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 memo given to
 President 8/23/35

THE BANKING ACT OF 1935.

The Banking Act of 1935 as it affects the present Federal Reserve Board provides for its reorganization; changes the terms of office and designations of the chief executive officers at the Federal reserve banks and makes their appointments subject to the approval of the Board of Governors of the Federal Reserve System; centralizes the open market policy making powers of the Federal reserve system in a new Federal Open Market Committee beginning March 1, 1936; increases the powers of the Board of Governors over reserves required to be kept by member banks; broadens the authority of the Federal reserve banks to make advances of funds to member banks; enhances the ability of national banks to make real estate loans; and simplifies in a number of respects the administration of the affairs of the Federal reserve system.

REORGANIZATION OF THE FEDERAL RESERVE BOARD

The Federal Reserve Board is to be known hereafter as the Board of Governors of the Federal reserve system, the governor will be known as the chairman, and the vice governor will be the vice chairman. On February 1, 1936, the Board is to be reduced from eight to seven members, the present members continuing in office until that date. At that time the Secretary of the Treasury and the Comptroller of the Currency will cease to be members and the Board is to be composed of seven members all of whom are to be appointed by the President and confirmed by the Senate. No change is made in the requirements of the present law with respect to the qualifications of members. Their salaries are increased from \$12,000 to \$15,000 per annum and the full term of a member is lengthened from twelve to fourteen years. The first appointments made hereafter are to be for periods from two to fourteen years, determined so that not more than one will expire in any two-year period. Thereafter each member will hold office for fourteen years unless sooner removed for cause by the President, and when he has served a full term of fourteen years will be ineligible for reappointment. One member is to be designated by the President as Chairman, who will be the active executive officer of the Board, and another as Vice Chairman. The Chairman and Vice Chairman are to serve as such for a term of four years.

CHIEF EXECUTIVE OFFICERS AT THE
 FEDERAL RESERVE BANKS

The senior executive officers of the Federal reserve banks are now known as governors and deputy governors and, while their salaries are subject to the approval of the Federal Reserve Board, their appointments are not. Effective March 1, 1936, they are to be known

as presidents and vice presidents, the president being the chief executive officer of the bank. The president and first vice president are to be appointed by the board of directors of each Federal reserve bank for terms of five years and these appointments are expressly made subject to the approval of the Board of Governors of the Federal Reserve System.

NEW FEDERAL OPEN MARKET COMMITTEE

The present Federal Open Market Committee composed of the twelve Governors of the Federal reserve banks is to be replaced on March 1, 1936, by a Federal Open Market Committee composed of the seven members of the Board of Governors of the Federal Reserve System and five representatives of the twelve Federal reserve banks. The five Federal reserve bank representatives (together with one alternate for each) are to be selected annually by the boards of directors of the Federal reserve banks, one by Boston and New York, one by Philadelphia and Cleveland, one by Chicago and St. Louis, one by Richmond, Atlanta and Dallas, and one by Minneapolis, Kansas City and San Francisco. The meetings are to be held in Washington at least four times a year upon request of the Chairman of the Board of Governors or of any three members of the Committee.

No Federal reserve bank will be permitted to engage or decline to engage in open market operations except in accordance with the directions and regulations of the Committee and all open market operations will be transacted with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country. By this change in the law the present diffusion of control over open market policies among the Federal reserve banks, the existing Federal Open Market Committee and the Federal Reserve Board, together with the lack of mandatory authority, will be terminated and replaced by the centralization of the entire power in one body, of which the seven members of the Board of Governors will constitute a majority.

The Board of Governors is required to keep a complete record of all actions taken by the Federal Open Market Committee and by the Board upon all questions of policy, to record the votes taken by them on all such questions, and to submit in its annual report to the Congress a full account of all such actions, together with a copy of the records required to be kept with respect to these matters.

