Extra

February 6, 1935

Mr. Parry ✓
Mr. Thomas
Mr. Currie
Mr. Blattner
Mr. Garfield
Mr. Gardner
Mr. Piser
Miss Burr

I am giving you a copy of a letter on the banking legislation, which was not sent, a memorandum which was to be attached to the letter and was not sent either, and an outline of the bill, which was not intended to be sent and was. These documents, together with the bill may be helpful in suggesting points that can be brought out in support of the bill or in answer to criticisms.

If you have criticisms of the bill, I should be glad to have them also.

February 4, 1935

Honorable Duncan U. Fletcher
Chairman, Banking and Currency Committee
United States Senate
Washington, D. C.

Dear Senator Fletcher:

I am sending to you herewith, for the consideration of your Committee, proposals for changes that I believe to be urgently required in our banking laws. The legislation contemplated in these proposals is designed primarily to accomplish the following purposes:

1. To accelerate the rate of economic recovery.

2. To make our banking and monetary system, which was designed under the conditions prevailing prior to the World War, more responsive to our present and future economic needs.

3. To prevent a recurrence of conditions that led to the collapse of our entire banking structure in the spring of 1933.

I am not unmindful of the important steps taken to strengthen and safeguard our banking system in the Banking Act of 1933, which the Congress adopted as the country was emerging from the crisis of that trying period. But I am convinced that further changes remain to be made in our banking laws if we are to grapple successfully with the pressing problems of recovery, and if the future of our economic life is to be secure from violent fluctuations in the supply or money and credit.

The banking system of this country has been put to a severe test and has not stood thattest. It has not been able to stand up under the strain of the depression or to lend effective support in the fight against it.

On the contrary, the banking system has proved to be an element of weakness in our economic structure that has aggravated and prolonged the worst phases of the depression. And it still impedes the rate of recovery.

These are facts too plain for us to overlook, too serious not to be a cause for concern, too significant in themselves to leave us in doubt as to the need for further remedial action. The explanation of them, I am convinced, is not to be found only in the excesses and abuses that characterized our banking practices in the recent past. Nor is the present relative inertia of the banking system to be accounted for by the metaphysics of confidence, on which some of our critics are still prone to theorize, nor by an assumption that bankers are less eager than other men to hasten the progress of recovery. The facts that I have briefly stated are to be explained rather, in large part, by the more fundamental fact that our banking structure has remained essentially unchanged during an epoch of far-reaching economic changes both in this country and in the world at large.

The principal measures submitted for your consideration are therefore designed to remedy deficiencies now inherent in the banking structure itself. Since the cornerstone of that structure is the Federal Reserve System, it is proposed to make the Reserve System more directly responsive to our national economic needs. It is further proposed to make our commercial banks better adapted to meeting the credit requirements of industry, commerce, and agriculture under the changes that have taken place in our economic system since ~~more~~ most of our present banking laws were enacted.

It is also proposed to make certain revisions in the deposit insurance law. This measure has been an important factor in restoring public confidence in our banks, and thus has been extremely helpful in the recovery effort. Practical experience with its operation, however, has shown that some of its provisions require amendment.

The remaining proposals that I am submitting for your consideration relate to corrective and clarifying amendments to existing banking laws other than the deposit insurance law. The purpose of these amendments is to provide for simplification of administrative procedure. They were for the most part embraced in the so-called Omnibus Banking Bill that was approved by the Banking and Currency Committee of the Senate and the House in the Seventy-third Congress.

A memorandum outlining the proposals and a draft of a bill in which they are incorporated are attached.

Very truly yours,

Franklin D. Roosevelt

Feby 4, 1935

MEMORANDUM ON PROPOSED BANKING LEGISLATION

In connection with the proposed amendments to the Federal Deposit Insurance law, it will be recalled that during the first six months of the year 1934 deposits were insured to the extent of $2,500 for each depositor. During the last six months of the year the insurance was extended to $5,000 for each depositor and it is found that this protects 98.39% of the depositors in the insured banks in full. This degree of protection has proved adequate to restore confidence in the insured banks as a whole and in the nine banks which closed during the year the payments by the Federal Deposit Insurance Corporation have entirely relieved the communities of the hardships and disturbances which heretofore have generally accompanied a bank failure.

Under existing law the permanent plan would give increased benefits to only 1.61% of the depositors but it would almost double the liability of the Corporation by increasing it from approximately $16,500,000,000 to more than $29,000,000,000. I recommend, therefore, that the limitation of $5,000 for each depositor be continued and make a part of the permanent insurance plan.

