

Minutes of actions taken by the Board of Governors of the Federal Reserve System on Monday, August 15, 1949.

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

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

Memorandum dated August 15, 1949, from Mr. Leonard, Director of the Division of Bank Operations, recommending the appointment of Willis H. Underwood, Jr., as an analyst in that Division, with basic salary at the rate of \$3,351 per annum, effective as of the date upon which he enters upon the performance of his duties after having passed the usual physical examination.

Approved unanimously.

Memorandum dated August 12, 1949, from Mr. Bethea, Director of the Division of Administrative Services, recommending the appointment of Aubrey Lake Simmons as a laborer in that Division on a temporary basis for a period of two months, with basic salary at the rate of \$2,020 per annum, effective as of the date upon which he enters upon the performance of his duties after having passed the usual physical examination.

Approved unanimously.

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

8/15/49

-2-

"Reference is made to your letter of August 8, 1949, submitting the request of Wilmington Trust Company, Wilmington, Delaware, for permission to establish a branch in Greenville, Delaware.

"It is understood that approval of the appropriate State authorities has been obtained, and in view of your recommendation, the Board of Governors approves the establishment and operation of a branch in Greenville, Delaware, by Wilmington Trust Company, Wilmington, Delaware, provided such branch is established within twelve months of the date of this letter and with the understanding that Counsel for the Reserve Bank will review and satisfy himself as to the legality of the steps taken to establish the branch."

Approved unanimously.

Letter to Mr. Williams, President of the Federal Reserve Bank of Philadelphia, reading as follows:

"This is in reply to your letter of August 1 regarding the proposed air conditioning of the Bank building. It is noted that a preliminary study made in mid-1948 indicated that the cost of completing air conditioning for the entire building would be approximately \$700,000.

"As requested in your letter, the Board authorizes your Bank to proceed with the preparation of more detailed plans and specifications for the air conditioning of the building. It is understood that before entering into any commitment to proceed with the installation you will submit the matter to the Board on the basis of the proposed plans and specifications and more definite information as to costs."

Approved unanimously.

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

"This refers to the purchase in May 1948 of substantially all the stock of Eastern Insurance Company by Deanwood Company, a wholly owned subsidiary of The City Bank of Washington, Washington, D. C., reported in the reports

8/15/49

-3-

"of examination of the bank as of June 17, 1948, and January 17, 1949, and discussed in Mr. Wallace's letter of March 22, 1949, to Mr. Baumann, of the Board's staff.

"All of the stock of Deanwood Company was owned by The City Bank of Washington when the bank was admitted to membership in 1940. Deanwood Company was organized in 1934 to hold the assets of one of the bank's borrowers who was engaged in real estate ventures and, following the borrower's death, the bank acquired the stock of the company as the result of debts previously contracted. When the bank was admitted to membership, the assets of Deanwood Company consisted of real estate, real estate loans, Government securities, and cash. In addition to managing its real estate and real estate loans, the company was acting as an insurance agent engaged principally in placing insurance on automobiles securing loans made by the bank; and the company has continued to engage in that business since the bank's admission to membership. The management and operations of Deanwood Company have been closely integrated with those of the bank, with the company being operated in effect as a part of the bank. The bank was not required by law to dispose of the stock of the company before its admission to membership, and this was not required by the Board as a condition of membership since it appeared that the company was not performing any functions which might not be properly performed by a member bank and, as set out below, any changes in the corporate powers exercised by the company were restricted by one of the standard conditions of membership.

"The purchase of the stock of Eastern Insurance Company by Deanwood Company in May 1948 was, in substance, the purchase by the bank of corporate stock which, under the law, a State member bank is not permitted to purchase. Section 9 of the Federal Reserve Act and section 5136 of the Revised Statutes prohibit the purchase by a State member bank of corporate stocks other than those which may be purchased by national banks. The Board so construed the pertinent statutory provisions in a ruling published in the Federal Reserve Bulletin for July 1933 at page 449 (F.R.L. S. #7080) and it has consistently adhered to this position. Since a national bank could not legally purchase the stock of Eastern Insurance Company, The City Bank of Washington, as a State member bank, was prohibited from doing so. The purchase of the stock by a wholly owned subsidiary was contrary to the spirit and purposes of the law, and the facts

8/15/49

-4-

"and circumstances of this case appear to afford ample justification for disregarding the corporate fiction and holding that the stock was purchased by the bank in violation of the law.

