

Minutes of actions taken by the Board of Governors of the Federal Reserve System on Monday, January 9, 1950. The Board met in the Board Room at 10:30 a.m.

PRESENT: Mr. Szymczak, Chairman pro tem.
Mr. Draper

Mr. Carpenter, Secretary
Mr. Sherman, Assistant Secretary
Mr. Morrill, Special Adviser
Mr. Thurston, Assistant to the Board
Mr. Riefler, Assistant to the Chairman
Mr. Leonard, Director, Division of Bank Operations
Mr. Vest, General Counsel
Mr. Young, Director, Division of Research and Statistics
Mr. Sloan, Assistant Director, Division of Examinations
Mr. Horbett, Assistant Director, Division of Bank Operations
Mr. Baumann, Assistant General Counsel
Mr. Solomon, Assistant General Counsel
Mr. Noyes, Assistant to the Director, Division of Research and Statistics
Mr. Cheadle, Economist, Division of Research and Statistics
Mr. Coleman, Administrative Assistant to the Chairman

Chairman McCabe was unable to be present at this meeting because he was at home with a severe cold, and Mr. Vardaman had another appointment and was unable to attend.

Mr. Vest stated that late on Saturday, January 7, 1950, Mr. Thomas, Economic Adviser to the Board, received from the Bureau of the Budget a copy of a draft of bill to amend the Federal deposit insurance law with a request that any comments that the Board might wish to make on the draft be sent to the Budget Bureau as early as

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possible today in view of the fact that Senator Maybank, Chairman of the Banking and Currency Committee, planned to introduce the bill tomorrow and to start hearings on it the following day, January 11. He added that several members of the staff reviewed the draft bill yesterday and that the portions of the bill which he felt would be of interest to the Board were as follows:

- (1) The bill would revise and re-enact in a separate law the federal deposit insurance law, now contained in Section 12b of the Federal Reserve Act.
- (2) Deposit insurance coverage would be increased from \$5,000 to \$10,000.
- (3) Assessments on banks for deposit insurance would be continued at the rate of 1/12 of one percent per annum, but there would be paid to insured banks on a pro rata basis, according to the amounts paid in assessments, a dividend at the end of each calendar year consisting of 60 percent of net assessment income, defined as income remaining from assessments after payment of operating expenses, insurance losses, and reserves for insurance losses during the year, and without inclusion of investment income. The other forty percent of net assessment income would be carried to the corporation's capital account.

In elaborating on this provision, Mr. Vest stated that he understood the proposal for payment of a dividend rather than reduction of the assessment rate on deposit insurance reflected the suggestion of Mr. A. L. M. Wiggins, formerly President of the American Bankers' Association, who had been studying the problem for some time, but that Mr. Wiggins proposed that eighty percent of net assessment income be distributed as dividends and that twenty percent be carried to capital account.

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- (4) The assessment base would be simplified by a number of technical changes and made more nearly uniform with call and other reports, and assessments would be based on deposits on four stated dates each year rather than on an average of daily deposit liabilities.
- (5) The draft of bill would give the Federal Deposit Insurance Corporation the right to examine State member banks without, as is now required, obtaining the consent of the Board of Governors.
- (6) The Federal Deposit Insurance Corporation would be given authority to make loans to prevent a bank from closing, whereas it now has authority to make loans for the purpose of preventing loss to the Corporation or facilitating a merger or consolidation.

With respect to this change, Mr. Vest stated that the way in which such authority might be used was not entirely clear and that conceivably it could be used by the Deposit Insurance Corporation to extend credit to banks which were not in imminent danger of closing.

- (7) Membership in the Federal Deposit Insurance Corporation would be restricted to banks engaged in receiving deposits.
- (8) Except with the consent of the Federal Deposit Insurance Corporation, no person who had been convicted of any criminal offense involving dishonesty or a breach of trust could serve as a director, officer, or employee of an insured bank.
- (9) The Federal Deposit Insurance Corporation would be authorized to purchase or erect a building in which it would carry on its operations in Washington.

