

STATEMENT OF  
THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM  
BEFORE THE SENATE BANKING AND CURRENCY COMMITTEE  
REGARDING RECOMMENDATIONS FOR  
CHANGES IN THE BANKING LAWS

PRESENTED BY GOVERNOR J. L. ROBERTSON

November 9, 1956

Mr. Chairman:

The Board of Governors welcomes this opportunity to express its views as to proposals for improvement of the banking laws.

In response to your Committee's request, the Board submitted several weeks ago a number of recommendations for changes in the statutes relating to the Federal Reserve System. As indicated in the Board's letter of transmittal, these recommendations are not directed at fundamental policy matters or the structure or scope of authority of the banking agencies, except for two proposals recommended by the Board during the last session of Congress. The recommendations relate chiefly to the repeal of obsolete provisions and changes designed to improve the operational activities of the System.

The Board's suggestions are arranged according to the numerical sequence of the sections of the Federal Reserve Act to which they relate. For the sake of simple presentation, they are discussed under four broad categories: First, those which would repeal clearly obsolete provisions;

second, those which would repeal provisions which appear to have no present significance or importance; third, those which are aimed at improving the operations of the Federal Reserve Banks and the Board; and, fourth, those which are designed to clarify or make more workable provisions relating to the supervision of member banks of the Federal Reserve System. For identification, I shall refer to the Board's suggestions by the numbers assigned to them in the Committee's Print of legislative recommendations.

#### Repeal of Obsolete Provisions

Nearly half of the 40 recommendations submitted by the Board relate to the proposed repeal of provisions which for one reason or another are clearly obsolete and of no legal effect. Many of these provisions are no longer carried in the United States Code; and their repeal would make no changes in substance. Consequently, there appears to be no need to take the time to explain each of these recommendations.

By way of illustration, however, I may say that a number of provisions of the Federal Reserve Act relate to the original organization of the Federal Reserve Banks. These provisions have all been fully executed and are obviously obsolete. Similarly, certain provisions of the law have a definite termination date which has long since expired. Again, some provisions refer to obligations of certain Government agencies that have been dissolved or are in process of liquidation.

In the same class with such obsolete provisions are a few provisions which contain references that are obviously incorrect, such as,

for example, a reference to the "six" members of the Federal Reserve Board, and references to section 12B of the Federal Reserve Act, a section relating to deposit insurance which was withdrawn from the Act some years ago and re-enacted as the Federal Deposit Insurance Act.

Repeal of the obsolete provisions and correction of the inaccurate references mentioned in the Board's recommendations would, of course, be a part of any codification of the laws relating to the Federal Reserve System. In addition, such a codification might include a rearrangement of certain sections and of provisions within some sections in order that provisions on the same subject may be grouped together. The work involved in any codification would obviously be of a technical nature; and the Board's staff will be glad to furnish any assistance in this connection that may be desired by your Committee.

#### Provisions of No Present Significance

Certain provisions of the law are not legally obsolete, but as a practical matter do not, in the Board's opinion, have any present significance or importance and are obsolete for all intents and purposes.

Thus, Recommendation Number 65 would repeal a section of the law which authorizes the Reserve Banks to make advances to groups of member banks, subject to a number of rigid limitations. This authority was enacted in 1932 as an emergency means of providing credit under the conditions then existing. No advances have ever been made under this authority and it seems clear that it serves no useful purpose at present and should be repealed.

Again, there is a provision of the original Federal Reserve Act which imposes double liability with respect to stock held in the Federal

Reserve Banks. Since that time, the double liability feature has been discarded as to national bank stock and as to many State banks. The Board feels that the provision of the law imposing double liability with respect to Federal Reserve Bank stock is unnecessary and, in Recommendation Number 48, suggests that this provision be repealed.

Section 7 of the Federal Reserve Act contains a provision requiring that net earnings derived by the United States from the Federal Reserve Banks shall, in the discretion of the Secretary of the Treasury, be used to supplement the gold reserve against United States notes or applied to the reduction of the bonded indebtedness of the United States. Any practical effect that this provision might have had on the use of funds by the Treasury appears to have been superseded by the general statute covering the administration of the public debt. This provision, therefore, would be repealed under Recommendation No. 55.

