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FFDERAL RESERVE BOARD

April 9, 1915.

SUBJECT Section 22 of
the Federal Reserve Act.

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As requested by the Board, I have carefully examined and considered that part of Section 22 of the Federal Reserve Act which relates to transactions between a member bank and the officers, directors or employees of such bank. The language which has been made the basis of a number of inquiries, and which the Board is asked to interpret, is contained in that paragraph of the Section which reads as follows.-

> " Other than the usual salary or director's fee paid to any officer, director or employee of a member bank and other than a reasonable fee paid by said bank to such officer, director or employee for services rendered to such bank, no officer, director employee or attorney of a member bank shall be a beneficiary of or receive, directly or indirectly, any fee, commission, gift, or other consideration for or in connection with any transaction or business of the bank Any person violating any provision of this Section shall be punished by a fine of not exceeding $5,000 or by imprisonment not exceeding one year, or both "

Under the terms of this provision any transaction engaged in between a member bank and its directors, officers or employees, which is not excluded from its operation, will constitute a crime and no ruling or interpretation of the Federal Reserve Board which it might attempt to apply to any concrete case would afford any protection to a person subse-

sequently indicted by a Federal grand jury for any violation of the provision in question. For this reason it does not seem advisable to attempt to express any opinion on the various hypothetical and concrete cases presented for consideration. Inasmuch, however, as there appears to be a wide diversity of opinion as to the proper interpretation and significance of this Section, it may be advisable to analyze, for the benefit of those making inquiries, the provision above quoted in order that the elements necessary to constitute a crime, within the meaning of this Section, may be made a little more clear.

The question for determination appears to be, what class and character of transactions did Congress intend to prohibit as between member banks and their officers, directors and employees.

It will be observed that directors, officers and employees are expressly prohibited from receiving any compensation on account of any transaction except (a) the usual salary or director's fee paid to any officer, director or employee of a member bank, and (b) a reasonable fee paid to such officer, director or employee for services rendered to such bank. Under this language it would seem that for serv-

ices rendered by directors, officers and employees in their respective capacities of directors, officers and employees proper compensation may be paid, and that in addition where services are rendered in some other capacity a resonable fee may in certain cases be paid for such services. It is, therefore necessary to interpret the language 'for services rendered", in order to determine under what circumstances directors, officers or employees may render services in any other than an official capacity and receive compensation therefor without violating the spirit and intent of the Act.

The Standard Dictionary defines "services" as: "Any work done for the benefit of another, the act of helping another or promoting his interest in any way, hence also a benefit conferred, or use and advantage in general". In 35 Cyc., Page 1434, "service" is defined as "an advantage conferred, that which promotes interest or happiness; benefit". Webster's Dictionary, quoted in Dayton v. Ewart, 28 Montana, 157.

In this connection it must be noted that the courts in construing penal statutes generally give the defendant the benefit of the doubt in cases of ambiguity, and in consequence, the language "for services rendered" would probably be

given a liberal rather than a restricted meaning. The Court, however, would necessarily consider all the circumstances in each case in order to determine whether the transaction involving such services was intended to be prohibited by the terms of the Act. The rule is clearly stated in the case of the United States v Stern, 17 Fed. Rep. 435, where the Court says.

> "It is a fundamental rule in the administration of criminal law that penal statutes are to be construed strictly, and that cases within the like mischief are not to be drawn within a clause imposing a forfeiture or a penalty, unless the words clearly comprehend the case. In construing a statute we ought undoubtedly to look at the public mischiefs which are sought to be suppressed, as well as the obvious object and intent of the legislature in enacting it, and in doubtful cases these have great influence on the judgment in arriving at its meaning."

And again in Bolles v. Outing Company, 175 U. S. 262 where the Court says.

> "The statute, then, being penal, must be construed with such strictness as to carefully safeguard the rights of the defendant and at the same time preserve the obvious intention of the legislature. If the language be plain, it will be construed as it reads, and the words of the statute given their full meaning, if ambiguous, the court will lean more strongly in favor of the defendant than it would if the statute were remedial. In both cases it will endeavor to effect substantial justice."

