Minutes of actions taken by the Board of Governors of the Federal Reserve System on Wednesday, March 16, 1949.

PRESENT: Mr. Eccles, Chairman pro tem.
Mr. Szymczak
Mr. Draper
Mr. Vardaman
Mr. Clayton

Mr. Carpenter, Secretary
Mr. Sherman, Assistant Secretary
Mr. Morrill, Special Adviser
Mr. Thurston, Assistant to the Board

Minutes of actions taken by the Board of Governors of the Federal Reserve System on March 15, 1949, were approved unanimously.

Memoranda from the heads of the divisions indicated below recommending increases in the basic annual salaries of the following employees in those divisions, effective March 20, 1949:

Date of Memo.	Name	Title	Salary Increases From	To
DIVISION OF EXAMINATIONS				
3/10/49	Mrs. Nancy R. Porter	Supervisor, Recording & Stenographic Section	$3,601.80	$3,727.20
3/10/49	Miss Myrtle P. Brown	Stenographer	2,284.00	2,423.04
DIVISION OF ADMINISTRATIVE SERVICES				
3/11/49	Karl J. Steger	General Mechanic	2,949.72	3,024.96

Approved unanimously.

Memorandum dated March 15, 1949, from Mr. Bethea, Director of the Division of Administrative Services, recommending the appointment of Miss Dolores Ann Ferris as a stenographer in that Division, with basic salary at the rate of $2,498.28 per annum, to be effective as of the date upon which she enters upon the performance of her duties after having passed the usual physical examination.

Approved unanimously.

Draft of letter to Bank of America National Trust & Savings Association, San Francisco, California, prepared in accordance with the understanding at the meeting of the Board on March 7, 1949, and reading as follows:

"This refers to the applications filed by your bank with the Board of Governors for permission to establish branches in Bremen, Hamburg, and Frankfurt-am-Main, Germany. These applications have involved numerous questions requiring careful consideration by the Board.

"The Board does not believe that it would be justified in approving these applications on the basis of such information as it now has. However, there are certain important questions which have arisen in connection with our consideration of the applications and, before taking final action in the matter, the Board feels that it would be desirable to have a discussion of these questions at a meeting in Washington between representatives of the Board and a senior officer or officers of your bank. If this is agreeable to you, we suggest that you get in touch with the Federal Reserve Bank of San Francisco in order that a mutually convenient time for such a meeting may be arranged."

The letter was approved, Messrs. Vardaman and Clayton voting "aye", and Messrs. Eccles, Szymczak, and Draper not voting. Messrs. McCabe and Evans had stated that if they were present they would vote to approve.

Letter to Mr. Trimble, Assistant General Counsel at the Federal Reserve Bank of New York, reading as follows:

"This refers to your letter of February 23, 1949, to Mr. Vest, enclosing copies of correspondence with Mr. Thomas F. Maude, Vice President, The First National Iron Bank of Morristown, Morristown, New Jersey, in which Mr. Maude requested that you submit to the

"Board the question whether a national bank in New Jersey which establishes a 'security fund' in accordance with State law must also deposit securities in its trust department to secure trust funds used by it in the conduct of its business.

"Mr. Maude contends that a national bank should not be required to deposit securities in its trust department in addition to establishing a 'security fund' because this is not required of State banks under a recently enacted New Jersey statute. He urges that, in order to avoid penalizing national banks, Regulation F should be amended to provide that the establishment of a 'security fund' pursuant to State law shall constitute compliance with the requirement that a national bank deposit securities in its trust department to secure trust funds used by it in the conduct of its business, provided that the 'security fund' shall at least equal the amount of trust funds so used by the bank.

"The provisions of the New Jersey Banking Act of 1948 relating to 'security funds' provide, in brief, that a bank exercising fiduciary powers may create such a fund by depositing securities with a Federal Reserve Bank or other approved depositary to be held subject to the order of the Superior Court as security for the performance of the bank's obligations in fiduciary capacities for which security shall be required and other security is not given. Recourse to the 'security fund' may be had only after the entry of a judgment against the bank 'for a breach of any fiduciary obligation or obligations to one or more persons for whose benefit the fund was deposited.'

