BOARD OF GOVERNORS OF THE
LIBRARY
FEDERAL RESERVE SYSTEM

RECOMMENDATIONS FOR CHANGES IN THE FEDERAL RESERVE ACT

PART 1

Introduction

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BOARD OF GOVERNORS OF THE
LIBRARY
FEDERAL RESERVE SYSTEM

RECOMMENDATIONS FOR CHANGES IN THE FEDERAL RESERVE ACT

Introduction

This memorandum proposes numerous amendments to the Federal Reserve Act that would be reflected in a complete but essentially "technical" revision of the Act. The revision would be intended to eliminate obsolete or anachronistic provisions, correct inaccuracies, resolve inconsistencies, and clarify ambiguities that have become parts of the Act as a result of hundreds of amendments to the law enacted since the Act was originally adopted in 1913. The revision would also rearrange provisions of the present Act in a more logical and coherent manner.

While most of the suggested amendments would make no important changes of substance, a few of them might be regarded as substantive in nature. However, it is believed that even these amendments are relatively minor and should be noncontroversial. None is intended to make any major or basic change in the structure or operations of the Federal Reserve System. Nevertheless, in those cases in which a change might be regarded as at all controversial, the related catchline is preceded by an asterisk.

The specific recommendations are consecutively numbered. In general, but not in all instances, they are set forth according to sections of the present Federal Reserve Act. References in brackets in the left margin are to corresponding sections of the appended draft bill.

The recommendations do not specifically cover the deletion of sections of the original Federal Reserve Act amending other statutes, such as sections 8, 17, 20, 21, and 27 of the present Act. These sections, which have been executed, would naturally be omitted in any general revision of the Act.

As Appendix A to this memorandum, there is attached a draft of a proposed bill that would implement the recommendations herein contained. Section 1 of the bill would constitute the recommended revision of the Federal Reserve Act. The remaining sections would make necessary conforming amendments to provisions of other Federal statutes or would re-enact as separate statutes provisions that do not belong in the Federal Reserve Act. References to the numbers of the corresponding recommendations discussed in this memorandum are set forth in the left

margin of the text of the draft bill. References to corresponding sections or paragraphs of present law are set forth in the right margin of the bill. Unless otherwise indicated, section references are to sections of the present Federal Reserve Act.

Immediately following this Introduction is a Table of Contents for this memorandum. Because of its length, the memorandum is divided into two "Parts".

The appended draft bill is preceded by its own Table of Contents. Appendix B is a table indicating, in order, the disposition made of each paragraph of the present Federal Reserve Act.

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1. DEFINITIONS

The second and third paragraphs of section 1 of the Act (12 U.S.C. 221) read as follows:

> "Wherever the word 'bank' is used in this Act, the word shall be held to include State bank, banking association, and trust company, except where national banks or Federal reserve banks are specifically referred to.
>
> "The terms 'national bank' and 'national banking association' used in this Act shall be held to be synonymous and interchangeable. The term 'member bank' shall be held to mean any national bank, State bank, or bank or trust company which has become a member of one of the reserve banks created by this Act. The term 'board' shall be held to mean Board of Governors of the Federal Reserve System; the term 'district' shall be held to mean Federal reserve district; the term 'reserve bank' shall be held to mean Federal reserve bank; the term 'the continental United States' means the States of the United States and the District of Columbia."

The extent to which terms used in the Federal Reserve Act should be defined in the statute presents a difficult question of judgment. It would be possible to attempt to define many words that frequently give rise to questions of interpretation, such as the words "bank", "branch", "deposit", and "capital and surplus". However, it is believed that, as a general rule, it is preferable to avoid precise statutory definitions of such terms. It is not only difficult to define terms of this kind but it is desirable to afford the flexibility provided by interpretative or regulatory definitions. For example, any effort to define the word "bank" on the basis of functions and for all purposes would be extremely

difficult in the light of rapid developments in the banking industry. Thus, the day may come when, with changes in the payments mechanism, deposits in banks generally will no longer be withdrawn or transferred by "check".

For the reasons indicated, it is believed that section 1 of the Federal Reserve Act should contain, with one exception hereafter noted, only "descriptive" or "short-hand" definitions that would facilitate drafting and reference. At the same time, it would be desirable to incorporate at some place in the Act - perhaps in the section relating to the Board of Governors - a provision giving the Board general authority to define terms used in the Act in order to effectuate the purposes and prevent evasions of the Act.

A. "Bank"

[§ 102] The definition of the word "bank" presently contained in section 1 is inappropriate and misleading since it suggests that it usually refers only to State banks, whereas, of course, the term is frequently used to include national banks as well. In any event, this definition seems unnecessary since in practically all instances the word "bank" is preceded by a descriptive word or phrase, such as "national", "State", or "Federal Reserve".

B. "National bank"

[§ 102(a)] The term "national bank" should be defined as any national bank or national banking association organized under the National Bank Act.

C. "State bank"

[§ 102(b)] There should be included a definition of the term "State bank" as meaning any bank, banking association, savings bank, or trust company organized under the laws of any State or of the District of Columbia. The word "organized" should be used instead of "incorporated" in order to include an unincorporated private banker or banking association since, while such organizations are not eligible for membership in the System, there are certain provisions of the Act that should be applicable to them. For example, the Board has held that a private banker may be a "nonmember clearing bank" for purposes of the first paragraph of section 13 of the Act.

Such a definition of a "State bank" would not include a bank organized under the local laws of a territory, dependency, or insular possession of the United States. It would be possible to provide for the inclusion of such banks in the definition of a "State bank", as has been done in the Federal Deposit Insurance Act; but it seems preferable to avoid logically contradictory definitions. To the extent that banks organized under the local laws of the territories, dependencies, and insular possessions are permitted to become members of the Federal Reserve System, any problem involved would be resolved by requiring any such banks becoming members of the System to comply with all provisions applicable to State member banks.

The suggested definition of the term "State bank" would include savings banks as well as commercial banks even though, here again, savings banks are not members of the System, since it is desirable that they be included in the definition for certain purposes. The proposed definition would retain the reference to trust companies now included in the present definition of the word "bank". The Federal Deposit Insurance Act defines the term "State bank" in a manner that excludes any trust company that does not receive deposits; but non-deposit trust companies are presently permitted to become members of the Federal Reserve System and there appears to be no reason to exclude them.

D. "Member bank"

[§ 102(c)] The definitional section should include a definition of the term "member bank" as meaning any bank that becomes a member of the Federal Reserve System.

At this time, there appears to be no need to include definitions of the terms "insured bank" and "noninsured bank". However, if the Federal Reserve Act should be amended in any manner that would make certain provisions applicable to all insured banks (such as an extension of reserve requirements to all such banks), such definitions would become necessary.

E. "Continental United States"

[§ 102] The present definition of the term "continental United States" is now clearly inappropriate since Hawaii is a State although not a part of the continental United States. Moreover,

this term occurs only in the present first paragraph of section 2 of the Act and in section 19(h) of the Act. In accordance with other recommendations, these references would be omitted from the Act.

F. "Affiliate"

[§ 102(h)] (1) One exception might appropriately be made to the general rule of avoiding functional definitions. Section 2(b) of the Banking Act of 1933 defines the term "affiliate". Since the term is defined in relation to member banks and since the term occurs frequently in the Federal Reserve Act, it is believed that section 2(b) of the Banking Act of 1933 should be withdrawn and re-enacted, with necessary changes, as a part of the definitional section of the Federal Reserve Act.

[§ 102(h)(5)] *(2) At present, the definition of an "affiliate" includes a company that owns or controls 50 per cent or more of the stock of a member bank. Under the Bank Holding Company Act, a bank is a "subsidiary" of a holding company if 25 per cent or more of its stock is owned or controlled by such company. Section 23A of the Federal Reserve Act, relating to dealings by member banks with their affiliates, expressly provides that for purposes of that section the term "affiliate" shall include any bank holding company of which a member bank is a subsidiary and any other subsidiary of such holding company. There is no logical reason for which a company of this kind should be regarded as an affiliate of a member bank for purposes of section 23A and not

also for purposes of other sections of the Federal Reserve Act. Accordingly, the definition of the term "affiliate" should be expanded to include a bank holding company of a member bank or any other subsidiary of such holding company.

2. FEDERAL RESERVE DISTRICTS

The first paragraph of section 2 of the Act (12 U.S.C. 222, 223) reads as follows:

> "As soon as practicable, the Secretary of the Treasury, the Secretary of Agriculture and the Comptroller of the Currency, acting as 'The Reserve Bank Organization Committee,' shall designate not less than eight nor more than twelve cities to be known as Federal reserve cities, and shall divide the continental United States, excluding Alaska, into districts, each district to contain only one of such Federal reserve cities. The determination of said organization committee shall not be subject to review except by the Board of Governors of the Federal Reserve System when organized: Provided, That the districts shall be apportioned with due regard to the convenience and customary course of business and shall not necessarily be coterminous with any State or States. The districts thus created may be readjusted and new districts may from time to time be created by the Board of Governors of the Federal Reserve System, not to exceed twelve in all. Such districts shall be known as Federal reserve districts and may be designated by number. When the State of Alaska or Hawaii is hereafter admitted to the Union the Federal Reserve districts shall be readjusted by the Board of Governors of the Federal Reserve System in such manner as to include such State. Every national bank in any State shall, upon commencing business or within ninety days after admission into the Union of the State in which it is located, become a member bank of the Federal Reserve System by subscribing and paying for stock in the Federal Reserve bank of its district in accordance with the provisions of this Act and shall thereupon be an insured bank under the Federal Deposit Insurance Act, and failure to do so shall subject such bank to the penalty provided by the sixth paragraph of this section."

[§ 501] (1) Since not more than twelve Federal Reserve districts may be created, the provision of the above paragraph regarding creation of new districts by the Board is obsolete and should be [Sec. 3] omitted. The present districts and Federal Reserve cities should be continued in effect.

[§ 501] (2) The specific reference to the admission of Alaska and Hawaii to the Union is now obsolete and should be replaced by a general provision requiring readjustment of districts when any new State is admitted to the Union.

3. MEMBERSHIP OF NATIONAL BANKS

The third, fifth, and sixth paragraphs of section 2 of the Act (12 U.S.C. 282, 501a), numbered for reference purposes, read as follows:

[3] "Under regulations to be prescribed by the organization committee, every national banking association in the United States is hereby required, and every eligible bank in the United States and every trust company within the District of Columbia, is hereby authorized to signify in writing, within sixty days after the passage of this Act, its acceptance of the terms and provisions hereof. When the organization committee shall have designated the cities in which Federal reserve banks are to be organized, and fixed the geographical limits of the Federal reserve districts, every national banking association within that district shall be required within thirty days after notice from the organization committee, to subscribe to the capital stock of such Federal reserve bank in a sum equal to six per centum of the paid-up capital stock and surplus of such bank, one-sixth of the subscription to be payable on call of the organization committee or of the Board of Governors of the Federal Reserve System, one-sixth within three months and one-sixth within six months thereafter, and the remainder of the subscription, or any part thereof, shall be subject to call when deemed necessary by the Board of Governors of the Federal Reserve System, said payments to be in gold or gold certificates.

* * * * *

[5] "Any national bank failing to signify its acceptance of the terms of this Act within the sixty days aforesaid, shall cease to act as a reserve agent, upon thirty days' notice, to be given within the discretion of the said organization committee or of the Board of Governors of the Federal Reserve System.

[6] "Should any national banking association in the United States now organized fail within one year after the passage of this Act to become a member bank or fail to comply with any of the provisions of this Act applicable thereto, all of the rights, privileges, and franchises of such association granted to it under the national-bank Act,

> or under the provisions of this Act, shall be thereby forfeited. Any noncompliance with or violation of this Act shall, however, be determined and adjudged by any court of the United States of competent jurisdiction in a suit brought for that purpose in the district or territory in which such bank is located, under direction of the Board of Governors of the Federal Reserve System, by the Comptroller of the Currency in his own name before the association shall be declared dissolved. In cases of such noncompliance or violation, other than the failure to become a member bank under the provisions of this Act, every director who participated in or assented to the same shall be held liable in his personal or individual capacity for all damages which said bank, its shareholders, or any other person shall have sustained in consequence of such violation."

[§ 701] (1) The provisions of the third paragraph of section 2, requiring every national bank in the United States to signify "within sixty days after the passage of this Act" its acceptance of the Act, obviously relate only to national banks in existence at the time of the original Act. The same is true as to the fifth paragraph of the section, regarding the effect of failure of a national bank to accept the terms of the Act within such sixty days. The first paragraph of section 2 was amended at the time of enactment of the 1958 Alaskan Statehood Act in order to make it clear that national banks organized since the original Federal Reserve Act must become members of the System. Consequently, the third and fifth paragraphs of section 2 should now be eliminated as obsolete.

[§ 702] (2) The sixth paragraph, regarding penalties for failure of a national bank to become a member of the System and to comply with the provisions of the Act, should be revised to make it clear

that it applies to all national banks and not merely to national banks existing at the date of the original Federal Reserve Act. As so revised, it should incorporate the substance of the sentence in the first paragraph of section 2 (quoted under Recommendation No. 2) regarding membership of national banks in new States admitted to the Union.

4. ORIGINAL ORGANIZATION OF RESERVE BANKS

A. Reserve Bank Organization Committee

[§ 502] The first paragraph of section 2 of the Act (12 U.S.C. 222, 223), quoted under Recommendation No. 2, provides that the Reserve Bank Organization Committee (consisting of the Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency) shall designate not less than eight nor more than twelve Federal Reserve cities and shall divide the continental United States (excluding Alaska) into Federal Reserve districts. In connection with the performance of these functions, the second paragraph of section 2 authorizes the Organization Committee to employ counsel, take testimony, and make investigations, and also to supervise the organization of the Reserve Banks. Other references to the Organization Committee appear in the third, fifth, eighth, tenth, and thirteenth paragraphs of section 2 (12 U.S.C. 282), and in the first, second, twelfth, and twenty-third paragraphs of section 4 (12 U.S.C. 302).

The functions of the Reserve Bank Organization Committee were fully discharged shortly after enactment of the Federal Reserve Act, and all references in the law to that Committee are therefore obsolete and should be eliminated.

