

A meeting of the Board of Governors of the Federal Reserve System was held in Washington on Friday, March 17, 1939, at 2:30 p.m.

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

Mr. Bethea, Assistant Secretary
 Mr. Carpenter, Assistant Secretary
 Mr. Clayton, Assistant to the Chairman

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

The minutes of the meeting of the Board of Governors of the Federal Reserve System held on March 16, 1939, were approved unanimously.

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

"In accordance with recommendation contained in Dillistin's letter of March 15, Board extends to March 31, 1939 time within which 'The Patchogue Citizens Bank & Trust Company', Patchogue, New York, may accomplish membership in the System, subject, however, to the same condition prescribed in telegram of December 5, 1938 in connection with a previous extension."

Approved unanimously.

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

"The Board recently received a letter from Mr. Thomas B. Gravatt, Assistant Secretary to the Philadelphia Stock Exchange, regarding the question whether certain 2-1/2

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"per cent Serial Water Revenue Bonds of the Bethlehem Municipal Water Authority are 'exempted securities' for the purpose of Regulation T. There was enclosed a circular issued by Elkins, Morris & Co. describing the bonds.

"This inquiry involves an interpretation of section 3(a)(12) of the Securities Exchange Act of 1934, which provision is of interest to the Securities and Exchange Commission, and also an interpretation of rules issued by the Commission under this provision. Accordingly, the views of the Commission were requested on the question.

"You will note that the attached copy of a letter from the Commission expresses the opinion that the bonds are not exempted by the terms of section 3(a)(12) of the Securities Exchange Act of 1934, and that the information submitted is not sufficient to show that the bonds are exempted under the Commission's Rule X-3A12-2.

"The Board sees no reason to differ with these views, and it will be appreciated if you will advise the Philadelphia Stock Exchange accordingly. The Board would, of course, be glad to forward to the Commission, or have the Exchange transmit directly any further information which the Exchange might wish to submit regarding the availability of an exemption under Rule X-3A12-2."

Approved unanimously.

Letter to Honorable Leo T. Crowley, Chairman of the Federal Deposit Insurance Corporation, prepared for the signature of Chairman Eccles, and reading as follows:

"The proposal outlined in your letter of March 9, relative to the making of special analyses of operating ratios of member banks for the year 1938, is viewed favorably by the Board and we shall be glad to cooperate with you in conducting the project along the lines proposed. If the Comptroller of the Currency gives his sanction to the transmission of the national bank data, we shall undertake to furnish your Corporation with the individual bank ratios as soon as they can be obtained from the Federal Reserve banks. The arrangements for securing the ratios sent in by the Reserve banks, and for supplying

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"us with the tabulations made from these ratios, should be made with Mr. Smead, Chief of the Division of Bank Operations.

"It is assumed that the Board will be furnished the tabulated material pertaining to member banks as soon as it becomes available."

Approved unanimously, together with a letter to the Presidents of all Federal Reserve banks, reading as follows:

A special project in the field of bank earnings is being undertaken jointly by the Federal Reserve System and the Federal Deposit Insurance Corporation. It is based largely on the operating ratios of member banks for 1938, which are in preparation or have recently been prepared at the Federal Reserve banks. For this purpose a supply of tabulation forms like the one attached (F.R. 456) is being forwarded to you. It will be appreciated if you will have one of these forms filled out for each member bank in your district whose figures were used in your 1938 compilation of average operating ratios, and if you will return the completed forms to the Board. Instructions concerning the tabulation of the desired data are contained in the accompanying memorandum.

"Upon receipt of the completed forms by the Board, the coding items (6-14) will be entered (for sorting purposes), and the data shown on the forms will be transferred to punched cards. The cards will then be sorted and tabulated in order to make available various analyses of member bank operating ratios in addition to the size of bank and geographic distributions which the Federal Reserve banks have prepared or are making."

Letter to Honorable D. W. Bell, Acting Director, Bureau of the Budget, prepared pursuant to the action taken at the meeting of the Board this morning, and reading as follows:

"This is in response to your request of March 11, 1939 for the views of the Board of Governors regarding a draft of Bill to amend the Federal Home Loan Bank Act, the Home Owners' Loan Act of 1933, Title IV of the National

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"Housing Act, and for other purposes, which you advised the Chairman of the Federal Home Loan Bank Board intends to submit to the Senate and House Banking and Currency Committees.

