

Minutes of actions taken by the Board of Governors of the Federal Reserve System on Tuesday, July 12, 1949. The Board met in the Board Room at 10:30 a.m.

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

Mr. Carpenter, Secretary
Mr. Hammond, Assistant Secretary
Mr. Thurston, Assistant to the Board
Mr. Riefler, Assistant to the Chairman
Mr. Vest, General Counsel
Mr. Nelson, Director, Division of Personnel Administration
Mr. Young, Associate Director, Division of Research and Statistics
Mr. Solomon, Assistant General Counsel
Mr. Dembitz, Chief, International Financial Operations Section, Division of Research and Statistics
Mr. Tamagna, Economist, Division of Research and Statistics
Mr. Hirschman, Economist, Division of Research and Statistics

Mr. Dembitz reported on the international situation with special reference to the current British exchange situation, and a general discussion of the subject followed. At the conclusion of the discussion, Messrs. Dembitz, Tamagna, and Hirschman withdrew from the meeting.

In accordance with the understanding at the meeting on July 8, 1949, further reference was made to the proposed amendments to Regulation T, Extension and Maintenance of Credit by Brokers, Dealers and Members of National Securities Exchanges, and Regulation U, Loans by Banks for the Purpose of Purchasing or Carrying Stocks Registered on

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a National Securities Exchange, which would exempt from the provisions of the Regulations credit granted to "specialists".

Mr. Szymczak stated that he had two questions in connection with the amendments: (1) What use was to be made of the information furnished to the New York Stock Exchange by the specialists in compliance with the amendments and should arrangements be made under which representatives of the Board or the Federal Reserve Bank of New York would review the reports and summary reports would be submitted to the Board from time to time, and (2) what arguments could be made for not approving the proposed amendments?

There was a discussion of the question whether specialists were in a position sufficiently different from other purchasers and sellers on the exchanges to justify the amendments and of the functions performed by the specialists, the extent to which they contribute to making ready markets for securities, and whether their operations do in fact tend to stabilize the market and prevent wide fluctuations in the securities in which they act as specialists. Mr. Clayton pointed out that under the rules of the New York Stock Exchange, specialists are required to carry out their obligations as specialists and to function effectively.

In connection with the information to be furnished by the specialists to the exchange and how this information could be used to assure the Board that the specialists were operating in a manner consistent with the credit policies of the System, Mr. Szymczak suggested that the New York Stock Exchange should be advised what

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information the Board wished to have submitted to it and in what form it was to be made available.

Various comments were made as to how this could be accomplished. It was suggested that it would not be necessary to have individual reports of specialists submitted to the Board but that provision should be made for periodic summary reports of the use of credit by specialists, with the right in the Board to ask for the individual reports and to have representatives of the Board or the Federal Reserve Bank of New York inspect the individual reports.

After some discussion, it was agreed that action on the amendment should not be taken until the first meeting of the Board at which a quorum was present, at which time advice likely would have been received from the New York Stock Exchange that it had taken action to require from specialists the information required by the amendments.

Mr. Eccles stated that he would be away during the rest of July but that he favored the adoption of the amendments and the arrangements above referred to with respect to the information to be furnished to the stock exchange by specialists.

× Reference was then made to a recent informal discussion of the procedure with respect to the selection of personnel for foreign missions and other services in connection with foreign matters and to the memorandum addressed to Mr. Szymczak by Mr. Hammond under date of July 5, 1949, which was read during an informal discussion of this matter at the meeting of the Board on July 8, 1949.

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At the request of Mr. Szymczak, Mr. Vest outlined the authority of the Board to require that the Federal Reserve Banks get the approval of the Board before entering into arrangements for foreign missions and other services by officers and employees of the Bank in connection with foreign matters. Mr. Vest stated that it was clear that the Board had such authority with respect to relations with foreign banks and bankers, that the law was not clear with respect to relations with foreign governments but that on the basis of the Board's authority for general supervision of the Federal Reserve Banks and the general intent of the law, Regulation N, Relations with Foreign Banks and Bankers, applied the same requirements to relations with foreign governments as to relations with foreign banks and bankers, and that he thought the Board would be justified as a legal matter in saying that the Federal Reserve Banks should get the permission of the Board, or should notify the Board, before entering into any relations with foreign banks and bankers, foreign states, and international agencies in this or other countries.