B. Organizational provisions

[§ 502] (1) The first three paragraphs of section 4 of the Act (not in U. S. Code) relate to the original organization of the

Reserve Banks, including certification by the Comptroller of the Currency as to the geographical limits of Federal Reserve districts and designations of Federal Reserve cities, the execution of an organization certificate by each Reserve Bank, and the filing of the organization certificate in the Office of the Comptroller of the Currency. The provisions of these paragraphs have been executed and, since no new Reserve Banks may be created, these paragraphs are obsolete and should be eliminated.

[§ 502] (2) Elimination of the first three paragraphs would require elimination of the first clause of the fourth paragraph of section 4 (12 U.S.C. 341), which refers to the filing of the organization certificate of each Reserve Bank with the Comptroller of the Currency.

(3) The fifth paragraph of section 4 (12 U.S.C. 341), providing that no Reserve Bank shall transact business except that incidental to its organization until it has been authorized to commence business by the Comptroller of the Currency, is likewise obsolete.

(4) The second and third sentences of the twelfth paragraph of section 4 (12 U.S.C. 302), referring to the original organization of the Reserve Banks and the exercise by the Organization Committee of the duties of the office of chairman pending organization of each Reserve Bank, should also be omitted as obsolete.

[§ 504(f)] (5) The first sentence of the twentieth paragraph of section 4 (12 U.S.C. 305), regarding appointment of class C directors by the Board of Governors, should be omitted since it is a duplication of a similar provision in the first sentence of the twelfth paragraph.

(6) The twenty-third paragraph of section 4, relating to meetings of directors pending the organization of a Reserve Bank, should be omitted as obsolete.

[§ 504(b)] (7) The first sentence of the twenty-fourth paragraph of section 4 (12 U.S.C. 308), relating to the staggered terms of original directors of the Reserve Banks, is no longer of any significance and should be eliminated. However, the concept of staggered terms should be retained by incorporating in the ninth paragraph a clause indicating that the term of one director of each class shall expire at the end of each calendar year.

(8) The second sentence of the twenty-fourth paragraph of section 4 (12 U.S.C. 308), regarding the terms of office of directors, is a duplication of a provision contained in the ninth paragraph and therefore should be omitted.

[§ 504(c)] (9) The third and last sentence of the twenty-fourth paragraph of section 4 (12 U.S.C. 308), regarding the filling of vacancies in the several classes of directors, should be transferred to the ninth paragraph (12 U.S.C. 302), which relates to the composition of the board of directors.

C. Title of Federal Reserve Bank

That part of the last sentence of the second paragraph of section 2 (12 U.S.C. 225) which provides that each Reserve Bank shall include in its title the name of the city in which it is situated is no longer necessary and should be omitted.

D. Effect on status of reserve cities

The second sentence of the thirteenth paragraph of section 2 (12 U.S.C. 224) provides that the organization of reserve districts and Federal Reserve cities shall not be construed as changing "the present status of reserve cities". This provision obviously related to the status of reserve cities at the time of enactment of the original Act and has no significance at the present time. It should therefore be eliminated.

5. STOCK OF RESERVE BANKS

A. Minimum capital

[§ 503] The first sentence of the thirteenth paragraph of section 2 (12 U.S.C. 281) provides that no Reserve Bank shall commence business with a subscribed capital less than $4 million. This was a condition precedent to commencing business and was fully complied with by the Reserve Banks when they were organized. Consequently, there is no need to retain this provision in the law. The Attorney General has specifically held that the provision does not require the specified minimum capital to be preserved when member banks reduce their capital stock or surplus or cease to be members. (30 Op. Atty. Gen. 517 (1916)

B. Stock offered to public and U. S.

[§ 503] The eighth paragraph of section 2 provides that, if subscriptions by banks to Federal Reserve Bank stock are not sufficient, in the judgment of the Organization Committee, to provide the required amount of capital, then Reserve Bank stock may be offered to the public, with a limitation, contained in the ninth paragraph, that no individual, copartnership, or corporation other than a member bank should be permitted to hold more than $25,000 par value of such stock.

The tenth paragraph of section 2 provides that, if stock subscriptions by banks and the public are not sufficient,

in the judgment of the Organization Committee, to provide the required amount of Reserve Bank capital, the Committee shall allot such amount of said stock as it might determine to the United States.

The eleventh and twelfth paragraphs of section 2 (12 U.S.C. 285, 286), relating to voting rights and transfer of stock, refer only to stock held by the public and by the United States. Section 5 of the Act (12 U.S.C. 287) specifically provides that stock owned by member banks "shall not be transferred or hypothecated."

Since the required capital of the Federal Reserve Banks was fully subscribed by banks, it never became necessary to offer stock to the public or to allot stock to the United States. Consequently, the provisions above described are now obsolete and should be omitted.

C. Liability of shareholders

[§ 503] The fourth paragraph of section 2 (12 U.S.C. 502) reads as follows:

> "The shareholders of every Federal reserve bank shall be held individually responsible, equally and ratably, and not one for another, for all contracts, debts, and engagements of such bank to the extent of the amount of their subscriptions to such stock at the par value thereof in addition to the amount subscribed, whether such subscriptions have been paid up in whole or in part, under the provisions of this Act."

A provision regarding "double liability" of shareholders was a common feature of commercial bank stock at the

time of enactment of the original Federal Reserve Act. Section 23 of the Act imposed such liability on shareholders of national banks. However, that section was repealed by Act of September 8, 1959 (73 Stat. 457); and the double liability feature has been eliminated with respect to the stock of most State banks.

As a practical matter, Reserve Bank stock is subject to double liability quite apart from the provision of law above quoted, since member banks have never been required to pay more than one-half of the price of the Reserve Bank stock to which they must subscribe under the law, the remaining one-half being payable on call of the Board if needed.

Elimination of the double liability provision with respect to Reserve Bank stock literally would be a substantive change in the law. However, it seems clear that it would be a change of an inconsequential nature and without any significant effect. Elimination of this provision was recommended by the Board in 1956 in connection with the then-proposed "Financial Institutions Act".

D. Subscriptions to stock

The first seven sentences of section 5 of the Act (12 U.S.C. 287) read as follows:

> "The capital stock of each Federal reserve bank shall be divided into shares of $100 each. The outstanding capital stock shall be increased from time to time as member banks increase their capital stock and surplus or as additional banks become members, and may be decreased as member banks reduce their capital stock or surplus or cease to be members.

> Shares of the capital stock of Federal reserve banks owned by member banks shall not be transferred or hypothecated. When a member bank increases its capital stock or surplus, it shall thereupon subscribe for an additional amount of capital stock of the Federal reserve bank of its district equal to six per centum of the said increase, one-half of said subscription to be paid in the manner hereinbefore provided for original subscription, and one-half subject to call of the Board of Governors of the Federal Reserve System. A bank applying for stock in a Federal reserve bank at any time after the organization thereof must subscribe for an amount of the capital stock of the Federal reserve bank equal to six per centum of the paid-up capital stock and surplus of said applicant bank, paying therefor its par value plus one-half of one per centum a month from the period of the last dividend. When a member bank reduces its capital stock or surplus it shall surrender a proportionate amount of its holdings in the capital stock of said Federal Reserve bank. Any member bank which holds capital stock of a Federal Reserve bank in excess of the amount required on the basis of 6 per centum of its paid-up capital stock and surplus shall surrender such excess stock. . . ."

The fifth paragraph of section 9 of the Act (12 U.S.C. 323) reads as follows:

> "Whenever the Board of Governors of the Federal Reserve System shall permit the applying bank to become a stockholder in the Federal reserve bank of the district its stock subscription shall be payable on call of the Board of Governors of the Federal Reserve System, and stock issued to it shall be held subject to the provisions of this Act."

Section 5 of the Act provides that a bank applying for stock in a Reserve Bank "at any time after the organization thereof" (presumably referring to the organization of the Reserve Bank) shall subscribe to such stock in an amount equal to 6 per cent of the applicant bank's paid-up capital stock and surplus, "paying therefor its par value plus one-half of one per centum a month from the period of the last dividend." This provision seems to

imply that the member bank must pay the full amount of the stock subscribed for. However, other provisions of the Act contemplate that such stock need be only partly paid for at the time of subscription.

The third paragraph of section 2 (12 U.S.C. 282) provides that a national bank shall subscribe to Reserve Bank stock in an amount equal to 6 per cent of the capital stock and surplus of the national bank, with one-sixth to be paid on call of the Board, one-sixth within three months, and one-sixth within six months thereafter, with the remainder of the subscription subject to call by the Board.

The fourth sentence of section 5 of the Act provides that, when a member bank increases its capital stock or surplus, it shall subscribe for an additional amount of Reserve Bank stock equal to 6 per cent of the increase, with one-half paid at the time and the other half subject to call by the Board of Governors.

The fifth paragraph of section 9 of the Act provides that a State member bank's subscription to Reserve Bank stock "shall be payable on call of the Board of Governors", thus suggesting that the Board may require cash payment of only part, in fact even less than half, of the amount subscribed.

Despite these inconsistent provisions, the Board's Regulations H and I, relating to membership in the System and to the issue and cancellation of Reserve Bank stock, have

always provided that a bank becoming a member of the System, both State and national, shall pay to the Reserve Bank one-half of the amount of the subscription, with the remaining half subject to call when deemed necessary by the Board. Thus, the regulations have in effect followed the manner of subscription described in the fourth sentence of section 5 of the Act relating to subscriptions to additional Reserve Bank stock upon the increase of the capital stock or surplus of a member bank.

The law should be amended to include a single provision regarding subscriptions to Reserve Bank stock that would be in [§ 503(b)] accordance with the practice, followed for many years, as set forth in the Board's regulations. At the same time, all other provisions of the Act relating to this subject should be omitted.

E. Effect of reduction of member banks' capital stock or surplus

The second sentence of section 5 of the Act provides that the stock of a Reserve Bank shall be increased as member banks increase their capital stock and surplus or as additional banks become members and that such stock "may" be decreased as member banks reduce their capital stock or surplus or cease to be members. Subsequently, in the same section, however, it is provided that when a member bank reduces its capital stock or surplus, it "shall" surrender a proportionate amount of its hold- [§ 503(c)] ings of Reserve Bank stock. This inconsistency should be corrected so as to make it clear that a member bank must reduce its holdings of Reserve Bank stock when it reduces its own capital stock or surplus.

F. Cancellation of stock

The provisions of sections 5 and 6 of the Act, as well as section 9, regarding the procedure to be followed upon the cancellation of Reserve Bank stock are inconsistent in a number of respects.

With respect to cancellation of Reserve Bank stock upon the voluntary liquidation of any member bank, the last two sentences of section 5 (12 U.S.C. 287) provide as follows:

> "When a member bank voluntarily liquidates it shall surrender all of its holdings of the capital stock of said Federal Reserve bank and be released from its stock subscription not previously called. In any such case the shares surrendered shall be canceled and the member bank shall receive in payment therefor, under regulations to be prescribed by the Board of Governors of the Federal Reserve System, a sum equal to its cash-paid subscriptions on the shares surrendered and one-half of 1 per centum a month from the period of the last dividend, not to exceed the book value thereof, less any liability of such member bank to the Federal Reserve bank."

With respect to cancellation of Reserve Bank stock in the event of insolvency of any member bank, the first paragraph of section 6 (12 U.S.C. 288) provides:

> "If any member bank shall be declared insolvent and a receiver appointed therefor, the stock held by it in said Federal reserve bank shall be canceled, without impairment of its liability, and all cash-paid subscriptions on said stock, with one-half of 1 per centum per month from the period of last dividend, if earned, not to exceed the book value, thereof, shall be first applied to all debts of the insolvent member bank to the Federal reserve bank, and the balance, if any, shall be paid to the receiver of the insolvent bank."

With respect to the effect of discontinuance of banking operations by a national bank, the second paragraph of section 6 (12 U.S.C. 288) provides:

> "If any national bank which has not gone into liquidation as provided in section 5220 of the Revised Statutes (United States Code, title 12, section 181) and for which a receiver has not already been appointed for other lawful cause, shall discontinue its banking operations for a period of sixty days the Comptroller of the Currency may, if he deems it advisable, appoint a receiver for such bank. The stock held by the said national bank in the Federal reserve bank of its district shall thereupon be canceled and said national bank shall receive in payment therefor, under regulations to be prescribed by the Board of Governors of the Federal Reserve System, a sum equal to its cash-paid subscriptions on the shares canceled and one-half of 1 per centum a month from the period of the last dividend, if earned, not to exceed the book value thereof, less any liability of such national bank to the Federal reserve bank."

With respect to the effect of termination of membership of a State member bank, whether by order of the Board or voluntarily, the last sentence of the tenth paragraph of section 9 (12 U.S.C. 328) provides:

> "Whenever a member bank shall surrender its stock holdings in a Federal reserve bank, or shall be ordered to do so by the Board of Governors of the Federal Reserve System, under authority of law, all of its rights and privileges as a member bank shall thereupon cease and determine, and after due provision has been made for any indebtedness due or to become due to the Federal reserve bank it shall be entitled to a refund of its cash paid subscription with interest at the rate of one-half of one per centum per month from date of last dividend, if earned, the amount refunded in no event to exceed the book value of the stock at that time, and shall likewise be entitled to repayment of deposits and of any other balance due from the Federal reserve bank."

Obviously, there are several inconsistencies among these provisions regarding cancellation of stock. For example, in the case of insolvency of a member bank, discontinuance of banking operations by a national bank, and termination of membership of a State member bank, the relevant provisions refer to payment of interest from the date of the last dividend, "if earned". However, in the case of voluntary liquidation of a member bank, the words "if earned" are not used. In the case of voluntary liquidation, deduction is required to be made for "any liability of such member bank to the Federal Reserve bank"; in the case of insolvency of a member bank, the amount of cash-paid subscriptions to stock is required to be "first applied to all debts of the insolvent member bank to the Federal reserve bank"; in the case of a national bank discontinuing operations, deduction must be made for "any liability of such national bank to the Federal reserve bank"; and, in the case of termination of membership of a State member bank, it is provided that payment to such bank shall be made "after due provision has been made for any indebtedness due or to become due to the Federal reserve bank" and, in addition, that the member bank shall "be entitled to repayment of deposits and of any other balance due from the Federal reserve bank." Only in the last-mentioned instance, termination of membership, is there any provision in the law for repayment to the member bank of its deposits with the Reserve Bank.

