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AMENDMENTS TO BANKING LAWS

JUNE 6, 1934.—Ordered to be printed

Mr. BULKLEY, from the Committee on Banking and Currency, submitted the following

REPORT

[To accompany S. 3748]

The Committee on Banking and Currency, to whom was referred the bill (S. 3748) to amend certain sections of the Banking Act of 1933 and the Federal Reserve Act, and certain laws relating to national banking associations, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

STATEMENT

The Banking Act of 1933 became a law on June 16, 1933. In administering this act the Comptroller of the Currency and the Federal Reserve Board have met with practical difficulties with respect to certain sections of the act, some of which have brought about situations which apparently it was not the intention of Congress to create. Both the Comptroller of the Currency and the Federal Reserve Board have recommended to Congress that certain clarifying amendments be enacted in the law at this session of Congress. This bill will in the main carry out these recommendations.

Section 1: This amendment makes it clear that section 20 of the Banking Act of 1933 permits the orderly liquidation of the affairs of securities companies affiliated with member banks, when such companies have been placed in formal liquidation and are transacting no business except such as may be incidental to their liquidation. It will prevent the possibility of such companies being required to dump upon the market real estate, securities, and other valuable assets which would entail sacrifices to stockholders and would tend further to depress the market for such assets.

Section 2: This section contains two amendments to section 21 of the Banking Act of 1933.

Subsection (a) adds a proviso making it clear that the provisions of section 21 of the Banking Act of 1933, which forbids organizations engaged in the business of issuing, underwriting, selling, or distributing securities to receive deposits, do not prevent banks from dealing in, underwriting, or purchasing obligations of the United States or general obligations of any State or any political subdivision thereof or obligations issued under authority of the Federal Farm Loan Act or issued by the Federal home-loan banks or the Home Owners' Loan Corporation. In view of the provisions of section 5136 of the Revised Statutes and section 9 of the Federal Reserve Act, as amended by the Banking Act of 1933, it is reasonably clear that this prohibition is not applicable to national banks and State member banks of the Federal Reserve System; but the amendment is necessary to clarify the situation respecting nonmember banks, and it seems desirable at the same time to remove any doubt about the fact that the prohibition is not applicable to national banks and State member banks.

Subsection (b) amends that part of section 21 which forbids any organization other than a financial institution or a private banker subject to examination and regulation under State or Federal law to engage in the business of receiving deposits without submitting to periodic examinations by the Comptroller of the Currency or the Federal Reserve bank, so as to make clear that this prohibition is not applicable to organizations which accept deposits only from their own employees. Many industrial corporations accept deposits from their employees for the purpose of promoting thrift, and it would seem that this practice should not be interfered with so long as such organizations do not solicit deposits from the general public. This amendment is recommended by the Comptroller of the Currency.

Section 3: Section 32 of the Banking Act of 1933, forbids officers and directors of member banks to be officers, directors, or managers of corporations, partnerships, or unincorporated associations engaged primarily in the business of purchasing, selling, or negotiating securities. Section 3 of the bill would amend this provision so as to make it apply to employees of member banks as well as to officers and directors thereof and also so as to forbid such officers, directors, and employees to be engaged in such business as individuals, as well as to forbid them to be officers, directors, or employees of organizations engaged in such business. This amendment also clarifies the language of this section and makes it harmonize with other sections of the Banking Act of 1933. It was recommended by the Federal Reserve Board.

Section 4: This section contains three amendments to paragraph Seventh of section 5136 of the Revised Statutes, as amended by the Banking Act of 1933.

Subsection (a) is purely a clarifying amendment and will remove any doubt as to the authority of national banks to purchase and sell corporate stocks solely on the order and for the account of their customers. Since this does not entail the investment by the bank of its own funds and the bank merely acts in an accommodation capacity, it is believed that it was not the intention of Congress to penalize the public located in communities removed from the money centers in disposing of or purchasing securities in the form of corporate stocks for investment purposes. This amendment was recommended by the

Comptroller of the Currency in his annual report dated January 3, 1934.

