A meeting of the Board of Governors of the Federal Reserve System was held in Washington on Wednesday, July 20, 1938, at 11:10 a. m.

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

Mr. Morrill, Secretary
Mr. Bethea, Assistant Secretary
Mr. Carpenter, Assistant Secretary
Mr. Clayton, Assistant to the Chairman
Mr. Wyatt, General Counsel
Mr. Paulger, Chief of the Division of Examinations
Mr. Dreibelbis, Assistant General Counsel
Mr. Leonard, Assistant Chief of the Division of Examinations

Just before the meeting there had been distributed among the members of the Board copies of a memorandum prepared by the Division of Examinations under date of July 20, 1938, in which reference was made to further discussions between representatives of the Board of Governors, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation with respect to the revision of the examination report forms used by the respective agencies in the light of the recent agreement regarding examination procedure. The memorandum stated that the discussions and a comparison of the respective drafts of the revised schedules contained in the examination report forms revealed fundamental differences as to the interpretation and application of the published agreement, and outlined the reasons why it was felt that certain proposed changes in the forms of the Comptroller

of the Currency and the Federal Deposit Insurance Corporation were not desirable or were not in accordance with the agreement.

During a discussion of the points covered in the memorandum, it was stated that since both Messrs. Diggs, Acting Comptroller of the Currency, and Folger, Chief National Bank Examiner, would be out of the city for approximately two weeks, there would be no opportunity before the end of that time for a further discussion of the differences between the report form suggested by the Board's Division of Examinations and the form proposed to be used by the Comptroller, but that Mr. Nichols, Chief of the Division of Examinations of the Federal Deposit Insurance Corporation, had indicated a possible preference for one or two of the changes proposed by the Board's representatives.

At the conclusion of the discussion, Mr. McKee moved that Mr. Paulger be requested to discuss the matter further with representatives of the Federal Deposit Insurance Corporation with a view to eliminating as many of the existing differences as possible.

Carried unanimously, with the understanding that at the conclusion of the conference with Mr. Nichols, copies of the Board's revised form of examination report would be sent to the Comptroller of the Currency and the Federal Deposit Insurance Corporation with letters of transmittal pointing out the substantial differences between the respective report forms and the Board's form and the reasons for not adopting the forms of the other agencies.

At this point Messrs. Wyatt, Paulger, Dreibelbis and Leonard left the meeting and consideration was then 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 July 19, 1938, were approved unanimously.

Memorandum dated July 15, 1938, from Mr. Morrill stating that, in accordance with the action taken at the meeting on July 12, he had talked with Mr. Gidney, Vice President of the Federal Reserve Bank of New York, by telephone with respect to the proposed ruling of the Board that the limitation upon the rate of interest on time and savings deposits contained in the Regulation of the Banking Board of the State of New York, effective October 1, 1938, is not applicable to national banks in the State of New York; that Mr. Gidney had advised Mr. White, Superintendent of Banks of the State of New York of the attitude of the Board; and that Mr. White had advised Mr. Gidney on July 15, 1938, that he considered it unnecessary to pursue the matter further with the Board as he felt the Board was fully acquainted with his position in the matter and that when the Board had issued its ruling he would determine what action to take.

Thereupon, the letters to Mr. Gidney and to Mr. White, as set forth in the minutes of the meeting on July 12, 1938, were approved unanimously with the understanding that they would be transmitted under today's date.

Letter to the board of directors of "The Avoca State Bank", Avoca, Iowa, stating that, subject to conditions of membership numbered 1 to 4 and 6 contained in the Board's Regulation H and the following 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:

"5. Such bank, except as permitted in the case of national banks exercising fiduciary powers, shall not invest collectively funds held by the bank as fiduciary and shall keep the securities and investments of each trust separate from those of all other trusts and separate also from the properties of the bank itself.

"7. Such bank shall make adequate provision for depreciation in its banking house and furniture and fixtures.

"8. Prior to admission to membership, such bank, if it has not already done so, shall charge off or otherwise eliminate estimated losses of $2,367.25, as shown in the report of examination of such bank as of June 21, 1938, made by an examiner for the Federal Reserve Bank of Chicago."

The letter also contained the following special comment:

"It has been noted that the bank is authorized to exercise full fiduciary powers, but that at the time of examination it had only a nominal amount of trust business, and it is reported that no effort is made to increase the volume of such business. According to the report of examination the President of the bank acts as trust officer, but has not been so designated formally, and other desirable steps with respect to the establishment and operation of a trust department have not been taken. Acceptance

"of trust business, no matter how small, entails serious responsibilities, and if the bank is to continue to accept trust business it will be expected to take appropriate steps to fix the responsibility therefor and to equip itself to handle such business in accordance with approved trust practice."

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 Avoca State Bank', Avoca, Iowa, 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 Superintendent of Banking for the State of Iowa for his information.

"There are listed in the confidential section of the report of examination for membership a number of time certificates which were paid before maturity and one savings account which does not conform to the definition of savings deposits as contained in the Board's regulations, and it is assumed that, if the bank is admitted to membership, these matters will be brought into conformity with the provisions of the Board's regulations. In this connection, it has been noted that in the open section of the report the examiner refers to the list of time certificates paid before maturity appearing in the confidential section. Inasmuch as the confidential section of a report of examination is not made available to the bank examined, reference in the open section to information contained in the confidential section hardly seems appropriate and it is suggested that this matter be brought to the attention of your examining staff."

