

Minutes of actions taken by the Board of Governors of the Federal Reserve System on Tuesday, May 10, 1949. The Board met in the Board Room at 10:35 a.m.

PRESENT: Mr. McCabe, Chairman
Mr. Eccles
Mr. Szymczak
Mr. Draper
Mr. Clayton

Mr. Carpenter, Secretary
Mr. Sherman, Assistant Secretary
Mr. Morrill, Special Adviser
Mr. Thurston, Assistant to the Board
Mr. Riefler, Assistant to the Chairman
Mr. Vest, General Counsel
Mr. Millard, Director of the Division of Examinations
Mr. Young, Associate Director of the Division of Research and Statistics
Mr. Solomon, Assistant Counsel

Mr. Carpenter stated that in accordance with the action at the meeting last Friday, he talked by telephone with Mr. Evans and Mr. Vardaman regarding the draft of the letter to the Bank of America N. T. & S. A., San Francisco, California, with respect to that Bank's applications for permission to establish three branches in Germany, that Mr. Evans stated that he had read the memorandum of the conferences with Mr. Russell G. Smith, Executive Vice President of the Bank of America, on April 13 and 14, 1949, and that he found no reason to change the view which he expressed at the meeting on February 21, 1949, that he would not vote to approve any of the branches applied for in

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Germany. Mr. Carpenter stated that Mr. Vardaman said that, for reasons which he had stated at earlier meetings of the Board, he would approve the applications for the three branches in Germany and would not write the Bank concerning its capital position.

Mr. Clayton stated that he still felt the Board would be in a better position to grant permission to establish the branches in Germany and to state in a letter to the Bank that approval of these branches was given because the Bank was not on notice as to the Board's views with respect to its capital position at the time the applications were filed, and that the Board would not be inclined to approve establishment of any further branches until the capital position had been improved. He added that he would also inform the Bank that the Board would be glad to consider a request for establishment of a corporation under Section 25a of the Federal Reserve Act for the purpose of operating the foreign branches of the Bank.

Mr. Szymczak stated that he felt differently, that the Bank of America had made it clear that it intended to expand in the foreign field, that such expansion in the services offered by the Bank would tend to attract to the Bank additional customers and deposits in the domestic and foreign fields, that he did not feel the Board would be doing the Bank an injustice by bringing to its attention the relationship of its capital position to expansion whether in the domestic or foreign field, and that he would not vote to approve the three pending applications but would tell the Bank of the possibility of expanding in the foreign field by establishment of a corporation under

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Section 25(a) of the Federal Reserve Act.

The matter was discussed in the light of these differing views, and Mr. Szymczak moved that a letter be sent to the Bank of America, informing it of the Board's views with respect to its capital position, that the Board was denying the pending applications for permission to establish three branches in Germany, and that the Board would be glad to consider the formation of a separate corporation under Section 25(a) of the Federal Reserve Act to carry on the foreign operations of the Bank.

Mr. Clayton moved that Mr. Szymczak's motion be amended in so far as it was related to the application for three branches in Germany to provide that the Board would approve the three applications.

Mr. Clayton's motion was put by the Chair and lost, Messrs. Eccles, Szymczak, and Draper voting "no" and Messrs. McCabe and Clayton voting "aye".

Thereupon, Mr. Szymczak's original motion was put by the Chair and carried, Messrs. Eccles, Szymczak, and Draper voting "aye" and Messrs. McCabe and Clayton voting "no". As recorded previously in these minutes, Mr. Evans had stated over the telephone that he would vote "aye" on this motion, and Mr. Vardaman had stated that he would vote to approve the applications for the three branches but would make no reference to the capital position of the Bank in advising the Bank of the action.