The original purpose of the Temporary Fund of the Federal Deposit Insurance Corporation was to provide insurance of deposits for a six months' period before the necessary arrangements could be completed for instituting the permanent plan. The Temporary Fund has been raised through assessments contributed by the banks based upon their insured deposit liability. The permanent plan in the existing law contemplates assessments.

based upon the entire deposit liability of the insured banks. It is believed that the general benefits both to the public and to the banking structure of the Country resulting from the insurance of deposits call for an assessment plan substantially as provided in existing law, but limited in amount. The plan of assessing upon the insured deposit liability alone, considering the general benefits, throws a disprpportionate share of the burden upon the smaller banks and upon banks in which small deposits predominate.

Provision should be made which will enable the Corporation to allocate to surplus part of its existing capital of approximately $290,000,000, contributed by the Government and by the Federal Reserve Banks, and to enable it to set up reserves from the proceeds of the assessments so that the insurance may be continued at all times upon a sound basis, at no greater cost than is necessary and without becoming unduly burdensome in times of stress.

In view of the liability of the Federal Deposit Insurance Corporation to depositors of failed banks, it is important to give to the Directors of the Corporation authority to protect the funds of the Corporation from the consequences of bad management and unsound banking practices on the part of insured banks. This should be accomplished with due regard to the existing authority for direct supervision.

The proposals relating to the Federal Reserve System are in recognition of changes that have occurred in our economic life since the

System was established more than twenty years ago. The whole ensuing period has been one of events that the framers of the Federal Reserve Act, skillfully and prudently as they planned, could neither have foreseen nor imagined. While the Federal Reserve System has rendered invaluable service to the nation--during the war years, during the post-war period of readjustment, during the years of depression and the period in which we have begun to emerge from the depression, the experience of twenty years has shown that in some important respects the Federal Reserve System needs to be strengthened and improved in order to meet nation-wide and world-wide economic changes. Our economic problems have long tended to become more and more national in scope, and especially so in the field of banking. Our commercial banks, through the creation of deposits, supply the great bulk of the country's means of payment-- for goods and services of all kinds, for production and employment in every field of economic endeavor. Hence any material changes in the volume of this means of payment, whether through enlargement or curtailment of the deposits created by our commercial banks, are nation-wide in their economic effects.

For this reason it has become imperative that regulation of the volume of our means of payment be entrusted to a body that represents

the nation as a whole, rather than to have a widespread division of authority in a matter of such grave national concern. It is desirable to retain regional management and responsibility at the Federal reserve banks in matters of local concern, and no change in this respect is contemplated in the proposed legislation. But it is recommended that responsibility for national policies be placed directly on the Federal Reserve Board, whose members are appointed by the President with the advice and consent of the Senate.

To accomplish this enlargement of the Board's responsibility, it is proposed to clarify the power of the Board to determine, in consultation with representatives of the Federal reserve banks, the open-market policy of the Federal Reserve System. In this manner national control will be established over operations that are now the most important single factor in determining changes in the volume of available credit and the rates to be paid for borrowed money.

Since the Federal Reserve Board would thus bear the responsibility for national policies to be pursued by the Federal Reserve System, it is also proposed that the appointment of the principal executive officer in each Federal reserve bank be subject to approval by the

Federal Reserve Board, and that this officer serve both as Governor and as Chairman of the Board of Directors. The Federal Reserve Act itself makes no provision for the office of Governor at the reserve banks, though in practice the Governor is the principal executive officer, selected by the directors without the requirement of approval by the Federal Reserve Board.

The change here proposed would recognize the office of Governor in the law and combine this office with that of Chairman of the Board of Directors, but the appointment of the Governor and Chairman by the directors would be subject to the approval of the Federal Reserve Board. A further effect of this proposed change would be to promote economy and efficiency in the reserve banks by doing away with the present dual organization and the consequent diffusion of responsibility.

The enlargement of the responsibility of the Federal Reserve Board, and additional measures proposed with a view to making membership on the Board more important, more attractive, and, in a pecuniary respect, more secure, should make it less difficult than it has sometimes been in the past to induce men who have the vision and courage, as well as the requisite training and experience, to undertake the difficult, vital, and often unpopular task of formulating national monetary policies.