A provision of present law, which was part of the original Federal Reserve Act, provides that, whenever any power vested by the Act in the Board of Governors appears to conflict with the powers of the Secretary of the Treasury, such powers shall be exercised subject to the supervision and control of the Secretary. While not entirely clear, this provision presumably was meant to avoid any question as to the effect of the Federal Reserve Act on the supervision, management, and control of the Treasury Department. In any event, the removal of the Secretary and the Comptroller of the Currency from ex officio membership on the Board by the Banking Act of 1935 clearly indicated an intent that the Board should perform its functions according to its own best judgment. So far as is known,

this provision has never had any significant effect on any of the operations or authority exercised by the Federal Reserve System or the Secretary of the Treasury, and Recommendation No. 63 would repeal this provision as being in the category of provisions that have no present significance.

Operations of the Federal Reserve Banks and the Board

The remaining 19 recommendations of the Board relate to changes which are largely aimed at clarifying or improving the operations of the System. Eleven of them relate to the operational activities of the Federal Reserve Banks and the Board.

Recommendation 51 would amend the law to provide that all directors of the Federal Reserve Banks shall be residents of the Federal Reserve District of the Reserve Bank on whose board they serve and shall continue to be residents during their term of office. Present law provides that Class C directors appointed by the Board must have been residents of the District for at least two years; but there is no specific requirement that all directors shall be residents of the district or, even in the case of Class C directors, that they shall cease to be directors if they should move out of the District.

Recommendation 52 would limit the service of Federal Reserve Bank directors, other than the Chairman, to two consecutive terms of three years each. Such a provision for rotation in the directorates of the Reserve Banks seems desirable in order to obtain the advantages of broader representation and wider experience over a period of time. A similar suggestion with the same purpose in mind is made for rotation of service on the Federal Advisory Council.

Recommendation Number 53 would clarify the right of the Federal Reserve Agent at each Federal Reserve Bank to delegate his ministerial functions to assistants, in order that the Agent, who is also chairman of the board of directors of the Reserve Bank, may devote more attention to the policy matters involved in Reserve Bank operations. It would be made clear also that an Assistant Federal Reserve Agent could act in lieu of the Agent in the event of a vacancy in that office. The present requirement that both the Agent and Assistant Agents be persons of "tested banking experience" would be eliminated as unnecessary, leaving to the Board's discretion the determination whether a person appointed is properly qualified for the position. When the Federal Reserve Act was passed, it was expected that the Chairman would be a full-time officer of the Bank. Such was the case until after the passage of the Banking Act of 1935, which provided that the President should be the chief executive officer of the Bank. Following that, the chairmanship was made a non-salaried position, and the nature of the duties does not call for "tested banking experience."

Recommendation Number 54 suggests specific authority for payment to the United States by the Federal Reserve Banks of a percentage of their net earnings after expenses and dividends. Provision for a franchise tax existed prior to 1933, but was repealed when the Reserve Banks were required to use half their surplus to subscribe to the initial capital stock of the Federal Deposit Insurance Corporation; and for some years thereafter the net earnings of the Reserve Banks were relatively small. In 1947, however,

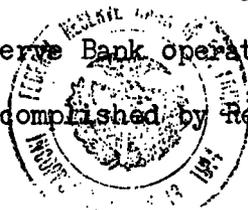
their earnings had increased substantially; and at that time, after discussing the matter with the Banking and Currency Committees of the House and Senate, the Board acted under section 16 of the Federal Reserve Act to impose an interest charge on the amount of outstanding Federal Reserve notes of each Federal Reserve Bank in excess of the amount of gold certificates held as collateral. In this way, approximately 90 per cent of the net earnings of the Reserve Banks was paid to the Treasury, and this has been done annually since that time. The Board believes, however, that it would be desirable to provide specifically for transfer to the Treasury of a part of the net earnings of the Federal Reserve Banks without relation to the amount of outstanding Federal Reserve notes. This could be done by an amendment specifically authorizing the Board to require the Reserve Banks to transfer annually to the United States Treasury such portion of their net earnings as the Board might deem appropriate, or, in the alternative, if Congress prefers, by restoration of the provision for a franchise tax equal to 90 per cent of the Reserve Banks' net earnings after provision for expenses and dividends and such reserves for contingencies as may be necessary. We are submitting legislative language with respect to both methods so that the Committee and Congress may consider which method is preferable.

Recommendation Number 56 relates to taxation of dividends on Federal Reserve Bank stock. The Public Debt Act of 1942 removed a previous exemption of such dividends from taxation, but only with respect to stock issued after the date of that Act. The proposed amendment would eliminate the exemption as to dividends on stock issued before that date, thereby

placing member banks admitted to membership before 1942 on the same basis as those admitted after 1942.

