A meeting of the Board of Governors of the Federal Reserve System was held in Washington on Friday, June 26, 1936, at 12:00 o'clock noon.

PRESENT: Mr. Eccles, Chairman
Mr. McKee
Mr. Davis

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

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

Telegrams to Messrs. Kimball, Strater and Young, Secretaries of the Federal Reserve Banks of New York, Cleveland and Chicago, respectively, stating that the Board approves the establishment without change by the New York bank on June 25, and by the Cleveland and Chicago banks today, of the rates of discount and purchase in their existing schedules.

Approved unanimously.

Telegram to Mr. Walsh, Federal Reserve Agent at the Federal Reserve Bank of Dallas, reading as follows:

"Referring your June 22 letter and June 23 telegram, Board approves appointment of G. C. Page as Acting Assistant Federal Reserve Agent at El Paso at salary of $2,700 per annum, effective July 1, 1936. It is assumed that Mr. Page's present surety bond in the amount of $50,000 will be continued."

Approved unanimously.

Letter to Mr. H. D. Vaughan, Cashier, The First National Bank, Keystone, West Virginia, reading as follows:

"Your letter of June 1, 1936, addressed to the Comptroller of the Currency, has been referred to this Board for reply.

"Such regulations as are in effect concerning loans by banks for the purpose of purchasing or carrying stocks registered on a national securities exchange are incorporated in

"the Board's Regulation U, a copy of which is inclosed herewith for your information.

"You will observe that the regulation does not apply to loans made prior to May 1, 1936, even if the proceeds thereof were used for the purpose of purchasing or carrying registered stocks, nor to the collateral securing them unless it also secures another loan made on or after that date which is subject to the regulation. The loan to which you refer in your letter and its collateral appear to be in this category unless the situation is changed by the fact that when stock is sold the note is not reduced but the proceeds of the sale are used to purchase a cashier's check of the bank which in turn is pledged to secure the loan, and subsequently the cashier's check is used to buy stock registered on a national securities exchange. Under such circumstances however, it would not appear that a new loan has been made for the designated purpose, and consequently the provisions of Regulation U do not apply.

"In passing, it is noted that the particular customer to whom you refer buys and sells the stocks in your name and in this connection it is suggested that consideration be given to Section III(g) of the interpretative rulings of the Comptroller of the Currency made with respect to section 5136, U. S. R. S. These interpretative rulings were issued on February 15, 1936 and for your convenience a copy of them is also inclosed with this letter.

"If you have any further questions regarding Regulation U it is believed that it will be more convenient for you to communicate first with the Federal Reserve Bank of Richmond, whose officers will be glad to answer your questions."

Approved unanimously.

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

"In reviewing the report of examination of the trust department of 'Union Trust Company of Springfield, Massachusetts', as of February 8, 1936, it is noted that your examiner criticizes the bank's practices with respect to switching participations in single real estate loans between trusts, i.e., the sale of such participations from one trust to another.

"As you know, such bank's condition of membership numbered 17, relating to the collective investment of trust funds, reads as follows:

"'Except with the permission of the Federal Reserve Board, such bank shall not, after the date of its admission to membership, invest the funds of various trusts held by the bank in participations in pools of mortgage bonds or other securities, and the funds of all such trusts shall be invested separately from each other; provided, however, that the Federal Reserve Board will not object to the collective investment of small amounts of trust funds where the cash balances to the credit of certain trust estates are too small to be invested separately to advantage, if the bank owns no participation in the securities in which such collective investments are made and has no interest in them except as trustee or other fiduciary.'

"Such condition is similar to the present standard condition of membership numbered 5, with respect to which Regulation H, in footnote 13, states:

'This does not prevent a bank from investing the funds of several trusts in a single real estate loan of the kind which could be made by a national bank under the provisions of section 24 of the Federal Reserve Act, as amended, if the bank owns no participation in the loan and has no interest therein except as trustee or other fiduciary.'

"The investment of trust funds in participations purchased from other trusts is, of course, subject to the same restrictions as the original investment of trust funds in such participations. As pointed out by your examiner, the switching of participations in single real estate loans in which the bank owns participations is in violation of the above-quoted condition of membership. Moreover, it appears that the bank has switched participations in loans which, at the time of such transaction, were not of the kind which a national bank might make under the provisions of section 24 of the Federal Reserve Act.

