The Papers of Eugene Meyer (mss52019)

118_01_001-	Subject File, Federal Reserve Board, Glass Bill (S. 3215), Composite Rough, 1932

EUGENE MEYER

SUBJECT FILE

FEDERAL RESERVE BOARD
GLASS BILL (S.3215)
COMPOSITE ROUGH

1932

Mr. Floyd Harrison

Here is the composite rough material on the Glass Bill. Also a copy of the original bill showing the changes made in it before it was reintroduced.

Yours Truly
Carter Glass

X-7118

CHANGES FROM ORIGINAL BILL.

In a very general way, the changes from the original bill may be indicated as follows:

Sec. 1. Title. No change

Sec. 2. Definitions. The definition of "affiliates" has been completely rewritten.

Sec. 3. Uses of Federal Reserve credit. No change.

Sec. 4. Group and chain banks forbidden to vote for directors of Federal reserve banks. No change.

Sec. 5. Earnings of Federal reserve banks. Provision inserted for restoring surplus to amount as of December 31, 1931.

Sec. 6. Requirement that State member banks comply with provisions of Federal Reserve Act relating to national banks omitted. Provision re condition reports of affiliates retained with slight changes.

Sec. 7. Federal Reserve Board. No substantial change.

Sec. 8. Reclassification of reserve cities. Omitted.

Sec. 9. (new Sec. 8). Board to limit aggregate collateral loans of member banks. Modified.

Sec. 10. Loans to groups of banks. Omitted.

Sec. 11. (new Sec. 9). Loans to affiliates. No change.

Sec. 12. (new Sec. 10):

Open Market Committee, One slight change.

Federal Liquidating Corporation. Provision authorizing issue of debentures added and few other detailed changes.

Sec. 13 (new Sec. 11). Advances to member banks. Modified.

Sec. 14(a). Clarifying Federal Reserve Board's powers over open market operations. Omitted.

Sec. 14(b)-(new Sec. 12). Control over negotiations with foreign banks or bankers. Modified.

Sec. 15. Amendments to provisions re Federal reserve notes. Omitted entirely.

Sec. 16 (new Sec. 13). Reserves of member banks.- "Thrift deposits" omitted and reserves against all time deposits increased in 5 annual installments until they equal those now required against demand deposits. More deflationary than original bill, which required only 5% reserves against "thrift deposits" and did not increase the reserves against other time deposits so rapidly.

Sec. 17.(new Sec. 14). Real estate loans of national banks. No important changes.

Sec. 18 (new Sec. 15). Investments of national banks. Modified.

Sec. 19 (new Sec. 16). Capital of national banks. Entirely changed.

Sec. 20 (new Sec. 17). Shares of national banks to be $100 each and not tied with those of affiliates. No change.

Sec. 21 (new Sec. 18). Relations with security dealers. Made much worse than before.

Sec. 22 (new Sec. 19). Holding companies denied right to vote shares of national banks. No change.

Sec. 23. Shareholders of national banks to swear they own no stock in any securities affiliate. Omitted.

Sec. 24 (new Sec. 20) Voting permits for holding companies. Numerous changes.

Sec. 25 (new Sec. 21). Branches of national banks. Changed as follows:

(a) Requires permission of Federal Reserve Board, instead of Comptroller of the Currency.

(b) Permits branches beyond State lines but only within 50 miles of parent bank.

(c) Requires capital of at least $500,000.

(d) Does not require allocation of capital to branches but aggregate amount must be equal to that necessary to organize equal number of independent banks in same locations.

Sec. 26 (new Sec. 22) Consolidations of national banks. No change.

Sec. 27 (new Sec. 23). Interest chargeable by national banks. No change.

Sec. 28 (new Sec. 24). Interest on deposits. Omits provision forbidding payment of interest on checking accounts.

Sec. 29 (new Sec. 25). Limits on loans by national banks, etc. Few slight changes.

Sec. 30 (new Sec. 26). Ten per cent limit on all loans by member banks on "collateral security". No change.

Sec. 31 (new Sec. 27). Condition reports by affiliates of national banks. No change.

Sec. 32 (new Sec. 28) Examinations of affiliates of national banks. No change.

Sec. 33. Restrictions on relations with security companies and private bankers. Omitted, except for part transferred

to new Sec. 18.

Sec. 34. Saving clause. No change.

COMMENTS ON THE GLASS BILL AS A WHOLE

The Glass Bill is entitled: "A bill to provide for the safer and more effective use of the assets of Federal reserve banks and of national banking associations, to regulate interbank control, to prevent the undue diversion of funds into speculative operations, and for other purposes." The purpose of the bill appears to be to oblige the member banks of the Federal reserve system to become primarily and essentially commercial banks, to protect Federal reserve funds from seepage into the security market, and to give the Federal reserve system, and particularly the Federal Reserve Board, power to bring about these results. The bill also tries to hinder the development of group banking, enlarges somewhat the authority of national banks to have branches, imposes publicity and restrictions on bank affiliates, and sets up a corporation for liquidating closed banks.

In attempting to prevent member banks from going into the security and capital markets, the bill provides drastic limitations on security loans and security holdings and directs the Federal reserve system to use all its authority to discourage such operations by the member banks. The provisions of the bill would require the elimination from the portfolios of national banks of enormous amounts of certain classes of securities now held by them. The bill also provides for a drastic increase in the reserve requirements of member banks.

So far as the Federal reserve banks are concerned, the principal methods in the bill of preserving or restoring their commercial character appear to be the imposition of a differential of one per cent against member bank collateral notes, the elimination of such notes secured by Government obligations from collateral against Federal reserve notes, and restrictions on the market in Federal reserve funds. The effect of these provisions would be chiefly an increase in the cost of operating the reserve banks, without changing the use

by member banks of funds obtained from the reserve banks. The elimination of 1917 amendments permitting the use of gold as collateral for notes would reduce the system's reserve ratio to 44 per cent and its excess reserves by over $1,-000,000,000 to $230,000,000. In view of this and of the elimination from collateral eligible against notes of Government-secured notes and of many classes of acceptances, the effect of the bill would be to make it impossible for the Federal reserve banks at the present time to purchase any additional United States securities and probably to make it necessary for them to sell large amounts of securities now held.

As a part of its purpose to divorce the banking system from the stock market, the bill proposes to strengthen greatly the authority of the Federal Reserve Board and its control over the reserve banks, particularly over open-market operations, which are necessarily centered in the New York Reserve Bank. It leaves the regional reserve banks little authority or power except the power to obstruct system policy. At the same time the Federal Reserve Board could not initiate open-market operations without approval of the Federal Open-Market Committee.

Except for the Liquidating Corporation and a provision for emergency loans to groups of banks, the bill proposes to undo the result of what its proponents consider as undesirable developments in banking, particularly during the period 1927-1929. It appears not to recognize the fact that what occurred in the past cannot be undone by decree and that, with the existing critical situation in banking, such legislation would cause disaster, not for the banks alone, but for the entire country.

The passage of the bill at the present time would result either in disastrous contraction of credit, or in wholesale withdrawals of banks from the Federal reserve system, or in both.

As a permanent measure, the bill provides for Government supervision and control of banking on a scale never witnessed before. In view of the competition between member banks and nonmember banks, the result of this bill, if enacted into law, would be one of two things, either all commercial banks in the country will have to be put on a parity by being placed under Federal control, or else the national banking system and the Federal reserve system would go out of existence. The Glass Bill proposes to build a fence that is horse high, bull strong, and hog tight, and then leaves the gate open through which all of these animals can escape at their pleasure.

810 Eighteenth Street
Washington, D. C.
February 7, 1932

Honorable Carter Glass, Chairman
Subcommittee, Banking and Currency
Committee of the Senate
United States Senate
Washington, D. C.

Dear Senator Glass:

The undersigned have been asked by the Subcommittee of the Senate Banking and Currency Committee to give consideration to the Glass bill, S-3215, and to make constructive suggestions with respect to that bill. We have undertaken this task as individuals, detached from our organizations for this purpose, and we are acting in no sense as representatives of our institutions. This report, therefore, has not been submitted to, or considered by, our institutions, and it represents only our own personal views and recommendations.

In the brief time at our disposal we have not been able to give all the sections of the bill the careful consideration which they require. We are, however, prepared to submit a statement of the principal modifications that we wish to recommend to be made in the bill, and certain additional proposals which we believe would serve effectively the purpose of the bill.

The modifications of the bill which we propose arise primarily from two considerations: First, that during the present state of ex-

treme depression and continuous contraction of bank credit, it would be dangerous to adopt legislation that would have further deflationary effects. Secondly, we believe that severe restrictions imposed on national banks and member banks alone would lead to withdrawals from the national system and from the Federal reserve system. We are convinced that certain of the proposals of the bill would operate to the public good only if they were a part of a plan to unify the banking system under one supervision. The division of the banking structure into non-harmonious systems carrying on a competition in laxity is one of the principal evils of American banking today; one of the greatest hindrances to proper supervision or regulation of banking. We believe that some means of bringing the banks under one system of control can be devised.

In our opinion, regulation of bank operations must be supplemented by strengthening the power of supervisory authorities over bank management. Some of the worst evils in banking arise from bad management. Consequently, we submit a proposal for the removal of bank officers in extreme cases.

We attach a detailed commentary on the Glass bill, section by section, giving our reasons for suggested omissions or modifications, including suggested substitutes for certain sections of the bill, as well as suggested additional provisions. All references are to the confidential committee print of January 28, 1932. On the sections dealing with

GENERAL PRINCIPLES GOVERNING LEGISLATION

AS TO NONBANKING AFFILIATES

We understand that the Senate Committee has considered whether it would be better to attempt to abolish affiliates altogether or to allow them to continue under supervision, and has decided to adopt the latter course. We interpret this decision to imply that no attempt will be made at present to effect a complete divorce of affiliates from their parent institutions.

There are several reasons why the present is not an auspicious time to attempt the abolition or divorce of affiliates from banking institutions. In the first place, the amount of information available as to affiliates is restricted--there has never been a comprehensive survey of the field, and any action taken now should be tentative in view of the paucity of information.

In the second place, under present conditions any vigorous attempt to bring about such a divorce would result in a general liquidation of affiliates.

Finally, too rigorous legislation at this time might be expected to have a disturbing effect upon the general situation. In the case of securities companies, for example, the unhappy consequences which followed the excessive issuance of securities in 1928 and 1929 have already reacted upon the machinery of securities distribution. Many banks have already taken steps to liquidate their securities companies or to reduce their capital and volume of operations. The market for new securities is disorganized and any action tending to disrupt the existing machinery still further would tend to retard recovery, since new enterprise is in a measure dependent upon the sale of

securities to investors.

Certain forms of affiliates, furthermore, appear to be legitimate and useful adjuncts to a commercial bank. Safe deposit companies have long been recognized as serviceable, and the same may be said of agricultural loan companies and bank building corporations. It is also true that holding companies have in several instances definitely strengthened the banking situation in certain areas. Even in respect to security affiliates there are certain advantages in having a part of the business of issuing securities done by institutions which are under supervision by the authorities rather than having all of it done by agencies over which there is no supervision whatever.

For these reasons our recommendations are confined to (1) supervision over affiliates, one of the results of which will be to make available information with regard to their operations; and (2) certain restrictions over the operations of affiliates or of banks in relation to their affiliates.

It may develop when sufficient information acquired under the provisions of this bill becomes available that, in order to make supervision effective, in regard to affiliates as in regard to banks, it may be necessary to find a way to require all institutions having to do with the initiating or marketing of securities, as well as bank holding companies, to have their power to engage in business originate from a national authority.

Nonbanking affiliates may be classified for convenience under two general types: subsidiary affiliates and holding company affiliates. These are so different in character and legal status as to require separate legislative treatment.

SUBSIDIARY AFFILIATES

There are from 15 to 20 distinguishable types of subsidiary affiliates in addition to banks and trust companies, the four most common nonbanking types being:

securities companies
real estate companies
bank building companies
safe deposit companies

In addition the following occur frequently:

mortgage companies
liquidating companies
agricultural loan companies
personal or small loan companies
investment trusts
building and loan associations
insurance agencies
finance and acceptance corporations
guaranty and mortgage guaranty companies
foreign banking corporations

Some affiliates carry on more than one of these various types of business. The character and function of subsidiary affiliates are so diverse that it is difficult to adopt any uniform regulation which will apply to all of them.

Our proposals, therefore, in regard to subsidiary affiliates are made with a view, first, to subjecting these companies to some type of supervision which, without destroying the existing machinery, will be helpful in safe-guarding the relations with the parent bank, and, secondly, to assembling over a period additional information about affiliates and their operations which shall form a basis for such further methods of control as may later appear to be desirable.

We therefore recommend limitations upon the loans of banks to their subsidiaries; also that subsidiary affiliates be subject to examination at the same time as their parent institutions, and that the call reports made by these

institutions be accompanied by reports for their affiliates, as of the same date, showing their balance sheets and profit and loss statements. These examinations and reports would have the double advantage of bringing the organizations under scrutiny and of accumulating information as to their organization and operations.

An important difference between our recommendation on this subject and the original bill is that we have followed the principle that all limitations enacted should be uniformly applicable to all member banks rather than to national banks alone.

HOLDING COMPANY AFFILIATES

Numerically, holding companies are a smaller problem than subsidiary companies. The number of domestic holding company affiliates of member banks probably does not exceed 100 as compared with some 1,200 domestic subsidiary company affiliates.

Supervision of holding companies is complicated by the dual banking system, for most holding companies control some national banks and some State banks. Too drastic regulation of holding companies of national banks would impel them to convert all their banks into State institutions. For this reason suggestions for regulations made in succeeding pages are confined to those which may be applied alike to holding companies for both national and State member banks.

This and a number of other holding company problems may be expected to be diminished by the extension of branch banking proposed in the Glass bill with the amendment we have suggested, because many holding company groups

would then be likely to become branch systems.

It seems clear that the Comptroller of the Currency and the Federal Reserve Board should be given authority to examine every holding company controlling a member bank and should receive current reports from such companies. There should also be means of assurance that the stockholder's liability upon stock held by a holding company should be at least as enforcible as the liability of independent individual shareholders. Loans to holding company affiliates upon their stock should be prohibited. We believe also that it would be desirable and practicable to have holding companies bring all the banks under their control into the Federal reserve system, if they are eligible, and thus make these banks, which benefit from the strength of their member bank associates in the group, assume the full responsibilities of membership in the system.

SPECIFIC PROVISIONS OF S-3215

On the basis of these general principles, the following specific suggestions are made with respect to the provisions of S-3215 relating to affiliates:

SECTION 2.

Definitions. -

Defines the term "bank", "national bank", "national banking associations", "member bank", "board", "district" and "reserve bank" as having the meaning assigned to them in the Federal Reserve Act.

Definition of "affiliate". -

The term "affiliate", which is used in numerous different sections of the bill, is defined as follows (pp. 2, 3):

"(b) The term 'affiliate' includes a trust company, a finance company, securities company, discount or acceptance company, investment trust, or other similar institution, or a corporation --

"(1) Of which a national bank or member bank, directly or indirectly, owns or controls either a majority of the voting shares or more than 50 per centum of the number of shares voted for the election of its directors, trustees, or other managing officers at the preceding annual meeting, or controls in any manner the election of a majority of its directors, trustees, or other managing officers; or

"(2) Of which control is held, directly or indirectly, through stock ownership or in any other manner, by the shareholders of a national bank or member bank who own or control either a majority of the shares of such bank or more than 50 per centum of the number of shares voted for the election of directors of such bank at the preceding annual meeting, or by trustees for the benefit of the shareholders of any such bank; or

"(3) Of which either a majority of the members of its executive

committee or a majority of its directors, trustees, or other managing officers are directors of a national bank or member bank; or

"(4) Which owns or controls, directly or indirectly, either a majority of the shares of capital stock of a national bank or member bank or more than 50 per centum of the number of shares voted for the election of directors of such bank at the preceding annual meeting, or controls in any manner the election of a majority of the directors of such bank; or

"(5) For the benefit of whose shareholders or members all or substantially all the capital stock of a national bank or member bank is held by trustees."

COMMENTS:

The scope and effect of all of the provisions of the bill relating to affiliates depend upon this definition, and it is entirely too broad.

The words "or a corporation" at the end of the first paragraph make it applicable to corporations of any kind or character, the control or management of which conforms to the succeeding paragraphs. Thus, if the same persons happen to own the controlling interest in a national bank and also in a corporation engaged in the business of conducting a newspaper or manufacturing textiles, the newspaper or manufacturing company would be an "affiliate" of such national bank and would be subject to all of the provisions of the bill applicable to

"affiliates", including the provisions requiring them to submit reports of condition to the Comptroller of the Currency and to submit to examinations by the Comptroller.

The wording of the first paragraph of the definition would also lead to uncertainties and confusion; because the meaning of such terms as "securities corporation", "discount or acceptance company", and "investment trust" are not well settled or clearly understood.

SECTION 2 -- Definitions

These suggestions supersede our recommendations in the memorandum submitted on February 8.

The definitions relating to affiliates have been further revised to distinguish more precisely between subsidiary affiliates and holding company affiliates. It is suggested that the following be substituted for subsections (b) and (c) of Section 2 of the Bill:

"(b) The term 'subsidiary affiliate', except where otherwise expressly defined, shall include any corporation, business trust, association or other similar organization engaged in the business of acting as trustee, executor, administrator, or in any other fiduciary capacity, or in the business of receiving deposits, making loans, or discounting notes, drafts, bills of exchange or other evidences of indebtedness, or in the business of underwriting, purchasing, selling, dealing in, holding, or acting as a broker of stocks, bonds, or other investment securities, or in the business of purchasing, selling, holding, dealing in, making loans on, or acting as a broker of, real estate or real estate loans, or in the business of renting safe deposit boxes, or in any kind of insurance business, either as insurer, broker, or agent, or in the business of granting bankers' acceptance credits, or in the business of examining, guaranteeing, or insuring titles to real estate, or in the business of acting as guarantor or

surety on the obligations of others, or in any similar business or undertaking:

"(1) In which any national bank or member bank directly or indirectly owns or controls a majority of the voting shares, or a lesser number of such shares if such lesser number is more than 50 per centum of the number of shares voted for the election of directors, trustees, or other managing officers at the preceding election; or

"(2) In which any national bank or member bank in any other manner directly or indirectly controls the election of a majority of its directors, trustees, or other managing officers; or

"(3) All or substantially all of the shares of which are held by trustees for the benefit of the shareholders of any national bank or member bank; or

"(4) The control of which is held directly or indirectly, through ownership of shares or in any other manner, by shareholders of any national bank or member bank who own or control a majority of the stock of such national bank or member bank.

"(c) The term 'holding company affiliate', except where otherwise expressly defined, shall include any corporation, business trust, association, or other similar organization:

"(1) Which directly or indirectly owns or controls a majority

SECTION 2 Continued

of the shares of capital stock of a national bank or member bank, or a lesser number of shares if such lesser number shall amount to more than 50 per centum of the shares voted for the election of directors at the preceding annual meeting of such national bank or member bank; or

"(2) Which in any other manner directly or indirectly controls the election of a majority of the board of directors of any national bank or member bank; or

"(3) For the benefit of the shareholders of which all or substantially all of the stock of any national bank or member bank is held by trustees."

SECTION 3.

Use of Federal Reserve Credit (pp. 3 and 4)

Federal reserve banks shall extend discounts, advancements and accommodations to their member banks only if they are intended for the accommodation of commerce, industry and agriculture.

The Federal Reserve Board may prescribe regulations further defining and regulating the use of the credit facilities of the Federal Reserve System.

Such facilities "shall not be" extended to member banks "for the purpose of" making or carrying loans covering investments, or facilitating the carrying of, or trading in, stocks, bonds or other investment securities, other than obligations of the Government of the United States.

Each Federal reserve bank shall keep itself informed of the loan and investment practices of its member banks and the uses made by them of the credit facilities of the Federal Reserve System.

The Chairman of each Federal reserve bank shall report to the Federal Reserve Board, with a recommendation for remedial action, any undue, unauthorized or improper use of such credit facilities.

The Federal Reserve Board may suspend for not more than one year from the use of the credit facilities of the Federal Reserve System any member bank making undue, unauthorized or improper use of such facilities.

COMMENTS:

The purpose of this Section apparently is to prevent evasion of the provision of the original Federal Reserve

Act which makes ineligible for rediscount by Federal reserve banks any paper "covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States." During the stock market inflation of 1929, the purpose of that provision was evaded by certain member banks, which were continuously indebted to the Federal reserve banks for large amounts and, at the same time, continuously had brokers' loans in amounts equal to or exceeding their indebtedness to the Federal reserve banks. If construed as forbidding this practice only, the proposed amendment would not seem to be seriously objectionable, either upon principle or on practical grounds; but it is doubtful whether it could be given such a narrow interpretation.

If construed as forbidding the Federal reserve banks to grant any discount, advancement or other credit accommodation to any member bank which at the time has any loan either to a broker or to one of its own customers on the security of stocks, bonds or other investment securities, it would be impracticable; because it would deny the credit facilities of the Federal reserve system to most, if not all, member banks.

Since its applicability depends upon the purpose for which credit is extended to member banks, it would be difficult to administer and would give rise to many controversies.

The machinery provided for enforcement merely states specifically what is implied in the present law; since the law now authorizes the Federal reserve banks to make examinations disclosing the credit practices of their member banks; the Board can require the Federal Reserve Agents to make reports on this subject; and the Board can suspend from membership any State bank violating the provisions of the Federal Reserve Act or of the Board's regulations made pursuant thereto; and can direct the Comptroller of the Currency to bring suit to forfeit the charter of any national bank violating the Federal Reserve Act.

The Bill would amend "the fourth paragraph after paragraph 'eighth' of section 4 of the Federal Reserve Act". It would be better to describe it as that paragraph of Section 4 of the Federal Reserve Act, as amended, which commences with the words "Said Board shall administer the affairs of said bank fairly and impartially".

SECTION 3

We suggest the omission of this section.

The language down to line 7 of page 5 presupposes that when a member bank borrows from the reserve bank it borrows for the purpose of relending and that, therefore, it is possible and proper to say to the bank, "we will lend you only in case you will relend for the purpose of accommodating commerce, industry, or agriculture." In the great majority of cases banks do not borrow for that purpose. They borrow because of loss of deposits through adverse clearing house balances or through withdrawals in cash which reduce their reserves to the point where they are below legal requirements. A statement of principle such as is proposed in the bill, which does not correspond to the realities of banking experience and practice, would place upon the Federal reserve banks a responsibility which they could not discharge.

