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Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 11, 1941

To The Files

Subject:

From Mr. Coe

MPC.

After correspondence with Mrs. Hamlin (see letters of May 25 and June 4, 1941) the items attached hereto and listed below, because of their possible confidential character, were taken from Volume 248 of Mr. Hamlin's scrap book and placed in the Board's files:

VOLUME 248

Page 31 - Confidential memo to Mr. Morrill from Mr. Van Fossen re Direct Loans to Individuals, etc.
Page 37 - Analysis of Agreement with The Calvin B. Taylor Banking Company.
Page 59
Memo Re Issue of Thomas Amendment - Notes for Purpose of Retiring Maturing Public Debt.
Page 61 - Memo to Governor Black from Mr. Gardner - Abstract of Monetary Policy.
Page 71
Memo to Board from Mr. Wingfield re Deferred Certificates issued to depositors in connection with reorganization of State banks in Illinois.
Page 77 - Memo to Gov. Black from Mr. Wyatt re Purchase by F.R. Banks of Obligations of R.F.C.
Page 83 - Memo to Mr. Hamlin from Mr. Wyatt re Question whether capital notes or debentures may be considered "capital" of bank in determining its eligibility for membership in the F.R. System.
Page 85 - Memo to Mr. Hamlin from Mr. Goldenweiser re monetary policy.
Page 89 - Analysis of Mr. Wyatt's Opinion, November 3, 1933.
Page 93 - Letter from Comptroller to Jesse Jones re "capital notes".
Pages 97 & 99 - Mr. Wyatt's Opinion re Capital Notes.
Page 113 - Memo to Gov. Black from Mr. Goldenweiser re conference on gold policy.
Page 115 - Memo re Devaluation of gold dollar. (Mr. Goldenweiser)
Page 119 - Memo to Mr. Hamlin from Mr. Gardner and Mr. Longstreet re Relation of central banks in England, France, and Germany to the Government.
Page 121 - Memo to Mr. Hamlin from Mr. Goldenweiser attaching a table showing changes in the F.R. Bank holdings of U.S. Gov. securities, etc.
Page 153 - Letter from Gov. Black to President Roosevelt, attaching memo re turning F.R. Bank gold over to Treasury.

Mr Hamlin

Sec Na

December 7, 1933.

TO: Mr. Morrill

SUBJECT: Direct Loans to Individuals, etc.

FROM: Mr. Van Fossen

CONFIDENTIAL

Attached hereto is a statement showing the number of applications of individuals, partnerships and corporations for loans not granted by the Federal Reserve banks during the calendar year 1933 to October 31, including a tabulation of the reasons for not granting the loans applied for.

It will be noted that of 171 applications refused, as shown in the statement, 116 were because of unsatisfactory security; 52 paper not eligible; and 3 other credit available.

Direct loans to individuals, partnerships and corporations granted by the Federal Reserve banks during the first 10 months of 1933 and the amount of such loans outstanding on October 31, 1933, were as follows:

	Advanced Jan. 1 to Oct. 31 1933	Outstanding Oct. 31, 1933	
		Total	Amount secured by U. S. Govt. obligations
Federal Reserve Bank of Boston			
H.T. Cushman Mfg.,Co., No.Bennington,Vt.	$25,000*	--	--
Federal Reserve Bank of New York			
Ira R. Crouse, Perth Amboy, N. J.	--	$10,000	--
Empire Trust Co., New York, N. Y.	1,000,000	--	--
Foster & Stewart Co., " "	45,000*	35,000	--
Joseph H. Meyer Bros. " "	--	3,479	--
Miller Cummings Co., " "	116,114*	--	--
Scaramelli and Company " "	---	2,500	--
L.C. Smith & Corona Typewriters,Inc.,N.Y.	150,000*	297,500	--
Nettie Shuff, Philadelphia, Pa.	8,960*#	4,788	--
Verna Whitfield, Brooklyn, N. Y.	45	--	--
Total	1,320,119	353,267	--

#In replacement of loan to S. Shuff's Sons, Inc., Brooklyn, N. Y.

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	Advanced Jan. 1 to Oct. 31 1933	Outstanding Oct. 31, 1933 Total	Amount secured by U. S. Govt. obligations
Federal Reserve Bank of Philadelphia			
Banta Refrigerator Co., Clearfield, Pa.	$711*	--	--
Darling Valve Mfg., Co., Williamsport, Pa.	15,000	--	--
Kurtz Bros., Clearfield, Pa.	75,000*	--	--
Adam Scheidt, Norristown, Pa.	67,500	--	--
William T. Tyler, Philadelphia, Pa.	12,000	--	--
Raymond E. Winter, Williamsport, Pa.	400	$400	$400
L.N. Renault & Sons., Inc., Egg Harbor, City, N. J.	25,000*	25,000	--
Total	195,611	25,400	400
Federal Reserve Bank of Cleveland			
American Savings Bank, Cleveland, Ohio	100,000	65,000	65,000
Bucyrus City Bank, Bucyrus, Ohio	28,000	--	--
Thomas B. Carmichael, Akron, Ohio	1,800	1,600	1,600
Farmers & Merchants Bank, Smithfield, Ohio	4,900	--	--
Warren J. Heldman, Cincinnati, Ohio	14,000	--	--
Tuscarawas Sav. & Loan Co., New Phila., O.	9,550	9,550	9,550
Total	158,250	76,150	76,150
Federal Reserve Bank of Richmond			
Alpine Orchard & Canning Co., Hancock, Md.	3,000	1,000	1,000
Blue Ridge Coal Co., Baltimore, Md.	2,880	2,880	2,880
K. C. Chinn, Lovettsville, Va.	200	200	200
P. F. Haigler, Orangeburg, S. C.	600	600	600
R. R. Mellette, Orangeburg, S. C.	100	--	--
E. A. Talbott, Ellicott City, Md.	34,000	22,000	22,000
Total	40,780	26,680	26,680
Federal Reserve Bank of Atlanta			
Alden Mills, New Orleans, La.	8,692	--	--
Atkinson & Co., " " "	600	--	--
Bank of New Roads, New Roads, La.	7,500	--	--
Citizens Bldg., & Loan Assn., Rome, Ga.	30,000	--	--
City Bank & Trust Co., Macon, Ga.	30,000	--	--
Geo. M. Cox, New Orleans, La.	2,000	--	--
Empire Trust Co., Atlanta, Ga.	11,000	--	--
Federal Land Bank, New Orleans, La.	300,000	--	--
A. J. Evans, " " "	950	--	--
Granite City Bank, Elberton, Ga.	25,000	--	--
Dr. Adolph Jacobs, New Orleans, La.	500	--	--
Alfred Lewis, Millen, Ga.	485	--	--
Lane Cotton Mills, New Orleans, La.	10,000	--	--
McFadden & West, " " "	600	--	--
New Orleans Stevedoring Co. " "	2,000	--	--
Bessie Scarborough, Poplarville, La.	1,000	--	--
Jackson J. Sells, Ft. Myers, Fla.	3,500	3,500	3,500
Southern Pecan Co., New Orleans, La.	600	--	--
George S. Weems, Shubuta, Miss.	4,017	--	--
A. B. Wright, Fayetteville, Tenn.	1,800	1,800	1,800
Total	440,244	5,300	5,300

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	Advanced Jan. 1 to Oct. 31 1933	Outstanding Oct. 31, 1933 Total	Amount secured by U. S. Govt. obligations
Federal Reserve Bank of Chicago			
Indiana Condensed Milk Co., Indianapolis, Indiana.	$67,500	--	--
International Harvester Co., Chicago, Ill.	210,000	--	--
Total	277,500	--	--
Federal Reserve Bank of St. Louis			
William Bahrenburg, Belleville, Ill.	4,750	4,750	4,750
Gabe Black, Little Rock, Ark.	2,000	--	--
Elkhorn Bk.&Tr. Co., Arkadelphia, Ark.	4,750	--	--
Farmers & Merchants Bk., Des Arc, Ark.	14,060	--	--
Charles P. Hamill, Belleville, Ill.	9,850	7,288	7,288
Peoples Bank, Indianola, Miss.	10,000	--	--
Barney Plessner, St. Louis, Mo.	2,250	2,150	2,150
W. T. Riley, New Madrid, Mo.	900	900	900
Sachar & Cantor, St. Louis, Mo.	18,500	--	--
T. C. Rosenberger, Little Rock, Ark.	450	450	450
Total	67,510	15,538	15,538
Federal Reserve Bank of Minneapolis			
Bank of Elk River, Elk River, Minn.	5,000	--	--
John Benson, Eagle River, Wis.	3,000	--	--
Peninsula Oil & Gas Co., Iron River, Mich.	1,000*	--	--
M. Ristinen, Menahoga, Minn.	30,000	--	--
Total	39,000	--	--
Federal Reserve Bank of Kansas City			
New Mexico Lumber & Timber Co., Bernalillo, N. M.	38,000*	--	--
Townley Metal & Hardware Co., Kansas City, Mo.	35,000*	--	--
Union Wire Rope Corp., Tulsa, Okla.	37,000*	5,100	--
Total	110,000	5,100	--
Federal Reserve Bank of San Francisco			
Ag. Credit Finance Corp., Phoenix, Ariz.	93,000	--	--
Am. Trust Co., Coeur d'Alene, Idaho	79,000	--	--
H. H. Benjamin, Anaheim, Calif.	18,000	6,600	6,600
Hibernia Savgs. & Loan Society, San Francisco, Calif.	1,000,000	--	--
J. L. McCarthy, Orofino, Idaho	3,400	3,400	3,400
Santa Cruz County B. & L. Assn., Santa Cruz, Calif.	18,000	18,000	18,000
Total	1,211,400	28,000	28,000
Total, all districts	3,885,414	535,435	152,068

*Secured otherwise than by U. S. Government obligations.

(B-940b)

APPLICATIONS OF INDIVIDUALS, PARTNERSHIPS AND CORPORATIONS FOR LOANS NOT GRANTED BY THE FEDERAL RESERVE BANKS IN 1933 TO OCTOBER 31.

eral eserve Bank	Number of applications not granted			Total number of applications not granted, January 1 to Oct. 31, 1933	Reasons for not granting loans applied for			Amount of loans declined Jan. 1 to Oct. 31, 1933*
	Oct. 1933	Sept. 1933	Aug. 1933		Paper not eligible	Paper not satisfactorily secured	Other credit available	
on	--	--	1	1	--	1	--	$100,000
York	6	13	8	83	15	67	1	4,074,400
adelphia	--	1	1	6	1	4	1	55,500
eland	--	--	--	3	3	--	--	15,000
mond	--	1	--	2	--	2	--	14,000
nta	--	--	2	20	8	12	--	680,900
ago	3	3	2	34	22	12	--	468,950
Louis	--	--	--	2	--	2	--	15,000
eapolis	2	3	--	11	2	8	1	306,000
as City	--	--	--	2	1	1	--	55,300
as	--	--	1	2	--	2	--	22,500
Francisco	--	--	2	5	--	5	--	140,000
Total	11	21	17	171	52	116	3	5,947,550

*Approximate; amounts sometimes not stated.

(B-940c)

November 2[illegible], 1933.

See Bu

The Calvin B. Taylor Banking Company

Brief Analysis of Agreement.

Reduce par value of capital from $100 to $10 a share.

Increase the number of shares by 4500.

Offer such new shares of the par value of $10 a share - first, to the present stockholders, and then to the depositors at $15 a share:

<u>In order to provide a fund for the additional protection of all the depositors in the said Institution</u>.

Further agreement:

1. The depositors to transfer to the bank 25% of the amount of their deposits:

"<u>For the purpose of creating a Guarantee Fund for the protection of the solvency</u>" of the bank

and

"<u>In order to at all times maintain such solvency</u>."

The bank is authorized and empowered to use any part or all of the said Guarantee Fund to replace any and all losses which it has in the past suffered or which it may in the future suffer, whether on account of losses in investments, depreciation in investments, uncollectibility of any of its assets, or otherwise.

Hereby releasing or discharging said bank of and from all liability for the repayment of said Guarantee Fund for any part thereof.

It is also provided that if at any time in the future the financial condition of the bank shall warrant the repayment of the Guarantee Fund in full or in part, then the Board of Directors of the bank, with the consent of the Bank Commissioner of Maryland, shall repay to said depositors ratably and in proportion to the amounts so set aside of their respective deposits, all or any portion of said Guarantee Fund <u>without interest</u>.

Said Guarantee Fund shall be considered as a Contingent Fund for the prevention of any impairment of the Capital Stock of said bank within the meaning of the laws of Maryland.

In the event of a consolidation, merger, reorganization, or future liquidation of said institution, this fund shall be preferred over the capital stock in a distribution of the assets by said institution.

No dividend shall be paid on the capital stock until the Guarantee Fund shall have been paid in full.

****

In this case, if an account were set up in which the Guarantee Fund is put down as a liability, the capital stock would be completely wiped out.

If this were a national bank under Revised Statute Section 5205, if the bank did not make good this deficiency in capital stock within three months by assessment upon the stockholders after receipt of notice from the Comptroller, the Treasurer of the United States would withhold interest upon all bonds held by him in trust for such association upon notice from the Comptroller.

If any such association shall fail to pay up its capital stock, and shall refuse to go into liquidation as provided by law for three months after receiving notice from the Comptroller, a receiver may be appointed to close up the business of the association under the provisions of Section 5234.

If this bank were a national bank, would it be possible for the Comptroller to place a receiver in the bank and wind it up under such agreement as the above? Clearly not, for the Guarantee Fund, at the most, is merely a contingent liability, and should not be set up as a direct liability of the company.

C O P Y

see Bu

August 18, 1933.

MEMORANDUM REGARDING ISSUE OF THOMAS AMENDMENT.

NOTES FOR PURPOSE OF RETIRING MATURING PUBLIC DEBT.

The issue of Thomas amendment notes to retire maturing obligations does not increase cash in the hands of the public. It merely adds to the excess reserves in the banks just as would be the case were the maturities to be met in the ordinary way by draft on Treasury balances.

Under present conditions the issue of Thomas Amendment notes would have unfortunate and disadvantageous effects because:

1. It is a waste of ammunition. The power to issue Thomas Amendment notes is, from the point of view of public psychology, the greatest inflationary instrument in the President's hands. If used at all, it should be reserved for an emergency in which nothing else would suffice to reach the objective. Its use now in lieu of milder devices available is unnecessary.

2. It would make public financing difficult. The maturities of interest bearing obligations during the present fiscal year are $221 millions in September, $725 millions in December, and $500 millions in March, a total of $1 billion. New money must be raised in the amount of approximately $2 billions. The Treasury can finance this program at reasonably low rates of interest and also refund a considerable portion of the fourt 4 1/4s. If, however, maturities are paid in Thomas Amendment notes, experience in other countries indicates that new money could be raised only at considerably increased interest charges.

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Thus, there is apt to be no saving in interest to the Government and the Government's credit, which has been carefully built up by the Administration, will be impaired. The use of Thomas Amendment notes at a time when clearly the Treasury is in a position to complete its financing program by normal methods, probably will be interpreted as the initiation of a policy of extreme inflation.

3. <u>It will create a wave of speculation.</u> The issue of Thomas Amendment notes will cause a speculative flight from the dollar into foreign currencies and into commodities and equities at home, thus risking a temporary speculative and exaggerated rise in prices, which, in the light of experience, would probably be subject to a sudden and damaging drop.

4. <u>It constitutes embarking upon a policy difficult to control or to stop.</u> If Thomas Amendment notes are issued to meet maturing obligations in September, there will be increasing pressure to meet subsequent maturing obligations in the same way and then to issue Thomas amendment notes to meet the expenditures of the Government. Such a policy once started would be politically very difficult to stop.

5. <u>Desired results may be obtained without control.</u> Open market operations to the extent engaged in will have the effect of putting out cash in Governments and increasing excess reserves, thus tending to support a more even rise in prices, without the ill effects described in Paragraph 3. Moreover, the open market operation is subject to control, if events move rapidly, by means of selling Governments.

6. Whatever advantage the United States now has by reason of the depreciation of the dollar in terms of sterling and gold might be jeopardized in the event that the issue of Thomas Amendment notes and the threat of further inflation here should prompt other countries to adopt offsetting steps whether trade embargoes or currency depreciation. This thought will be developed further in another memorandum.

7. It will retard the revival of the long time money market. Permanent recovery in large measure rests upon the availability of money for long time commitments, particularly in the basic heavy industries. The issue of Thomas Amendment notes probably would be construed to be a policy of extreme inflation which would further retard long time investments in the capital industries.

8. It will invite a sharp division of opinion. Public opinion today is united in an effort to cooperate fully with the President in his program of recovery. The issue of Thomas Amendment notes, however, with its implication of an extreme inflationary policy, would arouse those who believe in a more conservative policy. Thus, opinion now consolidated might be divided and the President and the whole recovery program might be subjected to opposition and criticism hitherto in large measure absent.

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To Governor Black August 26, 1933.

From Mr. Gardner.

Brief Abstract.

Monetary policy has taken the form of persuading the public that the currency can be depreciated, and that the instruments will be employed, if necessary, to bring about recovery of prices.

The objects of raising prices were:

1. To bring them into line with the debt structure inherited from a period of higher values, and

2. To restore the profits of agricultural and industrial enterprise, thereby leading to the re-employment of labor.

Once these objectives were achieved, the aim would be to hold the purchasing power of the dollar stable, but the immediate objective was to raise prices.

The initial stages of this monetary policy have been effective. The powers of currency issue and devaluation convinced the public that cash holdings are no longer immune from loss. People who had been anticipating falling prices, and had turned to cash as the one safe haven, suddenly began to spend. Prices responded with vigor in the organized markets.

In the economic system as a whole, however, there was slack in the form of idle plant and unemployed labor, and general prices were slow to move.

To spread the effects of the recovery, emphasis was shifted to the N.R.A.

At the present time, there is uncertainty as to how far the N.R.A. will affect the economic life of the country, particularly in agriculture and prices in the organized markets which have shown some tendency to subside.

This situation has led to a demand that the President should use his monetary powers.

Hitherto the vague threat has been sufficient.

The only real action has come from the Federal reserve open market operations.

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As against this renewed demand for inflation, J.P.W.'s memorandum of August 20th, 1933, urges the desirability of reestablishing confidence in the currency.

He would introduce the mild form of exchange "steadying" which was rejected by the President last June, and he would assure the public that there would be no experiments in the future with a commodity dollar. The chief advantage of restored confidence in the currency would be a greater willingness to enter into the long-term contracts essential to the conduct of modern business.

It might well be argued that the domestic recovery has reached a point where all that is now required is loosening up of the capital markets, and that assurance as to the future of the currency was the requisite first step.

J.P.W., however, throws chief emphasis upon the necessity of establishing some orderly relationship to the British Empire and to Europe generally.

He fears that without this America would be further isolated from the world and would fail to get the support that might come from a common advance.

It is hard for the writer to get excited about eliminating speculation from the exchange market. Had we taken that course last June, stating openly there was to be no interruption to our domestic program, the step might have relaxed the tenseness in the gold standard countries and have enabled the work of the London Conference to proceed.

It probably could not have proceeded far, however, and the Conference is now out of the picture until basic conditions become more settled.

The gold standard countries have found that they can shift for themselves. They are not threatened as much as they thought by inflation in America. England, too, appears to be content to play her usual waiting game.

If any worthwhile program could be worked out with England, - or more broadly, with the sterling group - for an attack on the still unsatisfactory economic situation, a policy of exchange steadying might well be an element in the program. The present Tory Government of England has set its face against the public works program, and the Bank of England can do little more than to continue keeping the short-term money market flooded with funds and gilt-edged securities high in price.

The writer, therefore, can not get excited about a program of exchange steadying at this juncture.

There could be no objection to the Federal Reserve Bank of New York quietly trying its hand at moderating exchange movements when it is given permission so to do. The effects should be beneficial, though not of major importance.

The same must be said of open market operations taken by themselves. They have no power to rectify the industrial situation. When banks are already plentifully supplied with funds for which they can not find satisfactory borrowers, increasing their funds still further will not make them lend.

The present potency of our open-market operations lies not so much in their quantitative influence as in their indication as to the drift of administration policy.

Large purchases are taken as a promise that the Government intends to inflate; a dwindling of purchases as an indication that the interest of the administration has turned elsewhere.

If the administration forswears the use of its most forceful inflationary weapons, namely, paper currency issues and devaluation, the response of the public to open market operations may become slight as in the gold standard years.

Desirable that preparations should be made for the future return to the gold standard. The program developed at the London Conference and further elaborated by J.P.W. looks in the right direction.

The gold standard would be strengthened by confining gold to the circle of central banks, and by freeing reserves now impounded by law for use internationally.

A better direct control by central banks should be established both over international and domestic capital markets - perhaps the greatest potential upsetting factors in the flow of income. These powers, together with the more conventional weapons of a central bank, can perhaps be used more consciously than ever before in the interest of preserving economic equilibrium.