CHANGES IN RESERVE REQUIREMENTS

Under present law the Federal Reserve Board may increase or decrease the reserve balances required to be maintained by member banks against their deposits but only during an emergency by reason of credit expansion, the existence of which must be declared by affirmative vote of at least five members of the Board, with the approval of the President.

Hereafter the Board, in order to prevent injurious credit expansion or contraction, may, by affirmative vote of four members, without the necessity of obtaining the approval of the President and without declaring the existence of an emergency, change the requirements as to reserves against either time or demand deposits, or both, by member banks in reserve or central reserve cities or by member banks not in those cities, or by both classes of banks, provided the amount of reserves required to be kept by any bank is not decreased below the amount now required by law or increased to more than twice that amount.

DISCOUNT RATES

No change is made in the present law except to require the Federal reserve banks to establish their discount rates every fourteen days or oftener if deemed necessary by the Board of Governors.

FEDERAL RESERVE BANK LOANS TO MEMBER BANKS

Under temporary authority which has expired Federal reserve banks in certain restricted circumstances could make advances to member banks when they had exhausted their eligible paper.

The new law grants permanent authority to any Federal reserve bank, under rules and regulations of the Board of Governors of the Federal Reserve System, to make advances to any member bank for periods up to four months when secured to the satisfaction of the Federal reserve bank, at an interest rate $1/2\%$ per annum above the highest discount rate of the Federal reserve bank.

This amendment relieves the Federal Reserve Board and the Federal reserve banks of the necessity of requiring that technical distinctions be drawn between eligible and ineligible paper and permits the acceptance of any satisfactory security in cases where member banks are willing to pay a slightly increased rate for needed funds.

REAL ESTATE LOANS OF NATIONAL BANKS

The opportunities of national banks for investing in real estate loans are broadened. The restriction of the present law as to the territory in which the real estate must be situated is removed and banks may also purchase real estate loans which meet requirements. In addition to loans up to 50% of appraised values for terms not more than five years, the new law permits loans up to 60% of the appraised value for ten years if payments on principal of 40% on an amortized basis are required within that period. Real estate loans which are insured under Title II of the Housing Act are not subject to these restrictions. The aggregate amount of real estate loans of a national bank may equal its unimpaired capital and surplus funds, or 60% of its time and savings deposits, whichever may be the greater. At present the law permits an aggregate amount of real estate loans equal to 25% of the unimpaired capital and surplus or to 50% of its savings deposits, subject to certain general limitations.

ADMISSION TO MEMBERSHIP IN FEDERAL RESERVE SYSTEM OF STATE BANKS WITH IMPAIRED CAPITAL

Heretofore the Federal Reserve Board could not admit to membership any State bank with impaired capital. The Banking Act of 1935 authorizes the Board to waive any or all requirements relating to the admission of State banks to the system in cases of banks having deposits of \$1,000,000 or more which are required to become members of the Federal reserve system before July 1, 1942, in order to retain the insurance of deposits provided by the Federal Deposit Insurance Corporation. The Board may require any such bank to increase its capital within a reasonable time up to the minimum amount required for the organization of a national bank in the same place. The law also lessens the restrictions upon the admission of other banks with impaired capital, when a part of their capital consists of preferred stock or when they have outstanding capital notes or debentures of the kind that may be purchased by the Reconstruction Finance Corporation.

SIMPLIFIED ADMINISTRATION

Among the technical amendments to the existing law contained in the new banking act are several which relieve the new Board of Governors of much administrative detail and enable it to concentrate more largely on important questions of policy. Among these are amendments relating to interlocking directorates which eliminate the necessity of dealing with thousands of individual permits; those relating to affiliates which enable the Board to waive unnecessary reports and examinations; and those which concentrate the requirements for permits for voting stock of national and State member banks upon holding companies which are engaged as a business in holding or managing or controlling banking institutions. In addition, authority to determine limitations upon interest which may be paid by banks on deposits is amplified and the computation of reserve requirements is clarified.