

A meeting of the Board of Governors of the Federal Reserve System was held in Washington on Saturday, October 23, 1937, at 11:00 a. m.

PRESENT: Mr. Eccles, 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 22, 1937, were approved unanimously.

Telegrams to Messrs. Kimball, Clark and Young, Secretaries of the Federal Reserve Banks of New York, Atlanta and Chicago, stating that the Board approves the establishment without change by the New York bank on October 21, and by the Atlanta and Chicago banks on October 22, 1937, of the rates of discount and purchase in their existing schedules.

Approved unanimously.

Letter to the board of directors of "The Auburn State Bank", Auburn, Indiana, stating that, subject to the conditions of membership numbered 1 to 6 contained in the Board's Regulation H and the follow-

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ing special conditions, the Board approves the bank's application for membership in the Federal Reserve System and for the appropriate amount of stock in the Federal Reserve Bank of Chicago:

- "7. Such bank shall make adequate provision for depreciation in its banking house.
- "8. As soon as practicable, such bank shall dispose of any loans which may be secured in whole or in part by its own stock, or obtain the substitution of other adequate security for each such loan.
- "9. Prior to admission to membership such bank, if it has not already done so, shall charge off or otherwise eliminate net depreciation of \$4,001.81 in securities and estimated losses of \$3,550.41 in other assets, all as shown in the report of examination of such bank as of September 27, 1937, made by an examiner for the Federal Reserve Bank of Chicago."

Approved unanimously, together with a letter to Mr. Schaller, President of the Federal Reserve Bank of Chicago, reading as follows:

"The Board of Governors of the Federal Reserve System approves the application of 'The Auburn State Bank', Auburn, Indiana, for membership in the Federal Reserve System, subject to the conditions prescribed in the inclosed letter which you are requested to forward to the board of directors of the institution. Two copies of such letter are also inclosed, one of which is for your files and the other of which you are requested to forward to the Director of the Department of Financial Institutions for the State of Indiana for his information.

"It has been noted that, while the bank has full trust powers, it has availed itself thereof only to a limited extent; that the management is reported to be desirous of discontinuing the trust business; that no effort is made to secure new business; and that the largest trust, the receivership of a bank, will be shortly closed out. According to the report of examination, the by-laws of the bank contain

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"no provisions with respect to a trust department, its officers and duties, or a trust committee. The report of examination also contains several criticisms of the operations of the department. Acceptance of any trust business, no matter how small, entails serious responsibilities, and the management should be advised that it will be expected to take proper steps to bring its trust activities, so long as it has any trust accounts, into conformity with approved practices.

"It will be noted that the eliminations required by condition of membership numbered 9 include, in addition to the estimated losses as shown in the report of examination, the amount of depreciation in group 2 securities less appreciation in group 1 securities. Such requirement is in accordance with the policy outlined in the Board's letter of December 9, 1933, (X-7705).

"The report of examination lists two savings accounts which do not conform to the definition of savings deposits as contained in the Board's regulations and it is assumed, of course, that the bank will be acquainted with the provisions of such regulations and that, if admitted to membership, any accounts which may not be considered as savings deposits under the regulations will be carried in some other manner.

"It is understood that the laws of the State of Indiana prohibit the bank from pledging its assets as security for trust funds deposited in its banking department and that trust funds so deposited are preferred claims in event of liquidation of the bank. Standard condition of membership numbered 6, however, has been prescribed in order that its provisions may be invoked at any time in the future if necessary. You are, of course, authorized to waive compliance with the condition until further notice in accordance with the general authorization previously granted by the Board with which you are familiar.

"The papers submitted with the application did not include a copy of a certificate from the State authorities authorizing the bank to commence business. If such a certificate was required in connection with the reincorporation of the bank in 1924, it will be appreciated if you will obtain and forward a copy thereof to the Board for its records."

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

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"This refers to your letter of October 11, 1937, with reference to whether the Lake Charles Bank and Trust Company, Lake Charles, Louisiana, and the Rapides Bank & Trust Company in Alexandria, Louisiana, should deposit trust funds now carried in their banking departments in other banks pending the passage of legislation which would authorize these and other banks in Louisiana to pledge securities to secure trust funds carried in their banking departments.

"In view of the active steps which you advise are being taken to obtain the enactment of legislation of the kind referred to at the next session of the Louisiana Legislature in May 1938 and the fact that it appears from the reports of examination which are available here that the banks referred to are in good condition and under capable management, the Board will not insist at this time that these banks carry funds of trusts which they administer in other banks in order to comply with the condition of membership to which the banks are subject.

