The Papers of Eugene Meyer (mss52019)

118_03_001-	Subject File, Federal Reserve Board, Glass Bill (S. 4115), Comments and Recommendations, 1932

EUGENE MEYER

SUBJECT FILE

FEDERAL RESERVE BOARD
GLASS BILL S. 4115 1932
COMMENTS + RECOMMEDATIONS

Feb 1932

The Federal Advisory Council has given careful consideration to Senate Bill 4115. It is of the opinion that the present is an inopportune time to raise many of the issues presented in this proposed legislative measure. Reforms in our banking system may be desirable, but such should be made at a time when the country has passed through the present crisis and when there is no danger that legislative enactments will retard recovery and add to the existing difficulties with which banks are confronted.

The Council feels that the effect of this proposed measure is likely to destroy the benefits of the Glass-Steagall Act, the Reconstruction Finance Corporation Act and similar measures. If the bill should be enacted into law it would necessitate a wholesale liquidation of securities which would most certainly cause a further decline in the prices of all securities. Such deflation would work extreme hardship not merely upon banks but upon all holders of securities in this country and especially upon those who have borrowed from banks and who are finding difficulties even at present in meeting their obligations.

It must also be pointed out that in the opinion of the Council, the thesis apparently underlying this measure that loans upon securities are in general undesirable and should be drastically limited would undermine the customary system of capital financing which has been an inherent part of the present industrial and financial system almost from its beginning. Without the flotation of securities which have been financed

directly or indirectly by banks, it would have been impossible to build up the large enterprises which have contributed so much to the progress of industrial development in this country.

In addition to the above general expression of opinion, the Federal Advisory Council desires to point out, in some detail, its specific objections to certain features of the bill.

1. Control of Affiliates. The Federal Advisory Council is in accord with the purpose sought to be achieved in Section 20 and believes that a control of affiliates is desirable.

The definition of affiliates in Section 2, however, is much too broad and comprehensive. It brings within the provisions of the Act any corporation regardless of its business which may happen to have a majority of its Executive Committee, directors or managing officers, directors of a member bank.

Section 9 limits the sum which a parent member bank may lend to an affiliate to 10% of the capital and surplus of the parent bank and such loans must be secured by 120% of listed exchange securities or 100% of either eligible paper or savings banks' securities, neither of which would be for the most part in the possession of an affiliate, unless it happened to be a bank. Furthermore, this provision would seem to bar the acceptance of real estate mortgages as collateral from an affiliate upon the part of those banks located in states where there are no laws regulating the investments of savings banks. Likewise, commodity or livestock paper, unless its maturity is such as to make it eligible, could not be used as collateral for a loan made to an affiliate.

The Federal Advisory Council also believes that the provision in Section 25, Page 49, Paragraph 2, which refers to the sale for cash of the stock of an affiliate within a three year period is not at all clear. If this means that the stock of the affiliate held by the parent institution must be sold for cash away from the bank, in other words divorcing the affiliate from control by the bank, it will create a distinct hardship, as there are large numbers of such affiliates in existence today whose compulsory liquidation would cause serious financial losses. Apparently this section is in conflict with some of the provisions of Section 20.

2. Centralization of Power. It was the original intention of the Federal Reserve Act to decentralize the banking power in this country by establishing twelve autonomous regional Federal reserve banks. The Federal Reserve Board itself was planned originally to be largely a supervising and coordinating body. The proposed Act, however, tends to increase radically the power of the Federal Reserve Board at the expense of the individual Federal reserve banks and to make of the Federal Reserve System in effect a centralized banking institution. In support of this statement attention is called to the following sections.

Section 3 delegates the power of direct action to the Federal Reserve Board which even if practical would result in so embarrassing the operations of member banks as to lead to the elimination of important and necessary activities or to the virtual surrender of individual bank management to the Federal Reserve Board.

Section 8 gives power to the Federal Reserve Board to fix the percentage of the capital and surplus which any member bank may lend in the form of collateral loans, and it is within the power of the Federal Reserve Board to change this percentage at any time upon ten days' notice and to direct any member bank to refrain from an increase of its security loans for any period up to one year. This would be a tremendous increase in the powers of the Federal Reserve Board and would introduce an element of uncertainty in the minds of those directing any given member bank as to when the bank in question might be subjected to the direct action authorized in this section.

The power of control by the Federal Reserve Board over the actions of the Federal Open Market Committee, as authorized in Section 10, might

possibly tend to slow up open market operations at times when quickness of action might be absolutely essential in order to bring about desired results.

In Section 11 the Federal Reserve Board is empowered to cancel the right of any member bank to borrow on so-called fifteen day paper and to declare existing loans due if such a member bank has failed to heed a notice instructing it not to increase loans on collateral security. It would appear to the Federal Advisory Council that this endows the Federal Reserve Board with an arbitrary power which is highly undesirable entirely aside from other features in this section to which reference will be made hereafter.

The Federal Advisory Council believes that subdivisions F and G of Section 13 give power to the Federal Reserve Board to regulate what is a purely routine loan operation of a member bank. The ability of member banks to trade in Federal reserve funds tends to maintain a greater degree of liquidity in the general banking situation than would otherwise be the case. In this connection attention is called to the ever increasing restrictions upon, and to the diminishing scope of, loaning operations of banks. This results in increasing unnecessary balances on the part of member banks and makes it more difficult for them to employ funds profitably.

3. Liquidating Corporation. In general the Council endorses the idea of a liquidating corporation. It is, however, not in harmony with the provisions as set forth under Section 10 (Section 12B) of the proposed Act. The Council is of the opinion that such a corporation as is proposed should be financed entirely by Government money as is intended to be done in the case of nonmember banks. Furthermore, the Council believes

that it might be well to consider the possibility of creating twelve agencies, one in each of the Federal reserve districts, rather than seeking to create a single body for the whole country. Such twelve agencies might then be placed under the control and guidance of the Federal Reserve Board or some other coordinating group. In no event does the Council believe it proper to require member banks to furnish the funds needed for such a corporation without at the same time giving the member banks control of such a corporation for which they are to furnish the capital from out of their own resources. The Council furthermore, suggests the possibility of having the activities of a Federal Liquidating Corporation taken over by the Reconstruction Finance Corporation.

4. Increase of Reserves. The Federal Advisory Council presumes that the requirement of larger reserves as set forth in Section 13 of the proposed Act is intended to provide for greater liquidity on the part of banks. The Council believes, however, that the experience of the past ten years has clearly indicated that there is little or no relation between reserves and liquidity. In the opinion of the Council liquidity is the result of careful and prudent bank management and is measured by the character of the assets held by the bank. Furthermore, the imposition of additional reserves will reduce available resources in the member banks at a time when these are largely needed, while at the same time they will bring no advantage to the System, the resources of which have been and are ample to take care of changing financial situations. The effect of this requirement would also be to tie up an additional volume of gold as a reserve against increased member bank deposits in the Federal reserve banks without any apparent justification.

5. Segregation of Time Deposits. The Federal Advisory Council regards the provisions in Section 14 of the proposed Act, intended to segregate the assets behind time deposits from those against other deposits, as likely to lead to undesirable results. In the opinion of the Council this provision will lead either to the withdrawal of demand deposits or the diversion of demand deposits into time deposits. It believes that the increase of investment in real estate foreseen in this section will tend to reduce the liquidity of banks. There is also imposed upon the Comptroller of the Currency a duty which burdens him with tremendous responsibility insofar as he is required to specify the type of property and the securities in which one-half of the time deposits of the member bank may be invested in the absence of state laws governing the investment of such funds. It has been the experience of a number of members of the Council that the absence of restriction in respect to the investment of time deposits has produced a greater degree of liquidity in banks than can be possibly accomplished under the permissions granted in this section.

The Council feels that the views here set forth in regard to Section 14 might be much amplified. In its opinion the most important effect of this section would be to bring about a disruption of the present credit structure of the country. Many banks in this country having a large percentage of time deposits use these funds for the purpose of aiding commerce, industry and agriculture in their respective communities. These would be compelled under the provisions of Section 14 to liquidate a large proportion of these loans and invest the funds so obtained in real estate or specified securities.

6. Fifteen Day Paper. Section 11 penalizes borrowers on so-called fifteen day paper. In the opinion of the Federal Advisory Council such a provision would make Government bonds a much less desirable form of investment for member banks. It would handicap the United States Treasury in its necessary financing, increasing the rate on Government securities and thereby the interest rate on all other classes of securities and thus depreciate the market price of securities generally. It should also be pointed out that the ability of member banks to borrow on their promissory notes for a period of not exceeding fifteen days is essential in periods of depression when sufficient eligible paper is not available for rediscount.

7. Limitation of Interest on Deposits. The limitation of interest which member banks may pay upon deposit balances provided for in Section 24 of the proposed Act, places such banks in unfair competition with nonmember banks not so restricted. It should be remembered that money is a commodity like any other and that member banks should be free to pay the rates necessary to hold their deposits.

8. Branch and Group Banking. In reference to Section 21 and other sections of the proposed Act referring to branch or group banking, the Council begs leave to refer to the recommendations which it made on September 15, 1931, a copy of which is appended hereto.

9. Collateral Loans and Securities. In the general statement the Federal Advisory Council has already expressed its views regarding the desire to limit collateral loans. It wishes here, however, to discuss somewhat more in detail the provisions in Sections 8, 11, 13, 15, etc., all of which deal in whole or in part with the control of the

volume of collateral loans and the volume of securities held by member banks. These sections give arbitrary powers of control and the right to impose penalties to the Federal Reserve Board. These sections deal with control of volume of collateral loans and volume of securities held by member banks and place arbitrary powers of control and penalties in the Federal Reserve Board. The enforcement of the mandatory provisions of these sections will result in the enforced liquidation and to the detriment of general business. The Council believes that such liquidation will retard if it does not entirely defeat the beneficent effects that may be expected to be realized as a result of the Glass-Steagall bill and the Reconstruction Finance Corporation Act. The Council does not share the view of the proponents of the bill that the underlying cause of either bank disasters or depression is directly related to the volume of collateral loans or the volume of securities held by banks. These did not, and do not now, impair the ability of member banks properly to care for those types of loans the proceeds of which go more directly into commerce, industry and agriculture.

In conclusion the Council calls attention to the fact that the bill, if enacted into law, would in effect place an undeserved stigma upon the flotation and selling of securities and make it almost impossible for banks to do business with dealers in securities. There would seem to be no justification whatsoever for such drastic action.

Finally, the Council believes that it is not possible to promote activity in commerce, industry and agriculture under an easy money and credit policy and at the same time prevent people by admonition or restriction from buying securities which are being made attractive by this very activity.

FEDERAL ADVISORY COUNCIL

X-7094

1932

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Address of Mr. Lichtenstein, 38 South Dearborn Street, Chicago, Illinois.

February 16, 1932.

COPY X-7091

FEDERAL ADVISORY COUNCIL

Washington, February 15, 1932.

Mr. Eugene Meyer, Governor,
Federal Reserve Board,
Washington, D. C.

Dear Governor Meyer:

Enclosed please find the recommendations of the Federal Advisory Council in reference to bill S. 3616, as reported to the Senate, with amendments, by Mr. Glass on February 12, 1932. These recommendations were adopted unanimously by the eleven members of the Council present.

In view of the existing situation, we request that you submit these recommendations to the proper committees of the Congress for their consideration.