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

"This refers to your letter of June 22, 1938, inquiring under what circumstances, if any, a member bank

"may lawfully make a loan secured by a collateral note for a sum in excess of $2,500 on which an executive officer of such bank is liable as maker or indorser. Regulation O defines the term 'loan' and the term 'extension of credit' as including any transaction as a result of which an executive officer becomes obligated to a bank, directly or indirectly by any means whatsoever, by reason of an indorsement on an obligation or otherwise, to pay money or its equivalent; but these terms do not include the acquisition of any evidence of indebtedness through foreclosure on collateral or similar proceeding for the protection of the bank.

"It is believed that the question presented in your letter is one upon which it is not feasible to attempt to give a definite answer which would be applicable to all cases which may arise, but in each case the answer must depend upon the particular facts. It turns largely on the matter of good faith and on whether or not the real intention of the parties is to evade the provisions of the law or the regulation.

"If the circumstances are such that it appears that the taking of the note of the executive officer as collateral to the loan was merely for the purpose of evading the provisions of the law or the regulation, or if the facts indicate that the loan was made for the accommodation of the executive officer or was in effect an indirect extension of credit to him, it seems clear that the acceptance of the note of the executive officer would be contrary to the intent of the statute and would not be permissible. It is probable that this is true in any case in which the note of the executive officer and the note given by the third party are made simultaneously. On the other hand, if an individual to whom an executive officer has previously become indebted offers the note of the officer to a member bank as collateral to a loan which he desires to obtain and the transaction is entered into by all parties in good faith, the transaction would appear not to be inconsistent with the purposes of the law and there is believed to be no sufficient reason for regarding it as prohibited by the statute or the regulation. If it was not contemplated by the parties at the time of the making of the loan by the bank that the note of the executive officer would be used as collateral security, and his note, because of subsequent

"developments, is delivered to the bank as collateral, the transaction would appear to be one for the protection of the bank and not within the prohibition of the law or regulation.

"We regret that we can not make a more definite reply to your inquiry on the basis of the facts at hand but we hope that with the statement of principles above expressed your bank will be able to pass upon the particular transaction referred to in your letter. If in the consideration of the matter any question should develop upon which you feel that it is desirable to have an expression from the Board, we would, of course, be glad to consider it upon presentation of all of the pertinent facts."

Approved unanimously.

Letter to Mr. Marshall R. Diggs, Acting Comptroller of the Currency, reading as follows:

"Reference is made to Deputy Comptroller G. J. Oppegard's letter of July 8, 1938, regarding questions with respect to Regulation U which were raised by the June 6, 1938 examination of the First National Bank, Independence, Missouri.

"It is understood that the bank made a loan on September 2, 1937, for the purchase of stocks registered on a national securities exchange, and that while the stocks serving as collateral for the loan then had a market value of only $20,178, the loan was in the amount of $10,000. At that time the regulation gave stocks a maximum loan value of 45 per cent of their market value. Accordingly, the $10,000 loan exceeded such maximum loan value by $920.

"Effective November 1, 1937, the loan value of stocks for the purposes of Regulation U was changed to 60 per cent of current market value. The market value of the collateral in question on November 1, however, is not indicated.

"At the time of the examination on June 6, 1938, the stocks had a market value of $13,193.

"Questions are presented as to whether the loan became conforming as the result of the change in loan values,

"as to the effect of the decline in the market value of the collateral to $13,193, and as to the 'reduction necessary or the amount of the additional collateral required to correct' the violation if there was a violation.

"From the facts as stated it appears that when the loan was made on September 2 it violated Regulation U because the loan exceeded the maximum loan value of the collateral; and this violation was not corrected by the November 1 change in loan values. Broadly stated, Regulation U deals with the making of loans and with the subsequent withdrawals and substitutions of collateral but it does not require a bank, in the event of declines in the market value of collateral, to reduce any loan, obtain additional collateral for any outstanding loan, or call any outstanding loan. The prohibition of the regulation is directed in the first instance against making a loan in excess of the maximum loan value of the collateral, and strictly as a matter of construction of the regulation, the unlawful making of a loan would not be made lawful by a subsequent change in loan value of the collateral, by a subsequent reduction in the amount of the loan, or by the pledge of additional collateral.

"With respect to the obtaining of compliance with the regulation, or more explicitly what should be done by the supervisory authority in the event of a possible violation, you will recall that some time ago representatives of your office, the Federal Deposit Insurance Corporation and the Board discussed the matter of procedure with respect to such possible violations, with a view to securing uniformity, and that the consensus of the discussion was outlined in the Board's letter to you under date of February 26, 1938. In general, this procedure contemplated that such possible violations would be handled in the same manner as possible violations of other banking laws and that compliance would be obtained so far as possible by persuasion, particularly where the violation appeared to the examiner to be inadvertent as distinguished from a willful disregard of the law and regulation.

"In the circumstances of the instant case, particularly in view of the small amount involved, it is questionable what good purpose would be served by requiring either a reduction in the amount of the loan or the pledge of additional collateral. The important consideration, assuming that the violation was not willful,

"would seem to be that the bank understand clearly the provisions of the law and regulations so that such violations will not occur in the future. On the other hand, in different circumstances, particularly if this or other violations of Regulation U should seem to be indicative of a willful intent to disregard statutory restrictions, more drastic measures might be required."

Approved unanimously.

Thereupon the meeting adjourned.

Secretary.

Approved:

Chairman.