"You will recall that somewhat similar proposals were made last year in the Bill S. 3874, concerning which the Board, at the request of the Banking and Currency Committee of the Senate, submitted its views.

"As pointed out in connection with that Bill, 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. However, many of the provisions which were regarded by the Board at that time as being open to objection are contained in the new proposal. Like the previous proposal, it would not be confined to technical and clarifying amendments, but would break away from the concept of Federal Savings and Loan Associations and other member institutions of Federal Home Loan Banks as local mutual thrift institutions. One group of provisions would place the lending powers of the Home Loan Bank System behind an enlargement of the lending powers of the Federal and State-chartered savings and loan associations to include securities and real estate mortgages of any sort. A second group of provisions would place the insurance of liabilities of these institutions on a preferential basis as compared with insurance of deposits of banks. In these respects, the proposed Bill would tend to establish a separate and complete banking system which would compete on favored terms with savings banks and the savings departments of commercial banks.

"Regarding the first group of provisions, section 1 of the Bill would support any past or future enlargement of the lending powers of State-chartered member associations, as well as Federal Savings and Loan Associations, by liberalizing the class of collateral 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'. This section would completely eliminate such restrictions so as to authorize advances upon the security

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"of any first mortgage. Section 2 would further extend the list of eligible collateral to a materially different class of securities, which would include not only Government-guaranteed obligations and obligations of the Federal Savings and Loan Insurance Corporation and of the Federal Home Loan Banks, but also whatever obligations a member association might lawfully have available.

"Although the restrictions on the types of mortgages in which Federal Savings and Loan Associations are authorized to invest would be somewhat liberalized by section 8, the additions would include only residential mortgages. However, the restrictions of that section would apply only to Federally chartered institutions: the lending powers of State-chartered institutions are governed by State law. The amendments proposed in section 1 would therefore encourage the latter to expand their activities to other fields instead of continuing as cooperative thrift and home-financing institutions which it was the purpose of the Home Loan Bank System to foster. Therefore, it would be desirable, in section 1, to place upon advances by Federal Home Loan Banks restrictions similar in terms to those which would be placed in section 8 upon the types of mortgages in which Federally chartered associations are authorized to invest.

"Section 8 would allow Federal Savings and Loan Associations to invest their assets in any securities that are legal investments for fiduciary and trust funds and are approved by regulations of the Federal Home Loan Bank Board. This is justified as permitting associations to employ idle funds 'when satisfactory home mortgage loans are not available'; but there appears to be no reason for permitting Federal Home Loan Banks to make advances upon such securities, as is done in section 2, if such securities are to be merely temporary investments and the associations are to continue as home-financing institutions.

"The transformation of the character of Federal Savings and Loan Associations from mutual thrift and home-financing associations into a separate banking system would be given additional impetus by a change in the name of the Insurance Corporation proposed in section 11. That section would abandon the name 'Federal Savings and Loan Insurance Corporation' and substitute 'Federal Savings Insurance Corporation'. This proposed name would create confusion

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"in the minds of the public, whereas the title now used clearly corresponds to the accepted designation of the mutual institutions for home financing whose shares the Corporation insures.

"The second group of objections centers around the provisions of the Bill which would permit Federal Savings and Loan Associations and State-chartered associations insured by the Home Loan Bank System to compete on unfair terms with other established institutions for the depositor's dollar to the detriment of the latter. The insurance of 'shares' of these institutions on the same basis as insurance of bank deposits, in spite of the fact that there is no limitation on the rate of return which may be paid on such shares, would constitute the means by which this advantage in competition would be given.

"Section 14 would foster unfair competition by granting unwarranted insurance benefits. It would reduce the 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, for three reasons:

(1) The assets of building and loan associations are normally on a long-term basis and are not as liquid as those of banks. 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.

(2) The two rates are not comparable because the uninsured portion of deposits in insured banks, upon which banks pay premiums, is much greater than the uninsured liability in building and loan associations. This means that the average effective rate of assessment upon insured deposits in banks is much higher than $1/12$ of 1 per cent.

