A meeting of the Board of Governors of the Federal Reserve System was held in Washington on Tuesday, November 9, 1943, at 11:00 a.m.

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

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 November 6, 1943, were approved unanimously.

Memorandum of this date from Mr. Morrill, recommending that Miss Betty A. Kessel 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 November 8, 1943.

Approved unanimously.

Letter to the board of directors of the "Commerce-Warren County Bank", Warrenton, Missouri, 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 St. Louis:

"4. Prior to admission to membership, such bank, if it has not already done so, shall charge off or otherwise eliminate estimated losses of $610 as shown in the report of examination of such bank as of September 4, 1943, made by an examiner for the Federal Reserve Bank of St. Louis."

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

"The Board of Governors of the Federal Reserve System approves the application of the 'Commerce-Warren County Bank', Warrenton, Missouri, 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 Finance for the State of Missouri, for his information.

"It is assumed that you will follow the matter of the bank's reducing to within the statutory limits the excess balance in a nonmember bank.

"It has been noted that, in connection with the retirement of $11,300 of the bank's 'A' preferred stock, common stock has been issued in a like amount as stock dividends, apparently without amendment of the articles of agreement. It appears that the articles of agreement authorize such action only in the event the retirement of preferred stock will reduce the bank's capital below the minimum amount required by law. Since it is understood that the minimum capital required of this bank by law is $25,000, and the retirement of the preferred stock did not reduce the capital below that amount, the Board's Legal Division questions whether the above-mentioned common stock was legally issued. It is suggested that the matter be reviewed by your counsel and that, unless he is satisfied that the stock was legally issued, the question be brought to the bank's attention in order

"that any necessary corrective action be taken at the next stockholders' meeting."

Telegram dated November 8, 1943, to Mr. Hill, Vice President of the Federal Reserve Bank of Philadelphia, referring to the application of the "Liberty State Bank & Trust Company", Mount Carmel, Pennsylvania, for permission to withdraw immediately from membership in the Federal Reserve System, and stating that the Board waives the usual requirement of six months' notice of intention to withdraw, and that, accordingly, upon surrender of the Federal Reserve Bank stock issued to the "Liberty State Bank & Trust Company", the Federal Reserve Bank of Philadelphia is authorized to cancel such stock and make appropriate refund thereon.

Approved unanimously.

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

"Referring to your letter of October 27, the Board extends until November 30, 1943, the time within which the First Trust and Savings Bank of Pasadena, Pasadena, California, a subsidiary of Transamerica Corporation, shall file affiliate reports in connection with the bank's October 18, 1943 call report. It is understood that the Comptroller of the Currency has granted a permanent extension of 30 days' time in which national bank subsidiaries of Transamerica Corporation shall file their affiliate reports.

"As you know, in its letter B-1087 of June 24, 1935, the Board advised each Federal Reserve Bank that if it is satisfied that additional time is needed for the preparation of the report of any affiliate, the Federal Reserve Bank is authorized, on behalf of the Board, to grant an extension of not to exceed 20 days, in addition to the

"original period of 10 days from the receipt by the member bank of the call for the report. While this contemplated an authorization on the occasion of each call for reports, there is no objection to your Bank granting permanent extensions, not to exceed 20 days in addition to the original period of 10 days, for the submission of reports of any affiliate if you are satisfied that additional time will be regularly required. The member banks concerned, however, should be advised that such extension of time is subject to revocation in the discretion of the Board of Governors or the Federal Reserve Bank acting on its behalf."

Approved unanimously.

Letter prepared for the signature of Mr. Dreibelbis, General Attorney, to Mr. Leonard A. Flansburg, Lincoln, Nebraska, reading as follows:

"Governor Ransom has referred to me your letter of October 28, 1943, regarding the Board's recent ruling on Regulation Q which appeared in the September issue of the Federal Reserve Bulletin. I appreciate your frank and able approach to the admittedly difficult problem with which the ruling dealt and I shall try to be as helpful as possible and equally as frank in expressing my personal views.

"I do not know the extent to which you are familiar with the legislative history of the statute or the background of the ruling. In any event, however, I believe a brief review of these phases of the question might be helpful.

"The Banking Act of 1933 amended section 19 of the Federal Reserve Act 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: *** ' The Banking Act of 1935 further amended section 19 to provide that: 'The Board of Governors of the Federal Reserve System is authorized, for the purposes of this section, * * * to determine what shall be deemed to be a payment of interest, and to prescribe such rules and regulations as it may deem necessary to effectuate the purposes of this section and prevent evasions thereof: * * *' Some idea of the legislative intent

"may be gained from the fact that in discussing the subject Senator Glass said: 'The payment of interest on demand deposits has resulted for years and years in stripping the country banks of all their spare funds.' Again he said: ' * * * This payment of interest, particularly on bank demand deposits, has resulted in drawing funds from the country bank to the money centers for speculative purposes.' And again he said: ' * * * The payment of interest on demand deposits, a system viciously and partially administered, particularly in the great money centers of the country, has resulted in withdrawing from the interior country banks of the United States millions upon millions of dollars to the money centers, to be cast into the maelstrom of stock gambling and we wanted to stop that.'