In taking this action, it was understood that the draft of letter to Bank of America would be revised and sent in the following form with copies to Mr. Earhart, President of the Federal Reserve Bank of San Francisco, Mr. Delano,

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Comptroller of the Currency, and Mr. Harl, Chairman of the Federal Deposit Insurance Corporation, for their information:

"In connection with the applications filed by your bank for permission to establish branches in Bremen, Hamburg, and Frankfurt-am-Main, Germany, the Board stated in its letter of March 17, 1949, that it would be desirable to have a meeting between representatives of the Board and a senior officer or officers of your bank to discuss certain questions which had arisen. Pursuant to this suggestion, Mr. Russell G. Smith, Executive Vice President of your bank, with Mr. Roland Pierotti, conferred at the Board's offices on April 13 and 14 with members of the Board and its staff. The Board appreciates the information which was furnished by Mr. Smith and the frankness with which the entire matter was discussed.

"It appears from Mr. Smith's statements that the Bank of America will wish to expand its business in foreign countries whenever opportunity offers and the bank feels that there is a reasonable probability of successful operation. Mr. Smith advised that your bank feels it should have in the foreign field a volume of business, correspondent relationships, volume of deposits, and volume of transactions which would be comparable in size (in relation to the size of your bank) to foreign business of other large American banks in relation to their size.

"One of the matters discussed with Mr. Smith when he was here was the capital position of the Bank of America NT&SA. Comparative figures taken from call reports of condition indicated that the percentage of capital accounts to risk assets of Bank of America had dropped from 16 per cent in 1935 to 9.2 per cent at June 30, 1948, a reduction of 42.5 per cent as compared with a reduction of 23.6 per cent in the comparable percentage for all member banks in the United States. Also, on December 31, 1948, the percentage of adjusted book capital to risk assets in the case of Bank of America was 9.8 per cent, as compared with 15.8 and 19.9 per cent in the case of two other national banks of comparable size which are active in the foreign field.

"In view of the bank's program for expansion in the foreign field as outlined by Mr. Smith, the Board would of necessity have to consider any application filed with it as a part of that program and not as a single application

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"standing by itself. It is apparent that in carrying out the program numerous branches might be established over the years and, if the foreign business of the bank develops as it might well do, it would result in the creation of large additional deposit and other liabilities. The Board is cognizant of the statements of Mr. Smith to the effect that it is the policy of your bank not to invest any substantial amount of capital in connection with the establishment of branches in foreign countries and to make loans at a branch in a total amount not to exceed the total deposits received at the branch. Nevertheless, the existence of a number of foreign branches would make possible a substantial expansion of the business of the bank which in turn would create additional liabilities which would have to be taken into account in determining the adequacy of the bank's capital structure. Therefore, the Board feels that actual and relative capital position becomes an important factor in consideration of a comprehensive program or a single application as a part of such a program for expansion through establishment of direct foreign branches.

"In all the circumstances, the Board is unwilling to approve the applications for authority to establish branches in Bremen, Hamburg, and Frankfurt-am-Main and will not be disposed to approve any further applications of your bank for permission to establish foreign branches until such time as its capital position has been substantially improved and the percentage of its capital accounts to its risk assets is more nearly in line with the average of other member banks in the United States including banks which operate foreign branches.

"During the discussion above referred to with Mr. Smith on April 13 reference was made to the possible organization of a corporation under Section 25(a) of the Federal Reserve Act (known as the Edge Act). The creation of such a corporation would not dispose of the question of the adequacy of the capital of Bank of America as discussed earlier in this letter. However, if upon further consideration of the matter, you should desire to propose the organization of a corporation under this section of the law, the Board would be willing to consider such a proposal, with capital for the corporation to be supplied in an adequate amount, preferably from sources other than Bank of America, assuming, of course, that the various provisions of Section 25(a)

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"are met. The operations of such a corporation, which under the statute would be organized 'for the purpose of engaging in international or foreign banking or other international or foreign financial operations,' would of course be segregated from the operations of the bank. If such a corporation should be organized, the Board would consider giving its approval for the establishment of branches by the corporation in foreign countries at such places and under such circumstances as the corporation might desire and as the Board might feel were justified. If you should wish to pursue this aspect of the matter, the Board will be glad to discuss it further with you either here in Washington or through the Federal Reserve Bank of San Francisco."

