December 18, 1936

MEMORANDUM:

Re: Legislation recommended by Comptroller of the Currency in his annual report to Congress for the year ending October 31, 1935, which it is proposed to introduce at the coming session of Congress.

1. CAPITAL REQUIREMENTS FOR CONVERSION. In many cases, state banks have heretofore effected the elimination of losses and depreciation on securities and have made adjustment of their capital structures by the reduction of their common capital and by the issuance of capital notes or debentures. These capital notes or debentures were issued because the laws of the state did not permit the issuance of preferred stock by such state banks. These capital notes or debentures do not constitute capital within the meaning of the provisions of the national banking laws. In some of these cases, the amount of common capital of the state bank is not sufficient to meet the requirements of the national banking laws as to the necessary amount of capital of a state bank converting into a national banking association, but the aggregate of such common capital and capital notes or debentures would be sufficient.

It is proposed that Section 44 of the National Banking Act (Section 5154, United States Revised Statutes) be amended to provide that, for the purpose only of authorizing the approval of the conversion of a state bank into a national banking association, the Comptroller of the Currency may treat capital notes or debentures as capital in those cases where the Comptroller of the Currency is assured, prior to his approval of the conversion, that preferred stock will be issued by such state bank as soon as the same has been converted into a national banking association, whereupon the capital notes or debentures of the bank, which are bills payable insofar as national banking associations are concerned, would be retired. It is not difficult to procure such assurances. The Comptroller's office has devised a very successful method of procedure to accomplish this end. Such method has been employed to effect the substitution of preferred stock for such capital notes or debentures in certain conversion cases where the state bank had sufficient common capital to meet the requirements of the national banking law but where the Comptroller required assurances that the capital notes or debentures of the bank would be retired and preferred stock issued in lieu thereof.

2. LIABILITY UPON SHARES OF COMMON STOCK OF NATIONAL BANKING ASSOCIATIONS RESULTING FROM THE CONVERSION OF A STATE BANK INTO THE NATIONAL SYSTEM. Under the provisions of Section 5151 of the Revised Statutes of the United States and Section 23 of the Federal Reserve Act, the holders of shares of common stock of a national banking association are individually responsible for the contracts, debts and engagements of the association (the so-called double liability). Section 22 of the Banking Act of 1933 provided that the liability imposed upon the holders of shares of common stock of a national banking association by the provisions of Section 5151 of the Revised Statutes of the United States and Section 23 of the Federal Reserve Act, shall not apply with respect to shares in any national banking association issued after June 16, 1933. Section 304 of the Banking Act of 1935 provided that the liability imposed upon the holders of shares of common stock of a national banking association by the provisions of Section 5151 of the Revised Statutes of the United States and Section 23 of the

Federal Reserve Act, shall cease on July 1, 1937 with respect to all shares issued by any national banking association which shall be transacting the business of banking on July 1, 1937, provided the notice required by the said Section 304 shall first have been given. It is clear, of course, that shares of common stock of a national banking association chartered subsequent to June 16, 1933 are exempt from the so-called double liability, But it is not clear that shares of common stock of a national banking association resulting from a conversion would be shares "issued" after June 16, 1933 and, therefore, exempt from the so-called double liability. And, if such shares are not shares "issued" after June 16, 1933 then compliance with Section 304 of the Banking Act of 1935 (six months' notice by publication of intention to terminate such liability) would be necessary for each converted national banking association even though the conversion were approved by the Comptroller subsequent to July 1, 1937.

While the matter has not been determined by the courts, the United States Supreme Court (Michigan Ins. Bank vs Elred, 143 U.S. 293) held that the conversion of a state bank into a national banking association does not destroy its identity or its corporate existence) that it is not a closing of business but simply a continuation of the same body, with the same officers and the same stockholders, the same property, assets and business of banking under a changed jurisdiction. In order to fix the liability of the holders of shares of common stock of a converted national banking association on a parity with the holders of stock of a newly chartered national bank, it is proposed that the liability imposed upon such shareholders by the provisions of Section 5151 of the Revised Statutes of the United States and Section 23 of the Federal Reserve Act, shall not apply with respect to shares in any such association resulting from the conversion of any bank incorporated by special law of any State or of the United States or organized under the general laws of any State or of the United States into a national banking association after July 1, 1937.

