A meeting of the Board of Governors of the Federal Reserve System was held in Washington on Saturday, September 3, 1938, at 11:30 a. m.

PRESENT: Mr. Szymczak
Mr. Draper

Mr. Morrill, Secretary

The action stated with respect to each of the matters hereinafter referred to was taken by the Board:

Letter to the Presidents of all Federal reserve banks, prepared pursuant to the action taken at the meeting of the Board on August 31, 1938, and reading as follows:

"From time to time since the adoption of Regulation O, Loans to Executive Officers of Member Banks, the Board of Governors has been asked to modify the regulation in so far as it applies to officers of member banks who do not participate in the executive management or lending activities of the banks except in their capacity as directors. Usually the situation presented has been that of a prominent individual in the community who holds an office such as that of president or vice president of the bank but who is entirely inactive in the management of the institution. The Board has uniformly taken the position, for reasons with which you are familiar, that the definition of executive officer as contained in Regulation O applies to inactive as well as active officers of the banks.

"The Board is considering suggestions as to solutions of the problem which would, on the one hand, meet as far as practicable the criticisms that have been made of the Regulation and, on the other hand, not contravene the general purpose of the provisions of the law relating to loans to executive officers. Therefore, the Board would like to be informed as to the extent or importance of the problem in your Federal reserve district, whether in your judgment it would be desirable to modify the Regulation, and if in your opinion the problem is one of a character which makes

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"it desirable to amend the Regulation, your suggestions as to the change that should be made.

"In this connection, the Board has before it suggestions that there be exempted from the definition of 'executive officer' as contained in subsection 1(b) of the Regulation (1) any person who does not actually participate in the management of the bank and who is denied authority to do so by express provisions in the bank's by-laws or by resolution of the board of directors or (2) any person who does not actually participate in the management of the bank and who is denied authority to do so by express provision in the bank's by-laws or by resolution of the board of directors, provided that the title by which his position is described includes the word 'honorary' or the word 'inactive'. Drafts of amendments which would carry out these suggestions are attached.

"There may be other suggestions which in your opinion would be preferable. It will be appreciated if you will advise the Board as to your views on this subject before the end of September."

Approved unanimously.

Letter to the Presidents of all Federal reserve banks, reading as follows:

"This supersedes previous letters regarding the classification, in reports of examination, of depreciation in securities.

"The division of securities into four groups for examination purposes was recognized in the agreement regarding examination procedure announced by the Secretary of the Treasury and published in the July Bulletin. The definitions of the four groups as given on page 8 of the revised form of report of examination, recently sent out to the Federal reserve banks, are in conformity with the agreement and are not here repeated in detail.

"All issues of bonds in default, either as to principal or interest, are to be included in Group 3.

"With respect to other general market obligations, the agreement provides that issues in the four highest grades are to be included in Group 1 and that issues below the four highest grades are to be included in Group 2. In case of doubt as to the classification of a particular

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"rated issue, the examiners should, before final determination of classification, take into consideration the available credit data as well as the ratings of more than one investment service.

"The agreement specifically recognizes that unrated securities (not in default) shall be classed as Group 1 or Group 2 in accordance with the quality of the respective issues. In determining whether or not an unrated security is distinctly or predominantly speculative, consideration should be given to the record of the issue, other credit data available, and the comparative classification of rated issues of similar quality.

"As stated in the agreement and as indicated in the revised form of examination report, Group 1 securities are not to be priced in the report either individually or in total, and no appreciation or depreciation in such securities is to be shown in the report.

"Group 2 securities are to be valued at the average market price for the 18 months preceding the examination. It is expected that average prices for 18 month periods will be shown in the publications of the various investment services and will appear about the middle of each month beginning with September. In the interest of uniformity, average prices as so published should be the basis for the valuation of Group 2 securities, and the figures published in one month should be used until publication of the averages in the following month. Pending the first publication of such averages, averages obtained from other sources believed to be reliable may be used. If not otherwise available, the averages should be computed by the Federal reserve bank by taking the simple average of the high price and low price for the period.

"The net depreciation in Group 2 securities, based on the average prices, should be included in Classification III in the recapitulation of classified assets on page 3 of the report of examination. Inasmuch as 50 per cent of Classification III is deducted in arriving at the total of adjusted capital, such classification will conform to the provisions of the agreement that 50 per cent of the depreciation in Group 2 securities, based on the 18 month average, be deducted in arriving at the net capital position.

"Group 3 and Group 4 securities, i.e., defaulted bonds and stocks, are to be priced on the basis of current market quotations and the net depreciation in the two groups combined is to be classified as IV. In other words, for the

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"purpose of computing depreciation to be classified as estimated loss, Groups 3 and 4 are to be regarded as one group.

"In the case a bank has established a valuation reserve or made an unallocated charge-off against the total account rather than against specific issues, such valuation reserve or unallocated charge-off should be considered as applying first to Groups 3 and 4 securities and then to Group 2 securities, thus reducing, to the extent of such reserves or unallocated charge-off, the amount of depreciation subject to classification as IV or III.

"The agreement also refers to the establishment and maintenance of adequate reserves. If analysis of the list of securities indicates that a bank is faced with serious problems and probable future losses in its investment account, comment should be made as to the situation and the adequacy of the reserves to provide for the write-off of depreciation should impending defaults materialize and to take care of losses realized in making shifts in the portfolio as opportunity permits in order to achieve a better balance and stronger position.

