A meeting of the Board of Governors of the Federal Reserve System was held in Washington on Monday, July 27, 1942, at 12:00 noon.

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

Mr. Morrill, Secretary
Mr. Bethea, Assistant Secretary
Mr. Carpenter, Assistant Secretary
Mr. Clayton, Assistant to the Chairman
Mr. Thurston, Special Assistant to the Chairman
Mr. Parry, Chief of the Division of Security Loans
Mr. Dreibelbis, Assistant General Counsel
Mr. Bonnar Brown, Special Assistant in the Division of Security Loans

Mr. Ransom presented a memorandum prepared by him and Mr. Parry under date of July 24, 1942, submitting and recommending the adoption, effective immediately, of two amendments to Regulation W which would liberalize the regulation with respect to credits relating to (1) the conversion of existing residential heating equipment and the purchase of insulating materials, and (2) the repair or replacement of property damaged or lost as the result of a disaster. The memorandum read in part as follows:

"'Fuel Conservation Credits'. - The purpose of this amendment is to remove a credit barrier, the 12-month limitation, that Regulation W places in the way of a Government-sponsored campaign to conserve fuel, mainly for transportation reasons, by inducing people (1) to convert furnaces from one fuel to another, principally from oil to coal, and (2) to insulate their homes -- and to do so forthwith. A number of other agencies are interested in this campaign, including among others the War Production Board and the Office of Defense Transportation. We have been in communication with

"these agencies as well as with the National Housing Agency, Office of Price Administration, Office of Bituminous Coal Consumers' Counsel, Office of Petroleum Coordinator for War, Secretary of the Treasury, and Secretary of Commerce. A copy of our letter to them is attached, together with the replies that have been received. We have been impressed by the extent to which they favor both the campaign in question and the proposed relaxation of Regulation W as a part of that campaign.

"'Disaster Credits'. - The purpose of this amendment is to remove barriers placed by Regulation W in the way of extensions of credit to sufferers from such community disasters as the 'flash floods' that have recently afflicted Kentucky, Pennsylvania, and New York. To prevent the instalment sale of furniture, for example, to these sufferers without a down payment of 20 per cent, seems unreasonable. So does the limitation to 12 months of loans to repair houses, etc., or to buy furniture, etc. Attached is a letter from Mr. R. B. Hays, Federal Reserve Bank of Cleveland, which presents the problem as it has recently appeared in Kentucky and a memorandum of a telephone call from Mr. Loren B. Allen, Federal Reserve Bank of New York, presenting the problem as it has recently appeared in New York.

"This amendment has been discussed informally with Mr. Bonner of OPA, who saw no objection, but has not been formally submitted to the Consultative Committee."

In the discussion of the proposed amendments, inquiry was made as to whether they might be used as a means of evading other provisions of the regulation, and Mr. Ransom stated that, while that possibility was always present, he felt it was not a serious one, that the amount of credit of the kinds contemplated by the amendments probably would not be large, and that he was of the opinion that the liberalization of the regulation in these respects was entirely justified, particularly because of the fact that, if under the conditions to which the amendments relate there were undue hardship because of lack of fuel or because of a community disaster, the public reaction against Regulation W would

be out of all proportion to anything that might be accomplished by not adopting the amendments. Mr. Ransom also stated that the amendment relating to fuel conservation credits did not include such items as lumber siding, that it had been urged that these items should be included, but that it was felt that the amendment went about as far as was justified at this time. He also read from some of the letters received from interested agencies of Government in which they concurred in the desirability of this amendment.

At the conclusion of the discussion, upon motion by Mr. Ransom and by unanimous vote, the following amendments to Regulation W were adopted, effective immediately, with the understanding that the Federal Reserve Banks would be advised by wire with a request that they print the amendments and distribute them to interested persons. It was also understood that press statements in the form read during the discussion would be given to the press this afternoon for immediate release.

"Amendment No. 6 to Regulation W

"Regulation W is hereby amended effective July 27, 1942, by adding the following new subsection at the end of section 8:

"(m) Fuel Conservation Credits. -- Any extension of credit to finance (1) the conversion of heating equipment to the use of any other fuel, (2) the installation of loose-fill, blanket, or batt-type insulation, or insulating board, within existing structures, (3) the installation of storm doors, storm windows, or weather stripping, or (4) the purchase of materials for any of the above purposes."