3. DIVIDENDS ON COMMON STOCK. The matter of the payment of dividends on shares of common stock of national banking associations causes many inquiries to be made, indicating considerable confusion in the minds of bankers as to the meaning of some of the language of the statute. The responsibility for the declaration of dividends on shares of stock of a national banking association rests with the board of directors. The question of the soundness of the provisions of the statute that dividends may be declared only semi-annually has been raised to a very considerable extent. The terms used in the present law (Sections 5199 and 5204 of the Revised Statutes) are not defined. When the so-called double liability was removed from the common stock of a national bank by the provisions of Section 304 of the Banking Act of 1935, it was provided (Section 315 of the Banking Act of 1935) that the surplus of the bank should be increased until it reached the amount of the bank's common capital. In the present law it is provided that dividends may be declared semi-annually and that before the declaration of a dividend on its shares of common stock, the bank shall carry not less than one-tenth part of its net profits of the preceding half year to its surplus fund until the same shall equal the amount of its common capital.

Sections 5199 and 5204 of the United States Revised Statutes pertain to the matter of the payment of dividends on shares of common stock of a national banking association and, necessarily, have to be read together. It is proposed that Section 5204, United States Revised Statutes, be repealed and that Section 5199 be restated so as to include the substance of both Sections 5204 and 5199 with some changes as herein indicated.

To avoid ambiguity the terms used in the new Section 5199 should be defined. It is proposed that the definition "net addition to profits" should spell out the item that has been used by the Comptroller's office for

years to determine the sum that must be transferred to surplus in order to meet the requirement that ten per cent of the net profits be transferred to surplus before the declaration of a dividend on shares of common stock, and that the definition "bad debt" be liberalised so as to eliminate the inequities in the present statute. It is also proposed that statutory bad debts be disassociated from losses and that the transfer of ten per cent of the net addition to profits to the surplus of the association be disassociated from the payment of dividends on shares of common stock. Excessive statutory bad debts would continue to operate as a limitation upon the ability of the association to pay dividends on its shares of common stock. The transfer of ten per cent of net addition to profits for each six months' period to surplus until the surplus equals the amount of the common capital of the association should be made mandatory irrespective of whether or not a dividend is declared upon shares of common stock of the association for such period.

It is also proposed that dividends on shares of common stock may be declared by the board of directors at any time they deem expedient, provided the association has sufficient undivided profits then on hand, instead of semi-annually only as now provided by statute. In keeping with the policy of building up the surplus of each national banking association to the amount of its common stock to compensate for the elimination of the double liability on the holders of shares of common stock it is likewise provided that the surplus of a national banking association may not be reduced below the amount of its common capital, except for the purpose of charging off losses or for the purpose of paying dividends in common stock in accordance with the provisions of Section 5142 of the Revised Statutes of the United States (Dividends payable in shares of common stock).

4. FEES FOR EXAMINATION OF CREDIT UNIONS. Under the provisions of the Act of June 23, 1932, the Comptroller of the Currency is required to make examinations of credit unions incorporated under the said act. These credit unions are increasing in number and in the volume of their assets. The rate of compensation fixed by the present law is insufficient to pay the actual costs of such examinations and, as a consequence, part of the cost of examinations of credit unions is being paid for by national banking associations. This amendment provides that the credit unions shall be assessed by the Comptroller for the actual cost of making the examination required under the act.

5. REGULATORY POWERS. Congress has heretofore granted to the Board of Governors of the Federal Reserve System, the Board of Directors of the Federal Deposit Insurance Corporation and the Securities and Exchange Commission certain regulatory powers. The Comptroller of the Currency has no authority to issue rules and regulations except as to the definition of the term "investment securities", and except as to limiting and restricting the purchase of "investment securities" by a national banking association for its own account.

The numerous changes in the provisions of law relating to national banks during the past few years necessitate interpretative rulings by the Comptroller of the Currency. The Comptroller of the Currency is in closer contact with the Congress and the committees thereof than are those persons who are directing financial institutions which are under the supervision of the Comptroller and, consequently, the Comptroller of the Currency is in a position, through the issuance of regulations when necessary, to carry out the intent of Congress in enacting banking laws. It is proposed that the Comptroller of the Currency should be authorized and empowered to make such rules and regulations as may be necessary and proper to enable him effectively to perform the duties, functions or services imposed upon him under the provisions of the laws relating to national banks.

6. APPORTIONMENT OF SALARIES. The salaries of the first and second Deputy Comptrollers of the Currency are fixed by law as a part of the expense of the examination of national banks and are paid from assessments levied by the Comptroller of the Currency upon national banks. The Comptroller of the Currency is authorized by law to apportion the salary of the third Deputy Comptroller of the Currency in accordance with the duties performed by him. At the present time one of the most important functions of the Bureau is the liquidation of national banks in receivership and the first Deputy Comptroller of the Currency is devoting his efforts exclusively to that function.

It is proposed that the Comptroller of the Currency should be authorized to apportion the salaries of the Deputy Comptrollers and of other officers and employees of his Bureau who are performing duties in connection with more than one administrative division or branch of his office to the end that the apportionment of such salaries among the funds under the control and supervision of the Comptroller would be fair and equitable.