"The agreement recognizes that profits from the sale of securities should not be regarded as ordinary or recurring income and that, until losses have been written off and adequate reserves established, such profits should not be used for any purpose other than to provide for charge-offs or reserves. Accordingly it is suggested that the answer to question 4 on page 6 of the examination report include a statement as to the amount of net profits from the sale of securities since previous examination and the disposition of such profits."

Approved unanimously.

Letter to Mr. Charles F. Zimmerman, c/o First National Bank, Huntingdon, Pennsylvania, reading as follows:

"Mr. McKee has brought to the attention of the other members of the Board the copy of the letter of August 11 addressed to the Comptroller of the Currency which you sent him with special reference to Regulation F of the Board of Governors. Mr. McKee told the Board that in response to an invitation which he extended to you in August 1936 to come to Washington and present your views to members of

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"the Board, you indicated that it was expected that studies would be made by a committee of the Trust Company Section of the Pennsylvania Bankers Association of criticisms of Regulation F and that when these studies had been made a committee would come to Washington for the purpose of presenting the results. Since then, as you know, the Committee on Mortgage Investment Funds of the Trust Company Section of your Association has presented its proposals with respect to a new form of common trust funds to be provided for by amendment to Regulation F but the Board has not been advised of any other suggestions that the Section might have to offer regarding the Regulation.

"In view of the fact that your correspondence indicates that you feel very strongly that Regulation F should be amended and the Board's desire always to give consideration to any constructive suggestions regarding its regulations, the Board has asked me to advise you that it would be glad to receive a committee of trust men of the Pennsylvania Bankers Association for the purpose of considering any criticisms and suggestions that they may feel should be presented or to have you come to Washington for that purpose. To that end it will be appreciated if you will indicate when it would be convenient for such a committee or yourself to come to Washington and the Board will be glad to fix a time for this purpose."

Approved unanimously.

Letter to Mr. S. L. Andrew, Chief Statistician, American Telephone and Telegraph Company, New York, New York, reading as follows:

"This refers to your letter of August 22 in which you suggest that the Board's weekly member bank press statement be amended so as to restore the segregation of 'Commercial, industrial and agricultural loans' and 'Other loans' into loans 'On securities' and loans 'Otherwise secured and unsecured'.

"As indicated in your letter, the Board in May 1937 revised the form of the weekly member bank condition report so as to provide a functional classification of loans, to replace the former classification which was based generally on type of collateral. The reporting banks were requested, however, to report a break-down of two of the new classes of loans into loans 'On securities' and loans

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"'Otherwise secured and unsecured'. That made it possible for your organization, as well as other users of the statistics, to continue the former series for the time being in view of its value for long-time comparisons. There are some inherent defects in the old series which make it undesirable to perpetuate it, particularly now that the new and improved series has been available for over a year and has provided a sufficient overlap for making an adequate comparison between the old and new series. The old series of 'Loans on securities' was generally used as a measure of borrowings for the purpose of purchasing and carrying securities, but in fact the figures included a substantial and, no doubt, varying proportion of loans on securities made for other purposes. They were not, therefore, nearly as suited to the use made of them as the new classification which, among other things, is specifically designed to reflect loans made for the purpose of purchasing and carrying securities. The old series of 'All other loans' was generally used as a measure of borrowings for commercial and industrial purposes, but in fact it included real estate loans, loans to domestic and foreign banks, and other non-business loans.

"The discontinuance of the segregation in question not only has simplified and improved the Board's weekly statement but will also make it possible for the member banks to simplify the loan records upon which their weekly reports are partly based. Early revisions of both the weekly report and the quarterly call report are now under consideration, and it will be impossible to continue the former series of total 'Loans on securities' and 'All other loans' from the proposed revised loan classification. So long, however, as the desired segregation is reported to the Board, an estimate of the total amounts of 'Loans on securities' and 'All other loans' of weekly reporting banks will be furnished to you monthly upon telephone request to the Board's Division of Bank Operations.

"The change that has already been made in the weekly statement and the changes contemplated in the call report will further focus the attention of readers of the statement on the purpose of loans made by member banks and will reduce correspondingly the attention that may have been paid to the type of collateral. This seems to the Board to be desirable, and it has been our experience over the

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"past year that the new classification of loans is much superior to the former one. In the circumstances the Board does not feel justified in restoring the segregation in question, although your views have been given careful consideration. It is hoped that you will appreciate that the Board's action was taken with a view to improving the type of banking statistics and at the same time reducing the burden imposed upon member banks in preparing reports."

Approved unanimously.

Letter to Mr. Fleming, President of the Federal Reserve Bank of Cleveland, reading as follows:

"This refers to your letter of August 22, with which you inclosed a copy of a letter you received from Mr. John M. Daiger, Financial Adviser of the Federal Housing Administration, dated August 18, in which he asked you to obtain, through such banking and credit sources as are available to you, confidential reports on certain named individuals.

"In response to your inquiry as to the reaction of the Board relative to your procuring such information for the benefit of other than member banks, it is the opinion of the Board that when requests are received from Governmental agencies for such information the Federal Reserve bank should comply with them so far as practicable. In furnishing credit information with respect to individuals or companies to Governmental agencies, however, it is assumed that you would advise the agencies that you are furnishing the information for their confidential use and that while you believe the information to be correct, you cannot guarantee its accuracy."

Approved unanimously.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved: M. S. Eccles
Member.

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