Very truly yours,

(signed) Walter W. Smith
President.

(signed) Walter Lichtenstein
Secretary.

COPY X-7091-a

The Federal Advisory Council has studied bill S. 3616 as reported by Mr. Glass, with amendments, to the Senate on February 12, 1932. The Federal Advisory Council approves of the aims designed to be accomplished by this measure, but it urges the following changes:

(1) Wherever in the proposed act it is specified that an affirmative vote of "not less than six members of the Federal Reserve Board" be required to permit any given action, substitute "not less than a majority of the members of the Federal Reserve Board holding office at the time, such majority in no case to consist of less than four members".

(2) In section 1 on page 2 in line 1, in place of the requirement that groups shall consist of five or more banks, substitute three or more banks, and in lines 10 to 14 inclusive, omit the phrase permitting loans to groups containing a lesser number of banks and omit the requirement as to the aggregate amount of their deposit liabilities.

(3) In section 1 on page 2, omit the language of the committee amendment beginning on line 3 and running to the period in line 6, reading as follows: "provided such banks have no adequate amounts of eligible and acceptable assets to obtain sufficient accommodation through rediscounting at the Federal reserve bank".

Confidential

FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

X-7122

March 26, 1932.

Honorable Peter Norbeck, Chairman,
Committee on Banking and Currency,
United States Senate,
Washington, D. C.

My dear Senator:

On March 17, 1932, I received a letter from Senator Glass inclosing copies of his Senate Bill 4115, and stating that the Banking and Currency Committee would be glad to have the Federal Reserve Board make any comments or suggestions that in its judgment would seem desirable. Accordingly, there is inclosed herewith for the consideration of your Committee a memorandum containing the Board's comments and recommendations.

The subjects dealt with in the bill may be classified under three general heads: (1) Those relating more directly to the Federal Reserve Board and the reserve banks; (2) those concerning primarily member banks, and (3) those dealing with affiliates of member banks.

The Federal Reserve Board is in sympathy with the purpose of the bill to strengthen the supervision of the Federal Reserve System over general credit conditions and with investing the Federal reserve authorities with certain disciplinary powers in relation to banks that pursue unsafe and unsound policies or abuse the privileges of membership. The Board's recommendations on this subject are incorporated in its proposed revision of Sections 3 and 29 of the bill.

Clarification of the Board's power of supervision over open market operations and over relationships with foreign banks is desirable, and the Board believes that, with such clarification of its authority, the machinery for formulating and adopting the system open market policy should be left to be developed through administrative experience. The Board is not, therefore, in favor of crystallizing into law the open market procedure which has been developed organized as a voluntary arrangement and may have to be modified on the basis of further experience.

The Board is not in sympathy with the provisions of the bill discriminating against member bank collateral notes. Experience shows that the particular instrument on which Federal reserve credit is obtained has little if any connection with the use made of the proceeds of the credit and that an attempt to control speculation through restrictions on member bank collateral notes would not be effective but would only interfere with the efficient and economical operation of the system.

On matters relating to member banks, the Board is of the opinion that the adoption of a system of reserves based on velocity of accounts as well as on their volume, as recommended by the System's Committee on Reserves, would be an important step in strengthening the influence that the Federal Reserve System could exert in the direction of sound credit conditions. The section of the bill dealing with reservesis undesirable, because it would exert a tightening influence on credit conditions at a time when it is not in the public

interest, and would accentuate rather than reduce the inequalities that have grown up in the distribution of reserves between different classes of member banks.

The Board is in favor of establishing a bank liquidating corporation, but proposes a different method of financing it and certain changes in the provisions for its administration.

On the question of branch banking it is suggested that the limitations be based on distance between the parent bank and its branches rather than on the boundary lines of States.

Complete divorce of affiliates from member banks at this time would have unfortunate consequences, and the Board believes that legislation on this subject should be confined chiefly to the granting of power to the supervisory authorities to obtain reports and to make examinations of all affiliates of member banks and to limitations on the loans that a member bank may make to its affiliates. In the Board's opinion, the proper approach to the question of affiliates is from the point of view of the effect of their operations on the welfare of member banks, and that legislation on the subject should be based on this principle.

The Board takes the view that legislation further materially restricting the character of member bank loans and investments is not desirable at a time when the country's banking system is going through a period of severe readjustment. Some of the provisions of the proposed bill would have a tendency to bring about further contraction of credit and thus retard the recovery of business. It should be recognized, furthermore, that effective

supervision of banking in this country has been largely nullified by the competition between member and nonmember banks, and that the establishment of a unified system of banking under national supervision is essential to fundamental banking reform.

Copies of this letter and the inclosed memorandum are being sent to Senator Glass, and, the Board will be glad to supply you with copies for the convenience of each member of your Committee.

In view of the unusual importance of the proposed legislation, the Board requests an opportunity to be heard before the Bill is acted upon by your Committee.

Very truly yours,

Eugene Meyer,
Governor.

Mr. Harrison

X-7131

April 14, 1932.

C.S. Hamlin.

THE GLASS BILL.

Reply to the Memorandum of Governor Harrison, and letters of February 6, and April 7, 1932.

On April 7, 1932, Governor Harrison sent to the Banking and Currency Committee of the Senate, a memorandum commenting on each section of the original Glass bill, - Senate 4115 - and on the amendments suggested by the Federal Reserve Board.

He also enclosed a copy of a letter sent by him to Senator Glass dated February 6, 1932.

In the letter of February 6, Governor Harrison stated that he would withhold detailed comments on the bill pending the report thereon of Dr. Goldenweiser and Dr. Burgess.

He did, however, discuss the provisions as to open market operations and some others, and strongly attacked the increased power given to the Federal Reserve Board, referring to it as a politically appointed body.

He stressed the necessity for autonomy in the Federal reserve banks and made three suggestions as to the amendments to the Federal Reserve Act.

These suggestions were:

1. To reduce the number of directors of each bank so as to concentrate responsibility and to encourage supervision and management <u>through the experienced directors</u>. (Italics mine).

2. A grant of power for removal of incompetent bank officers.

3. Restriction upon borrowing by bank officers except with approval of a committee of directors.

The first suggestion will be taken up later.

As to the second suggestion, it will suffice now to state that in the memorandum, Governor Harrison states that this should not be done at the present time.

II.

In the letter of April 7, 1932, accompanying the memorandum, Governor Harrison admits "certain past defects, and the need for provision for possible future abuses," but in another part of the letter states that "there do not appear to be any parts of the Glass bill for which there is an imperative need for immediate passage."

The only exceptions made to this sweeping condemnation are the Federal Liquidating Corporation and the branch banking provision; the former, he states, might be helpful and the latter he states would be helpful.

He reaffirms the position taken by the Federal Reserve Bank in 1929 that only the discount rate and open market operations can effectively regulate the price and total volume of credit.

He severely criticises the attempt of the Federal Reserve Board to control through direct action the loan or investment policies of individual banks.

He admits, however, that direct action has its uses in dealing with individual banks using more than their share of Federal reserve credit, but he asserts that it is neither an effective nor suitable method for general control of credit or the uses to which credit may be put, involving as it does an assumption of responsibility for the management of individual banks which could not be effectively fulfilled.

I shall not undertake in this connection to go over the arguments for

or against direct pressure. It will be sufficient to point out that the Federal Reserve Bank of New York, in 1929, wished to increase discount rates to prevent a runaway market which it believed was imminent; that the Board refused to increase the discount rate but kept in the 5% rate, exercising direct pressure upon the member banks to control their speculative loans, thus taking back part of the Federal reserve credit which had seeped into speculative markets; that the runaway market feared by the Federal Reserve Bank did not eventuate; that on the contrary, during the period of direct pressure, - from early in February to early in June, 1929, - the total bills and security holdings of the Federal Reserve Bank of New York steadily declined, while its reserve ratio steadily increased; that for the whole System, Federal reserve credit declined 193 millions during this period; that the large gold imports were kept by this direct pressure from swelling the member bank reserves and were used to take down acceptances, thus avoiding a tremendous further expansion of member bank credit; that member bank reserves in fact declined 68 millions during this period.

The fact is that direct pressure under the 5% rate was so successful that about the first of June, 1929, the Federal Reserve Bank informed the Federal Reserve Board that there was shortly to be expected a commercial need for expansion of Federal reserve credit; that the member banks were afraid to increase their borrowings, and that an easing policy would soon be essential.

Governor Harrison, in his letter, criticises Section 3 of the Glass bill, as amended by the Federal Reserve Board, perhaps more severely than any other Section of the bill. He absolutely opposes the grant of power in

this Section to close the discount window to banks abusing the discount privileges and to suspend such banks from further use of Federal reserve facilities.

He also objects to the duty imposed by this Section on Federal reserve banks to keep themselves informed as to the loan and investment policies of the member banks, (the imposition of which duty it may be parenthetically stated was strongly recommended by the Federal Advisory Council in February, 1931.)

He states that the powers granted and the duties imposed by this Section would be ineffective, would involve responsibilities which neither the Federal reserve bank nor the Federal Reserve Board could fulfill, and that the assumption of such powers would be harmful to the member banks and to the Federal Reserve System as a whole.

In this connection, I would point out that both Governor Harrison and Mr. Owen D. Young, who signed the memorandum stating the above objections, took a very different view of the matter in their testimony before the Sub-committee of the Senate.

On January 20, 1931, Governor Harrison suggested to the Sub-committee that power should be given to the Federal reserve banks, or the Federal Reserve Board, to suspend a member bank from any or all of the privileges of membership, during a given period, in the event that the bank has not conducted itself in the safest way for the depositors. (Testimony, p. 46).

On February 4, 1931, Mr. Owen D. Young stated to the Sub-committee that the Federal reserve bank should have the power to limit or refuse rediscount even of eligible paper, and to suspend other privileges of membership, if the banking practices of any particular bank were, in its judgment, unsound, and

therefore subjected its depositors to unreasonable risk, either as to liquidity or security, with a right of appeal on the part of the member bank in case the Federal Reserve Bank exercised its power unfairly, and that if the unsound practices were persisted in, the Federal Reserve Board, on complaint of any Federal reserve bank, might expel the bank from membership. (Testimony, p. 356).

Both Governor Harrison and Mr. Young were asked by the Chairman of the Sub-committee whether under existing law the Federal reserve banks had not the right to refuse to discount eligible paper.

Governor Harrison replied that that had always been his opinion, and that he had so advised the Federal Reserve Board when he was its Counsel, but that this right had been denied. (Testimony, pps. 47, 48.)

Mr. Young told the Sub-committee that the directors had never been able to agree that the power was clearly enough expressed to warrant such action by the Board of Directors; that he believed the power now existed but that such an extraordinary power and the obligation to execute it, should be made clear. (Testimony, p. 363).

The Glass bill, as amended, makes explicit these grants of powers, and yet the memorandum, signed by both Governor Harrison and by Mr. Young, positively objects to such power as harmful both to the member banks and to the Federal Reserve System!

It is possible that the Federal reserve bank may claim that it desired this power only over individual banks borrowing more than other banks of their class. This, however, would be tantamount to saying that if any one

bank loses its head in the way of speculative loans, they want power to correct it, but if all banks are infected with the speculative mania, they desire no power except their existing powers over the discount rates on commercial paper.