Lines 2 to 7 on page 5 might be interpreted to prohibit any bank from

SECTION 3 Continued

borrowing while making loans on securities. This would rule out all member banks since loans on securities are a large part of their business. Any other interpretation involves the establishment of a direct relationship between a particular loan of a bank or a group of its loans and its borrowing at a reserve bank. Such a relationship is almost always impossible to establish. Generally speaking a reserve bank can best prevent the improper use of its credit, first, by the use of the discount rate and, secondly, by avoiding lending any bank too large an amount relative to the size of the bank or for too long a period of time. There is now ample legal authority for proper control of Federal reserve credit in Paragraph 8 of Section 4 and Paragraph (d) of Section 14 of the Federal Reserve Act.

The second part of Section 3, beginning with line 7 of page 5, prescribes a degree of supervision of the detailed operations of all member banks, whether borrowers or not, that would be onerous, extremely difficult, and would involve the reserve banks in legal responsibilities which properly belong to the national and State supervisory authorities.

SECTION 4.

Affiliates denied right to vote for directors of Federal reserve banks. (p. 4).

"The twenty-fifth paragraph" of Section 4 of the Federal Reserve Act would be amended by adding a proviso forbidding any member bank to vote in elections of directors of Federal reserve banks.

1. If a majority of its stock is held or owned by any affiliate or other corporation which is in fact one of a chain or of a jointly controlled group of banks, controlled by an individual;

2. If its stock is in the hands of a voting trust; or

3. "If in any other way such bank is prevented from acting subject to the uncontrolled decision of the general body of stock - holders of such bank locally resident in the town or city in which such bank is established."

COMMENTS:

Since the facts would be difficult to ascertain and establish definitely, this would cause much confusion in elections of directors of Federal reserve banks and, in the case of close elections, probably might cause bitter disputes. It is doubtful whether this provision would be of sufficient value in discouraging group or chain banking to justify creating such confusion and uncertainty in the election of directors of Federal reserve banks.

It would be especially difficult to determine whether or not a particular bank is "subject to the uncontrolled decision of the general body of stockholders * * * locally resident in the town or city in which such bank is established."

Since the majority of stock in many banks is owned by non-residents, many member banks which are not parts of chains or groups would thus be prevented from voting for directors of Federal reserve banks. Thus the prohibition might apply to some of the largest member banks whose stock is held by thousands of scattered stockholders.

What is meant by the "twenty-fifth paragraph" of Section 4 of the Federal Reserve Act? Are the lines in Section 4 which commence with the words, "First", "Second", etc., separate paragraphs, or are they parts of the paragraph commencing with the words "Upon filing such certificate"? It would be much better to identify the paragraph to be amended in some other way.

SECTION 4 - Amends that portion of Section 4 of the Federal Reserve Act which deals with the election by member banks of directors of Federal reserve banks.

A member bank may not participate in the election of Federal reserve bank directors if a majority of its stock belongs to a chain or group or if in any other way such bank is prevented from acting subject to the uncontrolled decision of local stockholders.

COMMENT

This provision is apparently aimed at the prevention of the control of Federal reserve bank directorates by important groups and chains. The language of this Section leaves doubt as to its precise effect, but it is possible that it might affect different chains and groups in different ways.

1. Groups whose banks are more than 50 per cent owned by the holding company would be denied representation entirely. Groups of this sort are those in Minneapolis, Seattle, Detroit, and Buffalo.

2. Groups in which one bank is dominant, rather than a holding company, would have representation through the vote of that one bank. Groups of this sort are those in Boston, Pittsburgh, Chicago, and Atlanta.

3. It is possible individual member banks could still vote in those groups and chains which make it a policy to own less than 50 per cent of the stock of their banks and yet nevertheless effectively control them. There is a possible exception to this in the condition that a bank may not vote "if in any other way" it is "prevented from acting subject to the uncontrolled decision" of its local stockholders. Ownership of a minority of its stock might or might not be construed as controlling their decision. If it were held to leave them free, then multiple representation would be possible for several important groups and chains just as at present, and it would admit several others with a slight adjustment of their stockholdings. One or both of the important groups in Boston own only 51 per cent of the stock of their banks, a proportion which might easily be reduced in order to allow them to direct the votes of

of their banks in a way the bill seeks to prevent.

The apparent effect of the foregoing would be therefore to deny any vote at all to the most closely organized groups, to give one vote to those less closely organized, and to allow multiple representation to the most loosely organized. Such an effect would seem to be the reverse of what is desired, since it would, to the extent that voting for directors of reserve banks is important, discriminate against groups and in favor of chains.

SECTION 4

We suggest modification or omission of this section.

It prohibits banks that belong to a group or a chain from voting for Federal reserve bank directors. The wording of the section is such, however, as not to confine the prohibition to group and chain banks, but to include all banks that are not controlled entirely by locally resident stockholders. Since the stock of many important banks is widely owned throughout the country, this might restrict the voting privilege largely to smaller and less important banks that are owned by local stockholders. It is to be feared that this section would bar from participation in the selection of Federal reserve directors many of the better managed banks.

In the Minneapolis district, for example, this clause would deprive one-third of the members holding two-thirds of the member bank deposits from any vote. A chain of banks should at least have one vote, as a branch system would.

The provision for more extended branch banking in a later section would probably reduce chain bank strength to a point where this section would be unnecessary, and we are inclined to suggest its omission.

SECTION 4

This section was also discussed in the previous report. It is suggested that it be omitted on the ground (1) that the introduction of branch banking may be expected to reduce sufficiently the holding company problem so that no such provisions will be necessary, and (2) the provision as drawn appears to discriminate against well organized and more responsible groups in favor of looser and less responsible affiliations.

SECTION 5.

Use of earnings and surplus of Federal Reserve Banks (pp.4,5).

Beginning with the calendar year 1932 all net earnings of a Federal reserve bank after, (1) the payment of necessary expenses, (2) the restoration of surplus, when necessary, to its position as of December 31, 1931, and (3) the payment of the 6 per cent dividend to shareholders shall be paid to the Federal Liquidating Corporation.

COMMENTS:

This provision is in conflict with the provision of Sec. 10 (p.14) requiring the Federal reserve banks to subscribe annually to the stock of the Federal Liquidating Corporation an amount equal to one-fourth "of the annual increase of such surplus". When it is necessary to increase the surplus of a Federal reserve bank in order to restore it to its position as of December 31, 1931, the Federal reserve bank would be required to subscribe an amount equal to one-fourth of such increase to additional stock in the Federal Liquidating Corporation. Unless the net earnings equalled or exceeded 125% of the deficiency in the surplus, it could not do both.

The provision would require the restoration of surplus to its position as of December 31, 1931, before the payment of dividends to stockholders and would seem to preclude the payment of any such dividends out of surplus.

In this connection, see Section 10 (p. 14) requiring each Federal reserve bank to subscribe an amount equal to one-fourth of its surplus on December 31, 1931, to the stock of the Liquidating Corporation.

SECTION 5

We suggest the first paragraph of Section 7 of the Federal Reserve Act be left in its original form, but that the second paragraph be amended to read as follows:

> "The net earnings derived by the United States from Federal reserve banks shall, in the discretion of the Secretary, (1) be used to supplement the gold reserve held against outstanding United States notes, or (2) be applied to the reduction of the outstanding bonded indebtedness of the United States under regulations to be prescribed by the Secretary of the Treasury, or (3) be invested in debentures or other such obligations of the Federal Liquidating Corporation. Should a Federal reserve bank be dissolved or go into liquidation, any surplus remaining, after the payment of all debts, dividend requirements as hereinbefore provided, and the par value of the stock, shall be paid to and become the property of the United States and shall be similarly applied."

Section 5 of S-3215 would change the distribution of the reserve banks' earnings by taking what goes to the franchise tax and to surplus for the benefit of the Liquidating Corporation. This plan would provide no means of restoring any depletion of Federal reserve surplus since all net earnings after dividends would be paid to the Liquidating Corporation. This, incidentally, is in conflict with Section 12B (c)

SECTION 5 Continued

which provides that only one quarter of the annual increase in Federal reserve bank surplus shall be paid to the Liquidating Corporation.

We are proposing another method of financing the Liquidating Corporation and propose that the reserve banks continue their payments to surplus as heretofore but that the Secretary of the Treasury be given the option to invest the amount paid as franchise tax in the obligations of the Liquidating Corporation.

SECTION 6.

Condition reports of affiliates of member banks. (pp. 5,6)

Each affiliate of a member bank shall make and furnish to the Federal Reserve Board, through the president of such bank, not less than three reports of condition each year in the form prescribed by the Federal Reserve Board and verified by the oath or affirmation of the president of the affiliate or some other officer designated for that purpose by its board of directors, such reports to be filed at the same time as the corresponding reports of the member bank.

Each such report shall exhibit in detail "the holdings" of the affiliate, their cost and present value, the expenses of operation for the preceding year, and the balance sheet of the enterprise.

The president of the member bank must satisfy himself as to the correctness of such reports before transmitting them to the Federal Reserve Board.

Any affiliate which fails to make and furnish any such report and any member bank whose president fails to transmit it to the Federal Reserve Board is subjected to a penalty of $100 per day during the continuance of such failure.

COMMENTS:

The substance of this paragraph is believed to be desirable; but it is somewhat ambiguous. The meaning of the expression "the holdings of the affiliate in question" is very uncertain; but it is assumed that it means the stocks, bonds, real estate and other property owned by the affiliate.

SECTION 6

We suggest the following substitute for this provision making a few minor modifications to bring the practice in accord with Federal reserve practice as to member bank reports:

"Section 9 of the Federal Reserve Act, as amended, is further amended by inserting between the fifth and sixth paragraphs thereof the following new paragraph:

'Each bank admitted to membership under the provisions of this section shall obtain and furnish to the Federal reserve bank of which it becomes a member such reports of the condition of any or all of its subsidiary affiliates as the Federal Reserve Board, in its discretion, may require. Such reports shall be in such form as the Federal Reserve Board may prescribe, shall be verified by the oath or affirmation of the president or such other officer as may be designated by the Board of Directors of the affiliate to verify such reports, and shall disclose the financial condition of the affiliate on dates fixed by the Federal Reserve Board. Each such report shall be transmitted to the Federal reserve bank at the time required by the Federal Reserve Board and shall exhibit in detail and under appropriate heads all assets of the affiliate in question, their cost and present value, all liabilities of such affiliate, its earnings and expenses, and such other information as the Federal Reserve Board may require. Any member bank which fails to furnish any report of a subsidiary affiliate to the Federal reserve bank, when required by the Federal Reserve Board shall be subject to a penalty of $100 for each day during which such failure continues. Such penalty

SECTION 6 Continued

may be assessed by the Federal Reserve Board, in its discretion and, when assessed, may be collected by the Federal reserve bank by suit or otherwise.'"

We also suggest the following additional paragraph under Section 6 to put subsidiary affiliates of State member banks on the same status as those of National banks with respect to examinations:

"Section 9 of the Federal Reserve Act, as amended, is further amended by adding at the end thereof new paragraphs to read as follows:

'Examiners selected or approved by the Federal Reserve Board shall examine any subsidiary affiliate of a bank admitted to membership under the provisions of this section, when directed to do so by the Federal Reserve Board, in its discretion, or by the Federal reserve bank of the district in which such member bank or subsidiary affiliate is located, in its discretion. The examiner making the examination of any such affiliate shall have power to make a thorough examination of all the affairs of the affiliate, and in doing so he shall have power to administer oaths and to examine any of the officers, directors, employees, and agents thereof under oath, and shall make a full and detailed report of the condition of the affiliate to the Federal Reserve Board or to the Federal reserve bank which directed the examination to be made. Copies of the report of any such examination may, in the discretion of

SECTION 6 Continued

the Federal Reserve Board, be furnished to the State authorities having supervision of State member banks, to officers, directors, or the receiver of the affiliate examined, or to the officers, directors, or the receiver of the member bank with which it is affiliated, and to any other proper persons. The expenses of any examination made under the provisions of this paragraph may, in the discretion of the Federal Reserve Board, be assessed against the affiliate examined and, when so assessed, shall be paid by the affiliate examined. If the officers, directors, or stockholders of any affiliate of a bank admitted to membership under the provisions of this section shall refuse to permit an examiner to make an examination of the affiliate which the Federal Reserve Board or the Federal reserve bank has directed to be made, refuse to give any information required in the course of any such examination, or refuse to pay the expenses of any such examination, the Federal Reserve Board after a hearing, in its discretion, may require the member bank with which it is affiliated to surrender its stock in the Federal reserve bank and to forfeit all rights and privileges of membership. The Federal Reserve Board may restore membership upon due proof of compliance with the conditions imposed by this section.

SECTION 7.

Composition of Federal Reserve Board. (pp. 7-9)

The number of board members would be reduced from 8 to 7.

The Secretary of the Treasury would be eliminated from membership on the Board.

At least two members of the Board would be required to be persons of tested banking experience.

COMMENTS:

The Bill would not change the requirement for a fair representation of the financial, agricultural, industrial, and commercial interests and geographical divisions of the country, but would add a new requirement that at least two members of the Board shall be persons of tested banking experience.

Terms of Board members.

Upon the expiration of the terms of the present members of the Board, the President would be required to fix the terms of their successors, at "not to exceed twelve years", in such a manner that the term of not more than one member would expire in any two years, and thereafter each member of the Board would hold office for a term of twelve years.

COMMENTS:

In order to prevent confusion and the possibility of the regular rotation contemplated by this section being interfered with through delays in appointing successors to

members who have served their full terms, it should be provided that such terms should run for 12 years "from the expiration of the terms of their predecessors."

Under the provisions of the National Bank Act the Comptroller of the Currency is appointed for a term of five years, regardless of the time or circumstances of his appointment, and there is no provision with reference to unexpired terms. Even if his predecessor dies or resigns before serving his full term, the Comptroller is always appointed for a term of five years.

The amendment might give rise to a question as to whether it changes the term of the Comptroller to twelve years; and, if this is not intended, the word "appointive" should be inserted before the word "member" in three places.

Offices of the Federal Reserve Board.

There would be stricken from the second paragraph of Section 10 the provision to the effect that, "The Secretary of the Treasury may assign offices in the Department of the Treasury for the use of the Federal Reserve Board".

COMMENTS:

This apparently is intended to prevent the Board from having its offices in the Treasury Building; but it is not clear

that it would necessarily have this effect. The repeal of his specific authority to do so would give rise to an implication that the Secretary of the Treasury should not permit offices in the Treasury Building to be used by the Federal Reserve Board; but it is not clear that he would be absolutely prohibited from doing so.

If the Board were denied the right to use offices in the Treasury Building, it would seem that it should be specifically authorized to erect or purchase a building for its own use and to levy an assessment on the Federal reserve banks for the purpose of defraying the cost.

Chairman, oath of office and location of Board.

There would be stricken from the fourth paragraph of Section 10 of the Federal Reserve Act the provision to the effect that the first meeting of the Federal Reserve Board shall be held in Washington.

The provisions to the effect that the Secretary of the Treasury shall be ex officio chairman of the Federal Reserve Board would also be omitted.

The members of the Board would be required to file with the Board's secretary, instead of the Secretary of the Treasury, their oaths to the effect that they are not directors, officers or stockholders of banks.

COMMENTS:

While the provision regarding the first meeting of the Federal Reserve Board is obsolete, it is important; because it is the only provision fixing the location of the Board at Washington, D. C. If this provision is stricken out, therefore, there should be substituted a provision to the effect that the Federal Reserve Board shall have its offices in Washington, D. C.

If the present provision for the chairmanship of the Board is stricken out, it would seem that there should be substituted a provision prescribing that the Governor shall be the Chairman of the Board, or that the Board may elect its own chairman, or that the President may designate the chairman of the Board.

SECTION 7

No changes of consequence are suggested.

The domicile of the Board should be mentioned somewhere for legal reasons. The question is raised whether, if the authority for the Secretary of the Treasury to assign quarters to the Federal Reserve Board is repealed, there ought not to be in the Act a clause permitting the Federal Reserve Board to erect its own building, possibly to house the Comptroller's office in addition, levying an assessment on the reserve banks for this purpose. This would add to the dignity and independence of the Board's status and to the efficiency of its operation.

The following minor changes may be considered.

In sub-section (b), page 11, line 8 and also line 14, insert the word "appointive" before the word "member".

SECTION 7 Continued

In sub-section (b), page 11, line 15, insert after the word "years", the words "from the expiration of the term of his predecessor".

In sub-section (c), page 12, line 8, insert before the words "No member" the following:

"At meetings of the Board, the Governor shall preside as chairman and, in the absence of the Governor, the vice-Governor shall preside. In the absence of both the Governor and the vice-Governor, the senior member present shall preside as chairman. The offices of the Federal Reserve Board shall be in Washington, D.C."

At the end of Section 7 of the Bill, i.e., between lines 22 and 23 on page 12, insert a new sub-section reading as follows:

(d) Section 10 of the Federal Reserve Act, as amended, is further amended by adding at the end thereof a new paragraph reading as follows:

"The Secretary of the Treasury, upon the request of the Federal Reserve Board, shall (a) acquire, in accordance with the provisions of the Act of May 25, 1926, as amended, (Title 40, Sections 341-347, U.S.C.), a building in the

SECTION 7 Continued

District of Columbia for the Federal Reserve Board, or (b) acquire in accordance with the provisions of such Act, a suitable site and cause to be constructed thereon a building for the Federal Reserve Board, and (c) upon the request of the Federal Reserve Board enlarge or remodel any building so acquired or constructed. Any building or site selected by the Secretary of the Treasury and all sketches, plans, estimates, bids, and specifications for any building to be constructed on any such site shall be subject to the approval of the Federal Reserve Board. The Federal Reserve Board shall levy upon the Federal reserve banks, in proportion to their capital stock and surplus, assessments sufficient to defray all costs and expenses incurred under the provisions of this paragraph and shall reimburse the Secretary of the Treasury for all costs and expenses incurred by him under the provisions thereof."

SECTION 8.

(Section 9 of original bill)

Federal Reserve Board to limit collateral loans by member banks (pp. 9, 10)

By a vote of six members, the Federal Reserve Board may, from time to time, fix for any member bank the percentage of its capital and surplus which may be represented by "loans protected by collateral security".

Such percentages shall be fixed with a view to preventing the undue use of bank loans for the speculative carrying of securities, and may be changed from time to time by the Federal Reserve Board.

The Federal Reserve Board (by a majority vote) may direct any member bank to refrain from further increase of its "security loans" for any period up to one year.

Any violation of these provisions may be penalized by suspension of all rediscount privileges at Federal Reserve Banks.

COMMENTS:

This would impose an intolerable burden on the Federal Reserve Board and would make it responsible for the management of every member bank.

While apparently intended to apply only to loans on securities, it appears that the limitations prescribed by the Federal Reserve Board would necessarily apply to all "loans protected by collateral security", regardless of whether the collateral consisted of investment securities or of warehouse receipts, bills of lading or other documents arising out of commercial, agricultural and industrial transactions.

The amount of secured loans would be limited but the amount of unsecured loans would not be limited. The banks would be encouraged, if not compelled, to discontinue taking collateral to protect themselves against losses!

SECTION 9 - Control over Collateral Loans. Amends Section 11 of the Federal Reserve Act by inserting a paragraph limiting the amount that a member bank may loan on collateral to any one borrower to an amount not more than 10 per cent of the bank's capital and surplus.

In addition, it gives the Federal Reserve Board the power to fix the total volume of collateral loans which member banks can make. This power could be exercised in two ways.

First, the Federal Reserve Board could establish for all individual member banks in a district the maximum percentage of their capital and surplus which any of these banks could hold in the form of collateral loans. These percentages could vary as between districts and could be changed from time to time. To fix these percentages an affirmative vote of at least six members of the Federal Reserve Board would be necessary, and it is declared to be the duty of the Board to fix these percentages, and "with a view to preventing undue use of bank loans for the speculative carrying of securities".

Second, the Federal Reserve Board would be given the power to direct an individual member bank to refrain from further increase in its security loans for any period up to one year under penalty of suspension of all its rediscount privileges at Federal reserve banks.

COMMENT

The intent of this amendment is to make it the duty of the Federal Reserve Board to order member banks to stop increasing their loans on securities at a time of undue speculation in the security markets.

There appears to be some confusion between the two powers defined in the Act. The power to fix the maximum percentage of these loans is phrased in terms of collateral loans, not stock exchange loans alone but all collateral loans to the account of member banks in a district. The exercise of this power would require an affirmative vote of six members of the Federal Reserve Board. ~~No specific penalty is provided for failure to obey these orders.~~ The second power given in the amendment, however, is more direct. In this case, the Federal Reserve Board would be able to direct any member bank to refrain from any increase in its security loans, and the power is worded in terms of security loans; the Board could act on a simply majority vote, and a specific penalty is provided for infraction of the law.

In view of the wide differences prevailing in the portfolios of individual member banks, it is doubtful whether a blanket restriction applying to all member banks in a Federal reserve district as to the proportion of their portfolio which could be carried in collateral loans would be effective. Either this proportion would have to be fixed so low that it would penalize severely those individual banks which were already holding a larger proportion of collateral loans, or else it would be fixed so high in view of the condition of these banks that it would permit a tremendous expansion of security loans on the part of member banks which were holding a low percentage of such loans at the time the limitation was established.

The power to fix "the percentage of individual bank capital and surplus which may be represented by loans secured by collateral" seems to imply that this percentage must in all cases be less than 100 per cent. On September 29, 1931, all member banks had aggregate capital and surplus amounting to $5,275,000,000, loans secured by stocks and bonds amounting to $8,080,000,000, or 134 per cent of their aggregate capital and surplus, and other collateral loans, including loans secured by real estate, in excess of $3,000,000,000. If ordered to bring their "collateral" loans down to 100 per cent of aggregate capital and surplus member banks would have to call in, or convert into unsecured loans, about $6,000,000,000.

SECTION 9

The first of this Section up to line 9 on page 14, which repeals Sub-section (m) of the Federal Reserve Act, is desirable since this has expired by limitation. The substitute, we believe is not desirable.