Subsection (b) amends the provision which removes the 10-percent limit on the purchase by an association for its own account of a single issue of securities of any one obligor where such issue does not exceed $100,000 and 50 percent of the capital of the association, so as to provide that such limitation of 10 percent shall not apply where the total amount of any such issue does not exceed $1,000,000 and 50 percent of the capital of the association.

Subsection (c) amends the fourth sentence of paragraph seventh of section 5136 of the Revised Statutes to conform to the amendment contained in subsection (a) so as to make it clear that the purchasing of stock shall not be for the account of the association but for the account of its customers.

Section 5: The Banking Act of 1933 provides that no shares of stock of a national bank can be voted if held by the bank as sole trustee or held by a holding company affiliate which has not obtained a voting permit from the Federal Reserve Board. Cases have arisen where by reason of this prohibition banks have been unable to secure the necessary votes to reduce capital, issue preferred stock or take other action requiring a vote of two-thirds of the shareholders. This amendment would retain the prohibition but would eliminate from the calculation of a two-thirds vote, the stock which cannot be voted. This amendment was recommended by the Comptroller of the Currency in his Annual Report, dated January 3, 1934.

Section 6: The amendment contained in this section is in accordance with the following recommendation contained in the Annual Report of the Comptroller of the Currency, dated January 3, 1934:

> Revised Statutes 5154, United States Code, title 12, section 35, provides for conversion of State banks into national banks. There has been an increased number of State banks which have applied to the Comptroller of the Currency for conversion. In examining these banks it is found that they possess some assets which it is not legal for national banks to acquire and hold. To require a State bank to eliminate these assets places a burden on it which it may be unable to meet and many times results in its inability to join the national system.
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> It is recommended that Congress amend this statute to provide that such banks on conversion may continue to carry such nonconforming assets as may be determined, in the discretion of the Comptroller of the Currency, to be acceptable because of their intrinsic value.

Section 7: This amendment is in accordance with the following recommendation made by the Comptroller of the Currency in his annual report dated January 3, 1934:

> United States Revised Statutes, sections 5162, 5163, 5164, 5165, and Act of June 20, 1874, chapter 343, section 4, provide that in the withdrawal or transfer of registered bonds to secure circulation which are pledged with the Treasurer of the United States, such bonds shall be countersigned by the Comptroller of the Currency. The volume of this countersigning is so heavy due to the increased national bank circulation that it seriously interferes and handicaps the Comptroller and his deputies in handling other matters far more important. It is recommended, therefore, that this section be amended to provide that the Comptroller of the Currency may designate one or more persons to make these countersignatures.

Section 8: This section amends section 5197 of the Revised Statutes; but the sole change of substance consists of the addition of the proviso appearing on page 6 of the bill, lines 17 to 22, which permits branches of national banks located outside of the States of the United

States and the District of Columbia to charge such rates of interest on loans as may be allowed by the laws of the places where such branches are located. This amendment is believed to be necessary to enable branches of national banks to compete with other banks in such places.

Section 9: Under the present laws, the Comptroller of the Currency has no direct supervision over national-banking associations in voluntary liquidation as distinguished from banks in receivership. This section would provide for closer supervision in the following respects:

1. Annual reports to the Comptroller of the Currency.
2. Annual reports to the shareholders.
3. Examination by the Comptroller of the Currency.

In addition, it would provide for special meetings of the shareholders to remove liquidating agents or committees and also would provide for annual meetings. This amendment is recommended by the Comptroller of the Currency.

Section 10: This section amends section 12B of the Federal Reserve Act, which provides for the insurance of bank deposits, so as to exclude from the provisions of that section banks or branches thereof located outside of the States of the United States and the District of Columbia. It is felt that banks in the United States proper should not be required to contribute to the satisfaction of losses incurred by banks or branches located outside thereof.

Section 11: This section revises the last two paragraphs of section 19 of the Federal Reserve Act, as amended by the Banking Act of 1933, which pertains to the payment of deposits and interest thereon by member banks of the Federal Reserve System, so as to eliminate certain inconveniences, inequities, and administrative difficulties in accordance with the recommendations made by the Federal Reserve Board in a letter addressed to the Chairman of the Committee on Banking and Currency, which is included in the appendix to this report. In addition to the amendments recommended by the Federal Reserve Board, there is incorporated an amendment recommended by the Comptroller of the Currency which exempts from the prohibition on the payment of interest on deposits payable on demand deposits of funds by the United States, any Territory, District, or possession thereof (including the Philippine Islands), or by a public instrumentality or agency thereof, with respect to which interest, is required to be paid by law.

