A meeting of the Board of Governors of the Federal Reserve System was held in Washington on Thursday, July 8, 1937, at 3:00 p.m.

PRESENT: Mr. Eccles, Chairman
Mr. Ransom, Vice Chairman
Mr. Broderick

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 Mr. Leach, President of the Federal Reserve Bank of Richmond, Mr. Stewart, Secretary of the Federal Reserve Bank of St. Louis, and Mr. Thomas, Chairman of the Federal Reserve Bank of Kansas City, stating that the Board approves the establishment without change by the respective banks today of the rates of discount and purchase in their existing schedules.

Approved unanimously.

Letter to Mr. Charles T. Malone, Examiner in the Board's Division of Examinations, reading as follows:

"This will acknowledge the receipt from Mr. Paulger of your memorandum of July 6 reporting on your attendance at the 1937 Resident Session of the Graduate School of Banking, Rutgers University, New Brunswick, New Jersey.

"Your memorandum has been brought to the attention of the members of the Board, and I have been requested to express to you the Board's appreciation of the thorough and interesting manner in which your report was presented."

Approved unanimously.

Letter to Mr. Gidney, Vice President of the Federal Reserve Bank of New York, reading as follows:

"Reference is made to the report of examination of the 'Linden Trust Company', Linden, New Jersey, as of March 4, 1937, and the supplemental information submitted in connection therewith, particularly the inclosures transmitted with Mr. Dillistin's letters of June 1 and June 14, 1937.

"After allowance for estimated losses, doubtful assets, and unrealized appreciation in securities, the report of examination reflects net sound capital of $268,500 which amounts to 7.1% of deposits, aggregating $3,789,000. Other real estate, as shown by the report, amounts to $198,000, after allowance for $27,000 classified as doubtful and loss, and in addition the bank holds as collateral to the liquidating note of the Linden National Bank a substantial amount of real estate. The report also reflects a direct and indirect investment of $130,000 in banking premises and furniture and fixtures, the indirect investment being represented by a mortgage of $90,000 on the banking quarters, title to which is held by an affiliated company. It thus appears that the bank has an amount substantially in excess of its net sound capital invested in fixed assets.

"The matter of the adequacy of the bank's sound capital in relation to its deposits has heretofore been the subject of correspondence with your office. As you know, the Reconstruction Finance Corporation made a commitment to purchase $100,000 of preferred stock in the bank but the bank was not disposed to avail itself of the opportunity for strengthening its capital. Accordingly, the commitment was cancelled on May 21, 1935, when the bank's board of directors took the position that, while it recognized an increase in capital would become imperative in the near future, it was of the opinion that such capital increase could be handled locally. It is observed from the bank's letter of May 20, 1937, to Mr. Dillistin, that methods of raising additional capital are being considered by the directors and also from its letter of June 5, 1937, to Mr. Dillistin, that in view of the intention of the bank to increase its capital through the sale of additional stock and the favorable earnings during the current year, it felt it desirable to continue to pay its usual 4% annual dividend.

"The consistent position taken by your office relative to the importance of the bank making provision for and maintaining a proper ratio of sound capital to deposit liability has been noted by the Board and it fully concurs in the position taken by your office and the New Jersey State Banking Department that definite steps should be taken to bring about an increase in the bank's capital which the bank has assured you could be done. The Board feels that the bank should either "take prompt action to provide for an amount of sound capital adequate in all respects, or take action promptly to effect on a satisfactory and sound basis a merger with some other institution, as the bank has indicated that it might do. Please keep the Board advised of developments."

Approved unanimously.

Letter to Mr. Young, Vice President of the Federal Reserve Bank of Chicago, reading as follows:

"Reference is made to your letters of May 26 and 29, 1937, relative to your conference with Mr. J. W. Hansen, President of the Citizens State Bank of Sheboygan, Wisconsin, concerning the violations of law and activities of the bond department criticized in the report of examination of the bank as of February 15, 1937.

"The report of examination discloses that the bank was continuing to trade in securities extensively, a practice which has been subject to considerable criticism in previous reports, particularly because of lack of supervision and inherent dangers of such practices as well as the infraction of the provisions of Section 5136 U.S.R.S. regarding the purchase of investment securities. It is noted that these matters were discussed with President Hansen and that he assured you that the volume of trading had decreased materially and undoubtedly would be further decreased; that in the future all trading transactions would be subject to his final approval and that the provisions of Section 5136 U.S.R.S. would be observed in the purchase of securities. As a result of this conference it is noted also that you are confident that the next examination will reflect a substantial improvement in the investment department of the bank.