"In connection with the proposed amendment to the Louisiana statutes, it has been noted that the duty would be placed on a trustee bank to obtain collateral when carrying trust funds with an affiliate or in its own banking department 'unless dispensed from doing so by specific words in the trust instrument'. The question is raised for your consideration as to whether, in a case where a trust instrument relieved a bank from the duty of obtaining collateral, it would have authority to require such collateral in order to comply with the Board's condition of membership. It is suggested that if you have not already done so you have your counsel review the proposed legislation in order to be entirely certain that, if enacted, it will accomplish the purpose for which it is intended.

"Please advise the Board whether or not the proposed legislation is enacted into law at the next session of the Louisiana Legislature and if in the meantime there should be any substantial change which might affect the Board's position with regard to the handling of trust funds by the Lake Charles Bank and Trust Company and the Rapides Bank & Trust Company in Alexandria, please call the facts to the attention of the Board for consideration."

Approved unanimously.

Letter to Mr. William Prentiss, Jr., Deputy Comptroller of the Currency, reading as follows:

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"This refers to your letter of June 5, 1937, and inclosures, requesting the Board's views upon the question whether the amounts carried in a 'Construction Loan Account' by the Manufacturers National Bank, Detroit, Michigan, should be considered as deposits for the purpose of computing the bank's required reserves.

"It is understood that it is the practice of the bank to require the applicant for a construction loan to execute a note and mortgage for the full amount of the loan and also an agreement authorizing the bank to make advances on behalf of the borrower as the construction of the building progresses. The agreement provides that no part of the amount represented by the note shall be considered as loaned until actually advanced to or on behalf of the borrower; that interest shall be paid by the borrower only on the amounts actually advanced; and that at no time shall the unadvanced portion of the commitment be considered as money or credits owing to the borrower.

"It is also understood that as soon as the note and mortgage are executed and recorded the full amount of the note is set up as an asset in the bank's report of condition and the unadvanced portion of the amount of the note is transferred to an account entitled 'Construction Loan Account' which is shown in the condition report under the heading 'Other Liabilities'. The bank has indicated that the purpose of the above arrangement is to insure that the unadvanced portion of the amount of the note shall not be subject to garnishment or levy in suits against the borrower.

"In view of the fact that the agreement executed at the time the note and mortgage are given expressly provides that no part of the amount represented by the note shall be considered as loaned until actually advanced and that no interest shall be paid on the unadvanced portion thereof, it is the view of the Board of Governors that prior to the advancement of the entire proceeds of the loan it is improper for the bank to include the full amount of the note in the condition report as an asset and to list the unadvanced portion thereof under the heading of 'Other Liabilities'. It is believed that this method of reporting reflects the transaction inaccurately. On the basis of the facts stated above, it appears that only the amount which has actually been advanced should be shown as an asset in the condition report and that such report should not include under the heading 'Liabilities' the difference between the face of the note and the amount actually advanced.

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"If the bank should make the changes outlined above in the method of reporting the transaction in its condition report, it is the opinion of the Board of Governors that, on the basis of the facts stated herein, the unadvanced portion of the amount of the note would not represent a liability against which it is necessary to maintain reserves."

Approved unanimously.

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

"Receipt is acknowledged of your letter of October 19, 1937, together with inclosures relating to the temporary closing of the Shanghai Branch of the National City Bank of New York. The Board is in accord with your view that the requirements of Regulation 'M' seem to have been complied with and, while there appears to be no necessity for requesting further information at this time, the Board will appreciate advice of any developments which may come to your attention in the future."

Approved unanimously.

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

"Receipt is acknowledged of your letter of October 13, 1937, inclosing copies of certain correspondence of the Bank for International Settlements, together with a copy of your proposed reply to their letter of August 18, 1937.

"In reply, you are advised that the Board is in agreement with the views expressed in the second paragraph of your letter relating to the authority of your bank to purchase eligible dollar bankers acceptances and has no suggestion to offer regarding the proposed reply to the Bank for International Settlements."

Approved unanimously.

The proposed reply to the letter received by the New York bank from the Bank for International Settlements under date of August 18, 1937, read as follows:

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"We have for acknowledgment your letter of August 18, 1937, bringing to our notice certain points in connection with your operations in this market, and wish to refer to our separate letter of today quoting our revised terms and conditions which will henceforth substantially apply to all foreign accounts on our books.