Mr. Young stated that a letter from Mr. Wiggins dated January 3, 1950, was received in the Chairman's offices last Friday, in which Mr. Wiggins described his proposal for payment of dividends along the lines of the provision in the draft bill, and in which he indicated

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a preference for that means of reducing the assessment burden on the grounds that (a) it was the usual procedure followed by mutual insurance companies for reducing premium costs; (b) it would provide substantial relief to the banks on their assessments; and (c) it would avoid raising the question of relief from insurance assessments against savings and loan associations at this time. Mr. Young also stated that the formula proposed by Mr. Wiggins could readily be based on a moving average of several years, such as that proposed in the staff study and discussed at the meeting on December 29, 1949, and that he understood Mr. Wiggins would not be opposed to that procedure if it would not endanger a reduction in the assessment cost.

During the ensuing discussion, Mr. Szymczak suggested that the Board inform the Budget Bureau that it was in favor of the general objectives of the bill in so far as it applied to a reduction in deposit insurance costs, an increase in coverage, and simplification of the assessment base, concerning which there had been a great deal of study over the past year but that it was strongly opposed to the provision which would give the Federal Deposit Insurance Corporation the right to examine State member banks without the written consent of the Board, and that it had some question about the provision which would broaden the loan authority for the Corporation.

Mr. Vest stated that the staff had arrived at substantially the same conclusions, that it would suggest that consideration be given

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to the possibility of basing the proposed dividends on a from 5 to 10 year average rather than on a single year, that it would also suggest retention of the existing provision in the law with respect to examination of member banks by the Federal Deposit Insurance Corporation, and that alternative drafts of a substitute for the provision with respect to loans had been prepared. He then read the alternative drafts of a substitute for the provision with respect to loans (subsection (b) of Section 13 of the draft bill) which would make it clear that such loans were to be made by the Corporation only for the purpose of reopening a closed bank or of preventing the closing of a bank when that seemed imminent.

There was a further discussion, during which it was suggested that, in view of the request of the Bureau of the Budget that comments be submitted as quickly as possible, there be sent to the Bureau at once a draft in the form discussed at this meeting, of a substitute for subsection (b) of Section 13 of the bill, and a revision of subsection (b) of Section 10 with respect to examinations which would retain the existing provision that State member banks may be examined by the Corporation only with the written consent of the Board of Governors. It was also suggested that a letter commenting on these and other provisions in the draft legislation along the lines of the discussion at this meeting be prepared, and sent to the Bureau of the Budget when in a form satisfactory to Chairman McCabe.

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The foregoing suggestions were approved unanimously.

Secretary's Note: In accordance with this action, the following letter was transmitted to the Bureau of the Budget under date of January 9, 1950, Chairman McCabe having stated over the telephone that he agreed with the views expressed by Messrs. Szymczak and Draper and that he approved the letter:

"This is in reference to your oral request for any comments which the Board of Governors might wish to make with respect to a draft of bill to amend the Federal deposit insurance law, a copy of which we received on Saturday, January 7th.

"We wish to call especial attention to section 13(b) of the bill, relating to loans by the FDIC to prevent the closing of an insured bank, and to section 10(b) of the bill, relating to examinations of State banks which are members of the Federal Reserve System. The language of the bill on these points would seem to be so phrased as to provide a broad authority to the FDIC to make loans to going banks, and also to make examinations of State member banks without the consent of the Board of Governors as is required under present law. We assume that this broad effect is not intended and therefore, in view of the urgency of time, we have sent to your office earlier today proposed changes in subsection (b) of section 13 and in subsection (b) of section 10. If the bill is to be proposed in substantially its present form, we respectfully urge that these two amendments be included in the bill at this time. Copies of these proposed amendments to the bill are enclosed.

