Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date October 16, 1936

To Chairman Eccles

From Mr. Wyatt, General Counsel

Subject: Scope of section 14(g) of the Federal Reserve Act, as amended, and powers and duties of the Board of Governors of the Federal Reserve System arising thereunder. 16—852

For your convenience, I am handing you herewith a copy of an opinion on the above subject prepared by Mr. Dreibelbis and concurred in by the undersigned.

Such an opinion was requested several weeks ago and it should not be confused with the report to be prepared by a committee consisting of Messrs. Morrill, Goldenweiser and the undersigned pursuant to the action taken at the Board meeting on Tuesday, October 13, 1936. However, it is believed that this opinion will be helpful in connection with that report.

Messrs. Morrill, Goldenweiser and the undersigned had a meeting yesterday, at which we reached certain tentative conclusions and a draft of the committee report is now being prepared. We expect to have it completed on or before Tuesday, October 20, as requested by the Board.

Respectfully,

Walter Wyatt

Walter Wyatt,
General Counsel.

Attachment.

OFFICE CORRESPONDENCE October 15, 1936

TO Board of Governors

FROM Mr. Dreibelbis, Assistant General Counsel.

SUBJECT: Scope of section 14(g) of the Federal Reserve Act, as amended, and powers and duties of the Board of Governors of the Federal Reserve System arising thereunder.

We have been requested to advise the Board with respect to the scope of section 14(g) of the Federal Reserve Act, as amended, and its obligations and duties arising thereunder.

OPINION

While it is difficult to compress into one short statement general conclusions with respect to the entire scope of section 14(g) of the Federal Reserve Act, as amended, it can be said that, considering the section in its entirety, our conclusions are that:

1. The Board, by clear mandate of the law, is required to exercise "special supervision" over all relations with foreign banks and bankers. This obviously requires closer supervision than the general supervision over Federal Reserve banks provided for in section 11 of the Federal Reserve Act.

2. Officers or other representatives of any Federal Reserve bank are prohibited from conducting negotiations with any foreign bank or banker without first obtaining the permission of the Board.

3. The Board, in granting permission to the Federal Reserve banks, should exercise its independent judgment as to the advisability of permitting Federal Reserve banks to conduct negotiations with foreign banks or bankers.

4. The term "negotiation" includes all discussions or communications treating with a view of reaching an eventual agreement or engaging in a transaction.

5. The Board is not required to be but, in the exercise of its discretion, may be represented at any conference and in any negotiations.

6. Officers or representatives of a Federal Reserve bank may, without prior permission of the Board, hold conferences or discussions when the same are of a general nature, and are not with a view of reaching an eventual agreement or engaging in some transaction, but a full report of the same, as well as a full report of all negotiations, understandings, or agreements must be filed with the Board in writing by a duly authorized officer of such Federal Reserve bank.

7. There is an implied obligation, within reasonable limits, to keep the Board advised of forthcoming conferences in order that the

Board may exercise its discretion with respect to representation. (With respect to negotiations, section III of the Board's Regulation N requires reasonable notice in advance of the time and place of the same.)

8. The Board, by regulations, may prescribe such additional limitations and conditions as it deems necessary or advisable.

POWERS AND DUTIES AS PRESCRIBED BY SECTION 14(g) OF THE FEDERAL RESERVE ACT AND REGULATION N OF THE BOARD

Section 14(g) of the Federal Reserve Act reads as follows:

> "The Board of Governors of the Federal Reserve System shall exercise special supervision over all relationships and transactions of any kind entered into by any Federal reserve bank with any foreign bank or banker, or with any group of foreign banks or bankers, and all such relationships and transactions shall be subject to such regulations, conditions, and limitations as the Board may prescribe. No officer or other representative of any Federal reserve bank shall conduct negotiations of any kind with the officers or representatives of any foreign bank or banker without first obtaining the permission of the Board of Governors of the Federal Reserve System. The Board of Governors of the Federal Reserve System shall have the right, in its discretion, to be represented in any conference or negotiations by such representative or representatives as the Board may designate. A full report of all conferences or negotiations, and all understandings or agreements arrived at or transactions agreed upon, and all other material facts appertaining to such conferences or negotiations, shall be filed with the Board of Governors of the Federal Reserve System in writing by a duly authorized officer of each Federal reserve bank which shall have participated in such conferences or negotiations."