(3) The Federal Deposit Insurance Corporation insures only the deposits of banks. The net worth of banks, represented by the stockholders' interest in capital and surplus funds, constitutes a cushion for the protection of the depositors and the Corporation. The Federal Savings and Loan Insurance Association insures withdrawable or repurchasable shares, investment certificates, or

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"deposits, with the result generally that a fewer percentage of losses upon the part of one of its insured institutions will expose it to loss than is so in the case of the Federal Deposit Insurance Corporation. The risk, therefore, is greater and the premium should be higher if it is to be kept on a self-sustaining basis.

"Section 16 of the Bill would go still further in placing the insurance of building and loan association shares upon the same basis as savings deposits. It provides that in the event of default by a Federal or other insured association, the Insurance Corporation would have the option of making payment 'in full in cash'. Moreover, the holder of an 'insured account' would in any case have the option of receiving 'at least' 10 per cent thereof in cash, and the balance in interest-bearing debentures rather than in noninterest-bearing obligations as under the existing law.

"It is noteworthy that this theory of similarity between the shares of Federal and other building and loan association, and savings deposits, seems to be an underlying theory of these sections of the Bill. If this be true, and if the distinction in liquidity between the two is to be disregarded and eliminated, then certainly the Bill attempts to create a new system of banks.

"At the present time, building and loan associations are not regarded as being as liquid as banks. Conclusive evidence of this is given by the rates of return permitted to be paid, and actually paid, by building and loan associations upon their shares, which are much higher than the rates of interest permitted to be paid upon savings deposits. If building and loan associations are to be given an artificial liquidity, this discrepancy in the rate of return will constitute another serious competitive disadvantage for national and State banks, and will result either in the growth of unsound banking practices, or in mortality among the institutions competing with the favored Federal and other savings and loan associations.

"For all of 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 the Presidents of all Federal Reserve banks, reading as follows:

"Several of the Federal Reserve banks have recently suggested that the Secret Service Division furnish them with the necessary number of copies of each circular describing counterfeit notes in order to facilitate the distribution thereof and to eliminate a duplication of expense. Accordingly, this matter was taken up with the Secret Service Division and the Division was also asked whether it would furnish the Reserve banks with a sufficient number of franked envelopes to make distribution of the counterfeit notices.

"The Secret Service Division stated informally that at the present time the limited appropriations available to the Division make it impossible to furnish the Reserve banks with franked envelopes but that it would be able to furnish a sufficient number of copies of the circulars for distribution.

"The Secret Service Division asked whether an arrangement could be worked out, whereby the circulars could be mailed directly from Washington under the Board's frank rather than through the Reserve banks, particularly since it would expedite to some extent the distribution of the circulars. Such a procedure would appear practicable and accordingly arrangements have been made under which the Board will address envelopes to all member and non-member banks in the United States and deliver them to the Treasury Department which will insert and mail the counterfeit notices. The Board's mailing list comprises all national banks in the continental United States and all State commercial banks, trust companies, mutual and stock savings banks and such private and industrial banks as are included in abstracts issued by State banking departments. One copy of each notice will also be sent direct to each Federal Reserve bank and branch.

"The replies to the Board's telegram of December 14, 1938 indicate that the distribution of counterfeit notices by some of the Reserve banks is not limited to member and nonmember banks; also, that in certain cases bulk deliveries are made to banks and others. Under the procedure as set forth above, only one counterfeit notice will be sent to

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"each member and nonmember bank. It will be appreciated, therefore, if you will advise the Board the additional number of copies that should be sent to your bank for distribution to others than banks and to banks which have requested more than one copy."

Approved unanimously.

Letter to Mr. McRae, Chief Examiner, Federal Reserve Bank of Boston, reading as follows:

"Reference is made to your letter of March 8, 1939 regarding the time within which applications for extensions of time pursuant to section 3(f) or 4(c) of Regulation T may be acted upon by a business conduct committee of an exchange.

"The Board's views with respect to the question have been incorporated in the attached statement for the press on the subject of 'Extension of Time by Committee of Exchange after Original Period Has Expired'. You will note, however, that this is not to be released for publication until the time specified in the statement."