Section 12: This section amends section 21 of the Federal Reserve Act, as amended, so as to enable the Federal Reserve Board or the Comptroller of the Currency, as the case may be, to waive reports and examinations of affiliates of member banks when in their judgment such reports or examinations are not necessary to disclose the relations between the affiliates and the banks. This will eliminate the burden and expense of making examinations and handling the reports in cases where there is in fact no need therefor and no object to be gained thereby, since there are many corporations which are included technically in the broad definition of "affiliate" in the Banking Act of 1933, but which have no substantial effect on the affairs of the banks. This amendment was recommended by the Federal Reserve Board and the Comptroller of the Currency.

Section 13: This section amends paragraph (g) of section 22 of the Federal Reserve Act, which prohibits loans to executive officers of

member banks, by defining the term "executive officer" as now used in that section so as to eliminate the uncertainty of not only the banks but of the supervisory authorities as to the interpretation to be placed thereon. Since the paragraph imposes a penalty for violation of its provisions, such uncertainty should be eliminated. It also forbids loans to be made to a partnership in which executive officers have a majority interest. This amendment was recommended by the Comptroller of the Currency.

Section 14: This amends section 23A of the Federal Reserve Act, which prescribes certain limitations and conditions on loans by member banks to their affiliates.

Subsection (a) exempts from such limitations and conditions loans where the affiliate relationship has arisen out of a bona fide debt contracted prior to the creation of the relationship. The object of this amendment is to avoid the severe loss that may be occasioned by banks under the present law where they control an affiliate through having obtained its stock by foreclosure or otherwise in satisfaction of a previously contracted debt. It is frequently found necessary to advance funds to such an affiliate either for the purpose of continuing its operation or of assisting its liquidation, so as to salvage the real value out of the assets and reduce or avoid loss by the bank on the debt which had been secured.

Subsection (b) amends section 23A of the Federal Reserve Act so as to include in the classes of affiliates exempted from the provisions of that section (1) affiliates engaged solely in maintaining and operating properties acquired for banking purposes prior to the effective date of the amendment, (2) subsidiaries of affiliates in whose capital stock a national banking association may invest pursuant to section 25 of the Federal Reserve Act if all the stock of the subsidiaries (except qualifying shares of directors not in excess of 10 percent) is owned by the affiliate and (3) subsidiaries of affiliates organized under section 25 (a) of that act whose stock is similarly owned.

Section 15: This section would amend section 8A of the Clayton Antitrust Act, which was added to that act by section 33 of the Banking Act of 1933 and which pertains to interlocking relationships between banks organized or operating under the laws of the United States and corporations or partnerships which make loans secured by stock or bond collateral. The amendments would extend the provisions of this section so as to apply to State member banks of the Federal Reserve System as well as to national banks and would revise the section so as to eliminate certain unforeseen hardships in cases which are within the letter of the statute but which are not believed to be within the purpose of the statute. The amendments are explained in detail in a letter addressed by the Federal Reserve Board to the chairman of the Committee on Banking and Currency which is included in the appendix to this report.

Section 16: This section clarifies the present law with respect to the consolidation of two national banks to correspond to the law pertaining to the consolidation of a State bank with a national bank, and is desirable for the protection of dissenting shareholders. It also provides that publication of notice by registered mail may be waived by unanimous action of the shareholders in order that consolidations may not be delayed where the shareholders are in unanimous agree-

ment. This amendment was recommended by the Comptroller of the Currency.

Section 17: This section, like section 16 of the bill, amends the present law to protect the rights of dissenting shareholders and to enable the Comptroller of the Currency to take action to accomplish such result where the consolidated bank refuses to act.