"On page 12G of the report of examination your examiner has listed a number of issues of securities which were carried on the bank's books in excess of the call price. Your letters indicate that several of these issues have been sold or the carrying value reduced in conformity with the Comptroller's regulation issued under the provisions of Section 5136 U.S.R.S., and that other issues will be reduced or the entire amount eliminated in an orderly manner by December 31, 1937. The Comptroller's regulation provides that the purchase of investment securities at a premium is prohibited unless provision is made for regular amortization of the premium to date of maturity and that such securities shall at no intervening date be carried at an amount in excess of that at which the obligor may legally redeem them. Accordingly, all "securities acquired subsequent to February 15, 1936, and which are now callable, should be written down to call price and the deferring of such action until a later date does not appear warranted.

"The report of examination discloses that the bank had used the proceeds of nonbook assets to purchase bonds and corporate stocks. It is noted that among the bonds so purchased are a number of issues which appear to be speculative and while the bank has agreed to dispose of the corporate stocks on or before December 31, 1937, no mention was made as to the disposition of the speculative bonds purchased.

"It will be appreciated if you will advise the bank that the Board disapproves of the practices and policies with respect to trading in securities which have been the subject of criticism and that the present holdings of securities should be brought promptly into conformity with the statutory provisions. It is assumed that you will follow the situation closely and it is requested that you advise the Board as to the action which has been or will be taken to correct the violations and that you keep the Board advised as to developments."

Approved unanimously.

Letter to Mr. M. W. Harriss, Cashier of The National Bank of Sanford, Sanford, North Carolina, reading as follows:

"This refers to your letter of June 23, with respect to the reserves against deposits which member banks of the Federal Reserve System are now required to carry.

"In your letter you say that 'Such reserve requirements required of city banks, those located in Chicago, New York, and like cities, no doubt, would be fair and reasonable, but to a small country bank, like our own, where we are taking care of the farmers in our trade area and comprising four counties, it works a hardship'. The statement quoted indicates that possibly you are under the impression that the increases in reserve requirements made by the Board of Governors of the Federal Reserve System pursuant to the provisions of law applied only to the smaller banks. That is not the case; the reserve requirements of each of the three classes of member banks -- Central Reserve city banks, Reserve city banks, and Country banks -- were increased by the same proportion. Consequently, the percentage (14 percent) of reserves required to be carried by country banks on demand "deposits is about half of the percentage (26 percent) required to be carried by Central Reserve city banks in New York and Chicago and about two-thirds of the percentage (20 percent) required to be carried by banks in other Reserve cities. Country banks, therefore, have to carry a much smaller percentage of reserves than do city banks, as they did before reserve requirements were increased.

"It is noted that, although your reserve requirements have been doubled within the past year, the reserve balance which you actually have on deposit with the Federal Reserve Bank of Richmond is more than twice the amount required. Your excess reserves would, therefore, support an increase of 100 percent in your deposits. You say, however, that your reserves are out of all proportion to the amount carried with correspondent banks, and point out that one of your correspondent banks collects 94 percent of your foreign items, collects all of your non-par checks, and performs other services for you, which are very expensive. The Federal Reserve banks do not, of course, handle checks not payable at par, but as to other checks there appears to be no reason why they should not be cleared through the Federal Reserve bank. The Federal Reserve bank is also in a position to perform other services for you, most of them free of charge, and in view of the statements made in your letter, we are suggesting to the Federal Reserve Bank of Richmond that it get in touch with you to see whether it cannot be of greater service to your bank than it is at present.

"It is assumed that you read the article which appeared in the February issue of the Federal Reserve Bulletin with respect to the reasons underlying the increases in reserve requirements made by the Board pursuant to the provisions of law. For your greater convenience, however, there is inclosed a copy of the text of the Board's 1936 Annual Report, recently issued, on pages 9-21 of which appears a complete discussion of the growth of member bank reserve balances in recent years and the necessity for the successive increases in requirements made by the Board. Your particular attention is called to the section entitled 'Reasons for Increasing Requirements' beginning on page 14 and the section entitled 'History and Purpose of Reserve Requirements' beginning on page 17.