Impossible to give any assurance, however, of stability through central bank action, or through any monetary means.

In pointing out the crudities of the commodity dollar and the variable gold dollar, we must be careful not to imply that the ends sought through the devices can be obtained by the more refined and tested device of central bank action.

We must frankly point out that only through control of all the processes of production and consumption of goods could any assurance of general price stability be given. It is not possible of achievement by monetary means alone.

This inability to achieve any definitely predictable result through monetary action, and the fact that we have pretty much shot our bolt already as far as easy money is concerned, leaves us without any very significant new contribution to make at the present time.

We must follow the general lines of administration policy in our open market operations, but no great independent significance will attach to them.

The work of cleaning up the banking structure is of supreme importance, but is rather a matter of individual situations than general credit p olicy.

Once things are under way, our problem will be greater. If a runaway currency inflation really begins to threaten, if the price objectives of the administration are reached and passed, and the movement is getting out of hand, then a series of moves will be necessary, - a reversal of Federal reserve open-market policy and announcement of dollar stabilization measures by the President.

The first of these moves will be impossible if we are not free to sell the short-term Treasuries we have purchased, and that freedom will depend upon whether or not the revenues of the Government are by that time sufficient to cover the ordinary expenses. This in turn will depend upon the success of measures taken now.

Federal reserve sale of securities may have to be extraordinarily heavy because of the excess reserves now being accumulated by member banks, the potentially available currency in hoards, and the present unutilized power of national bank note issue. The problem will only be complicated further if devaluation of the dollar meanwhile takes place at a rate such as to attract gold from abroad, and swell excess member bank reserves without adding correspondingly to the open-market ammunition of the Federal reserve.

Devaluation of this character really would bring about the collapse of the gold standard countries, - something that mere speuclative depreciation of the dollar can not do.

The instrument of full legal devaluation is one that should not be employed until we are ready to return to gold after a period of de facto stabilization.

Until that time the mere suggestion from official sources that devaluation will occur and will be of such and such magnitude, should be a sufficient use of this weapon.

J.P.W. and J.H.R. both suggest the use of alterations in the price of gold as a permanent method of long-run control over commodity prices. The influence on commodity prices of such a device is remote and uncertain, but if gold should be confined to central bank reserves, changes in the price of gold by international agreement might be employed to mark central bank reserves up or down and thus adapt them better to a developing world situation.

The fact that gold could be obtained from a central bank only for export to other central banks, and that there would be no speculative advantage in making such transfers in view of the international uniformity of the agreement, would prevent speculative raids on central banks while the change was under discussion. This would not be the case if a single country should attempt such alterations.

November 7, 1933

Monetary policy over-emphasized

A great deal of attention has been given lately to the monetary policies pursued by the administration. It is not fitting at this time, while the experiment is in progress, to discuss this subject. It has occurred to me, however, that the emphasis placed on this phase of the program is out of proportion to its proper role in the general plan to bring about recovery. We hear a great deal about orthodox and unorthodox economists, but as I observe the situation, I find that they all agree on a great many propositions.

Reduction of unemployment

They agree that unemployment must be done away with and that in order to do that there must be an encouragement of industrial production and particularly of those industries which produce goods that are not currently consumed in the course of a few months or a year. The great mass of unemployment is in those industries engaged in the production of what is known as durable goods, and lasting recovery depends on the restoration of activity in these industries. The way to remedy that situation, in so far as it can be done by Government policy, is to undertake public works on as large a scale as conditions permit; to encourage building activity where building is desirable, and to encourage the building of railroad equipment by one means or another. All of these things are being done.

Relief of debtors

Another thing that everyone agrees on is that the burden of debt on many classes of the community is too heavy to bear and must be relieved. It is also generally agreed that where debt has been incurred at a much higher price level the indebtedness is not only too heavy to be discharged at the present price level, but is also essentially unfair. Where a farmer borrowed the price of one bushel of wheat, it is clearly unfair to make him pay back four bushels. The remedy for that, aside from raising the price level, is to provide machinery for reducing the carrying charges on debts. For it is carrying charges alone that a debtor has to pay. It is often forgotten that debt in the aggregate is never paid and increases rather than decreases in times of prosperity. What is necessary is a proper relationship between people's income and the service of their debts. Machinery for improving that relationship exists under the Farm Credit Administration, the Home Loan Banks, the Home Owners' Loan Corporation, and other agencies.

Readjustment of price relationships

Still another consideration on which everyone agrees is that there must be a better relationship between the prices of different groups of commodities, such as farm prices and industrial prices; prices of raw materials and of finished goods, and prices and wages. Progress in improving these relationships is being made through the activities of the Agricultural Adjustment Administration; through processing taxes and control of production. Considerable improvement in this respect has already been brought about by the rise in prices since last spring which has been more considerable in the case of agricultural prices and of raw materials in general than in the price of industrial and finished products.

Strengthening of banks and liquidation of frozen deposits

There is also complete agreement among holders of all shades of opinion that the fundamental necessity of the situation is to keep the banks that are open in that condition and to expedite the repayment of deposits to depositors in banks that are still closed. For that purpose great efforts are being made to supply additional capital to all banks that need it, so that they may be qualified for admission into the deposit insurance corporation. Vigorous efforts are also being made under a special committee in the Reconstruction Finance Corporation to pay off depositors in closed banks on the basis of the value of remaining assets as promptly as is feasible. These two banking measures are expected to contribute greatly to the reestablishment of public confidence in banks; the return of money from hoarding, and the restoration of buying power to individuals and concerns that have been crippled through the tying up of their deposits in closed banks.

Unanimity on fundamentals

Differences of opinion in Washington are numerous and acute, but they relate for the most part to matters of emphasis; to the best technique of bringing about the desired results and to the relative effectiveness of different pieces of machinery. There is substantial unanimity, not only as to objectives, which were summarized by the President as a restoration of employment; the relief of debtors; the reestablishment of better price relationships, and the restoration of confidence in banks, but also as to the general means that can be employed to bring about the desired results.

I believe that it is worth while to point out these fundamental elements on which there is substantial unanimity, because newspapers from the very necessity of their work and the taste of their readers are inclined to magnify disagreements and disputes and to minimize the fundamental harmony which prevails and which contains the greatest hope of the success of the administration's efforts to bring about recovery and to save the fundamentals of our political and economic system.

See Au

(Copy)

Sept. 18, 1933.

The Federal Reserve Board

Mr. Wingfield, Assistant Counsel.

Deferred Certificates issued to depositors in connection with reorganization of State banks in Illinois.

On September 11 and 12, 1933, the Auditor of Public Accounts of the State of Illinois and his assistants conferred with members of the Board and the Board's staff with reference to whether certain deferred certificates of deposit (the provisions of which are described in detail hereafter) issued to depositors in connection with the reorganization of State banks in the State of Illinois represent <u>liabilities</u> of the bank, and requested a reconsideration of rulings heretofore made by the Board in comparable circumstances.

The Auditor advised that numerous Illinois State banks had been reorganized under a plan involving the issuance of such deferred certificates to depositors and, in view of the ruling made by the Board in connection with an application of one of these banks for membership that the capital of the bank was impaired by the liability to pay such certificates and the bank was accordingly ineligible for admission to membership, he desired a reconsideration of the question and suggestions as to what might be done in order to eliminate the legal objection to the admission of such banks to membership. It was suggested that it might be possible for such banks to gain admission to the Federal Deposit Insurance Corporation and obtain an insurance of their deposits until July 1, 1936, even though such banks at this time are not eligible for admission to membership in the Federal Reserve System, and that, prior to July 1, 1936, when nonmember banks are no longer eligible for the benefits of insurance, means might be worked out for eliminating the liability of each of such banks for the payment

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of the deferred certificates. It was agreed that the Auditor would take up with the Deposit Insurance Corporation the question of the admission of such banks to the benefits of that Corporation.

The Auditor further pointed out that plans had been perfected for the reopening of certain State banks on the basis of the issuance of deferred certificates, that some of these banks are members of the Federal Reserve System, and that the Federal Reserve Agent at the Federal Reserve Bank of St. Louis is unwilling to recommend that the Secretary of the Treasury issue a license to such banks in view of the impairment of their capital which would be caused by the liability on the proposed deferred certificates. It was requested that the Board give careful consideration to the provisions of the certificates which it is proposed will be issued in these cases and advise whether, under such provisions, there is any liability on the bank to repay the amount represented by the certificates. The deferred certificates used in the case of the State Bank of Collinsville, Collinsville, Illinois, one of the member banks, has been furnished by the Auditor for the Board's consideration.

Obligation of Bank to pay deferred certificates.

The papers which have been furnished in this case are (1) a copy of the depositor's agreement with the bank and (2) a copy of the certificate issued by the bank to the depositor executing the agreement. The depositor's agreement contains the following provisions:

"The undersigned, ________________, a depositor in the State Bank of Collinsville, in consideration of the execution of like agreements on the part of other depositors of said bank, does hereby covenant and agree to keep on deposit with said bank, and/or does hereby waive, surrender and release said bank from payment of fifty per cent of the amount standing to (his, her, its) credit on the books of said bank at the close of business, March 3, 1933, * * * hereby waiving all right to ask or demand said sum of money, and agreeing to accept in lieu of payment in cash and as evidence of said sum waived a deferred certificate and/or a certificate of beneficial interest issued by said bank for like amount, payable out of the future recoveries on segregated assets and the net profits of the bank, and before any dividend or returns of any kind, or character are payable to the stockholders."

This agreement is signed by the depositor and accepted by the bank through an authorized officer.

The certificate issued by the bank to each depositor executing the agreement referred to above contains the following provisions:

"This certifies that ______________ hereinafter designated 'Certificate Holder' has, * * * transferred and assigned to said Bank ______________ of the amount of money which the above mentioned Certificate Holder had on deposit in said Bank at the close of the business of said Bank on March 4th, 1933, and that in consideration of said assignment said Bank has agreed, and hereby agrees, to pay the above mentioned amount to said Certificate Holder, but without priority over other depositors who have executed like assignments, in current funds solely out of the future net profits of said Bank, if and when such future net profits are earned (Net future profits are operating profits plus recoveries, less charge-offs and proper provision for reserves), and in all events before dividends to the stockholders of said bank are paid.

"It is agreed that in the event of voluntary or involuntary liquidation of the assets of the __________, ____________, Illinois, by the appointment of a receiver or otherwise, or in the event that said Bank shall discontinue carrying on the business of a Bank, or shall merge or consolidate with or transfer all or a major portion of its assets to another banking institution at any time prior to the payment of the above mentioned amount, the holder of this certificate shall be entitled to share in the proceeds of such liquidation, sale, merger or consolidation only after all liabilities of said Bank to its depositors and creditors shall have been paid or provided for, but in any event the holder hereof shall be entitled to priority over any of the stockholders of said Bank."

This certificate is issued by the bank through its duly authorized officer.

It will be noted that the agreement and the certificate refer to the payment of such certificate out of future recoveries and net profits of the bank and also further provide that, in the event of liquidation, merger, consolidation, or transfer of assets, the certificate holders, after payment of unwaived deposits claims of and other creditors of the bank, have priority of payment over any of the stockholders of the bank. In these circumstances, it is apparent that the bank has entered into a binding agreement to pay such certificates at some time and that, if it is placed in liquidation or involved in a merger or consolidation prior to the payment of such certificates, it must pay such certificates out of any assets on hand after payment of non-waiving depositors and creditors. Such payment must be made in event of liquidation regardless of whether the assets are derived from earnings or recoveries of the bank after the issuance of the certificates or are derived from assets in the bank at the time of the issuance of the certificates over and above the amount of claims of non-waiving depositors or creditors.

It also may be observed that these certificates arise out of agreements between the bank and its depositors, and that it is clearly the intent of such agreements that the depositors voluntarily authorize the bank to defer the immediate payment of their lawful claims against the bank and, in consideration thereof, the bank agrees definitely to pay such claims at some future time out of any assets remaining after non-waiving depositors and creditors are paid. It seems clear, therefore, that the depositors executing such agreements and accepting such deferred certificates do not release the bank from its liability to pay their claims as depositors but merely defer the time when such claims may be paid. Accordingly, there does not appear to be any legal difference as to the liability of the bank for the payment of such deferred claims and the liability of the bank to pay any deposit. The only difference between the two classes of claims is one of time of payment and of preference of payment in the event of liquidation, and it seems apparent that these differences do not justify a conclusion that there is no liability on the bank for the payment of the deferred certificates above referred to.

The counsel for the Auditor of Public Accounts has suggested that the stockholders of the bank have authorized the bank to act merely as agent in distributing future recoveries and earnings, to which the stockholders would normally be entitled, to deferred certificate holders and that, accordingly, the liability for the payment of such deferred certificates is on the stockholders of the bank rather than the bank itself. It does not appear how this can be true, on the basis of the facts involved in the case presented, when the stockholders of the bank are not parties to any of the agreements executed, but such agreements are executed between the bank itself and the depositors thereof. It may also be noted that there does not appear to be any way in which a stockholder can relieve the bank from its liability to pay the claims of depositors but that the bank can only be relieved of such liability by the agreement of the depositor. As noted above, the depositors here involved have not relieved the bank of the liability to pay their deposits but have merely entered into agreements with the bank, permitting the bank to defer the time of payment of such claims.

In view of these facts, and after a careful consideration of this matter, I am clearly of the opinion that the State Bank of Collinsville or any other bank issuing certificates similar to those described above, would itself have a liability for the payment of such certificates.

EFFECT ON APPLICATIONS FOR MEMBERSHIP AND MEMBER BANKS.

Under the provisions of Section 9 of the Federal Reserve Act, a State bank may not be admitted to membership in the Federal Reserve System unless its capital stock is unimpaired. Accordingly, a bank which has a liability for the payment of deferred certificates of the kind described above sufficient to impair its capital, would not be eligible for membership in the Federal Reserve System. It is understood that the State Bank of Collinsville proposes to issue deferred certificates to its depositors in the amount of approximately $200,000, the liability on which would be sufficient to impair and possibly wipe out the bank's capital stock of $100,000.

In these circumstances, if the bank were applying for admission to membership in the Federal Reserve System, it would not be eligible for admission. However, as noted above, the State Bank of Collinsville is already a member and the question presented in this particular case is whether the Secretary of the Treasury, upon the recommendation of the Federal Reserve Bank of St. Louis, should issue a license to the bank to reopen as a member bank. In view of the Board's rulings with regard to the liability of banks for payment of deferred certificates such as those described above, the Federal Reserve Agent at St. Louis is unwilling to recommend that the Secretary of the Treasury issue a license in this case. In this connection it may be noted that, if the bank were licensed to reopen with an impaired capital, the Board might, if it deemed it advisable, institute appropriate proceedings to require the bank to repair its capital and, upon failure to do so, expel it from membership in the Federal Reserve System. In these circumstances, of course, it would not seem advisable for the bank to be licensed as a member bank. There would seem to be two possible ways thru which the bank might be reopened:

(1) - Such bank might voluntarily withdraw from membership in the Federal Reserve System, and with the approval of the Auditor of Public Accounts of Illinois, reopen as a nonmember bank. If this were done, the bank could apply for readmission to membership in the System after it had eliminated the liability on the deferred certificates.

(2) - The bank could transfer to trustees, for the benefit of the depositors holding deferred certificates, the charged off assets of the bank and, with the consent of such depositors, exchange certificates issued by such trustees upon which the bank would have no liability for the deferred certificates now held by the depositors upon which the bank has a liability. If this were done, the new certificates would give the depositors a pro rata interest in the

recoveries made on the charged off assets held by the trustees. If deemed advisable, agreements might also be obtained from the stockholders of the bank that they would turn over to the trustees any dividends received from the bank on their stock for the benefit of holders of certificates issued by the trustees until all of such certificates are paid.

The advisability of a bank obtaining agreements of the kind just referred to from its stockholders would seem to be very questionable, since it is apparent that, in a case of this kind, any dividends on the stock of the bank will be for the benefit of deferred certificate holders for a considerable period of time and that, for such period, the bank's stock will have little, if any, value from the standpoint of earnings of the bank and, accordingly, will not be marketable. On such a basis, it is doubtful whether the people of a community will retain confidence in a bank so as to enable it to maintain or increase its deposits in competition with other banking institutions. It also would seem that, in any case of a reorganization of a bank where the stockholders have done everything possible to discharge their obligation to the bank and to save the depositors from loss, the depositors are not equitably entitled to any future earnings of the bank. However, there may be circumstances, where the stockholders have not fully discharged their obligation and the depositors have already agreed to a plan of reorganization and accepted the obligation of the bank to conserve future net earnings for the benefit of waiving depositors until their claims are satisfied, which would justify the execution of agreements by stockholders to turn over any dividends on their stock to such waiving depositors, in lieu of the agreement of the bank itself to conserve earnings for the benefit of the waiving depositors.

There is attached for the Board's consideration a draft of a letter to the Auditor of Public Accounts of Illinois advising him of the Board's views with regard to the liability of the bank on the deferred certificates issued by the bank and described above and containing the suggestions outlined with regard to the action the bank might take to eliminate the difficulties involved. It is suggested that a copy of such letter be forwarded to all of the Federal Reserve Agents for their information.

MISLEADING STATEMENTS.

It is understood that the Illinois banking authorities do not contemplate that the liability of a bank for the payment of deferred certificates will be shown in the published statements of the bank, and, accordingly, such a statement will not itself indicate any impairment of the bank's capital. It seems clear that a statement of this kind would not show the true liabilities of the bank and would be misleading. It is proposed that each such statement shall be accompanied by a foot note that "The bank has outstanding $____________ face amount of deferred certificates, payable solely out of future net profits, if and when such net profits are earned * * * representing contributions to the bank and subordinated to all deposit and creditor liabilities but payable before any distribution to stockholders as such". It has also been suggested that certificates of stock of any bank having deferred certificates outstanding be stamped with information showing that such certificates have a priority over stockholders in distribution of assets of the bank. It is doubtful whether such a foot note to the published statement of the bank or such a stamp on the stock certificates of the bank would eliminate the misapprehension which might be caused by the bank's statement itself, and such explanations would not seem to justify the publication of a misleading statement by the bank on which innocent parties might rely.

BOARD'S ACTION ON CASES INVOLVING COMPARABLE CIRCUMSTANCES.

The Board has had occasion to consider in a number of instances circumstances comparable with those involved in the proposed issuance of deferred certificates referred to above, and in each such case has ruled that the bank had a liability for the payment of the claims similar to those of such deferred certificate holders.

POCOMOKE CITY CASE.

This question first arose in connection with a proposed reduction of capital of the Citizens National Bank of Pocomoke City, Maryland. In connection with this reduction, it was proposed that waiving depositors should accept, in lieu of their deposit claims, in an aggregate amount of $135,000, preferred stock with a par value of $40,000, to be retired at $135,000. Provision was made that such preferred stock would be retired out of future earnings, and, in the event of the liquidation, was payable after claims of depositors and other creditors had been satisfied but before any distribution to common stockholders, in the aggregate amount of $135,000. Since the waiver of deposits, except as to the amount of the par value of the preferred stock, was to be used to charge off losses, it was proposed that the preferred stock would be carried on the books and published statements of the bank at only its aggregate par value of $40,000. After careful consideration of this case, the Board took the position that the bank had a liability for the payment of the aggregate retirement price of the preferred stock of $135,000, resulting in an impairment and almost an entire elimination of its capital. In the circumstances, the Board declined to approve the proposed reduction in the capital stock of the Citizens National Bank of Pocomoke City, which was a part of a plan of reorganization of that bank. The Comptroller of the Currency was advised of the Board's action in this case on May 3, 1933.

PATAPSCO NATIONAL BANK CASE.

Soon after disposing of this case, the Board considered an application for the reduction of the capital stock of the Patapsco National Bank of Ellicott City, Maryland, in which circumstances substantially similar to those involved in the Pocomoke City case were involved. In a letter of May 18, 1933, the Board advised the Comptroller of the Currency that it could not properly approve the proposed reduction in the capital stock of the Patapsco National Bank for substantially the same reasons as were involved in its decision in the Pocomoke City case. The Comptroller then requested the Board to reconsider the decision it had reached in the case of the Patapsco National Bank. The Board gave a careful reconsideration to the facts involved in the case, and on June 2, 1933, advised the Comptroller that it did not feel that it could properly approve the proposed reduction under the plan submitted.

On June 20, 1933, copies of the Board's rulings in the Pocomoke City and Patapsco cases were forwarded to all of the Federal reserve agents for their information. I also understand that as a result of these rulings the Comptroller of the Currency no longer authorizes the issuance of preferred stock by national banks which is retirable at a premium.

FARMERS STATE BANK OF CHADWICK CASE.