Section 18: The present law (U.S.C., title 28, sec. 41, par. 16) provides that United States district courts shall have original jurisdiction over all cases for winding up the affairs of national banks and (U.S.C., title 28, sec. 71) for the removal of such cases from State courts to the Federal courts. While, in practice, many cases involving insolvent national banks are not brought in the Federal courts or removed to the Federal courts, there is one type of case where Federal jurisdiction is especially important because many State courts do not follow the strict Federal rule regarding preferences against national banks. In such cases many State courts adopt a much more liberal rule than the Federal courts, to the detriment of the ordinary depositors of such banks. Recently, attorneys for claimants asserting preferred claims have attempted to avoid this Federal rule and obtain preferred treatment for their claimants by bringing suits against failed banks as corporations, rather than against the receivers, to prevent removal to the Federal courts and circumvent the strict Federal rule as to preferred claims. In order to preserve the rights of the general depositors against preferences, this amendment is necessary and is recommended by the Comptroller of the Currency. In this connection, attention is called to the following portion of the opinion of the court in the case of *Moulton* v. *National Farmers' Bank* (27 Fed. (2d) 403, 406):

> It is difficult to understand why, as a practical matter, a suit in a State court upon a claim against an insolvent national bank should be removable if the receiver is joined, and not removable if he is not joined, when, concededly, the result sought is the same in each case. The receiver may not be a necessary party to the suit as a matter of law, but he is a very necessary party when it comes to the payment of the claims established against the bank. His duty to protect the assets of the insolvent estate is as great in the one case as the other, and his rights and remedies should be the same. The situation appears to be one which might well be called to the attention of Congress.

APPENDIX A

LETTER FROM THE FEDERAL RESERVE BOARD PERTAINING TO AMENDMENTS CONTAINED IN SECTION 11

MAY 29, 1934.

Hon. DUNCAN U. FLETCHER,
Chairman Banking and Currency Committee,
United States Senate, Washington, D.C.

MY DEAR MR. CHAIRMAN: The inflexibility of the provisions of the last two paragraphs of section 19 of the Federal Reserve Act, which relate to the payment of interest on deposits, in a number of instances has caused hardships to member banks and to their depositors and has given rise to numerous difficulties in administration. In view of the undesirable situations created thereby, it is believed that these paragraphs should be amended in such respects as may be necessary to eliminate the objectionable features, and there is submitted herewith for the consideration of your committee a draft of a bill which it is believed will accomplish the end desired and at the same time will serve to further the purposes of the present law. There is also enclosed a draft of a revision of the last two paragraphs of section 19, which shows the textual changes which would be made by the bill if enacted.

In order that the provisions of the last two paragraphs of section 19 may be sufficiently adaptable to meet the requirements of actual conditions, it is believed that it is desirable to vest in the Board specific authority to define, for the purposes of such paragraphs, the terms "time deposits", "savings deposits", and "deposits payable on demand." In addition it is believed that the Board should be expressly authorized to prescribe such rules and regulations as may be necessary to effectuate the purposes of the paragraphs and to prevent evasions thereof. The bill submitted herewith contains amendments for such purposes.

The rates of interest customarily paid on deposits by foreign banking institutions are often in excess of the rates which may lawfully be paid by member banks of the Federal Reserve System on the same kinds of deposits, and, as a result thereof, branches of member banks operated in places outside of the United States may lose substantial amounts of deposits unless they are permitted to meet competition by paying interest at a rate equal to that currently paid by competing foreign banking institutions. In view of such circumstances, it is the opinion of the Board that the last two paragraphs of section 19 should be amended so as to except deposits payable only at an office of a member bank located outside of the States of the United States and of the District of Columbia from the prohibition upon the payment of interest on deposits payable on demand and from the provisions relating to the payment of interest on time and savings deposits. The enclosed bill would accomplish this purpose.

You will observe that the bill would also except from the prohibition upon the payment of interest on deposits payable on demand any deposit of trust funds with respect to which the payment of interest is required by State law. The laws of a number of States require the payment of interest on uninvested funds held in trust by banks, and, since trust funds awaiting investment as a practical matter must usually be available on demand and may not ordinarily be carried as time deposits, it is believed that the prohibition upon the payment of interest on deposits payable on demand should be made inapplicable to deposits of trust funds with respect to which the payment of interest is required by State law.