Mr. Clayton stated that further consideration had been given to the proposed reduction in margin requirements applicable to securities purchased through the exercise of rights, that a conference had been held on Wednesday, May 4, 1949, with the members of the Securities and Exchange Commission, and that the Commission had no objection to the proposed amendment to Regulations T, Extension and Maintenance of Credit by Brokers, Dealers, and Members of National Securities Exchanges, and U, Loans by Banks for the Purpose of Purchasing or Carrying Stocks Registered on a National Securities Exchange. Mr. Clayton also stated that a letter from the New York Stock Exchange dated May 6, 1949, commented favorably on the proposed changes, and that in informal consultations Messrs. Rouse and Norman P. Davis, Vice President and Assistant Vice President, respectively, of the Federal Reserve Bank of New York, favored the changes. He suggested that the regulations be amended to permit the purchase of stocks through the exercise of subscription rights with a 25 percent margin, provided

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such transactions were set up in a special account with the requirement that no substitutions or withdrawals could be made and provided further that if the margin in the special account were not increased to 50 percent within either six or nine months, no further credit could be extended in the account on the preferential basis.

During a discussion of the proposed amendments, Mr. Eccles suggested that before taking final action, the matter be presented to the Federal Reserve Banks by telegram for comment with the understanding that the Board would consider the matter at a meeting on Friday of this week.

Mr. Eccles' suggestion was approved unanimously.

Chairman McCabe referred to a draft of the statement which he proposed to make before the sub-committee of the Senate Banking and Currency Committee tomorrow with respect to proposed legislation relating to supplemental reserve requirements and consumer installment credit. He said that copies of the statement had been sent to members of the Board and that he would appreciate their giving him today any comments that they might have.

Messrs. McCabe, Riefler, Young, and Solomon then withdrew from the meeting to keep another appointment, and Mr. Hostrup, Assistant Director of the Division of Examinations, entered.

Mr. Clayton referred to the discussion at the meeting of

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January 28, 1949, regarding a proposed revision in the uniform examination procedure agreement adopted by the Federal bank supervisory agencies and the executive committee of the National Association of Supervisors of State banks in 1938, and stated that since that time he had met with representatives of the supervisory agencies on several occasions. In this connection, he referred to a memorandum which he prepared under date of May 9, 1949, copies of which were sent to each member of the Board before this meeting, and at his request, Mr. Carpenter read the memorandum as follows:

"On January 28, 1949, the Board gave consideration to my memorandum of January 7, with respect to the uniform examination procedure agreement adopted by the Federal Supervisory Agencies and the Executive Committee of the National Association of Supervisors of State Banks in 1938. In that memorandum, after reviewing the results of discussions of the matter at staff level, I recommended that the Board give consideration to approval of revision of the 'Uniform Agreement' to provide for recommended changes in the form of the report of examination as follows:

1. That the present classification of loans (II, III, and IV) be changed to Unsatisfactory, Doubtful and Estimated Loss. That the definitions of the loan classifications be eliminated except that a definition of 'Unsatisfactory' be included along the following lines: 'Loans, or portions of loans, not classified as doubtful or estimated loss but with unsatisfactory credit characteristics, as noted in the examiner's comments.'
2. That the definitions of the Schedule 'Summary of Examiner's Classifications' be eliminated except for the definition of 'Unsatisfactory' which would read: 'Book assets or portions thereof, not classified as doubtful or estimated loss but which appear to be unsatisfactory as bank assets. Included in this classification are loans so classified on page 11, that portion of the bank's fixed assets considered excessive,

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"holdings of other real estate, and other undesirable assets as scheduled."

3. That the 18 months average price for Group 2 securities be dropped and that such securities be appraised at market value.

"It was felt that there was no need to define 'Doubtful' or 'Estimated Loss' as used in reports of examination and it was contemplated that the one schedule would include all loans criticized because of unsatisfactory credit characteristics, except purely technical exceptions which would continue to be included in the schedule of other loans especially mentioned, possibly under the caption: 'Loans subject to technical and similar exceptions.'