Reduced to its simplest terms, it means that with respect to relationships and transactions with foreign banks or bankers that:

The Board of Governors of the Federal Reserve System -	Officers or other representatives of Federal Reserve banks -
Shall exercise special supervision over all relationships and transactions of any	Shall not conduct negotiations without first obtaining the permission of the Board.

kind, and all such relationships and transactions shall be subject to such regulations, conditions, and limitations as the Board may prescribe.	Shall file with the Board in writing a full report of all conferences or negotiations and all understandings or agreements or transactions agreed upon and all other material facts appertaining to such conferences or negotiations.
May, in its discretion, be represented in any conference or negotiation.	

Shortly after the enactment of section 14(g) of the Federal Reserve Act into law, the Board promulgated its Regulation N upon the subject of "Relations with Foreign Banks and Bankers". At that time it was the recommendation of the Governors' Conference that, since the terms of the section set forth explicitly the terms and conditions under which Federal Reserve banks might engage in foreign transactions, it was their view that a regulation simply paraphrasing the section would seem advisable. Accordingly Regulation N, as promulgated, does, in effect, simply paraphrase section 14(g) except in a few instances, the most important of which is set out in the underscored portion of the following quoted paragraph from Regulation N, and, for the purposes of this discussion, it is not deemed necessary to quote from Regulation N other than as follows:

> "Without first obtaining the permission of the Federal Reserve Board, no officer or other representative of any Federal Reserve bank shall conduct negotiations of any kind with the officers or representatives of any foreign bank or banker or any group of foreign banks or bankers, except communications in the ordinary course of business in connection with transactions pursuant to agreements previously approved by the Federal Reserve Board. Any request for the Board's permission to conduct any such negotiations shall be submitted in writing and shall include a full statement of the occasion and objects of the proposed negotiations."

BACKGROUND AND LEGISLATIVE HISTORY

The Board is familiar with the events, discussions, charges and countercharges leading to the enactment of section 14(g) of the Federal Reserve Act as a part of the Banking Act of 1933. For several years prior to that time the matter of foreign relationships had been one of great concern to the Board and as early as 1927 Mr. Wyatt, at the request of the Board, prepared and submitted an opinion advising the Board that, under the specific terms of the Federal Reserve Act,

no Federal Reserve bank could lawfully open or maintain foreign accounts, appoint correspondents or establish agencies in foreign countries without first obtaining the consent of the Federal Reserve Board; that by virtue of the specific provisions of the Federal Reserve Act, no Federal Reserve bank could lawfully open or maintain foreign accounts, appoint correspondents or establish agencies in foreign countries without first obtaining the consent of the Federal Reserve Board; that by virtue of the specific provisions of the Federal Reserve Act, the Federal Reserve Board was authorized and empowered to prescribe regulations, restrictions, and limitations governing dealings in bills of exchange between the Federal Reserve banks and foreign central banks; and that, by virtue of its right to exercise general supervision over Federal Reserve banks and by virtue of certain other powers specifically granted in the Act, the Board was authorized to regulate, limit or restrict open-market operations in gold involving large amounts between Federal Reserve banks and foreign central banks, under section 14(a) of the Federal Reserve Act as then in force.

By enactment of section 14(g) of the Federal Reserve Act as it is now in force and effect, however, express powers were granted to the Board and express duties imposed upon it.

Whatever may have been the other contributing factors to the enactment of section 14(g) and whatever may be the doubt, outside of the record, as to the motivating causes for its enactment, the record admits of no debate upon the subject.

