

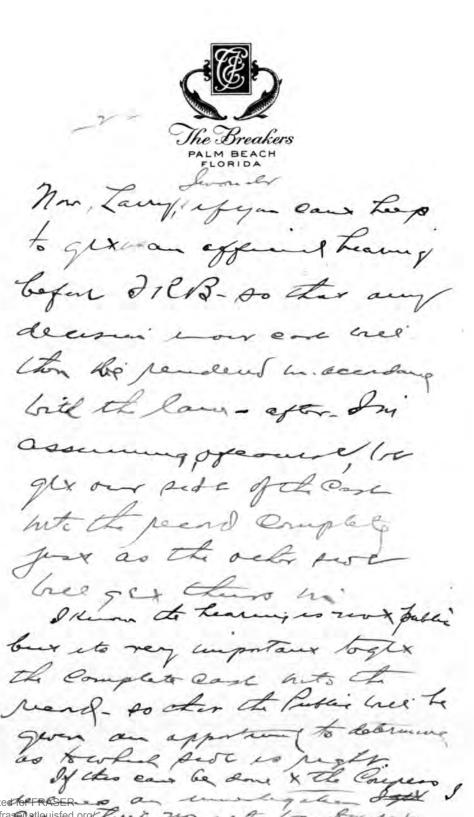
The Breakers

PALM BEACH FLORIDA

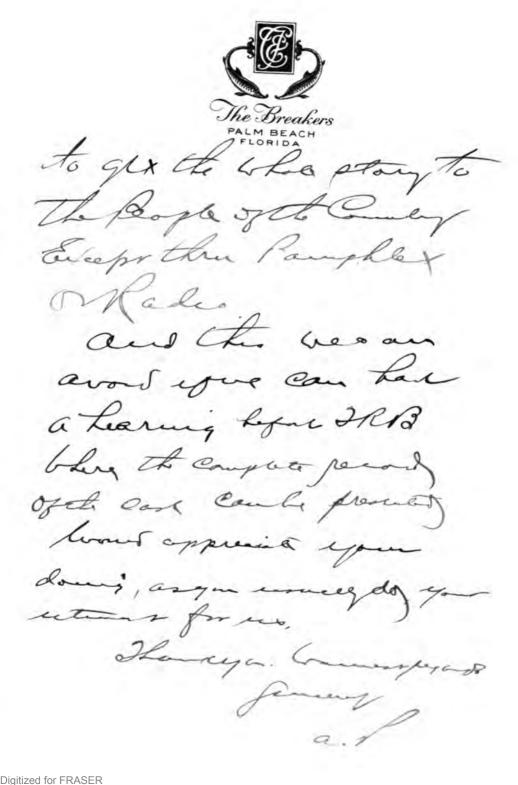
Dear Larry Maria guas pland me to pay ther he had to stay over they was mad ay.

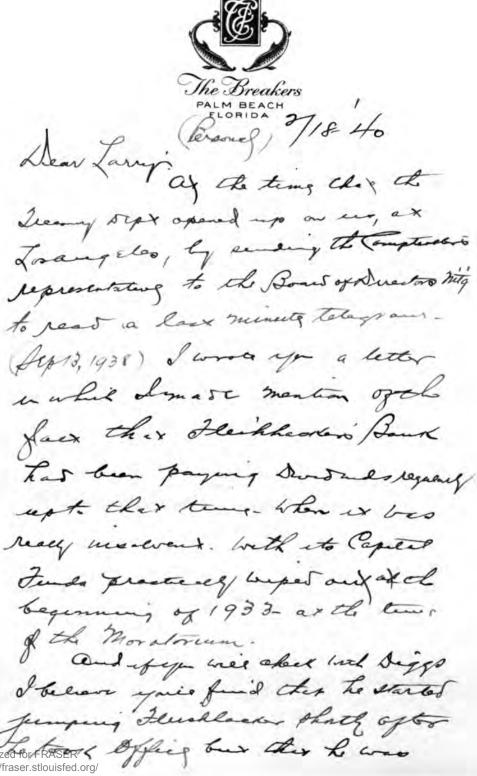
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Digitized for FRASER ory to be longer so be your fair http://fraseff-stlodisfed.org/, Jany for dur day grome sette staff our gray Federal Réserve Bank of St. Louis Mr. A. P. Giannini The Breakers Palm Beach, Florida

Dear A. P.:

This will acknowledge your two personal notes of February 16 and February 18 respectively.