"Amendment No. 7 to Regulation W

"Regulation W is hereby amended effective July 27, 1942, by striking out subsection (h) of section 8 and substituting the following:

"(h) Disaster Credits. -- Any extension of credit (1) made by the Disaster Loan Corporation, or (2) to finance the repair or replacement of real or personal property damaged

"or lost as a result of a flood or other similar disaster which the Federal Reserve Bank of the district in which the disaster occurs finds has created an emergency affecting a substantial number of the inhabitants of the stricken area."

At this point, Messrs. Thurston, Parry, Dreibelbis, and Bonnar Brown left the meeting, and 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 25, 1942, were approved unanimously.

Memorandum dated July 21, 1942, from Mr. Goldenweiser, Director of the Division of Research and Statistics, submitting the resignation of Haskell Wald as a junior economist in that Division, to become effective as of the close of business on July 19, 1942, and recommending that the resignation be accepted as of that date.

The resignation was accepted.

Telegram to Mr. Gilbert, President of the Federal Reserve Bank of Dallas, reading as follows:

"Retel July 24. Board is sorry to learn of Mr. Crump's condition and will interpose no objection to the payment to him of the proposed cash allowance in an amount equal to six months' salary to supplement retirement benefits if he is retired under the disability provisions of the Retirement System."

Approved unanimously.

Letter to Mr. Evans, Vice President and Secretary of the Federal Reserve Bank of Dallas, reading as follows:

"This refers to your letter of July 3, 1942, and Mr. Stroud's memorandum enclosed therewith, expressing the opinion that there is no legal objection to the retirement by Washington County State Bank, Brenham, Texas, of the remaining $5,000 of its capital debentures held by the

"Reconstruction Finance Corporation, and recommending that the Board approve the retirement of the debentures and other proposed readjustments in the bank's capital accounts.

"The Board has consistently taken the position in numerous cases involving this question, including some in your District (e.g., First State Bank, Kerrville, Texas), that capital debentures of State member banks which are owned by the Reconstruction Finance Corporation constitute capital stock within the meaning of the Federal statutes governing the withdrawal of capital stock of such banks and that, accordingly, a retirement of such debentures by a State member bank which reduces the aggregate outstanding stock and debentures to an amount below that required for the organization of a national bank in the same place constitutes a violation of the technical requirements of the Federal Reserve Act.

"In reaching a contrary conclusion, you have given very limited effect to the following provision of section 9 of the Federal Reserve Act:

> 'For the purposes of membership of any such bank the terms "capital" and "capital stock" shall include the amount of outstanding capital notes and debentures legally issued by the applying bank and purchased by the Reconstruction Finance Corporation.'

"Considering this provision together with the previously enacted statutory provisions relating to the purchase of capital debentures of State banks by the Reconstruction Finance Corporation, it is believed that one is clearly warranted in adopting a construction generally to the effect that, in so far as State member banks are concerned, the terms 'capital' and 'capital stock' wherever used in Federal statutes applicable to such banks by reason of membership shall be deemed to include such capital debentures. Such a construction is in accord with the apparent intent that where State banks could not issue preferred stock eligible for purchase by the Reconstruction Finance Corporation, the issuance and sale of capital debentures to that corporation should serve as a substitute which would accomplish the same purposes. Incidentally, this would appear to give the above-quoted provision no broader meaning than that it applies 'to admission to membership and to retention of membership', as suggested by Mr. Stroud, since the right of a bank to retain membership depends upon, among other things, compliance with the Federal laws applicable to it as a member bank and, therefore, the meaning of the terms 'capital' and 'capital stock' wherever used in the applicable statutes (including those relating to withdrawal of capital) is pertinent to the retention of membership.

"Further, when applied to other situations, a narrow construction which would justify the conclusion which you have reached in this case would produce unreasonable results which surely were not contemplated and should be avoided if possible. For example, it would follow that, upon admission of a bank to membership with stock and debentures in the minimum amount required for admission, the law would not prohibit the bank from immediately reducing its capital below the required amount by retiring debentures. On the other side of the picture, it would follow that capital debentures owned by the Reconstruction Finance Corporation could not be treated as capital or capital stock for the purposes of various statutory restrictions upon State member banks relating to loans, investments, establishment of branches, and other matters. This would definitely discriminate against State banks which had issued capital debentures and in favor of national banks and those State banks which had issued preferred stock; and, where a bank's capital consisted largely of debentures, its operations might be so restricted as to make membership inadvisable.