On June 28, 1933, the Board received an application for membership in the Federal Reserve System from the Farmers State Bank of Chadwick, Illinois. It appeared that the bank had obtained agreements from its depositors whereby 25 per cent of their deposits were assigned to the bank and used to eliminate criticized assets. The bank delivered to each such depositor a deferred certificate of deposit which was to be retired out of earnings of the bank, and, in the event of liquidation, was to be paid after claims of depositors and other creditors had been satisfied but before any distribution to stockholders. On August 14, 1933, the Board ruled that, since the liability for the payment of such deferred certificates was sufficient to impair the capital stock of the Farmers State Bank of Chadwick, such bank, under the law, was not eligible for admission to membership in the Federal Reserve System.

On August 14, 1933, a copy of the Board's ruling in this case was forwarded to all of the Federal Reserve Agents for their information.

BANK OF EDWARDSVILLE CASE.

On June 30, 1933, the Board approved the application of the Bank of Edwardsville, Illinois, for admission to membership in the Federal Reserve System on condition that the stockholders would raise $150,000 to eliminate losses. It later developed that the bank proposed to issue to such stockholders deferred certificates in the amount of $150,000 which would entitle contributing stockholders to the repayment of their contributions out of earnings of the bank, and, in the event of liquidation, after satisfaction of claims of depositors and other creditors, to payment out of any remaining assets of the bank before any distribution to stockholders. The Federal Reserve Agent at St. Louis raised an objection to this proposed procedure and after further consideration the bank decided not to issue such deferred certificates in the amount of $150,000. However, the bank desired to issue certificates of this kind in the amount of approximately $11,500, since it appeared impossible to obtain contributions from certain stockholders and it was necessary for other stockholders to contribute more than their share in this amount. It appeared that the issuance of deferred certificates in the amount of approximately $11,500 would not result in an impairment of the bank's capital, and on July 8, 1933, the Board permitted the bank to issue deferred certificates in an amount not exceeding $11,500 on the condition that such amount be shown on the bank's books and all published statements as a direct liability of the institution and with the understanding that when this had been done the bank's capital and surplus would remain unimpaired.

LETTER TO GOVERNOR WHITE.

In a letter of August 21, 1933, addressed to the Governor of the State of Ohio in connection with cases where banks had obtained agreements from their depositors restricting to some extent their right of withdrawal of their deposits, the Board advised the Governor of Ohio that in some cases it had been found that although depositors waived their right to demand immediate payment of their deposits the bank remained liable to repay such deposits at some future time and, when such liability was taken into consideration the bank's capital was impaired or wiped out. The Board further said that "in such cases, of course, the bank was not eligible for membership in the Federal Reserve System".

MARYLAND PLAN.

On August 7, 1933, the Board received a request from the Assistant Federal Reserve Agent at Richmond for advice regarding the eligibility for membership of a bank reorganized under a plan of reorganization submitted by the Bank Commissioner of the State of Maryland. It appeared that depositors would waive part of their deposits and receive in return certificates of beneficial interest which would be preferred to all claims of stockholders and would be payable from the recovery in charged off assets and from such part of the earnings of the bank as the board of directors, with the approval of the Bank Commissioner, might determine. It appeared that these certificates would be direct liabilities of the bank but would be carried on its books in the nominal amount of $1.00. On August 22, 1933, the Board referred the Federal Reserve Agent at Richmond to the statement contained in its letter of August 14, 1933, with regard to the eligibility for membership of the Farmers State Bank of Chadwick, Illinois, referred to above, as containing a clear description of the Board's position with regard to cases of this kind. In other words, the Board advised that in cases where the liability for the payment of such deferred certificates is sufficient in amount to impair the capital of the bank such bank is not eligible for admission to membership under the provisions of the Federal Reserve Act.

ILLINOIS PLAN.

On August 30, 1933, the Board addressed a telegram to the Federal Reserve Agent at St. Louis with regard to the plan used for the reorganization of State banks in Illinois whereby deferred certificates are issued to depositors of the bank who waive the right to withdraw immediately a part of their deposits, such certificates being payable out of earnings of the bank and, in the event of liquidation, before any distribution of assets to stockholders. It appeared that such certificates would be carried in the bank's statements in the nominal amount of $1.00. In this connection, the Board called attention to its action in the case of the Farmers State Bank of Chadwick, Illinois, and stated that the principles involved in the Board's decision in that case were applicable to the facts involved in the Illinois plan described above.

It will be seen therefore, that in each case which has been presented to the Board involving circumstances comparable to those involved in the plan of reorganization of the State Bank of Collinsville, Collinsville, Illinois, the Board has consistently taken the position that the deferred certificates or similar documents represented a liability of the bank involved and, when the question of eligibility for admission to membership was involved, that where such liability was in sufficient amount to impair the bank's capital stock such bank was not eligible for admission to membership in the Federal Reserve System.

Sec BU

October 31,1933.

Governor Black

Mr. Wyatt, General Counsel.

Purchase by Federal Reserve Banks of Obligations of Reconstruction Finance Corporation.

You have requested an opinion on the question whether the Federal reserve banks may purchase notes, debentures, bonds or other such obligations issued by the Reconstruction Finance Corporation pursuant to the provisions of Section 9 of the Reconstruction Finance Corporation Act approved July 21, 1932.

OPINION

While the question is not entirely free from doubt, I am of the opinion that the Federal reserve banks are not authorized to purchase such obligations of the Reconstruction Finance Corporation and that they are specifically forbidden to do so.

DISCUSSION

Section 9 of the Reconstruction Finance Corporation Act, which authorizes the Reconstruction Finance Corporation to issue its notes, debentures, bonds or other such obligations, specifically provides that:

> "Such obligations shall not be eligible for discount or purchase by any Federal reserve bank."

Unless this provision of law has been repealed by some later act of Congress, therefore, the Federal reserve banks are specifically forbidden to purchase such obligations.

I know of no act of Congress repealing, amending or superseding the provision quoted above, unless it can be said that it is impliedly repealed

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by the following provision of Section 43 of the Act of May 12, 1933, commonly known as the "Thomas Amendment":

"Sec. 43. Whenever the President finds, upon investigation, that (1) the foreign commerce of the United States is adversely affected by reason of the depreciation in the value of the currency of any other government or governments in relation to the present standard value of gold, or (2) action under this section is necessary in order to regulate and maintain the parity of currency issues of the United States, or (3) an economic emergency requires an expansion of credit, or (4) an expansion of credit is necessary to secure by international agreement a stabilization at proper levels of the currencies of various governments, the President is authorized, in his discretion--

"(a) To direct the Secretary of the Treasury to enter into agreements with the several Federal Reserve banks and with the Federal Reserve Board whereby the Federal Reserve Board will, and it is hereby authorized to, notwithstanding any provisions of law or rules and regulations to the contrary, permit such reserve banks to agree that they will, (1) conduct, pursuant to existing law, throughout specified periods, open market operations in obligations of the United States Government or corporations in which the United States is the majority stockholder, and (2) purchase directly and hold in portfolio for an agreed period or periods of time Treasury bills or other obligations of the United States Government in an aggregate sum of $3,000,000,000 in addition to those they may then hold, unless prior to the termination of such period or periods the Secretary shall consent to their sale. * * *"

It will be noted that this provision contemplates the purchase by Federal reserve banks, under certain conditions and subject to certain limitations and restrictions, of obligations of "corporations in which the United States is the majority stockholder". Inasmuch as the United States owns all of the stock of the Reconstruction Finance Corporation, the question arises: (a) whether the above language authorizes the Federal reserve banks to purchase obligations of the Reconstruction Finance Corporation when the Secretary of the Treasury has entered into agreements with them for such purchases pursuant to the direction of the President and when the Federal Reserve Board has authorized such action; or (b) whether the above language authorizes the Federal reserve banks to enter into agreements to conduct open market operations only in obligations of the United States and in such corporate obligations as they were previously authorized to deal in "pursuant to existing law" - - e.g., obligations of the Federal land banks and the Federal intermediate credit banks, of which the United States is a majority stockholder and whose obligations the Federal reserve banks were previously authorized to purchase "pursuant to existing law", when they had maturities not exceeding six months.

PRESUMPTION AGAINST IMPLIED REPEALS

In order to construe Section 43 of the Act of May 12, 1933, as authorizing the purchase by the Federal reserve banks of obligations of the Reconstruction Finance Corporation, it would be necessary to hold that the general language quoted above repeals by implication the very specific language of the Reconstruction Finance Corporation Act forbidding Federal reserve banks to purchase such obligations; and such a construction would violate certain well settled rules of statutory construction.

The presumption is always against an intention to repeal a statute by implication; and a statute will not be construed as repealing an earlier statute by implication unless it clearly appears that it was the intent of Congress to repeal the earlier statute or to enact a new law in place of the old. Bookbinder v. United States (C.C.A.), 287 Fed. 790,792. See also Summers v. Atcheson T. & S.F. Railway, 2 Fed. (2d) 717, 720; Stevens v. Biddle, 298 Fed. 209, 213.

This rule is especially applicable to a situation such as that we have here in which the question arises whether a later statute expressed in general terms was intended to repeal by implication an earlier statute stated in specific terms. The fact that the earlier statute is specific creates an additional presumption that it was not intended to be repealed by the later statute in the absence of express words to that effect; and the earlier specific statute should be construed as remaining in force as an exception to the general rule stated in the later statute, unless it is manifestly impossible to reach the conclusion that Congress intended such a result. Rodgers v. United States, 185 U.S. 83. See also Eastern Extension, A. & C. Telegraph Co. v. United States, 231 U.S. 326.

It might be contended that the words "notwithstanding any provisions of law or rules and regulations to the contrary" evidence an intention to repeal any provisions of law which might limit the exercise of the broad powers conferred by Section 43; but the words "pursuant to existing law", which appear in clause (1), indicate equally as clearly an intent to preserve the provisions of existing law in so far as the open market operations described in clause (1) are concerned.

THE LEGISLATIVE HISTORY OF THIS QUESTION.

The legislative history of the Reconstruction Finance Corporation Act greatly strengthens the presumption against an implied repeal. The original bill which later became the Reconstruction Finance Corporation Act contained a provision expressly making obligations of the Reconstruction Finance Corporation eligible for discount and purchase by Federal reserve banks; but, after considerable legislative maneuvering, these provisions and certain proposed compromise provisions were stricken out and there was inserted in lieu thereof the provision now appearing in the law which specifically renders such obligations ineligible for purchase or discount by Federal reserve banks.

The Reconstruction Finance Corporation Bill, as originally introduced in the Senate on December 9, 1931, (S. 1, 72nd Congress, 1st Session, page 9) contained the following provision:

> "Section 9. * * * The Federal Reserve Banks shall have the same powers (1) to discount notes, drafts, and bills of exchange secured by obligations issued by the corporation under this Act, (2) to make advances to member banks on their notes secured by such obligations, (3) to use all paper so acquired, and (4) to purchase and sell such obligations, as they have with respect to bonds and/or notes of the United States: * * *"

This language was stricken out by the Senate Committee on Banking and Currency and in lieu thereof the following paragraphs were added (S. 1, reported by the Senate Committee on Banking and Currency, January 6, 1932, pages 27, 28, 29):

> "Section 13 of the Federal Reserve Act is hereby amended by adding after the words: 'Any Federal Reserve Bank may make advances to its member banks on their promissory notes for a period not exceeding fifteen days at rates to be established by such Federal Reserve banks, subject to the review and determination of the Federal Reserve Board, provided such promissory notes are secured by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for rediscount or for purchase by Federal reserve banks under the provisions of this Act or by the deposit or pledge of bonds or notes of the United States' the word '<u>but no reconstruction bonds issued under the Act of 1932, entitled, 'An Act to provide emergency financing facilities for banks and other financial institutions and other purposes' shall be used as such security.</u>"

"Section 13a of the Federal Reserve Act is amended by adding after the words: 'Provided, That notes, drafts, and bills of exchange with maturities in excess of six months shall not be eligible as a basis for the issuance of Federal-reserve notes unless secured by warehouse receipts or other such negotiable documents conveying and securing title to readily marketable staple agricultural products or by chattel mortgage upon live stock which is being fattened for market' the words 'nor shall notes, drafts, and bills of exchange secured or collateraled by reconstruction bonds be so eligible."

"Subsection (f) of Section 14 of the Federal Reserve Act is amended to read as follows:

"'To purchase and sell in the open market, either from or to domestic banks, firms, corporations, or individuals, acceptances of Federal intermediate credit banks and of national agricultural credit corporations, and reconstruction bonds issued under the provisions of the Act of 1932, whenever the Federal Reserve Board shall declare that the public interest so requires.'"

During the debates on the floor of the Senate, the three paragraphs quoted above were stricken out; the first two by an amendment of Senator Bulkley and the third paragraph by an amendment of Senator Walcott. (Congressional Record, 72nd Congress, 1st Session, Vol. 75, part 2, page 1489 and page 1480, respectively).

By another amendment of Senator Bulkley the following sentence was inserted at the end of Section 9:

> "Such obligations shall not be eligible for discount or purchase by any Federal Reserve Bank."

(Congressional Record, 72nd Congress, 1st Session, vol. 75, page 1489)

This is the wording which appeared in the Reconstruction Finance Corporation Act as finally enacted.

Furthermore, although a limited search has failed to reveal any printed bill or committee report disclosing the fact, the files of this office show that, when Senate Bill 320 of the 73rd Congress "A Bill to provide for direct loans by Federal reserve banks to State banks and trust companies in certain cases" which later became the Act of March 24, 1933, was pending, there was submitted for Senator Glass's consideration, as recently as March 14, 1933, a proposed amendment which would have added to the Emergency Banking Act of March 9, 1933, a section containing exactly the same language as that contained in the original draft of the Reconstruction Finance Bill authorizing Federal reserve banks to purchase and sell obligations of the Reconstruction Finance Corporation; but this proposed amendment was rejected by Senator Glass.

As recently as January 8, 1932, Congress as a whole had given special consideration to the question whether obligations of the Reconstruction Finance Corporation should be eligible for discount or purchase by the Federal reserve banks and decided this question in the negative, after a definite struggle and after rejecting proposed compromises. It seems probable that, if Congress had decided a year and a half later to reverse this policy, it would have done so specifically and not merely by the general and ambiguous language contained in the Thomas Amendment. Furthermore, it is extremely probable that the words "pursuant to existing law" were incorporated in the Thomas Amendment for the specific purpose of preventing any such result.

The words "pursuant to existing law" appeared in the Thomas Amendment when it was first introduced in Congress; but that amendment may have been drafted after consultation with the members of the Banking and Currency Committees and those words may have been inserted in the amendment in order to allay any fear that the amendment would repeal the specific prohibition contained in the Reconstruction Finance Corporation Act and make the obligations of the Reconstruction Finance Corporation eligible for purchase or discount by Federal reserve banks.

THE GRAMMATICAL MEANING OF THE THOMAS AMENDMENT.

The only doubt about the above conclusion arises from the apparent conflict between the two phrases underlined in the above quotation from Section 43: (1) "notwithstanding any provisions of law or rules and regulations to the contrary", and (2) "pursuant to existing law".

These two phrases apparently are mutually contradictory; but it is necessary to reconcile them and to give effect to each of them if it is possible to do so; since it is well settled that, in construing a statute, some meaning must be given to every word, phrase and part of the statute, if it is possible to do so. United States v. Ninety-nine Diamonds, (C.C.A.), 139 Fed. 961; Pillsbury Flour Mills Co. v. Great Northern Ry. Co. (C.C.A.), 25 Fed. (2d) 66.

A careful analysis of the grammatical structure of the statute and a consideration of the purposes of the statute, discloses that it is possible to give a definite meaning and effect to each of these phrases and to construe the statute in its entirety so as to carry out the purposes for which it was enacted.

An analysis of the above quoted portion of Section 43 discloses that it consists of four distinct parts:

(i) The first paragraph, which states the circumstances under which the President may exercise the powers conferred in the succeeding paragraphs.

(ii) The first part of subsection (a), which authorizes the Secretary of the Treasury, when directed by the President, to enter into agreements with the several Federal reserve banks and the Federal Reserve Board whereby the Federal Reserve Board is authorized, "notwithstanding any provisions of law or rules and regulations to the contrary", to permit such banks to agree that they will do certain things. The words "notwithstanding any provisions of law or rules and regulations to the contrary" occur within this portion of the statute and obviously modify the words, "Federal Reserve Board will, and it is hereby authorized to, * * * permit such banks to agree that they will".

(iii) The subsidiary clause numbered (1), which reads as follows: "(1) conduct, pursuant to existing law, throughout specified periods, open market operations in obligations of the United States Government or corporations in which the United States is the majority stockholder." The words "pursuant to existing law", which occur within this clause; modify the words "conduct * * * open market operations in obligations of the United States Government or corporations in which the United States is the majority stockholder"; and are not affected grammatically by the words "notwithstanding any provisions of law or rules or regulations to the contrary", which occur outside of this clause.

(iv) The subsidiary clause numbered (2), which authorizes Federal reserve banks to (2) purchase directly and hold in portfolio for an agreed period or periods of time Treasury bills or other obligations of the United States Government in an aggregate sum of $3,000,000,000 in addition to those they may then hold, unless prior to the termination of such period or periods the Secretary shall consent to their sale." This language is of importance in connection with the question immediately before us, only because it helps to explain the significance of the phrase "notwithstanding any provisions of law or rules and regulations to the contrary", as shown below.

The clause "notwithstanding any provisions of law or rules and regulations to the contrary" removes any doubt about the right of the Federal Reserve Board and the Federal reserve banks to enter into agreements with the Secretary of the Treasury concerning the transactions specified in the subdivisions numbered (1) and (2). This is particularly important because of the doubts which had previously existed as to whether the

Federal reserve banks had any right to enter into agreements with the Secretary of the Treasury concerning their open market operations; to agree to purchase any given amounts of obligations of the United States Government; to agree to hold the obligations so purchased for any fixed period or periods of time; or to purchase pbligations of the Government directly from the Government under any circumstances. As to all of these questions the words "notwithstanding any provisions of law or rules and regulations to the contrary" eliminate all doubt; and, therefore, they have a very important practical effect, regardless of whether or not they enlarge the class of obligations which Federal reserve banks are authorized to purchase.

The words "pursuant to existing law" occur within subdivision (1) and limit the power of Federal reserve banks to conduct the transactions described in that subdivision. These transactions involve conducting open market operations, (a) in obligations of the United States Government, or (b) in obligations of corporations in which the United States Government is a majority stockholder. Such transactions may be conducted under subdivision (1) only "pursuant to existing law".

In other words, the first part of subsection (a), in which the words "notwithstanding any provisions of law or rules and regulations to the contrary occur, authorizes the Federal reserve banks and the Federal Reserve Board to enter into agreements with the Secretary of the Treasury to do only the things specified in sub-clauses numbered (1) and (2). It does not authorize them to do anything except what is specified in these two clauses; and the things specified in clause (1) are specifically limited to those things which may be done "pursuant to existing law".

WHAT WERE THE PROVISIONS OF "EXISTING LAW"?

This leads us to a consideration of the question what provisions of law were in existence prior to the Act of May 12, 1933, concerning the purchase on the open market by Federal reserve banks of obligations of the United States and of corporations in which the United States is a majority stockholder.

Prior to May 12, 1933, there were only four provisions of law on this subject:

(1) Section 14(b) of the Federal Reserve Act, which authorized the Federal reserve banks:

> "(b) To buy and sell, at home or abroad, bonds and notes of the United States, and bills, notes, revenue bonds, and warrants with a maturity from date of purchase of not exceeding six months, issued in anticipation of the collection of taxes or in anticipation of the receipt of assured revenues by any State, county, district, political subdivision, or municipality in the continental United States, including irrigation, drainage and reclamation districts, such purchases to be made in accordance with rules and regulations prescribed by the Federal Reserve Board;"

(2) Section 13(a) of the Federal Reserve Act, as amended by the Act of March 4, 1923 (42 Stat. 1470), which provides that:

> "Any Federal reserve bank may also buy and sell debentures and other such obligations issued by a Federal Intermediate Credit Bank or by a National Agricultural Credit Corporation, but only to the same extent as and subject to the same limitations as those upon which it may buy and sell bonds issued under Title I of the Federal Farm Loan Act."

(3) Section 27 of the Federal Farm Loan Act, approved July 17, 1916, (39 Stat. 380), which provided that:

> "Any Federal reserve bank may buy and sell farm loan bonds issued under this Act to the same extent and subject to the same limitations placed upon the purchase and sale by said banks of State, county, district, and municipal bonds under subsection (b) of section fourteen of the Federal Reserve Act approved December twenty-third, nineteen hundred and thirteen."

(4) The provision of Section 9 of the Reconstruction Finance Corporation Act which provides that obligations of the Reconstruction Finance Corporation "shall not be eligible for discount or purchase by any Federal Reserve Bank."

The Government owned a majority of the stock in the Federal Intermediate Credit Banks and the Federal Land Banks; and, therefore, it is entirely logical to assume that they were the corporations whose obligations the Federal reserve banks were expected to purchase "pursuant to existing law".

Not only were the Federal reserve banks not authorized to purchase obligations of the Reconstruction Finance Corporation "pursuant to existing law", but the existing law specifically forbade them to do so.