Mr. Eccles stated that the Board should be given prompt advice of any proposal for any such arrangements so that it would have an opportunity to object if it desired to do so.

Mr. Szymczak said that essentially that requirement was being met under the procedure agreed upon with the Federal Reserve Bank of New York in 1945 which provided that the Board and the Federal Reserve Bank of New York would advise each other promptly whenever either had occasion to consider sending representatives abroad, that

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there had been only a few occasions when the Board and the Bank had overlooked giving the other prompt advice of pending negotiations, and that in 1948 the procedure had been applied to service with international agencies.

During the ensuing discussion, it was stated that the question before the Board was whether the procedure agreed upon in 1945 should be changed to require that the Federal Reserve Bank get the approval of the Board before making a commitment of the kind contemplated by the procedure.

There was a discussion of the difficulties that might arise under such an arrangement, and Mr. Szymczak suggested that instead of amending the 1945 agreement, it be understood that he and the staff would watch the matter closely, and whenever it appeared that negotiations were proceeding to a point where a commitment might be made by a Federal Reserve Bank, the matter would be brought to the attention of the Board of Governors so that it would be in a position to take such action as appeared to be called for under the circumstances.

This suggestion was approved unanimously. X

Mr. Clayton stated that he had completed his negotiations with the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Executive Committee of the National Association of Supervisors of State Banks on the proposed amendment of the 1938 uniform bank examination procedure, that the proposal was acceptable to all concerned, and that the press release with respect to it could now be

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given out. The statement of the revised procedure together with a letter transmitting copies to the Presidents of all Federal Reserve Banks read as follows:

"Enclosed are copies of a joint statement of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Executive Committee of the National Association of Supervisors of State Banks which is to be released on Thursday for the morning papers of Friday, July 15, 1949. This statement relates to the revision of the agreement adopted in 1938 regarding bank examination procedure by the Federal bank supervisory agencies. Copies of the procedure, as revised, are also enclosed. The revised procedure will be published in the next issue of the Federal Reserve Bulletin.

"It is desired that the new procedure be made effective as soon as possible. It is requested, therefore, that your examiners be instructed to use the revised procedure in all examinations of State member banks beginning on or after Monday, July 18. Revised pages of the examination report form will be made available as soon as practicable. A letter is being sent today by the Board's Division of Examinations to the officer in charge of examinations at your Bank suggesting the procedure to be followed in preparing reports of examination pending the preparation of revised pages, and transmitting additional copies of the statement and revised procedure."

"BANK EXAMINATION PROCEDURE

As revised July 15, 1949

"THE CLASSIFICATION OF ASSETS IN BANK EXAMINATION

"The present captions of the classification units, namely, 'I', 'II', 'III' and 'IV' are to be abandoned.

"The classification units hereafter will be designated as 'Substandard', 'Doubtful' and 'Loss'. The term 'Substandard' will be defined as follows:

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

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"suitable reductions in amount, additional security, more complete financial data concerning the obligor's condition, or other such action as the specific circumstances may require.

"Present practice will be continued under which the totals of the three classifications are included in the recapitulation or summary of examiners' classifications.

"Fifty per cent of the total of 'Doubtful' and all of 'Loss' will be deducted in computing the net sound capital of the bank. Amounts classified 'Loss' should be promptly charged off.

"THE APPRAISAL OF BONDS IN BANK EXAMINATIONS

"Neither appreciation nor depreciation in Group I securities will be taken into account in figuring net sound capital of the bank. However, this policy is intended to apply to recognized sound investment practices of banks, and is not intended to apply to undue concentrations in securities other than U. S. Government issues, nor to other cases where the condition of the portfolio requires special treatment by the supervisory agency or agencies concerned.

Group I securities are marketable obligations in which the investment characteristics are not distinctly or predominantly speculative. This group includes general market obligations in the four highest grades and unrated securities of equivalent value.

"The securities in Group II will be valued at the market price and fifty per cent of the net depreciation will be deducted in computing the net sound capital.

Group II securities are those in which the investment characteristics are distinctly or predominantly speculative. This group includes general market obligations in grades below the four highest, and unrated securities of equivalent value.