Despite these discrepancies in provisions of the law regarding cancellation of Reserve Bank stock, the Board's Regulation I, "Issue and Cancellation of Capital Stock of Federal Reserve Banks", provides that, in all cases in which a bank ceases to be a member of the System, -

> ". . . the Federal Reserve Bank . . . will adjust accounts by applying to any indebtedness of the . . . bank to such Federal Reserve Bank all cash paid subscriptions made on the stock canceled plus one-half of one per cent a month from the period of the last dividend, not to exceed the book value thereof, and the remainder, if any, will be paid to the . . . [member] bank." (Reg. I, sec. 209.5(b))

It is recommended that a provision be included in the law that would generally follow the provision above quoted from [§ 503(d)] Regulation I, to be applicable in all cases of cessation of membership, and that all other provisions of the Act regarding the procedure to be followed upon cancellation of Reserve Bank stock be repealed.

G. Appointment of national bank receiver by Comptroller of the Currency

The first sentence of the second paragraph of section 6 (12 U.S.C. 288) provides that, if a national bank that has not gone into liquidation and for which a receiver has not been appointed for other cause shall discontinue its banking operations [Sec. 5] for a period of 60 days, the Comptroller of the Currency may appoint a receiver for such bank. This provision seems out of place in a section of the Federal Reserve Act relating primarily

to cancellation of Reserve Bank stock. It more appropriately belongs in section 191 of Title 12 of the U. S. Code relating to the general grounds for the appointment of receivers for national banks.

It is recommended, therefore, that the first sentence of the second paragraph of section 6 of the Federal Reserve Act be omitted and that section 191 of Title 12 of the U. S. Code be amended to make discontinuance of banking operations for a period of 60 days an additional ground for the appointment by the Comptroller of a receiver for a national bank.

6. FORFEITURE OF FRANCHISE OF RESERVE BANK

Subparagraph "Second" of the fourth paragraph of section 4 of the Act (12 U.S.C. 341) provides that each Reserve Bank shall have power "To have succession after the approval of this Act until dissolved by Act of Congress or until forfeiture of franchise for violation of law."

Insofar as this language appears to provide for succession after approval of the Federal Reserve Act, it is obviously incorrect since, under the original provisions of the Act, each Reserve Bank was not organized and did not become a corporate entity until several months after approval of the Act. Actually, the original Act provided only that each Reserve Bank should have succession for a period of 20 years from its organization. The present language resulted from an amendment made by Act of February 25, 1927. Apparently, therefore, the words "after the approval of this Act" refer to the 1927 amendment. [§ 502(b)] In any event, these words no longer appear necessary and should be omitted.

The reference to possible forfeiture of franchise for violation of law might be regarded as unrealistic and unnecessary. Actually, there is no provision in the Act expressly providing for the forfeiture of the franchise of a Reserve Bank for violation of law. Section 11(h) (12 U.S.C. 248(h)) authorizes the Board of Governors to <u>suspend</u> the operations of a Reserve Bank for violation of any provisions of the Act or "when deemed advisable, to liquidate or reorganize such bank."

7. REFERENCE TO EXECUTIVE OFFICERS OF FEDERAL RESERVE BANKS

The first sentence of subparagraph "Fifth" of the fourth paragraph of section 4 of the Act (12 U.S.C. 341) authorizes the board of directors of a Reserve Bank to appoint a president, vice presidents, and "such officers and employees" as are not otherwise provided for in the Act. The succeeding sentence states that the president shall be the chief executive officer of the Bank and that "all other executive officers" and all employees shall be directly responsible to him.

The use of the word "executive" in the last-mentioned provision could give the misleading impression that only the top officers, and not all officers, are responsible to the president of the Bank. It would be desirable to eliminate the modifying word "executive" in this provision.

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8. FEDERAL RESERVE BANK NOTES

Subparagraph "Eighth" of the fourth paragraph of section 4 (12 U.S.C. 341), relating to the issuance of circulating notes by the Reserve Banks, is obsolete and should be omitted. (See Recommendation No. 63, regarding omission of section 18 of the Act.)

9. DIRECTORS OF RESERVE BANKS

*A. Rotation of terms

The ninth paragraph of section 4 of the Federal Reserve Act (12 U.S.C. 302) provides that directors of the Federal Reserve Banks shall serve as such for terms of three years. There is no prohibition against the number of terms that a director may serve.

In connection with the appointment of class C directors, the Board of Governors, as a matter of policy, does not reappoint any such director who has served two full terms of three years, except that, if a director who has served more than three years as a class A, B, or C director is then designated by the Board of Governors as chairman of the board of directors, he is permitted to serve not to exceed one full three-year term as chairman for a total of not to exceed three full terms as a director.

Some degree of rotation in the terms of class A and class B directors, as well as those of class C directors, would be desirable in order to obtain the advantages of broader representation and wider experience over a period of time on the boards of directors of the Reserve Banks. At the same time, the length of service permitted for directors should be adequate to assure for the System and the public interest the benefits of suitable continuity of policy and acquired experience.

To accomplish these objectives, the law should be amended [§ 504(b)] so as to prohibit any director from serving more than two full

consecutive terms of three years each, except after an intervening period of not less than three years, and except that a director designated as chairman of the board of directors should be permitted to serve three full consecutive three-year terms without such an intervening period. Such changes in law were recommended by the Board in 1956 in connection with the then proposed "Financial Institutions Act".

B. Election

The seventeenth paragraph of section 4 of the Act (12 U.S.C. 304), relating to elections of class A and class B directors of the Reserve Banks, requires that an officer of a [§ 504(i)(2)] member bank "shall make a cross" opposite the name of first, second, and other choices. Instead of this arbitrary requirement, provision should be made for designation of such choices by a cross "or other mark".

*C. Residence

The twentieth paragraph of section 4 of the Act (12 U.S.C. 305) provides that class C directors "shall have been for at least two years residents of the district for which they are appointed". It is not clear whether this means that a class C director must have been a resident of the district for at least two years immediately preceding his appointment as a director. The provision may be, and has been, construed as permitting the appointment of a class C director who was not a resident of the district for the two years immediately preceding

his appointment but who had resided at some time in the past for at least two years within the district.

The law contains no requirement with respect to residence of class A and class B directors. Class A directors are required to be "chosen by and be representative of the stock-holding banks" and class B directors are required at the time of their election to be actively engaged "in their district" in commerce, agriculture, or some other industrial pursuit. Consequently, it appears to be contemplated that both class A and class B directors shall be residents of the district of the Reserve Bank for which they are elected, not only at the time of their appointment but also throughout their terms of office. Strictly speaking, however, there is nothing in the law that requires class A and class B directors to be residents of the district when they are elected or to continue as residents during their terms of office.

It is questionable whether there is any sound reason for requiring class C directors to have been residents of the district for two years prior to their appointment, and it is recommended that this requirement be eliminated. On the other [§ 504(h)] hand, the law should provide that all Reserve Bank directors shall be residents of the district at the time of their appointment or election and that they shall cease to be directors if they cease to be residents of the district.

10. FEDERAL RESERVE AGENTS AND ASSISTANT AGENTS

A. As "official representative" of the Board

The twentieth paragraph of section 4 of the Act (12 U.S.C. 305) provides that the chairman of the board of directors of a Reserve Bank shall also be designated as Federal Reserve agent and that he "shall be required to maintain, under regulations to be established by the Board of Governors of the Federal Reserve System, a local office of said board on the premises of the Federal reserve bank". It further provides that the agent "shall make regular reports to the Board of Governors of the Federal Reserve System and shall act as its official representative for the performance of the functions conferred upon it by this Act".

The Banking Act of 1935 amended the fourth paragraph of section 4 of the Federal Reserve Act (12 U.S.C. 341) to provide that the president of each Reserve Bank "shall be the chief executive officer of the bank". In the light of this change in the law, the Board of Governors in March 1936 transferred the nonstatutory duties previously performed by the Federal Reserve agent to the president of the Reserve Bank. The Board pointed out that this would mean that the technical duties of the office of the Federal Reserve agent could then "be performed by an Assistant Federal Reserve agent, making it possible for the chairman to discharge the important responsibilities of his

office without being required to devote more than a limited portion of his time to the bank." (1936 F.R. Bulletin, p. 145)

Since 1936, the Federal Reserve agent has not acted as the "official representative" of the Board of Governors in the performance of the Board's functions under the law. In actuality, the agent acts as the representative of the Board only in connection with the issuance of Federal Reserve notes under section 16 of the Act. The agent has no other specific statutory functions under the law.[1/]

[§ 505(a)] In order to bring the law into conformity with practice, the twentieth paragraph of section 4 of the Federal Reserve Act should be changed to provide simply that the Federal Reserve agent "shall act as the official representative of the Board of Governors in the performance of the functions conferred upon such agent by statute and shall make regular reports to the Board of Governors with respect to the performance of such functions".

1/ Under section 30 of the Banking Act of 1933, with respect to proceedings for the removal of directors and officers of member banks, the Federal Reserve agent is specifically required to issue a "warning" to any State member bank to discontinue any violations of law or unsafe or unsound practices. However, that section was repealed by the Financial Institutions Supervisory Act of October 16, 1966, for a period terminating on June 30, 1972. If that Act should be allowed to terminate on that date, section 30 of the Banking Act of 1933 would again become effective.

In addition, the requirement that the chairman of the board of directors of a Reserve Bank, acting also as Federal Reserve agent, must maintain a local office of the Board of Governors on the premises of the Reserve Bank is unnecessary and should be omitted.

B. Qualifications

The twentieth paragraph of section 4 of the Act (12 U.S.C. 305) requires that the class C director designated by the Board of Governors as chairman of the board of directors of a Reserve Bank and as Federal Reserve agent "shall be a person of tested banking experience". The twenty-first paragraph (12 U.S.C. 306) similarly requires that assistant Federal Reserve agents "shall be persons of tested banking experience".

The duties of the Federal Reserve agent under present law relate primarily to the issuance and retirement of Federal Reserve notes and the holding and releasing of collateral therefor. Such duties are largely of an administrative character and are not such as to require "tested banking experience". The requirement for such experience adds to the difficulty of finding qualified men to serve as chairmen of the boards of directors of the Reserve Banks.

Accordingly, it is believed that this requirement should be eliminated from the law, leaving to the discretion of the Board of Governors the determination whether a person

[§ 505(a)]

to be appointed as Federal Reserve agent or assistant Federal Reserve agent is properly qualified for the position.

C. Compensation

The twentieth paragraph of section 4 of the Act (12 U.S.C. 305) provides that the Federal Reserve agent "shall receive an annual compensation to be fixed by the Board of Governors of the Federal Reserve System and paid monthly by the Federal reserve bank to which he is designated." For many years, the duties of the Federal Reserve agent, who is also chairman of the board of directors of the Reserve Bank, have not required the full time of such person, and, as a matter of practice, the Board of Governors has fixed the compensation of the Federal Reserve agent simply as the equivalent of fees paid to other Reserve Bank directors in connection with their attendance at meetings of the board of directors. Consequently, the provision for the fixing of the annual compensation of the Federal Reserve agent is no longer significant and should be omitted.

Similarly, the twenty-first paragraph of section 4 of the Act (12 U.S.C. 306) provides that assistants to the Federal Reserve agent "shall receive an annual compensation, to be fixed and paid in the same manner as that of the Federal reserve agent." The status of assistant Federal Reserve agents is somewhat different from that of the Federal Reserve agent since the assistants actually are employed on a full-time basis by the Reserve Bank

to which they are attached. Consequently, provision for compensation of the assistants is appropriate. However, if the provision [§ 505(c)] for compensation of the Federal Reserve agents is eliminated as above recommended, the provision with respect to compensation of assistant agents should be changed to require such compensation to be fixed by the Board of Governors and paid monthly by the Reserve Bank to which the assistants are attached.

D. Service of assistant during vacancy

The twenty-first paragraph of section 4 of the Act (12 U.S.C. 306) provides that assistant Federal Reserve agents [§ 505(b)] shall have power to act for the Federal Reserve agent "during his absence or disability". It should be made clear that an assistant Federal Reserve agent is also authorized to act as Federal Reserve agent in the event of a vacancy in that office.

E. Delegation of functions

The Federal Reserve agent is also chairman of the board of directors of the Reserve Bank and, in the latter capacity, must devote most of his attention to important matters of policy. His duties as Federal Reserve agent are largely of a ministerial nature and, as a matter of practice, many of such functions are delegated to his assistants. However, it would [§ 505(b)] be desirable to make it clear in the law that such ministerial functions of the agent may be delegated to the assistant Federal Reserve agent.

11. "AGENCIES" OF FEDERAL RESERVE BANKS

Section 3 of the Act (12 U.S.C. 521) expressly authorizes the establishment of branches by the Reserve Banks, with the permission of the Board and subject to certain requirements regarding the number of directors of each branch.

On several occasions in the past, it has been found desirable for some Reserve Banks to establish currency depots or other offices for strictly limited functions. Such offices have not been regarded as "branches" subject to the provisions of section 3; the authority for establishment of such offices has been based on the implied powers of the Reserve Banks.

It may become desirable in the future for the Reserve Banks to establish offices solely for the purpose of providing regional check-clearing arrangements; and it is believed that such offices likewise would be permissible under the implied powers of the Reserve Banks. However, in order to avoid any [§ 509(d)] question, section 3 should include a provision specifically authorizing the establishment of limited-function offices without regard to the requirements applicable to branches.

12. RESERVE BANK EARNINGS

The first two paragraphs of section 7 of the Federal Reserve Act (12 U.S.C. 289, 290) read as follows:

> "After all necessary expenses of a Federal reserve bank shall have been paid or provided for, the stockholders shall be entitled to receive an annual dividend of 6 per centum on the paid-in capital stock, which dividend shall be cumulative. After the aforesaid dividend claims have been fully met, the net earnings shall be paid into the surplus fund of the Federal reserve bank.
>
> "The net earnings derived by the United States from Federal reserve banks shall, in the discretion of the Secretary, be used to supplement the gold reserve held against outstanding United States notes, or shall be applied to the reduction of the outstanding bonded indebtedness of the United States under regulations to be prescribed by the Secretary of the Treasury. Should a Federal reserve bank be dissolved or go into liquidation, any surplus remaining, after the payment of all debts, dividend requirements as hereinbefore provided, and the par value of the stock, shall be paid to and become the property of the United States and shall be similarly applied."

