

FEDERAL RESERVE BANK  
OF NEW YORK

[Circular No. 5595]  
December 30, 1964]

New Regulation F on Securities of Member State Banks

To State Member Banks in the Second Federal Reserve District:

The following statement was issued by the Board of Governors of the Federal Reserve System for release in morning newspapers, December 31:

The Board of Governors of the Federal Reserve System today issued its new Regulation F. This regulation relates to the registration of stock of State-chartered banks that are members of the Federal Reserve System, the filing of reports by such banks, solicitation of stockholder proxies, and disclosure of transactions in bank stocks by so-called "insiders." The Federal Deposit Insurance Corporation is simultaneously issuing a similar regulation applicable to other insured State banks. Both regulations become effective January 1, 1965, and banks subject to the regulations must register by April 30, 1965.

The regulations were adopted pursuant to a 1964 Act of Congress that, for the first time, extended to securities of banks and other corporations not listed on a national securities exchange the public disclosure requirements of the Securities Exchange Act of 1934. Under the terms of that Act, application of the new regulations to such "over-the-counter" bank securities is confined initially to banks with 750 or more holders of one class of stock; beginning in January 1967 coverage will be extended to banks with 500 or more stockholders. Of the Federal Reserve System's nearly 1,500 State-chartered member banks, it has been estimated that there are about 200 banks whose stock is held by a sufficient number of persons to require registration.

In adopting the new regulation the Board has sought to assure investors of adequate information regarding bank stocks in accordance with the public disclosure principles of the Securities Exchange Act, and at the same time to avoid imposing unnecessary burden and expense on the reporting banks.

Adoption of the new regulation was preceded by extensive study of comments invited by the Board when it published the draft regulatory proposals in August and September 1964. Responses were received from representative groups of bankers, securities analysts, and accountants, as well as from a number of individuals and concerns.

Further consideration of the preliminary proposals, in the light of suggestions received, resulted in a number of changes that are reflected in the regulation as now adopted. The Board recognizes, in addition, that experience in dealing with so new and complex an area may point to the need for further alterations, and it will be prepared to act expeditiously to remedy any deficiencies that may develop.

Major elements covered by the new Regulation F are as follows:

1. *Registration statements.* A registration statement is to be filed by next April 30 by each subject bank. This statement will contain pertinent information about the bank, including a description of its business; a list of its directors, officers and principal stockholders (persons holding 10 per cent or more); statements concerning the interests of management and principal stockholders in certain transactions with the bank, and outstanding stock-purchase options; high points of the bank's principal financial changes over a ten-year period; a consolidated balance sheet for the most recent year-end; and consolidated statements of income and expenses (along with changes in the bank's capital accounts) for 1964 and the two preceding years.

In special cases, where registration by the specified date is not feasible, or would impose an undue burden, or is not essential for the protection of investors, the Board has authority to grant extensions of time or exemptions upon application by the bank concerned.

2. *Periodic financial reports.* Registrant banks will be required to file an annual report updating much of the information contained in the registration statement, including balance sheet, earnings statement, and reconciliation of capital and reserve items for the year. In addition, they will be required to file quarterly reports detailing the major elements of net operating earnings, and special reports of important events as they occur. These include changes in control of the bank, material legal proceedings, changes in the bank's outstanding securities, the granting of stock options, and revaluations of assets or other major changes in asset structure.

3. *Solicitation of proxies from stockholders.* The regulation prescribes rules for the solicitation of proxies by management and others for annual and special meetings. These generally follow Securities and Exchange Commission procedures, except that the regulation does not require that proposals submitted by stockholders be set forth in the management's proxy solicitation and form of proxy for approval or rejection by the entire body of stockholders.

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The Board favors the principles and practices of "corporate democracy" to the fullest practicable extent. However, adoption of the new regulation marks the first application of governmental rules of this kind to banks' securities and public disclosure of banks' corporate affairs. For this reason, the Board decided to defer a decision regarding management presentation of minority stockholders' proposals. In the light of experience and further study, the Board will determine later the extent to which provisions of this character should be included in the regulation.