Recommendation Number 64 would eliminate from the law the present dollar limitation on expenditures for buildings for branches of the Federal Reserve Banks. Since that limitation was first placed in the law in 1922, it has been necessary in 1947 and again in 1953 for Congress to increase the statutory limitation in order to permit further branch construction and improvement necessary to keep pace with the increased volume of business and activities of the branches. No appropriations of Government funds are involved and the Board believes that a specific dollar limitation is unnecessary; but the existing requirement of the law for the Board's approval for all expenditures of this kind should be retained.

Turning to another aspect of Federal Reserve Bank operations, the Board believes that the activities of the Reserve Banks as fiscal agents of the United States and of various agencies of the Government should be made specifically subject to supervision and regulation by the Board. At present, certain Governmental agencies are authorized by statute to utilize the Reserve Banks as their fiscal agents, with no specific provision for over-all coordination. Such activities have increased substantially in recent years and it is more important than ever before that they should be coordinated through supervision by the Board of Governors. Accordingly, it is desirable that the Board's authority to supervise and regulate this substantial segment of Reserve Bank operations be specifically covered by the law. This would be accomplished by Recommendation Number 67.



In connection with their open market operations, the Reserve Banks for many years have utilized repurchase agreements as a convenient and flexible means of helping to smooth out temporary irregularities in the money market. The usual type of such an agreement is one by which a Reserve Bank purchases Government securities from a nonbank dealer in such securities under an agreement on the part of the dealer to repurchase the securities within a specified period of time at an agreed upon price and rate of interest. While the agreement has some of the attributes of a loan, it has the legal form of a purchase and sale.

Under instructions of the Federal Open Market Committee, such agreements may be for periods of not more than 15 days and may cover only Government securities maturing within 15 months, and the interest rate may not be below whichever is the lower of the discount rate at the Federal Reserve Bank or the average issuing rate on the latest Treasury bill. Generally, the discount rate is used. The authority is used sparingly as a means of providing the money market with temporary funds to avoid undue strains. Securities held under such agreements are reported on the weekly Federal Reserve Bank statement and in the Board's Annual Report.

Repurchase agreements are especially adapted to the implementation of open market policies in times of temporary market tightness when there is only a temporary need for reserves. The principal merit of this instrument is that the reserves provided are automatically withdrawn when the transaction reverses itself, without any affirmative action by the Federal Reserve.

Although repurchase operations are regulated by the Federal Open Market Committee, the law does not specifically refer to such transactions nor make them specifically subject to the direction of the Federal Open Market Committee. The Board believes, therefore, that the specific amendment suggested in its Recommendation Number 72 would be desirable.

Recommendation Number 73 would make certain changes in the paragraph of the law relating to the so-called Settlement Fund maintained with the Treasurer of the United States by the Federal Reserve Banks. The changes suggested would eliminate certain obsolete references and make some minor clarifying changes without modifying existing practices.

Under Recommendation Number 74, the lengthy and complicated provisions of section 16 of the Federal Reserve Act, relating to the issue and redemption of Federal Reserve notes, would be simplified and clarified, but no material changes of substance would be made in these provisions.

With respect to the operations of the Board of Governors, one change is suggested. Several provisions of present law require that certain actions of the Board be taken only with the concurrence of a specified number of the members of the Board. Such actions include changes in reserve requirements, permission for member banks in outlying districts of reserve and central reserve cities to carry lower reserves, and permission for one Federal Reserve Bank to rediscount paper for another Reserve Bank. Yet these and other such actions requiring concurrence of a certain number of Board members are no more important than other actions taken by the Board where the general rule requiring only concurrence by a majority of a quorum is applicable. Recommendation Number 66 would make a simple majority necessary for all Board actions.

#### Supervision of Member Banks

The foregoing covers all but eight of the Board's recommendations. These relate to changes designed to improve and clarify provisions having to do with the System's supervision of member banks.

First, the Board believes it would be desirable to broaden and clarify provisions relating to obtaining reports from State member banks so as to permit different types of reports for different groups of banks;

to permit reports on a sample basis for statistical purposes; to authorize the Board to require publication of reports of earnings and dividends; and to remove the present mandatory requirement for publication of all reports of condition of State member banks. Thus, the Board could then call for relatively simple reports from the great majority of State member banks and obtain more detailed reports only from the larger banks; and could waive some of the present publication requirements of reports of condition, but could require publication of reports of earnings and dividends, if deemed appropriate. These clarifications of authority would be accomplished by Recommendation Number 58.

