

A meeting of the Board of Governors of the Federal Reserve System was held in Washington on Friday, August 1, 1941, at 11:00 a.m.

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

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

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

The minutes of the meeting of the Board of Governors of the Federal Reserve System held on July 31, 1941, were approved unanimously.

Telegrams to Messrs. Sanford, Post, Hays, Dillard, and Stewart, Secretaries of the Federal Reserve Banks of New York, Philadelphia, Cleveland, Chicago, and St. Louis, respectively, Mr. Caldwell, Chairman of the Federal Reserve Bank of Kansas City, and Mr. Hale, Secretary of the Federal Reserve Bank of San Francisco, stating that the Board approves the establishment without change by the Federal Reserve Banks of St. Louis and San Francisco on July 29, by the Federal Reserve Banks of New York, Cleveland, Chicago, and Kansas City on July 31, 1941, and by the Federal Reserve Bank of Philadelphia today, of the rates of discount and purchase in their existing schedules.

Approved unanimously.

Letter to the board of directors of the "Solvay Bank", Solvay

8/1/41

-2-

New York, stating that, subject to conditions of membership numbered 1 to 3 contained in the Board's Regulation H and the following special condition, 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 New York:

- "4. Prior to admission to membership, such bank, if it has not already done so, shall charge off or otherwise eliminate estimated losses of \$13,461 as shown in the report of examination of such bank as of May 10, 1941, made by an examiner for the Federal Reserve Bank of New York."

Approved unanimously, together with a letter to Mr. Sproul, President of the Federal Reserve Bank of New York, reading as follows:

"The Board of Governors of the Federal Reserve System approves the application of the 'Solvay Bank', Solvay, New York, for membership in the Federal Reserve System, subject to the conditions prescribed in the enclosed letter which you are requested to forward to the Board of Directors of the institution. Two copies of such letter are also enclosed, one of which is for your files and the other of which you are requested to forward to the Superintendent of Banks for the State of New York for his information.

"In its letter to the applicant bank in connection with the previous application for membership the Board referred to the large concentration in loans to the president and his wife and pointed out that, as a matter of sound banking policy, loans to directors and officers of a bank and their interests should be kept within conservative limits. At the time of the examination in connection with the new application for membership there had been little reduction in the loans and the value of the collateral held against the president's loan was less than the amount of the loan. It is understood, however, that since the examination there has been a substantial reduction in the loan of the president's wife, and that the president has been asked to come into the Reserve Bank for a discussion of his indebtedness and at that time the suggestion will be made that a definite program be followed to place the loan in satisfactory shape.

8/1/41

-3-

"It is assumed of course that the Board will be advised of the understanding reached at that discussion."

Letter to the board of directors of the "Farmers State Bank of Millbrook", Millbrook, Illinois, stating that, subject to conditions of membership numbered 1 to 3 contained in the Board's Regulation H and the following special condition, 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:

- "4. Such bank shall increase the number of its directors to not less than five, the minimum number required in the case of all member banks under the provisions of Section 31 of the Banking Act of 1933, as amended."

Approved unanimously, together with a letter to Mr. Young, 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 'Farmers State Bank of Millbrook', Millbrook, Illinois, for membership in the Federal Reserve System, subject to the conditions prescribed in the enclosed letter which you are requested to forward to the Board of Directors of the institution. Two copies of such letter are also enclosed, one of which is for your files and the other of which you are requested to forward to the Auditor of Public Accounts for the State of Illinois for his information.

"If practicable the increase in the number of directors required by condition of membership numbered 4 should be effected prior to admission of the bank to membership. However, the Board will not object to the admission of the bank with only four directors provided that steps will be taken not later than at the next annual meeting of the shareholders to increase the number to five.

"Since the amount of estimated losses shown in the report of examination for membership is relatively small,

8/1/41

-4-

"the usual condition of membership requiring elimination of losses has not been prescribed. It is assumed, however, that proper provision for losses will be made as a matter of sound banking practice."