"Dealing with the suggestions as submitted in your letter for our consideration, we offer the following comments:

"You make reference to the old repurchase agreement covering bankers acceptances purchased through us, as contained in our letter of May 12, 1930, and suggest that we consider either inserting in our new terms a similar agreement to cover bankers acceptances not purchased through our intermediary or else granting to you in this domain the same facilities as to a member bank. As you will note from our new terms and conditions (II. INVESTMENTS) we no longer offer our correspondents a firm agreement covering the repurchase by us of bankers acceptances originally bought through us. With reference to other facilities which are available to a member bank, we have, in our letter of July 30, 1937, informed you that, although under the terms of the Federal Reserve Act a Federal reserve bank is authorized to 'rediscount' bankers acceptances at its official discount rate, for member banks, such rediscount facilities are, under the law, not available to any foreign bank. We can of course purchase acceptances from banks and others in the market but it is not our practice to make commitments for such future purchase. It is, however, our practice, without prior commitment, to purchase bankers acceptances offered to us at our current buying rate provided they are in the market to buy such acceptances and provided they are in all respects satisfactory from the standpoint of eligibility, negotiability, acceptability as to credit standing of parties liable thereon, and otherwise. In this connection we wish to repeat, as frequently stated in the past, that it is our policy to purchase only prime commercial bills accepted by a bank and endorsed by another bank or by a recognized dealer. In the ordinary course, therefore, if you should offer acceptances to us and if such acceptances were in all respects satisfactory to us, we know of no reason why we would not be willing to purchase such acceptances at our current buying rate provided we are then in the market to buy such acceptances; but we do not make advance commitments to do so.

"You next inquire whether we 'would consider the possibility of granting us a favored position as regards the

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"distribution among your correspondents of bankers acceptances at your disposal so as to assist us in the plan for concentrating central bank reserves with the Bank for International Settlements'. Bearing in mind that, with the exception of your account, all other foreign accounts on our books are those of foreign central banks, it would hardly be fair and equitable for us to discriminate against the latter in your favor. We have always made it a point to execute orders in the order in which they are received, which, it seems to us, is the only proper method to apply. We are, of course, fully aware that under prevailing conditions, in view of the present great scarcity of bills, this may be a greater hardship for you than for some of our other foreign correspondents; we like, however, to think that with a further improvement of international trade the supply of bankers acceptances will again become more plentiful and sufficient to execute a larger portion of the foreign orders now reaching us.

"You urge us to reconsider the possibility of making a reduction, in your case, of the commission of 1/8% per annum in connection with the purchase by us for your account of bankers acceptances, which you say now appears somewhat high in relation to the rate of discount at present prevailing in our market. This and similar questions have, as you state, been raised on a number of occasions in the past by your former President, Mr. Leon Fraser. When reviewing this part of our terms and conditions we had in mind Mr. Fraser's previous suggestions of a rebate of our commissions in the event of the repurchase by us of any such acceptances or the sale thereof in the market prior to maturity, and decided to provide for a rebate. (See II. INVESTMENTS, A, Bankers Acceptances, second paragraph of our new terms.) This, we believe, should simplify at least some of your problems and certainly help to remedy the situation described by Mr. Fraser to us in November, 1934. To make an exception in your case alone and to reduce our rate below 1/8% per annum would, we feel, hardly be fair to the many foreign central banks which carry accounts with us. To make a general reduction of this commission would, in our opinion, not be sound because the charge of 1/8% for guarantee of payment must be considered a reasonable compensation for the responsibility assumed by us, which, of course, remains the same irrespective of the rate of discount prevailing and of the bank to which the facility is extended.

"Finally, you inquire whether 'If at any time you were

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"to grant special conditions on the above mentioned points to the central banks in countries which have subscribed to the Multipartite Agreement, such privileges would also be extended to us?' Although it is, of course, a little difficult for us to deal in specific terms with developments which the future may hold, we can say that as regards the above-mentioned points our new conditions for transactions which we, as a bank of issue, handle for a foreign central bank, as a bank of issue, are identical in all cases and that these terms are also quoted to the Bank for International Settlements. While not related to the points you mention there have been cases, however, where special arrangements have been made by our Treasury with the Treasuries of other countries and where we have been asked, as fiscal agents of the United States, to enter into special arrangements with foreign central banks acting as fiscal agents for their Treasury Departments. We are not, of course, at liberty to grant such special conditions to others in cases where no special arrangements have been made with our Treasury Department."

Letter to Mr. Wm. H. Bush, Asbury Park, New Jersey, reading as follows:

"Your letter of October 8, addressed to the Federal Advisory Council, has been received by the Board of Governors of the Federal Reserve System, for whom, it is assumed, it was intended.

"The Board of Governors has been vested with no powers with respect to the manipulation of security prices and understands that all of such powers as have been given by Congress to federal government agencies have been given to the Securities and Exchange Commission.

"It is noted that you have already taken up the subject of your letter with the Commission."

Approved unanimously.

Thereupon the meeting adjourned.

Approved:

W. C. C. C.
Chairman.

Robert Morrie
Secretary.