It has been suggested that the words "pursuant to existing law" may have referred to the machinery or procedure provided in existing law"regarding open market operations; but there was no provision of existing law relating to the procedure or machinery governing open market operations. The procedure or machinery which had been established was purely voluntary and was not based upon any provision of existing law, other than those quoted above, which said nothing whatever about the machinery or procedure for open market operations. Section 12A of the Federal Reserve Act now provides for a Federal Open Market Committee and prescribes the procedure for that Committee; but Section 12A was added to the Federal Reserve Act by the Act of June 16, 1933, more than a month after the Thomas Amendment had been enacted.

The only provisions of existing law concerning open market operations by the Federal reserve banks in obligations of the Government or obligations of corporations in which the Government was a majority stockholder dealt with the question what the Federal reserve banks might purchase and did not concern themselves with the machinery or procedure for such purchases.

It would seem, therefore, that the words "pursuant to existing law" would have no meaning unless they are construed as limiting the classes of obligations which the Federal reserve banks may purchase under clause (1) of subsection (a) of the Thomas Amendment to those classes of obligations which they were authorized to purchase under the pre-existing provisions of law quoted above. These provisions include a specific prohibition against the purchase of obligations of the Reconstruction Finance Corporation; and the purchase of such obligations clearly cannot be said to be "pursuant to existing law".

In this connection, it is important to note that Section 12A of the Federal Reserve Act, which provides for the organization and procedure of the Federal Open Market Committee, specifically provides that no Federal reserve bank shall engage in open market operations under Section 14 of the Act except in accordance with regulations adopted by the Federal Reserve Board and that:

> "(c) The time, character, and volume of all purchases and sales of paper described in section 14 of this Act as eligible for open-market operations shall be governed <u>with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country</u>."

This is a later enactment than the Thomas Amendment and clearly negatives any intent to permit the Federal reserve banks to engage in open market operations for the purpose of financing any particular project, such as the activities of the Reconstruction Finance Corporation.

THE TRUE SIGNIFICANCE OF THE WORDS "NOTWITHSTANDING ANY PROVISIONS OF LAW OR RULES AND REGULATIONS TO THE CONTRARY"

It might be contended that to give the words "pursuant to existing law" the effect suggested above would deprive subdivision (1) of Section 43(a) of any practical significance; but this would not appear to be the case. This subdivision, when read in connection with the remainder of subsection (a), would still authorize something which was never before considered appropriate procedure for the Federal reserve banks and the legality of which was at least doubtful -- i.e., agreements between Federal reserve banks and the Secretary of the Treasury governing open market operations of the Federal reserve banks in obligations of the Government and of corporations in which the Government is the majority stockholder.

As indicated above, it would appear that the purpose of the words "notwithstanding any provisions of law or rules and regulations to the contrary" is to remove any statutory or regulatory inhibitions which might prevent the Federal Reserve Board or the Federal reserve banks from entering into agreements with the Secretary of the Treasury to engage in the transactions described subsequently in the clauses numbered (1) and (2).

Numerous discussions had previously taken place on the question whether the Federal Reserve Board had the right to require Federal reserve banks to engage in open market operations; whether the provisions of the Federal Reserve Act authorizing the Federal reserve banks to engage in open market operations authorized them to purchase obligations of the United States directly from the Treasury, thereby, in effect, making direct loans to the Treasury; whether the Federal reserve banks had any legal authority to agree among themselves or with the Federal Reserve Board or the Secretary of the Treasury to hold for a specified length of time any bonds which they might purchase on the open market, regardless of any change that might take place in the financial and economic conditions of the country in the meantime; and numerous other major questions of a fundamental character. In view of the fact, therefore, that Section 43 contemplated that the Federal reserve banks might be called upon to enter into agreements with the Secretary of the Treasury to purchase directly from the Treasury and hold in their portfolio for an agreed period of time obligations of the United States in an aggregate sum of $3,000,000,000 in addition to those which they already held, it is probable that the words "notwithstanding any provisions of law or rules and regulations to the contrary" were inserted in the statute for the purpose of brushing aside all of these major questions as to the fundamental purposes of the open market provisions of the Federal Reserve Act and were not intended to have any bearing whatever upon the relatively unimportant question of what specific types of obligations might be purchased by Federal reserve banks.

It will be remembered that the whole of Title III of the Agricultural Relief Act of 1933, which is known as the Thomas Amendment, dealt with the subject of general credit or currency inflation as a means of stimulating business recovery, rather than with the subject of financing any particular project.

This is quite apparent in the light of the first paragraph of Section 43, which authorizes the President to exercise the powers granted by the Thomas Amendment only when, upon investigation, he finds that:

1. The foreign commerce of the United States is adversely affected by reason of the depreciation in the value of the currency of any other government or ggvernments in relation to the present standard value of gold;

2. That action under this section is necessary in order to regulate and maintain the parity of currency issues of the United States;

3. That an economic emergency requires an expansion of credit; or

4. That an expansion of credit is necessary to secure by international agreement a stabilization at proper levels of the currencies of various governments.

All of these circumstances pertain to general credit and financial conditions rather than to the problem of financing any particular project; and all of them could be effected equally as well by making credit available through the purchase of one kind of obligationson the open market as through the purchase of any other kind of obligation.

Authority was given the President to adopt measures to bring about a general credit or currency inflation through such transactions as open market operations by the Federal reserve banks; the issuance of $3,000,000,000 of United States notes;the devaluation of the dollar; etc.; but the real object in view was to increase the aggregate amount of currency or credit available for all purposes rather than to finance any individual project.

Therefore, it is reasonable to assume that there was no intention of increasing the classes of obligations which the Federal reserve banks might purchase; since they were already authorized to purchase obligations of the United States (Federal Reserve Act, Sec. 14b), obligations of States, counties and municipalities issued in anticipation of the collection of taxes or the receipt of assured revenues and having maturities not exceeding six months (F.R. Act, Sec. 14b); farm loan bonds having maturities not exceeding six months (Farm Loan Act of July 17, 1916, Sec. 27), and debentures of Federal intermediate credit banks and national agricultural credit corporations having maturities not exceeding six months (F.R. Act, Sec. 13a); and the purchase of any of these obligations would have the contemplated inflationary effect by putting credit into the general money market.

Since the Federal reserve banks were already authorized to purchase obligations of the United States and obligations of certain corporations in which the United States is a majority stockholder (e.g., Federal land banks and Federal intermediate credit banks), it is apparent that it was contemplated that Federal reserve banks would agree to utilize the powers which they already possessed and that there was no intention of increasing the classes of obligations which they might purchase.

CONCLUSION

By this construction, the entire act is given a reasonable meaning; the apparently conflicting clauses are harmonized and both are given effect; and an implied repeal of the specific prohibition contained in Section 9 of the Reconstruction Finance Act is avoided.

A construction leading to the opposite conclusion on the main question considered in this opinion would deprive the words "pursuant to existing law" of all meaning whatsoever and would result in an implied repeal of the specific provisions of Section 9 of the Reconstruction Finance Act by the very broad and general provisions of Section 43 of the Act of May 12, 1933, and thus would violate the following well established rules pertaining to the interpretation of statutes:

1. That construction of a statute is to be favored and must be admitted if reasonably possible, which will give meaning to every word, clause and sentence of the statute and operation and effect to every part and provision of it. United States v. Ninety-nine Diamonds, (C.C.A.), 139 Fed. 961; Pillsbury Flour Mills Co. v. Great Northern Ry. Co. (C.C.A.), 25 Fed. (2d) 66.

2. Repeal by implication is not favored and will not be indulged in if there is any other reasonable construction. The presumption is always against the intention to repeal where express terms are not used, and the implication, in order to be operative, must be necessary. It must clearly appear from the statute under construction that it was the intention of the Congress to enact a new law in place of the old law. Bookbinder v. United States (C.C.A.), 287 Fed. 790, 792. See also Summers v. Atchison, T. & S. F. Ry., 2 Fed. (2d) 717, 720; Stevens v. Biddle (C.C.A), 298 Fed. 209, 213.

3. "It is a canon of statutory construction, that a later statute, general in its terms and not expressly repealing a prior special statute, will ordinarily not affect the special provisions of such earlier statute. In other words, where there are two statutes, the earlier special and the later general - the terms of the general broad enough to include the matter provided for in the special - the fact that one is special and the other is general creates a presumption that the special is to be considered as re-

maining an exception to the general, unless a repeal is expressly named, or unless the provisions of the general are manifestly inconsistent with those of the special". Rodgers v. United States, 185 U.S. 83, 22 Sup. Ct. 582, 583. See also Eastern Extension, A. & C. Telegraph Co. v. United States, 231 U.S. 326, 34 Sup. Ct. 57, 59.

While the question is not entirely free from doubt, I am of the opinion, therefore:

(1) That Section 43 of the Act of May 12, 1933, was not intended to add to or increase the classes of obligations which Federal reserve banks are authorized to purchase;

(2) That it does not authorize Federal reserve banks to purchase obligations of the Reconstruction Finance Corporation;

(3) That it does not repeal by implication the provision of Section 9 of the Reconstruction Finance Corporation Act which specifically renders such obligations ineligible for discount or purchase by any Federal reserve bank; and

(4) That, therefore, Federal reserve banks may not lawfully purchase obligations of the Reconstruction Finance Corporation.

Respectfully,

WW

Walter Wyatt,
General Counsel.

WW:sad:mw

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date November 7, 1933.

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To Mr. Hamlin.

From Mr. Wyatt

Subject: Question whether capital notes or debentures may be considered "capital" of bank in determining its eligibility for membership in the Federal Reserve System.

Dear Mr. Hamlin :

During the meeting of the Board on Monday, November 6, 1933, I told the Board that on Friday night, November 3, I had reconsidered the above subject and had written an opinion on it which covered numerous points not covered in the earlier opinions rendered by this office; and some members of the Board indicated a desire to see that opinion. I am, therefore, taking the liberty of handing you a copy of the opinion, which contains substantially what I told the Board during the meeting on November 6, plus certain other arguments which had passed out of my mind at the moment.

I worked very hard on this opinion; and I would deem it a personal favor if you would do me the courtesy to read it and let me have your comments upon it.

Respectfully,

Walter Wyatt

Walter Wyatt
General Counsel

Opinion attached

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PAGE 83

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(Dictated on November 3, 1933)

Governor Black

Mr. Wyatt, General Counsel.

Question whether capital notes or debentures may be considered "capital" of bank in determining its eligibility for membership in the Federal Reserve System.

You have asked me to consider again the question ruled upon by the Board in its letter of August 25, 1933, (X-7561a) to the Reconstruction Finance Corporation, the substance of which was published as a ruling of the Board in the Federal Reserve Bulletin for September, 1933, at page 566, and which was recently reconsidered and reviewed by Mr. George B. Vest, of this office, in his opinion of October 30, 1933, --i.e., whether so-called "capital notes or debentures" of a State bank or trust company which the Reconstruction Finance Corporation is authorized to purchase under certain circumstances by the provisions of Section 304 of the Act of March 9, 1933, as amended, may be considered in determining whether a State bank or trust company has sufficient capital to render it eligible for membership in the Federal Reserve System under the provisions of Section 9 of the Federal Reserve Act.

OPINION.

After a thorough and, I believe, unprejudiced reconsideration of this question I am unable honestly to reach any conclusion different from that heretofore reached by the Board and by Mr. Vest, -- namely, that the amount of such capital notes and debentures may not be considered "capital" within the meaning of Section 9 of the Federal Reserve Act and, therefore, may not be taken into consideration in determining whether a State bank or trust company has sufficient capital to be eligible for membership in the Federal Reserve System under the provisions of Section 9 of the Federal Reserve Act.

DISCUSSION.

The following considerations make it impossible for me to escape the above conclusion.

Section 9 of the Federal Reserve Act contains the following paragraph, which was amended and re-enacted on June 16, 1933, by the Banking Act of 1933:

> "No applying bank shall be admitted to membership in a Federal reserve bank unless it possesses a paid-up unimpaired capital sufficient to entitle it to become a national banking association in the place where it is situated under the provisions of the National Bank Act, as amended: Provided, That this paragraph shall not apply to State banks and trust companies organized prior to the date this paragraph as amended takes effect and situated in a place the population of which does not exceed three thousand inhabitants and having a capital of not less than $25,000, nor to any State bank or trust company which is so situated and which, while it is entitled to the benefits of insurance under section 12 B of this Act, increases its capital to not less than $25,000."

From the words underlined, it is clear that, in order to be eligible for membership in the Federal Reserve System, a State bank must have the same capital as would be required "under the provisions of the National Bank Act" for the organization of a national banking association in the place where such bank is situated. In so far as capital is concerned, therefore, the eligibility of a State bank for membership in the Federal Reserve System must be determined by a reference to the applicable provisions of the National Bank Act, which are incorporated by reference in the provisions of Section 9 of the Federal Reserve Act.

Prior to the enactment of the emergency banking act of March 9, 1933, national banks had only one kind of capital, which was represented by common stock, and the minimum amount required for the organization of a national bank was fixed by the provisions of Section 5138 of the Revised Statutes.

Under the well-established administrative interpretation it had become settled that the "capital" referred to in Section 5138 was capital stock and that surplus funds, undivided profits and other similar funds representing the financial interest of the bank's stockholders over and above the capital stock, which, together with the capital stock, are sometimes loosely referred to as "capital funds", could not be taken into consideration in determining whether enough capital had been provided for the organization of a national bank. In other words, it was clearly understood that the word "capital" in Section 5138 clearly referred to capital stock and nothing else.

When the Emergency Banking Act of March 9, 1933, was being drafted there was included therein a provision authorizing national banks to issue preferred stock for the first time in the history of the National Banking System; and the question arose whether the amount of such preferred stock could be taken into consideration in determining whether a bank had sufficient capital to comply with the provisions of Section 5138 of the Revised Statutes and the provisions of Section 11(k) of the Federal Reserve Act regarding the capital required in order for a national bank to obtain trust powers; whether the amount of such preferred stock should be taken into consideration in determining the amount which a bank might lend to one borrower under the provisions of Section 5200 of the Revised Statutes; and whether the amount of such preferred stock should be considered "capital" within the meaning of various other provisions of law relating to national banks.

In order to settle all of these questions and any similar questions which might arise later, the following provision was inserted in Section 303 of the Emergency Banking Act of March 9, 1933:

> "Sec. 303. The term 'common stock' as used in this title means stock of national banking associations other than preferred stock issued under the provisions of this title. The term 'capital' as used in provisions of law relating to the capital of national banking associations shall mean the amount of unimpaired common stock plus the amount of preferred stock outstanding and unimpaired; and the term 'capital stock', as used in section 12 of the Act of March 14, 1900, shall mean only the amount of common stock outstanding."

This clearly defines the term "capital" as used in connection with national banking associations as including only the amount of unimpaired common stock plus the amount of preferred stock outstanding and unimpaired. Expressio unius est exclusio alterius.

When we read Section 5138 of the Revised Statutes, therefore, in order to determine what "capital" is required for the organization of a national banking association in a certain place "under the provisions of the National Bank Act, as amended," and, therefore, what capital is required in order for a State bank located in the same place to be eligible for membership in the Federal Reserve System, it is necessary to bear in mind the definition contained in Section 303 of the Emergency Banking Act of March 9, 1933, and to consider only the amount of unimpaired common stock, plus the amount of preferred stock outstanding and unimpaired.

No one has had the temerity to suggest that capital notes and debentures which the Reconstruction Finance Corporation may purchase pursuant to provisions of Section 304 of the Emergency Banking Act of March 9, 1933, may be considered either preferred stock or common stock within the meaning of that Act, for the very obvious reason that Section 304 itself makes a clear distinction between stock and "capital notes or debentures". The Reconstruction Finance Corporation is specifically forbidden to purchase preferred stock in any State bank and trust company, if the holders of such stock are not exempt from double liability under the laws of the State in which such State bank or trust company is located; and the Reconstruction Finance Corporation is not permitted to purchase "capital notes or debentures" of a State bank or trust company if the laws of the State in which it is located permit the issuance of preferred stock exempt from the double liability without the unanimous consent of the stockholders. I do not believe it is necessary, therefore, to enter into any extended discussion of the well-recognized distinction between capital stock, on the one hand and notes or debentures representing borrowed money on the other hand.

In view of the considerations stated above, I do not see how it is possible to escape the conclusion that the amount of capital notes and debentures which a bank has outstanding cannot be taken into consideration in determining whether a State bank has sufficient "capital" to entitle it to membership in the Federal Reserve System under the provisions of Section 9 of the Federal Reserve Act. It would not be necessary to go any further in this opinion, therefore, were it not for the fact that it has been argued very earnestly that the opposite conclusion should be reached.

OPPOSING ARGUMENTS ANSWERED.

Most of the arguments made in opposition to the above conclusion either ignore or attempt to explain away the provisions of Section 9 of the Federal Reserve Act and of Section 303 of the Act of March 9, 1933. I shall endeavor to summarize and answer each of those arguments; but I respectfully submit that, in considering this question, the provisions of Section 9 of the Federal Reserve Act and Section 303 of the Emergency Banking Act of 1933 cannot be ignored, but must be reckoned with and borne constantly in mind.

Since most of the arguments opposing the conclusion stated above are based upon the provisions of Section 304 of the Act of March 9, 1933, as amended, it would seem appropriate to quote that section in full at this point. As amended, the section reads as follows, the words in capitals having been inserted, and the cancelled words having been stricken out, by the Act of March 24, 1933, which was entitled, "An act to provide for direct loans by Federal Reserve banks to State banks and trust companies in certain cases, and for other purposes":

"Sec. 304. If in the opinion of the Secretary of the Treasury any national banking association or any State bank or trust company is in need of funds for capital purposes either in connection with the organization or reorganization of such association, State bank or trust company or otherwise, he may, with the approval of the President, request the Reconstruction Finance Corporation to subscribe for preferred stock in such association, State bank or trust company, or to make loans secured by such stock as collateral, and the Reconstruction Finance Corporation may comply with such request. NOTHING IN THIS SECTION SHALL BE CONSTRUED TO AUTHORIZE THE RECONSTRUCTION FINANCE CORPORATION TO SUBSCRIBE FOR PREFERRED STOCK IN ANY STATE BANK OR TRUST COMPANY IF UNDER THE LAWS OF THE STATE IN WHICH SAID STATE BANK OR TRUST COMPANY IS LOCATED THE HOLDERS OF SUCH PREFERRED

STOCK ARE NOT EXEMPT FROM DOUBLE LIABILITY. IN ANY CASE IN WHICH UNDER THE LAWS OF THE STATE IN WHICH IT IS LOCATED A STATE BANK OR TRUST COMPANY IS NOT PERMITTED TO ISSUE PREFERRED STOCK EXEMPT FROM DOUBLE LIABILITY, OR IF SUCH LAWS PERMIT SUCH ISSUE OF PREFERRED STOCK ONLY BY UNANIMOUS CONSENT OF STOCKHOLDERS, THE RECONSTRUCTION FINANCE CORPORATION IS AUTHORIZED, FOR THE PURPOSES OF THIS SECTION, TO PURCHASE THE LEGALLY ISSUED CAPITAL NOTES OR DEBENTURES OF SUCH STATE BANK OR TRUST COMPANY. The Reconstruction Finance Corporation may, with the approval of the Secretary of the Treasury, and under such rules and regulations as he may prescribe, sell in the open market ~~or otherwise~~ the whole or any part of the preferred stock, CAPITAL NOTES, OR DEBENTURES of any national banking association, State bank or trust company acquired by the Corporation pursuant to this section. The amount of notes, bonds, debentures, and other such obligations which the Reconstruction Finance Corporation is authorized and empowered to issue and to have outstanding at any one time under existing law is hereby increased by an amount sufficient to carry out the provisions of this section. AS USED IN THIS SECTION, THE TERM 'STATE BANK OR TRUST COMPANY' SHALL INCLUDE OTHER BANKING CORPORATIONS ENGAGED IN THE BUSINESS OF INDUSTRIAL BANKING AND UNDER THE SUPERVISION OF STATE BANKING DEPARTMENTS OR OF THE COMPTROLLER OF THE CURRENCY."

The most persuasive arguments in support of the opposite view are based upon the theory that the purpose of Section 304 of the Act of March 9, 1933, as amended, is to enable the Reconstruction Finance Corporation to assist in the re-capitalization of State banks as well as national banks by whatever means may seem most appropriate in view of the applicable laws concerning the raising of capital funds by the respective institutions in question and that this purpose would be defeated pro tanto if State banks located in States whose laws do not permit the issuance of preferred stock exempt from double liability are not permitted to count capital notes and debentures sold to the Reconstruction Finance Corporation as "capital" for the purpose of obtaining admission to the Federal Reserve System. Such an argument necessarily assumes that one of the purposes of Section 304 was to enable State banks to acquire membership in the Federal Reserve System; but there is no evidence whatsoever that this was the case.