To facilitate the carrying out of these policies it will be necessary also to remove some of the restrictions now placed on the activities of

the Federal Reserve banks by the Federal Reserve Act. These restrictions were largely predicated on conditions prevailing when the Act was adopted in 1913, and were wisely imposed on a System that was new and untried; but in the course of time the circumstances that gave rise to them have diminished in importance, or greatly altered, and the restrictions have sometimes proved to be far more harmful than beneficial.

In this respect the rigid definition of the kinds of paper that are eligible for discount at the reserve banks is clearly to be regarded as an impediment. Changes in our economic life, notably in the methods of financing business enterprise, have materially reduced the volume of short-term, self-liquidating paper of the classes to which the discount privileges of the reserve banks are largely restricted by law. As a consequence of this, in times of stress, when the help of the Federal Reserve System has been most urgently needed, many banks have been devoid of assets eligible for borrowing at the reserve banks.

The undue severity of the limitations on eligible paper was finally recognized, and they were removed temporarily by emergency legislation; but this action was not taken until much harm had been done to the business of the country and unwarranted hardship and loss suffered by bank depositors. Furthermore, there is at present evidence that these limitations are contributing to the difficulty of persons

who need money and possess perfectly sound assets, but who are unable to obtain the required loans because their assets are technically ineligible for discount.

For these reasons it is urged that the legal limitations on eligibility be removed and authority be given to the Federal Reserve Board to determine the character of paper that shall be eligible for discount at the reserve banks.

Another of the proposed changes in the Federal Reserve Act would dispense with the requirement for segregation of collateral behind Federal Reserve notes. These notes are obligations of the United States Government and prior liens on all the assets of the twelve Federal Reserve banks. Segregation of the collateral back of the notes, therefore, adds nothing to their safety. On the other hand, the requirement for segregation caused serious difficulty, by tying up gold over and above the 40 per cent required reserve, when there was a foreign drain on our gold in 1931 and 1932. The situation was met for the emergency by permitting the pledge of United States Government obligations as collateral against Federal Reserve notes; but the authority of the reserve banks in this matter is only temporary. The advisable course would seem to remove this restriction altogether.

In connection with the proposals relating directly to commercial banking, it is to be remarked that they are few, but vital to the speeding of recovery. Their purpose is to remove restrictions in existing laws that experience has proved to be not only unnecessary,

but manifestly harmful to banks and borrowers alike, in the making of real estate mortgage loans. The proposed enlargement of the authority of our banks in making loans on real estate, under the safeguards contemplated in the proposals, would make it more feasible for banks to meet the present requirements of mortgage borrowers and to participate more aggressively in the revival of activity and employment in the construction industry.

I believe that enactment of this legislation with respect to mortgage lending would spur our commercial banks to further effort in serving the country's credit needs; for it would enable them to give their unstinted support, in a manner not now possible for them, to that branch of industry in which the opportunity for meeting both a social and an economic need is now greatest.

The following is a brief running summary of proposed banking legislation. The bill is to be known as the "Banking Act of 1935." Its principal provisions are:

Title I - Federal Deposit Insurance Corporation Amendments.

1. Existing Temporary Funds are merged into the Permanent Insurance Plan, which becomes operative immediately upon enactment of the "Banking Act of1935."

2. $5,000 continues to be the maximum insurance protection for each depositor in any bank. Trust funds are insured up to $5,000 for each trust estate.

3. Maximum limit of assessment of 1/12 of 1% of total deposits is substituted for obligatory stock subscription amounting to 1% of total deposits with liability for repeated assessments thereafter. A uniformly lower assessment may be fixed by the Board of Directors for mutual savings banks.

4. Banks not members of the Federal Reserve System are permitted to withdraw from insurance after notice to their depositors and to the Corporation. Similarly, after adequate notice and after a hearing the Corporation may terminate the insured status of any bank.

5. The Corporation's present right to buy assets of closed member banks is extended until July 1, 1936, to open banks when it will facilitate mergers and avert loss. For this purpose, the Corporation may also make loans to insured banks or guarantee other insured banks against loss in assuming liabilities of insured banks.

6. The proceeds derived from the sale of capital stock of the Corporation may be allocated between capitaland surplus in such amounts as the Board of Directors may prescribe, so that in the event of losses exceeding the proceeds of the annual assessments

the Corporation will not be forced to operate with impaired capital. Dividends on capital stock of the Corporation are eliminated.

