

A meeting of the Board of Governors of the Federal Reserve System was held in Washington on Friday, May 27, 1938, at 11:30 a.m.

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

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 May 26, 1938, were approved unanimously.

Telegrams to Mr. Young, President of the Federal Reserve Bank of Boston, Messrs. Kimball and Hays, Secretaries of the Federal Reserve Banks of New York and Cleveland, respectively, Mr. Leach, President of the Federal Reserve Bank of Richmond, Mr. McLarin, Vice President of the Federal Reserve Bank of Atlanta, Messrs. Young, Stewart and Powell, Secretaries of the Federal Reserve Banks of Chicago, St. Louis and Minneapolis, respectively, Mr. Thomas, Chairman of the Federal Reserve Bank of Kansas City, Mr. McKinney, President of the Federal Reserve Bank of Dallas, and Mr. Sargent, Secretary of the Federal Reserve Bank of San Francisco, all stating that the Board of Governors of the Federal Reserve System approves the establishment without change by the Federal Reserve Bank of San Francisco on May 24, by the Federal Reserve

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Banks of New York, Cleveland, Richmond, Chicago, St. Louis, Minneapolis, Kansas City and Dallas on May 26, 1938, and by the Federal Reserve Banks of Boston and Atlanta today, of the rates of discount and purchase in their existing schedules.

Approved unanimously.

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

"In accordance with the request contained in your letter of May 25, the Board approves the appointments as regular assistant examiners of William Hirst and John K. Neeley, whose designations as special assistants to examiners had been previously approved by the Board. It is assumed, of course, that you are satisfied that the mortgage indebtedness of Mr. Hirst held in the trust department of a member bank in Philadelphia, which indebtedness is reported to have been incurred in 1926, will in no wise interfere with the discharge of his duties as an assistant examiner for the Reserve bank nor cause any embarrassment to the Reserve bank."

Approved unanimously.

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

"This refers to your letter of May 20, 1938, forwarding a memorandum of a conference held at the Federal Reserve Bank on May 18, 1938, with representatives of the Fleetwood Bank, Mount Vernon, New York. It is noted that a representative of the Reconstruction Finance Corporation was also present at the conference and that the Federal Deposit Insurance Corporation would be informed of developments at the meeting.

"The memorandum indicates that the unsatisfactory features of the bank's condition as disclosed by the report of the examination made as of April 5, 1938, were

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"forcefully brought to the attention of the officers and directors present and that they were reminded of the conference held following the previous examination, as of January 26, 1937, at which objectionable practices, some of which are responsible for the bank's present unsatisfactory condition, were discussed, and of the promises which had been made but not fulfilled with respect to the treatment of the security account. The Board is pleased to note that as a first step in improving the management, Director Teipel, who it appears is largely responsible for the unsatisfactory condition of the bank, tendered his resignation subsequent to the conference, effective immediately. The memorandum, however, indicates other serious weaknesses in the management of the bank, the correction of which would appear to be an essential step in the rehabilitation of the bank's affairs.

"It is noted that the attention of the representatives of the bank present at the meeting was directed to condition of membership numbered 2 under which the bank was admitted to membership in the Federal Reserve System and which provides the Fleetwood Bank shall, at all times, conduct its business and exercise its powers with due regard to the safety of its depositors; that the representatives were told that on the basis of the most recent report and past experiences with the bank it did not appear that the bank's affairs had been conducted with this condition in mind and that the flagrant violations of the condition, as reflected in the report of examination as of April 5, 1938, might be made a basis for proceedings looking to the forfeiture of the membership of the Bank of Fleetwood in the Federal Reserve System.

"In the circumstances it would seem incumbent upon the bank to prepare promptly a satisfactory plan for the rehabilitation of its affairs and particularly the strengthening of its management. In the event of the failure of the bank to develop and submit a satisfactory program without undue delay, it would appear to be in order for the Reserve Bank to submit the facts in the case to the Board with a recommendation as to what action, if any, should be taken with respect to termination of the bank's membership in the System for violation of the provisions of condition of membership numbered 2."

Approved unanimously.

Letter to Mr. Fry, Vice President of the Federal Reserve Bank

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of Richmond, reading as follows:

"This refers to your letter of May 12, 1938, and inclosure, inquiring whether the liability of an executive officer of a member bank for the payment of a mortgage loan made by the Federal Land Bank of Baltimore or a mortgage loan made by the Land Bank Commissioner, to another person, under the provisions of the Emergency Farm Mortgage Act of 1933, as amended, should be reported by such officer to his board of directors, as provided in section 22(g) of the Federal Reserve Act and the Board's Regulation O.