4. *Securities transactions of "insiders."* Directors, major officers, and principal stockholders are required to file initial statements of their ownership of the bank's stock, as well as statements of subsequent sales and purchases in such stock as they occur.

One major difference between the regulation as proposed and as adopted today relates to authentication of financial statements that must be filed for public inspection. As originally proposed, annual balance sheets and income statements would have had to be certified by independent public accountants. As adopted, the regulation permits a bank to choose whether to have these financial statements certified by an independent public accountant or verified by the bank's principal accounting officer and its auditor. However, the Board reserves the right to require certification by an independent public accountant in exceptional cases.

Also modified from the earlier proposal are provisions governing the extent to which banks, in soliciting stockholders' proxies, must disclose transactions between the bank and enterprises in which the bank's directors, officers, or principal stockholders are interested. Because of differences in the nature of the business conducted by banks and that conducted by other corporations, the new regulation exempts from disclosure requirements loan transactions where the only interlocking relationships between the borrower and the banks are that (1) a director of the lending bank is also a director, officer, or minor stockholder of the borrowing corporation, or (2) a director of the borrowing corporation is also a director, officer, or large stockholder of the bank.

The scope and coverage of the new regulation are significantly affected by the definitions of a number of terms used therein. For example, an "officer" of a bank is defined to exclude persons who, regardless of title, do not participate in major policy-making functions. This revised definition is important chiefly in connection with section 16 of the Securities Exchange Act, under which profits obtained by so-called "insiders" (the bank's directors, "officers," and principal stockholders) from short-term trading in the bank's stock are subject to recovery by the bank.

Along with the new Regulation F, the Board also issued instructions governing the form and content of the financial reports called for. Among the provisions relating to these reports, which include the balance sheet, earnings statement, reconciliations of capital and reserve accounts, and subsidiary schedules, are the following:

1. Accrual accounting is to be employed by reporting banks where practicable, but with a one-year grace period for compliance;
2. Securities accounts, in both the balance sheet and income statements, are to reflect amortization of premiums and accretion of discounts, except that, if discount is not accreted, the effect on earnings of failure to do so is to be disclosed in a footnote;
3. Market value, as well as book value, is to be disclosed for holdings of common stocks, real estate other than bank premises, and bonds which are not of "investment grade";
4. Fixed asset accounts are to be reconstituted for the last five years, if necessary, to reflect original cost less depreciation. Also, the cost of premises and accumulated depreciation, as recorded for Federal income tax purposes, are to be shown;
5. Gains or losses in bond-trading department activities are to be shown separately from the interest income on the bank's investment portfolios; and
6. Allowances and reserves for bad debts and security portfolio losses are to be disclosed and treated either as deductions from the relevant asset item or as capital contingency reserves, depending on their character.

In harmony with the purpose of the Securities Exchange Act to make significant information widely available to investors, the Board's new rules provide that registration statements and reports of banks under its jurisdiction will be available for public inspection not only in Washington but also at each of the 12 Federal Reserve Banks, which are located in major financial centers throughout the country. In order to make it convenient for securities analysts and investors to compare information regarding different banks, the statements and reports of State banks supervised by the Federal Deposit Insurance Corporation also will be available at the Reserve Banks. The Board hopes that, in time, it will be possible to work out an arrangement under which information as to all banks subject to the Securities Exchange Act—national banks as well as State banks—can be brought together at these places for ready availability and comparison by the investing public.

The text of the new regulation and the related forms will be published in the *Federal Register* and *Federal Reserve Bulletin*. Pamphlet copies of the new regulation will be sent to you early in February. In the meantime, any inquiries concerning the regulation may be addressed to the Legal Department at our Head Office, attention of Robert J. Crowley, Assistant Counsel.

ALFRED HAYES,  
*President.*