"Pointing out that the statutory restrictions upon withdrawal of capital stock deal directly with national banks and are made applicable to State member banks only by reference, Mr. Stroud argues that they do not govern the retirement of debentures by State member banks because the statutory definition of 'capital' in the case of national banks does not include debentures. Identical reasoning also would be applicable in construing a number of other statutory provisions (e.g., those relating to purchase of investment securities) where it would be advantageous to State member banks to treat debentures as capital or capital stock and, in connection with the ruling published in the Federal Reserve Bulletin for November 1934 at page 749 which construed some of these provisions, this argument was dismissed as highly technical and contrary to the apparent intent and purposes of the law. Obviously, one is not justified in construing the law narrowly in those few cases in which it is advantageous to the banks and broadly in other instances where the narrow construction is disadvantageous.

"In your letter you suggest that the Board's construction of the law results in discrimination against State member banks because it restricts their right to retire capital debentures, whereas there is no restriction upon the retirement of debentures by national banks. The answer is that national banks obtain capital funds from the Reconstruction Finance Corporation through the issuance and sale of preferred

"stock, instead of debentures, and the retirement of such stock is subject to the same restrictions which the Board deems to be applicable to retirement of debentures by State member banks. As a matter of fact, a narrow construction, not a broad one, would result in discrimination, since State banks which had issued debentures would be in a more favorable position with respect to retirements than banks which had issued preferred stock and in a less favorable position in other respects, as noted above.

"As indicated above, the Board is of the opinion that the position heretofore taken by it is correct and that, accordingly, the proposed retirement by Washington County State Bank of its outstanding debentures would constitute a violation of the technical requirements of the Federal Reserve Act and the previous retirements made after the 1940 census figures for Brenham became available constituted like violations.

"However, the penalty for such violations by a State member bank is expulsion of the bank from membership and the law vests in the Board discretion with respect to whether such action should be taken. In view of this fact, the Board has interposed no objection to retirements of debentures in violation of the statutory requirements in some instances. In the two instances most comparable to the present case, member banks located in towns whose populations had increased subsequent to the banks' admission to membership had cooperated with the program of supervisory authorities for the rehabilitation of banks by selling debentures to the Reconstruction Finance Corporation in order to meet emergency situations arising at the time of the banking holiday and, after the emergency had passed, the banks found themselves penalized for their cooperation by the legal requirement requiring them to maintain capital stock in such amounts that their capital funds were obviously excessive.

"In the present case, it appears that the bank undoubtedly would have been admitted to membership with only $50,000 capital stock and, as a practical matter, that amount can not now be considered inadequate; that it may have been admitted to membership and proceeded with the retirement of its debentures in ignorance, or with a misunderstanding, of the statutory requirements; that retirements have been made in violation of such requirements with the approval of your bank and without objection by the Board, the increase in the population of Brenham and the legal question involved having been overlooked; that now only a relatively insignificant

"amount of debentures, $5,000, remains to be retired; that the bank is in satisfactory condition and its aggregate capital funds are adequate without the debentures; and that, in proposing to retire the remainder of its debentures and to transfer its reserve for dividends payable in common stock to surplus and undivided profits instead of declaring such a dividend, the bank is following the recommendation of the State banking authorities.

"On the other hand, the declaration of a stock dividend in an amount sufficient to satisfy the legal requirements would not result in excessive capital stock or an unsatisfactory distribution of the bank's capital accounts, and the fact that the bank has created a reserve for dividends payable in common stock which now exceeds the amount of the debentures which were outstanding when the bank was admitted to membership indicates that, over a period of years, the bank's management has contemplated that such action eventually would be taken. Also, while your bank's approval of the retirements previously made was not conditioned upon the creation of a reserve for dividends payable in common stock, the fact that the bank was voluntarily creating such a reserve was expressly noted and, although your bank and the Board are hardly in a position to complain about the previous retirements, they might properly insist upon the use of the reserve for the purposes for which it was created. There is no showing that the declaration of a stock dividend would work any hardship upon the bank and no reason is given for the change in the bank's program other than that it was recommended by the State authorities. There is no indication as to the basis for the State authorities' recommendation or how strongly they feel about the matter and it seems entirely possible that neither they nor the bank would have any serious objection to an increase in the outstanding stock of the bank if it were pointed out that this is necessary in order to comply with the technical requirements of the Federal Reserve Act.

"The reasons for disregarding the technical requirements of the law seem somewhat less impressive in this case than in those in which such action heretofore has been taken by the Board. However, you are, of course, much more familiar than the Board with the local situation and any understandings or commitments which may have been made and, in view of the circumstances recited above and your recommendation, the Board authorizes you to interpose no objection to the retirement of the bank's remaining debentures and to the other proposed changes in the bank's capital accounts if, after consideration of this letter and discussion of the

"matter with the State authorities, you feel that the circumstances warrant the disregard of the technical requirements in this instance. Similar cases arising in the future of course should be presented to the Board for action on the basis of the facts and circumstances of each case."