Under present law, State member banks as well as national banks are prohibited from purchasing corporate stock. Occasionally, a member bank in the course of absorption of another bank finds it would be convenient to purchase and hold the stock of the other bank for a short period -- perhaps momentarily -- as one step in the take-over process, but, because of the statutory prohibition, member State banks have been deprived of this convenient means of effecting an otherwise unobjectionable absorption. Recommendation Number 60 would permit member banks to acquire stock in such limited and temporary circumstances, but only with the Board's approval.

Recommendation 69 would authorize the Board, on complaint by the Comptroller of the Currency, to revoke trust powers of national banks if those powers have been improperly exercised. At present, the Board is authorized to grant national banks permission to exercise trust powers and to issue regulations; but there is no specific provision authorizing the Board to revoke such permission if the powers are improperly exercised.

Member banks are prohibited from paying interest on demand deposits, directly or indirectly, by any device whatsoever; and the law authorizes the Board to define "interest". The practical difficulty of determining whether various practices of member banks involve an indirect payment of interest has made administration and uniform application of the law extremely difficult and troublesome. The Board believes that the law would pose fewer problems for the banks and probably be more effective if the words "directly or indirectly, by any device whatsoever" were eliminated from the statute and if it were made clear that "interest" means only cash payments or credits made or given for the account or benefit of a depositor. Such a change would not, in the Board's opinion, defeat the basic purposes of the law.

In connection with this change, it would be important that the same limitations as to interest on deposits be made clearly applicable to both member banks and nonmember insured banks alike. It is apparently the intent of present law that this should be the case. However, on one point, there has not been uniformity for many years. The Board has taken the position that absorption of exchange charges by member banks involves a payment of interest, whereas the Federal Deposit Insurance Corporation has taken the opposite position. Consequently, member banks have been placed at a serious competitive disadvantage in some sections of the country. The Board believes that this lack of uniformity should be corrected, either by an express statement in the law that absorption of exchange is, or is not, to be considered a payment of interest for both member and nonmember insured banks, or by authorizing either the Board or the

Federal Deposit Insurance Corporation to define "interest" for both classes of banks. These suggested changes in the provisions regarding interest on deposits are explained more fully in Recommendation 77.

In 1933, Congress prohibited member banks from making loans to their executive officers. As an exception, however, loans up to \$2,500 were permitted. Conditions have changed considerably since that time and the Board believes that it would be reasonable, as stated in Recommendation 81, to increase the amount specified in that exception to at least \$5,000.

The proposal made in Recommendation 83 would authorize the Board by regulation to permit foreign branches of national banks to exercise such powers as may be usual in connection with the banking business in the countries in which they are located. Under present law, national banks must obtain the Board's approval before establishing foreign branches. The suggested amendment would enable such branches to operate more effectively than at present. A proposal of this kind was recommended to Congress by the Board in the last Congress and was incorporated in a bill introduced by Senator Robertson in May 1956.

Under section 30 of the Banking Act of 1933, relating to proceedings for the removal of directors or officers of member banks, it is now required that the Federal Reserve Agent shall issue a warning when a State member bank appears to have violated the law or engaged in unsound banking practices. If the violation or unsound practice is repeated after such a warning, a hearing is held by the Board to determine whether the officer or director should be removed. In Recommendation 84, the Board suggests that the warning in such a case be issued by the Board itself rather than

by the Federal Reserve Agent. This would be in accord with present practice under which the Federal Reserve Agent, who is of course the Board's agent, normally consults with the Board before issuing a warning in any such case.

Finally, the last of the Board's recommendations, Number 85, proposes an amendment to require every bank merger or consolidation involving insured banks to have the prior approval of the appropriate Federal bank supervisory agency, with a specific requirement that the supervisory agency -- whether the Comptroller, the Board, or the Federal Deposit Insurance Corporation -- shall take into consideration, not only the usual banking factors, but also the question whether the proposed transaction would lessen competition unduly or tend unduly to create a monopoly. The banking agency involved would be required to consult each of the other two banking agencies on the question of competition and would be authorized to request the opinion of the Attorney General with respect to that question. Such an amendment would fill a gap in present law and serve to insure consideration, on a substantially uniform basis, of the impact of bank mergers upon competition in the banking field. A bill incorporating this proposal was passed by the Senate in July 1956.

### Conclusion

That, Mr. Chairman, concludes this summary of the Board's recommendations. As requested, I am submitting drafts of amendments to the law which would carry out each of the recommendations. We have received a letter from the Federal Advisory Council expressing its views as to certain of the Board's recommendations and that letter is being made available to the Committee. As to any aspects of the Committee's study, the Board stands ready at any time to be of all assistance possible.