7. Detailed administrative and technical changes, which seem advisable in the light of the experience of the Corporation, include the following:

(a) Certain important terms used in the Act have been defined;
(b) Mechanics of pay-offs have been revised and clarified;
(c) The Corporation is given the right to require insured banks to maintain adequate fidelity and burglary insurance;
(d) The standards for determining whether or not banks should become insured are set forth;
(e) Insured banks not members of the Federal Reserve system are required to make reports of conditions, and the Corporation may order publication of such reports;
(f) Corporation approval is required before a merger or consolidation of insured banks with non-insured banks, or before a reduction of capital of non-member banks takes place;
(g) Other miscellaneous changes:

i. The use of the words "Deposit Insurance" in the name of a bank is prohibited;
ii. Examiners of the Corporation are prohibited from borrowing from insured banks;
iii. Criminal provisions are extended to protect all insured banks.

Title II - Federal Reserve Act Amendments.

With respect to Federal Reserve Banks:

1. Combine offices of Chairman of the Board of Directors and Governor at each of the Federal Reserve banks, appointments to be made annually by the directors of the bank, after approval by the Federal Reserve Board. Vice-Governors are to be selected in the same manner.

2. No members of the Board of a Federal Reserve bank, except Governor and Vice-Governor, shall hold office for more than six consecutive years.

With respect to the Federal Reserve Board:

3. Change qualifications for future appointive members of the Federal Reserve Board by providing that they shall be persons

well qualified by education or experience or both to participate in the formulation of national economic and monetary policies. The present geographical limitation shall not apply to selection of future Governors. The Governor's membership on the Board shall expire when he is no longer designated as Governor by the President.

4. Increase the salaries of future appointive members to $15,000 per annum, with compulsory retirement at 70 on $12,000 pension. Present members to be eligible for retirement at 70. Proportionate pensions will be allowed for service of less than twelve years.

5. The Board shall be empowered to delegate specific powers and duties not involving the determination of national or System policies to individual members of the Board or its representatives.

With respect to credit control:

6. Change Section 12A of the Federal Reserve Act so as to provide for an open-market committee to consist of the Governor and two members of the Board elected annually by the Board, and two governors of Federal Reserve banks elected annually by the governors of the Federal Reserve banks. This committee shall make recommendations about discount rate policies and shall formulate the System's open market policies which shall be binding on the Federal Reserve banks.

With respect to collateral requirements:

7. Any sound asset of a member bank shall be eligible for discount at a Reserve bank, subject to regulations of the Federal Reserve Board, and the Board shall also have authority to prescribe limitations on maturity of advances to member banks.

8. Section 14 is amended so that obligations the principal and interest of which are guaranteed by the United States shall be eligible for purchase by Federal Reserve banks without regard to maturity.

9. Collateral requirements for Federal Reserve notes shall be repealed, and the office of Federal Reserve Agent shall be abolished.

With respect to reserve requirements:

10. In order to prevent injurious credit expansion or contraction, the Federal Reserve Board may change reserve requirements

as to any or all Federal Reserve districts and/or any or all classes of cities, and as to time and/or demand deposits.

With respect to capital requirements:

11. At any time prior to July 1, 1937, the Federal Reserve Board may admit any insured non-member bank to membership in the Federal Reserve System; and may waive the capital requirements for admission; provided that such bank shall comply with all of the regular requirements of members within such time as the Federal Reserve Board shall prescribe.

With respect to real estate loans:

12. Section 24 of the Federal Reserve Act is amended to permit loans to be made on amortization basis for periods of 20 years and up to 75 per cent of value of property. The geographical limitation as to location of real estate is removed. The aggregate amount of real estate loans plus other real estate (except bank premises) is not to exceed 60 per cent of time deposits or 100 per cent of capital and surplus, whichever is the greater. All real estate loans are to be secured by first liens, but second and subsequent liens may be taken to secure debts previously contracted in good faith. The limitations of Section 24 are made applicable to State member banks.

Title III - Technical Amendments.

Section 301 exempts "accidental" holding company affiliates from voting permit requirements where not engaged as a business in holding bank stock.

Section 302 provides that member banks need not divorce securities affiliates which are in formal liquidation.

Section 303 (a) makes it clear that the prohibition against security dealers accepting deposits does not prevent banking institutions from dealing in, underwriting, purchasing and selling investment securities to the extent permitted to national banks and does not prevent banking institutions from selling mortgages without recourse. (National banks are limited, in dealing in and underwriting, to Government obligations, general obligations of States or political subdivisions, obligations issued under authority of Federal Farm Loan Act, by Federal Home Loan Board or Home Owners' Loan Corporation.) (b) Exempts business institutions accepting deposits solely from their employees, from examination and publication of reports of condition; and requires private banks to bear expense of their examination when made by Federal authorities.