Approved unanimously.

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

"This refers to your letter of July 15, 1942, regarding the special condition suggested in our letters of July 7, 9 and 10, 1942, for insertion in guarantee agreements where the agreement between the borrower and the financing institution provides that a rate of interest higher than the rate payable before maturity of the loan shall be paid by the borrower after maturity or as interest on overdue interest or otherwise. In view of the fact that you are rarely in a position to know whether there is to be a higher rate of interest charged after maturity, you suggest that, as indicated in the memorandum from Mr. Wallace which you enclosed, it would be a good idea to include the condition suggested in every guarantee agreement.

"We have taken this matter up informally with the War Department, Navy Department and Maritime Commission, and it is their feeling that it is preferable not to modify or add to the provisions of the standard form of agreement except where necessary or desirable because of the circumstances of particular cases and, accordingly, that it is not desirable to include uniformly in all guarantee agreements an additional provision on this subject at this time if it can be avoided. There will be no objection, however, to your including a special condition on this subject in any particular case where you think it is advisable to do so either because of absence of information with respect to the matter or otherwise."

Approved unanimously, together with a similar letter to Mr. Olson, Assistant Vice President of the Federal Reserve Bank of Chicago, and letters transmitting copies of the letter from Mr. Fry and the above reply to Colonel John C. Mechem, Chief of the Miscellaneous Branch, Fiscal Division of the

War Department; Mr. Sidney A. Mitchell, Chief of Finance Section, Office of Procurement and Material, Navy Department; and Mr. B. B. Griffith, Assistant to Director of Finance, United States Maritime Commission.

Letter to Mr. Olson, Assistant Vice President and Assistant Secretary of the Federal Reserve Bank of Chicago, reading as follows:

"This refers to your telegram of July 22, 1942, in which you inquire whether it is agreeable to incorporate in section 13 of the standard form of guarantee agreement a uniform paragraph intended to give protection to financing institutions against invalidity of assignments. The question of changes in or additions to the standard form of guarantee agreement has been the subject of informal discussion with representatives of the War Department, Navy Department and Maritime Commission, and it is felt that it is not desirable to make any such changes or additions if it can be avoided. It is suggested, therefore, that in your negotiations with financing institutions you indicate that the standard form of agreement is intended to be uniform and not subject to change, except, of course, special conditions may be necessary because of the circumstances of particular cases."

Approved unanimously, together with letters to Mr. Sidney A. Mitchell, Chief of Finance Section, Office of Procurement and Material, Navy Department; Colonel John C. Mechem, Chief of the Miscellaneous Branch of the Fiscal Division, War Department; and Mr. B. B. Griffith, Assistant to Director of Finance, United States Maritime Commission, reading as follows:

"There are enclosed herewith for your information a copy of a telegram received from Mr. A. L. Olson, Assistant Vice President and Assistant Secretary of the Federal Reserve Bank of Chicago, and a copy of our reply, with reference to whether it is agreeable to incorporate in section 13 of the standard form of guarantee agreement a uniform paragraph intended to give protection to financing institutions against invalidity of assignments. We believe that our reply is in accord with your views but if not please advise us."

Letter to Mr. Dillard, Vice President and Secretary of the Federal Reserve Bank of Chicago, reading as follows:

"Your letter of June 19, 1942, enclosing a letter of the same date from Hamilton Ross Industries, Chicago, Illinois, requested our advice as to whether transactions pursuant to the Hamilton Ross Industries' method of selling merchandise conforms to Regulation W and Interpretation W-64.

"In a typical case, it appears that Hamilton Ross Industries sells certain featured articles of merchandise to a local merchant and prepares and furnishes for his use mail or newspaper advertising inviting prospective customers to request delivery by the merchant of such articles on approval, trial or inspection for a period of about fifteen days, all without deposit by, or expense or obligation to, such customers. The customer is informed that if, by the end of such period, he decides to buy the merchandise, a down payment and an instalment contract conforming to Regulation W then must be made. However, the customer has the unconditional right to return the article, if he so chooses, without any expense to himself.

"Since it does not appear that the transactions of the type outlined above are entered into for the purpose of evading the Regulation, it is the Board's view that they fall within the terms of Interpretation W-64 and that, for the purposes of the Regulation, the date of sale may be regarded as the date on which the prospective customer informs the merchant of his decision to buy the article.