"Apart from the limitations prescribed by law, the purchase of the stock without the Board's permission was prohibited because it violated a condition of membership accepted by the bank when it was admitted to membership. The bank was admitted subject to standard condition of membership numbered 1 which reads as follows:

'1. Such bank at all times shall conduct its business and exercise its powers with due regard to the safety of its depositors, and, except with the permission of the Board of Governors of the Federal Reserve System, such bank shall not cause or permit any change to be made in the general character of its business or in the scope of the corporate powers exercised by it at the time of admission to membership.'

"In its letter of June 29, 1940, to The City Bank of Washington, approving the bank's application for membership, the Board stated that if the bank, directly or through Deanwood Company, should desire to exercise any corporate powers which were not being exercised when the bank was admitted to membership, it would be necessary under this condition of membership for the bank to obtain the Board's permission. The pertinent paragraph of the Board's letter read as follows:

'It appears that the bank possesses certain powers which are not being exercised and which are not necessarily required in the conduct of a banking business, such as the power to "guarantee, or become surety in respect of the stock, bonds, or other securities and obligations of other companies." Also in this connection it is understood that the bank's wholly owned subsidiary, the Deanwood Company, exercises no powers which the bank itself is not empowered to exercise. Attention is invited to the fact that if the bank, directly or through the subsidiary, should desire to exercise any powers not actually exercised by the bank at the time of its admission to membership, it will be necessary under condition of membership numbered 1 to obtain the permission of the Board of Governors before exercising them. It is assumed, of course,

8/15/49

-5-

"that there has been no change in the scope of the corporate powers exercised by the bank or the company since the date of the bank's application for membership."

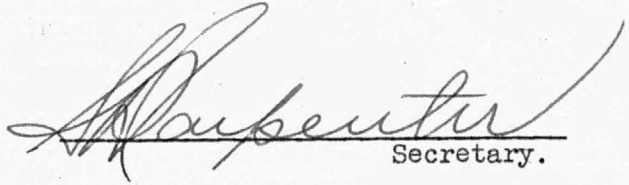
"Eastern Insurance Company is an insurance underwriting company with broad powers to write fire, marine, and casualty insurance. This is, of course, an entirely different type of business from that of an insurance agent or broker such as was being conducted by Deanwood Company when The City Bank of Washington was admitted to membership; and, in the Board's opinion, it is not a business in which a bank should be engaged. Under the above-quoted condition of membership, as construed in the Board's letter approving the bank's application for membership, The City Bank of Washington was required to obtain the Board's permission before it organized Eastern Insurance Company and purchased substantially all of its stock through Deanwood Company and, thus, undertook to operate an insurance underwriting business. The Board's permission was not obtained; and, had the matter been submitted to the Board, such permission would not have been granted.

"It is understood that, prior to the purchase of the stock of Eastern Insurance Company, the president of the member bank took the matter up with your Bank and was advised, as he had been in connection with earlier inquiries, that your Bank knew of no law or regulation which restricted the investments which might be made by Deanwood Company. However, the matter was not submitted to the Board and its permission was not obtained as required by the condition of membership. While it is unfortunate that no objection was expressed when the matter was brought to your Bank's attention, the Board does not feel that it can condone the continued ownership of the stock of Eastern Insurance Company and the operation of an insurance underwriting business by the bank. Accordingly, it is the Board's view that the bank should dispose of the stock of Eastern Insurance Company as promptly as practicable; and it will be appreciated if you will so advise the bank.

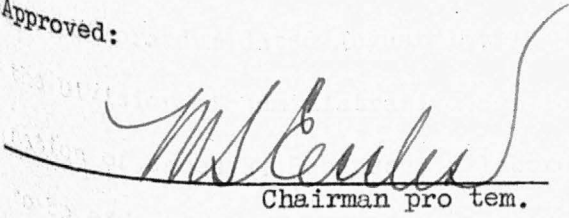
"It also appears from the report of examination of The City Bank of Washington as of January 17, 1949, that Deanwood Company had purchased and then held 600 shares of the common stock of Potomac Electric Power Company. If this stock is still held by Deanwood Company, the Board believes that prompt disposition should also be made of it."

Approved unanimously.

8/15/49


Secretary.

Approved:


Chairman pro tem.