The Act of March 9, 1933, was entitled, "An act to provide relief in the existing national emergency in banking, and for other purposes"; and it contains nothing whatsoever regarding the admission of State banks to membership in the Federal Reserve System. On the contrary, that Act was rushed through Congress in the midst of an emergency when the President had closed every bank in the country and the principal problem dealt with was how to facilitate the reorganization and re-opening of banks which were in a weakened or insolvent condition.

The major portion of the Act, including all of Titles II and III, dealt with this problem. Title II dealt solely with the appointment, powers and duties of conservators of national banks and with means of expediting the reorganization of such banks. Title III dealt solely with the issuance of preferred stock by national banks and the purchase by the Reconstruction Finance Corporation of preferred stock in national banks and in State banks and trust companies.

The Reconstruction Finance Corporation had previously been authorized to make loans to State banks and trust companies, irrespective of the question whether or not they were members of the Federal Reserve System; and there was little else that Congress could do to facilitate the reorganization and re-opening of State banks except to grant authority to the Reconstruction Finance Corporation to provide additional funds "for capital purposes" where it was needed. This had no reference whatsoever to membership in the Federal Reserve System and referred solely to the problem of reopening closed banks, irrespective of their membership in the Federal Reserve System.

In Section 304, as originally enacted, national banks and State banks were treated exactly alike and the Reconstruction Finance Corporation was authorized only to purchase or make loans on their preferred stock. There was no provision that such stock must be exempt from double liability. Nor was there, nor is there now, any provision in Section 304 that requires State banks who sell preferred stock to the Reconstruction Finance Corporation in order to become members of the Federal Reserve System.

Considerable emphasis has been laid upon the fact that the Reconstruction Finance Corporation was authorized to purchase preferred stock in national banks or State banks only when, in the opinion of the Secretary of the Treasury, they were "in need of funds for capital purposes" and it has been argued with great earnestness that the words quoted indicate that all funds provided under Section 304 should be considered as "capital" for all purposes. Those making this argument, however, either overlook or ignore the fact that these words were in Section 304 when it was originally enacted and when it dealt only with preferred stock. They also either overlook or ignore the fact that the real purpose of the section is indicated by the words "either in connection with the organization or reorganization of such association, State bank, or trust company, or otherwise" which immediately follows the words "funds for capital purposes" in Section 304, as will be seen from the following quotation:

> "If, in the opinion of the Secretary of the Treasury, any national banking association or any State bank or trust company is in need of funds for capital purposes either in connection with the organization or reorganization of such association, State bank or trust company, or otherwise. * * * "

The words underlined indicate that the specific purposes which Congress had in mind were the organization or reorganization of banks and not their admission to membership in the Federal Reserve System. It is true that there was tacked on at the end the general catch-all phrase "or otherwise", but it is obvious that this was merely intended to give some flexibility to the section and to avoid restricting the activities of the Reconstruction Finance Corporation too much. The mere inclusion of these general words gertainly furnishes no reason for ignoring the clear and specific language of Section 9 of the Federal Reserve Act and Section 303 of the Act of March 9, 1933.

In Section 304 the term "funds for capital purposes" was obviously used for the deliberate purpose of making the section somewhat flexible and not limiting the purchase of preferred stock to those cases where it was absolutely required in order to meet the legal requirements regarding "capital" or "capital stock". The term "capital funds" is a broad term and obviously would include the amount which might be needed to provide a reasonable margin of safety for depositors, or, stated differently, to give the bank an adequate ratio of "capital funds" to deposit liabilities.

Although there is nothing in the Federal statutes on the subject, it is generally recognized that a bank should not have deposit liabilities exceeding ten times its aggregate "capital funds"; but the term "capital funds" as used in this sense is usually regarded as including surplus and undivided profits, which, of course, cannot be taken into consideration in determining whether a State bank has sufficient capital to make it eligible for membership in the Federal Reserve System. The Board has recognized that the amount represented by capital notes and debentures may be taken into consideration in determining whether a State bank has an adequate ratio of "capital funds" in relation to its deposits; but this is no reason for considering such amounts as "capital" for the purpose of determining whether a State bank has sufficient "capital" to meet the requirements of Section 9 of the Federal Reserve Act. The term "funds for capital purposes" was used <u>for the deliberate purpose of conveying a different and broader meaning</u> than is conveyed by the words "capital" or "capital stock" in the provisions of the National Bank Act and the Federal Reserve Act; and, therefore, the word "capital" should <u>not</u> be given the same meaning and should <u>not</u> be construed as including everything included in the broad term "funds for capital purposes".

The second and third sentences of Section 304, which (1) forbid the Reconstruction Finance Corporation to purchase preferred stock which is not exempt from double liability and (2) authorize the purchase of "capital notes and debentures" from State banks which cannot issue preferred stock exempt from double liability, were inserted in Section 304 by an amendment contained in the Act of March 24, 1933, entitled "An Act to provide for direct loans by Federal reserve banks to State banks and trust companies in certain cases, and for other purposes". The chief purpose of that act was to authorize Federal reserve banks to make loans to State banks and trust companies which are not members of the Federal Reserve System; and the provision regarding the purchase of capital notes and debentures by the Reconstruction Finance Corporation was a mere afterthought tacked on to the bill by amendment.

In the light of these facts, it is impossible to say that, when Congress authorized the purchase of capital notes and debentures from State banks and trust companies, it intended also by implication to authorize the Federal Reserve Board to admit such State banks and trust companies to membership in the Federal Reserve System on the basis of such capital notes and debentures in lieu of capital stock. Such an idea is utterly inconsistent with the theory of the principal section of the bill, which authorized Federal reserve banks to make loans to such banks during the emergency, even though they were not members of the Federal Reserve System. With the credit facilities of the Federal reserve banks thus made available to non-member banks and trust companies, it was utterly unnecessary for them to become members of the System; and the effect of the Act was to discourage, instead of encourage, State banks and trust companies to seek membership in the Federal Reserve System.

In these circumstances it is obvious that it is a mistake to say that the purposes of Section 304 would be defeated if capital notes and debentures of State banks and trust companies cannot be considered capital for the purpose of enabling such banks to become members of the Federal Reserve System.

Moreover, if Congress had intended that capital notes and debentures should be considered as "capital", it seems that it would at the same time have amended Section 303 of the Act, which clearly prevents this result.

Furthermore, Congress dealt specifically with the question how much capital should be required of State banks in order that they might be eligible for membership in the Federal Reserve System on June 16, 1933, when it amended Section 9 of the Federal Reserve Act by the Banking Act of 1933; and it said nothing about capital notes and debentures. It is reasonable to assume that, in the light of the Act of March 24, 1933, which was still fresh in the minds of members of Congress, they would have provided that capital notes and debentures should be considered as "capital" in determining the eligibility of State banks and trust companies, if they had so intended; but they did not do so. On the contrary, they raised the capital requirements for State banks by striking out the provision permitting State banks to be admitted to the Federal Reserve System with a capital equal to 60% of that required of national banks and re-enacted the original provisions of Section 9 of the Federal Reserve Act requiring State banks applying for membership in the Federal Reserve System to have "a paid-up and unimpaired capital sufficient to entitle it to become a national banking association in the place where it is situated, under the provisions of the National Bank Act, as amended."

The National Bank Act does not authorize national banks to issue capital notes and debentures and Section 304 of the Act of March 9, 1933, does not authorize the Reconstruction Finance Corporation to purchase such capital notes and debentures from national banks. Any implications which might otherwise be drawn from the amendment of March 24, 1933, authorizing the Reconstruction Finance Corporation to purchase capital notes and debentures from State banks or trust companies, therefore, are clearly overcome by the amendment of June 16, 1933, requiring State banks applying for membership in the Federal Reserve System to have the "capital" required of national banks under the provisions of the National Bank Act.

Those differing with the position taken by the Board on this subject lay much emphasis on the last paragraph of subsection (y) of Section 12B of the Federal Reserve Act, which reads as follows:

> "It is not the purpose of this section to discriminate, in any manner, against State nonmember, and in favor of, national or member banks; but the purpose is to provide all banks with the same opportunity to obtain and enjoy the benefits of this section. No bank shall be discriminated against because its capital stock is less than the amount required for eligibility for admission into the Federal Reserve System."

It is contended with some earnestness that to deny admission to the Federal Reserve System to a State bank which has insufficient capital to render it eligible for membership under the specific language of Section 9 of the Federal Reserve Act, as amended by the Banking Act of 1933, would constitute a discrimination against such State bank in violation of the above provision; but this argument is obviously erroneous.

In the first place, the above paragraph deals only with the purposes and benefits "of this section" -- i.e., Section 12B of the Federal Reserve Act, which provides for the insurance of deposits of nonmember banks as well as member banks of the Federal Reserve System; and it has no reference to the provisions of Section 9 of the Federal Reserve Act, which prescribe the terms on which State banks or trust companies may be admitted to membership in the Federal Reserve System.

It has even been argued that the last sentence quoted above, which obviously refers only to the provision regarding deposit insurance, forbids the Federal Reserve Board to disapprove the application of a State bank for membership in the Federal Reserve System solely because it has insufficient capital. No one would make this argument who was familiar with the fact that the Banking Act of 1933, which inserted the above quoted provision in Section 12B of the Federal Reserve Act, also amended and re-enacted the paragraph of Section 9 of the Federal Reserve Act prescribing the amount of capital which a State bank must have in order to be eligible for membership in the Federal Reserve System and increasing the minimum amount of such capital.

It has been earnestly contended that, unless the amount of capital notes or debentures issued by a State bank be included in determining whether the bank has sufficient capital to entitle it to membership in the Federal

Reserve System, such State bank would be discriminated against in violation of the above quoted provision of subsection (y); because no bank would wish to be admitted to the benefits of the insurance fund if it knew that, on January 1, 1936, it would not be eligible for admission to the Federal Reserve System and would no longer be entitled to the benefits of insurance. This is a clever argument, and I have no doubt that it was made in good faith; but it completely ignores the theory upon which Congress admitted nonmember banks to the benefits of insurance by the Federal Deposit Insurance Corporation until July 1, 1936, although one of the principal purposes of Section 12B was to compel all banks to become members of the Federal Reserve System and to raise the standard of banking in this country to that set for member banks of the Federal Reserve System.

The real theory of Section 12B obviously is that nonmember State banks should be given the benefits of insurance for a temporary period, regardless of their lack of membership in the Federal Reserve System and regardless of the amount of their capital; but that, on or before July 1, 1936, they must become members of the Federal Reserve System if they desire to retain the benefits of insurance of deposits and must meet the same requirements as any other bank when they are admitted to the Federal Reserve System.

The members of Congress fully realized that many banks admitted temporarily to the benefits of the insurance of deposits would not be eligible for membership in the Federal Reserve System at the time they obtained such insurance and that a reasonable amount of time must necessarily be allowed for them to make themselves eligible for membership in the Federal

Reserve System. The question how much time should be allowed for this purpose was given most serious and earnest consideration and the provisions of the bill on this subject were amended repeatedly. The utmost importance was attached to this question; and it was only after a very bitter fight and after very mature deliberation that the date by which State banks must become members of the Federal Deposit Insurance Corporation was fixed as of July 1, 1936.

All of this would have been absolutely unnecessary if every bank which is admitted to the Federal Deposit Insurance Corporation should automatically become eligible for membership in the Federal Reserve System without any further improvement in its condition or without any further steps to meet the requirements for eligibility.

It is perfectly obvious, therefore, that the provisions respecting temporary insurance of deposits of nonmember State banks and trust companies have no bearing whatever upon the question what the capital a bank must have in order to be admitted to membership in the Federal Reserve System. It obviously has no bearing whatever upon the question whether capital notes or debentures should be considered "capital" within the meaning of Section 9 of the Federal Reserve Act. Nor is the fact that a particular nonmember State bank is unwilling to apply for and accept the benefits of temporary insurance of its deposits unless it is assured that it can become a member of the Federal Reserve System on or before July 1, 1936, any reason why the provisions of the Federal Reserve Act regarding the admission of State banks and trust companies to membership in the Federal Reserve System should be construed so as to accommodate them. One might as well say that the mere fact that a particular man would like to have a million dollars is sufficient reason for construing the act of Congress authorizing the expenditure of funds for emergency relief purposes as granting authority for the Government to make him a present of a million dollars.

It is argued that the purpose of Section 304 is to authorize the Reconstruction Finance Corporation to contribute capital funds to banks found to be in need of them; that optional forms are provided only to meet the legal difficulties incident to varying State laws concerning stockholders' liability and the power to issue stock and that every question concerning the status of the bank whose capital structure has been repealed should be considered from the standpoint of its "new capital position" rather than from the standpoint of the forms with which we have previously been familiar. Without admitting the correctness of this argument, it may be pointed out that it is an argument of policy which could appropriately be submitted to Congress in support of an amendment to the provisions of the Federal Reserve Act regarding the amount of capital required of State banks; but it furnishes no reason why the existing law should be construed to mean something which it does not say.

Reference has also been made to the provisions of Section 9 of the Federal Reserve Act, as amended by the Banking Act of 1933, which makes mutual savings banks having no capital stock eligible for membership in the Federal Reserve System; but this is an exceptional provision made for a peculiar class of banks which by their very nature have no capital stock; and it has no bearing whatever on the proper construction of the provisions of law regarding the capital required of banks which have capital stock.

The quotations from certain text books and court opinions as to the general meaning of the term "capital" have no bearing upon the meaning of the word "capital" as used in Section 9 of the Federal Reserve Act; because that Section incorporates by reference the provisions of the National Bank Act, and Section 303 of the Act of March 9, 1933, defines the term "capital" as used in the National Bank Act. It is obvious that, where Congress has defined a term as used in certain legislation, such definition fixes the scope and meaning of that term as used in such legislation; and the definitions given in text books or court decisions dealing with the general use of such terms or with their use in other statutes are totally inapplicable.

Respectfully,

Walter Wyatt,
General Counsel.

WW:sad:mw

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Serba

Date November 7, 1933

To Mr. Hamlin

Subject:

From Mr. Goldenweiser

Goldenweiser

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In connection with your talk to the stockholders of the Boston bank, it has occurred to me that you could possibly use the following thoughts:

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Analysis of Mr. Wyatt's Opinion, November 3, 1933.

Capital notes or debentures under Sections 303 and 304 of the Act of March 9, 1933, can not be considered "capital" under Section 9 of the Federal Reserve Act when a bank applies for admission.

Quotes Section 9 of the Federal Reserve Act to the effect that an applying bank must have a paid-up and unimpaired capital sufficient to entitle it to become a national bank in the place where it is situated under the provisions of the National Bank Act as amended.

The applying bank, therefore, must have the same capital as would be required "under the provisions of the National Bank Act, etc."

Prior to Act of March 9, 1933, national banks had only one kind of capital.

The word "capital" in Section 5138 of the Revised Statutes, was capital stock apart from surplus and undivided profits.

Act of March 9, 1933, provided for preferred stock of national banks without double liability.

Question arose whether such preferred stock could be taken into consideration on question of sufficient capital to comply with Section 5138 of the Revised Statutes and the provisions of Section 11 (k) of the Federal Reserve Act as to trust powers; in determining the amount a bank might loan to a borrower under Section 5200 of the Revised Statutes; and whether such preferred stock should be considered "capital" within meaning of various other provisions of law relating to national banks.

In order to settle this, Section 303 of the Act of March 9, 1933, provided that the word "capital" in provisions of law relating to national banks shall mean the amount of unimpaired common stock plus the amount of preferred stock outstanding and unimpaired; and that the term "capital stock" in Section 12 of the Act of March 14, 1900, shall mean only the amount of common stock outstanding.

The above clearly defines the term "capital" as used in connection with national banking associations.

In considering what capital is required for a state bank to be eligible for membership, we must bear in mind the definition in Section 303

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of the Act of March 9, 1933, and consider only the amount of unimpaired common stock, plus the amount of preferred stock outstanding and unimpaired.

Clearly, capital notes and debentures under Section 304 of the Act of March 9, 1933, are not either preferred stock or common stock, for the Section draws a clear distinction between stock and capital notes or debentures.

The R.F.C. is forbidden to purchase preferred stock in any state bank or trust company unless the holders are exempt from double liability under the state law.

The R.F.C. is not permitted to purchase capital notes or debentures of a state bank or trust company even if exempt from double liability, provided the unanimous consent of the stockholders is ~~obtained~~. required

Not necessary to discuss the well-recognized distinction between capital stock and notes or debentures representing borrowed money.

Can not escape the conclusion that the amount of capital notes and debentures can not be considered in determining whether a state bank has sufficient capital to entitle it to membership under Section 9 of the Federal Reserve Act.

Considers the opposing arguments.

Quotes Section 304 of Act of March 9, 1933.

The most persuasive argument is that the purpose of Section 304 of the Act of March 9, 1933, as amended, is to enable the R.F.C. to assist in recapitalizing the state banks as well as national banks by whatever means may seem appropriate in view of the applicable laws concerning the raising of capital funds by the respective institutions in question.

The argument is that this purpose would be defeated if state banks whose laws do not permit preferred stock exempt from double liability are not permitted to count capital notes and debentures sold to the R.F.C. as capital for the purpose of obtaining admission to the Federal Reserve System.

Such an argument assumes that one of the purposes of Section 304 was to enable state banks to acquire membership in the System.

There is no evidence whatsoever that this was the case.

There is nothing in the Act of March 9, 1933, regarding the admission of state banks to membership in the System.

On the contrary, the Act was rushed through Congress to facilitate the reorganization and reopening of banks which were in a weakened or insolvent condition.

Title III dealt solely with the issuance of preferred stock by national banks and the purchase by the R.F.C. of preferred stock in national and state banks.

The R.F.C. had previously been authorized to make loans to state banks and trust companies, irrespective of the question whether or not they were members of the Federal Reserve System; and there was little else that Congress could do to facilitate the reorganization and reopening of state banks except to grant authority to the R.F.C. to provide additional funds "for capital purposes" where it was needed.

This had no reference to membership in the Federal Reserve System and referred solely to reopening closed banks, irrespective of their membership in the System.

In Section 304, as originally enacted, national banks and state banks were treated exactly alike and the R.F.C. was permitted to purchase or make loans only on their preferred stock.

There was no provision that such stock must be exempt from double liability.

There was no provision, nor is there now, in Section 304, requiring state banks to sell preferred stock to the R.F.C. in order to become members of the Federal Reserve System.

Emphasis has been placed on the argument that the R.F.C. was authorized to purchase preferred stock in national or state banks only when, in the opinion of the Secretary of the Treasury, they were "in need of funds for capital purposes".

It is argued that these words indicate that all funds provided under Section 304 should be considered as "capital" for all purposes.

Those making this argument ignore the fact that these words were in Section 304 when it was originally enacted and when it dealt only with preferred stock.

They also ignore the fact that the real purpose of the Section is indicated by the words "either in connection with the organization or reorganization of such association, state bank, or trust company, or otherwise".

These words show that the specific purposes Congress had in mind were the organization or reorganization of banks and not their admission to membership in the Federal Reserve System.

The words "or otherwise" obviously were merely intended to give some flexibility to the section and to avoid restricting the activities of the R.F.C. too much.

The inclusion of these general words furnishes no reason for ignoring the clear and specific language of Section 9 of the Federal Reserve Act and Section 303 of the Act of March 9, 1933.

In Section 304 the words "funds for capital purposes" were obviously used to make the section somewhat flexible and not limiting the purchase of preferred stock to cases where it was absolutely required in order to meet the legal requirements regarding "capital" or "capital stock".

The term "capital funds" is a broad term and obviously would include the amount which might be needed to provide a reasonable margin of safety for depositors, or, stated differently, to give the bank an adequate ratio of "capital funds" to deposit liabilities.

Although there is nothing in the statutes regarding the subject, it is recognized that a bank should not have deposit liabilities exceeding ten times its aggregate "capital funds"; but the term "capital funds" as used in this sense is usually regarded as including surplus and undivided profits, which cannot be taken into consideration in determining whether a state bank has sufficient capital to make it eligible for membership in the System.

The Board has recognized that the amount represented by capital notes and debentures may be taken into consideration in determining whether a state bank has an adequate ratio of "capital funds" in relation to its deposits.

The above, however, is no reason for considering such amounts as "capital" for the purpose of determining whether a state bank has sufficient "capital" to meet the requirements of Section 9 for admission to the System.

The term "funds for capital purposes" was used for the deliberate purpose of conveying a different and broader meaning than is conveyed by the words "capital" or "capital stock" in the provisions of the National Bank Act and the Federal Reserve Act.

The word "capital" therefore should not be given the same meaning and should not be construed as included in the broad term "funds for capital purposes".

The part of Section 304 forbidding the R.F.C. purchasing preferred stock which is not exempt from double liability, and authorizing the purchase of capital notes and debentures from state banks which cannot issue preferred stock exempt from double liability, were inserted in Section 304 by an amendment contained in the Act of March 24, 1933, providing for direct loans by Federal reserve banks to state banks and trust companies in certain cases.