At that time Senator Glass, during the debates upon the bill, made the following charge from the floor of the Senate:

> "For a period of six years one of the Federal reserve banks has apparently given more attention to 'stabilizing' Europe and to making enormous loans to European institutions than it has given to stabilizing America. Accordingly, we have a provision in this bill asserting, in somewhat plainer terms, the restraint the Federal reserve supervisory authority here at Washington should exercise over the foreign and open market operations of banks which may assume to be a 'central bank of America.'
>
> "We did not think that we were having a central bank. We thought we were having 12 regional banks. The operations of the bank particularly referred to were so extensive in the European field that it found itself liable for hundreds of millions of dollars of foreign acceptances which could not be collected, which had to be renewed at maturity -- just a sort of a revolving fund -- absolutely foreign to the intent, and, as I contend, to the text of the Federal reserve act.

"For a long time that great bank resisted any suggestion -- and it does now -- that it should be brought within the actual jurisdiction of the central authority here at Washington. At one time it was so -- and I think it is now -- that all Europe regarded this Federal reserve bank as 'the central bank of the United States.' When its governor would go abroad he was accorded the privilege of an office and a clerical staff in the Bank of England, and he was spoken of as the 'governor of the central bank of the United States.' In turn, when the governors of the Bank of England and the continental central banks would come here they came by the invitation or notification to the governor of this one Federal reserve bank. Two members of the Federal Reserve Board once told me that the only contact this central supervising power at Washington ever had with one of these foreign central bank presidents was by courtesy of the governor of this particular Federal reserve bank."

The Committee on Banking and Currency in the House and the Committee on Banking and Currency in the Senate made identical reports with respect to the facts, as follows:

"4. Strengthening of Federal Reserve System. -- The Federal Reserve System has been seriously impaired of recent years and has wandered far away from its original function. This is the result of many complex conditions. Among these conditions has been the uncertainty of policy in the matter of exercising plainly authorized control by the central supervising authority at Washington and the tendency to submit rather timidly to considerations of immediate expediency. Among the Reserve banks themselves there has been a decidedly dangerous drfit toward the conversion of the system into a medium for transacting financial rather than commercial business. Further, the establishment of understandings or agreements with foreign central and other banks, and the attempt to carry out plans and measures of a hazardous nature relating to discount rates and problems of technique, have had unfortunate results.

"To reform these conditions the committee recommends:

"(a) Increase of independence of Federal Reserve Board.

"(b) Better definition of the powers of the Board

with respect to speculative transactions, particularly as to authority over open market dealings, by establishing a so-called 'open market committee' with designated authority.

"(c) Definition of powers of the Board in the management of foreign affairs."

As a result, section 14(g) of the Federal Reserve Act was enacted as a part of the Banking Act of 1933 and, in this connection, it is to be noted that the section was enacted into law by Congress in the face of the following comment of Mr. Harrison, Governor of the Federal Reserve Bank of New York, made in a letter addressed to the Honorable Carter Glass under date of February 6, 1932:

"As to the foreign accounts, it should be pointed out, however, that the Federal Reserve Bank of New York has never sought or solicited the opening of any account from any foreign bank or banker. No such account has ever been opened with us nor has a reciprocal account been opened by us abroad without the affirmative approval of the Federal Reserve Board. Furthermore, the terms and conditions on which we do business with all foreign banks have been specifically approved by the Federal Reserve Board in advance of our opening any account. In addition to this general approval we have always and without exception submitted to the Federal Reserve Board for its approval every credit arrangement which we have entered into with any central bank. All accounts and all credit arrangements which we have opened or entered into with the approval of the Federal Reserve Board have been participated in by each of the other Federal reserve banks of their own choice.

"Thus, all of our foreign transactions, even the day-to-day routine transactions, have been in accordance with agreements previously approved by the Federal Reserve Board, and every special engagement or arrangement has had the specific approval of the Federal Reserve Board, to which the fullest information is forwarded currently about all of our operations with or for foreign accounts. This is as it should be. More than this, however, I do not believe to be practicable or feasible.

"Foreign central bank operations, especially exchange operations, are difficult and technical operations, and must be handled promptly and expeditiously by men trained in foreign exchange and international banking business. If they

are made subject to any greater or more direct control of the Federal Reserve Board or to the supervision of the open-market committee, as provided in your bill, our handling of those accounts will become practically so difficult and so cumbersome that they will in all likelihood be forced to private banking institutions in New York, outside the Federal reserve bank, where we will lose all the very real advantages of the present contacts and the value of the information afforded by those contacts. I can not overemphasize the importance of those advantages to the proper functioning of the reserve bank in the principal money center of the country."