In your first letter you called attention to the delay that had been encountered by Mario and his fellow workers here due to the Comptroller leaving the city for several days. You have no doubt since heard from Mario that we did what we could here to avoid the consequences of delay by having Mr. Cushing come over here to the Board and present to its committee (Eccles and McKee)* the bank's counter-proposals to the program submitted by the Comptroller's office. That procedure at least gave our people here an opportunity to study over the counter-proposals prior to the meeting of the three banking agencies with Mario and Mr. Cushing which is in session this afternoon.

In the same letter you expressed the desire that the matters in controversy be heard before the Board of Governors under a section 30 proceeding. As you know, there is no way in which the Board itself can initiate such a move since the citation must come from the Comptroller. It is the feeling of everyone here, I am sure, that it is much preferable that the issues be composed through an agreement between the bank and the three bank supervisory agencies so as to put a stop to the injurious effects which inevitably flow from the public discussion of the conflict. However, it is quite apparent that if the parties cannot get together a section 50 proceeding may result.

In your second letter you referred to the treatment accorded the Fleishhacker bank and referred to a letter you wrote me in the fall of 1938 on this subject. You also suggest that I might check with Marshall Diggs as to the accuracy of the statements made in your letter.

^{*} Mr. Crowley sat in also.

I had already acquainted Marriner with the letter I received from you at the time it came but neither one of us was aware of the letter you wrote to Marvin McIntyre along about the same time, at least I have never heard Marriner mention this. Although I doubt that there is any use at this late date in pursuing the matter further, I shall be glad to check with Mr. Diggs when a suitable opportunity presents itself as a matter of personal curiosity, if for no other reason.

In both your letters you urge that I do what I can to bring the controversy before the Board of Governors, but as pointed out above, there is no way of my moving in that direction. What I am earnestly hoping, however, is that the bank and the Federal banking agencies can get together on a program. Section 30 relates solely to the removal of officers for continuing unsafe or unsound practices or violations of law and the end point does not in any way solve the issues between the bank and the Comptroller. In other words, while a section 30 proceeding is in progress the Comptroller's office can have other issues to complain about and could invoke other sanctions even more disturbing to the bank's standing in the public mind than a section 30 proceeding. To put it in another way, section 30 is based upon past performances whereas the solution of the problem at hand is an agreement respecting future performance. Now no one questions the ability of the bank's organization to render high class banking service to its customers. The principal issues relate to the sufficiency of the bank's capital funds in view of the tremendous growth in deposit structure over the past eight years and the bank's present asset condition with special reference to its real estate concentrations and again the propriety of taking bond profits into the bank's earnings for the purpose of maintaining the present dividend rate. These are not so much legal questions as questions of banking judgment. And while it might be said that the earning power of the bank justifies the present practice, I am sure that many bankers, including my chief and myself, would feel that this is a fair weather assumption. The bank ought to be so managed that it would be accumulating more rapidly the necessary reserves out of earnings to provide ample cushion for a change for the morse in the general economic situation. However this sounds like a discussion of the merits whereas I only intended to indicate the broad lines of the principal issues. As stated, I urgently hope that a program can be agreed upon so that the bank's management can devote its energies to operating the bank under an agreed program instead of spending most of its time defending its policies before the regulatory agencies. A compromise by the bank in the direction of more conservatism does not deprive the stockholders or the management of

Mr. A. P. Giannini - 3

any rightful remuneration; whatever is earned is still in the bank and belongs to the stockholders, it is simply a question of whether they shall have all their cake as soon as it is baked or keep some in reserve.

I hope that you can stop in Washington when you leave Florida for California and I also trust that by that time these issues will be composed.

