

FEDERAL RESERVE BOARD

WASHINGTON

June 17, 1915.

My dear Governor.

This office has been requested to give an opinion on the question of whether a member bank which reduces its surplus is required by law to surrender a proportionate amount of the stock held by it in the Federal reserve bank of its district, or whether such Federal reserve bank, may, at its option, permit the stock representing six per cent of such decrease in surplus of a member bank to remain outstanding.

The Federal Reserve Act provides in Section 2 that -

"Every national banking association
.....shall be required.....to subscribe to
the capital stock of such Federal reserve
bank in a sum equal to six per centum of
the paid-up capital stock and surplus of
such bank."

Section 5, in providing for the admission of a bank after the organization of the system, contains a provision that such a bank -

"must subscribe for an amount of the
capital stock of the Federal reserve bank
equal to six per centum of the paid-up
capital stock and surplus of said appli-
cant bank."

It is to be noted that in both of these sections an applying bank must subscribe for an amount equal to six per cent of its capital stock and surplus.

Section 5 further provides that -

"When a member bank increases its capital stock or surplus it shall thereupon subscribe for an additional amount of capital stock",

showing that when a member bank increases either its capital stock or its surplus it must subscribe for additional stock. This conclusion is corroborated by the requirement that the outstanding capital stock of a Federal reserve bank "shall be increased from time to time as member banks increase their capital stock and surplus."

In dealing with the question of reduction in the capital stock of a Federal reserve bank, however, the Act contains no mandatory provision for decrease of such stock on account of reduction in the surplus of a member bank. The specific language used in Section 5 in reference to this subject is as follows:

"The capital stock of each Federal reserve bank shall be divided into shares of \$100 each. The outstanding capital stock shall be increased from time to time as member banks increase their capital stock and surplus or as additional banks become members, and may be decreased as member banks reduce their capital stock or surplus or cease to be members."

This section further provides that. -

"When a member bank reduces its capital stock it shall surrender a proportionate amount of its holdings in the capital stock of said Federal reserve bank."

From an examination of the bill as it passed the House, as amended by the Senate and as adopted in conference, it appears that according to the House bill, stock of Federal reserve banks was to be increased only on account of an increase in the number of member banks or on account of an increase in the capital stock of member banks, and was to be reduced on account of decrease in the number of member banks or a decrease in the capital stock of such banks.

In the Senate this section was amended so as to require an increase of the capital stock of Federal reserve banks whenever member banks increased either their capital stock or surplus, but this amendment did not specifically require a Federal reserve bank to reduce its capital stock whenever the

surplus of a member bank is reduced. That part of the section above quoted which makes such decrease discretionary with the Federal reserve bank was added by the Senate Committee, and was adopted in the conference agreement.

It seems reasonable to assume therefore, that Congress contemplated that a reduction in the surplus of a member bank might be merely temporary and accordingly vested a discretion in the Federal reserve bank to cancel a proportionate amount of the capital stock held by a member bank the surplus of which is reduced, or to permit such stock to remain outstanding.

I am, therefore, of the opinion that the Federal reserve banks may, with the approval of the Federal Reserve Board, legally exercise this discretion but inasmuch as the general purpose and intent of the Act is that each member bank shall hold stock in its Federal reserve bank in the proportion that the capital and surplus of such member bank bears to the aggregate capital and surplus of all member banks, the circumstances in each case should be carefully considered and if the reduction in surplus is a material amount and involves any distribution of any part of the surplus to the shareholders of the member bank, or if such a reduction is likely to be of a permanent nature the Federal reserve bank should require the surrender and cancellation of a proportionate amount of stock held by the member bank making such reduction.

Respectfully,

M. C. ELLIOTT,

Counsel.

Hon. Charles S. Hamlin,
G o v e r n o r .