

A meeting of the Board of Governors of the Federal Reserve System was held in Washington on Wednesday, November 20, 1940, at 11:30 a.m.

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

Mr. Morrill, Secretary
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 November 19, 1940, were approved unanimously.

The minutes of the meetings of the Board of Governors of the Federal Reserve System with the Federal Advisory Council held on November 18 and 19, 1940, were approved unanimously.

Memorandum dated November 6, 1940, from Mr. Paulger, Chief of the Division of Examinations, recommending that, for the reasons stated in the memorandum, John J. Connell be appointed as a Federal Reserve Examiner, with salary at the rate of \$3,800 per annum, effective as of the date after January 1, 1941, upon which he enters upon the performance of his duties after having passed satisfactorily the usual physical examination.

In accordance with the above recommendation Mr. Connell was appointed an examiner to examine Federal Reserve Banks, member banks of the Federal Reserve System,

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and corporations operating under the provisions of Sections 25 and 25(a) of the Federal Reserve Act, for all purposes of the Federal Reserve Act and of all other Acts of Congress pertaining to examinations made, by, for, or under the direction of the Board of Governors of the Federal Reserve System, and was designated as a Federal Reserve Examiner, with salary at the rate of \$3,800 per annum, effective as of the date upon which he enters upon the performance of his duties after having passed satisfactorily the usual physical examination.

Approved unanimously.

Memorandum from Mr. Nelson, Assistant Secretary, submitting the resignation of James Kolinski as a stenographer in the Secretary's Office, effective as of the close of business on December 2, 1940, and recommending that the resignation be accepted as of that date.

The resignation was accepted.

Letter to the board of directors of the "First State Bank", Bandera, Texas, stating that, subject to conditions of membership numbered 1 to 3 contained in the Board's Regulation H, 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 Dallas.

Approved unanimously for transmission through the Federal Reserve Bank of Dallas.

Letter to the board of directors of the "First State Bank of Yorktown", Yorktown, Texas, stating that, subject to conditions of membership numbered 1 to 3 contained in the Board's Regulation H, the

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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 Dallas.

Approved unanimously for transmission through the Federal Reserve Bank of Dallas.

Letter to Mr. Hamilton, President of the Federal Reserve Bank of Kansas City, reading as follows:

"This is in reply to your letter of November 13, 1940, requesting an interpretation and suggesting the modification or elimination of condition of membership numbered 7, which was prescribed in connection with the approval of the application of the 'Mercantile Home Bank & Trust Co.', Kansas City, Missouri, for membership in the System and which reads as follows:

- '7. Such bank shall not pay any dividends on its common stock until its capital structure has been increased to an amount satisfactory to the Federal Reserve Bank of Kansas City.'

"Before discussing any modification or interpretation of the condition of membership, it might be well to review briefly some of the background. The bank admittedly is undercapitalized and has some definite problems yet to be worked out. As a matter of fact, earlier in the year, before the application was filed, the Board was advised that the management of the bank had been working for some years to place the institution in position to qualify for membership and had raised the question of whether sufficient progress had been made to justify applying for membership or whether the application should wait another year or two. In the concluding paragraph of his letter of January 30, 1940 to Mr. Woolley, the president of the bank said:

'....the value placed on the remaining assets (liquidating accounts) from a certain viewpoint really makes no difference - all we earn will stay in the bank - no one expects dividends until these accounts are entirely out of the

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"'way, and even then, it is our intention to continue to build up a strong capital structure....'

"In prescribing the condition of membership the Board had in mind that this was admittedly a borderline case and that the bank's capital account is considerably lower in relation to the bank's volume of business than is generally considered desirable. The application for membership, however, was approved in view of the progress which had been made and in the expectation that progress would continue. The Board does not feel that condition of membership numbered 7 is in any respect inconsistent with the assurances previously given by the trust company, the views of the Reserve Bank as expressed in the memorandum submitting the application for membership, or the position taken by the Board in its letter of March 4. The statement in that letter that no special requirement regarding an increase in capital would be made as a condition of membership was intended to mean that no requirement would be made as to either an increase in capital prior to admission to membership or a commitment for an increase, either in definite amount or within a stipulated time.