The chief object of that Act was to authorize Federal reserve banks to make loans to state banks and trust companies which are not members of the Federal Reserve System, and the provision regarding the purchase of capital notes and debentures by the R.F.C. was a mere afterthought tacked on to the bill by amendment.

In view of the above, it is impossible to say that when Congress authorized the purchase of capital notes and debentures from state banks and trust companies, it intended also by implication to authorize the Federal Reserve Board to admit such state banks and trust companies to membership in the System, on the basis of such capital notes and debentures in lieu of capital stock.

Such an idea is inconsistent with the theory of the principal section of the bill, which authorized Federal reserve banks to make loans to such banks during the emergency, even though they were not members of the System.

With the credit facilities of the Federal reserve banks made available to non-member banks and trust companies, it was utterly unnecessary for them to become members of the System, and the effect of the Act was to discourage, instead of encourage, state banks and trust companies to seek such membership.

It is obviously a mistake to say that the purposes of Section 304 would be defeated if capital notes and debentures of state banks and trust companies can not be considered capital for the purpose of enabling banks to become members of the Federal Reserve System.

Moreover, if Congress had intended that such notes and debentures should be considered as "capital" it would, at the same time, have amended Section 303 of the Act, which clearly prevents this result.

Furthermore, Congress dealt specifically with the question how much capital should be required of state banks in order to be eligible for membership in the System on June 16, 1933, when it amended Section 9 of the Federal Reserve Act by the Banking Act of 1933; and it said nothing about capital notes and debentures.

It is reasonable to assume that, in the light of the Act of March 24, 1933, they would have provided that capital notes and debentures should be considered as "capital" in determining the eligibility of state banks and trust companies for membership, if they had so intended; they did not do so.

On the contrary, they raised the capital requirements of state banks by striking out the provision permitting state banks to be admitted to the System with a capital equal to 60% of that required of national banks and re-enacted the original provisions of Section 9 of the Federal Reserve Act requiring state banks applying for membership to have a paid-up and unimpaired capital sufficient to entitle it to become a national banking association in the place where it is situated, <u>under the provisions of the National Bank Act, as amended</u>.

The National Bank Act does not authorize national banks to issue capital notes and debentures.

Section 304 of the Act of March 9, 1933, does not authorize the R.F.C. to purchase such capital notes and debentures from national banks.

Any implications which might otherwise be drawn from the amendment of March 24, 1933, authorizing the R.F.C. to purchase capital notes and debentures from state banks and trust companies, therefore, are clearly overcome by the amendment of June 16, 1933, requiring state banks applying for membership in the System to have the capital required of national banks under the provisions of the National Bank Act.

Much emphasis has been made on the last paragraph of Subsection (y) of Section 12 B of the Federal Reserve Act, which reads:

> "It is not the purpose of this section to discriminate, in any manner, against state non-member, and in favor of, national or member banks; but the purpose is to provide all banks with the same opportunity to obtain and enjoy the benefits of this section. No bank shall be discriminated against because its capital stock is less than the amount required for eligibility for admission into the Federal Reserve System."

It is contended that to deny admission to the Federal Reserve System to a state bank which has insufficient capital for membership under the specific language of Section 9 of the Federal Reserve Act, as amended by the Banking Act of 1933, will constitute a discrimination against such state bank in violation of the above provision.

This argument is obviously erroneous: (1) The above paragraph deals only with the purposes and benefits "of this section" - that is, Section 12 B of the Federal Reserve Act, which provides for the insurance of deposits of non-member banks as well as member banks of the System; it has no reference to the provisions of Section 9 of the Federal Reserve Act, which prescribes the terms on which state banks and trust companies may be admitted to membership in the System.

It has even been argued that the last sentence quoted above, which obviously refers only to the provision regarding deposit insurance, forbids the Federal Reserve Board to disapprove the application of a state bank for membership solely because it has insufficient capital.

No one would make this argument who is familiar with the fact that the Banking Act of 1933, which inserted the above quoted provision in Section 12 B of the Federal Reservd Act, also amended and re-enacted the paragraph of Section 9 of the Federal Reserve Act prescribing the amount of capital which a state bank must have in order to be eligible for membership in the System, and increasing the minimum amount of such capital.

It is contended that unless the amount of capital notes or debentures issued by a state bank be included in determining whether the bank has sufficient capital to entitle it to membership in the System, such state bank would be discriminated against in violation of the above quoted provision of Sub-section (y); because no bank would wish to be admitted to the benefits of the insurance fund if it knew that, on January 1, 1936, it would not be eligible for admission to the System, and would no longer be entitled to the benefits of insurance.

This is a clever argument, and I have no douht that it was made in good faith, but it completely ignores the theory upon which Congress admitted non-member banks to the benefits of insurance by the Federal Deposit Insurance Corporation until July 1, 1936, although one of the principal purposes of Section 12 B was to compel all banks to become members of the System, and to raise the standard of banking in this country to that set for member banks of the System.

The real theory of Section 12 B obviously is that non-member state banks should be given the benefits of insurance for a temporary period, regardless of their lack of membership in the System, and regardless of the amount of their capital; but that, on or before July 1, 1936, they must become members of the Federal Reserve System if they desire to retain the benefits of insurance of deposits and must meet the same requirements of any other bank when they are admitted to the System.

Congress fully realized that many banks admitted temporarily to the benefits of the insurance of deposits would not be eligible for membership in the System at the time they obtained such insurance, and that a reasonable amount of time must be allowed for them to make themselves eligible for membership in the System.

The question how much time should be allowed for this purpose was given earnest consideration, and the provisions of the bill on this subject were amended repeatedly.

It was only after a very bitter fight and after mature deliberation that the date by which state banks must become members of the Deposit Insurance Corporation was fixed as of July 1, 1936.

All of this would have been absolutely unnecessary if every bank which is admitted into the Deposit Insurance Corporation should automatically become eligible for membership in the Federal Reserve System, without any further improvement in its condition, or without any further steps to meet the requirements of eligibility.

It is perfectly obvious, therefore, that the provisions respecting temporary insurance of deposits of non-member banks and trust companies have no bearing whatever upon the question what the capital of a bank must be in order to be admitted to membership in the System.

It obviously has no bearing whatever upon the question whether capital notes or debentures should be considered "capital" within the meaning of Section 9 of the Federal Reserve Act.

Nor is the fact that a particular non-member state bank is unwilling to apply for and accept the benefits of temporary insurance of its deposits unless it is assured that it can become a member of the System on or before July 1, 1936, any reason why the provisions of the Federal Reserve Act regarding the admission of state banks and trust companies to membership in the System should be construed so as to accommodate them.

It is argued that the purpose of Section 304 is to authorize the R.F.C. to contribute capital funds to banks found to be in need of them; that optional forms are provided only to meet the legal difficulties incident to varying state laws concerning stockholders' liability and the power to issue stock, and that every question concerning the status of the bank whose capital structure has been repealed should be considered from the standpoint of its "new capital position" rather than from the standpoint of the forms with which we have previously been familiar.

Without admitting the correctness of this argument, it may be pointed out that it is an argument of policy which could appropriately be submitted to Congress in support of an amendment to the provisions of the Federal Reserve Act regarding the amount of capital required of state banks; but it furnishes no reason why the existing law should be construed to mean something which it does not say.

Reference has also been made to the provisions of Section 9 of the Federal Reserve Act as amended by the Banking Act of 1933, which makes mutual savings banks having no capital stock eligible for membership in the System; but this is an exceptional provision made for a peculiar class of banks which by their very nature have no capital stock, and it has no bearing whatever on the proper construction of the provisions of the law regarding the capital required of banks which have capital stock.

The quotations from certain text books and court opinions as to the general meaning of the term "capital" have no bearing upon the meaning of the word "capital" as used in Section 9 of the Federal Reserve Act; because that Section incorporates by reference the provisions of the National Bank Act and Section 303 of the Act of March 9, 1933, defines the term "capital" as used in the National Bank Act.

It is obvious that, where Congress has defined a term as used in certain legislation, such definition fixes the scope and meaning of that term as used in such legislation; and the definitions given in text books or court decisions dealing with the general use of such terms or with their use in other statutes are totally inapplicable.

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Compt of Com.

See Ans
W. Hamlin

November 11, 1933.

Dear Mr. Jones:

In regard to our conversation yesterday with respect to the issue by national banks of what are termed "capital notes", please be advised that I have given careful consideration to the letter of White and Case, and in order that you may fully understand my position, I have gone into some detail in regard thereto.

The position taken by the New York attorneys is in substance that a national bank having the power to borrow money may in borrowing such money make a contract with the lender whereby the lender may subrogate his debt to that of the general creditors of the bank. The Comptroller's office has never taken the position that this could not be done, subject, of course, to the limitations as to the amount which may have been borrowed as set forth in Section 5202 of the Revised Statutes as amended. The office has, however, taken the position that such borrowings must be shown as borrowed money and are not part of the capital of the bank. To hold otherwise would mean:

1. that a national bank could be organized with its capital composed of such notes;

2. that the limitations on the amount which might be loaned by a national bank would be affected by such notes;

3. that directors could qualify by owning such obligations;

4. that the holders of such obligations would have the right to vote;

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5. that the capital of a bank could be increased by an issue of such obligations;

6. that the amount of national bank notes which could be issued would be covered by such notes.

All of the above would be directly contrary to the express provisions of the National Bank Act. As illustrations:

1. section 5134 Revised Statutes provides that in organizing a national bank the organization certificate shall show "the amount of capital stock and the number of shares into which the same is to be divided;

2. that an increase of capital of a national bank must be made by a vote of shareholders "owning two-thirds of the stock of such association" and there must be filed a certificate with the Comptroller "specifying the amount of such increase in capital stock";

3. section 5144 of the Revised Statutes as amended by the Banking Act of 1933 provides for the election of directors by vote of "shareholders";

4. section 31 of the Banking Act of 1933 provides for the number of shares of stock which must be owned by each director of a national bank before he can qualify as a director;

5. section 5200 which limits the total obligation of any national banking association, states that the total obligation "shall at no time exceed ten per centum of the amount of the capital stock of such association";

The Emergency Banking Act defines the term "capital" as follows:

"The term 'capital' as used in provisions of law relating to the capital of national banking associations shall mean the amount of unimpaired common stock plus the amount of preferred stock outstanding and unimpaired; and the term 'capital stock', as used in section 12 of the Act of March 14, 1900, shall mean only the amount of common stock outstanding".

This would seem conclusive.

Under the circumstances I feel that it is obvious that I have taken the correct position but if you so desire, I shall be glad to submit the question to the Attorney General.

Sincerely yours,

(Signed)

J. F. T. O'CONNOR,
Comptroller.

Honorable Jesse Jones, Chairman,
Reconstruction Finance Corporation,
Washington, D. C.

November 13, 1933.

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Mr. Wyatt's Opinion - Capital Notes.

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The question was raised whether a bank applying for membership in the Federal Reserve Bank of Richmond, must subscribe 6% of its capital notes and debentures outstanding, but the Board has held in effect that these notes are included in the term "capital" under Section 9 of the Federal Reserve Act.

To hold that the bank must subscribe for such notes, it is necessary to go further than the Board intended to go in its ruling, and to hold that they are included in the term "paid up capital stock and surplus."

This office is of opinion that the terms "capital" and "capital stock" used in the Federal Reserve Act are synonymous.

The Board's ruling apparently took the position that there is a distinction between capital stock and capital, and that the latter term is broader than the former.

I am of opinion that capital notes and debentures can not properly be considered capital stock for the purpose of determining the amount of Federal reserve bank stock an applying bank must subscribe for.

A ruling to this effect, however, would appear inconsistent with the Board's ruling that capital notes and debentures may be included in determining whether a state bank or trust company has the amount of capital necessary to render it eligible for membership.

Ruling to this effect:

1. Would appear inconsistent.

2. Would lead to anomalous results.

e.g. - A national bank in a city of over 50,000 inhabitants must have a minimum capital stock of over $200,000, and must subscribe for not less than $12,000 stock in the Federal Reserve Bank.

A state bank, however, in the same place with a capital of $100,000 and with capital notes and debentures amounting to $100,000 sold to the R.F.C. would be required to subscribe for only $6,000 of stock in the Federal Reserve Bank.

Disregarding technical legal questions, three possible courses are open for the Board:

1. To hold that all capital notes and debentures must be considered capital stock to determine amount of state bank subscription.

This may lead to surprising results:

(a) Many banks reorganized since the bank holiday have enough capital stock to make them eligible for membership, and in addition thereto, have capital notes and debentures issued to their depositors in substitution of waived or frozen deposits.

They would be required to subscribe for large additional amounts of Federal reserve bank stock if such capital notes and debentures are to be considered capital stock for the purpose of determining the amount that such banks must subscribe to the capital stock of the Federal reserve bank.

It might work a real hardship on such banks to require them to subscribe to this additional stock.

2. To hold that capital and capital stock include only debentures which were issued for cash, and do not include those for pre-existing debts.

Some banks have sufficient capital stock to make them eligible, and in addition, have capital notes and debentures outstanding issued to persons who advanced additional cash to the bank to protect depositors, and who subordinated their claims to those of the depositors, and they might be unwilling to increase their subscriptions to Federal reserve bank stock by an amount equal to 6% of these capital notes and debentures.

3. It might be possible to hold that in determining the amount which a state bank must subscribe, the capital notes and debentures sold to the R.F.C. under Section 304 of the Act of March 9, 1933, as amended, should be considered capital stock, but that other capital notes and debentures should not be considered capital stock.

This would be consistent with the theory of the Board's ruling, if that ruling is based on the provisions of Section 304.

It would not be entirely free from other difficulties, e.g. if capital notes and debentures which are subordinate to the claims of depositors and other creditors have been issued to private parties who have contributed cash to aid reorganization, it would be difficult to justify a ruling that such capital notes and debentures may not be considered capital in determining whether such a bank is eligible for membership in the Federal Reserve System, or capital stock in determining the amount which it must subscribe to of stock in the Federal Reserve Bank, if admitted merely because such notes were not issued to the R.F.C.

Attention is invited to the fact that if the Board holds that capital notes and debentures must be included in computing amount of stock in the Federal reserve bank to which the applying state bank must subscribe, the question will arise whether these banks which have already been admitted to membership must increase the amount of their subscriptions to the stock of the Federal reserve bank by 6% of the amount of capital notes and debentures which they now have outstanding, or may hereafter issue. Such banks might be unwilling to subscribe to such additional stock, and might challenge the legality of the Board's position.

As indicated above, I am at a loss as to how to answer Mr. Hoxton's inquiry, and the question is respectfully submitted to the Board for determination.

November 14, 1933. See Ber

Mr. Wyatt's Memorandum - Capital Notes.

The question arises whether, in subscribing for stock in the Federal reserve bank, the applying state bank or trust company must subscribe to an amount equal to 6% of the capital notes or debentures issued to and bought by the R.F.C.

If the applying bank has notes or debentures issued and held by the public, these notes or debentures are not capital in any sense of the word, but are pure liabilities. The applying bank, therefore, would not have to consider these in determining the amount of its subscription to the Federal reserve bank. Under Section 304, however, a different question is presented. The Government, through the R.F.C., is authorized to subscribe to preferred stock of these applying banks. In the case of a national bank, its preferred stock would clearly be counted as part of its capital, and it would have to subscribe 6% of that amount in the way of subscription to the Federal reserve bank stock, and make a first payment of 3%.

Section 304, in my opinion, intends to make capital notes and debentures bought from the bank by the R.F.C. capital stock, to all intents and purposes, and when the bank applies for admission, it clearly must subscribe to 6% of the amount of these capital notes and debentures sold to the R.F.C.

It may be said that this will impose a hardship on banks applying for admission, to require them to take this additional subscription of

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stock in the Federal reserve banks, and that the same would apply to banks already in the System, but which have given capital notes requiring, on this theory, a further subscription to the Federal reserve bank stock.

To my mind, this will impose very little hardship on state banks, etc. now in the System, and those which may apply later for membership, as they will have to make an initial payment of only 3% of the amount of these capital notes or debentures.

In addition to this, it should be remembered that these banks will be entitled to a cumulative 6% dividend on the 3% of such capital notes and debentures actually paid in in exchange for Federal reserve bank stock, so far from being a hardship, therefore, it will be a profitable investment.

COPY

See Bu

To Governor Black

November 28, 1933.

From Mr. Goldenweiser

I am sending you a ribbon copy and a carbon of an account of the conference on gold policy on November 26, which I have prepared, and which has the approval of Mr. Smead and Mr. Gardner.

I am having the material on business and prices, which we gave you last week, brought up to date and will send it to you early in the afternoon.

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COPY

CONFERENCE ON GOLD POLICY ON NOVEMBER 26, 1932.

Level of devaluation.

On the question of devaluation, the first point raised was, if devaluation were decided upon, at what level shall the dollar be established. It was agreed that its proper level in relation to foreign currencies and to the relative position of prices here and abroad would place the dollar at about 15 per cent below its former parity. It was clear that it would not be practicable to revalue at once at so high a level. The dollar is now nearly 40 per cent below parity, and if its parity were established 25 points higher, it would unquestionably result in a serious decline in prices of international commodities.

It was also felt that devaluation to 50 per cent was not desirable as an immediate move, because it would carry the existing under-valuation of the dollar still further and would cause additional complications abroad. It would probably cause similar devaluations in other countries. The general feeling was that, if an immediate devaluation were undertaken, it should be somewhere near the present level of the dollar in the foreign exchanges, that is, at somewhere between 60 and 65 cents.

Effects of devaluation on capital movements

One effect of devaluation that was generally agreed upon was that it would reestablish certainty and would encourage long-time commitments by business enterprises. It might bring back a considerable part of the capital that has fled owing to uncertainty and might result in better conditions in the bond market. Incidentally it was brought out that since we have little excess of exports over imports and no exports of gold, it is clear that there has been no net export of capital from this country. Whatever export therehas been has been compensated by purchases in the American market by foreigners. These purchases have in part taken the form of foreigners buying at bargain prices their own bonds floated in this market. This has been notably true of the Germans. A reversal in this movement would mean that Americans would bring back their money, and foreigners would probably dispose of their American holdings to Americans at higher prices. The flight of capital, therefore, has not constituted an outflow of tangible funds, but has been reflected chiefly in an exaggerated demand for foreign currencies by Americans and a consequent drop in the exchange value of the dollar. It has been distinctly a buyers' market in dollars. A large number of people have offered dollars and have been willing to take losses in order to assure themselves the possession of funds abroad. A reversal of this process would mean a sellers' market in dollars. Americans having foreign currencies, being anxious to return their funds to this country, would bid up the dollar, provided it was not firmly fixed on gold. If it were so fixed, there would probably be a drain on the foreign gold reserves that would result in embargoes or other means of self-protection by the foreign countries.

Effect on prices

Would devaluation increase commodity prices? Devaluation at the present level would probably not have much immediate effect on commodity prides, because international commodities are already adjusted to the present exchange value of the dollar, while other commodities would only follow slowly over a long period of time and to varying degrees. If an immediate price advance resulted from devaluation, it would come from an increase in business caused by the return of confidence. Such a price advance might not be confined to this country and would be a healthy and desirable development. An increase in business activity would be likely to result from devaluation both because of firmer price conditions and because of an increase in confidence. There would probably be no immediate or proximate increase in wages, because wage increases always lag behind price increases, and also because of the existence of a large army of unemployed who would be prepared to take jobs at no advance in wages over the existing rates. Employed wage earners would, therefore, suffer, because their earnings would not buy as many commodities, and would not benefit in any way from devaluation, unless the better tone of business would make them more certain of retaining their employment.

Effect on bond holders

There was also discussion of the effect of devaluation on savings banks, insurance companies, and trust funds. These institutions would not be directly affected by devaluation or by an upward movement of prices, because their liabilities are expressed in terms of the same dollars as their assets. They might, however, be affected seriously, if devaluation were followed by a boom in stocks which would lead the public to withdraw their savings and to borrow from their insurance companiesfor the purpose of buying equities. That might result in a serious decline in bond prices which would be a severe blow to savings banks, insurance companies, and trust funds. It was pointed out, however, that all of these institutions have considerable holdings of mortgages and that improved business and rising prices would improve the quality of mortgages. Furthermore, bonds that are now selling at low levels because of low earnings of the corporations might advance, if the business situation improved and corporations would be better able to meet their coupon payments and their principal payments at maturity. The bonds that would be most unfavorably affected in case a move towards equities should develop, would be gilt edged bonds, including United States Government bonds.

On the whole, it seemed to be the general feeling that the net effect of devaluation on holders of long-term securities, including the special classes mentioned above, would probably not be serious. There is, however, no complete certainty that undesirable situations in some institutions might not develop.

Possibility of return to par.