The power vested in the Federal Reserve Board by Section 3 of the Glass bill, would, of course, be exercised only on individual banks, but it is a power which could not be defeated by proof that not one but all banks are possessed by the speculative mania.

III.

Analysis of Memorandum.

The memorandum comments on each section of the bill in detail.

It opposes every section of the original bill except Section 16, relating to a larger capital for future national banks, which it states it prefers to the draft submitted by the Federal Reserve Board.

It approves in general the Federal Reserve Board's recommendations as to 22 sections of the original bill, but states that of these 22, 13 are not now necessary, and should be postponed for future consideration. Among these latter were:

Most of the recommendations as to affiliates, and especially the divorce of affiliates.

The 90-day clause for member bank collateral notes secured by eligible paper.

Supervision of holding companies.

Removal of officers and directors of member banks.

The memorandum opposes the following recommendations of the Board:

The power to suspend member banks for abuse of Federal reserve facilities.

The Board's bill covering new reserve provisions.

The separation of bank and affiliate stock.

The divorce of affiliates, "the desirability of which at any time is doubtful".

IV.

The Glass bill, with the amendments of the Federal Reserve Board, is designed to give some assurance to depositors and the public that the speculative excesses culminating in the crash of 1929 will not be repeated.

The speculative craze which swept over the country will take its place in history along with the tulip mania and the South Sea bubble.

The crash of 1929 was probably one of the worst in the world's history.

It represented a successful raid of the speculating public upon the banks of the country.

The banks were unable to stem this raid. On the contrary, they permitted it to increase by undue and excessive loans to their customers.

The final crash brought ruin to thousands and thousands of our people and was felt over the whole world.

The Glass bill offers a remedy by giving the Federal Reserve Board the right and duty to protect the public interest against any such future mania of speculation.

The Federal Reserve Bank of New York admits past defects and the need for some provision for future possible abuses. It suggests, as

stated before, that the directors of each bank be reduced in numbers "so as to concentrate the responsibility and to encourage supervision and management through the experienced directors".

"Through the experienced directors"! To what directors does this refer?

At first blush it would seem to refer to the Federal reserve bank directors. Such a change, however, would disrupt the Federal Reserve System by removing all directors representing the public interest, as distinct from the member banks.

I assume, however, that the reference is to the directors of the member banks.

Coupled with this recommendation is a recommendation limiting borrowings by bank officers, and also giving power of removal of incompetent bank officers.

The memorandum, however, states that the latter suggestion should not be considered at the present time and, presumably, the same suggestion would apply to the other recommendations.

V.

To sum up:-

The Federal reserve bank admits abuses in the past, and admits the necessity for provision against possible future abuses, but it opposes the present bill, and in effect takes the position that practically no legislation is imperatively demanded at the present time.

The correspondence contains the statement that the business in the United States is more dependent upon the securities market (called in the correspondence the "capital market") than upon the banks, and that business recovery is dependent upon the proper functioning of the capital market. There may be an element of truth in this statement as regards what is popularly known as "Big Business", but it is certainly not true as to that large volume of business which is absolutely dependent upon short term credit extended by banks under the auspices of the Federal Reserve System.

It should not be forgotten that it was the secession of "Big Business" from the banks, and the issue of their own securities on specially favorable terms beginning in 1927, and later their action in pouring the funds thus obtained into the maelstrom of speculation, that was a major cause in the final collapse of 1929. Yet the attempt of the Glass bill to prevent a recurrence of these practices, is condemned as being injurious to the capital market, upon the prosperity of which the revival of business activity is stated to depend.

The conclusion irresistibly to be drawn from the correspondence and memorandum is that the need for changes in the Federal Reserve System must yield and give precedence to the needs of the capital market, and that any changes in the Federal Reserve System which might affect the capital market would be most unfortunate.

The Glass bill as amended by the Board by placing restraint upon future mad speculation, will ultimately place the securities market upon a much sounder foundation than exists today, and the argument that

legislation bringing about this ultimate result should be postponed, seems to be not sound. It is a customary objection to all remedial legislation that it should be postponed, and the time will never come when all will agree that the task should be then undertaken.

The Federal Reserve Bank, as before stated, denies that there is a necessity for legislation on any subject in the Glass bill, except possibly the Liquidating Corporation and branch banks. It takes the position squarely that when legislation is enacted, it should give the Federal reserve banks more complete autonomy, free from all but very general supervision by the Federal Reserve Board, but it makes clear that if given this autonomy, it will use it in meeting another speculative mania solely by the exercise of the discount rate and open market operations, and that too even though all of the member banks are feeding the fire of unbridled speculation by undue and excessive loans to their customers on stock exchange collateral.

I venture to express the view that the public demands something more than this, and that if such a wave of speculation should sweep over the country again, it will find the Federal Reserve Board charged with such power that its future warnings in the public interest will be received with respect and carried out with promptness.

Hearing Changes

Comments and Recommendations Regarding

Senate Bill 4115,

72nd Congress, First Session.

(All references are to sections, pages and lines of S. 4115 in the form in which it was introduced on March 14 (calendar day, March 17), 1932.)

Washington, D. C.

March , 1932.

SECTION 2

This section defines affiliates and upon its the scope of this definition depends in a large measure the scope and effect of all provisions of the bill relating to affiliates.

While the definition contained in the bill mentions certain specific types of institutions which are frequently affiliated with member banks, the words "or a corporation" in line 4 on page 2 make it applicable to corporations of any character which are affiliated with member banks in any of the ways described in the succeeding paragraphs of the definition

It is believed that the most satisfactory solution of this problem is to make the definition very broad but, in dealing with affiliates, to observe the following principles: (1) To require them to make reports and to submit to examination at the discretion of the Board or the Comptroller; (2) to limit the loans that can be extended to an affiliate by a member bank; and (3) to prohibit the tying up of capital stock of an affiliate with the capital stock of a member bank. In favoring these limitations, the Board has in mind that it may not be desirable to abolish all the existing relationships between member banks and their affiliates, but that it is desirable to protect the operations of the member banks from being unduly influenced by their affiliates. Recent experience has demonstrated that operations of the affiliates at times have unfavorable effects on the condition of member banks.

SECTION 2 Continued Page 2

With these principles in mind, it is recommended that the definition of affiliates be broadened by eliminating from paragraph (b) in lines 1 to 4, page 2, all references to specific types of corporations, and by inserting other words which would make the definition applicable not only to corporations but to business trusts, associations or other similar organizations, regardless of the type of business in which they are engaged. Certain other changes in the phraseology of the definition are also suggested for the purpose of clarifying them. The changes suggested are as follows:

1. On page 2, change lines 1 to 4, inclusive, to read as follows:

"(b) The term 'affiliate' includes any corporation, business trust, association or other similar organization --"

2. In lines 9, 11 and 22 on page 2, strike out the words "managing officers" and substitute in lieu thereof the words "persons exercising similar functions".

3. In lines 9 and 18 on page 2, and in line 3 on page 3, strike out the words "annual meeting" and substitute in lieu thereof the word "election".

SECTION 3 (See substitute pages for this section)

The Federal Reserve Board understands that the principles underlying Section 3 of the bill are (1) That discounting at the Federal reserve banks is a privilege and not a right; (2) that the Federal reserve system has the responsibility of keeping itself informed about the use of bank credit; (3) that the power of Federal reserve banks to withhold credit accommodations should be used to discourage unsound banking practices and (4) that the Federal Reserve Board should have power to suspend a member bank from the use of Federal reserve credit facilities. The Board is in sympathy with these principles.

For the purpose of accomplishing these objectives, the Federal Reserve Board suggests a substitute for Section 3, which will take the place of Paragraph 8 of Section 4 of the Federal Reserve Act. In this substitute the words "shall make advancements" is changed to "may make advancements", and the rest of the language is made somewhat more general than in the bill, for the purpose of avoiding the implication that a Federal reserve bank can tell specifically what use is being made of funds obtained from the bank on a given piece of paper. Member banks as a rule do not borrow to relend, but to make up deficiencies in reserves arising from withdrawals of deposits or from other causes. It is, therefore, usually impossible to say that a loan to a member bank is granted for this or that specific purpose. It is, however, possible to determine whether the loan and investment policies of a bank are inconsistent with the purposes of the Federal Reserve Act, and, if so, to refuse accommodation to such bank or in aggravated cases to suspend it from the privilege of using the system's credit facilities altogether.

SECTION 3 Continued Page 2

It is recommended that Section 3 of the bill be changed to read as follows:

"Sec. 3. The paragraph of Section 4 of the Federal Reserve Act, as amended, which begins with the words, 'Said board shall administer the affairs of said bank fairly and impartially', is amended and re-enacted to read as follows:

'Said board of directors shall administer the affairs of said bank fairly and impartially and without discrimination in favor of or against any member bank or banks and may, subject to the provisions of law and the orders of the Federal Reserve Board, extend to each member bank such discounts, advancements and accommodations as may be safely and reasonably made with due regard for the claims and demands of other member banks, the maintenance of sound credit conditions and the accommodation of commerce, industry and agriculture. The Federal Reserve Board may prescribe regulations further defining within the limitations of this act the conditions under which discounts, advancements and accommodations may be extended to member banks. Each Federal reserve bank shall keep itself informed of the general character and amount of the loans and investments of its member banks with a view to ascertaining whether undue use is being made of bank credit for the speculative carrying of or trading in securities, real estate or commodities, or for any other purpose inconsistent with the maintenance of sound credit conditions; and, in determining whether to grant or refuse ~~in passing upon~~ applications for advances, rediscounts or other credit accommodations, the Federal reserve bank shall give consideration to such information. Whenever, in the judgment of the Federal Reserve

SECTION 3 Continued Page 3.

Board, any member bank is making such undue use of bank credit, the Board may, in its discretion, after reasonable notice and an opportunity for a hearing, suspend such bank from the use of the credit facilities of the Federal Reserve System and may terminate such suspension or may renew it from time to time.'"

SECTION 3

The Federal Reserve Board understands that the principles underlying Section 3 of the bill are (1) that discounting at the Federal reserve banks is a privilege and not a right; (2) that the Federal reserve system has the responsibility of keeping itself informed about the use of bank credit; (3) that the power of Federal reserve banks to withhold credit accommodations should be used to discourage unsound banking practices; and (4) that the Federal Reserve Board should have power to suspend a member bank from the use of Federal reserve credit facilities. The Board is in sympathy with these principles.

For the purpose of accomplishing these objectives, a substitute for Section 3 is suggested. This substitute includes a revision of the paragraph of section 4 of the Federal Reserve Act which now reads as follows:

> "Said board shall administer the affairs of said bank fairly and impartially and without discrimination in favor of or against any member bank or banks and shall, subject to the provisions of law and the orders of the Federal Reserve Board, extend to each member bank such discounts, advancements and accommodations as may be safely and reasonably made with due regard for the claims and demands of other member banks."

In this revision the word "may" is substituted for "shall" and the remaining language of the section is made somewhat more general than in the bill.

SECTION 3 Continued Page 2

Member banks as a rule do not borrow to relend, but to make up deficiencies in reserves arising from withdrawals of deposits or from other causes. It is, therefore, usually impossible to say that a loan to a member bank is granted for this or that specific purpose. However, it would be possible to determine whether the loan and investment policies of a bank are inconsistent with the purposes of the Federal Reserve Act, and, if so, to refuse accommodation to such bank or in aggravated cases to suspend it from the privilege of using the system's credit facilities. In this connection attention is invited to the fact that Section 4 of the Federal Reserve Act requires the chairman and Federal reserve agent at each Federal reserve bank to "make regular reports to the Federal Reserve Board" and to "act as its official representative for the performance of the functions conferred upon it by" the Federal Reserve Act.