"Under the provisions of the statutes creating and defining the powers of the Federal Land banks it is provided, among other things, that such banks may issue and sell farm loan bonds, make real estate loans secured by first mortgages, borrow money, and accept deposits of securities or of current funds of national farm loan associations. Such banks may also be designated by the Secretary of the Treasury as depositaries of public money and may also be employed as fiscal agents of the Government. In this connection the Board has heretofore taken the position that a Federal Land bank is a 'bank' within the meaning of section 8 of the Clayton Act. In the circumstances, it is the view of the Board that a Federal Land bank should properly be regarded as a 'bank' within the meaning of that provision in section 22(g) of the Federal Reserve Act which requires an executive officer of a member bank to report his indebtedness 'to any bank other than a member bank of which he is an executive officer.'

"While the Land Bank Commissioner has the power to make certain real estate loans, he does not have the power to accept deposits nor may he be designated as a depositary of public money or as a fiscal agent of the Government. It would seem, therefore, that the Land Bank Commissioner is not a 'bank' within the meaning of section 22(g).

"Accordingly, an executive officer of a member bank who is indebted to a Federal Land bank is required to report such indebtedness to his board of directors in accordance with the provisions of section 5 of the Board's Regulation O; but an indebtedness of an executive officer to the Land Bank Commissioner need not be so reported."

Approved unanimously.

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Letter to Honorable Robert F. Wagner, Chairman of the Committee on Banking and Currency of the United States Senate, prepared by Counsel in accordance with the action taken at the meeting of the Board on May 24, 1938, and reading as follows:

"This is in response to the request of the Committee for the views of the Board of Governors with respect to Bill S. 3874, 'To amend the Federal Home Loan Bank Act, the Home Owners' Loan Act of 1933, the Federal Reserve Act and the National Housing Act, and for other purposes'.

"In the outset, it may be said that the members of the Board are in sympathy with the objectives of the Home Loan Banks as reservoirs of funds for the accommodation of their member institutions and with the objectives of their member institutions as local mutual thrift and home financing associations; and the Board would not be disposed to offer any objection to clarifying amendments designed to make the Federal Home Loan Bank Act more effective within the limitations of the purposes with respect to which the System was created.

"The Board, however, after a study of the provisions of the Bill is convinced that it departs so far from any concept of Federal savings and loan associations and other member institutions of Federal Home Loan Banks as local mutual thrift institutions, as to tend to establish, if indeed it would not establish, a separate and complete banking system competing on favored terms with savings banks and savings departments of commercial banks. In addition, the Bill contains certain provisions which, in the opinion of the Board, are in conflict with sound policies affecting Government credit and the Federal Reserve System.

"Regarding the Bill's specific provisions and illustrative of the broad conclusions above stated, section 1 of the Bill would broaden the definition of a 'home mortgage' from a mortgage upon a dwelling of not 'more than four families' to a mortgage upon any multiple dwelling unlimited in size as to the number of families it houses, except as determined by the Federal Home Loan Bank Board. This might result in an undesirable increase in the size of individual loans and in concentration of risks and, by implication at least, abandon any concept of such associations as mutual thrift and home financing associations.

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"Sections 2 and 3 would support the enlarged lending powers of Federal as well as State-chartered member associations by liberalizing the class of securities upon which Federal Home Loan Banks are authorized to make advances to their member institutions. At present, mortgages eligible for advances are restricted to 'home mortgages'. These sections would completely eliminate such restrictions so as to enable advances upon the collateral security of any mortgage. Because the later Section 4 refers only to home mortgages, none of the further restrictions contained in Section 4 would apply to these other mortgages. Section 2 would further extend the list of collateral eligible for rediscount by home loan banks to a materially different class of securities. It would include, as eligible security, not only Government guaranteed obligations and obligations of the Federal Savings and Loan Insurance Corporation but also whatever other obligations the Board might approve.

"Section 4 would further liberalize the list of collateral acceptable for advances by the home loan banks to member institutions by including home mortgages of longer maturities up to 25 years instead of the present limit of 20 years. It would increase the amount permitted to be advanced from \$20,000 to \$30,000 or such greater amount as the Board might fix by regulation. The amount, therefore, would be unlimited except in the discretion of the Board. No limit, even discretionary, is set upon the amount of advances on other mortgages than home mortgages. Section 4 also sets up certain restrictions on past due home mortgages, which are likewise not made to apply to other mortgages.