The blanket provision that no collateral loans shall be made to any person in excess of 10 per cent of a bank's capital and surplus is not desirable because it does not define collateral and would, therefore, include all classes of secured loans, such as wheat loans on warehouse receipts, etc. It would seem also to repeal the exceptions which were well considered and carefully made to Section 5200, largely for the benefit of agricultural borrowers.

The granting of authority to the Federal Reserve Board to fix a proportion of security loans to total capital and surplus for a district is impractical because the differences between banks are so great that any percentage adopted would be either too low to be practicable or too high to be restrictive.

Finally, the last proposal that the Federal Reserve Board should have authority to prohibit an individual member bank from making any additional security loans appears to be undesirable because it imposes on the Federal Reserve Board responsibility for the operation of individual member banks. The Reserve System has primary responsibility for its own credit and the general credit situation, while the national and State

SECTION 9 Continued

supervisory authorities have responsibility over operations of individual member banks. If the Reserve System encroaches on the field of the latter, responsibility cannot be fixed and endless confusion will result.

SECTION 9.

Section 11 of original bill).

Loans to, on the Stock of, and Investments in, affiliates by Member Banks. (pp. 10, 11).

If the aggregate amount of such loans, extensions of credit, investments, and acceptances of collateral security, in the case of any one affiliate would exceed 10% of the bank's capital and surplus, no national or member bank shall:

1. Make any loan or any extension of credit to any affiliate organized and existing for the purpose of buying and selling, stocks, bonds, real estate, or real estate mortgages, or for the purpose of holding title to any such property;

2. Invest any of its funds in the capital stock, bonds, or other obligations of any such affiliate; or

3. Accept the capital stock, bonds, or other obligations of any such affilate as collateral security to protect loans made to any person, partnership, or corporation.

Each loan made to an affiliate within the foregoing limitations shall be secured by:

1. Stocks or bonds listed on a stock exchange which have an ascertained market value at the time of making the loan of at least 20 per cent more than the amount of such loan;

2. Notes, drafts, bills of exchange or acceptances eligible for rediscount; or

3. Bonds or other obligations eligible for investment by savings bank in the member bank's own State.

A loan to a director, officer, clerk or other employee of any such affiliate is deemed a loan to the affiliate to the extent that the proceeds of this loan are transferred to the affiliate.

COMMENTS:

Loans to, or investments in, affiliated institutions of this kind by banks are, generally speaking, undesirable and frequently result in loss to the bank. Some limit upon the amount of such loans and investments therefore is believed proper.

On the whole, the provision is believed to be in the interests of sound banking; although it probably will be the subject of much opposition from a certain class of member banks.

SECTION 11 - Limits the aggregate commitments of a member bank in an affiliate which deals in securities, real estate, or mortgages, to 10 per cent of capital and surplus of member bank.

Commitments which must come within this limitation include (1) loans to affiliate, (2) investments in its stock or obligations, (3) loans to third persons secured by stock or obligations of affiliates.

Loans to affiliates must be collateraled by paper eligible for rediscount at Federal reserve banks, or obligations eligible for purchase by savings banks in respective state, or stock exchange securities with a 20 per cent margin above the loan.

Loans to persons associated with affiliates deemed as loans to affiliates.

COMMENT

This section raises a question as to whether National banks are to be empowered to own stock in securities affiliates up to 10 per cent of their own capital and surplus, which they are at present not empowered to do.

This section also has to be considered with Sections 20, 23, and the latter part of Section 29, which, with respect to National banks, prohibit control of securities or other affiliates through trusteed stock, or of security affiliates through community ownership by means of one or more identical stockholders.

SECTION 11

Provisions relating to the restriction of loans to affiliates are contained in Section 11 and also in Section 29. Section 11 relates to all member banks but includes only certain specified types of affiliates and is much less drastic than Section 29, which relates to National banks only and to all types of affiliates. We believe it is undesirable to enforce more drastic restrictions as to affiliates upon National banks than upon State member banks, and for this reason recommend that provisions in regard to loans to subsidiary affiliates should be covered in a single section applicable to all member banks and to all types of subsidiary affiliates. Loans to holding companies are treated in another section.

In accordance with this general principle, the following substitute is suggested for Section 11:

SECTION 11

The Federal Reserve Act as amended is hereby further amended by inserting between Sections 20 and 21 the following new section:

"Section 21A. No National banking association and no member bank shall (1) make any loan or any extension of credit to, or purchase securities under repurchase agreement from, any of its subsidiary affiliates, or (2) invest any of its funds in the capital stock, bonds, or other obligation of any such affiliate, or (3) accept the capital stock, bonds, or other obligations of any such affiliate as collateral security for advances made to any

SECTION 11 Continued

person, co-partnership, or corporation; if in the case of any such affiliate the aggregate amount of such loans or extensions of credit, repurchase agreements, investments, and advances against such collateral security will exceed 10 per centum of the unimpaired capital stock and surplus of such National banking association or member bank, or if in the case of all such affiliates the aggregate amount of such loans, extensions of credit, investments, and advances against such collateral security will exceed 20 per centum of the unimpaired capital stock and surplus of such National banking association or member bank; Provided, however, that in computing such aggregate amounts, either in the case of a single affiliate or of all affiliates together, there shall be excluded the investment of such National banking association or member bank in (1) the capital stock and obligations of an affiliate organized for the sole purpose of holding its banking house or houses and the site or sites thereof, (2) the capital stock of a corporation organized to conduct a safe deposit business, (3) the capital stock of any corporation in which such bank has been authorized to invest pursuant to Section 25 of the Federal Reserve Act, and (4) the capital stock of a corporation organized under Section 25-A of the Federal Reserve Act.

"Each loan or extension of credit made to a subsidiary

SECTION 11 Continued

affiliate within the foregoing limitations shall be secured by collateral having market value at the time of making the loan or extension of credit of at least 20 per centum more than the amount of such loan; except that such loans or extensions of credit on the security of obligations of the United States Government, Reconstruction Finance Corporation, Federal land banks, and of notes, drafts, bills of exchange, or acceptances eligible for rediscount at the Federal reserve banks, may be made in an amount equal to the ascertained market value of these securities, and that a loan made on the security of obligations of any State or political subdivision or agency thereof shall be secured by collateral having an ascertained market value at the time of making the loan of at least 10 per centum more than the amount of such loan. A loan or extension of credit to a director, officer, clerk, or other employee or nominee of any such affiliate shall be deemed a loan to the affiliate to the extent that the proceeds of such loan are transferred to the affiliate."

SECTION 10.

(Sec. 12 of original bill)

Open Market Committee. (pp. 11-13)

This section would create a Federal Open Market Committee consisting of the Governor of the Federal Reserve Board and one officer from each Federal Reserve Bank, selected by its board of directors.

The Committee would meet in Washington at least four times a year, with provision for additional meetings.

No Federal reserve bank may engage in open market operations except after approval and authorization by the committee and approval by the Federal Reserve Board.

The Committee would be required to adopt and transmit to the Federal reserve banks resolutions affecting open market transactions of such banks and the relations of the Federal Reserve System with foreign, central or other banks.

A review of the decisions of the committee and the reasons therefor would have to be included in the Board's annual report.

Open market transactions would be governed with a view of accommodating commerce and business and with regard to their bearing upon the general credit situation.

If a Federal reserve bank decides not to participate in any purchases or sales recommended, it is required to file with the chairman of the Committee a notice of its decision within thirty days.

COMMENTS:

The principal changes in the present organization and

procedure of the Open Market Policy Conference are indicated below:

1. The Governor of the Federal Reserve Board would be made a member of the committee and in his absence the Vice-Governor or some other member of the Board would serve in his place.

2. Each Federal reserve bank would have to be represented by one of its officers.

3. The committee would be required to meet in Washington at least four times a year.

4. Federal reserve banks would be forbidden by law to engage in open market operations except after approval and authorization by the committee. This would forbid any Federal reserve bank to purchase any Government bonds, bankers' acceptances, municipal warrants, bills of exchange or other paper or securities on the open market without first obtaining the permission of the committee and the Federal Reserve Board; but this apparently could be dealt with by having the Committee and the Board grant blanket permission for such open market transactions as may be necessary in the normal course of business.

5. The Committee would have jurisdiction over relations of the Federal reserve system with foreign banks as well as jurisdiction over open market transactions.

6. The resolutions of the Committee would specifically be made subject to approval by the Federal Reserve Board.

7. The Board would be required to include in its annual

report a review of the decisions of the committee for the preceding year and an explanation of the reasons therefor and the results thereof.

To create such a committee by statute and to give it such drastic powers would in effect create a single central banking system for the United States, except for the provision contemplating that any individual Federal reserve bank could decline to participate in the open market operations decided upon by the Committee.

The Board's control over open market operations would be qualified by the Committee's control over such operations; and neither the Board nor the Committee would be given power to initiate and put into effect changes in the open market policy if individual Federal reserve banks should be unwilling to do so.

SECTION 12 - Provides for the insertion between Sections 12 and 13 of the Federal Reserve Act of Sections 12A and 12B.

Section 12A provides legal authority for what is now known as the Open-Market Policy Conference, It changes the composition of that conference by: (1) Making the Governor of the Federal Reserve Board a member, and (2) Providing that the representatives of the banks selected by their boards of directors shall be subject to confirmation of the Federal Reserve Board.

The bill provides that no Federal reserve bank shall engage in operations described in Section 14 of the Federal Reserve Act, except after approval and authorization by the committee. This prohibits the purchase and sale not only of Government securities, but of acceptances, without the approval of the committee. It also applies to all relations with foreign central banks. All actions of the committee are subject to the approval of the Federal Reserve Board. It is also prescribed that the decisions of the committee, reasons therefor, and the results thereof be reported in the Board's Annual Report. The Section enacts into law the Board's declaration of the principle that open market operations shall be governed with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country.

The proposal reserves to the Federal reserve banks the right to decide whether or not they wish to participate in open market operations determined upon by the Open Market Committee.

COMMENT ON NEW SECTION 12A

The creation by law of a committee to be invested with drastic powers over open-market operations, together with the fact that the decisions of the committee, ~~both as to membership and decisions~~, is subject to approval of the Federal Reserve Board, in effect constitutes the Federal Reserve Board an operating central bank of the United States. The only important power in the field of credit operations it reserves to the regional banks is the power by concerted action to obstruct the carrying out of system credit policy.

SECTION 12

We suggest the omission of that part of this section dealing with the Federal open-market committee except paragraph (c) on page 19 which should be a part of Section 14 of the Federal Reserve Act.

It is believed that open-market operations of the Federal reserve system are satisfactorily controlled by the existing open-market policy conference as voluntarily set up. As a matter of principle, it is not desirable to crystalize into law a piece of detailed administrative machinery which may from time to time have to be modified as conditions change. The present machinery here outlined with some changes has been in operation a relatively brief time and its soundness and efficiency are far from demonstrated.

The proposed later amendment to Section 14, which we approve, placing beyond question all open-market operations under such regulations, limitations, and restrictions as the Federal Reserve Board may prescribe appears to give the Federal Reserve Board all the authority it needs to determine from time to time the desirable procedure.

FEDERAL LIQUIDATING CORPORATION.

Creation and membership. (pp. 13-24).

There would be created a "Federal Liquidating Corporation", the duty of which it would be to purchase, hold and liquidate the assets of member banks ordered closed by the Comptroller of the Currency, by vote of their directors, or by the appropriate State authorities.

The directors of the corporation would consist of the Comptroller of the Currency, who would be chairman of the board, and the members of the Federal Open Market Committee, which would be created by this bill and which would consist of the Governor of the Federal Reserve Board and one officer of each Federal reserve bank.

COMMENTS:

There is no reasonably close relationship between the functions of the Federal Open Market Committee and those of this corporation; and it is illogical for the members of that committee to serve with the Comptroller of the Currency as directors of the corporation. If an Open Market Committee is to be set up by law, it should be in all respects independent of collateral undertakings of this kind.

The constitutionality of the establishment by Congress of a corporation of this kind is open to some doubt. It is true that the corporation is to be an aid to national banks and might be upheld on that ground; but it is also to provide assistance to nonmember State banks. Generally speaking, Congress has no

authority to create a corporation unless it is to be an instrumentality or agency of the Federal Government. There is no provision expressly making this corporation an instrumentality or agency of the Federal Government. This might be remedied by the inclusion of a provision authorizing the corporation, when designated by the Secretary of the Treasury, to act as a depositary of public moneys or as a financial agent of the Government.

Classes of capital stock

Stock of the corporation which is to be divided into shares of $100 each shall be of two classes, Class A and Class B.

Class A stock is to be held by member banks only and is to be entitled to prior payment of dividends out of net earnings up to 30% of such net earnings in any one year, after payment of all expenses of the corporation. Class A has no vote at meetings of stockholders.

Class B stock is to be held by Federal reserve banks only and is not entitled to payment of dividends.

Shares of the capital stock of the corporation owned by member banks may not be transferred or hypothecated.

Original subscriptions to, and payments for, capital stock

Every member bank is required to subscribe for Class A stock in an amount equal to one-half of 1% of its total net outstanding time and demand deposits on the last "call date" in 1931. One-half of such

subscription is to be paid in full within 90 days after notice from the chairman of the board of the corporation. The remainder is subject tocall by the board of directors.

Every Federal reserve bank shall subscribe to Class B stock in an amount equal to one-fourth of its surplus on December 31, 1931. One-half of 1% of such subscription must be paid to the Comptroller of the Currency at the time of the subscription. The remainder is subject to call by the board of directors of the corporation upon 90 days' notice.

COMMENTS:

The requirement that member banks subscribe to this stock would impose to the extent of such subscriptions an additional burden on membership in the Federal Reserve System and would thus make membership less attractive. It would be especially burdensome on the banks at the present time.

Annual Subscriptions by Federal Reserve Banks.

Annual subscriptions to Class B stock of the Federal Liquidating Corporation shall be made by each Federal reserve bank in amount equal to one-fourth of the annual increase in its surplus.

COMMENTS:

This provision is in conflict with the provisions of Section 5, which require the Federal reserve banks to transfer to surplus each year such amount as may be necessary to restore the surplus to its status on December 31, 1931.

Changes in Class A stock upon changes in amounts of deposits of member banks.

When a member bank increases its time and demand deposits, it shall, at the beginning of each calendar year, subscribe for an additional amount of capital stock of the corporation equal to one-half of one per cent of such increase. One-half of the amount of the additional stock is to be paid for at the time of the subscription and the balance is subject to call by the board of directors of the corporation.

Upon a reduction in the time and demand deposits of a member bank, it must surrender, not later than the first of January thereafter, a proportionate amount of its holdings in the capital stock of the corporation. The shares so surrendered are to be cancelled and the member bank is to receive in payment therefor, under regulations of the Federal Reserve Board an amount equal to its cash-paid subscriptions on such surrendered shares and its proportionate share of earnings thereon, not exceeding one-half of one per cent per month from the last dividend, but not more than the book value of such earnings less any liability of the bank to the corporation.

COMMENTS:

The amount of time and demand deposits of every member bank is constantly changing. It would accordingly be necessary for every member bank to increase or decrease its holdings in the Class A stock of this corporation annually. This would be the cause of much trouble and expense to the corporation. A fluctuating capital of this kind seems unnecessary and inappropriate for such a corporation.

The provision that, upon a surrender of shares of the capital stock, member banks shall receive payment under regulations of the Federal Reserve Board does not seem to be in accord with the scheme of the corporation. It would seem more appropriate for such regulations to be prescribed by the corporation through its Board of Directors.

There would seem to be no good reason for limiting the amount of earnings paid on surrendered stock to one half of 1% per month from the period of the last dividend, in view of the fact that such stock is entitled to dividends up to 30% of net earnings. A reasonable provision would permit the payment of the proportionate share of the earnings up to the time of the surrender of the stock.

Subscriptions to Class A stock by new member banks.

A bank becoming a member of the Federal Reserve System shall apply for Class A stock in the corporation in an amount equal to one-half of 1% of its time and demand deposits, paying therefor its par value plus one-half of 1% per month from the last dividend.

Surrender of Class A stock upon liquidation or insolvency of member banks.

When a member bank voluntarily liquidates it shall surrender all its holdings of capital stock in the corporation for cancellation and be released from its stock subscriptions not previously called.

When a member bank is declared insolvent, its stock shall be cancelled without impairment of the liability on such stock. In case either of liquidation or receivership of a bank, there shall be returned to it all cash paid subscriptions on its stock with its proportionate share of earnings not to exceed one-half of 1% per month from the period of the last dividend but not above the book value of such earnings less any liability of the bank to the corporation. In the case of liquidation, such repayment shall be under regulations of the Federal Reserve Board.

When the Class A stock of the corporation is increased or decreased, the board of directors shall cause to be executed a certificate to the Comptroller of the Currency showing such increase or reduction, the amount paid in by or repaid to the member banks.

COMMENTS:

No provision is made for the surrender of stock by a member bank which withdraws voluntarily from the Federal Reserve System or whose membership is forfeited. This apparently was overlooked.

Organization Certificate.

When the minimum amount of Class A and Class B stock has been subscribed and paid, the Comptroller of the Currency is to designate five Federal reserve banks to execute a certificate of organization. The certificate is to state:

(a) The name of the corporation and the city and State where located;

(b) The amount and number of shares of capital stock;

(c) The name and place of business of each bank executing the certificates;

(d) The name and place of business of all banks which have subscribed to the stock of the corporation and the number of shares subscribed by each bank;

(e) That the certificate is made to enable all the banks executing it and the subscribing banks to avail themselves of the advantages of this section of the Act.

The organization certificate is to be acknowledged before a judge of a court of record or a notary public under the seal of such judge or notary and is to be filed with, and preserved by, the Comptroller of the Currency.

COMMENTS:

The execution of an organization certificate for this corporation would seem to serve no useful purpose. It is provided elsewhere that the corporation is created by the operation of the law itself. The organization certificate is, therefore, superfluous.

This provision refers to a minimum amount of Class A and Class B capital stock but no specific minimum is prescribed.

Formal powers of corporation

Upon the filing of the organization certificate with the Comptroller of the Currency, the corporation is to become a body corporate and have the usual corporate powers, with succession for twenty years.

COMMENTS:

The provision authorizing the appointment of officers and employees might well be broadened to include agents, experts and attorneys in order to make the authority of the corporation clear in this respect.

The authority of the corporation to pay salaries and expenses should also be clarified by express provision.

Administration of affairs of corporation

The Board of directors of the corporation is required to administer its affairs fairly and impartially and without discrimination.

The Board of Directors is required, "subject to the provisions of law and the orders of the Federal Reserve Board", to extend to each member bank which is ordered closed by the Comptroller of the Currency, by vote of its directors, and by the appropriate State authorities, such accommodations as may be safely and reasonably made with due regard for the claims and demands of other member banks.

COMMENTS:

This language is borrowed from Section 4 of the Federal Reserve Act, and is inappropriate - especially the reference to "the orders of the Federal Reserve Board."

Purchase of assets of closed national banks

When a national bank is declared insolvent or placed in receivership, the Comptroller of the Currency is to appoint a valuation committee of three members including the receiver, a person appointed by the board of directors of the bank and a third person named by the other two members.

The Committee, of which the receiver is to be chairman, shall at once make a preliminary valuation of the assets of the bank.

The Comptroller of the Currency, upon notice of the valuation agreed upon, is to tender the assets to the corporation, which may purchase them in whole or in part as determined by its board of directors.

The corporation is to realize upon the assets so purchased as "rapidly as possible", having due regard to the condition of credit in the district.

If the amount realized upon the assets exceeds the sum paid therefor, the excess is to be paid to the receiver after deducting a liquidation fee of 6% of the amount realized.

COMMENTS:

It would seem that, in lieu of the "liquidation fee", the corporation's compensation should be interest at a fixed rate on the amount advanced, in addition to which it should be expressly allowed to deduct all expenses of liquidation.

Investment of funds

Money belonging to the corporation, in excess of that necessary for current operating expenses, is required to be kept invested in the assets of insolvent or closed banks or in Government securities.

Purchase of assets of banks now in receivership.

In its discretion the corporation may purchase the assets of banks in the hands of receivers on the date of its organization on the same terms and conditions as are applicable in the case of banks closed thereafter.

The corporation may make loans to closed member banks or enter into negotiations to secure their reopening.

COMMENTS:

The provision for making loans to closed member banks applies apparently both to banks closed when the corporation is organized as well as banks closed thereafter.

There is no provision as to the maturity, security to be required, or other conditions of the loans which may be made to closed banks. Apparently all such terms and conditions are left to the discretion of the coporation.

It is questionable what powers are to be implied from the authority to enter into negotiations for the reopening of closed banks. Just how far the corporation may lawfully go in assisting in such reopening is not clear.

Purchase of assets of State member banks.

State member banks which are now or hereafter may become insolvent or suspended may offer their assets for sale to the corporation upon the conditions regarding the sale of assets of such banks prescribed by State law and upon receiving permission in accordance with law from the banking superintendent or commissioner of the State.

COMMENTS:

There is no specific authority for the corporation to purchase the assets of State member banks, although this would probably be implied.

It is not clear whether there is to be a valuation committee in the case of the assets of State member banks or how the value of such assets is to be determined by the corporation.

Advances to nonmember State banks.

For a period of two years the corporation may purchase and for a period of five years may hold and liquidate, the assets of closed nonmember State banks, may make loans to such banks and may enter into negotiations to secure their reopening, under the same terms and conditions as are applicable in the case of national and member banks.

Any such purchase, loan or negotiation must be permitted by the State law.

The amount realized by the corporation upon the assets of any such

nonmember bank in excess of the amount paid after deducting a 6% liquidation fee is to be paid into the Treasury of the United States as miscellaneous receipts.

There is authorized to be appropriated the sum of $200,000,000, to be paid by the Secretary of the Treasury to the corporation as the board of directors thereof may require and to be used exclusively for the purposes mentioned.

Nonmember State banks mentioned in these provisions include any savings bank, trust company or other banking institution, authorized to accept deposits and organized under State law, which is not a member of the Federal Reserve System.

COMMENTS:

It would seem advisable to limit the benefits of this corporation to member banks of the Federal Reserve System. Furthermore, no good reason appears why a Federal appropriation should be made for closed nonmember institutions and not for closed member institutions.