It is recommended that Section 3 of the bill be changed to read as follows:

"Sec. 3. The paragraph of Section 4 of the Federal Reserve Act, as amended, which begins with the words, 'Said board shall administer the affairs of said bank fairly and impartially', is amended and reenacted to read as follows:

'Said board of directors shall administer the affairs of said bank fairly and impartially and without discrimination in favor of or against any member bank or banks and may, subject to the provisions of law and the orders of the Federal Reserve Board, extend to each member bank such discounts, advancements and accommodations as may be safely and reasonably

made with due regard for the claims and demands of other member banks, the maintenance of sound credit conditions and the accommodation of commerce, industry and agriculture. The Federal Reserve Board may prescribe regulations further defining within the limitations of this act the conditions under which discounts, advancements and accommodations may be extended to member banks. Each Federal reserve bank shall keep itself informed of the general character and amount of the loans and investments of its member banks with a view to ascertaining whether undue use is being made of bank credit for the speculative carrying of or trading in securities, real estate or commodities, or for any other purpose inconsistent with the maintenance of sound credit conditions; and, in determining whether to grant or refuse advances, rediscounts or other credit accommodations, the Federal reserve bank shall give consideration to such information. Whenever, in the judgment of the Federal Reserve Board, any member bank is making such undue use of bank credit, the Board may, in its discretion, after reasonable notice and an opportunity for a hearing, suspend such bank from the use of the credit facilities of the Federal Reserve System and may terminate such suspension or may renew it from time to time."

SECTION 4

It is recommended that this section be omitted. 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.

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.

SECTION 5

This section would amend the first paragraph of Section 7 of the Federal Reserve Act so that, after the payment of expenses and dividends, all of the net earnings of the Federal reserve banks over and above any amounts necessary to restore its surplus to its position as of December 31, 1931, would be paid to the Federal liquidating corporation. The amendment is also worded in such a way as to prevent the payment of any dividends out of surplus and to prevent the payment of dividends whenever the surplus of a Federal reserve bank is less than it was on December 31, 1931.

A different method of financing the liquidating corporation is proposed and will be discussed under the appropriate section. For this reason a modification of Section 5 is suggested which would not change the provisions of the present law in regard to the surplus of the Federal reserve banks, but would authorize the Secretary of the Treasury to use the franchise tax received from the Federal reserve banks for the purpose of supplementing the funds of the corporation.

As changed, Section 5 of the bill would read as follows:

"Sec. 5. The second paragraph of Section 7 of the Federal Reserve Act, as amended, is amended to read as follows:

'The net earnings derived by the United States from Federal reserve banks shall, in the discretion of the Secretary of the Treasury, (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

SECTION 5 Continued Page 2

(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 6

In order that reports of affiliates of State member banks may be required only when deemed necessary by the Federal Reserve Board and also in order that suitable provision may be made for the examination of affiliates of State member banks when deemed necessary, it is recommended that Section 6 of the Bill be changed to read as follows:

"Sec. 6. Section 9 of the Federal Reserve Act, as amended, is further amended by adding at the end thereof two new paragraphs reading as follows:

'Whenever it shall be deemed necessary in order to obtain adequate information regarding the relations between any bank admitted to membership under the provisions of this section and its affiliates or the effect of such relations upon the management or condition of such bank, it may be required under rules and regulations prescribed by the Federal Reserve Board to obtain and furnish such reports as to any or all of its affiliates as may be called for. Each such report shall contain such information and shall be submitted at such time as may be specified in the call therefor. Any member bank which fails to furnish any report of an affiliate when and as required shall be subject to a penalty of $100 for each day during which such failure continues. Such penalty 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.

SECTION 6 Continued Page 2

'Any examiner selected or approved by the Federal Reserve Board may examine any affiliate of any bank admitted to membership under the provisions of this section when it shall be deemed necessary in order to inform the Federal Reserve Board or the Federal reserve bank of the relations of such affiliate with such member bank or of the effect of such relations upon the management or condition of such member bank. 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 to make a report of his findings to the Federal Reserve Board or to the Federal reserve bank. Copies of the report of any such examination may, in the discretion of 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 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 such affiliate shall refuse

SECTION 6 Continued Page 3

to pay such expenses or shall fail to do so within sixty days after the date of such assessment, then such expenses may be assessed against the affiliated member bank and, when so assessed, shall be paid by such member bank; Provided, however, That, if the affiliation is with two or more member banks, such expenses may be assessed against, and collected from, any or all of such member banks in such proportions as the Federal Reserve Board may prescribe. 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 such affiliate or refuse to give any information required in the course of any such examination, the member bank with which it is affiliated shall be subject to a penalty of not more than $100 for each day that any such refusal shall continue. Such penalty may be assessed by the Federal Reserve Board in its discretion, and, when so assessed may be collected by the Federal reserve bank by suit or otherwise.'"

SECTION 7.

There are certain changes which should be made in the text of this section for the purpose of clarification and of providing for certain matters not now covered in the bill which will be referred to at the appropriate places.

For the purposes of clarification, it is suggested that subsection (b) be amended as follows:

1. In lines 6, 11 and 12 on page 8, it is suggested that the word "appointive" be inserted before the word "member".

2. In line 13 on page 8, it is suggested that after the words "twelve years" there be inserted the words "from the expiration of the term of his predecessor".

In order that the domicile of the Board may be fixed for legal reasons, and in order that provision may be made for a chairman of the Board, it is suggested that the following be inserted at the beginning of line 23 on page 8:

"The offices of the Board shall be in the District of Columbia. At meetings of the Board, the Governor shall preside as chairman, and, in his absence, the Vice-Governor shall preside. In the absence of both the Governor and the Vice-Governor, the Board shall elect a member to act as chairman pro tem."

If the authority of the Secretary of the Treasury to assign quarters to the Federal Reserve Board is repealed, it would seem that the Board should be authorized to purchase or construct a building for its own use and that, in the interest of convenience and efficiency, space should be provided in such building for the Comptroller of the Currency

SECTION 7 Continued Page 2

and his staff and for the proposed Federal Liquidating Corporation. For this purpose, it is suggested that the following be added at the end of Section 7 of the Bill:

"(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 Federal Reserve Board is authorized and empowered to acquire by purchase, condemnation or otherwise, a building located in the District of Columbia which will provide suitable and adequate offices wherein the functions of the Board and the Comptroller of the Currency may be carried on, or to acquire by purchase, condemnation or otherwise, such site located in the District of Columbia as it may deem necessary and to cause to be constructed thereon a building which will provide suitable and adequate offices for the purposes of the Federal Reserve Board and the Comptroller of the Currency, and to maintain, repair, enlarge or remodel any building so acquired or constructed. The Federal Reserve Board may assign offices in any such building for the use of the Comptroller of the Currency and the Federal Liquidating Corporation without making any charge for the use of such offices, and nothing contained in the Act of June 3, 1864, or in Section 331 of the Revised Statutes (Title 12, Section 13, U.S.C.), or in any other provision of law, shall be construed

SECTION 7 Continued Page 3

as preventing the Comptroller of the Currency from making full use of any offices so assigned and from keeping therein the records and all other valuable things belonging to his department. The Federal Reserve Board may 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.'"

SECTION 8

The purpose of this section is to prevent the undue use of bank loans for speculation in securities. It is believed that this is sufficiently covered in Section 3 and, therefore, the omission of Section 8 is recommended.

SECTION 9.

In accordance with the principles indicated in the discussion of Section 6, it is recommended that Section 9 of the Bill be changed to read as follows:

"Sec. 9.

"The Federal Reserve Act, as amended, is amended by inserting between Sections 23 and 24 thereof the following new section:

'Section 23(a). No national banking association and no State member bank shall (1) make any loan or any extension of credit to, or purchase securities under repurchase agreement from, any of its 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 individual, partnership, association, 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 capital stock and surplus of such national banking association or State 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 capital stock and surplus of such national banking association or State member bank.

'Each loan or extension of credit to an affiliate within the foregoing limitations shall be secured by collateral having

Provided, however, That nothing in this section, or in any section of the banking act of 1932, shall be construed as authorizing member banks to invest their funds in stock otherwise than as specifically authorized by existing law.

SECTION 9 continued page 2.

'a 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: Provided, That this requirement shall not apply to loans or extensions of credit on the security of obligations of the United States Government, Reconstruction Finance Corporation, Federal Intermediate Credit Banks, or Federal land banks, or on the security of notes, drafts, bills of exchange, or acceptances eligible for discount or purchase by Federal reserve banks: And provided, further, That when any loan is made on the security of obligations of any State or political subdivision or agency thereof such obligations shall have a 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 any representative of any such affiliate shall be deemed a loan to the affiliate to the extent that the proceeds of such loan are used for the benefit of, or transferred to, the affiliate.

'The provisions of this section shall not apply to any affiliate of such national banking association or state member bank, (1) organized for the sole purpose of holding its banking house or houses and the site or sites thereof, (2) the sole function of which is organized to conduct a safe deposit business, (3) in the capital stock of which such bank has been authorized to invest pursuant to Section 25 of the Federal Reserve Act, (4) organized under Section 25(a) of the Federal Reserve Act,

SECTION 9 continued page 3.

'or (5) transacting only the business of an agricultural credit corporation or live stock loan company; but as to such affiliates member banks shall continue subject to the provisions of existing law limiting the amounts which they national ~~banks~~ or ~~State member banks~~ may lend to, or invest in the stock or other obligations of, such corporations.'"

SECTION 10 (See substitute pages for part of this section)

This section of the Bill deals with two separate and distinct subjects, (1) Open market operations of the Federal reserve banks, and (2) The proposed Federal Liquidating Corporation. For convenience, these subjects will be discussed separately.

OPEN MARKET OPERATIONS

The first part of Section 10 would establish a Federal open market committee along the lines of the existing open market policy conference which functions as a piece of administrative machinery without specific legal status. It would seem undesirable to incorporate into law a procedure which is gradually developing out of the experience of the system and may have to be modified from time to time.

The statement in paragraph (b) of Section 10 which says that, "No Federal reserve bank shall engage in open market operations, except after approval and authorization by the committee", appears to be too rigid. It deprives an individual reserve bank of all authority to make purchases in the open market except after obtaining the consent of both the Board and the committee. The open market committee would have no authority to act without approval of the Board and the Board would have no authority to act without approval of the committee. Seven Federal reserve banks holding less than half the resources of all twelve could prevent the adoption of any open market policy. This would result in the possibility of obstruction of any system program and would tend to make the operation of the Federal reserve system less timely and less efficient.

SECTION 10 Continued Page 2 - Open Market Operations

Lines 19 to 23 in paragraph (c) on page 12 of this section, incorporate into law a principle which the Federal Reserve Board has adopted in practice. It is suggested that this sentence and subsection (a) of Section 14 of S. 3215 be inserted into Section 14 of the Federal Reserve Act. These changes are suggested in the following substitute for the first part of Section 10 of the Bill:

"Section 14 of the Federal Reserve Act, as amended, is further amended by striking out the words, 'Every Federal reserve bank shall have power:' and inserting in lieu thereof the following two paragraphs:

'The time, character, and volume of purchases and sales in the open market 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.

