

A meeting of the Board of Governors of the Federal Reserve System was held in Washington on Wednesday, October 20, 1937, at 11:30 a. m.

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

The minutes of the meeting of the Board of Governors of the Federal Reserve System held on October 14, 1937, were approved unanimously.

The minutes of the meetings of the Board of Governors of the Federal Reserve System held on October 15 and 16, 1937, were approved and the actions recorded therein were ratified unanimously.

The minutes of the meeting of the Board of Governors of the Federal Reserve System with the Presidents of the Federal reserve banks held on October 19, 1937, were approved unanimously.

Telegrams to Messrs. Stewart and Sargent, Secretaries of the Federal Reserve Banks of St. Louis and San Francisco, stating that the Board approves the establishment without change by the respective

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banks on October 19, 1937, of the rates of discount and purchase in their existing schedules.

Approved unanimously.

Letter dated October 19, 1937, to the Federal Deposit Insurance Corporation, reading as follows:

"Pursuant to the provisions of section 12B of the Federal Reserve Act, as amended, the Board of Governors of the Federal Reserve System hereby certifies that 'The Morris Plan Bank of Toledo', Toledo, Ohio, became a member of the Federal Reserve System on October 14, 1937, and is now a member of the System. The Board of Governors of the Federal Reserve System further hereby certifies that, in connection with the admission of such bank to membership in the Federal Reserve System, consideration was given to the following factors enumerated in subsection (g) of section 12B of the Federal Reserve Act:

1. The financial history and condition of the bank,
2. The adequacy of its capital structure,
3. Its future earnings prospects,
4. The general character of its management,
5. The convenience and needs of the community to be served by the bank, and
6. Whether or not its corporate powers are consistent with the purposes of section 12B of the Federal Reserve Act."

Approved unanimously.

Memorandum dated September 20, 1937, from Mr. Baumann, Assistant Counsel, referring to the question raised in the report of examination of the Federal Reserve Bank of Boston as of July 22, 1936, whether guaranty funds set up pursuant to law by certain State member banks in the First Federal Reserve District should be regarded as surplus for the purpose of determining the amount of Federal reserve bank

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stock each of the banks should own. The memorandum stated that it was felt that the question could not be answered dogmatically; that while the question had not been expressly ruled on, the Board and the Federal Reserve Bank of Boston had acted consistently on the assumption that the guaranty funds do not constitute surplus for this purpose; that it was Mr. Baumann's opinion that such action constitutes such an administrative interpretation of the law as might properly influence the opinion of a court if the question arose, and that, in the circumstances it was recommended that the Board take no action concerning the matter and that the existing practice not be disturbed.

Approved unanimously.

Letter dated October 19, 1937, to Mr. Rounds, Vice President of the Federal Reserve Bank of New York, reading as follows:

"Reference is made to your letter of October 13, 1937, regarding the inquiry submitted to your bank by Mr. Robert E. Broome, Vice President of Guaranty Trust Company of New York, relating to section 3(i) of Regulation U.

"It is understood that the Guaranty Trust Company made a loan to an individual pursuant to Regulation U, and that by reason of depreciation in the market value of the collateral the margin behind the loan became less than the bank customarily requires to be maintained for its own protection. In reply to the bank's call for additional margin, the borrower advised the bank that his wife had an ordinary securities account at a brokerage office and was willing to transfer her account to the bank in order to give the bank the protection of her equity in the account. The wife's account at the brokerage office has a substantial equity but is a restricted account and, therefore, could not be taken over by the bank as an ordinary increase in the bank's loan to the husband. Section 3(e) of the regulation, which makes special provision for transfers between lenders, provides only for transfers from one bank to another bank.

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"Section 3(i) of Regulation U provides:

'Nothing in this regulation shall be construed as preventing a bank from taking such action as it shall deem necessary in good faith for its own protection.'

"Mr. Broome indicates that, while the taking over of the wife's account to strengthen the husband's loan would afford the bank additional protection, the bank would like the Board's views as to whether this would be considered to be 'necessary' for the bank's protection within the meaning of section 3(i). In this connection he points out that there are, at least in theory, three other methods by which the bank could be protected. The bank could take an assignment of the equity in the wife's account, securities could be liquidated from the husband's loan, or securities could be liquidated from the wife's account sufficient to make the account unrestricted and the account could then be transferred as an ordinary increase in the husband's loan. In other words, the transfer is not indispensable to the protection of the bank, although it probably would be more satisfactory than any of the other methods.

"The word "necessary" has not a fixed meaning or character peculiar to itself, but is flexible and relative. * * * It may mean something which in order to accomplish a given object cannot be dispensed with, or it may mean something reasonably useful and proper.' Marshall County v. Rokke, (Minn. 1916) 159 N.W. 791; Words and Phrases (Series 1-4); Black's Law Dictionary Third Edition (1933). From this scale of meanings, the word, as used in section 3(i), should, of course, receive that gradation of meaning that is most appropriate in the light of the general purposes of the regulation.

"The Board feels that a particular action might be 'necessary' for the bank's protection even though it might not be indispensable for such protection. On the other hand, the Board is of the opinion that an action should not be considered to be 'necessary' for the bank's protection, within the meaning of section 3(i), merely because it might afford some incidental protection to the bank.

"The Board believes that the proper test to be applied under section 3(i) is, in effect, whether the action is reasonable and appropriate as one whose only important purpose is to strengthen the collateral for one of the bank's existing loans. While this does not mean that the action must be indispensable to the safety of the loan, it necessarily means that the action could not be actively engaged

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"in with a view to increasing the bank's loan portfolio and could not be promotional or competitive in nature.

"Mr. Broome's caution in wishing to be certain that his bank operates in strict conformity with the spirit and purpose of Regulation U, as well as its letter, is, of course, highly commendable. The Board believes, however, that the possibility of protecting the bank by some other methods, as indicated in Mr. Broome's inquiry, does not prevent the proposed transfer from being 'necessary' for the bank's protection. On the basis of the facts indicated, and assuming the absence of promotional or competitive features as discussed above, the Board is of the opinion that the transfer would be permissible under the provisions of section 3(i)."

Approved unanimously.

Thereupon the meeting adjourned.

Chester Morrie
Secretary.

Approved:

W. S. ...
Chairman.