*A. Payment to Treasury

Prior to 1933, section 7 of the Act imposed a franchise tax on the Reserve Banks which in effect required them to pay to the United States annually an amount equal to 90 per cent of their net earnings after accumulation of surplus equal to subscribed capital. This provision was repealed by the Banking Act of 1933, when the Reserve Banks were required to subscribe to the capital stock of the Federal Deposit Insurance Corporation and the surplus of the Reserve Banks was thereby reduced to considerably less than half of their subscribed capital.

In 1947, when the accumulated earnings of the Reserve Banks had reached a high figure, the Board considered it appropriate to accomplish much the same result as a franchise tax by invoking a provision of section 16 of the Act (12 U.S.C. 414) that authorizes the Board to establish rates of interest to be paid by the Reserve Banks on outstanding Federal Reserve notes not covered by gold certificate collateral. The Board established a rate that resulted in the annual transfer to the Treasury of approximately 90 per cent of the earnings of the Reserve Banks after dividends and expenses and maintenance of the surplus of each Reserve Bank at 100 per cent of its subscribed capital. The formula has twice been modified by the Board and at present the rate established by the Board results in payment to the Treasury of all earnings of the Reserve Banks after dividends and expenses and maintenance of surplus at an amount equal to paid-in capital.

Although the utilization of the section 16 provision as authority for requiring the Reserve Banks to pay their net earnings to the Treasury in this manner is believed to be clearly authorized by the law, the procedure followed is at least awkward and extremely complicated and cumbersome.

When the "Financial Institutions Act" was under consideration in 1956, the Board recommended that section 7 of the Federal Reserve Act be amended either (1) to provide expressly for restoration of a 90 per cent franchise tax or (2) to authorize

the Board to require the Reserve Banks to transfer annually to the United States such portion of their earnings as the Board may deem appropriate in the circumstances.

It is believed that it would be desirable to amend the law along the lines of the second alternative proposed by the [§ 510(a)] Board in 1956, i.e., to authorize the Board in its discretion to require the Reserve Banks to make annual payments to the Treasury of such portion of their net earnings as the Board deems appropriate.

If such a change in the law should be adopted, the provision of section 16 of the Act regarding interest payments on Federal Reserve notes would no longer serve any useful purpose and should be omitted from the statute. (See Recommendation No. 60-E.)

B. Use by Treasury of funds received from Reserve Banks

The first sentence of the second paragraph of section 7 of the Act (12 U.S.C. 290) provides:

> "The net earnings derived by the United States from Federal reserve banks shall, in the discretion of the Secretary, be used to supplement the gold reserve held against outstanding United States notes, or shall be applied to the reduction of the outstanding bonded indebtedness of the United States under regulations to be prescribed by the Secretary of the Treasury."

In the original Act, this sentence immediately followed a provision that in effect required payment of a portion of the net earnings of the Reserve Banks to the Treasury as a franchise

tax. Presumably, the sentence above quoted regarding the use of net earnings derived by the United States from the Reserve Banks had reference to the earnings received by virtue of such franchise tax. However, the franchise tax provision was repealed in 1933, and there is now no provision of law expressly providing for payment of net earnings of the Reserve Banks to the United States. Since no Reserve Bank stock was ever allotted to the United States, no earnings in the form of dividends are received by the United States. So-called payments of "net earnings" paid to the Treasury as interest on Federal Reserve notes actually represent an expense of the Reserve Banks rather than payments of net earnings.

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Even if section 7 of the Act should be amended to provide for restoration of a franchise tax or to authorize the Board to require the Reserve Banks to pay a portion of their net earnings to the United States (as suggested in Recommendation No. 12-A), it is believed that the quoted sentence would be unnecessary. To the extent that the sentence provides for the use by the United States of net earnings derived from the Reserve Banks in order "to supplement the gold reserve held against outstanding United States notes", it no longer has any significance, since the requirement for the maintenance of gold reserves against such notes was repealed by the Act of March 18, 1968.

The remainder of the quoted sentence, regarding application of Reserve Bank earnings received by the United States to the reduction of the outstanding bonded indebtedness of the United States, is likewise unnecessary, since any practical effect that this provision might once have had on the use of funds by the Treasury appears to have been superseded by general statutes governing the administration of the public debt.

For the reasons indicated, it is believed that the first sentence of the second paragraph of section 7 should be deleted from the statute. If this is done, a change would be necessary in the second sentence of that paragraph, since it provides that,

[§ 510(b)] upon dissolution or liquidation of a Reserve Bank, any remaining surplus shall be paid to the United States and "shall be similarly applied."

13. TAXATION OF RESERVE BANKS

*A. Dividends on stock

The third paragraph of section 7 of the Act (12 U.S.C. 531) reads as follows:

> "Federal reserve banks, including the capital stock and surplus therein, and the income derived therefrom shall be exempt from Federal, State, and local taxation, except taxes upon real estate."

The Public Debt Act of March 28, 1942, provided that interest on obligations, and dividends, earnings, or other income from stock, issued on or after the effective date of that Act by any agency or instrumentality of the United States should not have any exemption from taxation, as such. The effect of this Act was to remove the exemption with respect to dividends on Reserve Bank stock issued after March 28, 1942, but to leave the exemption in effect with respect to dividends on such stock issued before that date.

In 1952, the Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report, of which Representative Patman was Chairman, recommended that the exemption of dividends on Reserve Bank stock from Federal taxation be removed entirely. In 1956, in connection with the then-pending "Financial Institutions Act", the Board of Governors likewise recommended that dividends on Reserve Bank stock, whether issued before or after 1942, should not enjoy an exemption from Federal taxation.

As pointed out by the Board in 1956, the present law results in a differentiation between banks admitted to membership after 1942 and those admitted previously. It also results in a differentiation between stock issued before and after that date in the case of banks that became members before 1942. Thus, the present law results in a certain inequity among member banks, depending upon when they became members of the System, and in a confusing and complicating situation with respect to banks that became members before 1942. While the change literally would be
[§ 514] of a substantive nature, it is recommended that the law be amended to provide that dividends on Reserve Bank stock, whether issued before or after 1942, shall not be exempt from Federal taxation.

B. Social security and unemployment compensation taxes

Although the third paragraph of section 7 of the Federal Reserve Act provides that the Reserve Banks shall be exempt from Federal taxation, they are clearly made subject to taxes imposed to finance operations under the Federal Social Security Act (42 U.S.C. chapter 7, subchapter II) and the Federal Unemployment Compensation Act (5 U.S.C. chapter 85). These taxes are imposed by chapters 21 and 23 of the Internal Revenue Code (26 U.S.C.), which are known, respectively, as the Federal Insurance Contributions Act and the Federal Unemployment Tax Act.

In order to clarify the tax status of the Reserve Banks, therefore, the third paragraph of section 7 of the Federal Reserve
[§ 514] Act should specifically indicate that the Reserve Banks are not exempt from taxation under the Acts just mentioned.

14. MEMBERSHIP OF STATE BANKS

The first two sentences and the last sentence of the first paragraph of section 9 of the Federal Reserve Act (12 U.S.C. 321) read as follows:

> "Any bank incorporated by special law of any State, or organized under the general laws of any State or of the United States, including Morris Plan banks and other incorporated banking institutions engaged in similar business, desiring to become a member of the Federal Reserve System, may make application to the Board of Governors of the Federal reserve system, under such rules and regulations as it may prescribe, for the right to subscribe to the stock of the Federal reserve bank organized within the district in which the applying bank is located. Such application shall be for the same amount of stock that the applying bank would be required to subscribe to as a national bank. . . . The Board of Governors of the Federal Reserve System, subject to the provisions of this Act and to such conditions as it may prescribe pursuant thereto may permit the applying bank to become a stockholder of such Federal reserve bank."

A. References to "membership"

The first sentence of the first paragraph of section 9, above quoted, provides in effect that a State bank "desiring to become a member of the Federal Reserve System" may make application for the right to subscribe to the stock of the Reserve Bank of its district, thus implying that such a bank becomes a member of the System by subscribing to the Reserve Bank's stock. However, there is a discrepancy among various provisions of the Act in describing membership in the System. For example, section 1 (12 U.S.C. 221) refers to a State bank becoming "a member of one of the reserve banks"; section 2 (12 U.S.C. 222) refers to

application by a national bank to "become a member bank of the Federal Reserve System by subscribing and paying for" Reserve Bank stock; and section 19(h) (12 U.S.C. 466) refers to banks becoming member banks "of the reserve districts". It would seem
[§ 801(a)] desirable in all cases to refer to "membership in the Federal Reserve System" and specifically, in the first sentence of section 9 above quoted, to refer to applications for membership rather than applications for the right to subscribe to Reserve Bank stock, even though membership is effected by payment for such stock.

The last sentence of the first paragraph of section 9, as above quoted, should be changed in conformity with the above suggestion to refer to approval by the Board of an application for membership, instead of an application to become a stockholder
[§ 801(a)] of the Reserve Bank; but it might be expanded to provide that, upon approval of the application, the bank shall subscribe to and pay for stock of the Reserve Bank in the manner and amount prescribed by section 5 of the Act.

B. Banks covered by section 9

The first sentence of the first paragraph of section 9, as above quoted, refers to any bank "incorporated by special law of any State, or organized under the general laws of any State or of the United States". Few, if any, banks today are incorporated by "special" laws of the States. Moreover, the reference to banks organized under the general laws "of the United States"

appears to have no relevance. National banks in States of the Union are required by section 2 of the Act to become members of the System and are therefore not covered by the provisions of section 9 regarding voluntary membership. Conceivably, the phrase could be regarded as including national banks located in dependencies or insular possessions of the United States. However, such banks are specifically authorized by section 19(h) of the Act either to remain nonmember banks or to become members of the System; and, if any such national bank should apply for membership, it would not be appropriate to make it subject to all of the restrictions that apply to State banks that become members under section 9. For example, that section makes a reduction of capital by a State member bank subject to the Board's approval; but reduction of capital by a national bank is subject to approval by the Comptroller of the Currency and other Federal statutes.

The first sentence of section 9 does not refer to banks organized under the laws of the District of Columbia. However,
[§ 801(a)] the term "State bank", as suggested heretofore under Recommendation 1-C, should be defined as including any bank organized under the laws of the District of Columbia.

For the reasons above stated, it is believed that the first clause of the first sentence of section 9 should be changed
[§ 801(a)] to refer simply to "any incorporated State bank".

C. Amount of stock subscription

[§ 801(a)] The second sentence of the first paragraph of section 9 of the Act, as above quoted, is unnecessary since section 5 of the Act (12 U.S.C. 287) prescribes the amount of stock of a Federal Reserve Bank that must be subscribed to by any member bank, whether national or State. Accordingly, this sentence should be omitted. (See Recommendation No. 5-D.)

15. MEMBERSHIP OF BANKS IN DEPENDENCIES AND INSULAR POSSESSIONS

Section 19(h) of the Act (12 U.S.C. 466) reads as follows:

> "National banks, or banks organized under local laws, located in a dependency or insular possession or any part of the United States outside the continental United States may remain nonmember banks, and shall in that event maintain reserves and comply with all the conditions now provided by law regulating them; or said banks may, with the consent of the Board of Governors of the Federal Reserve System, become member banks of any one of the reserve districts, and shall in that event take stock, maintain reserves, and be subject to all the other provisions of this Act."

A. Arrangement

This paragraph logically should not be in section 19, which relates principally to reserves of member banks and payment [§ 801(b)] of interest on deposits. It belongs with provisions of the Act, now in section 9, relating to voluntary membership in the Federal Reserve System.

B. National banks

If, as a matter of policy, membership of national banks in dependencies and insular possessions should continue to be on a voluntary basis, it should be made clear that any such bank that joins the System will be subject to provisions of the Act that apply to all member banks but not to those that apply specifically to State member banks. As heretofore noted, application to such national banks of the restrictions on State member [§ 801(b)] banks set forth in section 9 would result in duplication of

authority between the Board and the Comptroller of the Currency. This point is not clear under the present language of section 19(h), since it would seem to make any such national bank subject to all of the provisions of the Act.

C. Banks organized under local law

Conversely, it should be made clear that banks organized under local laws of dependencies and insular possessions, if they [§ 801(b)] elect to join the System, will be subject to the same restrictions as those applicable to State member banks, as well as those applicable to all member banks.

D. Determination of Federal Reserve district

The Federal Reserve districts do not embrace dependencies [§ 801(b)] and insular possessions. For this reason, section 19(h) provides that banks in such areas may, with the Board's consent, become "member banks of any one of the reserve districts". It should be made clear that the election rests not with the bank but with the Board of Governors.

E. Outside "continental" United States

Section 19(h) permits national banks located in "any part of the United States outside the continental United States" to remain nonmembers or voluntarily to join the System. Since Hawaii is not a part of the continental United States, this provision is obviously in conflict with the provision of section 2, as amended in 1958 and 1959, that requires every national bank

in any State to be a member of the System. Accordingly, the reference to parts of the United States outside the continental

[§ 801(b)] United States should be eliminated.

F. Inclusion of reference to Puerto Rico

For reasons set forth under Recommendation No. 72-F,

[§ 801(b)] specific reference to Puerto Rico should be inserted before the words "any dependency or insular possession".

16. REFERENCES TO CAPITAL NOTES AND DEBENTURES ELIGIBLE FOR PURCHASE BY RECONSTRUCTION FINANCE CORPORATION

The third sentence of the first paragraph of section 9 of the Act (12 U.S.C. 321) provides that, for purposes of membership of a State bank, "the terms 'capital' and 'capital stock' shall include the amount of outstanding capital notes and debentures legally issued by the applying bank and purchased by the Reconstruction Finance Corporation."

Section 345 of the Banking Act of 1935 (12 U.S.C. 51b-1), relating to impairment of capital of national banks and State member banks, contains the following sentence:

> "If any such bank or trust company shall have outstanding any capital notes or debentures of the type which the Reconstruction Finance Corporation is authorized to purchase pursuant to the provisions of section 304 of the Emergency Banking and Bank Conservation Act, approved March 9, 1933, as amended, the capital of such bank may be deemed to be unimpaired if the sound value of its assets is not less than its total liabilities, including capital stock; but excluding such capital notes or debentures and any obligations of the bank expressly subordinated thereto."

The Reconstruction Finance Corporation has been liquidated and few, if any, of the capital notes or debentures purchased by it from banks are now outstanding. Consequently, it is believed that, as recommended by the Board in 1956, in connection with the proposed "Financial Institutions Act", the above provisions should be eliminated from the law as obsolete. Moreover, as pointed out by the Board in 1956, "the reasons for which the purchase of such

[Sec. 9]
[§ 801(a)]

notes and debentures was authorized in the 1930's and for which they were allowed to be considered as part of a bank's capital have ceased to exist, and consequently the provisions of the statutes quoted above no longer have any real significance."