Section 304 terminates double liability of shareholders of national banks on July 1, 1937.

Section 305 corrects omission of national banks in Alaska and Hawaii from benefit of amendment repealing law requiring directors of national banks to increase their shareholdings.

Section 306 gives Federal Reserve Board power to control connections of officers, directors, and employees of banks with securities companies by regulation rather than by issue of individual permits.

Section 307 (a) eliminates any question of power of member banks to buy or sell stocks solely for the account of their customers and permits national banks to purchase for their own account investment securities not to exceed 10 per centum of unimpaired capital and surplus. (b) Restates existing prohibition against national banks purchasing stock for their own account.

Section 308 requires new national banks to have paid-in surplus equal to 20 per cent of capital, subject to waiver as to State bank converting into national bank.

Section 309 eliminates possibility that present law prevents corporations other than a bank from conditioning transfer of their shares on transfer of bank stock.

Section 310 (a) permits holding company to vote to place bank in voluntary liquidation without obtaining voting permit. (b). Since shares held by bank as sole trustee cannot be voted, same are excluded from determination whether resolution adopted by requisite number of shares. (c) Eliminates any doubt that holding company with voting permit may cumulate its shares as may other shareholders.

Section 311 gives Comptroller discretion to permit converting State bank to carry over sound assets not conforming to requirements as to assets held by national banks.

Section 312 allows Comptroller to delegate manual labor of countersigning bond transfer.

Section 313 permits national bank branches located outside United States to charge interest rate permitted by local law.

Section 314 provides for national banks gradually increasing surplus out of earnings, until equal to capital.

Section 315 extends criminal provisions applicable to member banks to include insured banks.

Section 316 gives Comptroller closer supervision over banks in voluntary liquidation.

Section 317 extends present prohibition on use of word, "national", by banks other than national banks, to include combinations of such word.

Section 318 corrects oversight by requiring member banks to reduce stockholdings in Federal Reserve bank upon a reduction of surplus.

Section 319 requires State member banks to publish reports of condition.

Section 320 places State member banks on parity with national banks as regards loans on government obligations.

Section 321 permits Federal Reserve bank direct loans to private business to be made on adequate indorsement or security, instead of requiring both as under present law.

Section 322. Reference to par value of Federal Deposit Insurance Corporation stock in the "Loans to Industry" Act changed to "amount paid for said stock."

Section 323 (a) authorizes Federal Reserve Board to define "deposit" and related terms for reserve and interest requirements respecting deposits. (b) Permits amounts due from other banks to be deducted from gross deposits, instead of amounts due to banks, in determining reserve requirements. (c) Extends power to regulate payment of interest by member banks to include all insured banks, except mutual savings and Morris Plan banks not members of system. (d) Requires member banks to maintain same reserves against government deposits as against other deposits.

Section 324 permits waiver of reports and examinations of bank affiliates where deemed unnecessary fully to disclose relationship.

Section 325 (a). Extends prohibition against loans and gratuities, to examiners of all insured banks. (b) Extends prohibition against disclosure of confidential information to Federal Deposit Insurance Corporation examiners. (c) Corrects impractical features of law prohibiting loans to executive officers, by vesting certain discretion in the Federal Reserve Board, substituting power of removal from office for present criminal provisions, and extending time within which existing loans must be paid.

Section 326. Excepts affiliates from existing requirements on loans where affiliation arose out of foreclosure by bank on collateral, and excludes affiliate engaged solely in operating property acquired for bank purposes controlled by bank in fiduciary capacity.

Section 327 exempts loans for industrial purposes made with Federal Reserve Bank or Reconstruction Finance Corporation from existing restrictions on real estate loans by national banks.

Section 328 amends Clayton Act to permit Federal Reserve Board to supervise matter of interlocking directorates through general regulations instead of by individual permits.

Sections329 and 330 bring law governing consolidation of national banks into conformity with that governing consolidations of State and national banks, offer additional protection to dissenting shareholders, but require notice of dissent to be given when vote to consolidate is had.

Sections 331 and 332 extend to Federal Deposit Insurance Corporation protection now given other Federal institutions against misleading use of name and extend to all insured banks law making robbery of member banks a Federal offense.