The statement enclosed with the letter read as follows:

"Section 3(b) of Regulation T provides that when a customer effects certain transactions in a general account the creditor must obtain the deposit of certain cash or securities in the account, and must obtain such cash or securities before the expiration of three full business days following the date of the transaction. Section 3(e) provides that if such cash or securities are not obtained within the specified period, certain liquidations must be effected in the account during the period. Section 3(f) provides, however, as follows:

'Extensions of time. - In exceptional cases, the three-day period specified in section 3(b) may, on application of the creditor, be extended for one or more limited periods commensurate with the circumstances by any regularly constituted committee of a national securities exchange having jurisdiction over the business conduct of

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"its members, of which exchange the creditor is a member or through which his transactions are effected, provided such committee is satisfied that the creditor is acting in good faith in making the application and that the circumstances are in fact exceptional and warrant such action.'

"Section 4(c) relating to the special cash account provides that, in general, if a customer does not make full cash payment for a security purchased by him in the account within seven days after the date on which the security was purchased, the creditor shall promptly cancel or otherwise liquidate the transaction. Another paragraph of the section specifies different periods of time for certain special types of transactions, and the section then provides:

'If any regularly constituted committee of a national securities exchange having jurisdiction over the business conduct of its members, of which exchange the creditor is a member or through which his transactions are effected, is satisfied that the creditor is acting in good faith in making the application, that the application relates to a bona fide cash transaction, and that exceptional circumstances warrant such action, such committee, on application of the creditor, may (A) extend any period specified in the two preceding paragraphs for one or more limited periods commensurate with the circumstances, or (B) in the case of the purchase of a registered or exempted security which has been effected by the customer in the account, authorize the transfer of the transaction to a general account or special omnibus account and the completion of the transaction pursuant to the provisions of this regulation relating to such accounts.'

"The Board has recently been asked whether an application for such an extension of time pursuant to section 3(f), or for an extension of time or transfer of a transaction pursuant to section 4(c), may be approved by a business conduct committee after the expiration of the period originally applicable to the transaction.

"It is the view of the Board that such an application may not be granted after such period has expired.

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"Thus an application for an extension of the three-day period applicable to a transaction in the general account could not be approved by the committee after midnight of the third full business day following the date of the transaction. Similarly, in the case of a transaction in the special cash account to which the standard seven-day period is applicable, an application for an extension of time or for a transfer of the transaction should be passed upon by the committee not later than midnight of the seventh calendar day after the date of the transaction. In case an extension of time has been granted for a particular transaction, any application for a further extension or for a transfer of the transaction should be received and acted upon before the expiration of the prior extension.

"In order to facilitate its consideration of the applications, each business conduct committee may, of course, further limit the period following a transaction within which it will receive any such application."

Approved unanimously, together with
a letter to the Presidents of all Federal
Reserve banks, reading as follows:

"There is attached a copy of a ruling which will be published in the Federal Reserve Bulletin regarding 'Extension of Time by Committee of Exchange after Original Period Has Expired'.

"It will be noted that the attached ruling is in the form of a statement for the press which, however, is not to be released until the time specified on the statement."

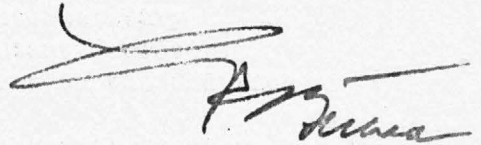
There was then presented, with the recommendation of the Office of General Counsel that it be published in the April issue of the Federal Reserve Bulletin in the form submitted, a statement with respect to the continuation of the Reconstruction Finance Corporation and related agencies.

Approved unanimously.

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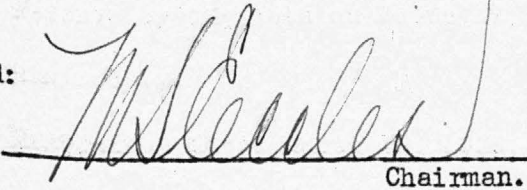
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Thereupon the meeting adjourned.



Assistant Secretary.

Approved:


Chairman.