

A meeting of the Board of Governors of the Federal Reserve System was held in Washington on Saturday, February 21, 1942, 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 February 20, 1942, were approved unanimously.

Letter to the board of directors of the "Bank of Menomonie", Menomonie, Wisconsin, stating that, subject to conditions of membership numbered 1 to 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 Minneapolis:

- "7. On or before June 30, 1942, such bank shall charge off not less than \$5,000 on its furniture and fixtures.
- "8. At the time of admission of such bank to membership its paid-up and unimpaired capital shall be not less than \$100,000."

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

"The Board of Governors of the Federal Reserve System approves the application of the 'Bank of Menomonie', Menomonie, Wisconsin, 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 Commissioner of Banking for the State of Wisconsin for his information.

"No depreciation has been taken on furniture and fixtures since 1933, the present carrying value, at \$12,000, is admittedly high and the bank has agreed to charge off \$5,000 on the account during this year. Therefore, except possibly for the time element, condition of membership numbered 7 is in line with the bank's plans. It would be preferable, of course, if the charge-off were made prior to admission of the bank to membership, and it is hoped that that can be done. Additional time, however, is being granted to be availed of if necessary because of the limited amount in the capital account available for charge-offs.

"Substantial progress has evidently been made during the past few years in improving the asset condition of the bank, the managing officer is reported to be well qualified and he is apparently intent on placing the affairs of the institution in satisfactory condition. However, as brought out in the report of examination for membership and the presentation memorandum, there are still some sizable problems to be worked out and it is assumed that the Reserve Bank will follow the situation closely until ultimate solution of the problem matters is more definitely assured."

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

"This refers to your letter of February 10, 1942, to Mr. Paulger, relating to the purchase by The Union Trust Company of Pittsburgh, Pittsburgh, Pennsylvania, of additional shares of stock of The Union Savings Bank of Pittsburgh and The Mellon National Bank, both affiliates of the trust company.

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"It is noted that prior to the purchase of the stock on December 22, 1941, The Union Trust Company of Pittsburgh was advised by its counsel that, despite the provisions of section 9 of the Federal Reserve Act and section 5136 of the Revised Statutes prohibiting generally the purchase of corporate stocks by State member banks, the proposed purchase was legally permissible. In expressing this opinion, counsel for the trust company construed section 23A of the Federal Reserve Act as impliedly authorizing investments in stocks of affiliates within the limitations prescribed by that section.

"Despite the fact that you had advised the trust company in 1939 that the Board did not so construe the law, the trust company proceeded with the purchase without consulting you again. Upon inquiry concerning its action, the trust company forwarded to you a copy of its counsel's opinion and suggested that the Board might be willing at this time to reconsider the question.

"The opinion of counsel for the trust company contains no arguments which have not been heretofore thoroughly considered by the Board; the Board believes that the conclusion previously expressed by it concerning this question is clearly correct. As you know, the basis for the Board's conclusion is indicated by its letters of November 21, 1938 (S-129) and July 21, 1934 (enclosure with S-129), which appear as item #7087 of the Federal Reserve Loose-Leaf Service.

"It seems unnecessary to add anything thereto, except to point out that the Board's construction of the law does not, as suggested by counsel for the trust company, render meaningless the words, 'invest any of its funds in the capital stock \* \* \* of any such affiliate', contained in the first paragraph of section 23A. Under the Board's construction, this reference to investments in stocks of affiliates, considered with other provisions of the statute, has the effect of requiring any such investments held by a member bank to be included in determining whether the limits upon extensions of credit and investments prescribed by section 23A have been reached. For example, take the case of a State member bank which had purchased a majority of the shares of stock of a corporation prior to June 16, 1933, and held the stock on that date, the investment in the stock equalling at least ten per cent of the bank's capital stock and surplus. Under the Federal law, the purchase of the stock prior to June 16, 1933, was not prohibited and stock held on that date legally might be retained. The corporation being an affiliate of the bank, section 23A of the Federal Reserve Act would have prohibited the bank from making a loan to the corporation after

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"June 16, 1933, because it already had an investment in the stock of the corporation equalling or exceeding the limitation prescribed by that section (assuming that none of the exceptions contained in the last paragraph of section 23A were applicable). However, if the words quoted above had been omitted from section 23A, the bank could have made a loan to the corporation despite the fact that it already had the investment in the corporation's stock. Thus, these words serve a definite purpose, without giving them the effect erroneously attributed to them by counsel for The Union Trust Company of Pittsburgh.