"Present practice will be continued under which net depreciation in the securities in Group III and Group IV are classified as loss.

Group III securities: Securities in default.

Group IV securities: Stocks.

"Present practice will be continued under which premiums on securities purchased as a premium must be amortized.

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"Present practice of listing securities and showing their book value will be continued.

"Present practice will be continued under which the establishment and maintenance of adequate reserves, including reserves against the securities account, are encouraged.

"Present practice will be continued under which speculation in securities is criticized and penalized.

"THE TREATMENT OF SECURITIES PROFITS IN BANK EXAMINATIONS

"Until losses have been written off and adequate reserves established, the use of profits from the sale of securities for any purpose other than those, will not be approved."

Mr. Clayton moved that the statement be approved by the Board and that the following joint statement of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Executive Committee of the National Association of Supervisors of State Banks be released for publication in the morning papers of Friday, July 15, 1949, with the understanding that the press release and the statement of procedure would be sent to the Federal Reserve Banks to reach them before the release date and that the procedure would be published in the next issue of the Federal Reserve Bulletin:

"The Comptroller of the Currency, The Federal Deposit Insurance Corporation, The Board of Governors of the Federal Reserve System, and the Executive Committee of the National Association of Supervisors of State Banks have adopted minor changes in the bank examination and reporting procedure which has been followed by the supervisory agencies since July, 1938.

"The revision provides for abandonment of the use of Roman numerals II, III and IV in the examiners' classification of bank assets, and substitution of the terms 'substandard', 'doubtful', and 'loss', and for discontinuance of the practice of appraising Group 2 securities

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"on the basis of the 18-months average of market value. Such securities will be appraised at current market value.

"There will be no change with respect to evaluation of U. S. Government and other Group 1 (investment quality) securities. This policy is intended to apply to recognized sound investment practices of banks, and is not intended to apply to undue concentrations in securities other than U. S. Government issues, nor to other cases where the condition of the portfolio requires special treatment by the supervisory agency or agencies concerned.

"The revision involves no fundamental change in the present procedure nor does it signify any intention on the part of the supervisory authorities to become more severe in the classification of bank assets. Its purpose is clarification and simplification of procedure in the interest of more uniform application. It also recognizes the fact that use of the 18-months average price for Group 2 securities is no longer of practical significance since the banks of the country have only a nominal investment in such securities."

Mr. Clayton's motion was put by the Chair and carried unanimously, inasmuch as at the meeting of the Board on June 3, 1949, at which Messrs. McCabe, Eccles, Szymczak, Draper, Vardaman, and Clayton were present, the Board favored the revised procedure and the issuance of the press release.

At this point Mr. Cherry, Assistant Counsel, entered the meeting.

Mr. Cherry stated that he had learned that the House Committee on Agriculture was considering a bill (H.R. 5512) which would amend the Federal Farm Loan Act to authorize Federal Land Banks, subject to regulations and limitations to be prescribed by the Board

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of Governors, to obtain advances at the Federal Reserve Bank discount rate for periods of not to exceed one year from any Federal Reserve Bank operating in the Land Bank's district on promissory notes of the land bank secured by Federal farm-loan bonds or United States Government securities. In that connection, Mr. Cherry referred to a letter addressed by the Board on May 23, 1940, to Mr. Marvin Jones, then Chairman of the House Committee on Agriculture, in which it was stated that the Board in principle was favorable to Federal Reserve Banks having authority to make loans and advances on the security of any sound assets to the Federal Land Banks on such terms and conditions as the Board might prescribe and in accordance with the general credit policies pursued by the System from time to time. The letter called attention to the fact, however, that the proposed bill would discriminate against member banks in that the same loans could be made to them only for four months at a higher discount rate.

Mr. Clayton stated that in May of this year in a personal reply to a letter addressed to Mr. Evans by Mr. Jones, he (Mr. Clayton) stated that in the event such a bill were reintroduced he knew of no reason why the Board, if called upon for a report, would take any different position with respect to it than it did in its letter of 1940.

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It was pointed out that the current bill provided that collateral for loans would be land bank bonds or Government securities rather than farm mortgages as contemplated by the bill previously under consideration but that otherwise the effect of the two bills would be substantially the same.

