

FEDERAL RESERVE BOARD

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WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

X-7594

September 20, 1933.

SUBJECT: Use of Preferred Stock or Debentures
by Banks in Obtaining Funds.

Dear Sir:

There is inclosed for your information, a copy of a letter which the Board has addressed to the Federal Reserve Agent at the Federal Reserve Bank of Kansas City, with regard, among other things, to the uses which may be made of preferred stock and capital notes or debentures for the purpose of obtaining funds to improve the condition of banks.

Very truly yours,



L. P. Bethea,
Assistant Secretary.

Inclosure.

TO ALL F. R. AGENTS EXCEPT AT KANSAS CITY.

C O P Y

X-7594-a

September 19, 1933.

Mr. M. L. McClure,
Federal Reserve Agent,
Federal Reserve Bank of Kansas City,
Kansas City, Missouri.

Dear Mr. McClure:

Receipt is acknowledged of your letter of September 5, 1933, enclosing copies of letters you have addressed to the State Banking Departments of Missouri and Colorado and advising of other steps you have taken to obtain information with regard to the condition and needs of banks in Groups 3 and 4 and to suggest to the State Banking Departments of the States in your district that banks in such groups make application to the Reconstruction Finance Corporation for the purchase of such preferred stock as may be necessary to place the banks in sound condition. Your efforts in this connection and the cooperation you are giving in working out the problems involved in this matter are greatly appreciated.

It is noted that you have called the attention of at least one of the State Banking Departments to the fact that the Reconstruction Finance Corporation can supply funds through loans to the purchasers of preferred stock which is subject to double liability, and it is suggested that, if you have not already done so, you call this fact to the attention of the State Banking Departments of the other States located in your district, the

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laws of which do not authorize banks to issue preferred stock exempt from double liability.

As you know, the Board has ruled in its letter of August 25, 1933 (X-7561) that capital debentures which represent the indebtedness of the issuing bank for money borrowed rather than a proprietary interest in such bank may not be considered capital stock of the bank for the purpose of determining whether it has sufficient capital to make it eligible for admission to membership in the Federal Reserve System. However, in any case where a bank has sufficient capital stock to make it eligible for membership but the amount of its capital stock and surplus is not adequate from the standpoint of a proper relationship to its deposit liabilities, there would seem to be no objection to the bank obtaining funds for the protection of its depositors through the issuance of capital notes or debentures which would be subject to payment by the bank only after claims of depositors are satisfied. As you know, the Reconstruction Finance Corporation is authorized to purchase legally issued capital notes or debentures of State banks, if the laws of the State in which the bank is located do not authorize the issuance of preferred stock exempt from double liability or if such preferred stock may only be issued by unanimous consent of the stockholders of the bank.

In this connection, it may be noted that lawfully issued capital debentures of the kind referred to above may properly be included in determining whether capital and surplus funds of a bank

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are adequate in relation to its total deposit liabilities within the meaning of the Board's usual condition of membership number 15. In any case where capital debentures are issued for protection of depositors, it would be advisable at the time of such issuance to make provision for an appropriate increase of the capital stock of the bank if and when such debentures are retired, in order that the bank may at all times have an adequate amount of capital funds for the protection of its depositors.

It appears from your letter that the constitution of the State of Nebraska forbids the issuance of bank stock which is not subject to double liability; and it would seem advisable to consider the enactment of legislation in that State authorizing the issuance of such capital debentures if they cannot be issued under existing law.

It also appears from your letter that Kansas, New Mexico, Oklahoma and Wyoming have no constitutional provisions forbidding the issuance of preferred stock not subject to the double liability; and it would seem advisable to obtain legislation in those States authorizing the issuance of such preferred stock.

Summarizing the situation, it would seem that:

(1) If the laws of a State permit banks located in such State to issue preferred stock which is exempt from the double liability, the best method of strengthening the capital structure of banks is for them to issue preferred stock and sell the same to the Reconstruction Finance Corporation, if it cannot be sold to other purchasers.

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(2) If the laws of the State do not permit the issuance of preferred stock exempt from double liability but there is no constitutional provision forbidding the issuance of such stock, it would seem desirable to seek legislation authorizing the issuance of preferred stock exempt from double liability, in order that the assistance of the Reconstruction Finance Corporation may be obtained through the purchase of such stock.

(3) If the constitution of a State forbids the issuance of preferred stock exempt from double liability but permits the issuance of preferred stock which is subject to double liability, it would seem desirable to issue such preferred stock and seek a loan from the Reconstruction Finance Corporation to enable the purchasers to pay for it; but would not seem proper in any case for a bank to make loans on the security of its own stock.

(4) If preferred stock cannot be utilized in any of the ways suggested above as a means of strengthening the capital structure of a bank, it would seem that relief must be sought through the issuance of capital notes or debentures for sale to the Reconstruction Finance Corporation. It would seem possible through this method to obtain the additional protection needed for depositors and to improve the condition of the bank for the purpose of obtaining admission to the Federal Deposit Insurance Fund; but it is not possible by this method to make a bank eligible for

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membership in the Federal Reserve System if it has insufficient capital to comply with the legal requirements of the Federal Reserve Act. This, however, is not the question presented in your letter. That question covers only the means of bettering the condition of banks to enable them to enter the Deposit Insurance Corporation on a sound basis, and that question I have endeavored to answer fully.

Very truly yours,

(Signed) E. R. Black

E. R. Black,
Governor.