In purchasing the assets of a nonmember State bank, the amount paid by the corporation will probably be conservative and the corporation will frequently realize a substantial profit on the deal. In justice to the depositors of the nonmember institutions, this amount should be returned to them after deduction of a proper liquidation fee.

Issuance of Debentures by Corporation.

The corporation may issue and have outstanding at any one time in an amount not greater than four times its capital, its notes, debentures, bonds, or other such obligations, redeemable at its option before maturity in such manner as may be stipulated in the obligations, with such rates of interest and such maturities as may be determined by the corporation.

The corporation may sell short-term obligations on a discount basis payable at maturity without interest.

Any such obligations of the corporation may be secured by its assets in such manner as may be prescribed by the board of directors.

Such obligations may be offered for sale at prices determined by the corporation.

The corporation may "dispose of" any promissory notes of a receiver evidencing loans made by the corporation, and may pledge such receivers' notes and the corporation's assets for the corporation's promissory notes under such terms and conditions as may be agreed upon by the corporation; but the obligations so incurred, together with all other outstanding obligations, shall not exceed four times the amount of its capital.

The Secretary of the Treasury is authorized to prepare forms of notes, debentures, notes and other obligations of the Corporation, which shall be approved by the corporation and held in the Treasury subject to delivery upon order of the corporation.

The engraving materials in connection with such bonds are to remain in the custody of the Secretary of the Treasury.

The engraving materials in connection with such bonds are to remain in the custody of the Secretary of the Treasury.

Exemption from Taxation of Corporation and of its Obligations.

All of the corporation's obligations are exempt, both as to principal and interest, from all taxation (except estate and inheritance taxes) imposed by the United States, or by any State, county, municipality or local taxing authority; and the corporation, including its franchise, capital, reserves, surplus and income is likewise exempt from all taxation imposed by the United States or by any State, county, municipality or local taxing authority, except that real property is subject to taxation to the same extent according to value as other real property is taxed.

The second part of Section 12 deals with the Liquidating Corporation. A draft of a tentative alternative proposal follows.

One reason for making changes in the original proposal is that it would be a severe hardship at the present time to collect from the member banks one-half of one per cent of all their deposits, or a total of about

$150,000,000. The banks are short of funds; they have had to make large contributions to the National Credit Corporation. It seems just now of relatively more importance to keep money in the member banks and help keep them open than to draw upon them for this purpose.

We are proposing instead that part of the money be supplied by the Treasury and part be raised by debentures which will be purchasable by the Federal reserve banks up to one-fourth of their surplus. Our idea is to confine this section to help for member banks and let the Reconstruction Finance Corporation take care of nonmember banks during this emergency. When the Reconstruction Finance Corporation expires, there will certainly be no obligation on the part of the Federal Government or the Federal reserve system to take care of the depositors of failed nonmember banks.

SUBSTITUTE FOR SECTION 12.

Sec. _____. The Federal Reserve Act, as amended, is further amended by inserting between Sections 12 and 13 thereof the following new section:

Sec. 12A (a) There is hereby created a Federal Liquidating Corporation (hereafter referred to as the "corporation") whose duty it shall be to make loans on, or to purchase and liquidate as hereinafter provided, all or any part of the assets of any member bank for which a receiver has been appointed. The term

SECTION 12 Continued

"receiver" as used in this section shall mean a receiver of a national bank, and a receiver, liquidating agent, commission, person or other agency charged by State law with the responsibility and the duty of winding up the affairs of insolvent State member banks.

(b) The management of the Corporation shall be vested in a board of directors consisting of fourteen members, one of whom shall be appointed by the Comptroller of the Currency, one by the Federal Reserve Board, and one by the Board of Directors of each Federal reserve bank. Each such director shall hold office at the pleasure of the Comptroller of the Currency, the Federal Reserve Board, and the appointing Federal reserve bank, respectively. The director appointed by the Comptroller of the Currency shall be chairman of the board of directors of the corporation. The board of directors shall meet in Washington, D.C., at least twice each year and special meetings may be called by the chairman at any time and shall be called by him upon written request of any three of the directors. The chairman of the board of directors and the director appointed by the Federal Reserve Board, together with one additional director designated by the chairman, shall constitute an executive committee, which shall have all the powers and authority of the board of directors in the interim between meetings of the board.

SECTION 12 Continued

(c) The corporation shall have a capital stock of $100,000,000, all of which shall be subscribed by the United States of America and payment for which shall be subject to call in whole or in part by the Board of directors of the corporation.

There is hereby authorized to be appropriated out of any money in the Treasury not otherwise appropriated the sum of $100,000,000 for the purpose of making payments upon such subscription. Receipts for payments by the United States for or on account of such stock shall be issued by the corporation to the Secretary of the Treasury and shall be evidence of the stock ownership of the United States.

Any Federal reserve bank may purchase and hold any debentures or other such obligations of the corporation in an amount not exceeding one-fourth of the amount of its surplus fund.

(d) The corporation shall have power

First: To adopt, alter, and use a corporate seal;

Second: To have perpetual succession from the date of enactment hereof, unless it is sooner dissolved by an Act of Congress;

Third: To make contracts, to purchase, lease, and hold or dispose of such real estate or personal property as may be necessary or convenient for the transaction of its business;

SECTION 12 Continued

Fourth: To sue and be sued, complain and defend in any court of competent jurisdiction;

Fifth: To appoint, employ, and fix the compensation of such officers, employees, attorneys and agents as shall be necessary for the transaction of the business of the corporation, without regard to the provisions of other laws applicable to the employment and compensation of officers or employees of the United States, to define their authority and duties, require bonds of them and fix the penalty thereof and to dismiss them at pleasure. Nothing in this or any other Act shall be construed to prevent the appointment and compensation as a director, officer, or employee of the corporation of any officer or employee of the United States in any board, commission, independent establishment, or executive department thereof;

Sixth: To prescribe, amend, and repeal by its board of directors by-laws and rules and regulations not inconsistent with law governing the manner in which its general business may be conducted and the privileges granted to it by law may be exercised and enjoyed;

Seventh: To exercise by its board of directors or duly authorized officers or agents all powers specifically granted by the provisions of this section and such incidental powers as shall be reasonably necessary to carry out the powers so granted.

SECTION 12 Continued

(e) The board of directors of the corporation shall determine and prescribe the manner in which its obligations shall be incurred and its expenses allowed and paid. The corporation shall be entitled to the free use of the United States mails in the same manner as the executive departments of the Government. The corporation with the consent of any Federal reserve bank or of any board, commission, independent establishment, or executive department of the Government including any field service thereof, may avail itself of the use of information, services, facilities, officers and employees thereof in carrying out the provisions of this act.

(f) Whenever the receiver of any member bank shall apply to the corporation for a loan on, or for the purchase in whole or in part of, any assets of such member bank, the corporation shall appoint a valuation committee of three members, one of whom shall be the receiver and one an agent of the corporation. The valuation committee shall estimate the value of the assets of the member bank and the corporation may in its discretion purchase such assets in whole or in part, or make loans to the receiver on the security of such assets or any portion thereof, on such terms and conditions as shall be agreed upon by the corporation and, (1) in the case of any national bank, the receiver with the approval of the Comptroller of the Currency, and (2) in the case of any State member bank, the receiver with the approval of the person or agency designated by State law:

SECTION 12 Continued

except that, in no case shall the corporation make any loan or purchase any assets in an amount which in the opinion of the corporation shall not fully protect such corporation and no such loan or purchase shall be made in the case of State member banks unless permitted by the law of the State in which the bank is located. Receivers of national banks are hereby authorized and empowered with the approval of the Comptroller of the Currency to borrow on, or sell, assets of banks of which they are receivers, and the proceeds of every such sale or loan shall be utilized for the same purposes and in the same manner as other funds realized from the liquidation of the assets of such banks. The Comptroller of the Currency may, in his discretion, pay dividends on proved claims at any time before or after the expiration of the time for proving claims under section 5235 of the Revised Statutes, and no liability shall attach to the Comptroller of the Currency or to the receiver of any national bank by reason of any such payment for failure to pay dividends to a claimant whose claim is not proved at the time of any such payment. The corporation, in its discretion, may take over, hold, and liquidate any assets which it may purchase, and in such event it shall be the duty of the corporation to proceed to realize on such assets as rapidly as possible, having due regard to the condition of credit in the district in which such bank is located. If the amount realized from such assets exceeds the sum

paid therefor, the corporation shall make an additional payment to the receiver of the bank equal to the amount of such excess, if any, after deducting the expenses of liquidating such assets and an amount equal to interest at the rate of 6 per centum per annum. All loans made by the corporation to receivers shall bear interest at the rate of 6 per centum per annum.

(g) Money of the corporation not otherwise employed shall be invested in securities of the Government of the United States, except that for temporary periods in the discretion of the board of directors, funds of the corporation may be deposited subject to check in any Federal reserve bank or with the Treasury of the United States. When designated for that purpose by the Secretary of the Treasury, the corporation shall be a depositary of public moneys, except receipts from customs, under such regulations as may be prescribed by the said Secretary, and may also be employed as a financial agent of the Government. It shall perform all such reasonable duties as depositary of public moneys and financial agent of the Government as may be required of it.

(h) The corporation is authorized and empowered to issue and to have outstanding at any one time in an amount aggregating not more than twice the amount of its capital, debentures, or other such obligations to be redeemable at the option of the corporation before

SECTION 12 Continued

maturity in such manner as may be stipulated in such obligations and to bear such rate or rates of interest, and to mature at such time or times as may be determined by the corporation: Provided that the corporation may sell on a discount basis short-term obligations payable at maturity without interest. Obligations of the corporation may be secured by assets of the corporation in such manner as shall be prescribed by the board of directors. Such obligations may be offered for sale at such price or prices as the corporation may determine. The said obligations shall be fully and unconditionally guaranteed both as to interest and principal by the United States and such guaranty shall be expressed on the face thereof. In the event that the corporation shall be unable to pay upon demand, when due, the principal of or interest on notes, debentures, bonds, or other such obligations issued by it, the Secretary of the Treasury shall pay the amount thereof, which is hereby authorized to be appropriated, out of any moneys in the Treasury not otherwise appropriated, and thereupon to the extent of the amounts so paid the Secretary of the Treasury shall succeed to all the rights of the holders of such notes, debentures, bonds, or other obligations.

(i) All obligations issued by the corporation shall be exempt, both as to principal and interest, from all taxation (except estate or inheritance taxes) now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by

SECTION 12 Continued

any State, county, municipality, or local taxing authority. The corporation, including its franchise, its capital, reserves, and surplus, and its income, shall be exempt from all taxation now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxation authority, except that any real property of the corporation shall be subject to State, county, municipal, or local taxation to the same extent according to its value as other real property is taxed.

(j) In order that the corporation may be supplied with such forms of obligations as it may need for issuance under this act, the Secretary of the Treasury is authorized to prepare such forms as shall be suitable and approved by the corporation, to be held in the Treasury subject to delivery, upon order of the corporation. The engraved plates, dies, bed pieces, and other material executed in connection therewith shall remain in the custody of the Secretary of the Treasury. The corporation shall reimburse the Secretary of the Treasury for any expenses incurred in the preparation, custody, and delivery of such obligations.

(k) The corporation shall annually make a report of its operations to the Congress as soon as practicable after the 1st day of January in each year.

(l) Whoever, for the purpose of obtaining for himself or for any other applicant any loan, or any extension or renewal

SECTION 12 Continued

thereof, or the acceptance, release, or substitution of security therefor, or for the purpose inducing the corporation to purchase any assets, or for the purpose of influencing in any way the action of the corporation under this act, makes any statement, knowing it to be false, or whoever wilfully overvalues any security, shall be punished by a fine of not more than $5,000, or by imprisonment for not more than two years, or both.

(m) Whoever (1) falsely makes, forges, or counterfeits any obligation, or coupon, in imitation of or purporting to be an obligation, or coupon issued by the corporation, or (2) passes, utters, or publishes, or attempts to pass, utter, or publish, any false, forged or counterfeited obligation or coupon, purporting to have been issued by the corporation, knowing the same to be false, forged, or counterfeited, or (3) falsely alters any obligation, or coupon, issued or purporting to have been issued by the corporation, or (4) passes, utters, or publishes, or attempts to pass, utter, or publish as true, any falsely altered or spurious obligation or coupon issued or purporting to have been issued by the corporation, knowing the same to be falsely altered or spurious, shall be punished by a fine of not more than $10,000 or by imprisonment for not more than five years, or both.

SECTION 12 Continued

(n) Whoever, being connected in any capacity with the corporation, (1) embezzles, abstracts, purloins, or wilfully misapplies any moneys, funds, securities, or other things of value, whether belonging to it, or pledged, or otherwise entrusted to it, or (2) with intent to defraud the corporation or any other body, politic or corporate, or any individual, or to deceive any officer, auditor, or examiner of the corporation, makes any false entry in any book, report, or statement of or to the corporation, or without being duly authorized draws any order or issues, puts forth or assigns any note, debenture, bonds, or other such obligation, or draft, bill of exchange, mortgage, judgment, or decree thereof, shall be punished by a fine of not more than $10,000 or by imprisonment for not more than five years, or both.

(o) No individual, association, partnership, or corporation shall use the words "Federal Liquidating Corporation, or a combination of these three words, as the name or a part thereof under which he or it shall do business. Every individual, partnership, association, or corporation violating this subdivision shall be punished by a fine of not exceeding $1,000, or by imprisonment not exceeding one year, or both.

(p) The provisions of Sections 112, 113, 114, 115, 116, and 117 of the Criminal Code of the United States (U.S.C., title

18, ch.5, secs. 202 to 207, inclusive), in so far as applicable, are extended to apply to contracts or agreements with the corporation under this act, which for the purposes hereof shall be held to include loans, advances, extensions and renewals thereof, and acceptances, releases, and substitutions of security therefor, purchases or sales of assets, and all contracts and agreements pertaining to the same.

(q) The Secret Service Division of the Treasury Department is authorized to detect, arrest, and deliver into the custody of the United States marshal having jurisdiction any person committing any of the offenses punishable under this section.

SECTION 11.

(Section 13 of original bill)

Advances to member banks on their promissory notes.

The seventh paragraph of section 13 of the Federal Reserve Act, which authorizes advances for periods not exceeding fifteen days to member banks on their promissory notes secured by eligible paper or by obligations of the Government, would be amended as follows:

1. The rate charged on such advances would be made 1% higher than the rediscount rate.

COMMENTS:

This is an unreasonable discrimination against a form of credit accommodation which is more convenient both to the Federal reserve bank and to the member bank, and more practical and desirable from every standpoint than rediscounting. There is no difference whatever, in substance or in principle, between rediscounting eligible paper and making advances on notes secured by such paper; and such a rate discrimination against this more convenient and practical form of borrowing cannot be justified on either theoretical or practical grounds.

2. If any member bank to which such an advance had been made should, during the life or continuance of such advance, and despite an official warning of the Federal Reserve Bank or of the Federal

Reserve Board to the contrary, increase its outstanding loans made, (1) "upon collateral security", or (2) to members of any organized stock exchange, investment house, or dealer in securities for the purpose of purchasing or carrying investment securities (except obligations of the United States), such advance (i.e., to the member bank) would become immediately due and payable and such member bank would be denied the privilege of borrowing from the Federal Reserve Bank upon its fifteen-day notes for such period as the Federal Reserve Board may determine.

COMMENTS:

This is but one of the numerous attempts in the Bill to prevent member banks from making loans on investment securities or to dealers in investment securities and, like most of such provisions, it goes entirely too far and is impractical. It would apply to any loan made "on collateral security", regardless of whether the collateral were investment securities, or Government bonds or bills of lading covering goods in transit, warehouse receipts for agricultural products and other commodities, or any other collateral arising out of business transactions. It would penalize banks which had the good judgment to take security for their loans and would encourage banks to take chances on unsecured loans.

3. The Federal Reserve Board would be authorized, from time to time, in its discretion, by unanimous vote, "to suspend the provisions of this paragraph in whole or in part", for a period of 90 days, whenever, in its opinion, the public interest shall call for such action, and to renew such suspension for one additional period of 90 days, upon unanimous vote.

COMMENTS:

If construed literally, this provision apparently would authorize the Board either, (a) to suspend the restrictions on the making of collateral loans by member banks which are indebted to Federal reserve banks for advances on their promissory notes, or (b) to suspend in toto the provision authorizing Federal reserve banks to make advances to their member banks on their promissory notes.

SECTION 13 - Relates to such advances as reserve banks are already authorized to make--up to 15 days--on member bank collateral notes. Provides that these shall be made only at rates of discount at least 1 per cent above the established rediscount rate, and that during the life of such advance the borrowing member bank shall not increase its collateral loans to any borrower, or its loans, whether secured or unsecured, to any member of any stock exchange, any investment house, or any dealer in securities, for the purpose of purchasing or carrying investment securities (except obligations of the United States). In case any member bank violates this provision, the advance becomes immediately due and payable and the bank becomes ineligible as a borrower on 15-day paper at the reserve bank. The Federal Reserve Board is authorized in its discretion, by unanimous vote, to suspend these provisions, in whole or in part, for a period of 90 days, and for one additional period of 90 days, or 6 months altogether.

COMMENT

The requirement that the rate on 15-day advances of this kind must be at a rate one per cent above the discount rate would operate in ordinary times to eliminate such advances. Member bank borrowing would be done altogether at the discount rate and altogether by the method of rediscounting eligible paper. This procedure would not, therefore, have the effect of preventing member banks from expanding their loans on securities, whether to brokers or to other borrowers, since the member banks have on hand an abundance of eligible paper. On October 4, 1929, for example, at the climax of the recent boom, when member banks were borrowing altogether $900,000,000 at the reserve banks, of which about $700,000,000 was represented by member bank collateral notes, the member banks held $4,600,000,000 of eligible paper, or 6 times the amount of their borrowings on collateral notes. Member banks in New York City with total borrowings of about $70,000,000 at the Federal reserve bank, held $1,170,000,000 of eligible paper, or 16 times the amount of these borrowings.

This procedure, however, would involve extra work and expense both to the member banks and to the reserve banks, and would also work a hardship on individual member banks at times when they held little eligible paper on account of

seasonal inactivity of business in the local community or on account of general business depression.

As this provision of the bill now stands it appears to forbid banks borrowing on collateral notes from increasing their loans on any kind of collateral, including U. S. Government obligations, warehouse receipts, real estate, etc., as well as on the stocks and bonds of corporations.

SECTION 14 - Makes clearer the authority of the Federal Reserve Board over all open-market operations, and in paragraph (g), which is added, gives specific and detailed provision for control by the Federal Reserve Board of all relationships with foreign banks.

COMMENT

This Section appears to make no real change in the law but eliminates all doubt about the Board's authority, and makes the Board's control over foreign relations, if literally interpreted, absolutely impracticable.

SECTION 13

We suggest the omission of this section and propose a substitute.

The proposed revisions of Section 13 in the Glass bill are discriminatory against member bank 15-day collateral notes; we are not in accord with them in principle and believe that they would be seriously disturbing at this time. The prospect of such legislation would have a most disturbing effect on the market value of 18 billions of Government securities outstanding with consequent further difficulties to the banks that hold such obligations. The proposal in the bill imposing a higher rate on member bank notes would be equivalent at the present time, when substitution of other paper is difficult and in many cases impossible, to an advance in the discount rate for certain banks and would be contrary to Federal reserve credit policy indicated by the present situation.

Furthermore, we find ourselves unable to agree with the principles that underlie the proposed discrimination against Government securities. The reason for this discrimination is the belief that it is through these notes that Federal reserve money finds its way into the stock market. It is our conviction that there is no such connection. A 15-day note is a convenience that enables member banks to borrow money without having to find rediscountable paper of the exact amounts and maturities required. United States Government bonds are the best security in the world. The

SECTION 13 Continued

only theoretical reason for discrimination is that the Government should be estopped from ever abusing the facilities of the reserve system. So long as the bond must be originally purchased by a bank or individual, this danger is slight.

The latter part of this section, beginning with line 17, appears to be unsound. Under this provision a member bank borrowing on a 15-day advance is not permitted to "increase its outstanding loans made to any borrower upon collateral security." Collateral loans include many agricultural loans, commodity loans, and real estate loans as well as security loans. Practically every bank is making collateral loans every day; so this provision would practically stop a bank from doing business while it was borrowing on a 15-day advance.

We propose a substitute for this section which would have the effect of making eligible as collateral for 15-day advances the debentures of the Federal Intermediate Credit Banks. Most of the paper these banks hold in portfolio is eligible and the debentures are a better security because they are the joint and several liability of all the Federal Intermediate Credit Banks. The debentures are now eligible for purchase but not for advances. Making them eligible for advances would have the important advantage of making the debentures more salable in the market and thus increasing the supply of funds available to these banks, which has latterly been restricted. Because of the lack of a ready market it has been neces-

SECTION 13 Continued

sary for the reserve banks to purchase considerable amounts of debentures which the Fiscal Agent was not able to sell in the market. They now hold $30,000,000 out of about $75,000,000 outstanding. If the debentures were made eligible, banks would buy them more freely, the reserve banks would be relieved from carrying the load, and the Credit Banks would get money more freely.

The proposed substitute amendment follows:

"Any Federal reserve bank may make advances to its member banks on their promissory notes for a period not exceeding 15 days at rates to be established by such Federal reserve bank, subject to 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 discount 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, or by the deposit or pledge of debentures or other similar obligations of Federal Intermediate Credit Banks which are eligible for purchase by Federal reserve banks under existing law."

Suggest that Sec. 14(a)
of original bill be restored

SECTION 12.

(Sec. 14(b) of original bill)

Control over dealings with foreign banks and bankers

Subject to the powers conferred upon the Open Market Committee, the Federal Reserve Board shall exercise special supervision and control over all relationships and transactions of any kind entered into by any Federal reserve bank with any foreign bank or banker or with any group of foreign banks or bankers and all such relationships and transactions shall be subject to such regulations, limitations and conditions as the Board may prescribe.

No officer or representative of any Federal reserve bank shall conduct negotiations of any kind with the officers or representatives of any foreign bank or banker without first obtaining the permission of the Federal Reserve Board.

The Federal Reserve Board shall have the right to be represented at any conference or negotiations by such representative or representatives as it may designate.

A full written report of all conferences or negotiations shall be filed with the Federal Reserve Board and signed by all representatives of the Federal reserve bank attending such conferences or negotiations, regardless of whether or not the Federal Reserve Board is represented.