17. BRANCHES OF STATE MEMBER BANKS

The third paragraph of section 9 of the Act (12 U.S.C. 321) reads as follows:

> "Any such State bank which, at the date of the approval of this Act, has established and is operating a branch or branches in conformity with the State law, may retain and operate the same while remaining or upon becoming a stockholder of such Federal reserve bank; but no such State bank may retain or acquire stock in a Federal reserve bank except upon relinquishment of any branch or branches established after the date of the approval of this Act beyond the limits of the city, town, or village in which the parent bank is situated. Provided, however, That nothing herein contained shall prevent any State member bank from establishing and operating branches in the United States or any dependency or insular possession thereof or in any foreign country, on the same terms and conditions and subject to the same limitations and restrictions as are applicable to the establishment of branches by national banks except that the approval of the Board of Governors of the Federal Reserve System, instead of the Comptroller of the Currency, shall be obtained before any State member bank may hereafter establish any branch and before any State bank hereafter admitted to membership may retain any branch established after February 25, 1927, beyond the limits of the city, town, or village in which the parent bank is situated. The approval of the Board shall likewise be obtained before any State member bank may establish any new branch within the limits of any such city, town, or village (except within the District of Columbia)."

A. Clarification of language

(1) This paragraph, which was added by the so-called "McFadden Act" of 1927 and amended in 1933, 1935, and 1952, is not only complicated and difficult to read but contains certain [§ 804(a)] language that may reasonably be regarded as obsolete. It should be revised to state plainly that a State member bank may not

establish and operate domestic branches, wherever situated, i.e., in-town or out-of-town, except on the same terms and subject to the same limitations as branches may be established by national banks, except that the approval of the Board rather than the Comptroller of the Currency would be required. The present paragraph requires approval of the Board not only for the establishment of branches but also for the retention of any out-of-town branch established after February 25, 1927, in the case of a State bank being admitted to membership. This requirement probably could be omitted without any significant substantive change in present law; but its omission would theoretically give State member banks an advantage over national banks unless a similar change is made in section 5155 of the Revised Statutes (12 U.S.C. 36), which now requires the Comptroller's approval for the retention of branches established after 1927 by a national bank resulting from a conversion or consolidation.

(2) The third paragraph of section 9 refers to the establishment of foreign as well as domestic branches; and the Board's Regulation M expressly states in a footnote that the provisions of that Regulation relating to foreign branches of national banks apply also to State member banks. However, it would be in the interest of clarity to rephrase the third paragraph of sec-

[§ 804(a)] tion 9 so as to provide expressly that no State member bank may establish a branch in a foreign country or dependency or insular possession of the United States except in accordance with the

provisions of section 25 of the Federal Reserve Act. (It might be urged that section 25 of the Act should itself be amended to make it applicable to all member banks rather than only national banks. However, this would not be appropriate since section 25 not only provides limitations with respect to the establishment and operation of foreign branches but constitutes the basic authorization for the establishment of such branches by national banks.)

B. Factors to be considered

The fourth paragraph of section 9 of the Act (12 U.S.C. 322) reads as follows:

> "In acting upon such applications the Board of Governors of the Federal Reserve System shall consider the financial condition of the applying bank, the general character of its management, and whether or not the corporate powers exercised are consistent with the purposes of this Act."

This paragraph was added by the Act of June 21, 1917, immediately after the first paragraph of section 9, relating to applications by State banks for membership in the System. In 1927, the present third paragraph of section 9, relating to branches of State member banks, was inserted between the former first and second paragraphs. In 1950, the present second paragraph of section 9, relating to the continued membership of member banks following a marger or consolidation, was inserted immediately after the first paragraph of the section.

Although the present fourth paragraph, setting forth the factors to be considered by the Board in acting "upon such applications", is now usually regarded as referring to branch applications, it is clear that the paragraph was intended to relate only to applications for membership.

The Federal Deposit Insurance Act (12 U.S.C. 1816) requires the Board of Directors of the FDIC, in acting upon applications for insurance, to consider:

> "The financial history and condition of the bank, the adequacy of its capital structure, its future earnings prospects, the general character of its management, the convenience and needs of the community to be served by the bank, and whether or not its corporate powers are consistent with the purposes of this Act."

With respect to consent of the FDIC for the establishment of branches by State nonmember insured banks, the Federal Deposit Insurance Act (12 U.S.C. 1828(d)) provides:

> ". . . The factors to be considered in granting or withholding the consent of the Corporation under this subsection shall be those enumerated in section 1816 of this title."

The provisions of the National Bank Act regarding the establishment of branches by national banks (section 5155 of the Revised Statutes) contain no requirement as to factors to be considered by the Comptroller of the Currency in acting upon applications for such branches.

Considering the fourth paragraph of section 9 of the Federal Reserve Act as relating only to applications for membership, it is believed that it should be changed to parallel the

above-quoted provision of the Federal Deposit Insurance Act
[§ 801(c)] regarding the factors to be considered in connection with applications for deposit insurance. The statement of such factors to be considered in connection with applications for membership should then be placed immediately following the provisions of the first paragraph of section 9 relating to such applications.

With respect to branches of State member banks, it would be desirable to include in the paragraph of section 9 of the Act relating to such branches a sentence stating that, in
[§ 804(b)] considering applications for such branches, the Board of Governors shall consider the same factors as those set forth with respect to applications for membership and, in addition, the effect of the proposed branch upon competition. In this connection, it may be noted that the Board's Rules Regarding Delegation of Authority (12 C.F.R. 265) require a Federal Reserve Bank, in approving branches of State member banks under delegated authority, to consider not only the member bank's capitalization and management but also the convenience and needs of the community to be served and whether or not the establishment of the branch will tend to create an undesirable competitive situation.

18. REPORTS OF STATE MEMBER BANKS

The last four sentences of the sixth paragraph of section 9 of the Act (12 U.S.C. 324), relating to reports of State member banks, read as follows:

> ". . . Such banks and the officers, agents, and employees thereof shall also be subject to the provisions of and to the penalties prescribed by sections 334, 656, and 1005 of Title 18, United States Code, and shall be required to make reports of condition and of the payment of dividends to the Federal Reserve bank of which they become a member. Not less than three of such reports shall be made annually on call of the Federal Reserve bank on dates to be fixed by the Board of Governors of the Federal Reserve System. Failure to make such reports within ten days after the date they are called for shall subject the offending bank to a penalty of $100 a day for each day that it fails to transmit such report; such penalty to be collected by the Federal Reserve bank by suit or otherwise. Such reports of condition shall be in such form and shall contain such information as the Board of Governors of the Federal Reserve System may require and shall be published by the reporting banks in such manner and in accordance with such regulations as the said Board may prescribe."

A. Number and dates of condition reports

Section 7(a)(3) of the Federal Deposit Insurance Act, as amended by Act of July 14, 1960 (12 U.S.C. 1817), provides, among other things, that each State member bank "shall make to the Federal Reserve bank of which it is a member, four reports of condition annually upon dates which shall be selected by the Chairman of the Board of Directors [of the FDIC], the Comptroller of the Currency, and the Chairman of the Board of Governors of the Federal Reserve System, or a majority thereof." That section

also provides for similar reports by nonmember insured banks and national banks to the FDIC and the Comptroller of the Currency, respectively, on the dates so selected.

The Act of July 14, 1960, amended the first sentence of section 5211 of the Revised Statutes (12 U.S.C. 161), relating to reports of national banks, to read: "Every association shall make reports of condition to the Comptroller of the Currency in accordance with the Federal Deposit Insurance Act." However, no similar conforming amendment was made to the sixth paragraph of section 9 of the Federal Reserve Act. Consequently, the requirement of that paragraph that State member banks make not less than [§ 805(a)] three condition reports annually on dates to be fixed by the Board of Governors is in conflict with the Federal Deposit Insurance Act. The conflict should be eliminated by an amendment to that paragraph similar to that made in 1960 to section 5211 of the Revised Statutes.

B. Publication of condition reports

The last sentence of the sixth paragraph of section 9 of the Federal Reserve Act requires that condition reports of State member banks shall be published in such manner and in accordance with such regulations as the Board may prescribe. In 1956, in connection with consideration of the proposed "Financial Institutions Act", the Board recommended that the absolute requirement for publication of condition reports be made permissive, so that the Board could waive publication of such reports. This

recommendation was intended to eliminate duplication, since nearly all States provide for the publication of condition reports by State banks.

Section 7(a)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1817) provides only that the Board of Directors of the FDIC "may require reports of condition [of nonmember insured banks] to be published in such manner, not inconsistent with any applicable law, as it may direct." The sixth paragraph of sec-
[§ 805(a)] tion 9 of the Federal Reserve Act should be amended to provide in similar manner that the Board of Governors may require publication of condition reports of State member banks.

C. Reports of dividends and other reports

The sixth paragraph of section 9 of the Federal Reserve Act specifically requires each State member bank to make reports of the payment of dividends and could be construed as requiring not less than three of such reports to be made annually. Until several years ago, income and dividend reports were required to be made by State member banks on a semiannual basis. Such reports are now required to be submitted only on an annual basis.

The Federal Deposit Insurance Act contains no specific provision with respect to reports of income and dividends of nonmember insured State banks. However, it does provide that the Board of Directors of the FDIC, in addition to authority to call for additional reports of condition, "may call for such other reports as the Board may from time to time require."

The sixth paragraph of section 9 of the Federal Reserve Act contains no corresponding provision authorizing the Board to require State member banks to submit, in addition to reports of condition, such other reports as the Board may require; but section 11(a) of the Federal Reserve Act (12 U.S.C. 248(a)) authorizes the Board to require from each member bank "such statements and reports as it may deem necessary." In view of the latter provision, it may not be essential to provide expressly for the submission of income and dividend reports by State member banks. On the other hand, the reference to such reports is now contained in the law and omission of this reference might be misinterpreted.

In connection with consideration of the proposed "Financial Institutions Act" in 1956, the Board recommended the inclusion in section 9 of a provision that would authorize the Board, when it deemed it appropriate, to require reports of condition on a sample basis and to prescribe different forms of reports and to make different requirements for different classes of banks. It is questionable whether such authority is essential. However, it would seem desirable to amend the sixth paragraph of section 9 of the Federal
[§ 805(a)] Reserve Act to provide, in a manner similar to that provided in the Federal Deposit Insurance Act, that the Board shall be authorized to require such <u>additional condition reports</u> and to call for such income and dividend reports and <u>other reports</u> as the Board may from time to time require. If such a provision is included in section 9, the provision in section 11(a), referred to

above, with respect to authority to require "such statements and reports" as the Board may deem necessary, would be a duplication and should be omitted.

Any redraft of the provisions regarding reports of State member banks should make it clear that the Board would have authority to require the publication, not only of condition reports, but also of income and dividend reports.

*D. Penalties

The sixth paragraph of section 9 of the Act provides that failure of a State member bank to make condition reports "within ten days after the date they are called for" shall subject the bank to a penalty of $100 a day for each day that it fails to transmit such report. With respect to reports of affiliates, however, section 9 provides that a member bank which fails to obtain and furnish a report of an affiliate shall be subject to a penalty of $100 for each day during which such failure continues; no reference is made here to a ten-day period for the submission of such reports.

Under section 5211 of the Revised Statutes, a national bank is subject to a penalty of $100 for each day "after the periods, respectively, therein mentioned [section 5211 of the Revised Statutes], that it delays to make and transmit its report." However, with specific reference to reports of affiliates of national banks, it is provided that a national bank that fails

to obtain and furnish any such report shall be subject to a penalty of $100 "for each day during which such failure continues".

The lack of uniformity is completed by the provision of section 7(a)(1) of the Federal Deposit Insurance Act which provides that every nonmember insured bank that fails to make "or publish" any condition report "within ten days" shall be subject to a penalty of not more than $100 a day; the provision does not specifically indicate from what date the ten-day period commences.

With respect to reports of State member banks and their affiliates, it would seem desirable to provide that the failure of such a bank to make, obtain, or publish any report as required by the Board within such time as the Board may specify shall subject such bank to a penalty of $100 a day for each day that such
[§ 805(b)] failure continues. This would mean that, if the Board required condition reports to be made by a specified date or to be published by a specified date, the penalty would begin to run after the date so specified. This might be regarded as a stricter requirement than that of present law if the present provision regarding condition reports of State member banks is construed as allowing a bank a ten-day "grace period" after the date a report is called for. However, the answer to any such objection lies in the fact that the member bank would be only "subject to" a penalty for failure to transmit a report by the date specified by the Board.

19. REPORTS OF AFFILIATES

With respect to reports of affiliates of State member banks, the seventeenth, eighteenth, and nineteenth paragraphs of section 9 of the Act (12 U.S.C. 334) read as follows:

> "Each bank admitted to membership under this section shall obtain from each of its affiliates other than member banks and furnish to the Federal reserve bank of its district and to the Board of Governors of the Federal Reserve System not less than three reports during each year. Such reports shall be in such form as the Board of Governors of the Federal Reserve System may prescribe, shall be verified by the oath or affirmation of the president or such other officer as may be designated by the board of directors of such affiliate to verify such reports, and shall disclose the information hereinafter provided for as of dates identical with those fixed by the Board of Governors of the Federal Reserve System for reports of the condition of the affiliated member bank. Each such report of an affiliate shall be transmitted as herein provided at the same time as the corresponding report of the affiliated member bank, except that the Board of Governors of the Federal Reserve System may, in its discretion, extend such time for good cause shown. Each such report shall contain such information as in the judgment of the Board of Governors of the Federal Reserve System shall be necessary to disclose fully the relations between such affiliate and such bank and to enable the Board to inform itself as to the effect of such relations upon the affairs of such bank. The reports of such affiliates shall be published by the bank under the same conditions as govern its own condition reports.
>
> "Any such affiliated member bank may be required to obtain from any such affiliate such additional reports as in the opinion of its Federal reserve bank or the Board of Governors of the Federal Reserve System may be necessary in order to obtain a full and complete knowledge of the condition of the affiliated member bank. Such additional reports shall be transmitted to the Federal reserve bank and the Board of Governors of the Federal Reserve System and shall be in such form as the Board of Governors of the Federal Reserve System may prescribe.