'Subject to such regulations, limitations, and restrictions as the Federal Reserve Board may prescribe, every Federal reserve bank shall have power:'"

SECTION 10 Continued Page 3

FEDERAL LIQUIDATING CORPORATION

The other part of Section 10 deals with the proposed Federal liquidating corporation, and there is submitted a proposed substitute for the section as drafted in the bill. The substitute would confine the benefits of the liquidating corporation to member banks. Assistance to nonmember banks is adequately taken care of in the Reconstruction Finance Act, and it would render membership in the system more attractive if the benefits of the Corporation were confined to member banks. In the substitute it is proposed that $100,000,000 of the capital of the liquidating corporation be supplied by the Treasury. This subscription to capital may be considered as being derived from the franchise tax previously paid to the Treasury by the reserve banks. In addition, it is proposed that the corporation be authorized to issue debentures up to twice the amount of its subscribed capital and that the Federal reserve banks be given authority to purchase those debentures up to one-fourth of their surplus. This is not a propitious time to ask the member banks to contribute to the liquidating corporation. The banks are going through a very difficult period and to tax them for the purpose of bailing out banks that have failed would be a considerable hardship on them. In order to make the operations of the corporation more easily manageable, it is proposed that the directorate be comprised of five members instead of fourteen as proposed in the bill.

For the reasons which have been stated the following separate section on the Federal Liquidating Corporation has been drafted:

SECTION 10

This section of the Bill deals with two separate and distinct subjects, (1) Open market operations of the Federal reserve banks, and (2) The proposed Federal Liquidating Corporation. For convenience, these subjects will be discussed separately.

OPEN MARKET OPERATIONS

The first part of Section 10 would establish a Federal open market committee along the lines of the existing open market policy conference which functions as a piece of administrative machinery without specific legal status.

The statement in paragraph (b) of Section 10 which says that, "No Federal reserve bank shall engage in open market operations, except after approval and authorization by the committee", appears to be too rigid. It deprives an individual reserve bank of all authority to make purchases in the open market except after obtaining the consent of both the Board and the committee. The open market committee would have no authority to act without approval of the Board and the Board would have no authority to act without approval of the committee. This would result in the possibility of obstruction of any system program and would tend to make the operation of the Federal reserve system less timely and less efficient.

Lines 19 to 23 in paragraph (c) on page 12 of this section would incorporate into law a principle which the Federal Reserve Board has adopted in practice.

The following substitute for the first part of Section 10 of the Bill is suggested:

SECTION 10 Continued Page 2 - Open Market Operations

"Sec. 10. Section 14 of the Federal Reserve Act, as amended, is further amended by striking out the words, 'Every Federal reserve bank shall have power;' and inserting in lieu thereof the following:

'Subject to such regulations, limitations, restrictions and procedure as the Federal Reserve Board may prescribe, every Federal reserve bank shall have power:'"

"Section 14 of the Federal Reserve Act, as amended is further amended by adding at the end thereof the following:

'There is hereby created a Federal Open Market Committee (hereinafter referred to as the "committee"), which shall consist of as many members as there are Federal reserve districts. Each Federal reserve bank by its board of directors shall annually select one member of said committee. The committee shall meet upon the call of the Federal Reserve Board, either upon the motion of the Board or at the request of any three members of the committee.

'It shall be the duty of the committee to confer with the Federal Reserve Board and among its own members with regard to the conduct of all open market operations for system account and to adopt and transmit to the several Federal reserve banks and to the Federal Reserve Board resolutions relating to the open market transactions of

SECTION 10 Continued Page 3 - Open Market Operations

such banks for system account and the relations of the Federal reserve system with foreign central or other foreign banks. The recommendations of the committee shall be subject to the approval of the Federal Reserve Board. No Federal reserve bank shall engage in open market operations for its own account except with the permission of the Federal Reserve Board or upon such conditions, limitations and restrictions as the Board may impose.

'The time, character and volume of all purchases and sales in the open market under this section 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.'"

FEDERAL LIQUIDATING CORPORATION

The other part of Section 10 deals with the proposed Federal liquidating corporation, and there is submitted a proposed substitute for the section as drafted in the bill. The substitute would confine the benefits of the liquidating corporation to member banks. Assistance to nonmember banks is adequately taken care of in the Reconstruction Finance Corporation Act, and it would render membership in the system more attractive if the benefits of the Corporation were confined to member banks. In the substitute it is proposed that $100,000,000 of the capital of the liquidating corporation be subscribed by the Treasury. This subscription to capital may be considered as being derived from the franchise tax previously paid to the Treasury by the reserve banks. In

SECTION 10 Continued Page 3a

addition, it is proposed that the corporation be authorized to issue debentures up to twice the amount of its subscribed capital and that the Federal reserve banks be given authority to purchase those debentures up to one-fourth of their surplus. This is not a propitious time to ask the member banks to contribute to the liquidating corporation. The banks are going through a very difficult period and to tax them for this purpose would be a considerable hardship on them.

In order to make the operations of the corporation more easily manageable, it is proposed that the directorate be comprised of five members instead of fourteen as proposed in the bill.

For the reasons which have been stated the following separate section on the Federal Liquidating Corporation has been drafted:

SECTION 10 Continued Page 4 - Federal Liquidating Corporation

"Sec. 5A. The Federal Reserve Act, as amended, is further amended by inserting between Sections 28 and 29 thereof the following new section:

'Sec. 28A. (a) There is hereby created a Federal Liquidating Corporation (hereafter referred to as the "corporation") for the purpose of making loans on, or purchasing and liquidating as hereinafter provided, all or any part of the assets of any member bank for which a receiver has been appointed. The term "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 an insolvent State member bank.

'(b) The management of the Corporation shall be vested in a board of directors consisting of five members, one of whom shall be the Comptroller of the Currency, one a member of the Federal Reserve Board designated by the Board for the purpose, and three ~~elected~~ selected annually by the Governors of the twelve Federal reserve banks under such procedure as may be prescribed by the Federal Reserve Board.

'(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

SECTION 10 Continued Page 5

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;

'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, to 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 such incidental powers as shall be reasonably necessary to carry out the powers so granted.

'(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

SECTION 10 Continued Page 7

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, and facilities thereof in carrying out the provisions of this Act.

'(f) Upon the application of the receiver of any member bank, the corporation may in its discretion purchase the assets of such bank, 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 between the corporation and the receiver, subject to the approval of (1) the Comptroller of the Currency, in the case of any national bank, ~~and~~ or (2) the person or agency designated by State law, in the case of any state bank; 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

SECTION 10 Continued Page 8

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 after the expiration of the period of advertisement made pursuant to 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. If the amount realized from any assets acquired by the corporation under the provisions of this Section exceeds the sum paid therefor or loaned thereon, 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, notes, debentures, bonds, or other such obligations, to be redeemable at the option of the corporation before maturity in such manner as may be stipulated in such obligations, 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 such 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 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 taxing 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 any loan from the corporation, or any extension or renewal thereof, or the acceptance, release, or substitution of security therefor, or for the purpose of 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 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

SECTION 10 Continued Page 12

(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.

'(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, bond, 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.

SECTION 10 Continued Page 13

'(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 $1000, 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), insofar 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 11 imposes a discriminatory rate against member bank collateral notes. It also prescribes limitations on the use of such notes by banks that may be making loans on stock exchange collateral. It is believed that the purposes of this section are accomplished by the proposed revision of Section 3 and that no further limitations along this line are desirable. The theory underlying this section, namely, that there is a more direct connection between member bank collateral notes and the use of reserve credit for speculative activity than between other borrowings and this activity is unfounded. Member banks borrow on 15-day notes, because of the greater convenience both to them and to the Federal reserve bank; and if this form of borrowing were prohibited or made more expensive, they would merely substitute the procedure of rediscounting eligible paper without any change in the use of the proceeds. For these reasons, it is believed that no useful purpose would be served by this section, but that it would make the operation of the Federal reserve banks less efficient and more expensive; and it is recommended that this section be omitted.

The recommendation has been made by the Federal Reserve Board in its Annual Reports for several years that the maturity for which advances may be made to member banks on their promissory notes secured by paper which is eligible for discount be increased from 15 to 90 days. Such an amendment would be especially helpful to country banks, and it is recommended that the following be substituted for Section 11 of the Bill:

"Sec. 11. The seventh paragraph of Section 13 of the Federal Reserve Act, as amended, is amended and reenacted to read as follows:

'Any Federal reserve bank may make advances for periods not exceeding fifteen days to its member banks on their promissory notes secured by the deposit or pledge of bonds, notes, certificates of indebtedness or treasury bills of the United States; and any Federal reserve bank may make advances for periods not exceeding ninety days to its member banks on their promissory notes secured by such notes, drafts, bills of exchange or bankers' acceptances as are eligible for rediscount or for purchase by Federal reserve banks under the provisions of this Act. All such advances shall be made at rates to be established by such Federal reserve banks, subject to the review and determination of the Federal Reserve Board.'"

SECTION 12:

Section 12 deals with relations of Federal reserve banks with foreign banks. ~~In view of the recommendation that the section creating the Federal open market committee be omitted,~~ It is recommended that the words "subject to the powers conveyed to and bestowed upon the Federal open market committee by Section 12A of this act" be omitted. From the middle of line 18 on page 26 through the word "writing" in line 11 on page 27, the section is acceptable, but the omission of the words "and control" in line 19 on page 26 is suggested, in order to preserve the distinction between supervision and operation.

It is recommended, therefore, that Section 12 of the Bill be amended as follows:

(1) Strike out the following language in lines 16, 17 and 18 on page 26:

"(g) Subject to the powers conveyed to and bestowed upon the Federal open market committee by Section 12A of this Act";

(2) Strike out the words "and control" in line 19 on page 26; and

(3) On page 27, line 11, insert a period after the word "writing" and strike out everything in line 11 after that word and all of lines 12, 13, 14 and 15.

Section 13.

The principal feature of this section is that it discontinues the distinction between time deposits and demand deposits in so far as reserve requirements are concerned. The distinction between these two types of deposits has led to many abuses and has been a factor in making possible a growth of bank credit without a corresponding growth in reserves. The proposal which would raise the requirements on time deposits to the level of those on demand deposits would increase reserve requirements by $132,000,000 a year for five years with an ultimate increase of $660,000,000. Unless there were a contraction in the amount of member bank deposits, this increase would result in an addition of about $230,000,000 to the gold requirements of the Federal reserve banks. It would be an influence in the direction of credit contraction without regard to the course of business and credit and would be particularly undesirable at this time. Furthermore, the increase would fall heaviest on banks outside of the principal financial centers, which have been discriminated against under the existing reserve requirements both because, owing to their distance from the cash facilities of the Federal reserve banks, they are required to carry relatively large amounts of cash in vault, which under existing law does not count as reserve, and because they are not in a position to take advantage of deductions in determining net deposits.

The proposal, therefore, would both increase the burden of reserves and increase the inequalities in their present distribution.

Any thorough-going revision of Section 19 of the Federal Reserve Act should base required reserves, in so far as practicable, upon the

SECTION 13 Continued Page 2

activity of the business handled through each bank, rather than on an arbitrary classification of banks according to location. A proposal submitted in the "Report of the Committee on Bank Reserves of the Federal Reserve System" embodies a method of calculating required reserves which is believed to be sound in principle and which would make fluctuations in the volume of required reserves exert an influence in the direction of sound credit conditions and would also eliminate many inequitable and unfair features of the present law.