"Under existing law the FDIC may examine State member banks only with the consent of the Board of Governors and national banks only with the consent of the Comptroller of the Currency. As now written, section 10(b) of the bill would give the Corporation full authority to examine State member banks whenever it so desired. This extension of the authority of the FDIC would duplicate the authority of the Federal Reserve System and in the Board's opinion is both unnecessary and undesirable. Moreover, the re-alignment of bank examination and supervisory functions

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"of the three Federal bank supervisory agencies is not a matter which should be dealt with in a piecemeal fashion or as an incident to a bill designed primarily for other ends. The Board's proposed amendment to section 10(b) of the bill would continue the existing statutory provisions with respect to the examination of State member banks by the FDIC.

"With respect to section 13(b) of the bill, the Board recognizes that in some circumstances it may be desirable for the FDIC to make loans to insured banks to prevent their closing. However, the authority of the FDIC in this respect should be appropriately restricted so that it will not be so broad as to justify assistance to going banks through loans of a kind which are the normal function of the central banking system. The Corporation should be authorized to make such loans only when there is imminent danger of the closing of a bank. It is assumed that this is the intent of the language in the bill, but it is the purpose of the Board's proposed amendment to section 13 (b) to make this entirely clear.

"The principal purposes of the proposed bill are to increase deposit insurance coverage from \$5,000 to \$10,000, to provide for the payment of annual dividends by the FDIC to insured banks based upon 60 per cent of net assessment income, and to make certain changes in the method of calculation of assessments. The Board favors the increase of insurance coverage and the changes in the method of calculating the assessments upon insured banks. The Board is also in sympathy with the provision for the payment of dividends to insured banks as provided in the proposed bill and feels that this is a step in the right direction.

"A study which has recently been made under the direction of the Board, however, indicates that any possible change which might be made in the assessment rate, either directly or through the device of dividends, should be based upon a moving average of the Corporation's loss experience over the preceding 10 (or possibly 5) years. The method of basing dividends on the Corporation's loss experience for the preceding year would have a pro-cyclical effect on bank earnings. In addition, under this formula, relatively small additions to the FDIC losses would be reflected in relatively large decreases in funds available for dividends. There would be a danger that the public

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"would come to regard changes in funds available for dividends as an index of soundness of the banking situation. Using an average of losses over a ten or five year period as a basis for the dividend formula would minimize these defects. The Board suggests, therefore, that consideration be given to the desirability of applying such a moving average to the dividend formula set up in the bill.

"Moreover, the Board notes that the formula for the payment of dividends is based upon net assessment income, which does not include income derived from investments. It seems to the Board that it would be desirable to consider including such investment income as a part of the base upon which dividends are to be calculated. The Board also feels that it might be well to consider providing in the formula that 80 per cent instead of 60 per cent of net income be used for the payment of dividends, and especially so if income from investments is not to be included as a part of the dividend base.

"Questions as to the possible increase in insurance coverage and possible changes in the assessment rate and in the assessment base have been under discussion for some time past and the Board is, therefore, glad to be in a position to give this prompt expression of its views on these points. The other provisions of the bill, however, involve a revision of the entire existing statute relating to the FDIC. These involve a lengthy bill with substantial modifications of the present law, and in the time available there has not been adequate opportunity to study the effects of these changes. It does not seem to us that the provisions of the bill other than those relating to insurance coverage, the payment of dividends, and the assessment base are necessary to the proposal at this time, and it might be preferable, therefore, that the bill be shortened so as to include only the provisions on the three subjects mentioned and that all the other provisions of the bill be deferred so that there may be adequate time for study of their advisability."

"PROPOSED CHANGES IN BILL TO AMEND THE
FEDERAL DEPOSIT INSURANCE LAW

"Revise subsection b of section 13 to read as follows:

"In order to reopen a closed insured bank or, when

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"the Corporation has determined that an insured bank is in imminent danger of closing, in order to prevent such closing, the Corporation, in the discretion of its board of directors, is authorized to make loans to, or purchase the assets of, such an insured bank upon such terms and conditions as the board of directors may prescribe.

