A meeting of the Board of Governors of the Federal Reserve System was held in Washington on Friday, August 6, 1943, at 11:00 a.m.

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

Mr. Morrill, 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 August 5, 1943, were approved unanimously.

Telegrams to Mr. Paddock, President of the Federal Reserve Bank of Boston, Messrs. Treiber and McCreedy, Secretaries of the Federal Reserve Banks of New York and Philadelphia, respectively, Mr. Leach, President of the Federal Reserve Bank of Richmond, Mr. Frazer, Secretary pro tem of the Federal Reserve Bank of Atlanta, Mr. Dillard, Vice President of the Federal Reserve Bank of Chicago, Mr. Stewart, Secretary of the Federal Reserve Bank of St. Louis, Messrs. Powell and Stroud, First Vice Presidents of the Federal Reserve Banks of Minneapolis and Dallas, respectively, 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 August 3, by the Federal Reserve Bank of Atlanta on August 4, by the Federal Reserve Banks of New York, Philadelphia, Richmond, Chicago, Minneapolis, Dallas, and San Francisco on August 5,
1943, and by the Federal Reserve Bank of Boston today, of the rates of discount and purchase in their existing schedules.

Approved unanimously.

Memorandum dated August 3, 1943, from Mr. Goldenweiser, Director of the Division of Research and Statistics, recommending that Gottfried Haberler be appointed as an Economic Specialist in that Division on a temporary basis for a period of not to exceed one year, with basic salary at the rate of $9,600 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, with the understanding that he will not become a member of the Retirement System of the Federal Reserve Banks during the period of his temporary employment. The memorandum stated that, if the work in which Mr. Haberler would participate was not completed within a year, consideration might have to be given to an extension of his appointment.

Approved unanimously.

Memorandum of this date from Mr. Morrill, recommending that Ralph Matthews be appointed as a cafeteria helper in the Secretary's Office on a temporary basis for a period of not to exceed 60 days, with basic salary at the rate of $1,080 per annum, effective August 6, 1943.

Approved unanimously.

Letter to Mr. McRae, Chief Examiner of the Federal Reserve Bank of Boston, reading as follows:
"This refers to your letter of May 20, 1943, and its enclosures, with regard to the applicability of section 32 of the Banking Act of 1933, as amended, to the service of four members of the Advisory Board of the Massachusetts Investors Trust, Boston, Massachusetts, who are serving at the same time as directors of member banks.

"It appears that the Advisory Board was created in order to provide the maximum assurance that changes would not be made by the trustees of the Massachusetts Investors Trust in the then existing policies and purposes of the Trust and, in giving effect to such purpose, the Advisory Board was vested with the following powers: (1) additional securities may not be added to the approved list (to which the trustees are confined for investment) by the trustees, without the approval of a majority of the Advisory Board; (2) a security of which the trust has no holdings may be removed from the approved list by affirmative vote of a majority of the Advisory Board; (3) no loan shall be contracted by the trustees on behalf of the trust without the approval of the Advisory Board if the aggregate amount of loans outstanding, including the proposed loan, will exceed five per cent of the liquidating value of the trust; (4) no alteration or amendment of the trust indenture shall be effective unless assented to in writing by a majority of the Advisory Board; (5) no merger of the trust with any other organization shall be effected unless first approved in writing by the Advisory Board; (6) certain distributions may be made to shareholders in the discretion of the trustees at rates of interest and other terms as the trustees may determine with the approval of the Advisory Board; (7) under certain limitations a new class of shares may be created and their terms and conditions specified by resolution of the trustees approved by the Advisory Board; and (8) the trustees, with the approval of the Advisory Board, may provide for the issue of scrip for fractions of shares.

"It will be observed that these powers are not merely advisory, as that term is generally understood, but are binding on the trustees. Moreover, it is noted that the Agreement and Declaration of Trust does not provide that the Advisory Board consult with and advise the trustees regarding investments and investment policies and matters generally. In these circumstances, it is the view of the Board that the functions of the Advisory Board of the Massachusetts Investors Trust are not merely advisory, and services to member banks by members of such a board are prohibited by section 32 of the Banking Act of 1933, as amended."
"While it is recognized that it can be argued that members of the Advisory Board are not technically either officers, directors, or employees of the organization with which they are connected, it seems clear that Congress intended that persons as intimately and importantly connected with an organization engaged in the activities described in the statute as are the members of this Advisory Board be included within the provisions of section 32 notwithstanding they do not have the official title of officer, director, or employee."

Approved unanimously.

Letter to Mr. Young, President of the Federal Reserve Bank of Chicago, reading as follows:

"This refers to your letter of July 27, 1943, relating to compliance by State member banks in Wisconsin with the condition of membership requiring a bank subject thereto to deposit securities with its trust department if it deposits trust funds in its commercial or savings department or otherwise uses them in the conduct of its business.