"Section 7 would authorize the Home Owners' Loan Corporation to purchase up to \$250,000,000 of Federal Home Loan Bank debentures and obligations of the Federal Savings and Loan Insurance Corporation. This authorization would constitute a revolving fund and would be in addition to the present authorization of \$300,000,000 made available for the purchase of obligations of the Federal Home Loan Banks and for investments in building and loan associations. Here again, funds would be made available to Federal Home Loan Banks for the making of advances to their member associations. Also, Government credit would be made available to the Federal Savings and Loan Insurance Corporation, the effect of which would lessen the burden of insurance to insured associations and their shareholders and shift it to

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"the Government. Moreover, since the Home Owners' Loan Corporation was created for emergency purposes, it would seem inappropriate to finance a permanent organization through the medium of such a temporary agency.

"By Section 9, Federal savings and loan associations would be permitted to loan as much as 30 per cent of their assets on improved real estate of any kind without regard to the \$20,000 limitation upon amount and without regard to the 50-mile limit, both of which limitations ordinarily apply to home mortgage loans. At present, this authority is limited to 15 per cent of the assets of the association. The associations would also be authorized to invest not only in obligations guaranteed as to principal and interest by the United States, but also in any other obligations approved by the Home Loan Bank Board, in addition to obligations of the United States and stock or bonds of Federal Home Loan Banks, as now provided.

"Federal savings and loan associations are already exempted from Federal taxation and are protected from any discriminatory taxation which might be imposed by any State, county, municipal or local taxing authority. Moreover, shares of Federal savings and loan associations are now exempted from Federal income taxation. Section 10 of this Bill goes a good deal farther, and exempts shares of the Federal associations from any State and local income and personal property taxes. In addition, the associations themselves are exempted from all but real property taxes imposed by States and other taxing authorities. It would be further provided that all Federal taxation and any State-chartered building and loan, savings and loan, or homestead association or cooperative bank should be on the same basis as that here prescribed for Federal savings and loan associations, that is, complete exemption for the associations and exemption of their shares from Federal normal income taxes.

"The tax provisions of this section have two undesirable effects. First, as regards Federal taxation, they give State-chartered building and loan associations and their shareholders an advantage over banks and their stockholders and depositors, which are now on an equal basis with Federal savings and loan associations. It should be borne in mind that neither national nor State banks are exempt from Federal income taxation, nor are dividends on their stock and interest on their deposits exempt from Federal normal income taxation. Such exemptions, already enjoyed by Federal savings and loan associations and their share-

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"holders, are now to be extended to State-chartered building and loan associations.

"Secondly, as regards taxation by the States, the bill would create a preferential tax status for Federal savings and loan associations over both banks and State-chartered building and loan associations. Here it should be remembered that national banks, State banks and State-chartered building and loan associations may be taxed by the States, also the income of depositors of national and State banks, and the dividends of shareholders of State-chartered building and loan associations are subject to such income taxes as may be imposed by the States. In both these respects the Bill would give Federal savings and loan associations and their shareholders new advantages. Section 10 therefore, might force all States which levy any taxation upon State building and loan associations or their shareholders to abandon such taxation or cause such State institutions to operate under a serious competitive disadvantage with Federal associations. In any event, even if such taxation were abandoned by the States, national and State banks would be left in a new competitive disadvantage in relation to building and loan associations. In view of the President's request that consideration be given to the matter of eliminating tax exemptions with respect to future Government securities and of all Federal and State salaries, Section 10 in its tax feature would appear especially unwise at this time.

"A second part of Section 10 makes insured shares of Federal associations lawful security for 'fiduciary, trust and public funds, etc.' In this connection, it may be pointed out that an insured deposit in a bank cannot be so used and, in this respect, the Bill would elevate the status of insured shares of building and loan associations above that of insured deposits in banks.

"Section 13 would permit national banks to purchase for their own account shares and accounts of Federal savings and loan associations and other institutions insured by the Federal Savings and Loan Insurance Corporation. Whether or not such securities should find their way into the portfolios of national banks may be questioned and furthermore, such a provision could result in building and loan associations becoming subsidiaries of or being controlled by national banks.

"With respect to Section 14, which would make obligations issued under the Home Loan Bank Act, eligible as security for fifteen day advances by Federal Reserve banks,

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"it is perhaps sufficient to point out that Federal Reserve banks can now make advances to a member bank on any of its sound assets.

"Section 18 provides a reduction in premium for insurance for Federal and other insured associations from the present rate of 1/8 of 1 per cent to 1/12 of 1 per cent. While it is true that 1/12 of 1 per cent is the current rate of the Federal Deposit Insurance Corporation, the risks of the two types of insurance are not comparable and should not be so treated for the following reasons:

"(1) The assets of building and loan associations are normally upon a long-term basis and are not as liquid as those of banks, and as a corollary the shares of Federal associations and building and loan associations are not intended to be and are not as liquid as bank deposits. Furthermore, the risk is greater as is evidenced by the higher rate of interest which such associations pay in comparison to that paid by banks.