> "Any such affiliated member bank which fails to obtain from any of its affiliates and furnish any report provided for by the two preceding paragraphs of this section shall be subject to a penalty of $100 for each day during which such failure continues, which, by direction of the Board of Governors of the Federal Reserve System, may be collected, by suit or otherwise, by the Federal reserve bank of the district in which such member bank is located."

In addition, the eighth paragraph of section 5240 of the Revised Statutes (12 U.S.C. 486) provides as follows:

> "Whenever member banks are required to obtain reports from affiliates, or whenever affiliates of member banks are required to submit to examination, the Board of Governors of the Federal Reserve System or the Comptroller of the Currency, as the case may be, may waive such requirements with respect to any such report or examination of any affiliate if in the judgment of the said Board or Comptroller, respectively, such report or examination is not necessary to disclose fully the relations between such affiliate and such bank and the effect thereof upon the affairs of such bank."

A. Arrangement

As will be noted, the provisions of section 9 of the Federal Reserve Act, above quoted, with respect to reports of affiliates, for the most part parallel provisions of that section with respect to reports of State member banks themselves. [§ 805(c)] Consequently, provisions with respect to reports of both the banks and their affiliates could easily be combined.

B. Number and dates of reports

The seventeenth paragraph of section 9 refers to the obtaining of "not less than three reports" each year from affiliates of State member banks and provides that they shall be

furnished as of dates identical with those fixed by the Board for reports of condition of the affiliated member bank. As previously indicated, State member banks are required under provisions of the Federal Deposit Insurance Act, as amended in 1960, to furnish four condition reports each year on dates selected by the Chairman of the FDIC, the Comptroller of the Currency, and the Chairman of the Board of Governors, or a majority thereof. Consequently, the provisions of the seven-
[§ 805(a)] teenth paragraph of section 9 regarding the number and dates of reports of affiliates have been superseded by these provisions of the Federal Deposit Insurance Act.

C. Waiver of reports

The eighth paragraph of section 5240 of the Revised Statutes relates to the waiver of reports and examinations of
[§ 805] affiliates of both national banks and State member banks. Insofar as it refers to affiliates of State member banks, the substance of that paragraph should be transferred to the Federal Reserve Act.

20. EXAMINATIONS OF MEMBER BANKS

With respect to examinations of State member banks, the seventh and eighth paragraphs of section 9 of the Act (12 U.S.C. 325, 326) provide as follows:

> "As a condition of membership such banks shall likewise be subject to examinations made by direction of the Board of Governors of the Federal Reserve System or of the Federal reserve bank by examiners selected or approved by the Board of Governors of the Federal Reserve System.
>
> "Whenever the directors of the Federal reserve bank shall approve the examinations made by the State authorities, such examinations and the reports thereof may be accepted in lieu of examinations made by examiners selected or approved by the Board of Governors of the Federal Reserve System: Provided, however, That when it deems it necessary the board may order special examinations by examiners of its own selection and shall in all cases approve the form of the report. The expenses of all examinations, other than those made by State authorities, may, in the discretion of the Board of Governors of the Federal Reserve System, be assessed against the banks examined and, when so assessed, shall be paid by the banks examined. Copies of the reports of such examinations may in the discretion of the Board of Governors of the Federal Reserve System, be furnished to the State authorities having supervision of such banks, to officers, directors, or receivers of such banks, and to any other proper persons."

The fourth paragraph of section 5240 of the Revised Statutes, as amended by section 21 of the Federal Reserve Act (12 U.S.C. 483), provides as follows for special examinations of all member banks:

> "In addition to the examinations made and conducted by the Comptroller of the Currency, every Federal reserve bank may, with the approval of the Federal reserve agent or the Board of Governors of the Federal Reserve System,

> provide for special examination of member banks within its district. The expense of such examinations may, in the discretion of the Board of Governors of the Federal Reserve System, be assessed against the banks examined, and, when so assessed, shall be paid by the banks examined. Such examinations shall be so conducted as to inform the Federal reserve bank of the condition of its member banks and of the lines of credit which are being extended by them. Every Federal reserve bank shall at all times furnish to the Board of Governors of the Federal Reserve System such information as may be demanded concerning the condition of any member bank within the district of the said Federal reserve bank."

A. Arrangement

The above provisions regarding examinations of member banks are overlapping and, to some extent, are inconsistent. As a matter of arrangement, it is obvious that the paragraph contained in section 5240 of the Revised Statutes with respect to [§ 806(c)] special examinations of member banks should be combined with the provisions of section 9 of the Federal Reserve Act regarding examinations of State member banks instead of being placed in a statute that relates primarily to national banks.

*B. Ordering of examinations

The seventh paragraph of section 9 provides for examinations of State member banks by direction of the Board of Governors or of the Federal Reserve Bank. The eighth paragraph of section 9 provides that the Board may order special examinations of State member banks. The fourth paragraph of section 5240 provides that every Federal Reserve Bank may, with the approval of the Federal Reserve agent or the Board of Governors, provide for special examination of member banks. Logically, there is no reason why

these provisions should not be consistent in respect to whether the examinations are ordered by the Board or are provided for by the Reserve Banks with the approval of the Board. Preferably, both as to regular and special examinations, it is believed that they should be made by direction or order or with the approval [§ 806(a)] of the Board of Governors by examiners selected or approved by the Board. Incidentally, this change would make it clear that such examiners would be acting on behalf of the Board, rather than the Reserve Banks, in making examinations.

C. Expenses of examinations

To the extent that the eighth paragraph of section 9 provides that the expenses of all examinations of State member banks may be assessed against the banks examined and that the fourth paragraph of section 5240 contains a similar provision with respect to expenses of special examinations of member banks, there is a duplication in the law. If the provisions of section 9 [§ 806(e)] and section 5240 were combined, a single provision with respect to examination expenses would be sufficient.

D. Approval by Federal Reserve agent

The reference in the fourth paragraph of section 5240 to "the approval of the Federal reserve agent" in the case of special examinations is now of no significance in view of the [§ 806(c)] changed functions of the Federal Reserve agent since 1936. It should be eliminated.

E. Administration of oaths and salaries of examiners

With respect to examinations of national banks, the first paragraph of section 5240 of the Revised Statutes (12 U.S.C. 481) specifically provides that examiners of such banks shall make a thorough examination of all the affairs of national banks and shall have power to administer oaths and examine officers and agents. The third paragraph of section 5240 (12 U.S.C. 482) authorizes the Comptroller of the Currency to fix salaries of national bank examiners. These provisions have no counterparts
[§ 806(a)] with respect to Federal Reserve examiners; and, as a matter of consistency, similar provisions should be incorporated in the Federal Reserve Act with respect to such examiners.

*F. Acceptance of State examinations

Consistent with the concept that examinations of member banks should be made by order or direction of the Board of Governors, the provision contained in the eighth paragraph of section 9 regarding the acceptance of State examinations in lieu of Federal Reserve examinations should be changed to provide that such examinations may be accepted whenever approved by the Board of Governors rather than by the directors of the Reserve
[§ 806(b)] Bank. It may be noted that until 1956 section 5240 of the Revised Statutes expressly provided that the Board might authorize acceptance of examinations by the State authorities.

The words "in any State" should be inserted after the words "State authorities" in the eighth paragraph of section 9 [§ 806(b)] in order to make it clear that the Board may decide to accept State examinations in one or more States without accepting them in all States.

G. Exemption of State member banks from examination by Comptroller

The first sentence of the thirteenth paragraph of section 9 of the Act (12 U.S.C. 330) reads as follows:

> "Banks becoming members of the Federal Reserve System under authority of this section shall be subject to the provisions of this section and to those of this Act which relate specifically to member banks, but shall not be subject to examination under the provisions of the first two paragraphs of section fifty-two hundred and forty of the Revised Statutes as amended by section twenty-one of this Act."

When this provision was first enacted in 1917, the first paragraph of section 5240 of the Revised Statutes, as amended by section 21 of the Federal Reserve Act (12 U.S.C. 481), provided literally for the examination of "member banks" by examiners appointed by the Comptroller of the Currency. However, this provision of section 5240 was amended in 1956 to refer only to national banks. Consequently, the last clause of the provision of section 9 above quoted is no longer necessary.

21. EXAMINATIONS OF AFFILIATES

The first sentence of the twenty-second paragraph of section 9 of the Act (12 U.S.C. 338) reads as follows:

> "In connection with examinations of State member banks, examiners selected or approved by the Board of Governors of the Federal Reserve System shall make such examinations of the affairs of all affiliates of such banks as shall be necessary to disclose fully the relations between such banks and their affiliates and the effect of such relations upon the affairs of such banks."

Waiver of examinations of affiliates of member banks is provided for in the eighth paragraph of section 5240 of the Revised Statutes (12 U.S.C. 486), which reads as follows:

> "Whenever member banks are required to obtain reports from affiliates, or whenever affiliates of member banks are required to submit to examination, the Board of Governors of the Federal Reserve System or the Comptroller of the Currency, as the case may be, may waive such requirements with respect to any such report or examination of any affiliate if in the judgment of the said Board or Comptroller, respectively, such report or examination is not necessary to disclose fully the relations between such affiliate and such bank and the effect thereof upon the affairs of such bank."

So much of the above-quoted paragraph of section 5240 as refers to waiver of examinations of affiliates of State member banks should be transferred to the Federal Reserve Act.

[§ 806(d)]

[Sec. 7(b)]

22. APPLICABILITY OF OTHER LAWS TO STATE MEMBER BANKS

A. Provisions applicable to member banks

(1) The first clause of the first sentence of the thirteenth paragraph of section 9 of the Act (12 U.S.C. 330) provides that -

> "Banks becoming members of the Federal Reserve System under authority of this section shall be subject to the provisions of this section and to those of this Act which relate specifically to member banks . . . ."

If this language is retained in the law, it should be changed to refer not only to provisions of the Federal Reserve Act but to any other provisions of Federal law relating specifically to member banks. However, it is believed that the language quoted serves no useful purpose and should be omitted. Obviously, a State member bank is subject to any provision of Federal law that specifically relates to member banks.

(2) The first part of the first sentence of the sixth paragraph of section 9 of the Act (12 U.S.C. 324) provides as follows:

> "All banks admitted to membership under authority of this section shall be required to comply with the reserve and capital requirements of this Act, ..."

For reasons similar to those stated above with respect to the first clause of the first sentence of the thirteenth paragraph of section 9, this language in the sixth paragraph is obviously unnecessary, since State member banks are "member banks"

and are therefore subject to the reserve and capital requirements of the Federal Reserve Act.

B. Retention of charter rights

The second sentence of the thirteenth paragraph of section 9 of the Act (12 U.S.C. 330) reads in part as follows:

> ". . . Subject to the provisions of this Act and to the regulations of the board made pursuant thereto, any bank becoming a member of the Federal Reserve System shall retain its full charter and statutory rights as a State bank or trust company, and may continue to exercise all corporate powers granted it by the State in which it was created, and shall be entitled to all privileges of member banks: . . . ."

Since the charter "rights" of a State member bank may be limited by provisions of Federal law other than those of the Federal Reserve Act, e.g., the bank merger provisions of the Federal Deposit Insurance Act, the first clause of the sentence above quoted should refer not only to provisions of "this Act" but also to "other provisions of Federal law".

[§ 802]

C. Applicability of certain criminal provisions

The second sentence of the sixth paragraph of section 9 of the Act (12 U.S.C. 324) reads in part as follows:

[§ 809(a)]

> ". . . Such banks and the officers, agents, and employees thereof shall also be subject to the provisions of and to the penalties prescribed by sections 334, 656, and 1005 of Title 18, United States Code, ..."

(1) Section 334 of the Criminal Code reads as follows:

> "Whoever, being a Federal Reserve Agent, or an agent or employee of such Federal Reserve Agent, or of the Board of Governors of the Federal Reserve System, issues or puts in circulation any Federal Reserve notes,

without complying with or in violation of the provisions of law regulating the issuance and circulation of such Federal Reserve notes; or

"Whoever, being an officer acting under the provisions of chapter 2 of Title 12, countersigns or delivers to any national banking association, or to any other company or person, any circulating notes contemplated by that chapter except in strict accordance with its provisions -

"Shall be fined not more than $5,000 or imprisoned not more than five years, or both."

The first paragraph of section 334 of the Criminal Code relates to the issuance of Federal Reserve notes without compliance with provisions of law relating thereto and, consequently, is clearly applicable to Federal Reserve agents and employees of such agents and of the Board of Governors. It is difficult to imagine, however, how it could in any way be applicable to an officer or employee of a State member bank. It is possible that the reference to this section of the Criminal Code was originally included in order to make clear that officers and employees of State member banks were prohibited from wrongfully issuing national bank notes, the matter covered by the second paragraph of section 334. Since national bank notes are no longer issued, that paragraph is clearly obsolete and inapplicable to officers and employees of State member banks. Consequently, the reference in section 9 to section 334 of the Criminal Code should be omitted.

(2) Section 656 of the Criminal Code relates to embezzlements by officers, directors, agents, or employees of any Federal Reserve Bank, member bank, national bank, or insured

bank. Section 1005 of the Criminal Code relates to false entries by any officer, director, agent, or employee of any Federal Reserve Bank, member bank, national bank, or insured bank. Since State member banks obviously are "member banks", the requirement of the sixth paragraph of section 9 that officers and employees of such banks shall be subject to the provisions of these sections of the Criminal Code is clearly a duplication and is therefore unnecessary. It may be noted that the Criminal Code provisions are broader than those of section 9 since they specifically cover directors of member banks as well as officers, agents, and employees.

23. FORFEITURE OF MEMBERSHIP

The ninth paragraph of section 9 of the Act (12 U.S.C. 327) reads as follows:

> "If at any time it shall appear to the Board of Governors of the Federal Reserve System that a member bank has failed to comply with the provisions of this section or the regulations of the Board of Governors of the Federal Reserve System made pursuant thereto, or has ceased to exercise banking functions without a receiver or liquidating agent having been appointed therefor, it shall be within the power of the board after hearing to require such bank to surrender its stock in the Federal reserve bank and to forfeit all rights and privileges of membership. The Board of Governors of the Federal Reserve System may restore membership upon due proof of compliance with the conditions imposed by this section."

A. Applicability only to State member banks

Although this paragraph refers to forfeiture of membership by a "member bank", it is clear that it is intended to refer [§ 812(b)] only to State banks admitted to membership under section 9, and the paragraph has always been so construed. Consequently, the paragraph should be changed to refer to "a State member bank".

