose resources represent a pooling of individual investor resources and whose dividend payments are a "pass-through" of income from other sources most of which are subject to these Guidelines or to other aspects of the stabilization program. These companies also derive and pass along income from capital gains, receipt of which is not subject to restriction for individual investors. Failure of these companies to distribute any increased earnings would subject them to extraordinary tax burdens under existing law.

2. <u>Real Estate Investment Trusts</u> are a pooling of resources for direct or indirect "passive" investment in real estate and pass through virtually all their income to their shareholders. Most of such income will be subject to other aspects of the stabilization program. As in the case of Regulated Investment Companies, failure of these trusts to pay out all increases in income as dividends would subject them to extraordinary tax burdens.

3. <u>Personal Holding Companies</u> are defined in the Internal Revenue Code as companies that are majority-owned by not more than five individuals and derive at least 60 per cent of their income from sources such as dividends, interest, royalties, and annuities. In order to discourage use of the corporate form to avoid payment of personal income taxes by their shareholders, the Code imposes an extra tax of 70 per cent on any undistributed income of such companies.

<u>Effective Date of the Guidelines</u>

The Guidelines apply to dividends paid after December 31, 1971. For all corporations covered by the Guidelines, the freeze on dividend payments is extended through December 31, 1971.

The use of the calendar year 1972 as the annual dividend period eliminates the need for devising a complex formula to cover dividends for a part of a quarter, simplifies monitoring, and provides corporations with information needed to make dividend decisions during fourth-quarter 1971 meetings of their Boardsof Directors.

COMMITTEE ON INTEREST AND DIVIDENDS
Washington, D.C. 20551

November 15, 1971

GUIDELINES FOR DIVIDEND PAYMENTS
(Issued pursuant to Executive Order 11627)

1. General Guideline. Cash dividends on any class of common stock to be paid in 1972 should be declared at such rates that the aggregate annual payment per share (adjusted for stock splits and issuance of stock dividends) will not exceed by more than 4 per cent the highest aggregate annual payment per share in any of the company's fiscal years ending in 1969, 1970, or 1971 (adjusted through December 31, 1971 for stock splits and issuance of stock dividends).

2. Guideline adjustment. A company that paid no dividend on common stock in the years enumerated in Paragraph 1 or whose permissible dividend payments in 1972, under Paragraph 1, would aggregate less than 15 per cent of net income (after taxes and dividends on preferred stock) in its fiscal year ending in 1971 may declare cash dividends on common stock at such rates that the aggregate dividends paid on common stock in 1972 will not exceed 15 per cent of said 1971 net income.

3. Companies to which the Guidelines apply. (a) Paragraphs 1 and 2 apply to any company that (i) has more than $1,000,000 in total assets and a class of equity securities held of record by 500 or more persons, and (ii) is subject to the reporting requirements of the Securities Exchange Act of 1934 or is an insurance company with capital stock.

(b) Paragraphs 1 and 2 do not apply to a regulated investment company, real estate investment trust, or personal holding company as defined in Subchapters M and G of the Internal Revenue Code.

4. Effective date; prior guidelines. These Guidelines are effective November 15, 1971 and supersede prior guidelines with respect to dividends to be paid in 1972. Dividends to be paid in 1971 remain subject to the prior guidelines issued by the Cost of Living Council, except dividends of companies excluded by Paragraph 3(a) and (b) hereof.