"(2) The uninsured portion of deposits in insured banks upon which banks pay premiums or assessments is much greater than the uninsured liability in insured building and loan associations. This means that when related to insured deposits in banks the assessment rate is much higher than 1/12 of 1 per cent, and

"(3) The Federal Deposit Insurance Corporation insures only the deposits of banks. The net worth of banks, represented by stockholders' interest in capital and surplus, constitutes a cushion of protection for depositors. There is no such comparable cushion in building and loan associations, whose liabilities are almost entirely capital liabilities and not at all deposit liabilities. It is these capital liabilities to the shareholders which are insured by the Federal Savings and Loan Insurance Corporation.

"Section 19 provides that in the event of default by a Federal association, the insurance corporation shall have the option to make payment in full in cash or upon a schedule as therein set out. Adoption of such a policy would tend further to place shares in savings and loan associations on a par with deposits in banks.

"For all the foregoing reasons the Board of Governors is of the opinion that the enactment of the Bill would not be in the public interest."

Approved unanimously.

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Letter to Honorable Preston Delano, Governor of the Federal Home Loan Bank Board, prepared for the signature of Mr. Clayton, Assistant to the Chairman, and reading as follows:

"This refers to your letter of May 2, 1938, and to my acknowledgment of May 6, 1938, regarding the purchase by member banks of the Federal Reserve System of shares of stock of Federal savings and loan associations and the retention by State member banks of such shares acquired before the banks were admitted to the System.

"As indicated in the inclosure with your letter of May 2, the Board of Governors has heretofore expressed the opinion that the provisions of section 5136 of the United States Revised Statutes forbid the purchase by member banks of shares of stock of Federal savings and loan associations. It is the view of the Board of Governors that the exemptions stated in section 5136 do not cover shares of stock of such associations and that the provisions of a State statute authorizing State banks to purchase such shares cannot exempt purchases by member banks, whether State or national, from the operation of the Federal statute.

"With respect to the second question presented in your letter, you are advised that it is the view of the Board of Governors that the provisions of section 5136 do not require State banks which have in good faith acquired shares of stock of Federal savings and loan associations or of other corporations while they were nonmember banks to dispose of such shares upon becoming members of the Federal Reserve System. Furthermore, it is not the practice of the Board of Governors to require as a condition of membership that banks dispose of stock, although it may be necessary in particular cases to require banks applying for membership to reduce undue concentrations in stock just as would be done in the case of undue concentrations in any other class of assets. A similar requirement might be necessary if it appeared that a bank contemplating membership had acquired stock for the purpose of evading the prohibition upon the purchase of stock by member banks.

"It is sincerely hoped that the above will clear up the questions regarding this matter, but, if there should be any further questions, please feel free to communicate with us again."

Approved unanimously.

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Letter to Honorable Daniel C. Roper, Secretary of Commerce,
reading as follows:

"In view of your interest in information concerning domestic trade, I am writing to tell you that the Board has decided to curtail the statistical work of the Federal Reserve System in the department store field and to ask whether the Department of Commerce wishes to take over the collection of department store statistics.

"The compilation of department store statistics has been done principally in the research departments of the Federal Reserve banks, which in recent months have been called upon to do an increased volume of work in other lines. For this reason and also because it is not work in which the Federal Reserve System is primarily concerned, we plan to reduce our work in the department store field to the collection of data on total sales and stocks, which we consider of importance in the general economic picture. It is hoped that we will be able, not later than the end of this calendar year, to discontinue the collection of statistics on sales and stocks by departments, cash and credit sales, and accounts receivable and collections.

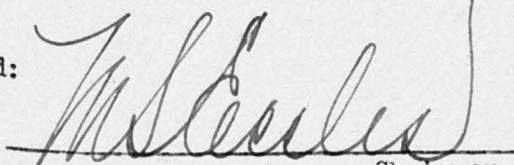
"We realize that these data are of considerable use to the department stores and to others but, in view of their limited value to the Reserve System and the large amount of additional work now required from the Reserve banks, the Board does not wish to continue the department store reporting service on its present scale.

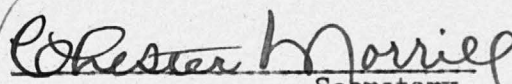
"If the Department of Commerce does not wish the collection of these data discontinued and would care to take over from the Reserve System the collection of department store statistics, we should be glad to cooperate in every way."

Approved unanimously, with the understanding that a copy of the letter would be sent to all Federal reserve banks.

Thereupon the meeting adjourned.

Approved:


Chairman.


Secretary.