"The Board agrees with the opinion of your counsel that under the law recently enacted in Wisconsin, copy of which was enclosed with your letter, any trust funds so deposited by a State bank would be protected by a preference over claims by general creditors in the distribution of the bank’s assets in the event of insolvency or liquidation. Accordingly, the Board waives compliance by State member banks in Wisconsin with the condition of membership in question, but expressly reserves the right to require full compliance with such condition if at any time as a result of statutory changes or otherwise it feels that trust funds so deposited are not otherwise adequately protected. Please so advise in writing each member bank in Wisconsin in your District which is subject to such condition of membership and forward to the Board for its records a copy of the advice you furnish each of such banks.

"A similar letter is being sent to the Federal Reserve Bank of Minneapolis with respect to Wisconsin banks in the Ninth Federal Reserve District."

Approved unanimously.
Mr. Ransom referred to informal discussions of members of the Board with respect to the procedure to be followed in the disposition of the question whether the absorption by member banks of exchange and collection charges constituted the payment of interest within the meaning of the Board's Regulation Q, Payment of Interest on Deposits, and stated that in accordance with the informal conclusion reached following these discussions he had sent today, over his signature, the following letter (with appropriate changes in references to individuals named in the letters) to Senator Wagner and Congressman Steagall as Chairman of the Senate and House Banking and Currency Committees, respectively, and to Congressman Doughton. He also said that before sending the letters he had advised Mr. Crowley, Chairman of the Federal Deposit Insurance Corporation, and Mr. Delano, Comptroller of the Currency, regarding the procedure which he was following and subsequently had sent to them copies of the letter and its enclosure:

"You may recall that early in 1937 I talked with you and with several other Members of Congress about the question whether the absorption by banks of exchange and collection charges should be regarded as a payment of interest on demand deposits within the prohibition of the law and the Board's Regulation Q. As a result of these discussions, it was understood that I would advise you in advance of any future action which might be taken by the Board affecting the status of this matter. That time seems to have arrived, as the necessity for action has increasingly impressed itself upon us.

"As you may also recall, the Banking Act of 1933 amended section 19 of the Federal Reserve Act so as to provide that no member bank 'shall, directly or indirectly, by any device whatsoever, pay any interest on any deposit which is payable on demand', and the Banking Act of 1935 authorized the Board to determine what shall be deemed to be a payment of interest within the meaning of this section. In view of this provision of the law, the Board adopted a definition of interest under which the absorption of exchange and collection charges by a
"Member bank as compensation for the maintenance of a demand deposit would be construed as a payment of interest on such deposit.

"On January 30, 1937, however, at the request of Senator Wagner and yourself, the Board deferred the effective date of this definition. Following a discussion with Mr. Crowley, because of the fact that the problem involved an interpretation of the law under which the Federal Deposit Insurance Corporation operates with respect to nonmember insured banks, the Board amended its Regulation 9 by striking out the definition in question and providing that, for the purposes of the Regulation, 'interest' should mean 'any payment to or for the account of any depositor as compensation for the use of funds constituting a deposit', and the Federal Deposit Insurance Corporation amended its Regulation so as to define interest in identical language. The Regulations of both Agencies therefore became uniform in this respect. At the same time, the Board and the Federal Deposit Insurance Corporation issued a joint statement for the press in which it was pointed out that the effect of the amendments was to declare existing law rather than to interpret and apply the law to particular cases. It was stated that this would permit the general application by each agency of a uniform law and a determination, based upon the facts involved, in specific cases.

"Since then the Board's Regulation has remained unchanged in this respect and no ruling has been issued by the Board regarding the question whether the absorption of exchange charges constitutes a payment of interest. It was hoped, and there was some reason to believe, that the practice would gradually diminish, particularly since many bankers regarded it as unsound, and that the problem would eventually solve itself without more specific action. Recently, however, it has appeared that the practice, instead of diminishing, has increased. The Board has been informed that some banks have taken advantage of the situation to engage in a competition for bank deposits on the basis of absorption of exchange and collection charges which other banks have believed to be unlawful. As a result, the Board of Governors has been urged on a number of occasions to take action. Requests of this kind have come from members of the Federal Advisory Council as well as from other bankers.