There is submitted a proposed substitute for Section 13 of the Bill which incorporates the proposals of the Committee on Bank Reserves of the Federal Reserve System with slight modifications.

Section 13 includes two subjects not directly related to bank reserves and not covered in the report of the Reserve Committee, namely: a prohibition against brokers' loans for the account of others and a provision subjecting the market for Federal funds to regulation by the Federal Reserve Board.

The purpose sought to be accomplished by paragraph (d) is desirable, but it is believed that the language used is too far reaching. It is suggested that the paragraph be changed so as to prohibit a member bank from acting as a medium or agent of a non-banking corporation or individual in making loans on the security of stocks, bonds and other investment securities to brokers or dealers in such securities. This suggestion is incorporated in paragraph (n) of the proposed revision of Section 13 of the Bill. It is not thought that provision prohibiting a member bank from making loans to, ~~or discounting paper for,~~ any corporation or

SECTION 13 Continued Page 3

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, or member of any stock exchange or any dealer in securities, ~~is practicable or capable of being enforced by the Federal reserve banks~~ would be enforceable, as it is impossible for ~~them~~ to follow the proceeds of loans once they ~~are~~ have been granted.

Paragraphs (f) and (g) of the Bill seek to control the market for Federal funds by placing limitations on the use of balances standing to the credit of member banks upon the books of the Federal reserve banks. It is not believed that ~~legal~~ regulations of the market for Federal funds by law is desirable. It is better to have these liquid funds move freely where they are most needed than to have them thrown on the call market. The Federal reserve banks keep in close touch with transactions in Federal funds and a ruling of the Federal Reserve Board now requires member banks to report purchases of Federal funds as borrowed money.

The proposed substitute for Section 13 of the Bill is as follows:

"Sec. 13. "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; Provided, That any member bank, at its option,

SECTION 13 Continued Page 4

for any period not less than 90 days, may omit any specific deposit account or accounts from such computation of its reserve requirements if such account or accounts are reported separately to the Federal reserve bank and if a reserve of 50% is maintained against such account or accounts: Provided, however, That, 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, 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, That when, in its judgment the public interest so requires, the Federal Reserve Board may limit to an amount less than that permitted hereunder the amount of cash which any member bank or banks may count as reserve: Provided, however, That, in prescribing such limi-

SECTION 13 Continued Page 5

tations, the Federal Reserve Board shall be guided by the general principle that member banks should be permitted to count as reserve, within the limitations of this section, as much cash as they reasonably need in view of the character of their business and their degree of 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", (1) 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, and (2) liabilities payable only at such a 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 and their branches in the United

SECTION 13 Continued Page 6

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 further 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

SECTION 13 Continued Page 7

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 indicated in subsection (b) hereof.

'(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 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

SECTION 13 Continued Page 8

purpose of meeting existing liabilities: Provided, however, That, whenever the reserves of any member bank have been continuously deficient for fourteen consecutive calendar days, the Federal Reserve Agent or Assistant Federal Reserve Agent of the district in which such member bank is located shall send to each director of such bank, by registered mail, a letter advising him of such deficiency and calling attention to the provisions of this subsection; and each director of such bank who assents to, or acquiesces in, the making of additional loans or investments by such bank after receipt of such a letter and before the reserves of such bank shall have been restored to the amount required by this section, shall be held liable in his personal or individual capacity for any and all losses sustained by such bank on any such loans or investments.

'(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.

SECTION 13 Continued Page 9

'(n) No member bank shall act as the medium or agent of any nonbanking partnership, association, business trust corporation or individual in making loans on the security of stocks, bonds and other investment securities 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 more 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 the continental United States, may remain nonmember banks, and shall in that event maintain reserves and comply with all the conditions now provided by law regulating them; or said banks may, with the consent of the 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.'

SECTION 13 Continued Page 10

"There are hereby repealed 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 on the first day of the seventh calendar month following the enactment of this Act."

SECTION 14

The first portion of this section down to line 4 on page 33 is existing law. The sentence in lines 4 to 8, inclusive, is new and would interfere greatly with the financing of real estate transactions. When a time loan has been made there appears to be no warrant, in the absence of default, for revising the valuations on which the loan is based; and this provision, together with that in lines 4 to 9 on page 34, would require the real estate on which each such loan is based to be revalued at least five times each year. It could not reasonably be expected that real estate loans would be made or applied for under such conditions.

The sentence in lines 17 to 20 on page 33 would classify as real estate loans all unsecured loans whose eventual safety depends upon the value of real estate, thereby subjecting all such loans to all the limitations or restrictions in this section. This would produce confusion and uncertainty in a large volume of loans and would interfere with the extension of adequate credit, particularly in the agricultural sections of the country.

The remaining amendments in this section make what appear to be unnecessary changes in the proportion of the real estate loans permitted and propose, without segregation, to give time depositors a preferred claim on all real estate loans and other assets of the bank which are acquired under this section ~~eligible under state laws as investments for savings banks~~. Such a provision would be difficult to administer and would be unfair to the other depositors.

The sentence in lines 15 to 22 on page 34 is existing law and is inconsistent with Section 24 of the Bill, which will be discussed later.

It would seem desirable to limit the amount which banks may invest in bank premises, but it is suggested that this be accomplished directly instead of indirectly.

It is recommended, therefore, that Section 14 of the Bill be stricken out and that the following new section be substituted:

"Section 14. The Federal Reserve Act, as amended, is 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, and except with the permission of the Federal Reserve Board, no State member bank, shall hereafter invest in bank premises or in the stock or obligations of, or in loans to, any corporation owning or holding its bank premises a sum exceeding the amount of the capital and surplus of such bank.'"

SECTION 15

This section would make it necessary for member banks to dispose of a large amount of securities at this time which would be very unfortunate. Since ~~this section~~ it is aimed generally at investments in securities, it is believed that its purpose is covered sufficiently by the proposed substitute for Section 3 of the Bill.

The clause commencing in line 19 on page 35 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.

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. This modification is undesirable.

For the reasons stated, it is recommended that this section be omitted entirely.

SECTION 16

This amendment is believed to be desirable; but it is recommended that it be strengthened and that a means of evasion be eliminated by striking out the exception in lines 17 to 21, inclusive on page 37, which would permit the organization of national banks with a capital of $25,000 in certain circumstances.

SECTION 17

The modification of the units in which bank stocks can be issued would create unnecessary complications; and it is recommended that all of Section 17 be omitted, with the exception of the sentence in lines 17 to 23 on page 38, which should be made effective not less than three years after enactment.

As modified, Section 17 would read as follows:

"Sec. 17. Section 5139 of the Revised Statutes, as amended, is amended by adding at the end thereof a new paragraph reading as follows:

'After three years from the date of the enactment of this Act, no certificate representing the stock of any such association shall represent the stock of any other corporation, nor shall the ownership, sale or transfer of any certificate representing the stock of any such association be conditioned in any manner whatsoever upon the ownership, sale, or transfer of a certificate representing the stock of any other corporation.'"

SECTION 18

The first part of this section would prohibit any director, officer or employee of any member bank from acting as a director, officer or employee of certain other specified classes of business enterprises. It would be capable of easy evasion and would become ineffective in many cases. The latter part of the section would prohibit any member bank from clearing checks or doing the ordinary banking business of a correspondent for any of the types of business enterprises mentioned in this section. The language of the section is so broad that it would include banks within the classes of business enterprises to which the prohibitions of the section would apply. For example, interlocking bank directorates would be prohibited, and one bank would be prohibited from acting as a correspondent of another bank.

It is, therefore, recommended that this entire section be omitted.

It has been clearly demonstrated that affiliations between member banks and security companies have contributed to undesirable banking developments. There are, however, difficulties in the way of accomplishing a complete divorce of member banks from their affiliates arising from the fact that a law intended for that purpose is likely to be susceptible of evasion or else to apply to many cases to which it is not intended to apply. Therefore, the Board is not prepared at this time to make a definite recommendation, but submits, for the consideration of the Committee on Banking and Currency, a substitute for Section 18 which is designed to provide for the divorce of security affiliates from member banks after three years.

"Sec. 18. From and after three years from the date of the enactment of this Act, no member bank shall be affiliated in any manner described in Section 2(b) hereof with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail ~~or through syndicate participation~~ of stocks, bonds, debentures, notes, or other securities.

"For every violation of this section, the member bank involved shall be subject to a penalty not exceeding $1,000 per day for each day during which such violation continues. Such penalty may be assessed by the Federal Reserve Board, in its discretion, and, when so assessed, may be collected by the Federal Reserve Bank by suit or otherwise.

"If any such violation shall continue for six calendar months after the member bank shall have been warned by the Federal Reserve Board to discontinue the same, (a) in the case of a national bank, all the rights, privileges and franchises granted to it under the National Bank Act may be forfeited in the manner prescribed in Section 5239 of the Revised Statutes, or, (b) in the case of a State member bank, all of its rights and privileges of membership in the Federal Reserve System may be forfeited in the manner prescribed in Section 9 of the Federal Reserve Act."

SECTIONS 19 and 20.

It is recommended that Section 19 of the Bill be combined with Section 20 in the manner hereinafter proposed; that the combined section be known as Section 19; and that a new section applicable to holding companies which own or control State member banks be substituted for Section 20.

Under the definition of "affiliate" contained in Section 2 and under the provisions of Sections 6, 27, and 28 of the Bill, if amended in accordance with the recommendations contained in this report, all holding companies which control State member banks or national banks and all banks owned or controlled by such holding companies will be affiliates of such member banks and will be required to make reports of condition and submit to examinations whenever deemed necessary or advisable by the Comptroller of the Currency, the Federal Reserve Board or examiners appointed by them; and, therefore, it is suggested that the provisions regarding examinations and condition reports of holding companies be omitted from this section and from the corresponding sections regarding holding companies which own or control State member banks.

It is also suggested that there be inserted in Section 19 and in the proposed new section 20, certain additional provisions providing for the regulation and supervision of holding companies and requiring all eligible State banks controlled by them to be members of the Federal Reserve System.

SECTIONS 19 and 20 Continued Page 2

It is, therefore, recommended that Section 19 of the Bill be changed to read as follows:

"Sec. 19. 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 affiliate, as defined by the Banking Act of 1932, or by any officer, director, employee, proxy, nominee, or representative or agent thereof, shall not be voted unless such affiliate shall have filed with the Comptroller of the Currency an agreement in such form as may be prescribed by him accepting, and agreeing to submit to and comply with, all of the provisions of this section, and such agreement shall not have been terminated. 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.

SECTIONS 19 and 20 - Continued page 3

'Within a period of one year from the date of any such agreement, each nonmember State bank owned or controlled by such 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 agreement remains in effect, such affiliate shall divest itself of all stock ownership or other interest in, or control of, such bank.

'Except as otherwise provided herein, every such affiliate, (1) on January 1, 1934, and at all times thereafter while such agreement remains in effect, shall possess, 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 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 such affiliate is required to possess at any given time, credit shall be given to such affiliate for all contributions which it has made during the preceding three years to banks owned or controlled by it at the time such computation is made. The term "contribution", as herein used, shall include all such gifts of money, assets or other things of value to any such bank, all such amounts paid for worthless or doubtful assets purchased from any such bank, and all such other similar amounts as the Comptroller of the Currency, in his discretion, may permit to be treated as contributions.