The question was raised whether there is any possibility of going back to the old parity of the dollar. The general understanding was that a return to the old parity either immediately or in the near future was not practicable. The reason that is so is that our prices and costs have gone up in relation to prices and costs abroad, so that a return to the old standard would put us at a competitive disadvantage with foreign countries and would cause pressure on our prices. In other words, a return to a 100-cent dollar in anything like the near future would mean a severe deflation in this country. The point was made that, if prices cannot be raised by monetary means alone, can a price decline be caused by such means. It was thought that a pressure on prices could and would develop from a return to gold on too high a level. It may be difficult to raise prices by monetary means, but it is impossible on the gold standard to maintain prices at a level seriously out of line with the world level.

The question was raised of the relation of this statement to the fact that the dollar is inherently strong. The fact is that since we went off the gold standard conditions have changed; prices of all our commodities in this country have gone up on the average by about 20 per cent and prices of international commodities have gone up as much as the dollar has depreciated. This changes the situation and makes the international value of the dollar, on what is known as purchasing-power parity, somewhere between 80 and 90 cents. A rise above that would certainly cause a severe pressure on our prices; and even a rise to as high as 80 or 90 per cent would subject such leading commodities as wheat and cotton to serious price declines.

It was mentioned that when England in 1925 returned to gold at pre-war parity, her prices were still 10 or 15 per cent above gold prices in other countries, and that this caused England to suffer severely in international trade. Cost of production in England, both because of an antiquated plant and because of heavy charges for social legislation, made it impossible for her to compete on equal terms with France and Belgium which had devalued their currencies to a low level. This, together with a run on the pound that developed in 1931, caused England to depart from the gold standard again after six years, this departure being followed by an immediate depreciation of the pound by 30 per cent. Such a rapid depreciation when the link with gold was severed indicates that the pound was kept at an artificially high level by the gold standard. Our situation is not strictly comparable because we have a highly developed and efficint plant, but our costs are high and have been made higher by the activities of the N.R.A. Our prices are probably 15 per cent out of line with world prices, and consequently a return to gold at the old parity in the near future might result in the loss of any progress we have made in business recovery and probably in a period of severe deflation and further readjustment.

This does not necessarily mean that, if stabilization were undertaken and the dollar were allowed to find its own level by gradual stages over a period of years, the strong international position of the dollar might not ultimately bring it back to par. That is not clear, but it is possible in view of the creditor position of the country, its ability to compete in foreign markets in the sale of many products, and the general strength of the dollar based on its large gold reserve and the fundamentally strong fiscal position of the Government. It seemed, however, that a long-time policy of stabilization with a view to possible return to the old parity offered little hope for continued and fairly rapid business recovery.

It was pointed out that except from the legal point of view, which has been largely discarded, and from the point of view of sentiment, there was no sanctity in the old parity. It represented a more or less accidental development to which we had become adjusted. Now that we have lost this adjustment, an effort to reestablish it would hardly be worth the cost either from the social or the economic point of view. The only important factor in favor of the return to the old parity is the strong belief in it prevailing among many people. To what extent these people are representative of the masses is a question. It would seem that the public at large is concerned with the size of its earnings and the prices of the goods it has to buy rather than with its theoretical ability to redeem its currency for any stated amount of gold.

Stabilization

It was further discussed whether an immediate stabilization could be advantageously undertaken by agreement with England and France. It was pointed out that such a stabilization if it became known would do away with a considerable part of the prevailing uncertainty, particularly if it was definitely understood that the dollar would not be allowed to depreciate further. Such a stabilization accomplished by international agreement would have a stimulating effect on world trade. It might result in some decline in the prices of international commodities in so far as these prices have been boosted by the expectation of inflation. Few commodities, however, have increased in price more than the dollar has fallen and it is not probable that there would be serious price disturbances. Stabilization would probably have a favorable effect on internal prices because it would stimulate activity. Also the dollar being now undervalued on the exchanges, in relation to the prices of internal commodities, the tendency would be for these commodities gradually to rise to a level approximating that to which world commodities have risen.

There was discussion of the details of stabilization and of possible losses involved. It was agreed that if stabilization were conducted in such a way as to convert promptly into gold all foreign currencies acquired for the purpose, the losses could not become considerable and would be in the nature of deductions from the profit that will be made when the existing stock of gold is revalued.

The point was made that stabilization with a gradual adjustment of the dollar to the level where it belongs economically was the most scientific course to pursue and one which experience has proved to be effective in the case of France. The only question raised was whether in view of the many shocks to confidence that the country has experienced, anything short of a definite action would be sufficient to reestablish confidence.

Position of France.

Following are Mr. Gardner's comments on the French situation:

France runs little immediate risk from depreciation of the dollar through our gold purchasing policy. It is true that the depressed dollar gives an advantage in world markets to American exporters and over the course of months or years the French balance of trade may be adversely affected by the situation. But this will be a slow development, partly because it takes time to alter the established channels of international trade, partly because the French employ a stringent quota system and can, at least in some degree, cut imports to match a falling export business. Not only will the growth of an adverse balance of trade be slow in France, but the immediate effects of our gold policy on capital movements is favorable in that capital tends to flee the United States. Certainly such a movement can put no strain upon the franc.

The only reason the franc has been under pressure in recent weeks is that the internal situation in France has been bad. Controversy has revolved about the budget deficit and two governments have fallen without making any headway on the problem. Hence while the Netherlands, Switzerland and England have all been gaining gold, France has lost $100,000,000 of reserves in the four weeks ending November 17. Probably much of this has represented withdrawal of foreign balances from Paris. But if the movement continues at this pace, it is only a matter of time before the French public generally takes alarm and maintenance of the gold standard becomes impossible. Such an outcome, however, cannot be attributable to the American gold policy.

Although our gold policy does not constitute a serious threat to the gold standard countries, there is no question that it does put their traders at a continuing disadvantage in world markets, and it is widely interpreted abroad as a hostile move. Foreign resentment at our action is real; but only because foreigners fear the unfavorable effect of a cheap dollar on their export trade, and not because they are experiencing any immediate strain on their gold reserves as a result of the policy.

COPY

Sec Bd

Goldenweiser

DEVALUATION.

Nov. 28, 1933.

The attached memorandum raises a number of legal questions and a number of economic questions which will become important if the weight of the gold dollar is reduced by the President pursuant to the provisions of Section 43 of the Act of May 12, 1933 (Public No. 10, 73d Congress), commonly known as the "Thomas Amendment". Such action would result in a paper profit to all holders of gold in this country; and the principal question is whether the profit on the large amount of gold now held by the Federal reserve banks would belong to them and, if so, whether the Government could take it from them.

This memorandum contains concise answers to the legal questions propounded in the attached memorandum. For convenience of reference, each legal question will be given the same number as in the attached memorandum and will be stated in the same form. The economic questions will be omitted, because they will be dealt with in a separate memorandum.

(1) "Can Government take this profit from reserve banks?"

There is no legislation entitling the Government to any profit realized by the Federal reserve banks on any gold owned by them at the time the dollar is devalued, and there appears to be no legal principle upon which the Government would be entitled to that profit.

If the dollar were devalued under present law, therefore, the profit on the gold owned by the Federal reserve banks would belong to them; and Congress would have no more right to enact legislation taking it away from them than it would have to take any other property of the Federal reserve banks without compensation. Such legislation would violate the

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Fifth Amendment to the Constitution, which forbids the taking of private property without due process of law, which necessarily requires just compensation.

(2) "<u>Is not title to this gold in reserve banks and how can Government divest them of this title?</u>"

Of course, the Federal reserve banks have no beneficial ownership in gold which they hold under earmark or in trust for others and such gold will be omitted from this discussion.

The situation respecting the gold treated as assets of the Federal reserve banks may be summarized briefly as follows:

Gold amounting to $250,503,000 is actually held by the Federal reserve banks themselves for their own account, and it is clear that they have both the legal title and the beneficial ownership of such gold.

Gold amounting to $1,521,091,000 is held by the Federal reserve agents in their own custody as collateral security for Federal reserve notes; but it is clear that the Federal reserve agents hold such gold only as pledgees and that the beneficial ownership is in the Federal reserve banks.

Gold amounting to $1,191,935,000 has been pledged by the Federal reserve banks with the Federal reserve agents as security for Federal reserve notes but has been deposited by the Federal reserve agents with the Treasurer of the United States for credit to their account with the Federal Reserve Board. As to this gold, the legal situation is not entirely clear; but it is believed that the beneficial ownership remains in the Federal reserve banks.

Gold amounting to $592,547,000 has been deposited by the Federal reserve banks with the Treasurer of the United States for credit to the account of the Federal reserve banks with the Federal Reserve Board in a fund known as the Gold Settlement Fund. The legal status of this gold is not clear, but it is believed that both the legal title and the beneficial interest therein have passed to the United States and that the Federal reserve banks are merely general creditors of the United States for this amount.

Gold amounting to $35,723,000 has been deposited by the Federal reserve banks with the United States Treasury in the Gold Redemption Fund for the purpose of redeeming Federal reserve notes. Theoretically it would appear that this constitutes a specific deposit, that it constitutes a trust fund, and that the beneficial ownership remains in the Federal reserve banks. Many years ago, however, this gold was covered into the general fund of the Treasury and a mere book credit was set up in favor of the Federal reserve banks. In view of this practice, acquiesced in by the Federal reserve banks for many years, it probably would be held that both the legal title and the beneficial interest in this gold has passed to the United States.

A more complete discussion of the above points is contained in a separate memorandum.

Although they were created to serve as instrumentalities of the Government to aid the Government in the performance of its functions by serving as depositaries and fiscal agents, the Federal reserve banks are private corporations to the same extent as national banks and they are owned entirely by their own stockholders, consisting exclusively of member banks of the Federal Reserve System. Like all banks, they are affected with a public interest and, more than any other banking institutions, they perform functions of great public importance; but this does not change the character of their ownership or their legal status as private corporations, except that they are subject to <u>regulation</u> by the Government to a much greater extent than ordinary private corporations.

Since they are privately owned, any confiscation of this property without just compensation would violate the Fifth Amendment to the Constitution, which forbids the taking of private property without due process of law.

Presumably, Congress could enact legislation requiring the Federal reserve banks to transfer their gold to the Government, if it were needed by the Government to enable it to coin money or perform any other governmental function; but the Government would have to compensate the Federal reserve banks for it, as it has to pay just compensation when it takes any other private property.

It would appear, therefore, that the Government can divest the Federal reserve banks of the title to the gold which they now hold only by due process of law, which includes the payment of just compensation therefor.

(5) "<u>Authority of Congress to pass legislation taking this profit from Reserve banks. Probable form of law that will be passed. Constitutionality of such law and of action following such law. Position of reserve banks in the matter relative to their responsibility to their stockholders in such transaction. Rights of stockholders.</u>"

Most of these questions have been discussed above under questions number (1) and (2).

It is impossible to foretell what form of legislation might be devised to take this profit from the Federal reserve banks; but it probably would take the form of a law providing that, in order to enable the Government to coin money as authorized by the Constitution, all gold held in the United States shall be delivered to the Treasury; but, in order to be constitutional, it is believed that such legislation would have to provide for the payment of just compensation to the holders of such gold. Furthermore, if such legislation were passed in contemplation of the devaluation of the dollar, it is doubtful whether the payment of an equivalent amount of dollars at the reduced valuation would be considered just compensation.

It might be claimed that the interest of the member banks as stockholders in the Federal reserve banks is limited to their right to the repayment of the amount they have invested in such capital stock plus 6 per cent interest from the date of the last dividend paid thereon and that a statute taking away part or all of the surplus of the Federal reserve banks does not affect their interests. This proposition, however, will not bear analysis. The Federal reserve banks own their surplus funds and they are in turn owned by their member banks and no one else has any proprietary interest in the Federal reserve banks. Therefore, the taking of the surplus of the Federal reserve banks or any other property in the Federal reserve banks is a taking of private property.

That this is not merely theoretical or legalistic, but is actually of practical importance to the stockholders of the Federal reserve banks becomes obvious when we inquire what would happen to the stockholders if the Federal reserve banks should incur losses amounting to $500,000,000, which could easily happen if there should be a substantial depreciation in the market value of the enormous amount of Government bonds now owned by the Federal reserve banks.

A loss of $500,000,000 would be more than enough to wipe out the entire capital and surplus of all the Federal reserve banks, so that, instead of being an excellent investment as it is today, the stock of the Federal reserve banks would become worthless and each member bank would have sustained a loss equivalent to its investment in the Federal reserve bank - i.e. 3 per cent of its own capital stock and surplus.

Moreover, any serious impairment of the capital of the Federal reserve banks would make it necessary for the Federal Reserve Board to call upon the member banks for the remainder of their subscriptions to the stock of the Federal reserve banks and this would compel them to invest an additional 3 per cent of their own capital and surplus in such stock.

It is obvious, therefore, that the member banks have a real interest in the Federal reserve banks as stockholders and that the Federal reserve banks owe to their stockholders a very definite duty to keep their capital and surplus intact.

(6) "<u>Can Secretary of Treasury under present laws order all gold in reserve banks into the Treasury?</u>"

There appears to be no authority under present law for the Secretary of the Treasury to require the Federal reserve banks to deliver <u>all</u> of their gold into the Treasury. He can require them to transmit to the Treasury such amount of gold as may be required for the exclusive purpose of redeeming Federal reserve notes, but it is doubtful whether the beneficial title to such gold would pass the Treasury.

As explained more fully in a separate memorandum, the holding of gold by Federal reserve banks is not "hoarding" within the meaning of Section 5 (b) of the Trading with the Enemy Act pursuant to which the President required other holders of gold to deliver it to the Federal reserve banks in order to stop the hoarding thereof; and the President could not utilize his powers under that Act to take all the gold from the Federal reserve banks.

The Secretary of the Treasury could not take this gold from the Federal reserve banks under the provisions of Section 11 (n) of the Federal Reserve Act, as amended by Section 3 of the Act of March 9, 1933, because such action would not protect the currency system of the United States but would destroy the present currency system of the United States and would, therefore, defeat the purpose of that section. (See separate memorandum).

(7) "<u>How would Secretary of Treasury pay reserve banks for this gold?</u>"

If the Federal reserve banks should voluntarily agree to transfer their gold to the Treasury or if Congress should enact legislation requiring them to do so, it would seem that the only practical means by which the Treasury could pay for such gold would be by a credit on the books or with currency, bonds, certificates of indebtedness or other obligations of the Government.

(8) "<u>Could Secretary give reserve banks some kind of receipt for return of gold dollars on devalued basis in same amount as gold dollars taken?</u>"

See answer to next question.

(9) "<u>How could reserve banks handle such a receipt among their assets?</u>"

Under the provisions of Section 16 of the Federal Reserve Act (1933 Edition, p. 75) the unpledged gold held by the Federal reserve banks in their own right (as distinguished from the gold which the Federal reserve banks have pledged with the Federal Reserve Agents) could be deposited with the Treasurer of the United States for credit to the account of the Federal reserve banks with the Federal Reserve Board in the Gold Settlement Fund and receipts therefor could be issued to the Federal reserve banks. Such gold (or the credit therefor) would be treated as assets of the Federal reserve banks and would continue to count as reserves against Federal reserve notes and deposit liabilities. It is probable that both the legal title and the beneficial interest in such gold would pass to the Treasury and that the Treasury could repay the deposit with devalued dollars; but this is not entirely clear.

The gold which has been pledged with the Federal Reserve Agents as security for Federal reserve notes could not be deposited in the Gold Settlement Fund, because it is subject to a lien. The Federal Reserve Agents, however, could deposit it with the Treasurer of the United States for credit to their accounts with the Federal Reserve Board and such gold would continue to serve both as security for Federal reserve notes and as reserve against Federal reserve notes and also would continue to be treated as assets of the Federal reserve banks. It is believed that the equity or beneficial ownership in such gold, however, would remain with the Federal reserve banks and that neither the Treasurer nor the Federal Reserve Agents could repay the Federal reserve banks in dollars of a devalued basis.

(10) "Could Secretary of Treasury pay with certificates (Treasury) and could these certificates be carried in assets in lieu of gold surrendered?

The Secretary of the Treasury could pay for such gold with certificates of indebtedness; and the transaction would legally amount to a purchase of the Government's obligations by the Federal reserve banks with gold. Unless the existing reserve requirements were completely suspended, however, the Federal reserve banks could not use all of their gold for this purpose and the suspension of the reserve requirements for the purpose of enabling the Federal reserve banks to use all of their gold for the purpose of purchasing obligations of the Government would be of doubtful legality.

(11) "What are present gold requirements for reserve banks as to reserve against deposits and note liabilities?"

Section 16 of the Federal Reserve Act (1933 Edition, p. 70) provides that:

> "Every Federal reserve bank shall maintain reserves in gold or lawful money of not less than thirty-five per centum against its deposits and reserves in gold of not less than forty per centum against its Federal reserve notes in actual circulation."

(12) "Could these reserve requirements be done away with and, if so, by what action?"

Section 11 (c) of the Federal Reserve Act (1933 Edition, p. 30) authorizes the Federal Reserve Board to suspend any reserve requirements of the Federal Reserve Act for a period not exceeding thirty days and to renew such suspension from time to time for periods not exceeding fifteen days; but this provision was intended to make it possible for the Federal reserve banks to utilize their reserves in order to meet demands upon them when it is impossible for them to maintain their legal reserves without failing to meet those demands. It is doubtful whether it would be in accordance with the intent of the law for the Federal Reserve Board to suspend the reserve requirements entirely for the deliberate purpose of enabling the Federal reserve banks to divest themselves voluntarily of all the gold which they hold as their legal reserves, in order to accomplish some object beyond the purposes of the Federal Reserve Act.

Section 43 of the Act of May 12, 1933, commonly known as the Thomas amendment (Appendix, 1933 Edition, F.R. Act, p. 157), however, authorizes the Federal Reserve Board to authorize the Federal reserve banks to agree that they will purchase obligations of the United States Government in an aggregate sum of $3,000,000,000 in addition to those they already have, "notwithstanding any provisions of law or rules and regulations to the contrary." This section also provides that no suspension of the reserve requirements of the Federal reserve banks under the terms of Section 11 (c) of the Federal Reserve Act, necessitated by reason of operations under the Thomas Amendment shall require (a) the imposition of the graduated tax upon any deficiencies in reserves or (b) the automatic increase in the rates of interest or discount charged by the Federal reserve banks, as specified in Section 11 (c) of the Federal Reserve Act.

These provisions probably would justify a total suspension of the reserve requirements of the Federal reserve banks, if such action became necessary as the result of the purchase by the Federal reserve banks of an additional $3,000,000,000 of Government bonds pursuant to the Thomas Amendment.

While it is not entirely clear, however, it is believed that the phrase "necessitated by reason of operations under this section" refers to operations of the Federal reserve banks and not to any action which the President might take with respect to the devaluation of the dollar. Unless, therefore, such action should become necessary as a result of operations by the Federal reserve banks under the Thomas Amendment, i.e., the purchase of Government obligations, it is doubtful whether this section would justify a total suspension of the reserve requirements.

(13) "If these reserve requirements could not legally be done away with, how could Secretary of Treasury take gold from reserve banks in face of the law requiring certain percentages of gold reserves against deposits and note liability?"

As shown above, the Secretary of the Treasury has no authority to take all the gold from the reserve banks. Even if he had such authority, it would be a violation of law for him to take all of the gold or to take enough of it to reduce the reserves of the Federal reserve banks below the amounts required by law. It would be equally as unlawful for him to force the reserve banks to violate the law as it would be for them to do so on their own motion.

As indicated above, the reserve requirements could be suspended by the Federal Reserve Board under certain circumstances; but it is doubtful whether the Board would be justified in suspending them completely for this purpose.

(14) "What other legal obstacles or requirements relative to gold of reserve banks that would have to be met or faced or followed by the Government in an effort to order gold of reserve banks turned over to Government?"

Numerous obstacles to any action by the Government to force the

Federal reserve banks to turn their gold over to the Government have been stated in answer to the above questions. Because of this fact and also because of the limitations of time, no exhaustive search has been made for additional legal obstacles and it is impossible to state that no additional ones exist.

However, it may be pointed out that any attempt by the Government to force the Federal reserve banks to deliver their gold to the Treasury might result in suits for injunction challenging the authority for such action and the constitutionality of any legislation upon which such action is based.

Such litigation probably would also give rise to decisions as to the constitutionality of Section 5 (b) of the Trading with the Enemy Act, the Executive Orders of the President issued thereunder, the constitutionality of the Thomas Amendment, and the constitutionality of the Joint Resolution of Congress abolishing the gold clause in private contracts heretofore entered into.

A reasonably prompt decision by the Supreme Court of the United States probably could be obtained; because such suits could be instituted in the United States District Courts, appeals could be taken directly to the Supreme Court of the United States, and the Supreme Court probably would advance the cases on the docket in view of their vast public importance.

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date December 8, 1933

Sec. Bd.

To Mr. Hamlin

From Mr. Gardner W.R.G. and Mr. Longstreet V.L.