"Last year the Board received a letter from the office of the Comptroller of the Currency under date of July 31, 1942 calling attention to the continued absorption of exchange charges in considerable amounts by a particular national bank and urging upon the Board the desirability of a prompt ruling with respect to the question as applied to this specific case.
"A copy of this letter is enclosed for your information. The Board has reconsidered the entire matter carefully in the light of this case; and there is also enclosed a copy of the reply which has been prepared with a view to its transmission to the Comptroller on August 23, 1943. In this letter the position is taken that the absorption of exchange charges by the bank is a payment of interest on demand deposits in violation of the law and the Board's Regulation Q. Since a ruling in conformity with this letter is one that would be applicable to all member banks, we contemplate publishing the ruling in the September issue of the Federal Reserve Bulletin, which will go to the press about the date of the letter to the Comptroller of the Currency. I am therefore writing you in accordance with the understanding mentioned in the first paragraph of this letter so that you may be advised of the proposed action before it takes effect, and I am writing letters to Messrs. Wagner and Doughton to the same effect. If in the meantime any of you should desire to discuss the matter with me, I will be at your service."

The letter to Comptroller Delano, referred to in the foregoing letter, read as follows:

"This refers to previous correspondence between your Office and the Board, regarding the question whether the absorption of exchange charges by National Bank of Commerce of Lincoln, Lincoln, Nebraska, constitutes a payment of interest on demand deposits in violation of section 19 of the Federal Reserve Act and of the Board's Regulation Q.

"Your Office has submitted detailed reports of your examiner with respect to the relevant facts in connection with this matter. The report of examination as of March 22, 1943, indicates that during the year 1942 the subject bank absorbed exchange charges in the amount of $18,576.22 out of $25,187.15 exchange charges paid, and that during 1943 up to the date of the examination such charges were absorbed in the amount of $4,615.80 out of $5,506.81 paid. It appears that the subject bank has absorbed exchange charges in hundreds of instances and for numerous depositors, principally with respect to balances maintained by correspondent banks; and that the practice has existed over a period of years. As of April 20, 1938, the report of examination of the bank indicated that during 1937 the bank had absorbed exchange charges in the amount of $14,953.68 out of $16,721.85 exchange charges paid; that such charges had been absorbed in amounts ranging from 10 cents to $160 for more than 250 correspondent banks; and that, in some instances, the exchange absorbed for particular
"banks amounted to as much as 2 or 3 per cent of their balances with the subject bank."

"The Board's Regulation Q defines interest as 'any payment to or for the account of any depositor as compensation for the use of funds constituting a deposit.' This definition is intended merely as a declaration of the general law. Accordingly, the questions to be determined in the present case are first, whether the absorption of exchange charges by the subject bank, as above described, constitutes a 'payment', and, second, whether such payment is made as compensation for the use of funds constituting a deposit."

"There can be no doubt that the absorption of each exchange charge by the bank results in a 'payment'. In any such case, the depositor receives a pecuniary benefit which he would not otherwise receive. For example, if a check for $1,000, drawn on a non-par bank which imposes an exchange charge of 1/10 of 1 per cent for paying checks drawn upon it, is deposited with the subject bank, and is forwarded to the drawee bank for collection, the non-par bank would remit to the subject bank $999 in payment of the check. If the subject bank then credits its depositor in the amount of $1,000, thus absorbing the $1 exchange charge, the depositor clearly receives a 'payment' in an amount equivalent to the exchange charge."

"From the facts in the present case it appears that the payments resulting from absorption of exchange charges are made by the subject bank for the purpose of soliciting and augmenting its demand deposit accounts; in other words, as 'compensation' for the use of funds constituting deposits. No other reason for the absorption of such charges is apparent."

"The bank's correspondent bank deposits, with respect to which exchange is regularly absorbed, have increased from less than $7 million at the end of 1941 to nearly $18 million in June 1943. It is significant that during this period the ratio of this bank's correspondent bank deposits to its total demand deposits has been much higher than at Reserve city banks as a whole, both in its district and throughout the country, notwithstanding the fact that Lincoln is located only a short distance from Omaha, which is a much larger financial center."

"That the absorption of exchange charges for depositing banks is in consideration for balances maintained by them is further indicated by the fact that in at least one instance the subject bank has advised a depositing bank that, since the bank's balance in a particular month was negligible, exchange charges could not be absorbed for such bank because the subject bank would 'have no way of making it back'. Moreover, it appears that the subject bank, on occasion, has written to its correspondent banks suggesting that they par
"Items sent to such banks in return for the parring by the subject bank of items received from such banks.

While the practice exists principally with respect to deposits of correspondent banks, it is understood that, in at least one instance, a corporate account formerly carried with a competing national bank was obtained by the subject bank because of its absorption of exchange charges.

In the circumstances, it is the opinion of the Board of Governors, on the basis of the facts here presented as outlined above, that the absorption of exchange charges by National Bank of Commerce of Lincoln, Lincoln, Nebraska, constitutes a 'payment of interest' within the meaning of the general law and is therefore a payment of interest on demand deposits in violation of section 19 of the Federal Reserve Act and of the provisions of the Board's Regulation Q."

Thereupon the meeting adjourned.

Chairman.

Approved:

Secretary.

Chairman.