"However, in cases of this nature you may find it desirable to advise that Interpretation W-64 contemplates the delivery of an article for an approval, trial or inspection period without obtaining a down payment and an instalment contract at the time thereof, only if such delivery is made for the purpose, in good faith, of allowing the prospective buyer to inspect, try out, and approve the article so delivered. If such purpose is not real, or if such transaction is merely a device to delay the down payment and instalment requirements of the Regulation, then the transaction would be considered to be of an evasive nature and not permitted by Interpretation W-64 or the Regulation.

"This interpretation relates, of course, to the Regulation as it now stands, but it would be only fair to remind any interested Registrant that the Regulation could at any time be amended to make transactions of the type outlined above unlawful. Study of this case has indicated

"that there may be a real need for such an amendment in order to make the Regulation more effective in accomplishing its purposes, and such an amendment is under active consideration."

Approved unanimously.

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

"Your letter of July 7 describes the various alternatives with which stores operating branches would be faced if section 5(b) of Regulation W is deemed applicable to all the accounts of a customer with the various branches of the store, as stated in the Board's letter to you of June 19. You point out that there has been an excellent feeling of cooperation in your district up to the present time, and that the trade has responded well to the efforts of the System to secure an understanding of the purposes and the provisions of the regulation, with the result that most Registrants have been desirous of complying not only with its technical provisions, but also with its intent.

"In view of the importance of these considerations, and others of a similar nature which you state in your letter, the relevant portions of the regulation have been restudied to determine whether there exists a basis for reversing the position taken in the Board's letter of June 19. This study has not yet revealed any way in which the regulation could be construed so as to reach the result you suggest, and therefore the only course open that would get that result would appear to be an amendment.

"Consideration and study will accordingly be given to the matter of possible amendment of Regulation W on this subject. In this connection we are interested in obtaining a clearer picture of the nature and degree of the hardship that the present rule will impose if it should not be changed.

"The problem of the store, under the present rule, appears to be that of determining in particular cases whether the customer has an account at one of its branches which is in default, and it is not easy at this distance to see just what difficulties would be involved in making this determination. At the beginning it would be necessary for the branches to compare the lists of their charge account customers to ascertain which of their customers

"have accounts at more than one branch. Thereafter, however, it would not seem to be unduly difficult for a branch which had an account in default, and which saw on the record of the account a symbol showing that the customer had an account at another branch, to notify that other branch of the default. As you say, it seems unlikely that there would be any very large number of instances of a customer's having an account at more than one branch.

"There would also be cases, of course, in which a customer opening a new account wants to charge something to it immediately. In such a case, under the present rule, if the customer said that he did not have an account at any other branch of the store and the store permitted the charge in reliance on his statement, there would be a question of fact whether the Registrant was negligent in extending credit to him if it later developed that he did have an account at one of the other branches and that account was in default.

"In order to give us a fuller understanding of the situation of the stores involved, which will be helpful in determining the exact substance of an appropriate amendment and in determining that the difficulties of these stores do in fact necessitate an amendment, it will be appreciated if you will let us have a further explanation with respect to the points in the two preceding paragraphs.

"In connection with any amendment on this subject, consideration will naturally have to be given to its consequences in the many different classes of cases that it would affect. There will also be the problem of how and where to draw the line as, for example, how to define 'separate credit departments' in such a manner as to care for legitimate cases without at the same time making possible a device that might permit extensive avoidance of section 5 of the regulation. Any suggestions or other assistance that you can give us on such points will be appreciated. An additional problem on which any comments will be welcome relates to cases in which a firm has two or more stores in the same city. In such a case a provision permitting the separation of accounts wherever the stores maintain separate accounting departments, without any further restriction, would seem to create possibilities of avoidance of the regulation.

"We have discovered one store in the East that has the same problem as the California stores to which your letter refers, but if the affected stores in California can indicate what stores in other parts of the country may prove to be similarly affected, such information would also be appreciated.

"Finally, it may be noted that any amendment of the kind in question would necessarily have some effect in further

"complicating an already complicated regulation. Obviously, a regulation applicable to a number of different types of business must, to a certain extent, be a compromise between a short and simple regulation which does not make provision for variations in conditions, and a long and complex regulation which provides for all sorts of cases but which may be difficult to administer because it is difficult for the Registrants to understand. It is largely for this reason that the Board, before passing any amendment on the point in question, wishes to be sure that it is necessary to do so in order to avoid some real hardship that would otherwise occur to the Registrants involved."

Approved unanimously.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved: M S Eccles
Chairman.