"The protection of trust funds which a State bank uses in the conduct of its business is covered by other provisions of the New Jersey Banking Act of 1948(see section 35). While a State bank is no longer required to deposit securities in its trust department to secure trust funds which it deposits in its own banking department, the New Jersey law now provides that, in the event of the insolvency of a State bank, such deposits of trust funds shall constitute preferred claims. In the event of the insolvency of a national bank, there is no similar statutory preference under Federal law.

"The fourth paragraph of section 11(k) of the Federal Reserve Act, relating to the exercise of fiduciary powers by national banks, provides in part as follows:

"'Funds deposited or held in trust by the bank awaiting investment shall be carried in a separate account and shall not be used by the bank in the conduct of its business unless it shall first set aside in the trust department United States bonds or other securities approved by the Board of Governors of the Federal Reserve System.'

"The sixth paragraph of section 11(k) provides as follows:

'Whenever the laws of a State require corporations acting in a fiduciary capacity, to deposit securities with the State authorities for the protection of private or court trusts, national banks so acting shall be required to make similar deposits and securities so deposited shall be held for the protection of private or court trusts, as provided by the State law.'

"As you pointed out in your correspondence with Mr. Maude, the Board has ruled that the foregoing requirements of section 11(k) are separate and independent requirements, both of which must be complied with; and that the deposit of securities with State authorities for the protection of private or court trusts is not a compliance with the requirement that securities be deposited by a national bank in its trust department to secure trust funds used by the bank in the conduct of its business (1920 Federal Reserve Bulletin 699; 1921 Federal Reserve Bulletin 309).

"The Board believes that the creation of a 'security fund' by a national bank pursuant to the New Jersey statutes to secure the faithful performance of fiduciary obligations of the bank clearly cannot be regarded as compliance with the requirement that securities be deposited by the bank in its trust department to secure repayment of trust funds deposited by the bank in its own banking department or otherwise used in the conduct of its business. The 'security fund' does not serve the same purpose or provide the same protection for trust beneficiaries as the deposit of securities in the trust department. This distinction is recognized by the provisions of section 11(k) of the Federal Reserve Act quoted above and also by the New Jersey statutes which, in addition to providing for 'security funds', create a preference to protect trust funds which a State bank deposits in its banking department.

"The provisions of Regulation F relating to the deposit of securities by a national bank in its trust

"department merely restate the statutory requirement and list the kinds of securities which may be deposited; and, since the requirement is prescribed by law, it cannot be modified or waived by an amendment to Regulation F.

"It will be appreciated if you will advise Mr. Maude in accordance with the foregoing. You may wish also to call his attention to the fact that the situation in New Jersey does not appear to differ materially from that which has existed for years in a number of other States where State banks are not required to deposit securities in their trust departments."

Approved unanimously.

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

"This refers to your letter of March 4, 1949, with its enclosures, regarding the question whether the absorption by a member bank of transportation charges on money shipped by it to certain customers constitutes a payment of interest on demand deposits within the meaning of section 19 of the Federal Reserve Act and of the Board's Regulation Q.

"The Board appreciates the desire of a member bank to be informed in advance whether a particular practice followed by it is consistent with the law. As you know, however, it has been the Board's policy for a number of years not to express an opinion as to whether a particular practice involves a payment of interest on demand deposits in violation of Regulation Q, except after consideration of all the facts and circumstances of a specific case as developed in the course of examinations of the member bank involved. The policy which the Board has followed in this respect since 1937 has proved to be the most satisfactory basis for dealing with questions of this kind. Prior to that date the Board had attempted to pass on numerous questions as to whether certain practices involved a payment of interest, but experience showed that it was impracticable to attempt to issue general rulings or to pass on these questions in the absence of full information, because the facts and circumstances differ widely with individual cases.

"In accordance with this policy, the Board in several instances has declined to express an opinion except on the basis of facts developed in examinations as to whether the absorption of the expense of shipping currency involves a payment of interest in violation of the law and the regulation. Moreover, in view of the difficulty of showing that the absorption of such an expense in a particular case involves a payment of compensation for the use of funds constituting deposits, it seems questionable whether practices of this kind would be held to involve a violation of law if in any case the matter should reach the point of litigation. It seems apparent that it would be difficult to establish a clear line of demarkation between the absorption of shipping costs and the absorption of the expenses incurred by member banks in furnishing many other services to their customers.