"In view of the questions raised by your Bank, however, the Board has modified the condition to read as follows:

- '7. Until such bank has a capital structure satisfactory in amount to the Federal Reserve Bank of Kansas City, it shall not pay any dividends on its common stock except with the permission of the Federal Reserve Bank.'

It is understood that the condition of membership as revised is satisfactory to the Federal Reserve Bank.

"The revised condition is in accordance with the interpretation of the original condition of membership as discussed by members of the Board's staff with Mr. Worthington during his recent visit but in order to avoid any question as to interpretation, the condition itself has been modified. The term 'capital structure' as used in the condition of membership is synonymous with the term 'total capital accounts' as used in the call report of condition. It includes, therefore, all other capital accounts as well as capital stock and capital debentures.

"Enclosed are the original and two copies of a letter to the directors of the Mercantile Home Bank & Trust

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"Co. containing the revised conditions of membership. Please substitute these for those forwarded with the Board's letter to you of November 6. It is understood that the Board's letter of November 6 to the directors of the trust company has not been delivered."

Approved unanimously.

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

"Reference is made to your letter of November 9, 1940, regarding the inquiry of Cummings Brothers, Inc., Syracuse, New York, with respect to Regulation T.

"It is understood that the inquiry is an example of questions that have come to you from several sources. The questions relate to certain transactions in which a broker subject to the regulation, acting on behalf of the Federal Deposit Insurance Corporation, sells certain unregistered securities under terms providing for the payment of the purchase price in installments over a substantial period of time. In some cases the broker may actually effect the sale on behalf of the Federal Deposit Insurance Corporation, whose name is disclosed to the purchaser at the time of the transaction. In other cases the broker may do no more than negotiate the sale with the purchaser and bring the purchaser and the Federal Deposit Insurance Corporation together, the actual transaction being effected directly between the Federal Deposit Insurance Corporation and the purchaser. In all cases, however, the broker does not at any time have any interest in the securities and does not in any way finance their purchase by the ultimate purchaser.

"As you suggest, the Securities Exchange Act of 1934 and Regulation T, as a general proposition, do not permit a broker subject to the regulation to effect or 'arrange' such an installment sale of unregistered securities. The situation, however, seems to be altered in the present case by the fact that the Federal Deposit Insurance Corporation is the real seller of the securities and also finances the sale.

"The Federal Deposit Insurance Corporation is a

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"Government corporation. It is not merely an 'instrumentality' of the Government in the very broad sense that, for example, a national bank is such an 'instrumentality'. It is much more. Its directors are appointed by the President with the advice and consent of the Senate, it is granted the free use of the United States mails, its capital stock is in effect supplied by the Government and it operates as an integral part of the Government.

"It is a settled principle that a statute, no matter how broad or general its terms, does not apply to the sovereign, or to one acting for the sovereign, unless the sovereign is brought under the statute by specific language. This principle is, in effect, set forth in section 3(c) of the Securities Exchange Act of 1934 which provides that:

'(c) No provision of this title shall apply to, or be deemed to include, any executive department or independent establishment of the United States, or any lending agency which is wholly owned, directly or indirectly, by the United States, or any officer, agent, or employee of any such department, establishment, or agency, acting in the course of his official duty as such, unless such provision makes specific reference to such department, establishment, or agency.'

"In view of the Governmental character of the Federal Deposit Insurance Corporation and the absence of any indication that Congress intended to bring the Federal Deposit Insurance Corporation under the present requirements, the Board is of the opinion that, without regard to the particular language of section 3(c), the present question is controlled by the fundamental principle that general language of a statute does not apply to the sovereign. Furthermore, since the sovereign necessarily must act through agents, it seems that the principle must apply to the broker's activities in the present case. The Board concludes, therefore, that in circumstances such as those described in which the Federal Deposit Insurance Corporation as a disclosed principal sells securities through a broker, and the broker acts purely as an agent for the Federal Deposit Insurance Corporation without acquiring any interest in the securities or doing any financing,

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"this principle exempts the transaction from the requirements of Regulation T and the provisions under which the Regulation is issued."

Approved unanimously.

Thereupon the meeting adjourned.

Orestes Morier
Secretary.

Approved:

W. S. Scales
Chairman.