COMMENTS:

It seems inappropriate to make the powers of the Federal Reserve Board subject to the powers conferred upon the Open Market Committee, although the purpose

apparently is to require joint action of the Open Market Committee and the Board on matters affecting open market transactions. Since major open market transactions and large commitments to foreign banks and bankers affect the country as a whole, this may seriously affect the Board's control over general credit conditions.

In view of the Board's function of exercising general supervision over all Federal reserve banks and seeing that they pursue a banking policy which is harmonious and desirable for the country as a whole, it would seem appropriate for the Board to have a right to be represented at important conferences leading to commitments to foreign bankers and for the Board to be kept fully advised of the results of such conferences.

SECTION 14A

We are in entire accord with the purport of this paragraph and believe that it would give the Federal Reserve Board all the authority that it requires to keep close supervision over all kinds of open-market operations.

SECTION 14B

We see no objection to the first part of the paragraph if it is modified to omit the reference to open-market committee which is discussed in our comment on Section 12. We propose also to omit the word "control" in order to preserve the distinction between the operating and the supervisory function. The paragraph would then read as follows:

> "The Federal Reserve Board shall exercise special supervision over all relationships and transactions of any kind entered into by any Federal reserve bank, with any foreign bank or bankers, or with any group of banks or bankers, and all such relationships and transactions shall be subject to such regulations, conditions, and limitations as the Board may prescribe."

The balance of the paragraph is open to the same objection as Section 12A in that it proposes to embody into law details of procedure which may much more wisely be left to regulation and the development of practice.

SEC. 13. RESERVES OF MEMBER BANKS.

(Sec. 16 of original bill with a few changes.)

In General.

Disregarding entirely the facts disclosed and recommendations made in the recent report of the Federal Reserve System's Committee on Bank Reserves (which was based upon a scientific study made by Federal reserve experts over a period of two years), Section 13 of the Bill (pp. 27-32) would amend and reenact Section 19 of the Federal Reserve Act so as to increase drastically and unjustifiably the reserves required of member banks and so as to make numerous radical changes in the provisions of that section.

The member banks would have to borrow the amount of the increased reserves from the Federal reserve banks; this would further tighten credit conditions; and the present process of deflation would be accentuated and prolonged.

The present practical discriminations against country banks would be perpetuated by allowing no credit for cash on hand and by failing to compensate them for the advantage enjoyed by city banks in being able to offset balances due to banks against balances due from banks in computing their net deposits against which reserves must be maintained.

The increased reserve requirements probably would cause numerous banks (and especially country banks) to withdraw from the Federal Reserve System.

Definitions of demand and time deposits.

Demand deposits and time deposits would be re-defined in the same way as they are now defined in the first paragraph of Section 19 of the Federal Reserve Act.

Amounts to be maintained.

On the first day of January in each year after 1932, however, the reserves required to be carried against time deposits would be increased, until at the end of five years the amount required to be carried against time deposits would be the same as that required to be carried against demand deposits.

The present distinction between central reserve, reserve and non-reserve cities would be maintained and the Board's power to permit banks in outlying sections of reserve and central reserve cities to maintain the lower reserves required of banks in other cities would be preserved.

Cash on hand would not be counted as reserve nor would any credit be given for it in computing reserves.

COMMENTS:

The increase in the reserves is even more drastic in the revised bill than it was in the original bill, which required reserves of only 5% against "thrift deposits."

By retaining the more or less arbitrary distinctions between central reserve cities, reserve cities and non-reserve cities and by failing to permit cash in vault to be counted as reserves, the bill would perpetuate the inequalities in the total amount of reserve balances, plus cash on hand, now required to be maintained by various banks and which the reserve committee found so unfair to many country banks.

Member banks forbidden to make collateral loans as agents for others or to others having such loans.

No member bank shall act as the medium or agent of any non-banking corporation or individual in making loans "protected by collateral security".

No member bank shall make loans or discount paper for any corporation or individual if the proceeds of such transaction are to be used directly or indirectly for the purpose of making loans protected by collateral security in favor of any investment banker, broker, member of any stock exchange, or any dealer in securities.

Violations would be punishable by a fine of "not less than $100 per day"; but it would be a good defense if the member bank had the sworn statement of the borrower that the proceeds of the transaction would not be used for such purpose.

COMMENTS:

If this became a law, no member bank could safely make any loan unless it had the sworn statement of the borrower on file that he would not use the proceeds of the

loan for the purpose described.

Like other provisions of the Bill, it applies generally to loans "protected by collateral security", regardless of the nature of the collateral.

Penalties for deficiencies in reserves.

The present provisions of the law permitting reserve balances to be checked against, subject to such regulations and penalties as may be prescribed by the Federal Reserve Board, and forbidding any bank to make any new loans or pay any dividends while its reserves are deficient, would be retained in substantially their present form.

COMMENTS:

The provisions against making loans while the reserves are deficient have been found to be entirely impracticable and are honored more in their breach than in their observance. They are also believed to be unfair to directors who may incur liabilities for losses on loans made while the reserves are deficient, although they may be ignorant of the fact that the reserves are deficient when they make such loans.

It is believed that this provision should be changed so as to provide that any director who approves or acquiesces in the making of additional loans after receiving notice that his bank has been continuously deficient in its reserves for a given period shall be personally liable for all losses

sustained on such loans. This would be enforceable and fairer to bank directors.

Restrictions on dealings in "Federal funds."

No member bank shall sell or transfer to another member bank or to a nonmember bank, private banking house, or banker, any balance standing to its credit upon the books of the Federal Reserve Bank "in excess of the balances required by this section" unless the Federal Reserve Board shall have authorized such transfers by a general order.

On all such sales or transfers the bank shall charge a fee, to be fixed by the Federal Reserve Board on the basis of the rate or discount charged on 90 day paper by the Federal reserve bank of the district in which the selling or transferring bank is located.

The Federal Reserve Board shall have power to suspend all dealings in reserve balances for such periods as it may deem best.

COMMENTS:

This apparently would restrict member banks in transferring "excess balances" but would not restrict them in selling or transferring part of their reserve balances when their reserves were deficient.

The wisdom of placing restrictions on the use

by member banks of their balances with the Federal reserve banks is very doubtful, although it might be advisable to require the charging of a fee for dealing in Federal funds if the class of dealings which this pertains to is defined in such a way as not to apply to normal transfers of reserve balances for ordinary banking purposes.

Computation of reserves - liabilities on repurchase agreements.

The present provision to the effect that, in estimating the balances required by this Act, the net difference of amounts due to and from other banks shall be taken as the basis for ascertaining the deposits against which reserves must be maintained, would be retained in substantially its present form.

There would be added a provision to the effect that the liability created by every repurchase or similar agreement entered into by a member bank shall be added to such net difference as ascertained under the provisions of this paragraph.

COMMENTS:

The present provisions allowing the deduction of balances due from banks from balances due to banks in

effect allows the city banks to make deductions in computing their reserves which are not allowed to country banks as a class, because they have no balances due to banks; and this has been the cause of much dissatisfaction on the part of country banks.

In order to eliminate this discrimination, the Federal Reserve System's Committee on Reserves has recommended that balances due from banks be deducted from total deposit liabilities, so that the country banks as well as the city banks may have the benefit of this deduction.

The provision regarding liabilities on repurchase and similar agreements is somewhat ambiguous; but it apparently would result in such liabilities being added to the total amount of deposit liabilities against which banks would be required to maintain reserves.

It is not clear why member banks should be required to maintain reserves against liabilities on repurchase agreements and other similar agreements and not against all other liabilities for money borrowed.

There would be considerable confusion and uncertainty as to what is meant by the term "repurchase or other similar agreement."

SECTION 16 - This Section relates to member bank reserve requirements, brokers' loan control, trading in Federal reserve funds, and repurchase agreements.

MEMBER BANK RESERVE REQUIREMENTS. - The bill divides time deposits into "thrift deposits", which would carry a reserve of 5 per cent at all member banks, and "other time deposits", which would carry the same reserve as demand deposits. Thrift deposits are defined as all deposits "subject to not less than 60 days' notice before payment, which are not subject to transfer by check, and the total monthly balance of which in any individual case does not exceed $5,000". No change is made in the definition of demand deposits nor in the percentage of reserves required against them.

Postal savings deposits are excluded from thrift deposits and would carry the same reserve as demand deposits. United States Government deposits are not mentioned and presumably would be allowed to remain without reserve requirements.

Reserve balances with the reserve banks must be "realized" balances, which would eliminate the Federal reserve float.

COMMENT ON RESERVE REQUIREMENTS

The bill greatly increases reserve requirements at all member banks except those which have no time deposits at the present time. This increase is to come into effect gradually at a rate of one per cent per year, i.e., all time deposits as at present defined will carry a reserve of 3 per cent in 1932, 4 per cent in 1933, and 5 per cent in 1934, and the reserve on time deposits other than thrift deposits will continue to increase at the same rate until it is equal to the reserve on demand deposits. At country banks this would fall in the year 1936, at reserve city banks in the year 1939, and at central reserve city banks in the year 1942. After these years of transition are completed thrift deposits will carry a reserve of 5 per cent and other deposits a reserve of 7, 10, or 13 per cent.

Bring up to date

The increase in reserve requirements after the transition period is estimated at $500,000,000. The required reserves of country banks would probably be increased between 20 and 30 per cent, those of reserve city banks between 40 and 50 per cent, and those of central reserve city banks between 10 and 20 per cent.

The increase in aggregate reserve requirements occasioned by the bill, which would not start in 1932 but would begin in 1933, may be estimated at $110,000,000 in 1933, $110,000,000 in 1934, and smaller amounts in subsequent years through 1941.

The proposed revision of reserves corrects none of the difficulties that the existing reserve requirements have produced, and makes no attempt to establish a closer relationship between changes in reserve requirements and the course of business.

The distinction between time and thrift deposits is of the character that has given rise to evasions in the past and may be expected to continue to do so.

BROKERS' LOAN CONTROL. - Paragraph (c) of Section 19, as amended. Prohibits member banks from acting as agents in making collateral loans for account of any nonbanking corporation or individual and also from making loans to any corporation or individual that is lending on collateral to any investment banker, broker, etc.

COMMENT ON BROKERS' LOAN CONTROL

To prohibit member banks from making collateral loans "For account of others" is in line with a recent rule of the New York Clearing House Association.

The bill goes much further, however, than this rule, it prohibits member banks from lending to anyone who is lending to brokers, investment bankers, or dealers in securities. Strictly construed, this would prohibit loans to any nonmember bank that is lending on the Street--since a nonmember bank is a "corporation"--as well as loans to any other corporation making Street loans.

REGULATION OF TRADING IN FEDERAL RESERVE FUNDS. - Paragraph (e) of Section 19. Prohibits member banks from selling or transferring excess reserves held on the books of the Federal reserve banks except as authorized by general orders issued by the Federal Reserve Board, (2) Requires that all such sales or transfers shall be charged for at the prevailing rediscount rate, and (3) Authorizes the Federal Reserve Board to suspend all such dealings in reserve balances for such periods as it may deem best.

COMMENT ON REGULATION OF TRADING IN FEDERAL RESERVE FUNDS

This would make dealings in Federal reserve funds subject to regulation by the Federal Reserve Board. The wording of the bill may, however, cover transactions other than dealings in Federal reserve funds--for example, an ordinary loan made by a member bank having excess reserves at the time of the loan, whether made to another bank or to some business concern.

REPURCHASE AGREEMENTS. - Paragraph (f) of Section 19. Provides for the inclusive in deposits subject to reserve of liabilities arising out of repurchase agreements.

COMMENT ON REPURCHASE AGREEMENTS

It is not clear why this particular class of liabilities, rather than all classes of borrowed money, is made subject to reserves. Singling them out would evidently tend to discourage their use.

SECTION 16

We propose the substitution of the reserve proposal advanced by the Federal Reserve System Committee on Bank Reserves for the proposals made in the bill. The terms of the bill would greatly increase reserve requirements and tend to tighten money conditions. The reserve committee's proposal maintains total reserve requirements near present levels but provides for changes in requirements in response to changes in business conditions tending to tighten credit at times of overexpansion and to ease credit at times of depression.

The proposals made in Section 16 of the bill include two subjects not covered in the report of the Reserve Committee, namely, a prohibition against brokers' loans for the account of others, and, a clause subjecting the market for Federal funds to regulation by the Federal Reserve Board.

We are in agreement with the purpose of paragraph (c) of the bill which seeks to prohibit brokers' loans for account of others and agree with the clause forbidding a member bank from acting as agent in making such loans. This clause has been incorporated in paragraph (n) of the following draft. It has been made a separate paragraph in order that the penalty provision may apply to it alone.

SECTION 16 Continued

We suggest omitting the other provision in Section (c) of the bill prohibiting banks from lending to a corporation making brokers' loans. This clause would be difficult and annoying to enforce. Strictly speaking, it would prohibit loans to a bank which was lending quite properly to brokers or dealers.

We also suggest the omission of paragraphs (e) and (f) of the bill, which deal with the market for Federal funds.

We do not believe there is any necessity for formal regulation of the market for Federal funds. The market is in essence no different from that for "badmoney" in London and day-to-day money in other centers. It is generally desirable to have these liquid funds move freely where they are most needed. It is better to have the money flow to any part of the country where needed than to have it thrown on the call market.

The reserve banks keep a current record of transactions in Federal funds and deal informally with any abuse that may arise. A ruling of the Board now requires that Federal funds purchased be reported as borrowed money.

The following draft contains other slight modifications to the proposals of the Committee on Bank Reserves in addition to the one

SECTION 16 Continued

in paragraph (n) noted above. The first one which appears in paragraph (b) of the draft gives the Federal Reserve Board discretion in times of need to modify the proportion of vault cash that a member bank may count as part of its legal reserves, and the second which appears in Section (c) defines more carefully the manner in which deposits due to or payable at branches of member banks located abroad or in dependencies or possessions of the United States shall be treated. There have also been modifications in the language of other sections of the Committee's proposals which in no way change its meaning or effect.

The following draft contains all our suggestions for an amendment to Section 19 of the Federal Reserve Act.

SECTION 16 Continued

Section 19 of the Federal Reserve Act (United States Code, Title 12, Sections 461 to 466, inclusive, and Section 374), as amended, is further amended and reenacted to read as follows:

"RESERVES OF MEMBER BANKS"

"Section 19, (a) Each member bank shall establish and maintain reserves equal to five per centum (5%) of the amount of its net deposits, plus fifty per centum (50%) of the amount of its average daily debits to deposit accounts; but, in no event, shall the aggregate reserves required to be maintained by any member bank exceed fifteen per centum (15%) of its gross deposits.

"(b) Each member bank located in the vicinity of a Federal reserve bank or branch thereof shall maintain not less than four-fifths of its total required reserves in the form of a reserve balance on deposit with the Federal reserve bank, and every other member bank shall maintain not less than two-fifths of its total required reserves in the form of a reserve balance on deposit with the Federal reserve bank. The remainder of the total required reserves of each member bank, over and above the amount required to be maintained in the form of a reserve balance on deposit with the Federal reserve bank, may, at the option of such member bank, consist of a reserve balance on deposit with the Federal reserve bank,

SECTION 16 Continued

or of cash owned by such member bank either in its actual possession or in transit between such member bank and the Federal reserve bank: Provided, however, That when, in the opinion of the Federal Reserve Board, the public interest requires, the Federal Reserve Board on the affirmative vote of five members may limit the amount of cash which member banks or groups of member banks may count as reserve to less than one-fifth of the total reserve required by this Act in the case of member banks located in the vicinity of a Federal reserve bank or a branch thereof and to less than three-fifths in the case of other member banks; Provided, further, That in making such limitations, the Federal Reserve Board shall be guided by the general principle that member banks should be permitted to count as reserve, within the general limits of this section, as much cash as they reasonably need in view of the character of their business and their accessibility to the currency facilities of the Federal reserve banks.

"(c) The term 'gross deposits,' within the meaning of this section, shall include all deposit liabilities of any member bank whether or not immediately available for withdrawal by the depositor, all liabilities for certified checks, cashiers', treasurers' and other officers' checks, cash letters of credit, travelers' checks, and all other similar liabilities, as further defined and

specified by the Federal Reserve Board: Provided, however, That, in computing the amount of 'gross deposits,' amounts shown on the books of any member bank as liabilities of such bank payable to a branch of such bank located in a foreign country or in a dependency or possession of the United States, or payable at such branch, shall be treated as though said liabilities were due to or payable at a nonmember bank.

"(d) The term 'net deposits,' as used in this section, shall mean the amount of the gross deposits of any member bank, as above defined and as further defined by the Federal Reserve Board, minus the sum of (1) all balances due to such member bank from other member banks in the United States and their branches in the United States, and (2) checks and other cash items in process of collection which are payable immediately upon presentation in the United States, within the meaning of these terms as further defined by the Federal Reserve Board.

"(e) The term 'average daily debits to deposit accounts,' as used in this section, shall mean the average daily amount of checks, drafts, and other items debited or charged by any member bank to any and all accounts included in gross deposits as above defined and as fur-

ther defined by the Federal Reserve Board, except charges resulting from the payment of certified checks and cashiers', treasurers', and other officers' checks.

"(f) The term 'cash,' within the meaning of this section, shall include all kinds of currency and coin issued or coined under authority of the laws of the United States.

"(g) The term 'reserve balances,' as used in this section, shall mean a member bank's actual net balance on the books of the Federal reserve bank representing funds available for reserve purposes under regulations prescribed by the Federal Reserve Board.

"(h) The term 'vicinity of a Federal reserve bank or branch thereof,' as used in this section, shall mean the city in which a Federal reserve bank or branch thereof is located, until such term is otherwise defined by the Federal Reserve Board: Provided, that, with respect to each Federal reserve bank and each branch thereof, the Federal Reserve Board, from time to time, in its discretion, may either (1) define a specific geographic area as comprising the vicinity of such Federal reserve bank

or branch thereof, within the meaning of this section, or (2) compile a list of member banks which shall be deemed to be located in the vicinity of such Federal reserve bank or branch thereof, within the meaning of this section, and add banks to, or remove banks from, such list, from time to time: Provided, however, That, in defining such areas and compiling such lists, the Federal Reserve Board shall be guided by the general principle that banks whose proximity to a Federal reserve bank or branch thereof enables them, in the judgment of the Federal Reserve Board, to transact business with cash on hand averaging one-fifth or less of their required reserves, should be deemed to be located in the vicinity of such Federal reserve bank or branch thereof, within the meaning of this section.

"(i) With respect to each member bank, the term 'Federal reserve bank,' as used in this section, shall mean the Federal reserve bank of the district in which such member bank is located.

"(j) The Federal Reserve Board is authorized and empowered to prescribe regulations defining further the various terms used in this Act, fixing periods over

SECTION 16 Continued

which reserve requirements and actual reserves may be averaged, determining the methods by which reserve requirements and actual reserves shall be computed, and prescribing penalties for deficiencies in reserves. Such regulations and all other regulations of the Federal Reserve Board shall have the force and effect of law and the courts shall take judicial notice of them.

"(k) Subject to such regulations and penalties as may be prescribed by the Federal Reserve Board, any member bank may draw against or otherwise utilize its reserves for the purpose of meeting existing liabilities: Provided, however, That if any member bank shall fail for thirty consecutive calendar days to maintain the reserves required by this section, it shall not declare or pay any dividend or make any new loan or investment until its reserves are restored to the amount required by this section.

"(l) All penalties for deficiencies in reserves incurred under regulations prescribed by the Federal Reserve Board pursuant to the provisions of this Act shall be paid to the Federal reserve bank by the member bank against which they are assessed.

"(m) No member bank shall keep on deposit with any State bank or trust company which is not a member bank a

sum in excess of ten per centum of its own paid-up capital and surplus. No member bank shall act as the medium or agent of a nonmember bank in applying for or receiving discounts from a Federal reserve bank under the provisions of this Act, except by permission of the Federal Reserve Board.

"(n) No member bank shall act as the medium or agent of any nonbanking corporation or individual in making loans on the security of stocks, bonds and other investment securities or to brokers or dealers in stocks, bonds and other investment securities. Every violation of this provision by any member bank shall be punishable by a fine of not less than $100 per day during the continuance of such violation; and such fine may be collected, by suit or otherwise, by the Federal reserve bank of the district in which such member bank is located.

"(o) National banks or banks organized under local laws, located in Alaska or in a dependency or insular possession or any part of the United States outside of the continental United States, may remain nonmember banks, and shall in that event maintain the reserves required by law prior to the enactment of the Federal Re-

SECTION 16 Continued

serve Act; or said banks may, with the consent of the Federal Reserve Board, become member banks of any one of the Federal reserve districts, and shall in that event take stock, maintain reserves, and be subject to all the other provisions of this Act.

"(p) All acts or parts of acts in conflict with this section are hereby repealed only in so far as they are in conflict with the provisions of this section."

There are hereby repealed those parts of the provisions of Section 7 of the First Liberty Bond Act, approved April 24, 1917, Section 8 of the Second Liberty Bond Act, approved September 24, 1917, and Section 8 of the Third Liberty Bond Act, approved April 4, 1918 (U. S. Code, Title 31, Section 771) which read as follows:

"That the provisions of section fifty-one hundred and ninety-one of the Revised Statutes, as amended by the Federal Reserve Act, and the amendments thereof, with reference to the reserves required to be kept by national banking associations and other member banks of the Federal Reserve System, shall not apply to deposits of public moneys by the United States in designated depositaries."

This section shall become effective eighteen months after the enactment of this Act.

SECTION 14. REAL ESTATE LOANS AND INVESTMENTS.

(Sec. 17 of original bill)

Limitations on aggregate amount.

Whereas national banks are now permitted to make real estate loans in amounts equal to 25% of their capital and surplus, or one half of their savings deposits, whichever is the greater, the limitation would be changed to 15% of capital and surplus or one half of time deposits.

Investments in bank premises and unsecured loans, "whose eventual safety depends upon the value of real estate" would be considered real estate loans for all the purposes of this section.

These provisions would apply to State member banks as well as to national banks.

COMMENTS:

Except for the provision requiring unsecured loans whose eventual safety depends upon real estate to be considered as real estate loans, (which would be difficult to enforce), the above amendments would seem desirable. Banks having time deposits equal to less than 30% of their capital and surplus should not be permitted to invest more than 15% of their capital and surplus in bank premises and real estate loans. Those having greater amounts of time deposits should not invest more than half of such deposits in real estate loans and bank premises.