The present law provides that the prohibition upon the payment of interest on deposits payable on demand shall not be construed to prohibit the payment of interest by a member bank in accordance with the terms of any certificate of deposit or other contract entered into in good faith and in force on the date of enactment of the Banking Act of 1933. The enclosed bill provides in substance that such prohibition shall not be construed to apply to any payment made in accordance with the terms of a bona fide contract in force on the date on which the bank becomes subject to such provisions. The amendment would except from the prohibition upon the payment of interest on deposits payable on demand any payment made by a bank entering the system subsequent to the enactment of the Banking Act of 1933, provided such payment is made in accordance with the terms of a contract entered into in good faith and in force on the date the bank becomes a member of the system. Such an amendment is believed to be desirable.

It is the view of the Board that the absolute prohibition against the payment of any time deposit before maturity should be relaxed so as to permit the payment of such deposits before maturity in exceptional circumstances and in order to avoid hardships. Accordingly, the enclosed bill provides that no time deposit may be paid before its maturity "except upon such conditions and in accordance with such rules and regulations as may be prescribed by the Federal Reserve Board."

It should also be noted that the bill submitted herewith contains language which would make the provisions of the last 2 paragraphs of section 19 applicable to every bank whose deposits are insured under the provisions of section 12B of the Federal Reserve Act. It is the view of the Board that banks which are not members of the Federal Reserve System, but the deposits of which are insured under the provisions of said section 12B, should be on the same basis as to the payment of deposits and of interest thereon as member banks of the Federal Reserve System. Under the existing law, banks which are members of the Federal Reserve System are subject to certain limitations and restrictions with respect to the payment of deposits and of interest thereon which are not applicable to other banking institutions, notwithstanding that their deposits are insured under the provisions of said section 12B, and such institutions are thereby afforded a competitive advantage over member banks. The proposed amendment would place all banks whose deposits are insured under section 12B on a basis of equality in this respect.

It is believed that the amendments suggested in the enclosed bill are desirable and that the enactment of the bill would be in the interest of the member banks of the Federal Reserve System and in furtherance of the essential purposes of the present law. Because of the existing situation, the Board hopes that your committee will give early and favorable consideration to the proposed amendments with a view to the enactment of the bill enclosed herewith during the present session of Congress.

Very truly yours,

E. R. BLACK, *Governor.*

APPENDIX B

LETTER FROM THE FEDERAL RESERVE BOARD PERTAINING TO AMENDMENTS CONTAINED IN SECTION 15

MAY 8, 1934.

Hon. DUNCAN U. FLETCHER,
Chairman Committee on Banking and Currency,
United States Senate, Washington, D.C.

MY DEAR MR. CHAIRMAN: This refers to the letter from the acting clerk of your committee, dated March 21, 1934, enclosing a copy of S. 3100, entitled "A bill to amend section 33 of an act to provide for the safer and more effective use of the assets of banks, to regulate interbank control, to prevent the undue diversion of funds into speculative operations, and for other purposes", and requesting a report thereon.

Section 33 of the Banking Act of 1933 amended the Clayton Antitrust Act by adding after section 8 thereof a new section, designated section 8A, which forbids any director, officer, or employee of any bank, banking association, or trust company "organized or operating under the laws of the United States" to be at the same time a director, officer, or employee of a corporation (other than a mutual savings bank) or a member of a partnership "organized for any purpose whatsoever" which shall make loans secured by stock or bond collateral to any individual association, partnership, or corporation other than its own subsidiaries.

While the purposes of this section are not entirely clear, it is believed that they are generally to prevent an undue use of credit for speculative purposes and to supplement other provisions of the Banking Act of 1933 which were designed to discourage corporations engaged in commerce or industry from making loans to brokers or dealers in stocks and bonds—i.e., the so-called "brokers loans for others." It seeks to accomplish these objects by preventing individuals associated with organizations which make loans on the security of stock or bond collateral from serving at the same time as directors, officers, or employees of banks organized or operating under the laws of the United States.