See to same effect :

U. S. v. Wiltberger, 5 Wheat. 75;
U. S. v. Morris, 14 Peters 464;
U. S. v. Buchanan, 9 Fed. Rep. 689;
U. S. v. Hartwell, 6 Wall. 385.

Following the rule laid down in these and other cases it is proper to construe liberally that part of the Act which excepts certain transactions from its operation but the true test in each case would seem to be whether or not compensation has been received in a transaction which may be said to come within what the court describes as " the public mischiefs which are sought to be suppressed. "

Giving a liberal interpretation to the language " for services rendered" it would seem that a director of a member bank may receive, in addition to the usual salary or fee for services rendered as a director, reasonable compensation in those transactions where a bona fide consideration moves from such director to the bank, provided, the transaction is one in which it is proper for him to render such services or to furnish such consideration. Congress clearly intended to prohibit the receipt of any compensation, commission or benefit, either from the bank or from a third party, where the director furnishes no consideration

to the bank.

A consideration of the law prior to the passage of this Act, and of the "public mischiefs sought to be suppressed," clearly indicates, however, that the sufficiency of the consideration is not the only element involved; and that Congress intended to prohibit not only the payment of fees when no consideration is furnished, but also another class of transactions, namely, those in which the director, by reason of his control of the assets, undertakes to use such assets for his own purposes. In such case the director may furnish a consideration; but inasmuch as he occupies at least a quasi-fiduciary relation as custodian of the funds of others, it may be inferred that Congress deemed it against public policy to permit him to use such funds directly or indirectly for his benefit.

It is unquestionably true that in conservatively managed banks transactions engaged in as between the bank and the directors acting as individuals have resulted in great benefit to the bank. A director connected with other successfully managed corporations may very frequently be the agency through which the bank makes profitable investments, and

directors having large interests in their banks have in many cases materially added to the earnings of such banks through the agency of other firms or corporations in which they were likewise interested. Consequently, transactions between a national bank and its directors were, prior to the passage of this Act, not made criminal by statute, and, as a matter of fact, were not restricted. On the other hand, to incur a criminal penalty it has heretofore been necessary for the transaction to be of such a fraudulent nature as to constitute misapplication of funds or embezzlement. It is true that under the provisions of the National Bank Act, a director may be punished by fine or imprisonment for making a false entry or a false report with intent to deceive the office of the Comptroller or the public, but in such cases the penalty is based not upon the ground that a prohibited transaction has been engaged in but rather upon the ground that the true status of the bank has been concealed by such false entry or false report.

Under the National Bank Act, the only penalties prescribed for the use of funds of the bank by directors where such use does not amount to misapplication or embez-

element, are of a civil nature. For example, the directors may be held liable, civilly, where excess loans or loans upon real estate are made and loss results thereby, or, for the violation of any of the provisions of the Act, the Comptroller may institute a suit for the forfeiture of the charter of the bank.

While "directors" have been specifically referred to in the foregoing discussion, analagous principles apply with equal force to transactions involving officers or employees.

It may be assumed, therefore, that Congress intended to restrict transactions between member banks and the officers, directors and employees of such banks, since experience has demonstrated the fact that although the bank may be the beneficiary in many or most instances of such unrestricted transactions, this lack of restriction has afforded a wide field for dishonesty and fraud not punishable by statute or under the common law.

To summarize transactions permitted under the views herein expressed, a director, officer, or employee of a member bank may receive compensation from such bank where services are rendered in his official capacity, or where bona fide

services are rendered, or an adequate consideration is furnished to the bank by such director, officer or employee acting in his individual capacity, provided the transaction engaged in is not one in which the use of his official position could in any way be instrumental in causing the payment of the fee, commission, gift or other consideration received.

In no case should compensation be received by such director, officer or employee from a third party for services rendered in his official capacity when such compensation results from a transaction between such third party and a member bank.

As above suggested, it is not within the province of the Federal Reserve Board to make an official ruling on the subject under consideration, and the foregoing analysis is intended merely as an expression of individual opinion as to what transactions Congress intended to prohibit by that part of Section 22 which is under consideration.

Respectfully,

(Signed) H. C. ELLIOTT,

Counsel.

Hon. F. A. Delano,
Vice Governor, Federal Reserve Board.