

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON



ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

X-9506

February 28, 1936.

SUBJECT: Procedure under Conditions of Membership
Regarding Maintenance of Adequate Capital
Structure.

Dear Sir:

In accordance with Regulation H as revised effective January 1, 1936, the standard condition of membership regarding maintenance of an adequate capital structure as now prescribed reads as follows:

- "2. The net capital and surplus funds of such bank shall be adequate in relation to the character and condition of its assets and to its deposit liabilities and other corporate responsibilities, and its capital shall not be reduced except with the permission of the Board of Governors of the Federal Reserve System."

Footnote 8 of the Regulation further provides:

- "8. If at any time, in the light of all the circumstances, the aggregate amount of the bank's net capital and surplus funds appears to be inadequate, the bank, within such period as shall be deemed by the Board to be reasonable for this purpose, shall increase the amount thereof to an amount which in the judgment of the Board shall be adequate in relation to the bank's aggregate deposit liabilities and other corporate responsibilities."

Prior to the adoption of the new standard condition of membership quoted above, the following standard condition of membership

relative to capital structure had been prescribed:

"15. Such bank shall maintain an amount of paid-up and unimpaired capital and unimpaired surplus which, in the judgment of the Federal Reserve Board, will 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."

In the Board's letter dated June 30, 1933 (X-7469), it was stated that the letter addressed to banks advising of the Board's approval of their applications for membership would contain the following comments regarding condition of membership numbered 15:

"In connection with condition numbered fifteen above and in the absence of any special action by the Board, if in any period of twelve months ending on the thirtieth day of November the average amount of deposit liabilities of the bank during such period as determined on the basis of reports made by the bank to the Federal Reserve bank for the purpose of computing its required reserve, exceeds ten times the aggregate amount of the bank's paid-up and unimpaired capital stock and unimpaired surplus, the Board will expect that the bank, as soon as possible and within the next succeeding six months, will increase the aggregate amount of its paid-up and unimpaired capital and unimpaired surplus to an amount at least equal to ten per cent of the average amount of its deposit liabilities during such twelve months."

In letter X-7469 it was also stated that while each bank subject to condition of membership numbered 15 was expected to comply with its provisions without any special action on the part of the Board, the Board would, in special circumstances and upon the specific recommendation of the Federal Reserve Agent, consider whether, in view of all of the facts involved in the particular case, it would

be justified in not requiring the bank to increase its capital and surplus to an amount at least equal to one-tenth of its deposit liabilities, or whether, on the other hand, a larger proportion of capital and surplus should be required in order to afford adequate protection because of special conditions existing in the case of the particular bank under consideration.

The revision of former standard condition of membership numbered 15 does not reflect in any degree whatsoever a modification of the Board's position that it is essential that member banks maintain a sound and adequate capital structure. It is anticipated, however, that the condition, as revised in the Board's existing Regulation H, while maintaining the fundamental principle, will provide the flexibility necessary to facilitate administration. The Board feels, therefore, that a compliance by each State member bank subject to former condition numbered 15 with the portion of the new standard condition of membership numbered 2 relating to the adequacy of its capital structure and with footnote 8, set forth in Regulation H, should be considered a compliance with the former condition numbered 15. In any case in which a member bank subject to condition numbered 15 complies with such portion of the new condition numbered 2 and with footnote 8 of Regulation H the detailed requirements contained in condition numbered 15 and in the Board's letter X-7469 regarding such condition may be disregarded. In the circumstances, it will be appreciated if you will advise each such State member bank in your district accordingly.

It is requested that, annually as of the close of the year, the Federal Reserve Agents review the condition of each member State bank subject to the new standard condition of membership numbered 2 or former standard condition of membership numbered 15 and advise the Board of any situation in which it appears that the net capital and surplus funds of any such bank are inadequate under the provisions of the condition of membership, supplementing such advice with a brief statement as to the facts of each case and a recommendation as to the action which should be taken. Of course, if, during the year, any situation should develop which would require more immediate action under the conditions of membership in question, the Federal Reserve Agents are requested to advise the Board fully as to the situation and submit a recommendation as to the action which should be taken in the matter.

It is expected that the Federal Reserve Agents will continue to keep themselves currently advised as to the condition of all State member banks in their districts, whether or not subject to the new standard condition numbered 2 or former standard condition numbered 15, and in the case of any State member bank which appears to be in need of additional capital will take such action as may be appropriate in the circumstances, advising the Board fully in the premises.

Very truly yours,



L. P. Bethea,
Assistant Secretary.

TO ALL FEDERAL RESERVE AGENTS