

INTERPRETATION OF LAW OR REGULATION

(Copies to be sent to all Federal Reserve banks)

November 15, 1939

Mr. _____, Vice President,
Federal Reserve Bank of _____,
_____, _____.

Dear Mr. _____:

This refers to your letter of September 13, 1939, relating to a request from Mr. _____, Secretary-Comptroller, _____, _____, that the Board define the terms "net earnings" and "actual net earnings" used in subsections (c) and (e)(4), respectively, of section 5144 of the Revised Statutes of the United States. The Board believes that it is not feasible for it to furnish comprehensive definitions of these terms which would cover all of the specific questions which may arise in various cases and circumstances. It is believed, however, that the following views on the matter will furnish the information which Mr. _____ desires regarding undistributed earnings of subsidiary banks.

Subsection (e)(4) requires that a holding company affiliate shall agree, in its application for a voting permit, that thenceforth it will declare dividends only out of actual net earnings. The Board feels that the amount of the "actual net earnings" of a holding company affiliate, within the meaning of such subsection, should be arrived at on the basis of the most conservative accounting principles. Accordingly, it is felt that the actual net earnings of a holding company affiliate generally should not be construed to include earnings of subsidiary banks which have not been distributed to the holding company affiliate in the form of dividends.

With respect to the provisions of subsection (c) regarding the establishment and maintenance by a holding company affiliate of a reserve of readily marketable assets out of net earnings over and above 6 per centum per annum on the book value of its own shares outstanding, it is felt that "net earnings" should not be construed to include undistributed earnings of subsidiary banks which, in accordance with the comments in the preceding paragraph, are not regarded as "actual net earnings" of the holding company affiliate.

Very truly yours,

(Signed) L. P. Bethea

L. P. Bethea,
Assistant Secretary.