"The Board would very much regret to have you withdraw from the Federal Reserve System and convert into a State nonmember bank because of the increased reserve requirements. It is inclined to feel, in view of the careful studies that were made of the probable effect of the increases in reserve requirements, that your bank in common with other small banks will not experience the difficulty which you anticipate in meeting credit demands during the height of your borrowing seasons. As you know, State banks "in North Carolina are required to carry a reserve of 15 percent against aggregate demand deposits, compared with 14 percent required to be carried by country member banks of the Federal Reserve System against net demand deposits. It is true that nonmember State banks in North Carolina may treat vault cash and balances on deposit with other banks as reserves, whereas cash and bank balances may not be counted as reserves by member banks. As in the case of reserve balances on deposit with Federal Reserve banks, however, balances with correspondent banks are not income-producing assets, inasmuch as member banks and insured nonmember banks are no longer permitted to pay interest on demand deposits. In contrast with the State reserve requirements, the 14 percent requirement in the case of country member banks applies to net demand deposits, that is, to the excess of gross demand deposits over balances due from banks and cash items in process of collection. In the case of your bank this is important, since your March 31, 1937, condition report indicates that out of total deposits of $971,000, $355,000 was on deposit with other banks. The amount of net demand deposits subject to reserves, consequently, is considerably reduced by the provision of law permitting the deduction of bank balances.

"The Board of Governors of the Federal Reserve System, in considering the increases in reserve requirements, was particularly concerned with their probable effect upon small banks during the peak of borrowing periods, and carefully considered the views of country banks on the problem. Although the matter of reserves has been disposed of for the time being, the effects of the increases are being closely observed. Your comments on the subject are, therefore, of considerable interest to the Board.

"Copies of this letter are being sent to Senator Bailey and Congressman Lambeth, to each of whom you sent a copy of the letter which you addressed to the Board."

Approved unanimously.

Letter to Mr. Knoke, Vice President of the Federal Reserve Bank of New York, reading as follows:

"Reference is made to your letter of July 3, 1937, stating that the Bank for International Settlements has advised you that the Hungarian National Bank is making arrangements to transfer to your bank on July 19, 1937, interest due on that date at the rate of one per cent per annum on the First and Second Syndicate Credits, in accordance with the renewal "agreement of October 18, 1936, and that the amounts due the Federal reserve banks are $614.09 on the First Credit and $5,630.50 on the Second Credit according to the legal definition of the dollar in force on December 17, 1931.

"The Board approves the proposal that your bank advise the Bank for International Settlements that you prefer payment in dollars and, as in the case of previous interest payments, of your willingness to have such amounts converted into present United States dollars, and upon receipt of dollar proceeds to credit $614.09 and $5,630.50 as interest and the balance as partial repayments of principal, with the understanding, of course, that you will obtain the assent of the other Federal reserve banks to the proposal before advising the Bank for International Settlements in the premises.

"It is noted that your advice to the Bank for International Settlements on this subject will contain the usual reservations with respect to your rights under existing agreements and otherwise."

Approved unanimously.

Letter to the Presidents of all Federal Reserve Banks, reading as follows:

"In its letters of April 4, 1923 (X-3683) and January 22, 1936 (X-9459), the Board requested that the Federal Reserve Agents report to the local United States Attorneys and to the Board for submission to the Department of Justice all cases of apparent violations of the criminal provisions of the banking laws of the United States coming to their attention in the performance of their duties, involving State member banks or Federal Reserve banks.

"The Board has recently given careful reconsideration to its policy in regard to the reporting of misdemeanors and is of the view that a Federal Reserve bank, in determining whether or not to report the facts of any such case to the local United States Attorney, should give consideration to the question whether the making of such report would be desirable or undesirable in the public interest or would serve any useful purpose in view of the importance of the case and all of its facts and circumstances. The bank should then report or not report the matter in the exercise of a sound discretion. In every case in which such a report is not made, a complete record of the facts and circumstances of the case should be preserved in the files of the Federal Reserve bank for review by the Board's examiners.

"The above applies only to misdemeanors and not to felonies, however, and the Federal Reserve bank should report to the local United States Attorney every case in which facts come to the bank's attention from which it appears probable, even though it is not entirely clear, that a violation of the banking laws constituting a felony may have occurred. In this connection, it is suggested that counsel for the Federal Reserve bank be consulted on doubtful questions which may arise from time to time, both in respect to the question whether the facts of a particular case may constitute a felony or a misdemeanor and in regard to other aspects of the matter. In every case in which a report is made to the local United States Attorney, whether of a felony or of a misdemeanor, three copies of the report should be forwarded to the Board in order that the Board may transmit copies to the Attorney General of the United States.

"This letter relates to the manner of reporting apparent violations of the criminal provisions of the Federal banking laws which involve Federal Reserve banks or State member banks, as well as any other violations of such provisions which should appropriately be reported by the Federal Reserve banks or the Board of Governors. However, the letter is not to be understood as affecting the reporting of apparent violations which involve national banks, as this is covered by the Board's letter of February 8, 1928 (X-5072), nor the reporting of bank robberies, as this is covered by the Board's letters of September 24, 1934 (X-8017) and March 15, 1935 (X-9147)."

Approved unanimously.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved: M S Eccles
Chairman.