

Letter dated April 27, 1935, to Senator Duncan U. Fletcher:

"This refers to your letter of April 17, 1935, with which you inclosed a letter from Mr. Bion H. Barnett, Chairman of the Board of the Barnett National Bank, Jacksonville, Florida, in which he calls attention to section 323(a) of the proposed Banking Act of 1935 which would authorize the Federal Reserve Board 'to determine what shall be deemed to be a payment of interest'.

"In endeavoring to administer the amendment to the Federal Reserve Act contained in the Banking Act of 1933 which provides that 'no member bank shall, directly or indirectly by any device whatsoever, pay any interest on any deposit which is payable on demand', the Federal Reserve Board has been confronted with a number of questions of considerable difficulty as to what constitutes a payment of interest within the meaning of this clause. For example, it has been called upon to state its view as to whether and in what circumstances the absorption of exchange or collection charges on deposited items, the failure to impose service charges on accounts, the payment of premiums on surety bonds required as security for deposits, and the absorption of State taxes on deposits, constitute the payment of interest on deposits payable on demand within the meaning of the provision quoted. In considering such questions the Federal Reserve Board has had no discretion of any kind in undertaking to state what is a payment of interest but has been bound by strictly legal considerations as to the nature of interest. In this connection it is to be observed that the law does not prohibit all payments in connection with deposits payable on demand but merely prohibits payments of interest. Accordingly, it has been necessary to try to determine in each case whether the payment in question is of such a character as to constitute interest. As a result some of the rulings which it has been necessary for the Board to make in this connection have not been altogether satisfactory and have been the cause of difficulties to member banks which it is believed might otherwise have been avoided. This problem has proved to be one of the most difficult arising under the Banking Act of 1933.

"It is for the purpose of enabling the Federal Reserve Board to take into consideration the practical aspects of the subject in determining these close questions as to what is interest in circumstances such as those mentioned and in other similar cases, that the proposed Banking Act of 1935 would authorize the Board to 'determine what shall be deemed to be a payment of interest'. It is believed that enactment of this provision would enable the Board to exercise a limited discretion in these matters which would result in a more practical administration of the law and would be more satisfactory to the member banks, which are, of course, primarily concerned.

"Mr. Barnett appears to feel that member banks should not be permitted to absorb any exchange charges or other out-of-pocket expenses in connection

with deposits payable on demand. The Board has felt that it has no authority under existing law to take such a position. While it cannot be stated at this time just what modifications may be made in existing rulings with respect to this question if the provision in question is enacted, it is hoped that it will be possible to put the matter of absorption of out-of-pocket expenses on a more practicable and satisfactory basis than now exists.

"Mr. Barnett also suggests that the provision above quoted in the proposed Banking Act of 1935 may be invalid. In this connection it appears that the provision is not intended to confer upon the Federal Reserve Board an arbitrary power to declare to be interest or a payment of interest something which obviously has no relation to interest, or vice versa, but that it is intended to give the Board a limited authority or discretion in its administration of the law to determine, within reasonable limitations and in accordance with what appears to be the intention of Congress as indicated by a reading of all the provisions of the law relating to interest, what type of payment or compensation given by a bank to a customer is of such a character as to be regarded as a payment of interest, particularly in those cases where the question is close and doubtful and is influenced largely by practical considerations. It is believed, therefore, that the provision in question would be a valid enactment.

"Mr. Barnett's letter is returned herewith for your files."