With best wishes, I am

Yours sincerely,

Lawrence Clayton

LC/fgr

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LAWRENCE CLAYTON. PERSONAL EXECUTIVE ASSISTANT TO CHAIRMAN OF BOARD OF GOVERNORS OF FEDERAL RESERVE SYSTEM= (DLR ONLY AT RES NOT OFFICE) WASHDC=

JUST RECEIVED YOUR LETTER, WHILE I DON'T AGREE WITH SOME OF THE CONTENTIONS THEREIN I HAVE NEVERTHELESS WIRED MARIO AT HIS NEXT MEETING DO HIS UTMOST TO GET TOGETHER POSS I BI F TO DO SO ON A BASIS THAT WILL NOT HAMSTRING 115 INTEREST OF THE DASTARDLY AND DIABOLICAL CONSPIRACY BACK OF THE HAPPENINGS OF THE PAST YEAR AND

THANK YOU LARRY AND WARMEST REGARDS TO YOU AND TO YOUR GOOD CHIEF=

AP.

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Mr. A. P. Giamaini The Breakers Palm Beach, Florida

Dear A. P.:

I was glad to have your telegram this morning and gratified that you had wired Mario urging that he make every effort to agree upon a program.

In your wire you stated that you disagreed with some of my contentions and I want to make sure that you have not considered my statement of the issues to be a position on my part as to how these issues should be resolved. The only position I took was that necessary reserves should have been accumulated more rapidly out of earnings but again this should be considered in the light of the remarkable deposit growth of the bank. When things like this happen it is of course preferable that the capital structure be increased proportionately, not necessarily in strict proportion but substantially so. This could not have been done in your case except with a drastic curtailment of dividends which under all the circumstances probably would have prevented the bank's rapid progress in covering the State of California with banking services. In other words, I agree that the dividends should have been resumed when they were and gradually increased as earnings increased. On the other hand, I would not necessarily agree that dividends had to be increased to the same extent they were in order to keep stockholders satisfied. But in any event a deposit growth as spectacular as was achieved under your leadership should best be accommodated by an increase in the capital structure not through the curtailment of dividends so much as through the addition of capital funds by the issue of new stock. In fact the suggested program for thirty or thirty-five million of new capital would make the payment of dividends at the current rate entirely defensible so long as the current earnings are in excess of the dividend by a reasonable margin. On the other hand, the current rate is difficult to justify without the addition of capital funds. I say this not because of a belief in any arbitrary capital ratio but because I would like to see in a bank with a billion and a-half of deposits more generous volume of undivided profits than is shown by the bank's current statement. Therefore I think it is to the interest of the bank to obtain the added capital providing, of course, a workable and

reasonable program can be agreed upon including the settlement of the various controversies by the government and the bank and its allied interests.

The reference I made to "the propriety of taking bond profits into the bank's earnings for the purpose of maintaining the present dividend rate" was a mere statement of the contention made by the Comptroller. Personally I have taken the position all the way along that thus far at least the bank's use of bond profits to absorb losses has been entirely consonant with the so-called "Revision in Bank Examination Procedure" as agreed to by the Treasury, the Board and the FDIC. Others have argued that the losses have absorbed all the bank's earnings and that the dividends therefore were paid out of bond profits. This is simply arguing in a circle and I think is contrary to the plain implication of the uniform agreement. The only point at which the treatment of bond profits might raise any issue would be in a situation where the bond profits were in excess of losses and should be added to undivided profits. In such a situation if the dividend were in excess of current earnings outside of bond profits the uniform agreement would require that such bond profits should be set aside in reserves until such reserves were "adequate". This point, of course, has not been reached over the past six or eight years although it may well be reached from here on out, as it is reasonable to assume that the bank's losses from now on will be very considerably less.

There was a postponement today of the scheduled conference between the parties originally set for this afternoon and I have not yet found out what was behind it, but I still feel optimistic for the prospects for an agreement.

With warmest regards, I am

Yours sincerely,

Lawrence Clayton

LC/fgr