

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 5444]
January 9, 1964]

Capital Notes and Debentures
As "Capital," "Capital Stock," or "Surplus"

To the Member Banks of the Second Federal Reserve District:

The following statement was made public today by the Board of Governors of the Federal Reserve System:

The Board of Governors has been presented with the question whether capital notes or debentures issued by banks, that are subordinated to deposit liabilities, may be considered as part of a bank's "capital stock," "capital," or "surplus," for purposes of various provisions of the Federal Reserve Act that impose requirements or limitations upon member banks.

A "note" or "debenture" is an evidence of debt, embodying a promise to pay a certain sum of money on a specified date. Such a debt instrument issued by a commercial bank is quite different from its "stock," which evidences a proprietary or "equity" interest in the assets of the bank. Likewise, the proceeds of a note or debenture that must be repaid on a specified date cannot reasonably be regarded as "surplus funds" of the issuing corporation.

Federal law (12 U. S. C. 51c) expressly provides that the term "capital," as used in provisions of law relating to the capital of national banks, shall mean "the amount of unimpaired common stock plus the amount of preferred stock outstanding and unimpaired." In addition, when Congress in 1934 deemed it desirable to permit certain notes and debentures — those sold by State banks to the Reconstruction Finance Corporation — to be considered as "capital" or "capital stock" for purposes of membership in the Federal Reserve System, Congress felt it necessary to implement that objective by a specific amendment to section 9 of the Federal Reserve Act. These plain evidences of congressional intent compel the conclusion that, for purposes of statutory limitations and requirements, "capital" notes and debentures may not properly be regarded as part of either "capital" or "capital stock."

Accordingly, under the law, capital notes or debentures do not constitute "capital," "capital stock," or "surplus" for the purposes of provisions of the Federal Reserve Act, including, among others, those that limit member banks with respect to loans to affiliates, purchases of investment securities, investments in bank premises, loans on stock or bond collateral, deposits with nonmember banks, and bank acceptances, as well as provisions that limit the amount of paper of one borrower that may be discounted by a Federal Reserve Bank for any member bank.

ALFRED HAYES,
President.