'If any such affiliate shall fail to comply with the provisions of this section or with the provisions of any agreement with the Comptroller of the Currency made pursuant thereto, the Comptroller, in his discretion, may terminate such agreement.

SECTIONS 19 and 20 Continued Page 5

'Any officer, director, agent or employee of any such affiliate, which has entered into an agreement with the Comptroller of the Currency in accordance with the provisions of this section, who shall make any false entry in any book, report or statement of such affiliate with intent in any case to injure or defraud such 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 affiliate or of any member bank, or the Comptroller of the Currency, or any agent or examiner appointed to examine the affairs of such 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 affiliate which owns or controls such National bank directly or indirectly, (2) make any loan to any affiliate which owns or controls such National bank, directly or indirectly, on the security of any shares of stock of any corporation owned or controlled by such affiliate, or (3) be the purchaser or holder of the stock of such 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.

SECTIONS 19 and 20 - Continued page (6).

'Unless there is in effect at the time an agreement filed with the Comptroller of the Currency pursuant to the terms of this section, 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 affiliate, or by any officer, director, employee, proxy, nominee or representative or agent 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.'"

It is recommended that, in lieu of Section 20, there be inserted a new Section 20 making similar requirements regarding holding companies which own or control State member banks of the Federal Reserve System; and it is recommended that such new Section 20 read as follows:

"Sec. 20. 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 shall be permitted to become a member of the Federal Reserve System unless any af-

SECTIONS 19 and 20 - Continued page (7)

filiate of such State bank or trust company, as defined in the Banking Act of 1932, which owns or controls such member bank directly or indirectly shall have filed with the Federal Reserve Board an agreement in such form as may be prescribed by such Board accepting, and agreeing to submit to and comply with, all of the provisions of this section; and no State bank shall remain a member of the Federal Reserve System after one year from the date of the enactment of this act unless any affiliate of such State bank which owns or controls such member bank directly or indirectly shall have filed such an agreement with the Federal Reserve Board.

'Within a period of one year from the date of any such agreement, each nonmember State bank owned or controlled by such 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 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 affiliate shall divest itself of all of the stock ownership or other interest in, or control of, such bank.

SECTIONS 19 and 20 - Continued Page (8)

'Except as provided herein, every such affiliate, (1) on January 1, 1934, and at all times thereafter during the membership in the Federal Reserve System of any State bank owned or controlled by it, shall possess, free and clear of any lien, pledge or hypothecation of any nature, readily marketable assets other than bank stock, which shall not amount to be less than 15 per cent of the aggregate par value of bank stocks held or owned by such 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 such affiliate is required to possess at any given time, credit shall be given to such affiliate for all contributions which it has made during the preceding three years to banks owned or controlled by it at the time such computation is made. The term "contribution", as herein used, shall include all such gifts of money, assets or other things of value to any such bank, all such 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.

'If any such affiliate shall fail to comply with the provisions of this section or with the provisions of any agreement

SECTIONS 19 and 20 - Continued Page (9)

with the Federal Reserve Board made pursuant thereto, the said Board, in its discretion, may require any State member bank owned or controlled by such 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.

'Any officer, director, agent or employee of any such 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 affiliate with intent in any case to injure or defraud such 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 affiliate or of any member bank, or the Federal Reserve Board, or any agent or examiner appointed to examine the affairs of such 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 affiliate which owns or controls such State member bank ~~or trust company~~ directly or indirectly, (2)

SECTIONS 19 and 20 - Continued Page (10)

make any loan to any 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 corporation owned or controlled by such affiliate, or (3) be the purchaser or holder of the stock of such 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

Section 21 deals with branch banking. It is recommended that the limitations be based on geographical location rather than on state lines. By permitting branches to be established with the approval of the Federal Reserve Board within a distance of 100 miles, many situations where communities are entirely deprived of banking services could be remedied, because banks in neighboring localities could establish branches there. At the same time, the proposed restrictions would prevent an undue extension of branch banking. There is no logical economic connection between state boundary lines and the channels of trade, and for this reason it would seem desirable to base the extension of branch banking on a principle that is not connected with state lines. The further provisions of this section regulating the capital requirements of banks having branches are desirable.

It is recommended that Section 21 of the Bill be changed to read as follows:

"Sec. 21. Paragraphs (c), (d) and (e) of Section 5155 of the Revised Statutes, as amended, are amended to read as follows:

'(c) Any national banking association, with the consent of the Comptroller of the Currency and the Federal Reserve Board, may establish and operate branches within the limits of the city, town or village in which it is located or in any city, town or village which is not more than 100 miles distant from the city, town or village in which its head office is located.

'(d) No such association shall establish a branch

SECTION 21 Continued Page 2

'outside of the city, town, or village in which it is situated unless it has a capital stock of not less than $500,000. The aggregate capital of every national banking association and its branches shall at no time be less than the aggregate minimum capital required by law for the establishment of an equal number of national banking associations situated in the various places where such associations and its branches are situated.

'(c) No branch of any national banking association shall be established or moved from one location to another without first obtaining the consent of the Comptroller of the Currency and the Federal Reserve Board.'"

In order that State member banks may not be prohibited by the Federal Reserve Act from exercising the same privileges as will be allowed to national banks under the above amendment, it is recommended that the following additional section be inserted in the Bill:

"Sec. 21A. Section 9 of the Federal Reserve Act, as amended, is amended by changing the period at the end of the second paragraph thereof to a colon and adding the following:

'Provided That nothing in this Act shall prevent any such bank which has a capital of not less than $500,000 and which first obtains the consent of the Federal Reserve Board from establishing branches in any city, town or village located at a distance not more than 100 miles from the city, town or village in which

SECTION 21 Continued Page 3

'its head office is located: Provided, however, That no such bank shall be permitted to establish any branch outside of the city, town or village in which its head office is located unless such bank has a capital not less than the aggregate minimum capital required by law for the establishment of an equal number of national banking associations situated in the various places where such banks and its branch are situated.'"

SECTION 21

If the Committee on Banking and Currency decides to recommend the enactment of Section 21 of the Bill in substantially its present form, it is suggested that paragraph (d) of Section 5155 of the Revised Statutes, (which forbids the establishment of any branch in a place with a population of less than 25,000), be amended in order that small communities may not be denied the banking facilities which otherwise might be provided under this section. It is also suggested that the second paragraph of Section 9 of the Federal Reserve Act be amended so as to place State member banks on the same basis as national banks with respect to branches either in this country or in foreign countries.

The sentence commencing in line 7 on page 46 of the Bill might be substituted for paragraph (d) of Section 5155 of the Revised Statutes; and the following might be added at the end of the second paragraph of Section 9 of the Federal Reserve Act:

> "Provided, however, That nothing herein contained shall prevent any State member bank from establishing and operating branches in the United States or any dependency or insular possession thereof or in any foreign country, on the same terms and conditions and subject to the same limitations and restrictions as are applicable to the establishment of branches by national banks.

SECTION 22.

In order to conform to the proposed new Section 21 regarding the establishment of branches of national banks, it is recommended that Section 22 be changed to read as follows:

"Sec. 22. Sections 1 and 3 of the Act entitled 'An Act to provide for the consolidation of national banking associations,' approved November 7, 1918, as amended, are amended by inserting after the words 'county, city, town, or village' wherever they occur in each such section, the words 'or in cities, towns, or villages not more than 100 miles distant from each other.'"

SECTION 23

This section is desirable; but, in view of the fact that the Federal Reserve Act authorizes different rates of discount for different classes of paper, it is recommended that this section be amended by striking out the word "of" in line 2 on page 47 and inserting in lieu thereof the words "on 90-day commercial paper in effect at".

SECTION 24

While it is recognized that certain evils arise from the competitive bidding for deposits through the payment of unduly high rates, it is believed that it is undesirable to further regulate by law the rates of interest, which may be paid on deposits, especially since to do so would place member banks at a disadvantage in competition with nonmember banks. It is, therefore, recommended that this section be omitted.

SECTION 25

In the interests of clarity, it is recommended that sub-section (a) of Section 25 of the Bill be amended by striking out the period at the end thereof (i. e., at the end of line 8 on page 48) and inserting the following:

"in which such corporation owns or controls a majority interest."

It is recommended that the remainder of Section 25 of the Bill (page 48, lines 9-25 and page 49, lines 1-21) be omitted entirely.

The first part of paragraph (b) (lines 9 to 18, inclusive, on page 48) would seem to be unnecessary because the exceptions in section 5200 are not applicable to borrowers of the kind described, except the eighth exception which applies only to loans secured by Government securities.

In so far as the remainder of paragraph (b) and the provisions of paragraph (c) relate to affiliates of national banking associations, the exact meaning of the restrictions is not clear; but it is believed that these provisions appear to be in conflict with those of section 9 of the bill, and the limitations on loans which may be made by national banking associations to their affiliates are covered adequately by the proposed substitute for section 9. This substitute contains a limitation on loans that may be made to one affiliate and a separate limitation on the aggregate amount of loans that may be made to all affiliates of the same member bank.

In the comments upon the definition of the term "affiliate" in section 2 of the bill certain principles were indicated which have been applied in the recommendations with respect to various sections of the bill relating to affiliates; and it is believed that these recommendations are sufficient.

SECTION 26

It is recommended that this section be omitted entirely.

It would apply to all loans on "collateral security" regardless of the nature of the security, and would nullify certain provisions of Section 5200 of the Revised Statutes, including those permitting national banks to make loans (1) in amounts not exceeding 25% of their capital and surplus on the security of shipping documents or chattel mortgages on live stock, and (2) in amounts 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 could be extended by banks in agricultural communities to farmers, cattle men and dealers in cotton, grain and other agricultural commodities.

SECTION 27

In order that reports of affiliates of national banks may be required only when deemed necessary and to clarify the provisions of the bill with respect to such reports, it is recommended that Section 27 of the Bill be amended to read as follows:

"Sec. 27. 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:

'Whenever it shall be deemed necessary in order to obtain adequate information regarding the relations between any national bank and its affiliates, or the effect of such relations upon the management or condition of such bank, it may be required under rules and regulations prescribed by the Comptroller of the Currency to obtain and furnish such reports as to any or all of its affiliates as may be called for. Each such report shall contain such information and shall be submitted at such time as may be specified in the call therefor.'"