Since the eventual safety of most loans to farmers

depends upon the value of real estate, these limitations would curtail materially the aggregate amount of loans which many banks in agricultural sections could make to their own farmer customers.

Revaluation and revision.

National (and State member) banks could make real estate loans for five years and in amounts not exceeding 50% of the value of the real estate; but the Comptroller of the Currency would be required to revise such valuations at the time of each examination (not less than twice a year) and would have the power to order changes in such valuations and to require the adjustment of loans to such valuations.

COMMENTS:

If real estate should decline in value, persons who had borrowed from member banks on real estate for five years in amounts equal to 50% of its value and had incurred the expense of having titles searched, mortgages recorded, appraisals made, and the property insured and had paid commissions on such loans would run the risk every six months of being required by the Comptroller of the Currency to curtail such loans in amounts sufficient to bring them within 50% of the Comptroller's revised valuations.

Someone would have to bear the expense of reapprais-

ing the property every time the bank is examined, which would be at least twice a year.

If constitutional, this would drive many member banks either out of the business of making real estate loans or out of the Federal Reserve System.

To be Reported at Market Value.

Every member bank must report its investments in, or holdings of, "any such property and securities" at an aggregate valuation which shall not exceed the aggregate market value thereof at the time such report to the Comptroller of the Currency or to the Federal Reserve Board is made.

COMMENTS:

While the meaning of the words "any such property and securities" is not clear, it apparently would include all real estate loans, all investments in bank buildings, all unsecured loans the safety of which depends on real estate, all loans or investments of time deposits made in accordance with the provisions of State law, and all property or securities specified by the Comptroller of the Currency as investments for time deposits.

All investments in such property or securities would have to be reported at current market value. In times of unusual business depression, this would close many banks which could otherwise weather the storm.

Since condition reports are required of all member banks three times a year, it would seem that in order to ascertain the market value of their bank premises and real estate loans, it would be necessary for the bank to have appraisals made three times a year. This, together with the appraisals of real estate required at each examination, would require five appraisals a year.

These provisions probably would drive many banks out of the Federal Reserve System.

Segregation of Time Deposits.

Time deposits must be invested in real estate loans, bank premises, unsecured loans whose eventual safety depends upon the value of real estate, or in property and securities in which savings banks may invest under State law or (where there is no State law prescribing such investment) in such property and securities as may be specified by the Comptroller of the Currency, except that the reserve required to be maintained against time deposits may be counted as part of such investment.

In the case of the insolvency of any national (or State member) bank, all investments in real estate loans, bank premises, unsecured

loans whose eventual safety depends upon the value of real estate and all investments of time deposits in such property or securities, shall be applied by the receiver thereof in the first place ratably and proportionately to the payment in full of its time deposits.

COMMENTS:

This is a curious attempt to give savings depositors a prior lien on certain assets of the bank without requiring a complete segregation of the savings department from all other departments of the bank. In the case of a run on a member bank by time depositors, the liquid assets representing the investment of the funds of the commercial depositors would be used to meet such runs; and, if the bank failed, the time depositors would still have a lien on all of the assets acquired under this section, which apparently would include all real estate loans, all bank premises, all loans the eventual safety of which depend upon real estate, and all investments made in accordance with the provisions of State law regarding investments of savings banks or in accordance with the regulations of the Comptroller prescribing investments for time deposits. This seems manifestly unfair.

Time Allowed for Compliance.

Every existing national and State member bank must comply with all of the provisions of Section 24 of the Federal Reserve Act as amended within two years from the enactment of the Bill.

Every national bank hereafter organized must comply from the date of its organization.

Every State bank hereafter admitted to membership must comply from the date of its admission.

SECTION 17

We suggest a substitute section incorporating therein the reduction on the percentage of capital allowed to be invested in real estate loans as now contained in the present bill and in addition reducing the total amount to be invested in real estate to one-third of the savings deposits which is a return to the law prior to the enactment of the amendment of February 25, 1927. We suggest the elimination of the provision which would include, in the amount of real estate, bank buildings and loans depending eventually upon real estate, since a large proportion of the loans of many country banks are necessarily predicated upon real estate. It is, furthermore, almost impossible to determine precisely what loans would be required to be listed in this category. But we do recommend a provision restricting the investment of funds in bank premises in the future to 100 per cent of the capital of the institution, except where approved by the Comptroller in the case of national banks and by the Federal Reserve Board in the case of State member banks.

The provision for revaluation of real estate loans at each examination is impracticable, both from the point of view of the examiner, and from the point of view of the contract which the bank has with the recipient of the loan.

The proposal in the bill for a partial segregation of savings deposits would not, we believe, prove practicable, nor would it be possible

under this plan to render complete justice to both types of depositors in various kinds of contingencies. The whole principle of segregation is, moreover, highly debatable.

In the proposed substitute, banks are given five years instead of two years to comply with the provisions of the law in order that the reduction in investments permitted in real estate may work no hardship and cause no disturbance.

The suggested substitute for Section 17 is as follows:

Sec. 17. Section 24 of the Federal Reserve Act, as amended, is amended to read as follows:

"Sec. 24. Any national banking association may make loans secured by first lien upon improved real estate, including improved farm land, situated within its Federal reserve district or within a radius of one hundred miles of the place in which such bank is located, irrespective of district lines. A loan secured by real estate within the meaning of this section shall be in the form of an obligation or obligations secured by mortgage, trust deed, or other such instrument upon real estate when the entire amount of such obligation or obligations is made or is sold to such association. The amount of any such loan shall not exceed 50 per centum of the actual value of the

real estate offered for security, but no such loan upon such security shall be made for a longer term than five years. Any such bank may make such loans in an aggregate sum, including in such aggregate any such loans on which it is liable as indorser or guarantor or otherwise, equal to 15 per centum of the amount of the capital stock of such association actually paid in and unimpaired and 15 per centum of its unimpaired surplus fund, or to one-third of its savings deposits, at the election of the association, subject to the general limitation contained in Section 5200 of the Revised Statutes. Such banks may continue hereafter as heretofore to receive time and savings deposits and to pay interest on the same, but the rate of interest which such banks may pay upon such time deposits or upon savings or other deposits shall not exceed the maximum rate authorized by law to be paid upon such deposits by State banks or trust companies organized under the laws of the State wherein such national banking association is located.

"Every national banking association and every member bank which is in existence at the date this section as amended takes effect shall be required, within a period of five years from such date, to comply fully with the provi-

SECTION 17 Continued

sions of this section, and every national banking association hereafter organized and every State bank or trust company hereafter becoming a member of the Federal reserve system shall comply with the provisions of this section from the date of its organization or admission to membership, as the case may be."

SECTION 17(a)

The provision with regard to bank premises mentioned under Section 17 is as follows:

Sec. 17(a). The Federal Reserve Act, as amended, is hereby amended by inserting between Section 24 and Section 25 thereof the following new section:

"Sec. 24(a). Except with the permission of the Comptroller of the Currency, no national bank shall hereafter invest in bank premises a sum exceeding the amount of its paid-in and unimpaired capital. Except with the permission of the Federal Reserve Board, no State member bank shall hereafter invest in bank premises a sum exceeding the amount of its paid-in and unimpaired capital."

SECTION 15.

(Section 18 of original bill)

National Banks granted all powers of State banks.

National banks would be granted the power to engage in all forms of banking business permitted by the laws of the States in which they are located to "Banks of deposit and discount" organized under such State laws, except to the extent that the exercise of such powers is forbidden by the provisions of the National Bank Act, the Federal Reserve Act, or any other laws of the United States.

COMMENTS:

This apparently is intended to enable national banks to compete more effectively with State banks. Its tendency would be to lower the standards of banking in the national banking system to the standard of the State banks, where more liberal powers are granted to the State banks by the State law.

Since Section 5136 of the Revised Statutes already gives national banks most of the usual banking powers, there would be much uncertainty and confusion as to what is meant by "banking business" and "banking transactions" permitted to "banks of deposit and discount" under State law.

In a number of States the statutes authorize banks to exercise certain unusual or extraordinary powers which are, however, generally considered as banking powers in those States. National banks in some States would, therefore, under this section have authority to act in a number of capacities not strictly within the banking field, while national banks located in other States would continue as at present to have only strict banking powers.

A provision of this kind invites questions as to whether the exercise of the additional powers conferred by State law is to be subject to the limitations and restrictions on such powers prescribed by State law, and if so to what extent. It also serves to invite controversies as to the authority of State supervisory officials over national banks in exercising powers permitted by State law.

Dealings in investment securities.

The purchase and sale of investment securities by national banks is limited to purchasing and selling such securities without recourse solely upon the order and for the account of customers, and in no case for the account of the national bank, except that national banks may purchase and hold for their own account investment securities in such amounts and of such kind as may be by regulation prescribed by the Comptroller of the Currency.

No national bank shall underwrite any issue of securities.

In no event shall the total amount of investment securities of any one obligor held by any national bank exceed 10% of the total amount of such issue outstanding, "nor shall the total amount of the securities so purchased and held for its own account at any time exceed 15% of the bank's capital and 25% of its surplus fund.

No national bank shall purchase or hold any shares of stock of any corporation, except as otherwise permitted by law, and except that national banks may invest not more than 15% of their capital and surplus in the stock of safe deposit companies.

These limitations do not apply to obligations of the United States or to general obligations of any State or of any political subdivision thereof, or obligations issued under authority of the Federal Farm Loan Act.

COMMENTS:

The limitations which would be prescribed are peculiar. It is clear that no national bank could purchase or hold more than 10% of the total amount of any issue of securities of any one corporation; but it is not clear whether the words "total amount of securities so purchased" are intended to mean, (1) the total amount of securities issued by any one corporation, or (2) the aggregate amount of all securities of all corporations held by any national bank.

If the language is construed literally, the aggregate amount of all investment securities (other than Federal, State and municipal bonds and those issued under the Farm Loan Act) which any national bank might own would be limited to an amount equal to 15% of the capital and 25% of the surplus of such national bank. This would be a very severe limitation and would require national banks to sell a large portion of the securities which they now own. No time is allowed for this readjustment; and the dumping of a large amount of securities on the market at this time would be disastrous.

If this is intended to be an alternative limitation on the amount of securities of <u>any one corporation</u> which may be purchased by any national bank, the words "of any one obligor or maker"

should be inserted after the word "securities" and either the words "whichever may be the greater" or the words "whichever may be the lesser" should be inserted at the end of the sentence.

The definition of investment securities which is contained in the law, as amended by the Act of February 25, 1927, would be stricken out and apparently the Comptroller would be given unlimited power to prescribe his own definition except that stocks could not be included. The law now describes investment securities as, "Marketable obligations evidencing indebtedness of any person, copartnership, association or corporation, in the form of bonds, notes and/or debentures, commonly known as investment securities, under such further definition of the term 'investment securities' as may by regulation be prescribed by the Comptroller of the Currency."

SECTION 18 - Amends the general powers paragraph of the National Bank Act (Subdivision Seventh Section 5136 of the Revised Statutes).

Allows national banks in any State to exercise all the powers accorded by State law to banks of deposit and discount in that State, except those especially denied by Federal statute.

Dealing and investing in investment securities by National banks:
(1) No National bank shall act as an underwriter;
(2) Purchase and sell only as agent for customers upon their orders, except purchase for own account for investment and not for merchandising;
(3) Purchases for own account limited as follows for securities other than those of U. S. Government, domestic municipalities, and Federal Farm Loan --

(a) To not more than 10 per cent of the total of any one investment issue outstanding;
(b) "Total amount of the securities so purchased and held for its own account" shall not exceed 15 per cent of capital and 25 per cent of surplus.

Corporate bonds or other corporate obligations may be held only if, in each of the five years prior to purchase by bank, the obligor earned 4 per cent on its outstanding capital stock.

COMMENT

On June 30, 1931, National bank capital approximated $1,700,000,000; surplus, $1,500,000,000. Investments under the provision as drafted would thus have been limited to about $630,000,000 in securities other than United States Governments, domestic municipals, and Federal Farm Loans which are exempted from the provision. As a matter of fact, on June 30, 1931, National banks had more than $3,000,000,000 so invested, an amount which in order to comply with the bill would have to be diminished by approximately $2,400,000,000.

SECTION 18

We recommend the omission of this section.

While we have sympathy with the proposal for prohibiting national banks from engaging in the investment banking business, we believe, nevertheless, that the present is not the time to disturb the situation by either putting such a law into operation or adopting it for operation in the future.

Other proposals in this section for reducing the amount of bank investments or specifying the earnings of a corporation, the obligations of which may be held by a national bank, would be extremely disturbing and would in fact make it necessary for banks to dump many hundreds of millions of dollars of securities in an already disturbed market.

SECTION 16.

(Substitute for Section 19 of original bill)

Capital required for organization of national banks.

This section would amend Section 5138 of the Revised Statutes so as to provide that, after this section as amended takes effect, no national bank may be organized with a capital of less than $50,000, except that associations formed for the purpose of succeeding to the business of an existing bank may, in the discretion of the Comptroller of the Currency, be organized with a capital of less than $50,000 but not less than $25,000.

Section 5138 would also be amended so as to eliminate the present requirement that the organization of national banks with a capital of less than $100,000 shall be subject to the approval of the Secretary of the Treasury.

COMMENTS:

This amendment, requiring a minimum capital of $50,000 for new national banks, is a desirable amendment to the National Bank Act, but it would seem advisable to require also that in case of the organization of a national bank to succeed an existing bank the capital of the succeeding bank shall not in any case be less than that of such existing bank. The elimination of the requirement with regard to the approval of the Secretary of the Treasury does not appear to be seriously objectionable.

SECTION 17.

(Sec. 20 of original bill)

Shares of stock must be $100 each.

"After this section as amended takes effect", the capital stock of every national bank shall be divided into shares of $100 each.

Banks having certificates of stock for shares in amounts other than $100 must issue new certificates, at $100 each "within two years after such date."

COMMENTS:

This repeals an amendment contained in the Act of February 25, 1927, which permitted national banks to issue shares in amounts less than $100 and which resulted in the split-up of shares which were selling at high prices and apparently accelerated trading in such shares. The purpose of the amendment, therefore, apparently is to discourage speculating and trading in bank stocks.

It would seem that, "after this section as amended takes effect", the capital stock of national banks by law would be divided into shares of $100 each, although two years would be allowed in which to issue new certificates. If this is the legal situation, how would holders of certificates for $10 shares vote? Would each such certificate entitle the holder to 1/10th of a vote or would the holders of such shares be unable to vote at all? Section 5144 of the Revised Statutes provides that each shareholder of national bank stock "shall be entitled to one vote on each share of stock held by him."

National Banks Forbidden to Have Shares of Affiliates "Trusteed".

No certificate of stock of any national bank shall represent the stock of any other corporation.

The ownership, sale or transfer of any certificates of national bank stock shall not be conditioned in any manner whatsoever upon the ownership, sale or transfer of a certificate representing the stock of any other corporation.

COMMENTS:

This obviously is intended to break up the present practice whereby affiliated securities companies, holding companies and trust companies, savings banks, etc., are tied up with national banks by trustee agreements and similar arrangements so that the stock of the national bank cannot be transferred without at the same time transferring the stock of the affiliated corporation and so that every shareholder must necessarily own shares of both corporations in a certain proportion.

Many national banks are so connected and involved with their affiliated institutions that the enforcement of this provision would be difficult and many national banks might prefer to give up their national charters rather than to dissolve their present connections and comply with this provision.

SECTION 20 - Amends the section of the National Bank Act dealing with capital stock certificates (Section 5139 of Revised Statutes).

Par value of National bank stock to be $100 only.

Prohibits a certificate of National bank stock representing at the same time stock in another corporation or being conditioned in ownership or transfer by relationship to stock in another corporation.

COMMENT

All National banks with par of less than $100, which includes a large number of the largest banks such as Chase and National City, will be required to change it back to $100. They have two years in which to do this. Member State banks apparently will not be subject to this requirement.

The second part of this Section appears to intend the unscrambling of National banks and their affiliates. It would require separation of the trusteed share-for-share relationship between the National City Company, the City Bank Farmers Trust Company, and the National City Bank, and of similar relationships between many of the larger National banks and trust companies in the country. No time limit is set for this unscrambling, but under Section 23 it would have to be effected by March 1, 1934 with respect to security affiliates. Also under Section 23, it would be necessary for securities affiliates of National banks in fact to be either liquidated or disposed of to entirely different owners. In the case of two or more banks whose stock is trusteed share for share, divorcement would seem to be required.

SECTION 20

We suggest omission of this section. The units in which bank stocks can be issued are a relatively unimportant matter, and yet modification of these units at the present time would create many complications.

The balance of this section relates to the question of dealing with affiliates, upon which we have requested more time for consideration.

SECTION 20

The second half of this section relates to affiliates and it is suggested that it be omitted, in accordance with the general principle previously discussed that no attempt should be made at this time to divorce affiliates from the banks with which they are connected.

SECTION 18.

(Section 21 of original bill).

Relations with Securities Dealers.

From and after January 1, 1933, no director, officer or employee of any National bank or member bank shall be an officer of any unincorporated association or corporation engaged primarily in the business of purchasing, selling or negotiating securities.

COMMENTS:

While theoretically it would seem desirable to break up such relationships between banks and securities corporations, it is doubtful whether the actual good which would be accomplished would be sufficient to compensate for the disturbing effect upon the banks and their officers and employees. The provisions would not forbid an officer, director or employee of a national bank or member bank to be a director of a securities corporation.

Relations with Corporations making collateral loans.

From and after January 1, 1933, no director, officer or employee of any national bank or member bank shall be a director, officer or employee of a corporation organized for any purpose whatsoever which makes "loans secured by collateral" to any corporation other than to its own subsidiaries, or to any individual, association or partnership.

COMMENTS:

Since all banks and trust companies make loans secured by collateral, this would forbid all national banks and member banks to have interlocking directorates or common officers and employees with any other banks, thereby repealing all of the exceptions of Section 8 of the Clayton Antitrust Act. It would also forbid them from having common officers, directors or employees with affiliated foreign banking corporations such as are authorized under Section 25 and 25(a) of the Federal Reserve Act.

Correspondent Relationships.

From and after January 1, 1933, no National bank or member bank shall perform the functions of a correspondent for, nor utilize as its own correspondent (1) any individual, partnership, unincorporated association or corporations engaged primarily in the business of purchasing, selling or negotiating securities, or (2) any corporation which makes loans secured by collateral to any corporation other than its own subsidiaries:

COMMENTS:

Since all banks make loans secured by collateral, this would forbid any national bank or member bank to

act as correspondent for any other bank or use any other bank as its correspondent. If construed literally it would even forbid them to have correspondent relationships with Federal reserve banks; since the Federal reserve banks make loans to their members secured by collateral in the form of Government bonds and eligible paper.

In its present form this section is absolutely impractical.

SECTION 21

It is suggested that this section be omitted also on the principle that no attempt should be made at this time to divorce affiliates from the banks with which they are connected.

As previously noted in our first report, the last part of this section would make it impossible for a member bank to clear checks or do the other ordinary banking business of a correspondent for a foreign banking house or any out-of-town investment house.

SECTION 19.

(Sec. 22 of original Bill).

Holding corporations and nominal shareholders of national banks deprived of votes.

Would amend Section 5144 of the Revised Statutes so as to provide that:

1. In all elections of directors and in all meetings of shareholders of national banks, each shareholder shall be entitled to one vote on each share of stock "actually owned by him as the result of bona fide purchase, gift, or inheritance".

2. No shareholder who shall become such through nominal transfer, or ownership on behalf of another shall cast such vote.

3. No corporation, association or partnership which owns more than 10% of the stock of any national bank and no officer, director, or employee of such corporation, association or partnership shall vote either the shares owned by the corporation or by such officer, director or employee.

COMMENTS:

The present law gives each shareholder one vote for each share "held" by him.

How are judges of election to know whether shareholders acquired their stock by "bona fide"

purchase, gift or inheritance?

How are they to know whether a shareholder became such through nominal transfer or ownership on behalf of another?

The prohibition against votes by corporations, associations and partnerships or officers, directors or employees thereof which hold more than 10% of the stock are obviously intended to break the control of holding companies over national banks; but they would be difficult to enforce, and the amendment would cause disputes and confusions in elections.

SECTION 22 - Amends the section of the National Bank Act dealing with the voting of National bank shares (Section 5144 of Revised Statutes).

Nominal shareholders shall not vote.

Corporations or partnerships which own more than 10 per cent of the stock of National bank shall not be allowed to vote nor shall officers and directors of such organizations be allowed to vote stock owned by them as individuals.

COMMENT

This is a blanket restriction on affiliation or group banking in general, since it prohibits any sort of affiliate from voting the stock it may own in a National bank if it owns more than 10 per cent. It does not seem to apply, however, to ownership of stock in a State member bank. It is to be read in connection with Section 24, which provides that affiliates not engaged in securities business may be excepted from the prohibition, providing the group meets regulations stipulated in Section 24.

SECTION 20.
(Sec. 24 of original bill)

Conditions under which holding companies may vote - Submission to Examinations, Reports of Condition, etc.

Notwithstanding the provisions of Section 5144 of the Revised Statutes, the Federal Reserve Board, on application, may, in its discretion, permit any corporation, association or partnership which owns or controls stock of a national bank to vote such shares but only on the following conditions:

(a) Every applicant for such a permit must agree:

1. To submit to examination at its own expense by the examiners of the Comptroller of the Currency.
2. That the examination report shall disclose all facts ascertained by the examination and shall include a statement of the name, location, capital, surplus and undivided profits of each bank in which the applicant owns stock, the number and value of shares so owned, the number acquired and sold since the last examination, and a list showing separately the value of the other assets of the applicant;
3. That the Comptroller may examine each national bank owned or controlled by the applicant, both individually and in conjunction with others so owned and controlled, and may require publica-

tion periodically of individual or consolidated statements of condition of such bank.

(b) Every applicant shall hold free of any lien or claim thereon obligations of the United States equal to 10% of the capital stock owned by it in any national bank and shall agree that:

1. If any such national bank shall fail, the shareholders liability accruing on account of such failure shall be a first lien on the obligations so held, and
2. Any resulting deficiency in such obligations will be made up within 90 days after such deficiency occurs.