POINTS OF CONTROVERSY ARISING OUT OF THE SECTION

It is clear from the foregoing that, as a matter of policy, Congress had decided to require the Board to exercise closer supervision over all relationships and transactions with foreign banks than had theretofore been exercised and that such supervision should be "special" in its character.

Furthermore, the language of the section would seem to be clear and unambiguous.

Such confusion as arises out of it, seems to arise out of a misunderstanding or misconception of a few terms used therein, which is best illustrated by a particular case and a comparison of the views expressed with respect to it.

On August 29, 1936, the Board received a communication from the Federal Reserve Bank of New York with respect to proposed transactions with the Banco Central de Reserva de El Salvador. The transactions in question involved the exportation by the San Salvador bank of gold and silver for sale in the New York market and a loan upon earmarked gold.

Upon investigation it was found that the correspondence in question was but a link in a chain of correspondence upon the same subject matter dating back to March 18, 1936.

In approving the request of the New York bank for permission to engage in the transaction, the following comment was made by the Board in its letter of September 4, 1936 to Mr. Sproul of the New York bank:

"The information and correspondence which has been

furnished to the Board in connection with this matter discloses the fact that the negotiations respecting the deposit of gold by and a loan to the El Salvador bank against the security of such gold were initiated by an exchange of letters between the El Salvador bank and the Federal Reserve Bank of New York under dates of March 18 and March 27, 1936, respectively, and were continued by subsequent correspondence without the Federal Reserve Bank of New York first having obtained the permission of the Board of Governors to conduct such negotiations as required by the provisions of section 14(g) of the Federal Reserve Act. In view of the clear mandate contained in section 14(g) that 'The Board of Governors of the Federal Reserve System shall exercise special supervision over all relationships and transactions of any kind entered into by any Federal Reserve bank with any foreign bank or banker, or with any group of foreign banks or bankers,' the Board feels that it cannot permit this incident to pass without comment and that it must insist that hereafter the Federal Reserve Bank of New York obtain the permission of the Board of Governors before opening or conducting negotiations of any kind with the officers or representatives of any foreign bank or banker. Your cooperation to this end will be appreciated."

Under date of September 15, 1936, Mr. Sproul replied in part as follows:

"Since the addition of section 14(g) to the Federal Reserve Act by the Act of June 16, 1933, and the issuance of the Board's Regulation N effective August 10, 1933, we have not conducted what we considered to be negotiations with the officers or representatives of any foreign bank or banker or any group of foreign banks or bankers, without first obtaining the permission of the Board of Governors. We have not considered, however, that the answering by one of our officers of a request for information, received by us from a foreign bank or banker, concerning practices of this bank or in this market, for example, constituted entering into negotiations, even though the information which we supplied in this way might later lead to negotiations concerning relationships which might be established between this bank and a foreign bank, or transactions which we might

enter into with foreign banks or bankers. This has seemed to us to be a reasonable interpretation of the meaning of the term 'negotiations,' and one which would permit of real compliance with the law and regulation without surrounding all of our contacts with foreign banks with a cumbersome and perhaps detrimental formality.

"Until the receipt of the Board's letter of September 4, 1936, we had assumed that the Board placed the same interpretation upon the term 'negotiations' and had no objection to our making response to requests for information from foreign banks or bankers without first obtaining the permission of the Board. We had so assumed because from time to time in the past we have sent to the Board, for its information, copies of correspondence with foreign banks entered into without the prior permission of the Board, because we did not believe such correspondence constituted negotiations, and no question has been raised by the Board. A recent case in point has to do with our correspondence with the Banco Central de Reserva de El Salvador. Under date of July 31, 1936, we sent to the Board a copy of a letter dated July 25, 1936, received by us from the El Salvador bank, and a copy of our reply dated July 31, 1936, (which incidentally referred to, and indicated the general character of, our letter of March 27, 1936, to the El Salvador bank), concerning loans on gold. The Assistant Secretary of the Board replied under date of August 3, 1936, merely acknowledging receipt of this correspondence and stating that our letter and its enclosures would be brought to the attention of the members of the Board for their information."