7. BUILDING AND LOAN CODE. The present code of laws of the District of Columbia respecting building and loan associations is very inadequate from the viewpoint of both the associations and the supervising authority. The present code does not prescribe sound practices for the conduct of the business of such association, but leaves the determination of the manner in which the business shall be conducted to the associations themselves through empowering them to determine such matters by by-law. The terms used in the present code are not defined. The supervising authority is powerless to take any corrective steps prior to the insolvency of an association. There is no authority for consolidation or for the appointment of a conservator therefor. There is no requirement for reserves. Building associations may charge premiums or membership fees which premiums or membership fees are sometimes used for the payment of promotion expenses. Funds may be withdrawn at any time and fixed rates of interest are paid on various accounts. The public, generally speaking, do not understand that when they pay money into building and loan associations they are subscribing for shares of stock, nor that when they borrow money from building associations they have no set-off for the amount paid in in amortization of the amount borrowed against the face amount of the debt to the association.

A draft of a proposed code of laws for building and loan associations in the District of Columbia, which was prepared prior to the appointment of a receiver for Fidelity Building and Loan Association, is now in the hands of the General Counsel of the Treasury Department for study. The experience of the Comptroller's office in administering the receivership of Fidelity Building and Loan Association has disclosed certain other weaknesses in the present law. It is also desired to include certain provisions recently considered and approved by the National Association of Building and Loan Supervisors. As soon as the new draft incorporating the additional features has been completed by the Comptroller's office it will be forwarded to the General Counsel of the Treasury Department for consideration.

While this particular piece of legislation may not be of any special interest to other banking agencies of the Government, and would concern only the Secretary of the Treasury and the Comptroller of the Currency, by reason of the latter's jurisdiction over these associations in the District of Columbia, the matter is referred to in this memorandum by reason of the fact that the last report of the Comptroller recommended the enactment of a new code of laws for the District of Columbia in respect to buildingand loan associations. It is proposed that the new building and loan code for the District of Columbia should give to the Comptroller of the Currency such powers as are proper to enable him, as the supervising authority, to control the or-

ganization of new associations, to properly supervise such associations as going concerns and to facilitate the reorganization or liquidation of insolvent associations.

> Amendment to Section 3 of the Act of June 30, 1876 (Title 12, U.S.C. Sec. 197) not included in the last report of the Comptroller of the Currency to Congress but introduced in the last Congress and known as Senate Bill 4510.

8. SHAREHOLDERS' AGENT. Under the present law, whenever all claims of the creditors of a national bank in receivership shall have been paid, and all expenses of the receivership shall have been provided for, the Comptroller of the Currency is required to call a meeting of the shareholders of such association for the purpose of determining whether the receivership shall be continued for the benefit of the shareholders, or a liquidating agent elected by the shareholders for that purpose. Under the present law many administrative difficulties have been encountered, the solutions of which are important to the Comptroller's office by reason of the large number of receiverships being supervised by him, the constantly increasing number of which are reaching the stage where, under the law, the shareholders' meeting must be called by the Comptroller. The manner provided in the present law for the electing of a shareholders' agent has proven to be inequitable in many cases, in that a large shareholder who has not paid his assessment may, and sometimes does, control the election of the shareholders' agent, electing himself as such agent and paying himself a salary that consumes a major portion if not all of the returns to the agent from the liquidation of the balance of the assets in his hands.

Without disturbing the method now provided by law for the pro rata distribution of the proceeds of the assets among shareholders after those shareholders who have paid assessments have been paid in full, the proposed amendment should provide that in event the assets are not sufficient to completely reimburse shareholders who have paid assessments levied upon them, the percentage of aggregate liability upon such assessment paid in by each shareholder shall, as nearly as possible, be equalized in that where some of the shareholders have paid greater percentages of their assessments than other shareholders, the shareholders paying such greater percentages shall, in each case, first be progressively reimbursed the excess of their payments over those of said other shareholders, to the end that after such adjustments of excess percentages have been made, all shareholders shall have due them the same percentage of unreimbursed assessment, and thereafter reimbursement shall be made to all shareholders upon a pro rata basis. It is proposed that this amendment should provide that whenever all claims of creditors of a national banking association in receivership shall have been paid the full amount of such claims, together with interest thereon at the rate of three per centum per annum, and all expenses of the receivership shall have been provided for, the Comptroller of the Currency may continue, through a receiver, the liquidation and collection of the assets of such association and of unpaid assessments on shareholders, or the Comptroller of the Currency may call a meeting of shareholders for the purpose of electing an agent and an executive committee; such agent to conduct the liquidation and collection of the assets for the benefit of the shareholders of the association in accordance with law and under the supervision of the executive committee, which shall consist of not less than three shareholders elected by the shareholders.

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