"Please advise The Union Trust Company of Pittsburgh concerning the Board's views and request prompt advice as to steps taken to correct the violation."

Approved unanimously.

Letter to Mr. Clerk, First Vice President of the Federal Reserve Bank of San Francisco, reading as follows:

"This refers to your letter of August 8, 1941, with enclosures, requesting the Board's opinion as to whether the balance in a 'differential account' set up in connection with certain proposed contracts for the purchase of instalment paper by the Bank of America National Trust and Savings Association, gives rise to a deposit liability against which reserves must be carried with the Federal Reserve Bank. As you know, since the receipt of your letter, this matter has been the subject of correspondence between Mr. Wyatt, the Board's General Counsel, and Mr. Agnew, General Counsel for your bank, who has given it careful consideration in consultation with representatives of the Bank of America.

"While the four proposed forms of contracts enclosed with the bank's letter of July 29, 1941, vary somewhat in language because of their different subject matter, it is understood that all of such contracts may be regarded as having the same effect in so far as the present question is concerned. It appears that under these contracts the bank would purchase instalment paper at a price less than the face amount of the paper and that at the time of the purchase the dealer would be credited with the amount of the purchase price and full title to the paper would pass to the bank. Under the agreement, no further amounts would be credited to the dealer until 'an amount in excess of the purchase price, plus \_\_\_\_\_% per annum computed monthly of the unpaid balance of the amount paid by the bank for such paper, is realized by the bank'; and any excess so realized would be applied first to satisfy any past due

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"indebtedness of the dealer to the bank arising under the contract or otherwise, and any balance then remaining would be paid or credited to the dealer.

"In practice, it is understood that the transaction is handled in the following manner. At the time of the purchase, in order to maintain a record of payments, the bank sets up what is termed a 'differential account' representing the difference between the face amount of the paper and the purchase price. As monthly collections are made on the face amount of the paper, any amount realized in excess of the proportionate monthly part of the purchase price (plus the agreed interest or discount) is paid over to the dealer; and at the same time the differential account is reduced by the amount of such additional payment. As a result, the differential account at all times represents a certain percentage of the unpaid balance.

"As you know, the Board had under consideration in 1938 a case involving somewhat similar facts. In that case it appeared that a national bank, in connection with its purchase of instalment paper from dealers, required each dealer to set aside out of the proceeds of the paper and carry with the bank in a 'special reserve account' a certain percentage of the face amount of the paper or of the unpaid balance thereon. The bank was authorized to charge this account with any losses sustained in the collection of the paper discounted for the dealer or as the result of any other indebtedness incurred by the dealer. In a letter dated March 22, 1938 (S-81; F.R.L.S., #5978), the Board ruled that the amounts held in such a special reserve account, not being segregated from the other assets of the bank, should be regarded as deposits against which reserves must be carried with the Federal Reserve Bank.

"In the case now under consideration it appears that the so-called differential account constitutes merely a current record of the excess of the unpaid balance of the face amount of the paper over the unpaid balance of the agreed purchase price. Under the terms of the contract, the bank is under no liability to the dealer for the amounts credited to the differential account until actually collected. In the case considered by the Board in 1938, it was understood that the bank at the time it acquired the notes gave the dealer credit for the full face amount thereof but set aside an agreed percentage of this amount as a special reserve fund which was not available to the dealer until after full payment of the paper. In this respect, therefore, it is believed that the present case may be distinguished from the case above mentioned.