B. Violations of any applicable law

The paragraph refers to failure to comply with "the provisions of this section or the regulations of the Board of Governors of the Federal Reserve System made pursuant thereto". [§ 812(b)] It should be changed to refer to failure to comply with the provisions "of this Act or any provision of Federal law applicable to member banks".

C. Violation of conditions of membership

It should be made clear that failure to comply with conditions of membership prescribed by the Board may subject a State member bank to forfeiture of membership.

[§ 812(b)]

D. Restoration of membership

The last sentence of the paragraph authorizes the Board to restore membership upon proof of compliance "with the conditions imposed by this section." In the interest of clarity and consistency, this sentence should refer to proof of "compliance with such provisions of law or regulations or conditions of membership".

[§ 812]

[§ 812(b)]

24. VOLUNTARY WITHDRAWAL FROM MEMBERSHIP

The tenth paragraph of section 9 of the Act (12 U.S.C. 328) reads as follows:

> "Any State bank or trust company desiring to withdraw from membership in a Federal reserve bank may do so, after six months' written notice shall have been filed with the Board of Governors of the Federal Reserve System, upon the surrender and cancellation of all of its holdings of capital stock in the Federal reserve bank: Provided, That the Board of Governors of the Federal Reserve System, in its discretion and subject to such conditions as it may prescribe, may waive such six months' notice in individual cases and may permit any such State bank or trust company to withdraw from membership in a Federal reserve bank prior to the expiration of six months from the date of the written notice of its intention to withdraw: Provided, however, That no Federal reserve bank shall, except under express authority of the Board of Governors of the Federal Reserve System, cancel within the same calendar year more than twenty-five per centum of its capital stock for the purpose of effecting voluntary withdrawals during that year. All such applications shall be dealt with in the order in which they are filed with the board. Whenever a member bank shall surrender its stock holdings in a Federal reserve bank, or shall be ordered to do so by the Board of Governors of the Federal Reserve System, under authority of law, all of its rights and privileges as a member bank shall thereupon cease and determine, and after due provision has been made for any indebtedness due or to become due to the Federal reserve bank it shall be entitled to a refund of its cash paid subscription with interest at the rate of one-half of one per centum per month from date of last dividend, if earned, the amount refunded in no event to exceed the book value of the stock at that time, and shall likewise be entitled to repayment of deposits and of any other balance due from the Federal reserve bank."

*A. Notice of withdrawal

The provision requiring six-months' notice of intention to withdraw from membership, unless waived by the Board, is not

[§ 812(a)] essential and should be omitted. In practice, the Board (or the Federal Reserve Bank under delegated authority) always waives the six-months' notice requirement.

B. Cancellation of Reserve Bank stock

(1) The second proviso of the first sentence of the paragraph prohibits a Reserve Bank from canceling more than 25 per cent of its capital stock during any calendar year as the result of voluntary withdrawals from membership, except with the express authority of the Board. It may have been the purpose of this provision to guard against sudden mass withdrawals of State banks from the System and the resulting substantial reduction in the

[§ 812(c)] capital of the Reserve Banks. However, it is questionable whether this limitation is any longer necessary and it should be omitted.

(2) The last part of the last sentence of the tenth paragraph of section 9, relating to the refund of a member bank's cash-paid subscription and repayment of deposits and other balances due from the Reserve Bank, would be covered by provisions of another section of the Act, relating to cancellation of Reserve Bank stock, if the law should be amended as proposed under Recom-

[§ 812(c)] mendation No. 5-F. Accordingly, that part of that sentence, beginning with the words "and after due provision has been made", should be omitted.

C. Consideration of withdrawal applications

The second sentence of the paragraph, requiring applications for withdrawal from membership to be dealt with in

the order in which filed, may originally have had some significance; but there appears to be no more reason for such a requirement in the case of withdrawals from membership than in the case of any other applications received by the Board.

[§ 812(a)]

25. WAIVER OF MEMBERSHIP REQUIREMENTS FOR CERTAIN INSURED BANKS

The twelfth paragraph of section 9 of the Act provides that the Board may waive requirements for membership in the System as to any State bank required by subsection (y) of section 12B of the Federal Reserve Act to become a member of the System in order to have its deposits insured. Subsection (y) of section 12B was repealed in 1939, and all of the former section 12B itself was withdrawn from the Federal Reserve Act and enacted as a separate Federal Deposit Insurance Act in 1950. Consequently, this paragraph of section 9, which is omitted from the United States Code, is clearly of no present significance and should be repealed.

26. FALSE CERTIFICATION OF CHECKS

The fourteenth paragraph of section 9 of the Act (12 U.S.C. 331), relating to false certification of checks by officers of State member banks, reads as follows:

> "It shall be unlawful for any officer, clerk, or agent of any bank admitted to membership under authority of this section to certify any check drawn upon such bank unless the person or company drawing the check has on deposit therewith at the time such check is certified an amount of money equal to the amount specified in such check. Any check so certified by duly authorized officers shall be a good and valid obligation against such bank, but the act of any such officer, clerk, or agent in violation of this section may subject such bank to a forfeiture of its membership in the Federal Reserve System upon hearing by the Board of Governors of the Federal Reserve System."

Section 5208 of the United States Revised Statutes (12 U.S.C. 501), relating to false certification of checks by officers, directors, or employees of Federal Reserve Banks and member banks, reads as follows:

> "It shall be unlawful for any officer, director, agent, or employee of any Federal reserve bank, or any member bank as defined in the Act of December 23, 1913, known as the Federal Reserve Act, to certify any check drawn upon such Federal reserve bank or member bank unless the person, firm, or corporation drawing the check has on deposit with such Federal reserve bank or member bank, at the time such check is certified, an amount of money not less than the amount specified in such check. Any check so certified by a duly authorized officer, director, agent, or employee shall be a good and valid obligation against such Federal reserve bank or member bank; but the act of any officer, director, agent, or employee of any such Federal reserve bank or member bank in violation of this section shall, in the discretion of the Board of Governors of the Federal Reserve System, subject such Federal reserve bank to the penalties imposed by section 11, subsection (h) of the Federal

> Reserve Act, and shall subject such member bank, if a national bank, to the liabilities and proceedings on the part of the Comptroller of the Currency provided for in section 5234, Revised Statutes, and shall, in the discretion of the Board of Governors of the Federal Reserve System, subject any other member bank to the penalties imposed by section 9 of said Federal Reserve Act for the violation of any of the provisions of said Act."

In addition, section 1004 of the Criminal Code (18 U.S.C. 1004) provides criminal penalties for false certification of checks by officers, directors, or employees of Federal Reserve Banks and member banks.

The paragraph of section 9 of the Federal Reserve Act, above quoted, was added in 1917. Subsequently, section 5208 of the Revised Statutes was revised to cover false certification of checks not only in the case of State member banks but in the case of all member banks, as well as Federal Reserve Banks. Thus, section 5208, as amended, completely duplicates and goes beyond the provisions of the fourteenth paragraph of section 9 of the Act. Consequently, the fourteenth paragraph of section 9 is unnecessary and should be repealed.

If that paragraph of section 9 should be repealed, however, it is believed that section 5208 should be incorporated in the Federal Reserve Act itself, most appropriately along with the provisions of section 22 relating to offenses of directors, officers, and employees of member banks. Its incorporation in the Federal Reserve Act seems logical and desirable because the provisions of section 5208 of the Revised Statutes relate to false certification of checks by officers, directors, and employees of Federal Reserve Banks and of member banks.

[§ 903(d)]

27. MEMBER BANKS AS DEPOSITORIES OF PUBLIC FUNDS

The fifteenth paragraph of section 9 of the Act (12 U.S.C. 332) reads as follows:

> "All banks or trust companies incorporated by special law or organized under the general laws of any State, which are members of the Federal reserve system, when designated for that purpose by the Secretary of the Treasury, shall be depositaries of public money, under such regulations as may be prescribed by the Secretary; and they may also be employed as financial agents of the Government; and they shall perform all such reasonable duties, as depositaries of public money and financial agents of the Government, as may be required of them. The Secretary of the Treasury shall require of the banks and trust companies thus designated satisfactory security, by the deposit of United States bonds or otherwise, for the safe keeping and prompt payment of the public money deposited with them and for the faithful performance of their duties as financial agents of the Government."

Section 10 of the Act of June 11, 1942 (12 U.S.C. 265), reads as follows:

> "All insured banks designated for that purpose by the Secretary of the Treasury shall be depositaries of public money of the United States (including, without being limited to, revenues and funds of the United States, and any funds the deposit of which is subject to the control or regulation of the United States or any of its officers, agents, or employees, and Postal Savings funds), and the Secretary is hereby authorized to deposit public money in such depositaries, under such regulations as may be prescribed by the Secretary; and they may also be employed as financial agents of the Government; and they shall perform all such reasonable duties, as depositaries of public money and financial agents of the Government as may be required of them. The Secretary of the Treasury shall require of the insured banks thus designated satisfactory security by the deposit of United States bonds or otherwise, for the safekeeping and prompt payment of public money deposited with them and for the faithful performance of

their duties as financial agents of the Government; Provided, That no such security shall be required for the safekeeping and prompt payment of such parts of the deposits of the public money in such banks as are insured deposits and each officer, employee, or agent of the United States having official custody of public funds and lawfully depositing the same in an insured bank shall, for the purpose of determining the amount of the insured deposits, be deemed a depositor in such custodial capacity separate and distinct from any other officer, employee, or agent of the United States having official custody of public funds and lawfully depositing the same in the same insured bank in custodial capacity. Notwithstanding any other provision of law, no department, board, agency, instrumentality, officer, employee, or agent of the United States shall issue or permit to continue in effect any regulations, rulings, or instructions or enter into or approve any contracts or perform any other acts having to do with the deposit, disbursement, or expenditure of public funds, or the deposit, custody, or advance of funds subject to the control of the United States as trustee or otherwise which shall discriminate against or prefer national banking associations, State bank members of the Federal Reserve System, or insured banks not members of the Federal Reserve System, by class, or which shall require those enjoying the benefits, directly or indirectly, of disbursed public funds so to discriminate. All Acts or parts thereof in conflict herewith are hereby repealed. The terms 'insured bank' and 'insured deposit' as used in this Act shall be construed according to the definitions of such terms in section 3 of the Federal Deposit Insurance Act, as amended (12 U.S.C., sec. 1813)."

The fifteenth paragraph of section 9 of the Federal Reserve Act, as above quoted, was added to the Act in 1928, prior to establishment of the Federal Deposit Insurance Corporation. It relates to the use of only State member banks as depositories of public money. However, section 10 of the 1942 Act, quoted above, enacted after establishment of the Federal Deposit Insurance Corporation, contains almost identical provisions

regarding the use of all insured banks as Government depositories. Since State member banks must be insured banks, the fifteenth paragraph of section 9 of the Federal Reserve Act is therefore unnecessary and should be omitted. Moreover, retention of that paragraph in the Federal Reserve Act can be misleading, since it does not provide, as does the subsequent 1942 enactment, that security for deposits of public money is not required to the extent that such deposits are insured under the Federal Deposit Insurance Act.

*28. MEMBERSHIP OF MUTUAL SAVINGS BANKS

The sixteenth paragraph of section 9 of the Act (12 U.S.C. 333), which was added by the Banking Act of 1933, reads as follows:

> "Any mutual savings bank having no capital stock (including any other banking institution the capital of which consists of weekly or other time deposits which are segregated from all other deposits and are regarded as capital stock for the purposes of taxation and the declaration of dividends), but having surplus and undivided profits not less than the amount of capital required for the organization of a national bank in the same place, may apply for and be admitted to membership in the Federal Reserve System in the same manner and subject to the same provisions of law as State banks and trust companies, except that any such savings banks shall subscribe for capital stock of the Federal reserve bank in an amount equal to six-tenths of 1 per centum of its total deposit liabilities as shown by the most recent report of examination of such savings bank preceding its admission to membership. Thereafter such subscription shall be adjusted semiannually on the same percentage basis in accordance with rules and regulations prescribed by the Board of Governors of the Federal Reserve System. If any such mutual savings bank applying for membership is not permitted by the laws under which it was organized to purchase stock in a Federal reserve bank, it shall, upon admission to the system, deposit with the Federal reserve bank an amount equal to the amount which it would have been required to pay in on account of a subscription to capital stock. Thereafter such deposit shall be adjusted semiannually in the same manner as subscriptions for stock. Such deposits shall be subject to the same conditions with respect to repayment as amounts paid upon subscriptions to capital stock by other member banks and the Federal reserve bank shall pay interest thereon at the same rate as dividends are actually paid on outstanding shares of stock of such Federal reserve bank. If the laws under which any such savings bank was organized be amended so as to authorize mutual savings banks to subscribe for Federal reserve bank stock, such savings bank shall

> thereupon subscribe for the appropriate amount of stock in the Federal reserve bank, and the deposit hereinbefore provided for in lieu of payment upon capital stock shall be applied upon such subscription. If the laws under which any such savings bank was organized be not amended at the next session of the legislature following the admission of such savings bank to membership so as to authorize mutual savings banks to purchase Federal reserve bank stock, or if such laws be so amended and such bank fail within six months thereafter to purchase such stock, all of its rights and privileges as a member bank shall be forfeited and its membership in the Federal Reserve System shall be terminated in the manner prescribed elsewhere in this section with respect to State member banks and trust companies. Each such mutual savings bank shall comply with all the provisions of law applicable to State member banks and trust companies, with the regulations of the Board of Governors of the Federal Reserve System and with the conditions of membership prescribed for such savings bank at the time of admission to membership, except as otherwise hereinbefore provided with respect to capital stock."

As far as is known, only three mutual savings banks have ever become members of the System; and for many years no mutual savings bank has been a member. Apparently, there is little or no incentive for such banks to join the System. Accordingly, it is believed that the special provisions of present law regarding membership of mutual savings banks serve no practical purpose and should be eliminated. It may be noted that these provisions would be repealed by pending proposed legislation regarding Federal chartering of mutual savings banks.