Subject: Relation of central banks in England, France, and Germany to the Government

16—852

Bank of England

The Bank of England is a privately owned corporation managed by its stockholders. Its relations with the Government are fundamentally those of banker and client. Before the Macmillan Committee in December 1929, Sir Ernest Harvey, deputy Governor of the Bank of England, testified: "We never venture to interfere on any question that can be considered a political question unless we are asked to express an opinion as to what the financial effect of a certain political operation may be. The Treasury, on the other hand, do not seek to dictate an alternative line of financial policy if we consider a particular line of policy essential for the protection of the country's main reserves. The color of the Government at the moment has absolutely no influence whatever on the nature of these relations."

The law does impose certain reserve requirements on the bank that it can vary only with the consent of the Treasury. And the Treasury takes the profits of the issue department, an arrangement, incidentally, that will insure its receiving the full mark-up on the bank's reserves when legal devaluation of the pound occurs.

While officially the Bank of England is entirely independent of the Government, it is always in close touch with it, and the balance of power depends largely on the personalities of the Governor of the Bank and the Chancellor of the Exchequer. The Bank and the Treasury cooperate closely in administering the Exchange Equalization Fund.

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Bank of France

The Bank of France is also a private institution in the sense that its capital is supplied by the public. But unlike the Bank of England, powers of the shareholders are strictly limited and the Government has a major part in the management. The shareholders elect members of the General Council, which administers the bank, but the Governor and two deputy Governors, who are ex-officio members of the Council, are appointed by the President of France on the proposal of the Finance Minister. Since the Governor's position is of dominating importance it would seem that the influence of the French Government with the bank is assured. But the Governor is not appointed for any definite term and the law does not provide for his removal. It is therefore possible for the Governor to persist in a policy unacceptable to the Government and still remain in office. There is no example, at least in recent years, of a real clash of this sort.

Some indication of the influence the Governor can exert was given in the summer of 1928. At that time Governor Moreau felt that the bank's foreign-exchange holdings, already large and rapidly growing, were becoming unwieldy and that their further growth could be checked by a legal stabilization of the franc, which had been stabilized de facto for over a year and a half. It was on the Governor's insistence at this juncture that the Poincaré Government finally stabilized the franc de jure. At the same time the Government indebtedness to the bank was fixed at fr.3,200,000,000, at which figure it has since remained. This limitation of Government borrowing at the bank was a reaction against the large advances the bank was compelled to make to the Treasury during the period of post-war inflation.

Mr. Hamlin

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Reichsbank

The Reichsbank is also a privately owned institution with the powers of the shareholders strictly limited. Under the old provisions of the law, before they were amended on October 28, 1933, the General Council, a body elected by shareholders, chose the President of the bank with the confirmation of the President of the Reich. Under the new amendments the General Council is abolished and the President of the Reich is given the power to select and also to remove the President of the bank and members of the Managing Board, which directs the bank's policies. This gives the Government full control. In a confidential letter to the Bank for International Settlements submitting the proposed changes in the law, the German Finance Minister stated, "As regards the election of the President of the Reichsbank, the General Council can henceforth be dispensed with, as there cannot possibly be a President of the Reichsbank who is not persona grata with the President of the Reich. This being the case the appointment as well as the dismissal of the President of the Reichsbank had better be left to the head of the State. The same holds good for the members of the Managing Board."

Another feature of the old law designed to establish the independence of the bank was a provision that the bank could not lend to the Government on open account more than Rm. 100,000,000, such loans to be for not more than three months and to be paid off completely at the end of each fiscal year. Furthermore the bank was not permitted to hold Treasury bills, either as a result of direct purchase or as collateral for loans, in excess of Rm. 400,000,000 at any one time. These provisions, together with the fact that the bank could deal in securities only on behalf of customers, effectively kept the Government from endeavoring to milk the bank for its own purposes. Under the new law the limitations on lending to the Government and on Treasury bills remain; but the Reichsbank has now been given the power to deal without limit in interest-bearing Government securities maturing within one year. Whether the Government will endeavor to force the bank under this new power to finance its program of public works remains to be seen.

A great deal depends on the personal force of the bank head. President Schacht of the Reichsbank is the actual leader of monetary policy in Germany today. But no doubt his official position will last only so long as he can persuade the Hitler Government that his policy is the correct one, which he seems capable of doing for some time to come.

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date December 9, 1933

sec Bm

To Mr. Hamlin

Subject:

From Mr. Goldenweiser

gpo 16—852

LEP

In response to your request made by telephone yesterday afternoon, I am attaching a table showing changes in the Federal reserve banks' holdings of United States Government securities, and changes in monetary gold stock of the United States between November 2, 1927 and March 1, 1928, during March, and between March 28, 1928 and the year end. Changes in the discount rate at the Federal Reserve Bank of New York between November 1, 1927 and December 31, 1928 are also shown.

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United States Government Securities Held by Federal Reserve Banks, and Monetary Gold Stock of the United States

(In millions of dollars)

	Change from--		
	Nov. 2, 1927 to Feb. 29, 1928	Feb. 29, 1928 to Mar. 28, 1928	Mar. 28, 1928 to Jan. 2, 1929
U. S. Government securities	- 118	- 22	- 142
Monetary gold stock	- 170	- 53	- 181

Discount Rate Changes at the Federal Reserve Bank of New York

February 3, 1928	from	3 1/2	to	4	per cent
May 18, 1928	from	4	to	4 1/2	per cent
July 13, 1928	from	4 1/2	to	5	per cent

Inserted in Vol 148 Sec Bk

E. R. Black to Roosevelt

Mr. Hamlin

December 29, 1933

My dáar Mr. President:

I have the honor to acknowledge your esteemed letter of the 29th in which you detail a proposed plan for the transfer of the gold of the Federal Reserve Banks to the Treasury.

In reply to your letter I beg to advise that for the past week I have endeavored in conference with the Attorney General, the Acting Secretary of the Treasury and his counsel, Mr. Oliphant, and our counsel, Mr. Wyatt and Mr. Baker, to work out some plan which could by agreement solve our problem. While the Attorney General and Mr. Oliphant were of opinion that a legal plan would be formulated, I found it impossible to formulate such plan by reason first of the law involved and second because of the necessity of such plan meeting the views of one hundred and eighty directors located in twelve different cities and all actuated by the highest sense of their obligations and responsibilities as trustees.

These difficulties have this morning been fully presented to you in our conversation and it is unnecessary to repeat them here.

There are two other courses which present themselves: first, an executive order, and second, congressional action. The first I have also discussed with you and have presented its legal

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and policy difficulties, and the similar difficulties presented to the Secretary in the execution of a companion order by him.

In reference to the second course-- that is, congressional action-- may I earnestly urge its adoption. It removes every difficulty before us.

First: It relieves what is to me a serious difficulty presented to the Secretary in the question of his right to requisition gold of the Reserve System under the statute authorizing requisition of gold in protection of the currency system of the country.

Second: It presents the opportunity to Congress of granting by congressional action protection to the Reserve System in event of future revaluation upward of the dollar.

Third: It gives to Congress the right to allocate the profit upon gold in event of devaluation.

Fourth: It leaves to Congress the full question of legislation relative to the Reserve System and its currency, both creations of Congress.

Fifth: It will obviate all chances of criticism upon the Reserve System and upon the Administration in respect to the problem involved, and all uneasiness and unrest as to Reserve Banks and their credit and currency functions.

May I earnestly urge that this Congressional course is the straight, simple, legal course to all the ends desired.

In conclusion, Mr. President, may I assure you that this suggestion is not written in the selfish interest of the Reserve Banks, but in the interest of your Administration and of the country, as an evidence of which I desire to repeat that the question of profit on our gold is not involved, as I have heard no other suggestion from any member of our Board or any Reserve Bank than that any profit arising from a monetary policy of the Government should go to the Government.

With great respect, I am

Very sincerely yours,

Governor.

Honorable Franklin D. Roosevelt,
President,
The White House.

MEMORANDUM

At a conference on Thursday, December 14th, the following were present:

The President

The Attorney General

The Acting Secretary of the Treasury

The General Counsel to the Treasury Department

The Governor of the Federal Reserve Board.

It was stated by Mr. Morgenthau that the meeting was to discuss a plan by which the Government would obtain the profit upon the gold owned by the Federal Reserve Banks in event of devaluation.

Mr. Cummings then rad a memorandum embracing a plan for this purpose.

My reaction to the plan was asked and after stating several objections to it I asked time for its full consideration. This consideration has now been given and this memorandum contains the conclusions reached.

Before discussing the plan may I present four facts:

First: Several weeks ago the President appointed a committee consisting of the Secretary of the Treasury, the Attorney General and me, to consider the very question presented at the conference and to report to him. Immediately after the appointment of this committee the questions involved were studied and I reported to the Secretary of the Treasury and to the Attorney General that I was prepared to discuss them. This committee is still in existence, has had no meeting and has made no report. This statement is made solely for the purpose of making it clear that the plan proposed by the Attorney General is not the product of this committee.

Second: During the present administration the Federal Reserve System has operated in complete harmony with the Recovery Program of the Administration, as illustrated in part by its purchase during this period of $600,000,000 of governments in an effort to supply funds for every credit need in aid of the Recovery Program.

Third: There has been no manifestation on the part of any Reserve Bank of any opposition to the proper disposition under full legal authority of the profit upon the Reserve System's gold holdings, regard being had for the constitutional provision that just compensation be made for the property taken.

Fourth: The gold in question is either in the Treasury or in the twelve Federal Reserve Banks. The gold of the System has been in the same places for approximately twenty years. There has been discussion for many months of devaluation and profit upon gold in event of devaluation. This discussion has not affected the location of one dollar of this gold. No effort has been made or considered to change the possession of this gold. None will be made. The gold will remain right where it is in event of devaluation until all question of the profit upon this gold is legally settled. The Reserve Banks can be trusted to this extent, but if desired an agreement to this effect can be made.

In the light of these four statements of fact the plan suggested by the Attorney General must be discussed. This plan involves:

(1) Action by the Treasury commandeering the gold holdings of the System. This action to be without publicity, to be based upon authority of the law relating to the protection of the currency system of the United States, to be applied after usual banking hours without prior notice to the officers of the Reserve Banks.

(2) The demand at this hour and under these conditions of all gold in the vaults of the Reserve Banks, all gold held by the Federal Reserve Agents in trust for the holders of Federal Reserve notes, and all denominated "equity" in the gold of the System held by the Treasury.

(3) If the demands of the Government agents are not complied with then these agents are to post on the vaults of the banks a notice that all gold held therein is the property of the United States.

(4) Compensation for the gold so commandeered is to be made by these government agents through the medium of a writing stating that the bank is "entitled" to gold certificates for the gold taken.

Under this plan it is proposed to give the Government both possession of and title to all gold in the vaults of the Reserve Banks, all gold held in a trust capacity by the Federal Reserve Agents, and all gold held in the trust relations by the Treasury covered in the Gold Redemption Fund, the Federal Reserve Agents' Gold Fund and the Federal Reserve System's Gold Settlement Fund.

To this whole plan I enter my very earnest and serious objection. My objections are:

(1) That the whole plan is of doubtful legality, and in my opinion would be unwarranted in law.

(2) That under the plan the result desired cannot be obtained-- that is, title to the gold would not in the end rest in the Government.

(3) The plan is unworkable.

(4) The plan is unnecessary.

(5) An attempt to put the plan in operation would result disastrously to the Federal Reserve System and to the entire banking and credit situation, and would be inimical to the Administration.

May I discuss these objections?

First: The whole plan is of doubtful legality and in my opinion would be unwarranted in law.

This conclusion rests upon three bases:

(1) The problem as to the constitutionality of the Thomas amendment.

This problem exists. There is a serious question whether the Thomas Amendment is not unconstititional in delegating legislative power to the President. This question of the validity of the

Thomas Amendment is a vital one, because unless the President's action is valid the Reserve Banks will in fact obtain no profit on their gold stocks. If the statute is unconstitutional any action by the President would be a nullity and the existing parity between the dollar and gold would not be affected by a proclamation reducing the value of the dollar. Again, if the gold content of the dollar was reduced fifty per cent resulting in a book profit to the Reserve Banks upon its gold, such profit would be lost if the present parity between the dollar and gold were subsequently reinstated. If the entire profit of the Reserve Banks on their gold were taken by the Government upon a fifty per cent devaluation of the dollar, the subsequent restoration of the 20.67 ratio would result in wiping out the capital and surplus of the Reserve Banks. Again, any action which is taken with respect to the gold profit must be considered in view of the statutory requirement regarding the maintenance of gold reserves.

(2) There is no authority in law for calling in the Reserve Banks' gold under the anti-hoarding provision, first, because under the law the Reserve Banks have the right to buy and hold gold; second, because the law requires them to hold gold as reserves; third, because some of their gold was turned over to them under Government order against hoarding and the Reserve Banks were recognized as the proper agency for holding this returned gold; fourth, because the central banks of a nation holding gold for reserves and as the base for the nation's credit could hardly be termed "hoarders."

(3) There is no authority in law for calling in the reserve gold under the provision that gold may be called in by the Secretary of the Treasury when "such action is necessary to protect the currency system of the United States." There could be no logic in asserting that the currency system would be protected by depriving sixty per cent of the currency of the country of its gold base. It would appear superfluous to argue this question.

(4) The Thomas Amendment does not in terms confer any authority upon the President to deprive the Federal Reserve Banks of any gold profit resulting from devaluation. The Thomas Amendment vests no one, even by implication, with authority to deal with the subject. The debates in the Senate upon the bill show that the question whether gold profits should be taken was discussed; that the Chairman of the Committee on Banking and Currency expressed the view that the bill was not intended to cover that subject, and that it could be dealt with later. Senator Fletcher was asked whether the amendment provided any method by which any profit made by those holding gold, at the date of devaluation, could be taxed. He replied there was not, and further that he did not favor incorporating such a provision in the pending bill, although he was in sympathy with the proposal and believed that it should be considered later. The determination as to profits must be made by Congress.

Second: Under the plan the result desired cannot be obtained-- that is, title to the gold would not in the end rest in the Government.

It may be possible under the plan to obtain actual or constructive possession. As a matter of fact the gold of the reserve banks now in the Treasury is as follows:

$40.888.000 in the Gold Redemption Fund.

$1.105.174.000 in Federal Reserve Agents' Gold Fund.

$ 673403000 in the Gold Settlement Fund.

942794000 Collateral for Gold Certificates held.

While it is true that these funds are gold deposits placed with the Treasury in trust for certain authorized statutory trust purposes, the possession is with the Treasury. Title to these funds could not be given to or vested in the Treasury by any action of the Governor or the Federal Reserve Agent or any other officer of a Reserve Bank. The "control" of a reserve bank is vested by law in its "Board of Directors," and any disposition of its gold with any legal authority could only be had by the Board of Directors. And, under the plan suggested, any demand of the Treasury upon or compliance with such demand by an officer of a Reserve Bank would be ineffectual to vest title to the gold in the Government. For the same reason-- that is, lack of authority in the bank officers to pass title-- no title could be vested in the Government in the gold coin or gold bullion, by action of the officers in compliance with the plan.

A directors' meeting would have to be held and, laying aside for the present the authority of directors even in dealing with the gold reserve of a central bank, the holdings of such meetings would contravene the evidence purposes of the plan and the devaluation proposed coincident with the plan. What has been said as to the impossibility of passing of title under the plan is especially applicable to the gold held by the Federal Reserve Agent, whether it is in his possession or is deposited in trust with the Treasury, since under the law this gold is held by him only as trustee for holders of Federal Reserve notes, and as such trustee he would have no right to transfer the title to such trust gold to the Government or any other party.

Again, title to the gold could not be obtained under the proposed plan by giving to the Reserve Bank a writing declaring that the Reserve Bank is "entitled" to gold certificates for its gold. That is not payment, and if payment, the giving of such an obligation is prohibited under joint resolution of Congress abrogating the gold clause, in which resolution the Government is prohibited from making any obligation containing language specifying that the "obligation shall be paid in gold or a particular kind of coin or currency."

The Reserve Banks have only $ 910,577,000 of gold coin and bullion that is not in the hands of the Treasury. Under the plan possession of this gold might be obtained, if it were not for the lack of authority of the bank's officer to deliver possession, but in no way under the plan could title be obtained.

It would be futile to adopt a plan that could not accomplish its purpose and which would not vest title in the Government.

Third: The plan is unworkable.

This is true, first, because of the legal difficulties discussed, especially the lack of authority in the bank's officers to deliver title and, second, because no bank officer, in the absence of such authority, should dare to part with the bank's gold and in my opinion would not take this responsibility, but would immediately refer it to the directors upon whom the responsibility rests. This would involve the calling of a directors' meeting, the time involved in that procedure, the publication of devaluation to the bank's officers and to one hundred and eight directors, and, however proper that might be since the survival of the bank is involved, the plan would fall in this procedure and devaluation would become public property.

Consideration, too, should be given to the question as to whether these bank officials should be required to choose between a course which would subject them to the criticism of their directors, if they arrogated to themselves the power vested by law in their directors, or a course which might subject them to the penalty of the law against hoarders. I am of opinion that these officers have not merited the necessity of such a choice, and I am also of opinion that the record of these banks in support of the Administration's recovery program should preclude the possibility of the imposition of such a plan upon them.

FOURTH: The plan is unnecessary.

It is not necessary to resort to this or any other plan when the law can provide very speedily a full plan. This full plan can be provided by Congressional legislation which could be had immediately after devaluation. This Congressional action could ratify the devaluation and remove the constitutional questions surrounding the Thomas Amendment. It could provide for compensating advantages to the Reserve Banks for taking their gold and remove the constitutional doubt as to such taking without compensation. It could give necessary protection to the Reserve Banks in event of a later revaluation. No private plan of devaluation could provide such necessary protection, and the proposed plan is devoid of such protection.

It would remove the uncertain legal problems involved in applying the anti-hoarding law or laws for improving the currency system in taking possession of this gold. It could make effective the title to the gold and could provide, through giving certain compensating advantages to the reserve banks, for the application of the profits made.

All of this is so simple, so straight, and so effective that it should be followed. It would remove a large element of criticism which would follow devaluation under any other plan. Congressional action is going to be absolutely necessary in connection with devaluation. It can be of no practical effect without determination of many monetary problems involved in its application. Congressional action could well embrace this problem of profits.

Fifth: An attempt to put the plan into operation would result disastrously to the Federal Reserve System and to the entire banking and credit situation and would be inimical to the Administration.

This is equally true whether the plan succeeds or fails. It would be foolish to subject the System, the banking situation, and the Administration to the harsh criticism that will follow the attempt. It would be more foolish to accept the criticism and then fail in the plan, and this outcome would seem certain.

We must realize what is being suggested. It is to take the gold reserves from the System and to replace them with gold certificates that may not be redeemed in gold; to deprive the System of what the law says it must have; to leave sixty per cent of the currency off the gold base that the law requires; to do this without notice even to the Central Banks themselves; to raise large questions of the goodness of reserve currency; to jeopardize in certain contingencies even the solvency of the Reserve System; to have the reaction of this situation upon the banking structure of the country, probably to cause large withdrawals from the Reserve Banks themselves: all followed by a distrust of the whole banking structure.

The method of approach of this plan will bring its own criticism. All this without necessity when the straight path is the simple path to the end desired. The Administration should not be subjected to this criticism.

I respectfully suggest that the success of the proposed plan resulting in putting title in the Treasury to the gold should be the last thing the Administration should want. In the Treasury the gold could (1) remain in the treasury and not be used, or (2) could be sold by the Treasury, and this it would not want to do, or (3) could serve as the base for an issue of gold certificates, and then under the law could be used for no other purpose. Neither the Administration nor the Treasury would want such an issue of gold certificates nor such a limitation upon the gold. At present gold certificates are not allowed to circulate. If circulated by the Treasury they must be redeemed in gold by the Treasury, or the Treasury would be in the anomalous position of issuing gold certificates not redeemable in gold. If redeemable in gold, then three or more billions of gold would be payable to the public on these gold certificates and could be hoarded or exported by the public. And this in the face of the present policy of the Administration in respect to gold.

As against this defenseless situation, in view of our present policy with respect to gold, exactly the reverse would occur if the gold was left in the Federal Reserve Banks. There all the gold would be for reserve purposes, and as the base for an issue of currency redeemable in gold <u>or</u> lawful money. Federal reserve notes would be issued and the present policy in regard to gold would be preserved. The profit on the gold as allocated by Congress to the Government would be credited by the Reserve Banks to the Government and would be available in lawful currency or in deposit credit for meeting Government obligations. The gold would remain in the Reserve Banks for other purposes in accord with Governmental policy.

I trust it may not be necessary but in conclusion I must ask, if my objections are overridden and this plan is adopted, that the confidence reposed in me in this matter be broadened to embrace the Governor and Chairman of each reserve bank so that they may be fully informed and be guided by their own view of their responsibility in the matter.

I regret the length of this memorandum. To have said less would have been to fail the Administration and to fail the Reserve System. This I would not do.

Respectfully submitted,

Governor, Federal Reserve Board.