Letter to the board of directors of the "Citizens State Bank", Royse City, 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", Brackettville, 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 Mr. Sproul, Chairman of the Presidents' Conference Committee on Defense Savings Securities, Federal Reserve Bank of New York, reading as follows:

"Governor McKee has reported to the Board that as a

8/1/41

-5-

"result of the meeting of your Committee with the Secretary of the Treasury on July 21, 1941, it was agreed that each Federal Reserve Bank would designate an officer to supervise contacts and relationships in connection with the promotion of the sale of Defense Savings Bonds and that the Board would also designate a liaison officer to handle contacts between the Treasury officials in Washington in charge of the Defense Savings Bond program and the Federal Reserve Banks. It is understood that you have already communicated with the other Federal Reserve Banks on this subject. Upon the recommendation of Governor McKee the Board has designated Mr. L. P. Bethea, Assistant Secretary, to serve as the liaison representative of the Board, with Mr. L. S. Myrick of the Division of Bank Operations as his alternate.

"It is suggested that you advise the Presidents of the other Federal Reserve Banks of these designations and that any inquiries relating to the Defense Savings Bond program, apart from its fiscal agency aspect, may be directed to Mr. Bethea as Assistant Secretary, who will be glad to obtain any information that may be desired. All information made available by the Defense Savings Bond staff of the Treasury will be forwarded promptly to the Federal Reserve Banks by Mr. Bethea, or in his absence by Mr. Myrick."

Approved unanimously.

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

"Reference is made to your letter of June 19, 1941 regarding a question raised by The First National Bank of The City of New York under section 8(a) of the Securities Exchange Act of 1934, which reads in part as follows:

'SEC. 8. It shall be unlawful for any member of a national securities exchange, or any broker or dealer who transacts a business in securities through the medium of any such member, directly or indirectly --

'(a) To borrow in the ordinary course of business as a broker or dealer on any security (other than an exempted security) registered on a national securities exchange except (1) from

8/1/41

-6-

"or through a member bank of the Federal Reserve System, (2) from any nonmember bank which shall have filed with the Federal Reserve Board an agreement, which is still in force and which is in the form prescribed by the Board, undertaking to comply with all provisions of this Act, the Federal Reserve Act, as amended, and the Banking Act of 1933, which are applicable to member banks and which relate to the use of credit to finance transactions in securities, and with such rules and regulations as may be prescribed pursuant to such provisions of law or for the purpose of preventing evasions thereof, or (3) in accordance with such rules and regulations as the Federal Reserve Board may prescribe to permit loans between such members and/or brokers and/or dealers, or to permit loans to meet emergency needs. ..."

"The question is, in effect, whether a broker subject to the provision may borrow from a nonmember bank that has not signed the specified agreement if the loan is not obtained directly from the nonmember bank but is made by a member bank acting as agent for the nonmember bank.

"As you indicate in your letter, the Board has previously considered the question and in a letter dated December 4, 1934, to Mr. Curtiss, Federal Reserve Agent at Boston, the Board has expressed the opinion that such borrowing was not authorized under section 8(a). You have indicated, however, that you are inclined to agree with the contrary view which is urged by The First National Bank. The question has accordingly been carefully reconsidered in the light of your letter and the views of the Board on the matter are indicated in some detail below.

"It is the view of the Board that section 8(a)(2) states the general rule for borrowings, of the specified type, from nonmember banks. It is true that under clause (3) the Board is authorized 'to permit loans to meet emergency needs', and that under this authority the Board might conceivably authorize such emergency loans even by nonmember banks that have not filed the specified agreement. Such emergency authorization, however, would not alter the fact that ordinary day-to-day borrowings from nonmember banks are covered by clause (2).

"Similarly, the Board feels that the provision in clause (1) for borrowings 'from or through a member bank of the Federal Reserve System' should not be construed to

8/1/41

-7-

"authorize a broker to do indirectly what the law clearly forbids him to do directly. Such a construction of the provision would, in the opinion of the Board, extend the meaning of the word 'through' considerably beyond that which it might reasonably be expected to have in the context.

"It is perhaps not entirely clear why the word 'through' was included in clause (1), or why it was omitted in clause (2). However, it may have been included to authorize, or to clarify, borrowings by a broker from a member bank when the member bank is acting as agent for another member bank or for a nonmember bank that has signed the agreement. Such a construction would seem to be more in conformity with the general purpose and tenor of the section than would the suggested extension of the term.