(c) Every applicant shall, upon the issuance of such voting permit and during the existence thereof, possess, free and clear of any lien, assets other than bank stock which, together with the above required obligations of the United States, shall not be less than 25 per cent of the aggregate par value of all bank stock owned by such applicant. The 25 per cent requirement shall be increased by not less than 2 per cent per annum after January 1, 1935, and at no time shall the assets so held be less than the total assets held by the applicant on January 1, 1932; but sums advanced during 1931 and 1932 for replacement of capital in banks owned by the applicant or for losses incurred or charge-offs made by it in those years may be counted as a part of such assets up to 10 per cent of the aggregate

par value of bank stocks held or owned by it. Such applicant shall also reinvest in assets other than bank stock all net earnings in excess of 6 per cent of the book value of its own shares until such assets shall be equal to the outstanding par value of the bank shares owned by it.

(d) Every officer and employee of the applicant shall be subject to the same penalties for false statements as are applicable to officers and employees of national banks.

(e) When applying for such permit, each applicant shall:

1. File with the Comptroller a statement that it does not own, control, or have any interest in, "or" is not participating in the management or direction of, any affiliate engaged in the issue, flotation, underwriting, public sale or distribution at wholesale, retail or through syndicate participation of, stock, bonds, debentures, notes or other securities of any sort, and that during the period of such permit, it will not acquire any ownership, interest or control in any such affiliate or participate in the management or direction thereof; or
2. Agree that it will, within two years after filing such application, divest itself of its ownership, control and interest in any such affiliate and will cease participating in the management or direction thereof and will not thereafter, during the exist-

ence of such permit, acquire any further ownership, control or interest in any such affiliate or participate in the management or direction thereof; and

3. Agree that it will declare dividends only out of actual net earnings as indicated by the last preceding examination made by the Comptroller.

The Federal Reserve Board, in its discretion, may revoke any such permit after 60 days' notice, and thereafter no national bank whose stock is owned by such affiliate, association, corporation or partnership shall receive deposits of United States money, or pay any further dividends to such affiliate, association or partnership.

COMMENTS:

In so far as these provisions relate to reports of condition and examinations, they would seem to constitute unnecessary duplications of the provisions of Sections 27 and 28, which purport to require affiliates of national banks (including holding companies) to file reports of condition with, and to submit to examinations by, the Comptroller of the Currency.

The provisions requiring holding companies to agree that the Comptroller may examine national banks controlled by them are unnecessary; because the Comptroller can examine any and all national banks whenever he desires to do so.

The provisions of subsections (b) and (c) which require the holding of securities to assure the payment of its stockholders' liability by a holding company when a national bank whose stock it owns fails, would seem to be desirable.

The provision requiring such holding companies to dispose of any affiliate or subsidiary engaged in the sale or distribution of investment securities would seem to be desirable, in order to divorce the banking business from such business.

SECTION 24 - General regulation and supervision of groups.

Qualifies Sections 22 and 23 by providing that the Comptroller of the Currency may permit a corporation to vote the stock of a subsidiary National bank on certain conditions of which the following are the most important:

(1) controlling corporation must submit to examination;

(2) it shall deposit and accumulate over a period of time assets equal to the outstanding par value of the bank shares owned by it;

(3) the corporation must abjure securities business directly or indirectly;

(4) the corporation must also limit its activities to those general types of business legal for National banks under Section 5136 Revised Statutes.

COMMENT

This section brings group banking which involves any National bank under the regulation and supervision of the Comptroller. The effect of this section is to discriminate between securities affiliates and other affiliates such as holding companies. The former are simply left cut off under the general prohibition in Section 22, but the latter are permitted to continue under supervision. Moreover, owners of National bank stock are permitted to continue as owners of stock in all types of affiliates except securities affiliates.

SECTIONS 22, 23, AND 24

It is recommended that Section 23 be omitted since it is directed toward divorcing and destroying affiliates. For Sections 22 and 24 we suggest a revision. The principal change is that an additional section has been prepared to place holding companies of State member banks under the same supervision and restriction as holding companies for National banks.

The provision for free assets to guarantee stockholders' liability has been modified to make it more practicable.

A provision has been added designed to bring into the reserve system eligible nonmember banks controlled by holding companies coming under the

provisions of this section.

We have not assigned numbers to these sections, because they take the place of several sections in the bill, and, if accepted by the Subcommittee, can be numbered continuously.

SECTION ___

Section 5144 of the Revised Statutes, as amended, is amended to read as follows:

"Sec. 5144. In all elections of directors and in deciding all questions at meetings of shareholders, each shareholder shall be entitled to one vote on each share of stock held by him, except that shares of its own stock held by any National bank as trustee shall not be voted, and shares owned or controlled by any holding company affiliate, as defined by the Banking Act of 1932, or by any officer, director, or employee thereof, shall not be voted unless there is in effect at the time a voting permit issued to such holding company affiliate as hereinafter provided. Shareholders may vote by proxies duly authorized in writing; but no officer, clerk, teller, or bookkeeper of such association shall act as proxy; and no shareholder whose liability is past due and unpaid shall be allowed to vote.

"Any holding company affiliate may make application to the Comptroller of the Currency for a voting permit entitling it and its officers, directors and employees to cast one vote at all

meetings of shareholders of such National banking association on each share of stock actually owned or controlled by it or by its officers, directors, or employees. The Comptroller of the Currency may, in his discretion, grant or withhold such permit as the public interest may require; and every holding company affiliate which applies for and receives such a permit shall be subject to, and shall comply with, all of the applicable provisions of this section, so long as such permit shall remain in force.

"Every such holding company affiliate and each bank owned or controlled thereby shall be subject to examination by examiners representing and acting for the Comptroller of the Currency, who shall have the same powers and duties with respect to such examinations as they have with respect to examinations of National banks. The expenses of each such examination shall be assessed against, and paid by, such holding company affiliate or the bank examined. The report of the examiner shall set forth all facts ascertained by the examination and shall include the name, location, capital, surplus, and undivided profits of each bank in which the applicant owns stock and the number of shares so owned.

"Each holding company affiliate and each bank owned or controlled thereby shall file with the Comptroller of the

Currency reports of condition (including consolidated reports of such holding company and all banks controlled thereby) at such times and in such form as the Comptroller may prescribe, in his discretion, and shall publish in such manner as the Comptroller shall prescribe such reports of condition or such parts thereof as he may require.

"Within a period of one year from the issuance of any such voting permit, each nonmember State bank owned or controlled by such holding company affiliate which is eligible for membership in the Federal reserve system shall apply for membership therein in the manner prescribed by, and subject to the terms of, Section 9 of the Federal Reserve Act. If such application is approved by the Federal Reserve Board, such bank shall become a member of the Federal reserve system and shall comply with all of the provisions of law applicable to member banks. If such application is not approved by the Federal Reserve Board, or if any such bank shall fail to become, or shall cease to be, a member of the Federal reserve system at any time while such voting permit remains in effect, such holding company affiliate shall divest itself of all stock ownership or other interest in, or control of, such bank.

See p. 23
See 9a

"Except as otherwise provided herein, every such holding company affiliate, (1) shall possess on January 1, 1934, or at the time of the issuance of such voting permit, and shall

thereafter continue to possess during the existence of such permit, free and clear of any lien, pledge or hypothecation of any nature, readily marketable assets other than bank stock, which shall not amount to less than 15 per centum of the aggregate par value of bank stocks held or owned by such holding company affiliate, and (2) shall reinvest in readily marketable assets other than bank stock all net earnings over and above six per centum per annum on the book value of its own shares outstanding, until its readily marketable assets other than bank stocks shall amount to 25 per centum of the aggregate par value of bank shares held or owned by it; Provided, however, That, in computing the amount of readily marketable assets, other than bank stock, which any holding company affiliate is required to possess at any given time, credit shall be given to such holding company for all contributions which such holding company has made during the preceding three years to any bank owned or controlled by such holding company at the time such computation is made. The term 'contribution,' as herein used, shall include all gifts of money, assets or other things of value to any such bank, all amounts paid for worthless or doubtful assets purchased from any such bank, and such other similar amounts as the Comptroller of the Currency, in his discretion, may permit to be treated as contributions. No holding company affiliate, whose shareholders are

liable by the law of the State in which such holding company affiliate is incorporated for the liabilities of such corporation to an amount not less than the par value of the shares of stock held by any such shareholder, in addition to the amount invested in such shares, shall be required to comply with the provisions of this paragraph.

"There is hereby created a board composed of the Secretary of the Treasury, Governor of the Federal Reserve Board and the Comptroller of the Currency, who may, in their discretion, revoke any such voting permit after giving sixty days' notice of their intention to the holding company affiliate by registered mail. Whenever such board shall have revoked any such voting permit, no member bank whose stock is owned in whole or in part by the holding company affiliate whose permit is so revoked shall receive United States Government deposits, nor shall any such member bank pay any further dividend to such holding company affiliate upon any shares of such bank owned or controlled by such holding company affiliate.

"When any holding company affiliate has obtained a voting permit from the Comptroller of the Currency in accordance with the provisions of this section, any officer, director, agent or employee of such holding company affiliate, who shall make any false entry in any book, report or statement of such holding company affiliate with intent in any case to injure or defraud

such holding company affiliate, any member bank or any other company, body politic or corporate, or any individual person, or with intent to deceive any officer of such company or of any member bank, or the Comptroller of the Currency, or any agent or examiner appointed to examine the affairs of such holding company affiliate, shall be deemed guilty of a misdemeanor and upon conviction thereof in any district court of the United States shall be fined not more than $5,000 or shall be imprisoned for not more than five years, or both, in the discretion of the court.

"No National bank shall, (1) make any loan on the stock of any holding company affiliate which owns or controls such National bank directly or indirectly, (2) make any loan to any holding company affiliate which owns or controls such National bank directly or indirectly on the security of any shares of stock of any affiliate of such holding company affiliate, (3) be the purchaser or holder of the stock of such holding company affiliate; unless such security or purchase shall be necessary to prevent loss upon a debt previously contracted in good faith; and any stock so purchased or acquired shall be sold or disposed of at public or private sale within two years from the date of its acquisition.

"Unless there is in effect at the time a permit issued pursuant to the terms of this section authorizing such stock to be voted, any person, firm, corporation, association, business trust,

or other organization, which shall vote, or cause, direct, authorize, or permit to be voted, the stock of any National bank owned or controlled by any holding company affiliate, or by any officer, director or employee thereof, shall be deemed guilty of a misdemeanor and, upon conviction thereof in any district court of the United States, shall be fined not more than $5,000 for each such offense. Each vote cast shall constitute a separate offense within the meaning of this paragraph."

SECTION ___

The Federal Reserve Act, as amended, is further amended by inserting therein immediately after Section 9 thereof a new section reading as follows:

"Section 9A. No State bank or trust company shall be permitted to become a member of the Federal Reserve System unless each holding company affiliate of such State bank or trust company, as defined in the Banking Act of 1932, shall have filed with the Federal Reserve Board an agreement in such form as may be prescribed by said Board accepting, and agreeing to submit to, and comply with, all of the provisions of this section; and no State bank or trust company shall remain a member of the Federal Reserve System after one year from the date of the enactment of this act unless each holding company affiliate of such State bank or trust company shall have filed such an agreement with the Federal Reserve Board.

"Every such holding company affiliate and each bank owned or controlled thereby shall be subject to examination by examiners selected or approved by the Federal Reserve Board and acting under the direction of the said Board, who shall have the same powers and duties with respect to such examinations as they have with respect to examinations of member banks. The expenses of each such examination shall be assessed against, and paid by, such holding company affiliate or the bank examined. The report of the examiner shall set forth all facts

ascertained by the examination and shall include the name, location, capital, surplus and undivided profits of each bank in which such holding company affiliate owns stock and the number of shares so owned.

"Each such holding compnay affiliate and each bank owned or controlled thereby shall file with the Federal Reserve Board reports of condition (including consolidated reports of such holding companies and all banks controlled thereby) at such times and in such form as the said Board may prescribe, in its discretion, and shall publish in such manner as the said Board shall prescribe such reports of condition or such parts thereof as the said Board may require.

"Within a period of one year from the date of any such agreement filed with the Federal Reserve Board by any holding company affiliate, each nonmember State bank owned or controlled by such holding company affiliate which is eligible for membership in the Federal Reserve System shall apply for membership therein in the manner prescribed by, and subject to the terms of, Section 9 of this Act. If such application is approved by the Federal Reserve Board, such bank shall become a member of the Federal Reserve System and shall comply with all of the provisions of law applicable to member banks. If such application is not approved by the Federal Reserve Board, or if any

SECTION Continued

such bank shall fail to become, or cease to be, a member of the Federal Reserve System at any time while such agreement remains in effect, such holding company affiliate shall divest itself of all of the stock ownership or other interest in, or control of, such bank.

"(b) Except as provided herein, every such holding company affiliate (1) shall possess on January 1, 1934, and at all times thereafter during the membership in the Federal Reserve System of any State bank or trust company of which it is a holding company affiliate, free and clear of any lien, pledge or hypothecation of any nature, readily marketable assets other than bank stock, which shall not be less than 15 per cent of the aggregate par value of bank stocks held or owned by such holding company affiliate; and (2) shall reinvest in readily marketable assets other than bank stock all net earnings over and above 6 per centum per annum on the book value of its own shares outstanding, until its readily marketable assets, other than bank stocks, shall amount to 25 per centum of the aggregate par value of bank shares held or owned by it; Provided, however, That, in computing the amount of readily marketable assets, other than bank stock, which any holding company affiliate is required to possess at any given time, credit shall be given to such holding company for all

Sec 8 18

contributions which such holding company has made during the preceding three years to any bank owned or controlled by such holding company at the time such computation is made. The term 'contribution,' as herein used, shall include all gifts of money, assets or other things of value to any such bank, all amounts paid for worthless or doubtful assets purchased from any such bank, and all such other similar amounts as the Federal Reserve Board, in its discretion, may permit to be treated as contributions. No holding company affiliate whose shareholders are liable by the law of the State in which such holding company affiliate is incorporated for the liabilities of such corporation to an amount not less than the par value of the shares of stock held by any such shareholder, in addition to the amount invested in such shares, shall be required to comply with the provisions of this paragraph.

"If any holding company affiliate shall fail to comply with the provisions of this section or with the provisions of any agreement with the Federal Reserve Board made pursuant thereto, the said Board, in its discretion, may require any State member bank to which said company is a holding company affiliate to surrender its stock in the Federal reserve bank and to forfeit all rights and privileges of membership in the Federal Reserve System as provided in Section 9 of this Act.

SECTION Continued

"Any officer, director, agent or employee of any holding company affiliate which has filed an agreement with the Federal Reserve Board, as provided in this section, who shall make any false entry in any book, report or statement of such holding company affiliate with intent in any case to injure or defraud such holding company affiliate, any member bank or any other company, body politic or corporate, or any individual person, or with intent to deceive any officer of such company or of any member bank, or the Federal Reserve Board, or any agent or examiner appointed to examine the affairs of such holding company affiliate, shall be deemed guilty of a misdemeanor, and upon conviction thereof in any district court of the United States, shall be fined not more than $5,000 or shall be imprisoned for not more than five years, or both, in the discretion of the court.

"No State member bank or trust company shall, (1) make any loan on the stock of any holding company affiliate which owns or controls such State member bank or trust company directly or indirectly, (2) make any loan to any holding company affiliate which owns or controls such State member bank or trust company directly or indirectly on the security of any shares of stock of any affiliate of such holding company affiliate, (3) make loans to any holding company affiliate amounting in the aggregate to more than 10 per cent of the unimpaired capital and

SECTION Continued

surplus of such member bank, or (4) be the purchaser or holder of the stock of such holding company affiliate; unless such security or purchase shall be necessary to prevent loss upon a debt previously contracted in good faith; and any stock so purchased or acquired shall be sold or disposed of at public or private sale within two years from the date of its acquisition."

SECTION 21.

(Sec. 25 of original Bill)

Branches of National Banks.

A national bank with the approval of the Federal Reserve Board, would be authorized to establish branches at any point in the State within which it is located, if the establishment of such branches is permitted to State banks by State law.

If, by reason of proximity of a national bank to a State boundary line, its ordinary and usual business extends into an adjacent State, the Board may permit the establishment of branches by the bank in an adjacent State, but not more than fifty miles from the location of the parent bank.

No national bank, however, could establish a branch outside of the city, town or village in which it is located unless it has a capital of at least $500,000.

Every national bank having branches would be required to have a minimum capital equal to the aggregate minimum capital required by law for the establishment of an equal number of national banks located "in the various places where such association and its branches are situated".

COMMENTS:

This is a compromise between the provision of the original bill and the Comptroller's recommendation for "trade area" branch banking. Its benefits would be seriously curtailed by the limitation to States permitting branch banking. The fifty mile limitation is arbitrary.

SECTIONS 25 AND 26

We suggest that the clauses on lines 12 to 14 limiting the right of State-wide branch banking to such States as permit it for their own banks be omitted, and that a clause be inserted permitting the establishment of branches in adjacent States where the business of the bank is found to extend itself naturally into the adjacent territory. We believe that this extension of branch banking would be particularly helpful at the present time to make possible the establishment of banking service in many communities which are now completely deprived of such service and to take care of a great many small banks which have been so weakened in recent months that the only prospect of securing adequate banking service in their communities appears to lie in the taking over of these institutions as branches of stronger banks. We believe that the growth of branch banking along proper lines can be assured by arrangements for careful attention to supervision and safeguarding of the establishment of additional branches through the office of the Comptroller of the Currency. Moreover, the experiences of recent months are likely to assure for some time to come a greater conservatism in bank expansion. We agree with the proviso requiring a capital of $1,000,000 for banks having branches outside of their city, provided the preceding recommendation is adopted. The allocation of capital to each branch, however, appears to us to be undesirable, because of the possibility of complications, and unnecessary, because the

capital of the parent institution is back of each of its branches under existing law.

With regard to the provision for the aggregate capital of national banking associations having branches, we believe that this matter should be left to the judgment of the Comptroller of the Currency in acting upon applications for the establishment of branches.

Section 25, as revised in accordance with our proposal, would read as follows:

Section 25, Paragraph (c) of Section 5155 of Revised Statutes, as amended, is amended to read as follows:

"(c) A national banking association may, with the approval of the Comptroller of the Currency, establish and operate new branches within the limits of the city, town, or village, or at any point within the State in which said association is situated: Provided, That, if by reason of the proximity of such an association to a State boundary line its ordinary and usual business is found to extend into an adjacent State, the Comptroller of the Currency may permit the establishment of a branch or branches by such association in such adjacent State within the territory to which such ordinary and usual business is found to extend; except that no such asso-

ciation shall establish a branch outside of the city, town, or village in which it is situated, unless it has a paid-in and unimpaired capital stock of $1,000,000."

In order to conform to the above amendment, it is suggested that Section 26 of the bill be amended to read as follows:

"Section 26. Sections 1 and 3 of the Act of November 7, 1918, as amended, is amended by inserting after the words, 'within the same county, city, town, or village', in the first clause of each, the following: 'or within the geographical area within which such association may be permitted to establish a branch'. Paragraph (d) of Section 5155 of the Revised Statutes, as amended, is hereby repealed."

The repeal of sub-section (d) of Section 5155 of the Revised Statutes is recommended: because it prevents the establishment of branches in many small communities which are entirely without banking facilities.

SECTION 22.

(Sec. 26 of original Bill)

Consolidations with other banks in the same State.

The provisions of Sections 1 and 3 of the Act providing for the consolidation of two or more national banks or for the consolidation of State banks with national banks would be amended so as to permit such consolidations to take place between banks located anywhere in the same State.

COMMENTS:

Apparently two banks located in different cities in the same State could consolidate, regardless of whether the State law permits State-wide branch banking; but they could not have branches in different cities in the State unless the State law permits State-wide branch banking.

Where a State bank is consolidated with a national bank under the provisions of the present law, however, the consolidated institution may retain and operate all branches of the constituent banks which may have been in lawful operation "by any bank" on February 25, 1927. A national bank consolidating with a State bank in another city in the same State, therefore, could retain any branches which such State bank had before February 25, 1927, but it could not establish a branch at the location of the head office of such State bank, unless the State law permits State-wide branch banking. (Note; In some States which do not now permit branch

banking, banks may have retained branches established before the statute prohibiting branches was enacted.)

SECTION 23.

(Sec. 27 of original Bill)

Rate of interest on loans.

Section 5197 of the Revised Statutes would be amended so that national banks could charge on loans and discounts, (1) the rate of interest allowed by the State law (or 7 per cent where the State law fixes no limit), or (2) a rate 1% in excess of the Federal reserve discount rate, whichever may be greater.

COMMENTS:

Federal reserve banks sometimes have different rates for different classes of paper, and it is not clear which rate would apply in such a case. It could not be said that the rate would be 1% above the rate of discount on the same class of paper; because national banks discount much paper which is not eligible for rediscount. It would be better if the Bill indicated which rediscount rate is referred to - e.g., the rate on 90-day commercial paper.

This recognition of the right of national banks to make a profit on rediscounts with the Federal reserve bank is inconsistent with central bank theory and would tend to nullify the effect of increasing rediscount rates for the purpose of discouraging inflation.

SECTION 27

Permitting national banks to charge a rate of interest in excess of the maximum allowed in the State at a time when the discount rate at the reserve bank is at a high level appears to be desirable. We suggest only the insertion of the words "on 90-day commercial paper in effect at" in substitution for the word "of" in line 19, page 56, because there is sometimes more than one discount rate in effect.

SECTION 24.

(Sec. 28 of original Bill)

Interest on deposits.

Section 24 would limit the rate of interest which national and State member banks would be permitted to pay on deposits as follows:

1. Interest on balances due to banks would be limited to 2-1/2% or "the current rate of discount of the Federal reserve bank", whichever is the smaller.

2. On all other deposit balances, the rate would be limited to one-half the rate of interest which national banks are permitted to charge on loans.

COMMENTS:

These restrictions would seem reasonable; but they would place national banks and member banks at a serious disadvantage in competing with nonmember banks and might result in further withdrawals from membership in the Federal Reserve System.

SECTION 28 - Limits the rates that member banks, whether national or State, may pay on deposits.

Interest on balances subject to check is forbidden; interest on bankers' balances is limited to 2 1/2 per cent or the discount rate of the reserve bank, whichever is smaller; interest that a bank may pay on other deposits is limited to one-half the maximum rate that it is allowed to charge. (See preceding section.)