"With further reference to securities, I felt that any revision of the Uniform Agreement should include:

A statement that the 1938 agreement was intended to apply to recognized sound investment practices of banks and that it was not intended to be a protection to banks with undue concentrations in securities other than U. S. Governments. Also, that supervisory authorities may properly ask for corrections in such cases.

"At the conclusion of the Board's discussion of the matter it was agreed that I would continue negotiations with the other bank supervisory agencies to bring about an agreement as to changes to be made in the procedure, it being understood that I would have discretion in the negotiations except that I would avoid other than minor changes in the existing definition of loans classified II and in the existing definitions in the summary of examiner's classifications.

"On February 14, 1949, Mr. Millard and I met with Deputy Comptroller Robertson and Assistant Chief Shearer of the FDIC Division of Examination for further discussion of the matter. Three different designations for the former classification II were offered. Instead of 'Unsatisfactory' the Comptroller preferred 'Substandard' and the FDIC 'Unsound'. Three somewhat different definitions of the suggested terms were also offered. Little was accomplished but Deputy Comptroller Robertson stated that he would like to give further thought to the matter and present his memorandum on the subject at a later date.

"On March 31, 1949, Mr. Robertson submitted for comment and suggestions his proposal that the term 'Substandard' be defined as follows:

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"Book assets or portions thereof which involve more than a normal bankable risk due to the financial condition or unfavorable record of the obligor, insufficiency of security, or other factors noted in the examiner's comments. In some cases, assets so classified should be pressed for complete and immediate payment. However, in most cases this classification signifies that the specified assets should be given such special and corrective attention as may be warranted -- by obtaining suitable reductions in amount, additional security, more complete financial data concerning the obligor's condition, etc.'

"Before further consideration of the matter between the Federal agencies, Mr. Elliott Bell, Chairman of a Special Committee of the National Association of Supervisors of State Banks, advised each of the agencies of a resolution passed by the Executive Committee of the Supervisors' Association at a meeting in early April, which recommended changes in the Uniform Agreement substantially the same as those set forth in my memorandum of January 7, and requested that a meeting be arranged for a discussion of the matter.

"The meeting was held at the offices of the FDIC on May 2, 1949, between representatives of the three Federal Supervisory Agencies and the three representatives of the State Supervisors: Messrs. Bell, Lyon and Hospelhorn.

"Mr. Bell explained that the recommendation of the Executive Committee was based upon a questionnaire on Examination Procedure to which the banking authorities of 45 States had responded, and was made in the light of the actual practices of the State authorities and in the interest of greater uniformity. In brief, the resolution recommended:

1. Abandonment of Roman numerals for classification of assets and use of words, such as: Unsatisfactory, Doubtful and Loss.
2. Retention of the present Grouping of Securities.
3. Retention of Fourth rating (Baa) securities in Group I.
4. Abandonment of the 18 month average for pricing Group II securities.

"After a discussion in which the views of the Board as to the nature and effect of proposed changes, substantially as expressed at the meeting on January 28, were presented for consideration, general agreement was reached among representatives of the State authorities and the other two Federal agencies on the following points:

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1. Use of the words, Substandard, Doubtful, and Loss, in lieu of the present classifications II, III and IV.
2. Definition of 'Substandard' as:
'Book assets or portions thereof not classified as doubtful or loss and which involve more than a normal risk due to the financial condition or unfavorable record of the obligor, insufficiency of security, or other factors noted in the examiner's comments. These assets should be given special and corrective attention, for example, by obtaining suitable reductions in amount, additional security, more complete financial data concerning the obligor's condition, etc.'
3. Abandonment of the use of the 18 months average price with respect to Group II securities.

"It should be noted that the definition of 'Substandard' as set forth above is designed to apply to all such assets with no separate definition of substandard loans.

"No commitment was made on behalf of the Board, of course, and it was understood that the matters with respect to which the other agencies appeared to concur would be submitted to the Board for consideration. They were to be advised of the Board's concurrence or nonconcurrence.

