

FEDERAL RESERVE BOARD

280

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

X-5056

February 3, 1928.

SUBJECT: Administration of Section IV (b) of Regulation D

Dear Sir:

The Federal Reserve Board has received a request for an interpretation of the language of Section IV (b) of Regulation D which pertains to the personal liability of directors permitting violations of the law regarding reserves.

The primary purpose of this section is not to lay the basis for a law suit to establish the personal liability of directors of member banks which fail to maintain their reserves, but to challenge the attention of the directors to the fact that such banks are not complying with the law regarding reserves in order that they will take proper steps to see that the banks do comply with the law in the future. It is not necessary, therefore, to define precisely in advance the measure of the personal liability of such directors. It is only necessary to call the attention of the directors to the fact that they may incur personal liability if they continue to permit the bank to violate the law regarding the maintenance of its reserves. In writing to the directors, therefore, a general statement of the common law rule regarding their personal liability will be sufficient. The exact grounds and measure of legal liability which may be incurred by the directors in their personal capacity is a matter which depends upon the peculiar circumstances of each case and which may be left for future determination in the event that it becomes necessary for the receiver, stockholders or creditors of a bank to bring suit against the directors.

For your own information, however, it may be stated that the Board is advised by its counsel that the directors of a bank would be liable for any loss or damage sustained by the bank, its stockholders, or its creditors as a result of the failure of such bank to maintain the reserves required by law or as the result of permitting such bank to make loans or pay dividends while its reserves are deficient. Such loss obviously would include the amount of penalties incurred by the bank for deficiencies in reserves and probably any amounts which the bank might lose on loans made while its reserves were deficient. Moreover, in the case of a national bank, its charter may be forfeited for

failure to maintain its reserves and, in the case of a State member bank, all of its rights and privileges as a member of the Federal Reserve System may be forfeited. In either case, damages may be sustained by the bank for which the directors would be personally liable.

The fact that Section 19 provides that the required balance carried by a member bank with a Federal reserve bank may, under the regulations and subject to such penalties as may be prescribed by the Federal Reserve Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities does not exempt a bank from the mandatory provisions of Section 19 requiring it to establish and maintain its reserves. This is evidenced by the fact that Section 19 also provides that no bank shall at any time make new loans or pay any dividends unless and until the total balance required by law is fully restored. A bank violates the law every time it makes a loan while its reserves are deficient. It is obvious, therefore, that the privilege of checking against its required minimum reserve balance is a privilege intended to be availed of only in emergencies, in order that the reserve may be of some use and not merely an idle fund impounded with the Federal reserve bank. It is obviously proper, however, for a member bank to withdraw any balance which it may have with the Federal reserve bank in excess of its required reserve.

For your guidance, in writing to directors of member banks pursuant to the provisions of Section IV (b) of Regulation D, there is enclosed herewith a draft of a proposed letter for this purpose. This is not intended as a form letter but is intended merely to indicate the character of letter which the Board desires you to send to such directors. It is desirable that a personal letter be written to each director, designed to fit the particular case in hand, rather than a form of printed or mimeographed letter.

By order of the Federal Reserve Board.

Walter L. Eddy,
Secretary.

Enclosure.

TO ALL FEDERAL RESERVE AGENTS.

(Draft of personal letter to be written by Federal Reserve Agent pursuant to Section IV (b) of Regulation D. Not to be mimeographed or printed.)

Dear Sir:

Pursuant to the provisions of Section IV (b) of Regulation D of the Federal Reserve Board, Series of 1928, a copy of which is enclosed for your information, I am writing to direct your attention to the fact that the (Name of Bank), of which you are a director, is not paying due regard to the maintenance of its reserves, having been deficient in its reserves during _____ reserve computation periods between _____ (date) and _____ (date).

Section 19 of the Federal Reserve Act requires the above mentioned bank to maintain a reserve consisting of an actual net balance with this Federal reserve bank equal to not less than _____% of the aggregate amount of its demand deposits and 3% of its time deposits, and specifically forbids such bank to make any loans or to pay any dividends while its reserves are deficient. Moreover, Section IV of the Federal Reserve Board's Regulation D prescribes penalties for a failure to maintain the reserves required by law and provides for summary action to be taken against any bank which is continuously deficient in its reserves for six consecutive months.

I am also directed by the Regulations of the Federal Reserve Board to call your attention to the fact that the directors of a bank are required to administer the affairs of such bank in accordance with the laws to which it is subject; and a failure so to administer the affairs of the bank will subject the directors to personal liability for any loss or damage sustained by said bank, its stockholders, or its creditors as a result of the failure to comply with the law. If, therefore, the (Name of Bank), its stockholders, or its creditors sustain any loss or suffer any damage through a failure of such bank to maintain its reserves as required by Section 19 of the Federal Reserve Act, or through the making of any loans or the payment of any dividends while its reserves are deficient, you, as one of the directors of said bank, may be held personally liable for such loss or damage.

Very truly yours,

Federal Reserve Agent.

Enclosure.