"The background of the Board's ruling is set out in the enclosed mimeographed statement which was transmitted to the Presidents of the Federal Reserve Banks for their information.

"You will observe from the enclosure that, as a result of the Board's action in 1937, the meaning of the term 'interest' was rested squarely on its meaning as a matter of general law. I recognize that it is not always easy to determine whether a specific case falls within the scope of principles of general law as announced by the courts. At the same time the courts have dealt with hundreds of cases, particularly in the usury field, in which the general conception of 'interest' as set out in the Board's Regulation Q was applied to the facts of a particular case and judgment rendered accordingly. It does not seem to me, therefore, that the question is insoluble nor that it should be very difficult for a lawyer, so far as the law is concerned, to advise his client in most of the cases which might arise. Indeed, I think for instance that you show a very clear grasp of the question in the following paragraph from your letter:

> 'The banks in general have felt that the absorption of exchange, in such small amounts as would be justified in a saving of accounting costs, would not be held to be the payment of interest. The absorption of exchange on the ground of a saving in costs, we believe, is justified when the amount does not substantially exceed such saving. In such a case,

"'quite obviously, the exchange is not absorbed with the purpose of compensating or rewarding the customer for his deposit.'

"I think the approach which this statement reflects is entirely logical. On the other hand, I could not agree that banks could by mutual understanding as to the amount of exchange they would absorb thus bring that fixed amount within the scope of the principle you state. Again, the facts of the particular case would have to speak for themselves. Incidentally, while I am sure you did not make the point as having any significance from a legal standpoint, I think I should say that I do not believe there is any distinction between absorbing exchange to retain an account and absorbing exchange to obtain one. Also, I am quite sure that you would agree with me that violations of the statute by one bank or group of banks would not condone violations by others.

"This brings me to that portion of your letter in which you suggested the advisability of the Board giving a further clarifying interpretation, by general rule, to the effect that 'absorbing exchange, which is not in amount in excess of the approximate amount of accounting costs of the bank which would be incurred to charge it back, shall not be considered the payment of interest.' I have already stated that I quite agree with your statement that the absorption of exchange when the costs of collecting it would exceed the amount absorbed is quite a different matter from absorbing exchange as a means of compensating or rewarding a customer for the use of his deposit. To issue a general rule along the lines you suggest would be to abandon the position which the Board took jointly with the FDIC in 1937. Moreover, it does not seem to me that a bank should have as much difficulty as you seem to think in determining whether or not it is absorbing exchange charges incurred for its customers as compensation or reward for the use of such customers' deposits. It is my understanding that examiners, in due course of examination will develop and report all facts which would indicate an apparent violation of section 19 and that such apparent violations will be dealt with in due course in the same manner as are all other violations of banking statutes. In these circumstances, I do not believe the Board should attempt any clarifying rule which of necessity would have to be an attempt to narrow a general principle of law by a further generality.

"I think it might be well for me to comment also upon your assumption that the ruling was intended as an advice and direction to banks in general, rather than as an individual ruling intended to apply to the specific bank. This assumption is partly correct and partly incorrect. The ruling was general in that it established a precedent which the Board (in the same manner that a court would apply the doctrine of 'stare decisis') would expect to follow in expressing its views in future cases in which the precedent would be in point. On the other hand, the ruling was addressed to a specific case, the facts of which were developed by an examiner in due course of examination; were included in his report of examination, a copy of which was furnished the bank; and as to which, so far as I know, no exception was made by the bank. Because of the Board's responsibility for administering section 19 the facts were referred by the Comptroller of the Currency to the Board for an expression of its opinion. This does not mean that the bank is denied a hearing or that the facts have been conclusively found. No penalty has been imposed and none would be imposed without a formal hearing which necessarily would involve an adequate opportunity to raise any pertinent issues of law or fact. If you think the facts have been incorrectly reported by the examiners, then you should take the matter up with the Chief National Bank Examiner or the Comptroller of the Currency.

"Your letter has been called to the attention of the other members of the Board and of the Comptroller of the Currency. I have written at some length, hoping that by doing so I may be of some assistance, and am sending a copy of this reply to the Comptroller of the Currency."

Approved unanimously, with the understanding that copies of Mr. Flansburg's letter, the above reply, and the letter transmitting copies thereof to the Comptroller of the Currency would be sent to the Presidents of all the Federal Reserve Banks.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved:
M S Eccles
Chairman.