"Amend the first two sentences of subsection (b) of section 10 to read as follows:

"The board of directors shall appoint examiners who shall have power, on behalf of the Corporation, to examine any insured State nonmember bank (except a District bank), any State nonmember bank making application to become an insured bank, and any closed insured bank, whenever in the judgment of the board of directors an examination of the bank is necessary. Such examiners shall have like power to examine, with the written consent of the Comptroller of the Currency, any national bank or District bank, and, with the written consent of the Board of Governors of the Federal Reserve System, any State member bank."

At this point Messrs. Riefler, Leonard, Vest, Young, Sloan, Horbett, Baumann, Solomon, Noyes, Cheadle, and Coleman withdrew, and the action stated with respect to each of the matters hereinafter referred to was taken by the Board:

Memorandum dated January 6, 1950, from Mr. Millard, Director of the Division of Examinations, recommending increases in the basic annual salaries of the following employees in that Division, effective January 22, 1950:

<u>Name</u>	<u>Title</u>	<u>Salary Increase</u>	
		<u>From</u>	<u>To</u>
William H. Drake	Messenger	\$2,652	\$2,732
Robert L. Piper	Messenger	2,652	2,732

Approved unanimously.

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Memorandum dated December 28, 1949, from Mr. Bethea, Director of the Division of Administrative Services, recommending a leave of absence without pay for Mrs. Muriel S. Duncan, a stenographer in that Division, for the period December 12, 1949, through February 28, 1950.

Approved unanimously.

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

"In accordance with the recommendation contained in your letter of January 4, 1950, the Board of Governors extends to February 11, 1950, the time within which The Farmers State Bank of Breckenridge, Michigan, Breckenridge, Michigan, may accomplish membership. Please advise the applicant to this effect."

Approved unanimously.

Letter to Mr. Frank B. Pace, Jr., Director, Bureau of the Budget, reading as follows:

"This is in response to your letter of December 14, 1949, requesting the Board's views with respect to a draft of a bill entitled 'Armed Services Contract Settlement and Property Disposition Act of 1949'.

"After the receipt of your letter, we were able to obtain from your Office a revised draft of this bill which would be cited as the 'Armed Services Contract Settlement Act of 1950' and, accordingly, this letter should be regarded as referring to the latter draft of the bill.

"The proposed legislation appears to follow very closely the Contract Settlement Act of 1944. It contains similar provisions with respect to the settlement of contracts entered into by the Department of the Army, Department of the Navy and Department of the Air Force, settlement of termination claims of subcontractors, financing

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"of contractors in connection with termination of their contracts, advance notice of termination, removal and storage of termination inventory, functions of the General Accounting Office with respect to termination settlements, and other matters. It is understood that the draft has been proposed by the Secretary of the Air Force on behalf of the National Military Establishment because of the fact that the Contract Settlement Act of 1944 applies only to 'war contracts' and only to Government contracting agencies which were authorized to make contracts pursuant to the First War Powers Act.

"The provisions of the draft which are of the most direct concern to the Federal Reserve System are those contained in section 7 with reference to the financing of contractors pending settlement of their claims under terminated contracts. That section, in addition to authorizing partial payments by the Armed Services to contractors, would empower the Services to guarantee financing institutions against losses on loans made to contractors for the purpose of financing them in connection with, or in contemplation of, the termination of their production or procurement contracts with the Armed Services. The Services would also be authorized to participate with financing institutions in the making of direct loans to contractors for this purpose.