"Mr. Bell advised that, if the Board should withhold approval of the suggested changes, he would endeavor to arrange for further discussion. Mr. Robertson advised that, if agreement could not be reached, he would recommend to the Comptroller that action along the lines indicated should be taken by that office with respect to the designation of classifications and the definition of the term substandard, particularly with respect to loans. He advised that the Comptroller's Office wished to have revised examination report forms in use by July 1, 1949.

"In presenting my memorandum of January 7, I stated that my recommendation of the proposed changes in the Uniform Agreement was based upon my belief that the action would revitalize the agreement but would not change in any fundamental way the principles involved. It now appears that the Comptroller is prepared to take independent action and it is probable that the other agencies will adopt similar procedures with respect to the matters on which there was agreement among them at the recent meeting.

"In the circumstances, I submit the attached draft of a proposed letter to the other two Federal Supervisory Agencies

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"and the Committee of the Association of State Supervisors which I recommend that the Board approve. In view of the fact that agreement has not been reached with respect to joint announcement and in regard to the proposed statement concerning securities concentrations, I would ask that the Board authorize me to negotiate with respect to such matters and act to secure the most acceptable compromise in the interest of united action."

In commenting upon the proposals in the memorandum, Mr. Clayton stated that if an agreement could be reached with the supervisory agencies as outlined, he hoped a joint statement would be issued by the three Federal supervisory agencies and the executive committee of the National Association of Supervisors of State Banks which would revitalize the present agreement, and he outlined the contents of such a statement.

There was a discussion of the background of the agreement, of the fact that it was not being carried out effectively at the present time, and of the significance of the changes proposed in Mr. Clayton's memorandum. During this discussion, Mr. Carpenter stated that Chairman McCabe requested before he left the meeting that he be recorded as voting to authorize Mr. Clayton to negotiate with respect to the matters discussed in the memorandum and to act to secure the most acceptable compromise possible in the interests of united action by the supervisory agencies.

At the conclusion of the discussion, the members present expressed concurrence in the

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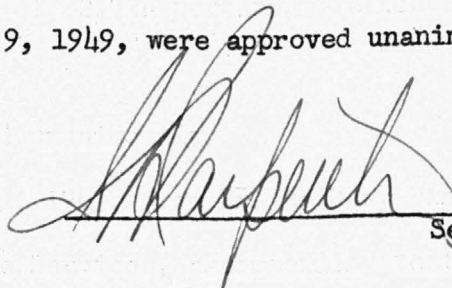
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changes in the uniform agreement, and upon motion by Mr. Clayton, he was authorized to confer with the other agencies for the purpose of perfecting the proposed joint statement which would be submitted to the Board for approval.

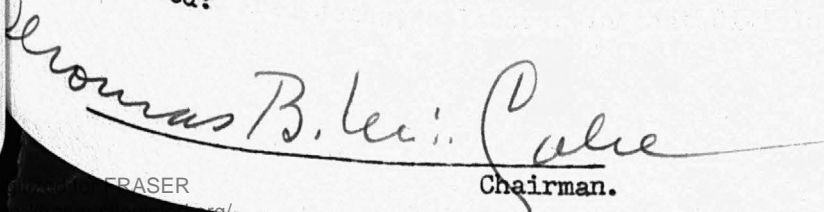
Reference was made to the discussion at the meeting on May 2, 1949, of the question raised by Mr. Vardaman what, if any, action should be taken by the Board with respect to the policy adopted on January 31, 1945, of not making reports of examination of holding company affiliates available to such affiliates. A portion of the memorandum written by Mr. Morrill on May 4, 1949, recording the telephone conversation which he had with Mr. Townsend on this subject in accordance with the Board's request on May 2 was read, and after an informal discussion, it was agreed that consideration of the matter should be deferred until the next meeting at which Mr. Vardaman was present.

At this point Messrs. Vest, Millard, and Hostrup withdrew and the action stated with respect to the matter hereinafter referred to was taken by the Board:

Minutes of actions taken by the Board of Governors of the Federal Reserve System on May 9, 1949, were approved unanimously.


Secretary.

Approved:


Chairman.