"The Committee reports on the legislation and the drafts of the provision in the bills that preceded the final statute have been carefully examined for any light they might throw on the question, and the Board is unable to see how these conflict with the views expressed above. In fact, they seem to reinforce the conclusion.

"As originally introduced by Senator Fletcher on February 9, 1934 (S.2693) and Congressman Rayburn on February 10, 1934 (H.R. 7852) the provision on the point in both bills entirely excluded borrowings from nonmember banks and did it in a form somewhat different from that of later drafts. The identical provision in both these bills provided that it would be unlawful for the specified persons:

'(a) To borrow on any security registered on a national securities exchange from any person other than a member bank of the Federal Reserve System;'

"The word 'through' first appeared in H. R. 8720, introduced by Congressman Rayburn on March 19, 1934. Section 7(a) of that bill prohibited the specified borrowing:

'.... except (1) from or through a member bank of the Federal Reserve System, or (2) in accordance with such rules and regulations as the Federal Reserve Board may prescribe to permit limited loans between members and/or brokers or dealers who transact a business in securities through the medium

8/1/41

-8-

"of a member, or to permit loans from or through others than member banks in localities where there are no member banks, or to meet emergency needs.'

"Section 8(a) of S. 3420, introduced by Senator Fletcher on April 20, 1934 and reported out by the Senate Banking and Currency Committee on the same day, contained substantially the same provision. The Committee report on the bill strongly negatives any thought that the word 'through' was intended to have the meaning suggested by The First National Bank. Instead, it rather indicates that the word was used more or less as a synonym for 'from' and was intended to add very little to that term. The report at page 7 says that the provision:

'....prohibits brokers and dealers from borrowing except through a member bank of the Federal Reserve System or in accordance with regulations of the Commission'.

And on page 16 the report states that the provision confines the specified borrowings to:

'.... loans from member banks of the Federal Reserve System and loans from other sources made in accordance with such rules as the Commission may prescribe, either in general or under particular conditions.'

It seems clear that the terms 'from' and 'through' were considered to be more or less synonymous and interchangeable.

"Section 7(a) of H. R. 9323, introduced by Congressman Rayburn on April 25, 1934 and reported out on April 27, 1934 by the House Committee on Interstate and Foreign Commerce, contained a provision identical with section 8(a) of the final Act. The Committee report on this bill, like that on the Senate bill, gives every indication that 'from or through' was intended to refer only to the usual direct banking relations, and that the word 'through' was not intended to have the extended meaning now suggested by The First National Bank. On page 7 the report states that:

'Borrowings by brokers to finance their customers are confined to borrowings from or through member banks of the Federal Reserve System or those nonmember banks which apply for a license from the Board.'

8/1/41

-9-

"Far from giving the suggested broad meaning to the word 'through', the Committee did not even draw any distinction between clause (1), where the word 'through' is used in authorizing borrowings from member banks, and clause (2), where the word is entirely omitted in authorizing borrowings from nonmember banks. The same is true when the provision is described in more detail on pages 19-20, as follows:

'By subsection (a), borrowing on registered securities (other than exempted securities) by members, brokers, and dealers who do a business through members is confined to loans from member banks of the Federal Reserve System or from nonmember banks which agree to comply with the provisions of this act, the Federal Reserve Act, and the Banking Act of 1933, insofar as they relate to the use of credit to finance transactions in securities. This, however, is subject to certain exceptions in case of transactions between members, brokers, and dealers and in emergency cases.' (Underscoring added)

"In view of these considerations, which have been set forth at some length because of the novelty of the question and the Board's re-examination of the matter, the Board believes that section 8(a) does not authorize ordinary borrowings from a nonmember bank which has not filed the specified agreement and that this is not altered by the fact that the loan is made by a member bank acting as agent for the nonmember bank."

Approved unanimously.

Thereupon the meeting adjourned.

Chester Norrie
Secretary.

Approved:

W. C. C. C.
Chairman.