Thus, it would appear that while there is no misunderstanding as to the general purport and language of section 14(g), there is considerable misunderstanding as to the scope and meaning of the term "negotiations" as that term is used in the section.

DISCUSSION

Under the most limited construction of the term "supervision" implies general oversight over the matter which is being supervised.

In re James 123 Atl. 385, State v. Bronson, 21 S. W. 1125; Cutrona v. Mayor, 127 Atl. 421. It has been construed as providing for general oversight with the added power of direction: State v. Chicago & Ry. Co., 130 N. W. 802; McCarthy v. Board, 115 Pac. 458; Great Northern Ry. Co.,v. Snohomish County, 93 Pac. 924, New York Life Insurance Co., v. Rhodes, 60 S.E. 828; Hutchins v. City of Des Moines, 157 N. W. 687; and it has even been construed as including along with general direction, actual participation in the work. Businessmens' Assurance Co.,v. Campbell, 6 Fed. (2) 540; Peterson v. Time Indemnity Co., 140 N. W. 286; Smith v. American Mutual Accident Association, 71 N.W. 601.

Under the provisions of section 14(g) of the Federal Reserve Act the Board is required to exercise special supervision and, some significance must be given to the use of the term "special". As an indication of what Congress had in mind in connection with the exercise of special supervision, it is to be pointed out that the section also provides for actual representation, within the discretion of the Board, in any conference or negotiation, and gives to the Board the power to deny to a Federal Reserve bank the right to conduct negotiations.

It is to be noted that in objecting to the enactment of section 14 because it would not be feasible, Mr. Harrison, in his letter above referred to, pointed out that no foreign account had ever been opened without the consent of the Board; that the terms and conditions upon which the bank did business with foreign banks were specifically approved by the Board; that every credit arrangement entered into with any central bank was submitted to the Board; that even day to day routine transactions had been in accordance with agreements previously approved by the Board, and that every special enactment or arrangement had been approved by the Board. Congress, however, must have seen fit to require more to be done in the way of supervision than was then being done; otherwise it would not have enacted the section. Plainly, therefore, the special supervision intended by Congress included more than a general oversight of a particular Federal Reserve bank's relations with foreign banks or bankers.

This special supervision which the Board is required to exercise extends over "all relationships and transactions of any kind" and over "all conferences or negotiations" with any foreign bank or banker.

The term "relationship" connotes a connection of any kind or character, whereas the term "transaction" is synonymous with the term "negotiation" and connotes a relationship limited more to a business relationship than a relationship in its broader sense.

It is to be presumed, therefore, that, when Congress directed the Board to exercise special supervision over "all relationships and

transactions of any kind", the mandate included the exercise of special supervision over all relationships and not only those limited to business transactions.

Similarly, the term "conference" connotes a discussion or consultation in its broadest sense, whereas the term "negotiation" is more limited in its meaning in that it implies a purpose to reach an agreement.

In the Oxford Dictionary the term "confer" is defined as meaning "to converse, talk together; now always on an important subject or on some stated question; to hold conference, take counsel, consult." In the same dictionary, the term "negotiate" is defined as meaning "to hold communication or confer nce for the purpose of arranging some matter by mutual agreement; to discuss the matter with a view to some settlement or compromise." Thus, a negotiation may be defined as a conference having for its purpose an eventual agreement.

This distinction is significant because it is to be remembered that section 14(g) provides that negotiations may not be conducted without first obtaining the permission of the Board. At the same time, however, with respect to reports which are required to be filed with the Board, the section speaks of conferences or negotiations. Impliedly, therefore, conferences may be held without the permission of the Board, whereas negotiations may not be held without the prior permission of the Board. Congress must have recognized the distinction between conferences and negotiations; otherwise it would not have provided for reports of conferences or negotiations but for prior permission only in connection with conducting negotiations.