COMMENT

Under existing law (F. R. Act, Sec. 24), a National bank is allowed to pay the same interest on deposits that is allowed by State law for a State bank.

The limitation on rates payable on bankers' balances--to not more than 2 1/2 per cent when rediscount rates are above 5 per cent, and at other times to not more than one-half of the rediscount rate--is evidently intended to keep money out of New York at times of speculative demand. (If bankers' balances are considered "balances subject to check," then interest on such balances would appear to be forbidden by the bill.)

(This section conflicts with Section 17, p. 41, lines 20-25, where existing law is reenacted.)

SECTION 28

The proposed limitation on interest rates to be paid to depositors would make it impossible for the member banks to compete with nonmember banks, and it is, therefore, proposed that this section be omitted.

SECTION 25.

(Sec. 29 of original bill).

Limitations on loans to affiliated corporations.

The first paragraph of Section 5200 of the Revised Statutes would be amended so that, in computing the amount which a corporation could borrow from a national bank, the corporation and all of its subsidiaries would be treated as a single borrower.

COMMENTS:

In other words the basic limitation in the amount which a national bank could lend to any corporation and all of its subsidiaries would be 10% of the national bank's capital and surplus.

It is not entirely clear what the term "Subsidiaries" would mean in this connection, since this term is not defined in the revised bill.

Limitations on loans by a national bank to an "affiliate."

No national bank would be permitted to lend to "an affiliate" an amount exceeding 10% of the capital and surplus of such national bank or exceeding the capital stock of such affiliate, whichever may be the smaller.

COMMENTS:

The meaning of this provision is not at all clear. It might be construed as a limitation on (1) the total amount which any national bank may lend to any one of its own affiliates; (2) the total amount which any national bank may lend to one affiliate of any national bank or any member bank; or (3) the total amount which a national bank may lend to any one affiliate of a finance company, securities company, investment trust or other similar organization.

When all of the various conflicting provisions regarding loans to affiliates are considered together and in connection with the definition of an affiliate contained in Section 2 of the Bill, it probably would be construed to be a limitation on the total amount which any national bank may lend to one of its own affiliates or to any one affiliate of any national bank or State member bank.

Limitations on loans to dealers in securities.

The amount which any national bank might lend to any broker or member of any stock exchange or similar corporation or any finance company, securities company, investment trust or other similar organization would be strictly limited to 10% of the capital and surplus of such national bank.

COMMENTS:

This would amend Section 5200 of the Revised Statutes, which provides, in general that no national bank may lend to any one borrower an amount exceeding 10% of the bank's capital and surplus but which contains eight exceptions permitting loans on certain classes of paper to be made without any limitation, loans on other classes of paper to be made in amounts equal to 25% of the bank's capital and surplus and loans on other classes of paper under certain conditions to be made in amounts equal to half the national bank's capital and surplus.

The amendment would make all such exceptions to the general rule inapplicable to the special classes of borrowers listed above and would limit their borrowing strictly to 10% of the bank's capital and surplus.

Limitations on loans by national banks to "all affiliates."

The aggregate amount which all affiliates of a national bank could borrow from such national bank (including repurchase agreements) would be strictly limited to 10% of the national bank's capital and surplus, except that loans secured by Government bonds or by bonds issued by the State in which such bank

is situated or by any political subdivision of such State would be excluded altogether from the limitations of Section 5200 of the Revised Statutes, if (sic. such bonds) were actually owned by the borrower.

COMMENTS:

It is not clear whether this refers to "all affiliates" of (1) any national bank or (2) the lending bank; but the latter meaning probably is intended.

Under present law a national bank cannot lend to a single borrower on the security of bonds of the United States an amount exceeding 25% of the bank's capital and surplus, but this provision apparently would permit national banks to lend unlimited amounts to their own subsidiaries on the security of Federal, State or municipal bonds, since it exempts such loans from all the "foregoing limitations" of Section 5200 of the Revised Statutes.

Loans by affiliate on the stock of parent institutions.

During a period of three years after this section as amended takes effect, no affiliate shall hold, or lend upon, more

than 10% of the shares of the capital stock of the parent institution.

COMMENTS;

In view of the very broad terms of the definition of affiliates taken in connection with the words "parent institution", this would appear to forbid any corporation owned or controlled by a national bank to make loans on the stock of such national bank.

Such prohibition would seem to be desirable; but the reason for limiting the prohibition to three years from the time this section takes effect is not at all clear. It would seem that, if it is sound in principle, it shouod be a permanent prohibition and not a temporary one.

Capital not to be provided by National Banks.

No national bank shall establish or capitalize an affiliate through cash or stock dividend declarations made from its surplus or from undivided profits.

"Within three years after this section as amended takes

effect", every affiliate shall be capitalized through the sale of its own stock which shall be paid for in cash in the same manner as required in the case of a national bank.

COMMENTS:

These provisions obviously are intended to stop directors of national banks from declaring special dividends with the understanding that the proceeds will be used by their shareholders to subscribe capital for affiliated corporations.

Apparently, it is intended that all affiliates whose capital has been provided by national banks in this manner should return such capital to the national banks and have new capital subscribed and paid in cash; but the language clearly is not sufficient to accomplish this purpose. In fact, it is not at all clear what it means or what its legal effect would be.

SECTION 29

Paragraphs (b) and the first part of (c) are discussed under Section 11. Paragraph (a) appears to be too sweeping as it would include with a borrowing corporation all of its "subsidiaries or affiliates," terms which have not been defined in relation to industrial or other corporations. Therefore, we suggest omission.

The second part of Section 29 (c) is not clear, and appears to contemplate an undue control over an individual's use of funds obtained as dividends on bank stock. We suggest omission.

SECTIONS 29 and 30 - Amend the section of the National Bank Act dealing with the limitation of loans to one interest (Section 5200 of Revised Statutes).

The aggregate of loans to a corporation and its affiliates shall be regarded as loans to one interest under this limitation section.

Loan to a broker or security dealer shall not be more than 10 per cent of bank's capital and surplus.

All affiliates of a National bank in the aggregate may not borrow more than 10 per cent of bank's capital and surplus; loans collateraled by U. S. Government and municipal bonds, however, are excepted from this limitation.

Within two years, every affiliate must be separately capitalized through sale of its stock and the parent bank may make no contribution by stock dividend or otherwise.

COMMENT

This section may possibly prohibit the formation of a holding company through exchange of stock for National bank stock. It also appears to prohibit a National bank from establishing an affiliate, as the National City Company for instance was established, by declaration of a stock dividend. It is not clear what if any retroactive effect is intended as to holding company affiliates already so created but permitted under Section 24 to continue. Such question would relate to the Northwest Bancorporation, for example, whose capital was provided through exchange of stock rather than sale of stock for cash.

SECTION 26.

(Sec. 30 of original Bill).

Limitations on collateral loans to single borrowers.

No member bank shall lend to any individual or corporation "upon collateral security" an amount exceeding 10 per cent of its own capital and surplus, or an amount exceeding the percentage fixed by the Federal Reserve Board, whichever is the smaller.

COMMENTS:

This would apply to all loans on "collateral security" regardless of the nature of the security, and would nullify the provisions of Section 5200 of the Revised Statutes permitting national banks (1) to make loans in amounts not exceeding 25% of their capital and surplus on the security of shipping documents or chattel mortgages on live stock or on the security of Government bonds, and (2) to make loans not exceeding 50% of their capital and surplus on the security of shipping documents, warehouse receipts or other such documents covering readily marketable non perishable staples.

It would greatly curtail the amount of credit which banks in agricultural communities could extend to farmers, cattle men and dealers in cotton, grain and other agricultural commodities.

It would discriminate against secured loans and in favor of unsecured loans and would lead to more unsound, instead of sounder, banking practices.

SECTION 30

We suggest omission of this section.

It would exclude from the benefits of Section 5200 any loans on collateral. Without a more specific definition of the word "collateral" this would operate against the interest of many agricultural communities. If the section is changed so as to apply only to loans on stocks and bonds, there seems to be no objection to it, but it then becomes unnecessary.

SECTION 27.

(Sec. 31 of original bill) .

Condition reports of affiliates of national banks.

Each affiliate of a national bank shall furnish to the president of the bank for transmission to the Comptroller of the Currency not less than three reports each year in such form as the Comptroller may prescribe, verified by the oath or affirmation of the president or other such officer of the affiliate as may be designated by the board of directors, covering the condition of such affiliate on dates identical with those for which the Comptroller shall require the reports of condition of national banks.

Each such report shall show in detail "the holdings of the affiliate in question", their cost and present value, the expenses of operation for the preceding year, and the balance sheet of the enterprise.

The president of the national bank shall satisfy himself as to the correctness of such reports before transmitting them to the Comptroller.

The reports of such affiliate shall be published under the same conditions as reports of national banks.

The Comptroller may also call for special reports of affiliates.

Any affiliate failing to make such reports and any national bank whose president fails to transmit them to the Comptroller shall be subject to a penalty of $100 per day.

Every affiliate which is indebted "to any bank or banks" in an amount exceeding 5% of the capital and surplus of "its parent bank" shall "publish its entire portfolio" at a date and in a manner pre-

scribed by the Comptroller of the Currency but not oftener than once each year.

Every affiliate which is indebted "to any bank or banks" in an amount exceeding 10% of the capital and surplus "of its parent bank" shall be required "to publish its portfolio" in at least one daily newspaper issued in the place where such bank is located within 10 days after receiving notice therefor from the Comptroller, but such publication shall not take the place of the annual publication required by the preceding provision.

COMMENTS:

This is similar to the provisions of Section 6 regarding affiliates of State member banks.

The provision requiring an affiliate to publish "its entire portfolio", when indebted to a national bank in excess of 5% of the bank's capital and surplus seems unnecessarily severe. It is not clear just what would be included in a publication of the entire portfolio; but, if it would include the names of all borrowers from the affiliate, it would be extremely objectionable.

SECTION 31

In place of this provision as it stands we suggest the following substitute:

"Section 5211 of the Revised Statutes of the United States, as amended, is further amended, by adding at the end thereof the following new paragraph:

'Each national bank shall obtain and furnish to the Comptroller of the Currency such reports of the condition of any or all of its subsidiary affiliates as the Comptroller of the Currency, in his discretion, may require. Such reports shall be in form as the Comptroller of the Currency may prescribe, shall be verified by the oath or affirmation of the president or such other officer as may be designated by

the board of directors of the affiliate to verify such reports, and shall cover the condition of the affiliate on dates fixed by the Comptroller of the Currency. Each such report shall be transmitted to the Comptroller of the Currency at the time required by the Comptroller of the Currency, and shall exhibit in detail and under appropriate heads all assets of the affiliate in question, their cost and present value, all liabilities of such affiliate, its earnings and expenses, and such other information as the Comptroller of the Currency may require.'"

SECTION 28.

(Sec. 32 of original Bill)

Examinations of Affiliates.

"During the period of three years after this section as amended takes effect", the examiner making an examination of any national bank or of any State member bank shall also examine the affairs of all affiliates of such banks.

In the event of the refusal to give any information required in the course of the examination of any such affiliate or to permit such examination; if a national bank, all of its rights, privileges and franchises "shall be thereby forfeited"; or, if a State member bank, the membership of such bank in the Federal Reserve System "shall be forfeited and no notice of the termination of such membership shall be required."

After 90 days' notice, the Comptroller of the Currency may publish the report of his examination of any national bank or of any affiliate, which shall not have complied with his recommendations or suggestions to his satisfaction within 120 days after notice to do so.

COMMENTS:

Since Section 9 of the Federal Reserve Act exempts State member banks from examinations by the Comptroller of the Currency, it is doubtful whether this would apply to their affiliate.

It is believed that affiliates of national banks and member banks should be examined, in order that the supervisory authorities might be fully informed as to all the matters affecting the solvency and management of such banks; but there would seem to be no reason for limiting the requirement of such examinations to three years.

The mandatory (and apparently automatic) forfeiture of the charter of a national bank or of the membership of a State bank whose affiliate refuses to permit such an examination or to furnish information required by the examiner, however, seems to be a very harsh and unreasonable means of enforcing this provision. It might result in hardships to innocent depositors, who are not responsible for such refusal.

It is believed that such a drastic remedy should at least be made discretionary with the Board or the Comptroller, and also that notice and hearing of any such action should be required in all cases. It is not clear whether the forfeiture of the charter of a national bank under this section would have to be effected through a proper court proceeding, but such a procedure is believed desirable and it should be made clear that this is required.

The publication of reports of examination might be disastrous not only to the banks and their affiliates, but also to persons who have borrowed from such banks and such affiliates. It is fortunate that this is not mandatory but is left to the discretion of the Comptroller of the Currency.

Some means of compelling banks to comply with the recommendations and suggestions of the Comptroller of the Currency without appointing a receiver for them or closing them is badly needed; but it would seem that the publication of their examination reports would not be the appropriate remedy. That would be such a drastic and dangerous remedy, and one so unjust to borrowers, that the Comptroller never would resort to it.

SECTION 32

In place of this provision as it stands, we suggest the following substitution:

"Section 5240 of the United States Revised Statutes, as amended, is further amended by adding at the end thereof a new paragraph reading as follows:

'Examiners appointed under the provisions of the first paragraph of this section may examine any subsidiary affiliate of a national bank, when directed to do so by the Comptroller of the Currency. The examiner making the examination of any subsidiary affiliate of a national bank shall have power to make a thorough examination of all the affairs of the affiliate, and in doing so

SECTION 32 Continued

he shall have power to administer oaths and to examine any of the officers and agents thereof under oath and shall make a full and detailed report of the condition of the affiliate to the Comptroller of the Currency. The expense of examinations provided for in this paragraph shall be assessed by the Comptroller of the Currency upon the affiliates examined in proportion to assets or resources held by the affiliates upon the dates of examination of the various affiliates. If the officers, directors, or stockholders of any affiliate of a national bank shall refuse to permit an examiner to make an examination of the affiliate which the Comptroller of the Currency has directed to be made, refuse to give any information required in the course of any such examination, or refuse to pay the expense of any such examination, the national bank with which it is affiliated shall be subject to a penalty of not more than $1,000 for each day that any such refusal shall continue. Such penalty may be assessed by the Comptroller of the Currency, in his discretion and, when assessed, may be collected by the Comptroller of the Currency by suit or otherwise. All sums of money collected for penalties under this paragraph shall be paid into the Treasury of the United States.'"

SECTION 29.

(Entirely new)

Removal of Bank Directors or Officers from Office.

Whenever, in the opinion of the Comptroller of the Currency, a director or officer of a national bank, or of a bank or trust company doing business in the District of Columbia, has persistently violated any law relating to such bank or trust company, or has continued unsafe or unsound practices in conducting the business of the institution, the Comptroller shall certify the facts to the Governor of the Federal Reserve Board.

Likewise, whenever in the opinion of a Federal Reserve Agent, a director or officer of a State member bank of his district has persistently violated such a law or has continued such practices, the Agent shall certify the facts to the Governor of the Federal Reserve Board.

The Governor of the Federal Reserve Board is required thereupon to serve notice upon such director or officer to appear before a Committee consisting of the Governor, the Comptroller of the Currency and the Federal Reserve Agent, to show cause why he should not be removed from office; and, if upon such hearing the Committee finds that such director or officer has persistently violated the law or has been responsible for the continuance of such unsafe or unsound practices, it may order his removal from office.

A copy of the order is to be served upon the director or officer and upon the bank with which he is connected.

After the service of such an order upon a director or officer, participation by him in any manner in the management of the bank is punishable by a fine of $5,000, or imprisonment of not more than five years, or both.

COMMENTS:

These provisions are in accord with a recommendation of the Comptroller of the Currency and are believed to be desirable.

Removal of Bank Officers and Directors

Recent experience has demonstrated that many bank failures and evils that have developed in the banking situation in general have been due not to the inadequacy of existing regulatory legislation, but to incompetency or willful mismanagement on the part of bank officers and directors. The only power possessed by the Comptroller of the Currency in such cases is the forfeiture of a national bank's charter, and the only power possessed by the Federal reserve system in relation to State member banks is their exclusion from membership. The use of either of these powers must result in the closing of a bank, while the object should be to keep the bank from closing. For these reasons, we suggest the addition of a section which provides for the possible removal of officers or directors of member banks by a procedure which we believe to be adequate to protect their rights and at the same time to accomplish the desired purpose. It is probable that actual removal would seldom be necessary, but the threat of removal would be an important aid in correcting mismanagement.

Section _____. Whenever, in the opinion of the Comptroller of the Currency, any officer or director of a national banking association, or of a bank or trust company doing business in the District of Columbia, shall have persistently violated any law relating to such bank or trust company or shall continue unsafe and unsound practices in conducting the business of such bank or trust company, the Comptroller of the Currency may certify the facts to the Governor of the Federal Reserve Board and the Federal reserve agent of the district in which such bank or trust company is located. Whenever in the opinion of a Federal reserve agent any officer or director of any State bank or trust company in his district which is a member of the Federal reserve system shall have persistently violated any law relating to such bank or trust company or shall continue unsafe and unsound practices in conducting the business of such bank or trust company, such Federal reserve agent may certify the facts to the Governor of the Federal Reserve Board and the Comptroller of the Currency. In any such case, the Governor of the Federal Reserve Board, the Comptroller of the Currency, and the Federal reserve agent of the district in which such bank or trust company is located, together may serve notice upon such officer or director to appear before them and show cause why he should not be removed from his office or position. If, after granting to such officer or director a hearing or an opportunity to be heard, the Governor of the Federal Reserve Board, the Comptroller of the Currency, and the Federal reserve

ADDITIONAL NEW SECTIONS

Malicious Rumors

In view of the frequent instances in recent months where banks have been subjected to heavy pressure due to the spreading of malicious rumors, it would appear to be desirable to have a statute of the United States making the spreading of such malicious rumors about banks a penal offense, and we suggest the addition of the following section:

"Section _____. Whoever maliciously or wantonly makes, publishes, utters, or repeats to, or in the hearing of, or under such circumstances that it becomes known to, any other person, any false or misleading statement which is directly or by inference derogatory to the financial condition or affects the solvency or financial standing of any national bank, any State member bank of the Federal reserve system, or any bank, trust company, or building and loan association in the District of Columbia, or any other bank, banking association, trust company, savings bank or other banking institution organized or operating under the laws of the United States, or which tends to cause a general withdrawal of deposits from any such institution, shall, upon conviction thereof, be fined not more than $5,000, or imprisoned not more than five years, or both."

agent shall find that, in their judgment, such officer or director has violated any provision of law relating to such bank or trust company or that he has been responsible for unsafe and unsound practices in conducting the business of such bank or trust company, they may, in their discretion, by unanimous vote, order that he be removed from his office or position. Such finding and order shall be signed by the Comptroller of the Currency, the Governor of the Federal Reserve Board, and the Federal reserve agent, and they shall cause copies thereof to be served upon such officer or director and upon such bank or trust company, whereupon such director or officer shall cease to be an officer or director of such national banking association or bank or trust company.

The findings made under Section 1 hereof shall not be made public, except to the officer or director involved and the directors of the bank or trust company involved and such finding shall not be produced in any court of law except as evidence to punish violations under Section 3 of this act.

Any officer or director who ceases to be a director or officer under the provisions of this act shall not further engage in any manner in the management of such bank or trust company of which he was a director or officer, and any violation of this section shall be punishable by a fine of $5,000, or five years' imprisonment, or both, in the discretion of the court.

ADDITIONAL NEW SECTIONS

Borrowing by bank officers and employees

Borrowing by officers and employees of banks has in some cases caused serious complications and difficulties. It would seem to us proper that persons connected with banks should not borrow money from brokers or dealers in securities and should not borrow either from their own bank or from another bank without approval of a properly constituted committee. This would not prevent legitimate borrowing, but would act as a check on speculative borrowing by bankers and their employees.

Section ____. Section 22 of the Federal Reserve Act, as amended, is amended by adding the following paragraph after paragraph (e) and renumbering paragraph (f) as paragraph (g).

"(f) No Federal reserve agent nor any of his assistants or employees and no officer or employee of any Federal reserve bank or of any member bank shall hereafter borrow money from, or otherwise become indebted to, any broker or dealer in stocks, bonds, or other investment securities. No Federal reserve agent nor any of his assistants or employees and no officer or employee of any Federal reserve bank or of any member bank shall hereafter borrow from any bank or banker upon collateral consisting of stocks, bonds, or other investment securities, or upon an unsecured note, without the written consent of a committee consisting

SECTION_____ Continued

of not less than three of the directors of the bank of which he is an officer or employee. Such committee shall be appointed at a regular meeting of the directors of such bank; and not more than one of its members shall be an officer of the bank. It shall be the duty of such committee to require written financial statements of all officers and employees of such bank desiring to borrow upon the security of stocks, bonds, or other investment securities, or upon an unsecured note and to determine whether such borrowing is contrary to the interests of such bank; and such committee shall maintain records of its proceedings which, together with the financial statements of such officers and employees, shall be open to inspection by authorized examiners examining such banks.

"No member bank shall hereafter make any loan or advance on the security of stocks, bonds, or other investment securities, or upon an unsecured note to any Federal reserve agent nor to any of his assistants or employees or to any officer or employee of any Federal reserve bank or of any member bank without the written consent of a committee of directors of the bank of which the person obtaining such advance is an officer or employee, appointed in accordance with the provisions of this subsection."

Branches of state member banks

In our earlier report we recommended extension of the branch banking privilege of national banks, but by inadvertence did not provide for a similar extension for state member banks. The following section corrects this omission by placing state member banks on an equality with national banks in so far as the state laws will permit.

Section_____. The second paragraph of Section 9 of the Federal Reserve Act, as amended, is amended and reenacted to read as follows:

"No bank admitted to membership pursuant to the provisions of this section shall establish any branch beyond the corporate limits of the city, town, or village in which its head office is located unless it has a paid-up and unimpaired capital of not less than $1,000,000 and first obtains the permission of the Federal Reserve Board: Provided, however, That no such bank shall be permitted to establish any branch beyond the territorial limits within which national banks are permitted by law to establish branches at the time. The term 'branch', as used in this section, shall be held to include any branch, branch office, branch agency, additional office, or any branch place of business at which deposits are received, or checks paid, or money lent."