

A meeting of the Board of Governors of the Federal Reserve System was held in Washington on Monday, March 16, 1936, at 10:15 a. m.

PRESENT: Mr. Eccles, Chairman
Mr. Broderick
Mr. Szymczak
Mr. McKee
Mr. Ransom
Mr. Morrison

Mr. Morrill, Secretary
Mr. Bethea, Assistant Secretary
Mr. Carpenter, Assistant Secretary
Mr. Clayton, Assistant to the Chairman

Mr. Morrill reported that the Comptroller of the Currency today issued a call on all national banks for reports of condition as at the close of business on March 4, 1936, and that, in accordance with the usual practice, a call was made on behalf of the Board of Governors of the Federal Reserve System on all State member banks for reports of condition as of the same date.

The call made on behalf of the Board was unanimously approved.

Consideration was then given to each of the following matters hereinafter referred to and the action stated with respect thereto was taken by the Board:

Letter to the George A. Fuller Company, Washington, D. C., reading as follows:

"Reference is made to Vice President Distler's letter of February 24 in which were submitted certain proposed sub-contractors for consideration by the Board.

"I am authorized by the Board to advise you in accordance with Article 31 of the construction contract that the proposed sub-contractors whose names are listed below are not objectionable to the Board for the purposes stated in your letter:

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- "W. A. Fingles, Inc., Baltimore, Md. - Roofing Sheet Metal Work and Skylights.
 Norman Campbell, Washington, D. C. - Setting of Exterior Marble, Granite, Blue-stone, etc.
 Builders Wood Flooring Co., New York - Wood floors."

Approved unanimously, the sub-contractors referred to having been approved by the Board's architect, the Board's superintendent of construction, and by Mr. Miller.

Letter to Mr. Fletcher, Assistant Federal Reserve Agent at the Federal Reserve Bank of Cleveland, reading as follows:

"Consideration has been given to your letter of February 13, 1936, regarding the applicability of section 32 of the Banking Act of 1933 to Mr. A. V. Foster, who is a director of The Fayette State Savings Bank, Fayette, Ohio, and an officer and director of A. V. Foster & Co., Inc., Toledo, Ohio; and also your letter of February 24, 1936, relating to this matter and to the applicability of section 32 to Mr. H. S. McLeod, who is a director of the Commercial Bank, Delphos, Ohio, and a director of Lowry Sweney, Inc., Columbus, Ohio.

"You inclosed a copy of a letter dated February 1, 1936 from Mr. Foster, which shows that, from the date of its organization on May 1, 1935 until February 1, 1936, A. V. Foster & Co. Inc., handled approximately \$600,000 of bonds, and that of that amount \$230,000 were purchased or sold for Mr. Foster and his family, \$263,000 were sold to Parker Rust Proof Company, the President of that company, and other business associates connected with that company, \$81,000 were sold to dealers in securities, and \$35,000 to other persons who were friends and associates of Mr. Foster.

"The opinion of counsel for your bank, a copy of which you also inclosed, reaches the conclusion that since the major portion of the bonds handled by the company are for the account of others than Mr. Foster and his family, section 32 is applicable, even though the customers are few in number and their custom is obtained through friendship rather than through the efforts of a sales organization. The Board believes that this conclusion is correct.

"In a letter dated February 7, 1936, you informed the Board that you had advised Mr. McLeod that it appeared that section 32 was applicable to his relationships, and added that you would inform the Board as soon as you had received

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"information as to the steps taken by Mr. McLeod to bring his relationships into conformity with the statute.

"However, in your letter of February 24, 1936, you point out that, in the case of both Mr. Foster and Mr. McLeod, the banks involved will probably experience difficulty in obtaining any competent and qualified directors to replace these gentlemen, and, further, that, in the case of Mr. McLeod, there has never been any transaction of any kind between the company and the bank, and that the company and the bank are willing to agree that there shall never be any transactions whereby the investment policy of the member bank or the advice given to its customers regarding investments might be unduly influenced.

"In the circumstances, you feel that the matter should be brought to the attention of the Board and that consideration should be given to the question whether circumstances of the kind involved in these cases might properly form the basis for an exception to be made by the Board under the provision in section 32 which reads:

'* * * except in limited classes of cases in which the Board of Governors of the Federal Reserve System may allow such service by general regulations when in the judgment of the said Board it would not unduly influence the investment policies of such member bank or the advice it gives its customers regarding investments.'

"These and similar questions have been the subject of very careful consideration by the Board over a considerable period of time. Section 32 of the Banking Act of 1933 as originally enacted authorized the Board to permit interlocking relationships between dealers and member banks when in its judgment it would not be incompatible with the public interest. After carefully reviewing the legislative history of the section, including the hearings and the debates in Congress, the Board reached the conclusion that one of the principal purposes of the Banking Act of 1933 was the divorcement of commercial banking from the securities business and that section 32 was one of a number of provisions in that Act which were designed to that end, the underlying reason for these provisions being the conflict of interests between organizations engaged in these two types of business. Relationships of the type dealt with in section 32 between commercial banks and dealers in securities may result in unduly influencing the investment and credit policies of the banks and the investment advice

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"which they give to their correspondent banks and other customers, and may result in the banks undertaking, directly or indirectly, commitments in connection with the flotation and distribution of securities which are harmful to their interests.

"Accordingly, the Board felt that in passing upon applications for permits under that section it should not adopt the policy of attempting to determine in each case whether the relationships involved had been, or were likely to be, characterized by the evils at which the section was directed; and the Board therefore adopted the policy of granting permits only in extraordinary cases such as those which were included within the literal terms of the statute, but which were actually of a kind different from those at which its provisions were directed.

"The amendments which were made to section 32 by the Banking Act of 1935 took away the power of the Board to issue permits in individual cases and gave the Board authority to make exceptions by regulations having general applicability. However, the amendments did not make any change which indicated that there had been a change in the general policy of Congress underlying section 32. Therefore, in preparing its regulation pursuant to the amended section, the Board felt that it should be guided by principles similar to those which it had followed in administering the section prior to its amendment. The Board felt that it should obviously not make any exception which would in effect repeal the section or which did not appear to be in harmony with its underlying purpose and policy. The only exception which is made in the regulation relates to dealers who handle no securities except obligations of the United States, obligations guaranteed by the United States, debentures issued by Federal Intermediate Credit banks, bonds issued by Federal Land banks and general obligations of Territories, dependencies and insular possessions of the United States. The Board felt that, in such cases, interlocking relationships would not be open to objections which the Congress had in mind in enacting the section.

"Of course, the Board, and undoubtedly the Congress also, realized that in many individual instances relationships of the kind prohibited by section 32 had not been characterized by any of the evils which led to the enactment of the section, and that the bank involved would feel that it was losing the services of a valuable director; but the relationships were prohibited evidently for the same reason that many other relationships involving a

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"conflict of interests are prohibited, in order to eliminate a danger which had been found to exist.

"In the circumstances, it is suggested that you advise Mr. Foster and Mr. McLeod that section 32 appears to be applicable to their relationships, and advise the Board of the steps which they take to bring their relationships into conformity with the requirements of the statute."

Approved unanimously.

Thereupon the meeting adjourned.

Robert Monroe

Secretary.

Approved:

W. McLeod

Chairman.