"Subsection (h) of section 7, in language similar to that contained in the Contract Settlement Act of 1944, would authorize any Federal Reserve Bank to act, on behalf of the contracting agencies, as fiscal agent of the United States in carrying out the purposes of the proposed legislation, 'subject to such regulations as the Board of Governors of the Federal Reserve System may prescribe with the approval of the contracting agency.' On the basis of its experience in the administration of the V-Loan program during World War II, the Board feels strongly that such a requirement for approval of regulations of the Board by each of the contracting agencies would tend to produce lack of uniformity in procedures and policies; and it is recommended, therefore, that the words 'with the approval of the contracting agency' in this subsection be changed to read 'after consultation with the contracting agencies or their authorized representatives'. This language would follow language used in a corresponding provision of the President's Executive Order No. 9112 of March 26, 1942, under which the wartime

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"V-Loan program was inaugurated.

"It is assumed, of course, that if the Federal Reserve Banks should be called upon to act as fiscal agents for the Armed Services under the proposed bill, the Reserve Banks would be fully reimbursed for all expenses incurred by them in acting in such capacity, as was the case under the Contract Settlement Act of 1944.

"Subsection (g) of section 7 provides, in effect, that loans to contractors may be secured by the assignment of, or by covenants to assign, the rights of contractors in connection with the termination of their contracts. In this connection, the Board wishes to call attention to the fact that, under an opinion rendered by the Comptroller General of the United States to the Secretary of the Army in May 1949, the so-called 'Price Revision Article' contained in certain Government contracts is construed as authorizing the Government to withhold from payments to an assignee bank, or to recover directly from the assignee bank if already paid, any amounts determined to be in excess of the contract price as revised. The Board believes that the inclusion of the price revision article in contracts of the Armed Services, as so interpreted by the Comptroller General, would constitute a substantial deterrent to the participation by commercial banks in any program for the financing of contractors after termination of their contracts under the proposed bill. As a matter of fact, a specific case has recently come to our attention in which a bank refused to finance a Government contractor for this reason. Accordingly, the Board feels that consideration should be given to the desirability of adding to subsection (g) of section 7 of the draft appropriate language which would have the effect of eliminating the deterrent arising from price revision articles, renegotiation clauses or similar matters.

"With further reference to the security for loans by banks to finance Government contractors, it may also be mentioned that during the war it was a matter of great importance to commercial banks participating in the V-Loan program that the War and Navy Departments were authorized by the Assignment of Claims Act of 1940 to include in contracts provisions to the effect that payments to an assignee should not be subject to reductions or set-off for any indebtedness of the contractor to the United States arising independently of such contract.

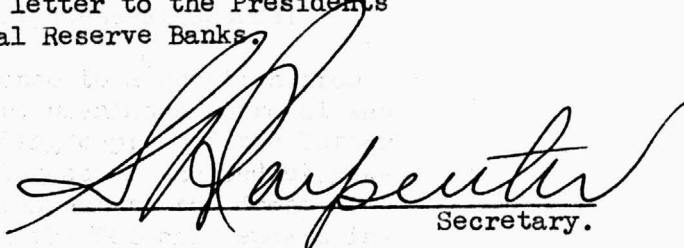
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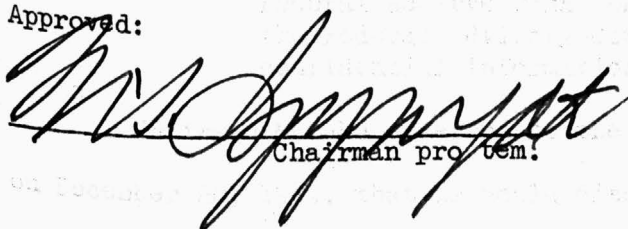
"The Board feels that, in connection with the financing provisions of the proposed bill, consideration should be given to the desirability of amending this provision of the Assignment of Claims Act in order to extend the authority for the use of the 'no set-off' clause to the Department of the Air Force and possibly to other Government agencies.

"The Board is in sympathy with the objectives of the proposed bill and, with the qualifications indicated above, the Board would have no objection to the enactment of this legislation."

Approved unanimously, together with a letter transmitting a copy of the above letter to the Presidents of all Federal Reserve Banks.


Secretary.

Approved:


Chairman pro tem.