"Some time ago, the Federal Reserve Bank of St. Louis presented the Board with a similar question regarding the absorption by member banks in St. Louis of the costs of shipping currency to their correspondent banks. After stating its general policy and pointing out the considerations mentioned above, the Board suggested to the Reserve Bank that if it should be pressed by any member bank for an answer to this question, it might, without condoning the practice, advise the member bank that, in the absence of very unusual circumstances, the Board of Governors would not be disposed at this time to take any action with respect to any member bank on the ground that this practice constitutes a payment of interest.

"Recently we were informed that the practice of the St. Louis banks of absorbing costs of shipping currency to correspondent banks, at first followed by only a few banks, had become so prevalent as to be the general rule rather than the exception, not only in St. Louis, but in neighboring cities. Consequently, it developed that the practice, which involved considerable expense to the banks, no longer afforded any competitive advantage. As a result, the Federal Reserve Bank of St. Louis has now advised us that the member banks which had been absorbing the costs of currency shipments discontinued this practice effective March 1, 1949.

"In connection with the inquiry which has been received by your bank, it is suggested that you advise the member bank involved of the Board's general policy of not passing on questions of this kind until after development of the facts by examinations, or, if you feel it

"necessary to do so, you may advise the bank along the lines of the advice given by the Board to the Federal Reserve Bank of St. Louis as indicated above. In any event, we think it would be desirable, in your communication with the member bank, to point out the possible effects of any general adoption of this practice in a particular locality as illustrated in the St. Louis situation described above. It is to be hoped that the member bank and other banks in the community will decide that the practice would involve such expense and would be so likely to become general as to outweigh any possible competitive advantages which might result from its adoption."

Approved unanimously.

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

"This refers to your letter of March 4, 1949 regarding an inquiry received by you from one of your member banks as to whether the practice followed by a national bank in Pittsburgh, Pennsylvania, in operating a group life insurance plan involves a violation of section 19 of the Federal Reserve Act and of the Board's Regulation Q. It is understood that the insurance plan in question covers, not only employees of the Pittsburgh bank, but also employees of its correspondent banks. The Pittsburgh bank pays no part of the premiums payable for insurance covering such employees of correspondent banks, although it does attend to the accounting, correspondence, and other details connected with the operation of the plan without making any charge for this service to its correspondent banks.

"Since 1937, as you know, it has been the Board's general policy not to attempt to pass upon questions as to whether particular practices involve a payment of interest in violation of Regulation Q except after consideration of all the facts of a specific case as developed by examinations of the member bank involved. It has been found impracticable to issue any general rulings as to whether certain practices constitute a payment of interest because of the variation of the facts in individual cases, and the policy which the

"Board has followed has proved to be the most satisfactory basis for dealing with questions of this kind.

"The Board feels that it would not be desirable for it to depart from its general policy in the instant case, but it will of course be glad to consider the question if it should arise at any time as the result of an examination of any particular bank. Without attempting to pass upon the question raised in your letter, it may be said, however, that our Counsel comments that the absorption of the costs of operating such an insurance plan does not appear to be different in principle from the absorption of other overhead expenses customarily incurred by member banks in providing various services to their customers.

"We are, of course, not commenting on the question whether the practice of the Pittsburgh bank contravenes the law of West Virginia. We also make no comment on the question whether the bank may be exceeding its powers under the law, as this matter falls within the province of the Comptroller of the Currency and presumably will come to his attention, if it has not already done so, through reports of examination. In the circumstances we have hesitated to take the matter up with the Comptroller of the Currency, but we would be willing to do so if the Kanawha Valley Bank has requested it and you feel that it should be done."

Approved unanimously.

Letter to Mr. Harold A. Rouse, Steiner, Rouse & Company, 25 Broad Street, New York 4, New York, reading as follows:

"We are replying for Chairman McCabe to your letter of March 1, 1949, in which you suggest that margin requirements be reduced.

"Chairman McCabe and this Board are interested, as you are, in the orderly and efficient operation of securities markets and in maintaining conditions throughout the economy that are favorable for sustained high levels of business activity.