Mr. Cherry stated that it did not appear that the House Committee would ask the Board for a report on the bill, that the Committee was fully aware of the question of discrimination raised in the Board's letter of 1940, and that the Committee hoped that the Board would not object to the bill.

In a discussion of what, if any, action should be taken by the Board in the matter, it was suggested that inasmuch as the authority proposed in the bill would be subject to regulations and limitations of the Board of Governors and operations under the bill could be made to harmonize with System credit policy, no objection should be offered to the bill.

This suggestion was approved unanimously.

Mr. Eccles referred to the discussion at the meeting of the Board on July 8, 1949, with respect to changing the discount rates in effect at the Federal Reserve Banks and suggested that consideration of that matter be deferred until a meeting at which Chairman

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McCabe and he could be present about the first of August.

At this point Messrs. Riefler, Vest, Nelson, Young, Solomon, and Cherry withdrew and the action stated with respect to each of the matters hereinafter referred to was taken by the Board:

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

"In accordance with the request contained in Mr. Johns' letter of July 9, 1949, the Board of Governors approves, effective July 1, 1949, the payment of salary to Mr. William F. Fairley, Federal Reserve Agent's Representative, Omaha Branch, at the rate of \$4,500 per annum."

Approved unanimously.

Letter to The Dover Plains National Bank, Dover Plains, New York, reading as follows:

"This refers to the resolution adopted on November 12, 1948, by the board of directors of your bank, signifying the bank's desire to surrender its right to exercise fiduciary powers heretofore granted to it.

"The Board, understanding that your bank has been discharged or otherwise properly relieved in accordance with the law of all of its duties as fiduciary, has issued a formal certificate to your bank certifying that it is no longer authorized to exercise any of the fiduciary powers covered by the provisions of section 11(k) of the Federal Reserve Act, as amended. This certificate is enclosed herewith.

"In this connection, your attention is called to the fact that, under the provisions of section 11(k) of the Federal Reserve Act, as amended, when such a certificate has been issued by the Board of Governors of the Federal Reserve System to a national bank, such bank (1) shall no longer be subject to the provisions of section 11(k) or the regulations of the Board of Governors of the Federal Reserve System made pursuant thereto, (2) shall be

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"entitled to have returned to it any securities which it may have deposited with the State authorities for the protection of private or court trusts, and (3) shall not exercise thereafter any of the powers granted by section 11(k) without first applying for and obtaining a new permit to exercise such powers pursuant to the provisions of section 11(k).

"Since it may be necessary for you to file a certified copy of the Board's certificate with the State authorities in connection with the release of the securities which you may have on deposit with them, such copy is enclosed herewith."

Approved unanimously.

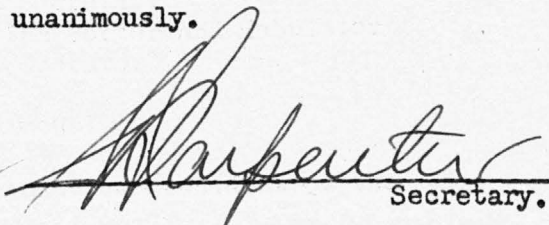
Letter to Mr. Harold W. Bangert, Bangert and Bangert, 404 Black Building, Fargo, North Dakota, reading as follows:

"This refers to the proposal which you recently discussed with members of the Board's staff relating to the collection at par of checks drawn on North Dakota banks.

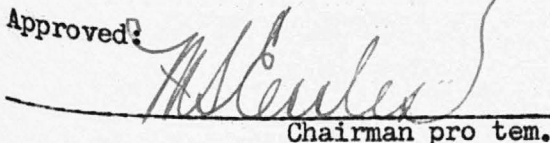
"After careful consideration of this matter, it does not appear to us that the interpretation of State law which you suggest has been established by the courts as the law of North Dakota. This problem, as you know, is one of considerable complexity and it is difficult for us here in Washington to appraise the situation in North Dakota. For this reason and because your proposal involves an interpretation of State law, we are referring the matter to the Federal Reserve Bank of Minneapolis for its consideration in accordance with the Board's usual policy with respect to matters of a local character.

"We appreciate your interest in this subject and the members of the Board's staff were glad to have the opportunity to discuss the matter with you."

Approved unanimously.


Secretary.

Approved:


Chairman pro tem.