"Like any other investment of trust funds in such obligations, the switching of participations in obligations of the bank's directors, officers, employees or their affiliations or corporations affiliated with the bank, as mentioned in the report of examination of this bank as of May 11, 1935, is in violation of the bank's condition of membership numbered 16, which reads as follows:

'Such bank shall not, after the date of its admission to membership, invest trust funds held by it in obligations of the bank's directors, officers, employees or their affiliations or corporations affiliated with the bank.'

"Even though the transaction does not violate a condition of membership, assets of one trust should not be sold to another unless such assets constitute a proper investment for funds of the purchasing trust. Moreover, it is felt that a bank should, in any event, exercise particular care in selling assets of one trust to another since it is essential that the transaction not be to the disadvantage of either trust. In this connection, attention is called to the following statement contained in the American Law Institute's Restatement of the Law of Trusts, Volume 1, section 170:

'q. Duty of trustee under separate trusts. Where the trustee is trustee of two trusts if he enters into a transaction involving dealing between the two trusts, he must justify the transaction as being fair to each trust. If the circumstances are such that the interests of the beneficiaries of the different trusts are so conflicting that the trustee cannot deal fairly with respect to both trusts, he cannot properly act without applying to the court for instructions.'

"It has also been noted that the trust department has agency and corporate trust cash on deposit in the banking department of the bank and, in this connection, reference is made to the Board's letter to Mr. Curtiss of January 17, 1936, in regard to a similar situation in the case of The Union Trust Company of Boston. The views expressed therein are applicable to other State member banks which are subject to a condition of membership requiring that collateral be pledged with the trust department to secure trust funds deposited in the trustee's own banking department.

"The matter of deposits of trust cash in non-member uninsured banks will be taken up in a separate letter at a later date."

Approved unanimously.

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

"Consideration has been given to your letter of June 8, 1936, and inclosures with reference to the applicability of section 32 of the Banking Act of 1933 to the service of Mr. Edward F. Breed as a director of Security Trust Company, Lynn, Massachusetts, a member bank, and as a director and officer of Loomis, Sayles & Company, Inc., Loomis-Sayles Mutual Fund, Inc., and Loomis-Sayles Second Fund, Inc.

"The information submitted indicates that the only factor which might make section 32 applicable is the sale of the stock of Loomis-Sayles Second Fund, Inc., an investment trust organized in December 1934. In this connection, careful consideration has been given to the opinion of your counsel, which you inclosed, in which he states that, bearing in mind the nature and purpose of the organization, which is simply an investment trust, and the fact that an organization of this type depends upon the issuance of stock as a normal method of replenishing its capital, and also the fact that the shares are sold at a determined liquidating value without other profit to the organizations involved except the management fee charged by Loomis, Sayles and Company, Inc., he believes that it may be reasonably inferred that Loomis-Sayles Second Fund, Inc., is not primarily engaged in the 'issue, flotation, underwriting, public sale, or distribution' of its own securities within the meaning of section 32. Mr. Breed makes a similar argument when he suggests that the sale of the shares is merely the sale of 'a piece of investment counsel' in the form of a participation in a portfolio of investments managed by Loomis, Sayles & Company, Inc.

"However, as stated in its letter of October 26, 1934 (X-8097), the Board has found that in some cases the nature and extent of the activities of such investment trusts in connection with dealing in their own securities have been such as to become a factor in determining the applicability of section 32 to them; and upon further consideration it does not believe that it should modify this position.

"Accordingly, the Board believes that it cannot determine the applicability of section 32 in this case without having information showing the extent of the present activity in connection with the sale of the stock of Loomis-Sayles Second fund, Inc., since it appears that the sale of such shares might involve a situation of the kind contemplated by section 32.

"You refer in your letter to the difficulty which Mr. Breed anticipates in furnishing detailed statistical information bearing upon the applicability of section 32 in this case; but most of the information described in the Board's letter of October 26, 1934 (X-8097) is contained in the inclosures which accompanied your letter, and it would seem that Mr. Breed might not have difficulty in furnishing the remaining information, namely, the number of shares already sold, the number of shares still to be sold, and the degree of activity in connection with such sale at the present time."

Approved unanimously.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved: M S Eccles
Chairman.