"Differences in liquidity between real estate and stocks, or between various other kinds of investments, may be important from many viewpoints, particularly when considering the safety of the lender. Such

"differences, however, are less significant in connection with margin requirements, which were authorized by Congress in the Securities Exchange Act of 1934 chiefly for the purpose of protecting the general economy. Any increased protection for the lender was considered to be largely incidental to the broader purposes of the legislation.

"The willingness or unwillingness of people to invest in stocks may depend on a number of factors. There is sometimes a tendency, however, to over-estimate the average investor's interest in minute-to-minute stability of quotations and to attach far too little importance to his desire for longer term stability for his investment. Heavy trading may tend to result in smaller differences from one trade to the next but, especially if carried to extremes on the basis of excessive credit, it may not necessarily contribute to longer run stability in securities markets or in business generally.

"It is a source of strength in the present situation that, in spite of the serious inflation elsewhere, there has not been a dangerous expansion of credit in the stock market. That fact has helped to prevent the general inflation from being even worse, and it will inevitably lessen the shock of any readjustment, not only so far as the stock market is concerned, but also in other parts of the economy.

"It should perhaps be mentioned that the differences between the rules applicable to banks and those applicable to brokers with respect to loans on unlisted securities arise from the basic legislation rather than from regulations of this Board.

"You may be sure that your point of view will be given careful consideration in the Board's continuing study of the matter with a view to making such changes in the level of margin requirements as may be appropriate from time to time."

Approved unanimously.

Letter to Mr. Leedy, President of the Federal Reserve Bank of Kansas City, reading as follows:

"Thank you for your letter of March 4 directing our

"attention to an editorial regarding Regulation W which appeared in the Kansas City Times of March 4.

"The editorial is interesting indeed but it is somewhat unfortunate that it implies that the Board considers inflationary dangers as having disappeared. Potential inflationary forces are still present. The regulation, however, is a flexible measure designed to be tightened or relaxed as circumstances indicate.

"The Board feels, and has so stated from time to time, that consumer credit authority, as well as authority to require additional reserves, should be permanent to be used as conditions indicate from time to time.

"Again, thank you for the information."

Approved unanimously.

Letter to the Honorable Abraham J. Multer, House of Representatives, reading as follows:

"In the absence of Chairman McCabe, I wish to acknowledge receipt of your letter of March 9, 1949, requesting comments on H. R. 1949, a bill to amend section 12B of the Federal Reserve Act.

"H. R. 1949 is identical with S. 949, concerning which the Board has previously expressed its views to the Banking and Currency Committee of the Senate. For your information there is enclosed a copy of Chairman McCabe's letter dated February 25, 1949, to the Chairman of the Senate Banking and Currency Committee reporting on S. 949, together with a copy of a report dated June 18, 1948, to the Senate Committee on Banking and Currency regarding an identical bill which was introduced in the 80th Congress."

Approved unanimously.

Letter to Mr. Jerry Voorhis, Executive Secretary, The Cooperative League of the United States of America, 343 South Dearborn Street, Chicago 4, Illinois, reading as follows:

"Chairman McCabe has asked me to respond to your letter of March 1 in which you suggest a meeting of representatives of The Cooperative League with members of the Board for the purpose of discussing the financial situation of the United States.

"The members of the Board who will be in Washington at the time you suggest will be pleased to meet with your group and it is suggested that Thursday, April 14, 1949, at 2:30 p.m., be fixed as the time for the conference. At present it appears that Governor Eccles will be away from Washington on both of the dates you suggest but should his plans be changed he will be glad to join the group.

"If the suggested time of the meeting is agreeable to you, it will be appreciated if you will let me know and if you will send to me, when definitely determined, a list of the representatives of your organization who will attend the conference together with your suggestions as to the points to be covered during the conference."

Approved unanimously.

Telegram to Mr. Caldwell, Chairman at the Federal Reserve Bank of Kansas City, reading as follows:

"Reurlet March 9, 1949. Board will interpose no objection to payment by your bank to Mr. J. C. Williams fee for attending recent meeting of Advisory Council as representative of your bank, as well as reimbursement for expenses incurred by him in such attendance, on same basis as such fees and expenses are paid by your bank to regularly appointed member of Council for your district."

Approved unanimously.

A. Carpenter
Secretary.

Approved:

M. S. Eccles
Chairman pro tem.