In passing, it might be well to point out that, while there is no obligation upon the part of a Federal Reserve bank to obtain permission before holding a conference, as that term is used in the section, there is an implied obligation to keep the Board advised of forthcoming conferences in so far as possible, otherwise the Board would have no opportunity to exercise its discretion of having a representative present at such conference, as provided for in the section. In this connection the Board's regulation requires that the Board shall be given reasonable notice in advance of the time and place of any negotiations.

Summarizing, itis my opinion that negotiations, within the meaning of section 14(g) of the Federal Reserve Act as it is now in force, include all communications or conferences treating with a view to coming to terms upon a particular matter, and that conferences held or communications sent within this meaning of the term require the prior permission of the Board. By a provision in Regulation N, blanket permission has been given with respect to "communications in the ordinary

course of business in connection with transactions pursuant to agreements previously approved by the Federal Reserve banks."

As opposed to this view, it is argued that such an interpretation of the term "negotiations" is unreasonable and is not in harmony with the prior action of the Board.

As to the first argument, it is stated that the answering of requests for information concerning practices of a Federal Reserve bank in the market, for example, do not constitute entering into negotiations, even though the information which is supplied may later lead to negotiations concerning relationships which might be established between the bank and a foreign bank or transactions which might be entered into with foreign banks or bankers. On the contrary,however, that would seem to be precisely what the real meaning of the term "negotiations" is. Each step in the process would seem to be a part of the negotiations leading to the final agreement or transaction.

It may be that the practice required by this section is not feasible and that the results will be as argued; but this fact has no applicability in construing the statute unless it is subject to such interpretation.

In this connection it should be remembered that, when the section was about to be enacted, Mr. Harrison argued that it should not be enacted because if activities in this respect should be "made subject to any greater or more direct control of the Federal Reserve Board or to the supervision of the Federal Open Market Committee, as provided in your bill, our handling of those activities will become practically so difficult and so cumbersome that they will in all likelihood be forced to private institutions in New York, outside the Federal Reserve Bank, * * *." It is now argued that the section should not be interpreted as meaning what it was said at that time it would mean because, to attach the meaning to it which was attached at that time, would surround "all of our contacts with foreign banks with a cumbersome and perhaps detrimental formality."

The force of this argument is obviously lost in the fact that the same argument was made prior to the enactment of the section and that it was enacted in the face of such argument.

With respect to the second point, it is true that the practice in the past has not been wholly in accord with the views as expressed herein and has been somewhat in accord with the views as expressed in Mr. Sproul's letter. This, however, has no bearing upon the legal obligations imposed by the section. Powers granted to Governmental officers to be exercised in the public interest cannot be waived; and a failure for a time to perform a

public duty prescribed by law does not excuse a continuance of such practice.

It is also argued that the Board's regulation gives support to the more limited interpretation of the meaning of the word "negotiations". Section 3 of the regulation, among other things, provides that any request for the Board's permission to conduct any such negotiations shall be submitted in writing and shall include a full statement of the occasion and objects of the proposed negotiations; and from this it is argued that there must be preliminary correspondence in order to make it possible to include a full statement of the occasion and object of the proposed negotiations.

No doubt such may be the case in some instances. However, from such of the files as the writer has had an opportunity to examine, it would appear that some idea of the proposed object of the correspondence is generally conveyed in the first communication, and it is quite evident that, in the absence of knowing what the Board might desire in a particular case, representations might be made which, although not being commitments, might be embarrassing in the absence of subsequent permission by the Board. In view of the fact that the Board is required to exercise special supervision, it would seem that it should be as currently informed as the officers or representatives of the Federal reserve banks carrying on negotiations leading towards eventual agreements or transactions which must receive the Board's approval.

CONCLUSION

For all of the foregoing reasons, our opinion with respect to the powers and duties of the Board under section 14(g) of the Federal Reserve Act, as amended, is as set out in the first paragraph of this memorandum.

Respectfully submitted,

(Signed) J. P. Dreibelbis

J. P. Dreibelbis,
Assistant General Counsel.