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"On the basis of the facts as outlined above, and without undertaking to approve specific forms of contracts, the Board has reached the following conclusions:

"1. If the purchase price of the paper is credited to the dealer's account, the resulting credit obviously is a deposit against which reserves must be maintained.

"2. The uncollected difference between the purchase price and the face amount of the paper is in practical effect a potential margin of security and does not constitute a deposit against which reserves must be maintained.

"3. Where, however, an instalment payment has been received and a portion of such payment (say 90 per cent) has been credited against the purchase price and the remainder (say 10 per cent) has not been credited against the purchase price, the 90 per cent of the payment which has been applied against the purchase price does not constitute a deposit balance, but the remaining 10 per cent of the payment does constitute a deposit unless and until it is paid over to the dealer or applied against his indebtedness.

"4. Whenever the payments received on any paper purchased aggregate an amount in excess of the purchase price plus interest or discount, any such excess which is not paid over to the dealer or credited against his indebtedness likewise constitutes a deposit against which reserves must be maintained."

Approved unanimously.

Memorandum dated February 20, 1942, from Mr. Vest, Assistant General Counsel, stating that the replies received from the Federal Reserve Banks to the telegram which was sent to the Presidents of the Banks following the meeting of the Board on February 17, 1942, indicated that all of the Reserve Banks were in favor of an amendment to Regulation D which would permit member banks in central reserve and reserve cities to compute their required reserves on a weekly basis.

The following resolution was adopted  
by unanimous vote:

"RESOLVED, That Regulation D, Reserves of Member Banks,  
is hereby amended in the following respects, effective with

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"the reserve computation period beginning February 28, 1942:

"1. Subsection (a) of section 3 of Regulation D is amended to read as follows:

"(a) Computation of deficiencies.

"(1) Deficiencies in reserve balances of member banks in central reserve cities and in reserve cities shall be computed on the basis of average daily net deposit balances covering weekly periods. Deficiencies in reserve balances of other member banks shall be computed on the basis of average daily net deposit balances covering semimonthly periods.<sup>8</sup>

"(2) In computing such deficiencies the required reserve balance of each member bank at the close of business each day shall be based upon its net deposit balances at the opening of business on the same day; and the weekly and semimonthly periods referred to in paragraph (1) hereof shall end at the close of business on days to be fixed by the Federal Reserve banks with the approval of the Board of Governors of the Federal Reserve System.'

"2. Section 4 of Regulation D is amended to read as follows:

"SECTION 4. LOANS AND DIVIDENDS WHILE RESERVES ARE DEFICIENT

"It is unlawful for any member bank the reserves of which are deficient to make any new loans or pay any dividends unless and until the total reserves required by law are fully restored, and the payment of penalties for deficiencies in reserves does not exempt member banks from this prohibition of law. As provided in section 3 of this regulation, penalties for deficiencies in reserves are computed on the basis of the average reserve balances for weekly or semimonthly periods; but this prohibition of law applies whenever the reserves are deficient for one day or more, regardless of whether or not the average reserve balances for the weekly or semimonthly period are deficient.'"

"8/ Deficiencies in reserve balances of member banks in outlying sections of central reserve and reserve cities which have been authorized by the Board of Governors of the Federal Reserve System, under the provisions of subsection (a) of section 2 of this regulation, to maintain seven per cent reserves against demand deposits, will also be computed on the basis of average daily net deposit balances covering semimonthly periods.'"

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Unanimous approval was also given to a telegram to the Presidents of all Federal Reserve Banks, reading as follows, it being understood that the text of the resolution as set forth above would be sent to the Federal Reserve Banks in a separate letter:

"Board has today amended its Regulation D, effective with the reserve computation period beginning February 28, 1942 so as to provide that deficiencies in reserve balances of member banks in all central reserve and reserve cities shall be computed on the basis of average daily net deposit balances covering weekly periods. Letter containing text of amendment will follow. Board is today issuing the following announcement for immediate release to the press regarding this amendment:

"Under Regulation D of the Board of Governors of the Federal Reserve System, deficiencies in reserve balances of member banks in cities where Federal Reserve Banks or branches thereof are located and in a few other reserve cities are at present computed on the basis of average daily net deposit balances covering semiweekly periods. Such computations by member banks in other reserve cities are made on a weekly basis.