SECTION 28

Section 28 of the Bill purports to authorize examinations of affiliates of both national banks and State member banks; but it is doubtful whether it would accomplish this purpose as to State member banks, because it amends the first paragraph of Section 5240 of the Revised Statutes so as to provide for such examinations to be made by examiners acting under the jurisdiction of the Comptroller of the Currency, whereas Section 9 of the Federal Reserve Act, as amended by the Act of June 21, 1917, exempts State member banks from examination by the Comptroller of the Currency under the provisions of the first two paragraphs of Section 5240 of the Revised Statutes. It has been recommended above that Section 6 of the Bill be amended so as to provide for examinations of affiliates of State member banks; and it is recommended that Section 28 of the Bill be amended to read as follows:

"Sec. 28. Section 5240 of the Revised Statutes of the United States, 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 affiliate of a national bank whenever it shall be deemed necessary in order to obtain adequate information concerning the relations of such affiliate with such national bank or the effect of such relations upon the management

SECTION 28 - Continued Page 2

or condition of such national bank. The examiner making the examination of any affiliate of a national bank 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 and agents thereof under oath and to make a report of his findings to the Comptroller of the Currency. Copies of the report of any such examination may, in the discretion of the Comptroller of the Currency, be furnished to officers, directors or the receiver of the affiliate examined or of the national bank with which it is affiliated or to any other proper persons. 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 such affiliate shall refuse to pay such expenses or shall fail to do so within sixty days after the date of such assessment, then such expenses may be assessed against the affiliated national bank and, when so assessed, shall be paid by such national bank: Provided, however, That, if the affiliation is with two or more national banks, such expenses

SECTION 28 - Continued Page 3

may be assessed against, and collected from, any or all of such national banks in such proportions as the Comptroller of the Currency may prescribe. 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 or shall refuse to give any information required in the course of any such examination, the national bank with which it is affiliated shall be subject to a penalty of not more than $100 for each day that any such refusal shall continue. Such penalty 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."

SECTION 29

Section 29 provides for the removal of officers or directors of national banks under certain circumstances. It is believed that there should be some means by which in extreme cases unsatisfactory management could be corrected through the removal of officers and directors responsible therefor.

It is believed, however, that the power of removal should be vested in the Federal Reserve Board as a whole rather than in a special committee consisting of three officials, one of whom is the person bringing the charges against the accused officer or director; and, in order to afford adequate additional protection to the interests of the banks and their officers and directors, certain other changes in this section should be made. It is, therefore, recommended that Section 29 be amended to read as follows:

"Sec. 29. Whenever, in the opinion of the Comptroller of the Currency, any director or officer of a national bank, or of a bank or trust company doing business in the District of Columbia, or whenever, in the opinion of a Federal Reserve Agent, any director or officer of a State member bank in his district, shall have continued to violate any law relating to such bank or shall have continued unsafe or unsound practices in conducting the business of such bank after having been warned by the Comptroller of the Currency or the Federal Reserve Agent, as the case may be, to discontinue such violations of law or such unsafe or unsound practices, the Comptroller of the Currency or the Federal Reserve

SECTION 29 - Continued Page 2

Agent, as the case may be, may certify the facts to the Federal Reserve Board. In any such case, the Federal Reserve Board may cause notice to be served upon such director or officer to appear before such Board to show cause why he should not be removed from office. A copy of ~~each~~ such order shall be sent to each director of the bank affected by registered mail. If, after granting the accused director or officer a reasonable opportunity to be heard, the Federal Reserve Board finds that he has continued to violate any law relating to such bank or has continued unsafe or unsound practices in conducting the business of such bank after having been warned by the Comptroller of the Currency or the Federal Reserve Agent to discontinue such violation of law or such unsafe or unsound practices, the Federal Reserve Board, in its discretion, may order that he be removed from office. A copy of ~~each~~ such order shall be served upon such director or officer, ~~and upon~~ A copy of such order shall also be served upon the bank of which he is a director or officer, whereupon such director or officer shall cease to be an officer or director of such bank: Provided, however, That such order and the findings of fact upon which it is based shall not be made public or disclosed to any one except to the officer or director involved and the directors of the bank involved, and no such finding or order nor the evidence upon which it is based shall be produced in any court of law except as evidence to punish violations of law under this section. Any such director or officer upon whom any such order

SECTION 29 - Continued Page 3

has been served as herein provided and who thereafter participates in any manner in the management of such bank shall be fined not more than $5,000 or imprisoned for not more than 5 years, or both, in the discretion of the court."

(copy)

Honorable Carter Glass - (2) May 7, 1932

CONFIDENTIAL

Honorable Carter Glass,
United States Senate,
Washington, D. C.

Dear Senator Glass:

Since our conversation regarding your bill S. 4412 in the form in which it was introduced on April 18, I have reviewed its more important controversial features and I am setting forth below in summary form certain points in respect to which modifications of the bill would seem to be especially desirable.

AFFILIATES

In view of the present unsettled conditions and the practical problems involved in the separation of security affiliates from member banks and their holding companies, it has been suggested, and I think the suggestion has great merit, that all of the provisions requiring divorce of affiliates be amended so as to allow five years instead of three years for this purpose. This could be accomplished by striking out the word "three" and substituting the word "five" in each of the following places: Page 8, line 11; page 37, line 17; page 42, line 11; and page 45, line 18.

As the bill indicates, the purpose for which examinations are to be made and reports required of affiliates is to ascertain the facts with respect to their relations with member

banks and the effect of such relations upon the condition of such banks. However, as you know, the definitions of affiliates set forth in section 2 of the bill are so broad that they include organizations having business interests largely outside the field of banking or which do not necessarily have an important effect upon the condition or management of member banks with which they are affiliated, and the bill contains mandatory provisions for examinations and reports of all affiliates concurrently with the examinations and reports of their affiliated member banks. This would impose unnecessary burdens upon all affiliates and upon the supervisory authorities. You will recall that the Board recommended that these provisions of the bill be modified to permit the exercise of discretion on the part of the supervisory authorities and I feel that in the interest of practical administration this is important. The changes necessary to accomplish this purpose are as follows:

Page 6, lines 14 and 15, strike out the words "not less than three reports during each year" and substitute the words "such reports as the Board shall deem necessary". Beginning in line 19, on page 6, strike out all after the word "reports" down to and including the word "shown" in line 2 on page 7.

Page 39, lines 10 and 11, strike out the clause "on dates identical with those fixed for the examination of banks

with which it is affiliated".

Page 47, line 9, strike out the words "not less than three reports during each year in such form" and substitute the words "such reports". In lines 14 to 17, inclusive, strike out the words "as of dates identical with those for which the Comptroller shall during such year require the reports of the condition of the association". In lines 19 to 23, inclusive, strike out the entire sentence beginning with the word "Each" and ending with the word "shown".

Page 48, line 20, strike out the word "include" and substitute therefor the words "have power to make".

CERTAIN POWERS OF NATIONAL AND STATE MEMBER BANKS

In its unanimous report the Federal Reserve Board recommended the omission of all of section 15 of S.4115, which is contained in S.4412 in modified form as section 14. The modifications which have been made in this section meet some of the Board's objections but not all of them. In this connection, I invite your attention particularly to the clause on page 34 in lines 15 to 21, inclusive, which would confer upon national banks all banking powers granted by State law to banking institutions in the States where such national banks are located, except to the extent expressly forbidden by Congress. Obviously this clause would have a strong tendency in the direction of lowering the

standards of the national banking system and would be inconsistent with the general theory of your bill. It would perpetuate the competition in laxity which to a certain extent has already been permitted to grow up.

I have given thought to the suggestion that the restriction in section 5(b) on the powers of State banks to invest in stocks and other securities be made applicable only to State banks hereafter admitted to membership. While this would meet the objection that the restriction would deprive existing State member banks of their charter rights in contravention of their understanding of the terms upon which they were admitted to the system, it must be borne in mind that it would discriminate unfairly in favor of State banks now holding membership and against national banks as well as State banks hereafter admitted. It brings home the fact that if restrictions of this character are to be imposed, they cannot be made effective except through a unified banking system, where regulations can be applied uniformly to all member banks.

Therefore, it is recommended that section 14 and the relevant portion of section 5 (b), contained in lines 5 to 10, inclusive, on page 8, be stricken out entirely.

OPEN MARKET COMMITTEE

In my opinion all of the proposed "Section 12(A)" as set forth in section 7 of the bill should be eliminated for the

reasons set forth in the Board's recommendations transmitted with my letter of March 29, 1932. If, however, the provisions relating to the Open Market Committee are to be retained in the bill they should be modified by inserting on page 13, in line 16, after the word "operations" the words "for system account" in order to avoid conferring upon this committee functions which it does not now possess with respect to the operations of individual banks, the exercise of which would hamper unnecessarily the ordinary handling of open market purchases by individual banks under the authority of existing law.

ADVANCES TO MEMBER BANKS

For the reasons contained in the Board's recommendations of March 29, 1932, the restrictions which would be imposed by section 8 upon advances by Federal reserve banks to member banks should be eliminated, and there should be substituted the section recommended by the Board on page 33A of its report which would enable Federal reserve banks to make advances to member banks on their promissory notes for periods up to ninety days when secured by paper eligible for rediscount or for purchase by Federal reserve banks.

FEDERAL LIQUIDATING CORPORATION

The proposed section 12(B) of the Federal Reserve Act as set out in section 7 of the bill contemplates that the Federal Liquidating Corporation shall have a capital and surplus composed

of (a) funds derived from subscriptions by memberbanks to the extent of one fourth of one per cent of their net time and demand deposits; (b) one fourth of the surplus of the Federal reserve banks as of July 1, 1932; (c) the sum of $125,000,000 to be paid in by the Treasury of the United States. In addition, the corporation would be empowered to sell and have outstanding at any one time its obligations in an amount equal to twice its capital and surplus. It has been estimated that the amount thus required of member banks would be about $65,000,000 and the amount required of the Federal reserve banks about an equal amount. Thus the entire capital and surplus of the corporation might be approximately $255,000,000 and its borrowing capacity approximately $510,000,000, or a total of $765,000,000. This is believed to be far in excess of any reasonably probable needs of the corporation.

The Board, as you will recall, recommended that the corporation be provided with a capital of $100,000,000 paid in by the Treasury and authorized to sell its obligations in an additional amount equal to twice its capital, or, in other words, it might have approximately $300,000,000 of resources available for carrying on its operations, which the Board felt would be adequate. In these circumstances it seems unnecessary to impose upon member banks the burden of providing part of the capital of the proposed corporation and, as you know, a great deal of objection has been made to the imposition of such a requirement, particularly at this time. Likewise, no

to the Comptroller of the Currency to bring about compliance with necessity seems to exist for requiring the Federal reserve banks to subscribe to the capital stock of the corporation. On the other hand, the provision permitting the Federal reserve banks to pur - chase debentures of the corporation, as recommended by the Board, would be helpful to the marketing of the corporation's obligations.

It is therefore recommended that on pages 15 to 18, inclusive, all of paragraphs (c), (d), (e), (f) and (g) be stricken out and that paragraph (c) on pages 23 and 24 of the Board's report be substituted. In this connection, on page 23, in lines 12 and 13, the words "and the amount authorized to be appropriated pursuant to paragraph (c) of this section" should be stricken out and the word "stock" substituted therefor.

PUBLICATION OF EXAMINATION REPORTS

While it is not one of the more controversial points in the bill, it is believed that careful consideration should be given to the elimination of the last two sentences of section 24(a) of the bill, which appear in lines 5 to 13, inclusive, on page 49, and which would authorize the Comptroller of the Currency to publish reports of examinations of member banks and their affiliates in certain circumstances. This is a drastic power which, if exercised, would have a damaging effect upon the banks involved and their borrowers, and perhaps upon general banking conditions. Furthermore, it is inconsistent with the confidential nature of reports of examination. Under other sections of the bill adequate powers are given

to the Comptroller of the Currency to bring about compliance with his requirements, including particularly the power to remove officers and directors.

For your convenience, there is inclosed a copy of bill S. 4412 showing the changes discussed in this letter.

Very truly yours,

(Signed) Eugene Meyer

Governor.

Inclosure.