

FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

X-7581

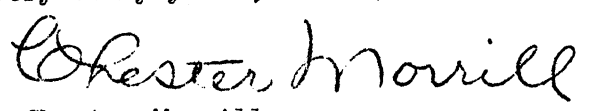
September 11, 1933.

SUBJECT: Statement of Board's general policy
in connection with consideration of
applications for membership.

Dear Sir:

You will recall that upon the request of some of the Federal reserve agents during the conferences with the Board on August 15 and 16, 1933, there was submitted a preliminary draft of a statement of the Board's general policy in connection with the consideration of applications for membership in the Federal reserve system. This statement has been revised and amplified in the light of the discussions during those meetings and the suggestions made by the Federal reserve agents with regard thereto. There are attached hereto mimeographed copies of the revised statement which may be used solely for the guidance of the appropriate committee of the Federal reserve bank and members of your staff in considering applications for membership.

Very truly yours,



Chester Morrill,
Secretary.

Inclosures.

TO ALL FEDERAL RESERVE AGENTS.

GENERAL PRINCIPLES APPLICABLE TO CONSIDERATION
OF APPLICATIONS FOR MEMBERSHIP IN
FEDERAL RESERVE SYSTEM

Under the provisions of the Federal Reserve Act, the Federal Reserve Board, in acting upon an application for membership, is specifically required to consider the financial condition of the bank, the general character of its management and whether or not the corporate powers exercised are consistent with the purposes of the Federal Reserve Act. The Federal Reserve Act further provides that no applying bank shall be admitted to membership unless it has an unimpaired capital.

While no rigid formula can be prescribed for the admission of State banks to the system, the following is an expression of the Board's general policy on the points mentioned. It should be clearly understood that they do not necessarily cover all questions that may be involved in any case, and that each particular case must be determined on its merits after careful consideration of all circumstances involved. In this connection, the standard or customary conditions of membership which the Board now prescribes for all banks admitted to membership are set forth in the circular letters dated March 11, 1933 (X-7356) and June 30, 1933 (X-7469).

1. The bank must be sound with unimpaired capital which, together with the bank's unimpaired surplus, must be adequate in relation to its total deposit liabilities, having due regard to the general principle that a bank's capital and surplus ordinarily should not be less than one-tenth of the average amount of its aggregate deposit liabilities and, in some circumstances, should be more than one-tenth of such amount.

2. All amounts classified as losses must be eliminated from the assets prior to admission to membership.

3. All depreciation on stocks and defaulted securities and all depreciation on other securities not in the four highest grades should be eliminated prior to admission to membership.

4. The surplus, undivided profits, and applicable reserves must be sufficient to cover all depreciation on securities in the four highest grades.

5. While, in the absence of special circumstances, it is not the Board's general practice to require chargeoffs on account of assets classified as slow and doubtful, consideration must be given to the fact that substantial losses often develop in the liquidation of such assets, and therefore, the aggregate of such assets should not exceed a reasonable amount when considered in relation to the bank's capital structure, the nature of its other assets, and the stability of the deposits. Consequently, in some cases, provision for loss to the extent of a part or all of the doubtful assets may be required through elimination or establishment of reserves, as circumstances warrant.

6. Investment in banking house, furniture and fixtures should be reasonable, the reasonableness of the investment to be determined in each case after taking into consideration the limitations prescribed by Section 24A of the Federal Reserve Act, as amended by Section 14 of the Banking Act of 1933, the bank's capital structure, the nature of the building, the community, the income produced, the liquidity of the other assets, etc.

7. Other real estate is an undesirable asset for a bank and should be disposed of as soon as practicable. In determining whether

immediate removal of other real estate should be required, consideration should be given to the nature and amount of such assets, taking into consideration the distribution and character of other assets, the soundness of the values, and the length of time the properties have been held. In some cases where the combined investment in banking house furniture and fixtures and other real estate has been large as compared with the total unimpaired capital and surplus of the applicant bank but where the other features of the bank's condition were such that the Board felt justified in approving the Federal Reserve Agent's recommendation that the bank be admitted to membership in the System, the Board has prescribed a condition requiring that a substantial part of the bank's net earnings be carried annually to its surplus account before the payment of any dividend, until such time as its unimpaired capital and surplus has been increased to a prescribed amount which bears a proper relation to its investment in banking house, furniture, fixtures and other real estate or until such investment has been reduced by a corresponding amount.

8. Since, under the provisions of the Federal Reserve Act as amended by the Banking Act of 1933, a member bank may not purchase corporate stocks, except in certain limited classes of cases where national banks are permitted to purchase stocks, a State bank, prior to admission to membership, should be required to dispose of at least all corporate stocks acquired within such a short time previously as to indicate that such stocks were acquired in anticipation of membership. Moreover, the Board has taken the position that an applicant for membership should divest itself of all stocks, no matter how acquired, through which the applicant may have control over any other banking institution or over any corporation which carries on a business in which the applicant would not be permitted to

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engage directly as a member bank. In general, it may be observed that the Board feels that stocks are not suitable investments for funds of commercial banking institutions and has suggested to applicants admitted to membership that they consider the advisability of disposing of all stocks held by them as soon as it is feasible to do so.

9. The bank's liquid position, considering the distribution of its assets, its borrowing capacity, and the nature of its deposits, should be satisfactory and such as to indicate that it would not need to resort to emergency loans or to borrow continuously in order to remain in business.

10. Special consideration should be given to the character of the management and control of the institution, and any changes should be effected prior to admission which previous conduct of the bank's management or other circumstances indicate are desirable. When a directorate or management is retained in whole or in part notwithstanding the fact that the record of the institution may have been unsatisfactory, there must be an affirmative showing that the persons retained do not merit substantial criticism for the unfavorable conditions and that confidence may properly be reposed in them in the future. In this connection, particular consideration should be given to whether the directorate and management of the bank have a substantial financial stake in the success of the bank through ownership of its stock.

11. Careful consideration should be given to all corporate powers exercised by the bank and their effect on the bank and whether they are consistent with the purposes of the Federal Reserve Act. Prior to admission to membership, the bank should be required to terminate the

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exercise of any powers that are not appropriate for a bank receiving deposits, such, for example, as insuring or guaranteeing titles to real estate, executing surety bonds, acting as warehouseman, or carrying on any class of business covered by the Federal Reserve Board's standard condition number 12, contained in the Board's letter of March 11, 1933 (X-7356).

12. Attention should be directed in each case to the needs of the community for the banking facilities to be provided by subject bank, and to the probability of the successful operation of the bank in view of all circumstances involved in the particular case. In this connection particular consideration should be given to the circumstances involved in any reorganization of the applicant bank which has occurred within a short time prior to its application for admission to the system, and attention is called to the Board's letter of August 21, 1933 (X-7556), with regard to applications involving such circumstances.

It may be added that it has been the consistent policy of the Board not to admit a bank to membership unless the Federal Reserve Agent and the Federal Reserve Bank committee have recommended such admission. As pointed out in its letter of March 11, 1933 (X-7356) the Board would like to have the recommendations of the bank's committee and the Agent as to any special requirements which in their judgment should be prescribed in each particular case with the view to correcting or preventing unsatisfactory conditions. In connection with each such recommendation there should be a clear statement of the circumstances which form the basis of such recommendation. It should also appear that counsel for the Federal reserve bank is satisfied with all legal aspects of each case.