"The Board has amended Regulation D, effective with the reserve computation period beginning February 28, 1942, so as to provide that member banks in all central reserve and reserve cities shall make such computations on a weekly basis. This change places banks in all these cities, including those in which Federal Reserve Banks or branches are located, on the same basis in this respect and has been made for the convenience of member banks in these cities in adjusting their reserve positions.

"Country banks, i.e., those located outside of central reserve or reserve cities, will continue as heretofore to compute deficiencies in reserve balances on a semimonthly basis."

Telegram to Mr. Austin, Assistant Cashier of the Federal Reserve Bank of Dallas, reading as follows:

"Reference your telegram February 19 Board is of the opinion that a two-way radio transmitting and receiving unit for use on an aeroplane is not included as a radio receiving set in Group C-10 of the Supplement."

Approved unanimously.



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Letter to Honorable D. W. Bell, Under Secretary of the Treasury,

reading as follows:

"A comparison of insurance premiums paid by the Federal Reserve Banks since the establishment of the Federal Reserve System with losses sustained indicates that the Federal Reserve Banks might save substantial amounts by entering into agreements with each other to share losses on certain types of risks, particularly those covered by registered mail and express insurance and the bankers' blanket bond.

"However, before reaching a conclusion as to whether the System should discontinue the purchase of insurance covering specified risks, it was thought desirable to approach the insurance companies for the purpose of determining whether any further reductions in insurance rates could be obtained. Following a discussion of this question with the insurance companies, they have agreed to reductions in the premium rates on the blanket bond and on registered mail and express shipments, except shipments of currency from Washington, of around 25 per cent. On currency shipments from Washington to Federal Reserve Banks and Branches, the insurance companies agreed to a reduction from 2 cents to 1-3/4 cents per thousand dollars. We did not think this to be an adequate reduction and we are now informed that the insurance companies are willing to reduce the rate further to 1-1/2 cents per thousand dollars, provided reimbursement is not claimed for any shipment of Federal Reserve notes from Washington to a Federal Reserve Bank or Branch where total destruction of the shipment occurs.

"If both the Treasury Department and the Board of Governors were fully convinced that a shipment of Federal Reserve notes from Washington to a Federal Reserve Bank or Branch had been completely destroyed en route, and consequently that there was no possibility that any of the notes would ever be presented for redemption, it would seem that such notes should be treated as if they had never been issued.

"If you concur in this viewpoint, it will be appreciated if you will write the Board that where it is proved to the satisfaction of the Treasury Department and the Board of Governors that Federal Reserve notes shipped to a Federal Reserve Bank or Branch have been completely destroyed in transit and that there is no possibility that any of them would ever be presented for redemption, the charge to the Federal Reserve Bank will be reversed and the notes replaced with no charge to the Federal Reserve Bank except for printing. Upon receipt of such a letter from you, it would be our purpose to negotiate with the insurance companies for a further reduction in the insurance rate on shipments of currency from Washington to Federal

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"Reserve Banks and Branches."

Approved unanimously.

Memorandum dated February 17, 1942, from Mr. Wingfield, Assistant General Counsel, recommending that there be published in the March issue of the Federal Reserve Bulletin statements in the form attached to the memorandum with respect to the following subjects:

Consumer Credit  
Interpretations of Regulation W; and

Foreign Funds Control  
General License and Public Circulars  
Issued by the Secretary of the Treasury.

Approved unanimously.

Thereupon the meeting adjourned.

Chester Morrill  
Secretary.

Approved:

[Signature]  
Chairman.