It is not believed that this section was actually intended to prevent the same person from serving as director, officer, or employee of two or more banks; but the conclusion that it has that effect seems inescapable, because banks clearly are included in the broad term "corporation * * * organized for any purpose whatsoever" and also because the specific exception of mutual savings banks indicates that all other banks which make loans on stock or bond collateral are included. It is believed, therefore, that the amendment contained in the bill S. 3100, which would broaden the exception so as to apply to all banks instead of mutual savings banks alone, is in harmony with the real purposes of the section and should be adopted. It is believed, however, that certain other amendments to this section should also be adopted.

Because of the very comprehensive language employed, and especially the words "corporation * * * organized for any purpose whatsoever", section 8A has been found to apply to certain other types of situations which are not believed to be within the purpose of the statute; and there is respectfully submitted herewith for the consideration of your committee a draft of a bill to amend said section 8A which has received the careful consideration of the Board and which it is believed will meet the principal objections to that section without affecting the accomplishment of its primary purposes.

Numerous member banks have suffered the loss of some of their most valuable directors and are threatened with the loss of others solely because such directors are officers or directors of corporations which occasionally make loans on stock or bond collateral to their own officers and employees or because they are officers or directors of corporations engaged primarily in an agricultural, industrial, or commercial business which occasionally make such loans to their own customers

as an incident to their principal business; and it is felt that the statute should be made inapplicable to such situations.

Section 8A as originally enacted in section 33 of the Banking Act of 1933 specifically excepts from its operation corporations and partnerships which make loans on stock or bond collateral only to their own subsidiaries; and it is the view of the Board that this exception should be extended to include those which make such loans only to their own officers and employees. Many corporations make loans to their own officers and employees on their own stock for the purpose of enabling such officers and employees to become stockholders of the corporations and others sometimes make loans to their own officers or employees on stock or bond collateral in order to assist them when they are in financial difficulties. Obviously, such loans are not within the intent of the statute, although they are clearly within the language thereof.

Numerous cases have come to the Board's attention in which corporations and partnerships engaged primarily in industrial, commercial, or agricultural business sometimes make loans to their own customers on the security of stocks or bonds as an incident to their principal business; and it is believed that such loans are not within the intent of the statute if they are not made for the purpose of enabling such customers to purchase or trade in stocks or bonds.

The amendments contained in the enclosed draft of a bill to amend section 8A have been drawn with a view of making exceptions covering these classes of cases and at the same time to guard carefully against any evasion of the true purposes of the law. In this connection, attention is invited to the proviso which prevents the exceptions from applying in the case of corporations or partnerships which make loans to brokers or dealers in stocks or bonds or which make loans to finance the purchase or sale of, or trading in, stocks or bonds other than loans to their own officers and employees for the purpose of enabling them to buy stock in such corporations.

Attention is also invited to the fact that, under date of September 10, 1917, the Acting Attorney General of the United States rendered an opinion with respect to section 8 of the Clayton Antitrust Act in which he held that the phrase "organized or operating under the laws of the United States" does not include State banks which are members of the Federal Reserve System. The reasoning of the opinion is equally applicable to the same phrase as used in section 8A of the Clayton Act; and, therefore, the Board has ruled that section 8A does not forbid interlocking relationships between State member banks and corporations or partnerships which may make loans on the security of stock or bond collateral. It is believed that the purposes of section 8A will be accomplished more effectively if its provisions are made applicable to State banks which are members of the Federal Reserve System as well as to national banking associations; and the enclosed draft of a bill would place national banks and State member banks on the same basis in this respect by striking out the words "any bank, banking association, or trust company organized or operating under the laws of the United States" and substituting the words "any member bank of the Federal Reserve System." Incidentally, this change would make the section inapplicable to Federal Reserve banks, Federal land banks, Federal intermediate credit banks, Federal home-loan banks, and similar institutions, which are not believed to be within the intent of the section.

For the reasons stated above and in view of the fact that the existing provisions of law became effective on January 1, 1934, the Federal Reserve Board recommends the enactment of the enclosed bill at the earliest practicable date. In this connection it should be noted that the enclosed bill would fully accomplish the purpose of S. 3100 to make section 8A inapplicable to interlocking relationships between banking institutions, and, therefore, it could appropriately be substituted for S. 3100.

Very truly yours,

E. R. BLACK, *Governor.*