29. MEMBERS OF BOARD OF GOVERNORS

The first two paragraphs of section 10 of the Act (12 U.S.C. 241, 242) read as follows:

"The Board of Governors of the Federal Reserve System (hereinafter referred to as the 'Board') shall be composed of seven members, to be appointed by the President, by and with the advice and consent of the Senate, after the date of enactment of the Banking Act of 1935, for terms of fourteen years except as hereinafter provided, but each appointive member of the Federal Reserve Board in office on such date shall continue to serve as a member of the Board until February 1, 1936, and the Secretary of the Treasury and the Comptroller of the Currency shall continue to serve as members of the Board until February 1, 1936. In selecting the members of the Board, not more than one of whom shall be selected from any one Federal Reserve district, the President shall have due regard to a fair representation of the financial, agricultural, industrial, and commercial interests, and geographical divisions of the country. The members of the Board shall devote their entire time to the business of the Board and shall each receive an annual salary of $15,000, payable monthly, together with actual necessary traveling expenses.

"The members of the Board shall be ineligible during the time they are in office and for two years thereafter to hold any office, position, or employment in any member bank, except that this restriction shall not apply to a member who has served the full term for which he was appointed. Upon the expiration of the term of any appointive member of the Federal Reserve Board in office on the date of enactment of the Banking Act of 1935, the President shall fix the term of the successor to such member at not to exceed fourteen years, as designated by the President at the time of nomination, but in such manner as to provide for the expiration of the term of not more than one member in any two-year period, and thereafter each member shall hold office for a term of fourteen years from the expiration of the term of his predecessor, unless sooner removed for cause by the President. Of the persons thus appointed, one shall be designated by the President as chairman and one as vice chairman of the Board, to

serve as such for a term of four years. The chairman of the Board, subject to its supervision, shall be its active executive officer. Each member of the Board shall within fifteen days after notice of appointment make and subscribe to the oath of office. Upon the expiration of their terms of office, members of the Board shall continue to serve until their successors are appointed and have qualified. Any person appointed as a member of the Board after the date of enactment of the Banking Act of 1935 shall not be eligible for reappointment as such member after he shall have served a full term of fourteen years."

The first three sentences and the last two sentences of the fourth paragraph of section 10 (12 U.S.C. 244) read as follows:

"The principal offices of the Board shall be in the District of Columbia. At meetings of the Board the chairman shall preside, and, in his absence, the vice chairman shall preside. In the absence of the chairman and the vice chairman, the Board shall elect a member to act as chairman pro tempore. . . . No member of the Board of Governors of the Federal Reserve System shall be an officer or director of any bank, banking institution, trust company, or Federal Reserve bank or hold stock in any bank, banking institution, or trust company; and before entering upon his duties as a member of the Board of Governors of the Federal Reserve System he shall certify under oath that he has complied with this requirement, and such certification shall be filed with the secretary of the Board. Whenever a vacancy shall occur, other than by expiration of term, among the six members of the Board of Governors of the Federal Reserve System appointed by the President as above provided, a successor shall be appointed by the President, by and with the advice and consent of the Senate, to fill such vacancy, and when appointed he shall hold office for the unexpired term of his predecessor."

The fifth paragraph of section 10 (12 U.S.C. 245) reads as follows:

"The President shall have power to fill all vacancies that may happen on the Board of Governors of the Federal Reserve System during the recess of the Senate by granting commissions which shall expire with the next session of the Senate."

A. Obsolete references to Banking Act of 1935

The first paragraph of section 10 of the Act, relating to the appointment and qualifications of members of the Board, is in the form in which it was amended by the Banking Act of [§ 201(a)] 1935, when the composition of the Board was drastically changed. Much of the language of this paragraph, necessary in 1935, is now obsolete, such as the provision for the continued service of the Secretary of the Treasury and the Comptroller of the Currency as members of the Board until February 1, 1936. Similarly, the second sentence of the second paragraph of section 10, providing for the appointment of successors to appointive members in office on the date of enactment of the Banking Act of 1935, and the last sentence of the same paragraph, regarding reappointment of Board members, should be recast to eliminate references to the Banking Act of 1935.

*B. Qualifications of members

The original Federal Reserve Act, in addition to providing that not more than one member should be appointed from any Federal Reserve district, required the President, in appointing Board members, to have due regard to a fair representation of the different "commercial, industrial and geographical divisions of the country" and further provided that at least two of the members should be "persons experienced in banking or finance." In 1922, the law was amended to add a

requirement for representation of "financial" and "agricultural" interests and, at the same time, the provision requiring two members to be experienced in banking or finance was eliminated.

In his replies to the questions submitted in 1952 by the Subcommittee on General Credit Control and Debt Management of the Joint Economic Committee (the "Patman Questionnaire"), Chairman Martin of the Board recommended elimination of the restriction on appointment of more than one member from any Federal Reserve district and the restoration of the earlier provision requiring two members to be experienced in banking or finance. (Joint Committee Print of Joint Committee on the Economic Report regarding "Monetary Policy and the Management of the Public Debt", Part 1, 1952, p. 300) However, the Subcommittee, in its Final Report of June 26, 1952 (p. 56), recommended removal from the law of both the restriction on appointments from a single district and the provision regarding representation of various interests. In this connection, the Subcommittee's Report stated:

> "The geographic portions of this provision have reduced the flexibility of the appointing authority in seeking the best possible membership for the Board, while its non-geographical portions reflect in part the older concept of the Federal Reserve System as simply an organization for the 'accommodation of commerce and industry' rather than one whose primary responsibility is the formulation of monetary policy in the public interest. It is, of course, important that the Board include in its membership persons understanding of and sympathetic to the various interests in the county [sic], and the President and the Senate may be expected to

> insist upon this, but it is also important that men be appointed with a broad understanding of the economic bases of monetary policy. The Subcommittee believes that, in the long run, the quality of membership of the Board would be improved if the present qualifications were removed and the appointments left to the full discretion of the President and the Senate."

The provision with respect to representation of various interests of the country has never been regarded as meaning that Board members, in their capacity as members, actually represent any particular interests; they have always been regarded as representing the public interest generally. Nevertheless, the provision can be misunderstood as suggesting such representation of special interests; and indeed it has been suggested that the law be amended to add reference to representation of labor. Actually, the statutory requirement has probably not had any great signifi-

[§ 201(b)] cance. It might be questioned whether professional economists appointed to the Board in fact represent "financial, agricultural, industrial, and commercial" interests. This requirement of the law should be omitted.

While the President should, of course, and as a practical matter would be inclined to, avoid appointing a preponderance of Board members from any particular geographical section of the

[§ 201(b)] country, the present limitation on the appointment of more than one member from any Federal Reserve district constitutes an unnecessary restriction upon the President's discretion. It should likewise be omitted.

C. Salaries of members

The last sentence of the first paragraph of section 10 specifically refers to the salary of Board members as being $15,000. This is, of course, incorrect and misleading, since salaries of Board members are now governed by the Executive Pay Act. Consequently, the sentence should be omitted. In this connection, see also Recommendation No. 55.

*D. Terms of Chairman and Vice Chairman

The third sentence of the second paragraph of section 10 of the Act provides that the Chairman and Vice Chairman of the Board shall be designated by the President to serve as such for terms of four years. When this provision was added by the Banking Act of 1935, it was apparently contemplated that the terms of the Chairman and Vice Chairman would be approximately coterminous with the term of the President and that this arrangement would afford a new President an opportunity to designate these officers of the Board. Assuming such a purpose, however, the provision has not operated to bring about this result.

In 1952, in his replies to the questionnaire submitted by Chairman Patman of the Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report, Chairman Martin of the Board suggested that the law be changed so as to make the terms of the Chairman and Vice Chairman coincide roughly with the term of the President. Such an amendment to the

law was recommended by President Kennedy in 1962 in a message to Congress:

> ". . . As has been recognized throughout the history of the Federal Reserve, the principal officer of the System must have the confidence of the President. This is essential for the effective coordination of the monetary, fiscal, and financial policies of the government. It is essential for the effective representation of the Federal Reserve System itself in the formulation of Executive policies affecting the System's responsibilities."

In a letter dated October 6, 1966, to Chairman Multer of the Subcommittee on Bank Supervision and Insurance of the House Banking and Currency Committee, the Board recommended that the terms of the Chairman and Vice Chairman should be related to the President's term of office and that the terms of Board members should be adjusted so that a new President would be able to appoint a Chairman and Vice Chairman of his own choice without being limited in his selection to incumbent Board members.

The law should be amended to provide that terms of Board members shall expire in odd-numbered years, rather than even-numbered years, so that a vacancy would occur in the year [§ 201(c)] of a President's inauguration, thus permitting him to appoint a Chairman from outside the existing membership. Any such amendment should also provide for a reasonable time lag between the date of the President's inauguration and the expiration of the terms of the incumbent Chairman and Vice Chairman. Terms of [Sec. 2] members in office on the date of the amendment should be adjusted to expire in the year following that in which they would otherwise expire.

E. Inaccurate reference to number of members

The last sentence of the fourth paragraph of section 10 of the Act provides that, whenever a vacancy shall occur, other than by expiration of term, "among the six members of the Board of Governors of the Federal Reserve System appointed by the President as above provided", a successor shall be appointed by the President for the unexpired term.

Originally, the Board consisted of seven members, five appointed by the President plus the Secretary of the Treasury and the Comptroller of the Currency as ex officio members. Consequently, in the original Act, the provision above quoted referred to the "five" members of the Board appointed by the President. In 1922, the law was changed to provide for six appointed members with the Secretary of the Treasury and the Comptroller of the Currency continuing to serve as ex officio members; and at that time the language above quoted was changed to refer to the "six" members appointed by the President. By the Banking Act of 1935, the Secretary of the Treasury and the Comptroller of the Currency were removed from the Board and provision was made for a Board of seven members, all appointed by the President.

Obviously, the present reference to the "six" members of the Board appointed by the President is obsolete. It should be changed to refer simply to the "members" of the Board.

F. Rearrangement

Provisions relating to the qualifications, appointment, and terms of Board members are scattered among several paragraphs [§ 201] of section 10, along with material relating to other matters. The provisions regarding Board members logically should be arranged together.

*30. SIMPLE MAJORITY FOR ALL BOARD ACTIONS

In several instances, the Federal Reserve Act requires certain actions by the Board to be taken only with the affirmative vote of a specified number of members.

Thus, section 10(a) of the Act (12 U.S.C. 347a) provides that a Reserve Bank may make advances to groups of member banks under certain conditions, but only upon receiving the consent of not less than five members of the Board of Governors.

Section 11(b) of the Act (12 U.S.C. 248(b)) provides that, on the affirmative vote of at least five members of the Board, the Board may require a Reserve Bank to rediscount the discounted paper of another Reserve Bank.

Section 11(m) of the Act (12 U.S.C. 248(m)) provides that, upon the affirmative vote of not less than six of its members, the Board shall have power to fix for each Federal Reserve district the percentage of individual bank capital and surplus that may be represented by loans secured by stock or bond collateral made by member banks within the district.

The third paragraph of section 13 (12 U.S.C. 343) provides that, in unusual and exigent circumstances, and by the affirmative vote of not less than five of its members, the Board may authorize a Reserve Bank to discount eligible paper for any individual, partnership, or corporation under certain circumstances.

Section 19(b) (12 U.S.C. 462) provides that reserve requirements of member banks shall be determined by the affirmative vote of not less than four members of the Board.

The actions of the Board authorized by section 10(a), section 11(m), and the third paragraph of section 13 have never been taken by the Board since the enactment of those provisions. In any event, the requirement that Board actions of the kinds above described be taken only with the affirmative vote of a specified number of Board members appears to be no more necessary with respect to such actions than with respect to other equally important actions taken by the Board as to which there is no specific statutory requirement for the concurrence of a specified number of Board members. There is no sound reason for which all actions of the Board should not be taken in accordance with the general rule that the action of a board or commission may be taken by a majority of a quorum of such board or commission.

It is recommended, therefore, that the provisions of the Federal Reserve Act above mentioned be amended to eliminate the requirement for concurrence of a specified number of Board members.[2/] Although not essential, it might be desirable to

2/ Such an amendment to section 10(a) would be unnecessary if either Recommendation No. 33 or No. 46 should be adopted. Amendments to section 11(b) and the third paragraph of section 13 would be unnecessary if Recommendation No. 46 should be adopted.

include at an appropriate place in the Act a provision explicitly stating that any action which the Board is authorized to take may be taken by the affirmative vote of a majority of the members of the Board present at any meeting at which there is a quorum.

31. RESERVATION OF POWERS OF THE SECRETARY OF THE TREASURY

The sixth paragraph of section 10 of the Federal Reserve Act (12 U.S.C. 246) reads as follows:

> "Nothing in this Act contained shall be construed as taking away any powers heretofore vested by law in the Secretary of the Treasury which relate to the supervision, management, and control of the Treasury Department and bureaus under such department, and wherever any power vested by this Act in the Board of Governors of the Federal Reserve System or the Federal reserve agent 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."

In 1956, in connection with the then-pending "Financial Institutions Act", the Board recommended the elimination of the last part of the above paragraph, specifically the language reading "and wherever any power vested by this Act in the Board of Governors of the Federal Reserve System or the Federal reserve agent 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."

In explanation of this recommendation, the Board stated:

> "This provision was included in the original Federal Reserve Act in 1913, which provided for a Federal Reserve Board on which the Secretary of the Treasury and Comptroller of the Currency were members ex-officio. The provision appears to reflect some uncertainty on the part of Congress in 1913 as to the possibility of overlapping authority between the Treasury and the Federal Reserve System. However, the meaning and intent of the language suggested for repeal are not at all clear. The language apparently refers only to powers of the Secretary relating to the supervision, management, and control of the Treasury Department and its

> bureaus, although it is possible to interpret it as applying to other powers vested by the original Federal Reserve Act in the Federal Reserve Board and the Federal Reserve agent. It is not believed that Congress intended that this provision should be more broadly interpreted and, in any event, the removal of the Secretary of the Treasury and the Comptroller of the Currency from membership on the Federal Reserve Board by the Banking Act of 1935 clearly indicated an intent that the Board should perform its functions according to its own best judgment. Moreover, as 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 of the Secretary of the Treasury. It is believed that it is in the category of obsolete or unnecessary provisions and should be repealed." ("Study of Banking Laws", Committee Print of Senate Banking and Currency Committee, Oct. 12, 1956, p. 87.)

Actually, the first part as well as the last part of the paragraph in question serves no present purpose. There is clearly nothing in the Federal Reserve Act that impairs in any way the powers of the Secretary of the Treasury with respect to his supervision, management, or control of his Department.

Accordingly, the entire sixth paragraph of section 10 of the Act should be omitted.