Minutes of actions taken by the Board of Governors of the Federal Reserve System on Friday, May 2, 1952. The Board met in executive session in the Board Room at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Szymczak
Mr. Evans
Mr. Vardaman
Mr. Powell
Mr. Mills
Mr. Robertson

Following the executive session, Governor Robertson informed the Secretary that the discussion and action during the executive session were as follows:

Governor Robertson stated that he had been reviewing the role which the Board of Governors should fill in the field of bank supervision and particularly the direction which it should give to bank supervision and examination by the System in the light of the law and the authority delegated to the Federal Reserve Banks in the letters addressed to the individual banks in 1936 when the examination function was transferred from the Federal Reserve Agents' departments to the operating side of the banks. It was his feeling that membership in the System should be a badge of distinction and prestige and that the supervisory and examination activities of the System should be carried on with a view to enhancing that distinction and prestige and without regard to whether the policies followed for that purpose would result in a loss of membership or make it more difficult for banks to become members. With that purpose
in mind he was of the opinion that, among other things, the following actions should be taken by the Board:

1. Increase the quality of performance and enhance the prestige of the Board's Division of Examinations.

2. Make more certain that the examining work is conducted by qualified men by requiring - when the necessary procedures are established - that before an individual is commissioned as an examiner at a Federal Reserve Bank he pass a written and oral examination to be given by members of the Board's staff.

3. Refuse to approve appointments of officers in charge of examinations at the Federal Reserve Banks who are not qualified by training, experience, judgment, and ability to fill that position in a satisfactory manner.

4. Recognize that salaries of System examiners are not as high as those of examiners in other Federal agencies and see that provision is made for adequate compensation.

5. Initiate a survey of the examining departments of the Federal Reserve Banks as a means of providing an unbiased appraisal of the quality of the men and the effectiveness of the organizations handling bank examination work at the Federal Reserve Banks. This survey should be made by a man who is not an employee of the Board or a Federal Reserve Bank and would not remain an employee after the survey was completed.

6. Establish an arrangement under which the members of the Board will keep in closer touch with the examination work carried on by the
System. Every member of the Board - not only the Governor to whom bank examinations are assigned for primary consideration - should be actively interested in the work of the Division of Examinations and should keep fully informed of important policies being followed by the Division.

7. Arrange for frequent review of "problem" banks by the Division of Examinations with the members of the Board.

8. When all other available supervisory actions have been taken without the desired results, the Board must be willing to invoke any available sanctions, including the institution of proceedings to remove officers and directors, to expel a State bank from membership, to deny the use of credit facilities pursuant to paragraph 8 of section 4 of the Federal Reserve Act, etc.

9. Recognize that vigorous action to improve the quality of bank supervision probably will meet with opposition on the part of some Federal Reserve Banks and some member banks and that the Board must be prepared to meet that problem.

During a discussion of Governor Robertson's suggestions, the other members were in general agreement with the views that he had expressed and as a first step in carrying some of his suggestions into effect the Board voted unanimously to authorize him to:

1. Explore with representatives of the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, and report back to the Board when
plans had reached a final blueprint stage, the feasibility of establishing a training school for new assistant examiners which, at least during an experimental period, would be located in Washington, the school to be sponsored by all three agencies. It would be understood that if this school proved to be successful, a graduate school would be added for men who had served as assistant examiners and had developed to a point where they could be considered for commissions as examiners.

2. Work out an arrangement under which all communications between the Board's Division of Examinations and the Federal Reserve Banks relating to bank supervisory or examining matters (including requests to obtain capital, change management, correct asset condition, etc.) be in writing, with ample leeway for use of telephone in exceptional cases. For the time being, in order to place a higher degree of responsibility on the Director and Assistant Directors of the Division, all such communications should be signed by one of them. No communication should be mailed without Governor Robertson's initials, until different arrangements with respect thereto are made by him. Communications should be routed through the Legal Division in all cases where there is any doubt as to a legal question being involved. Communications should be routed through the Secretary's Office if there is any question whether the position taken is in line with Board policy and the Secretary, or an Assistant Secretary, should determine whether such communication should be brought to the attention of all members of the Board, and as to whether there are any suggestions that should be made with regard to the proposed communication. A note setting forth the views of the Secretary's Office regarding these factors should be attached to the file before it is sent to Governor Robertson for his approval on behalf of the Board, or as the first Board member to see the communication on circulation. Communications involving broad policy questions or advising of formal action by the Board should be signed by the Secretary, or an Assistant Secretary.

3. Request the members of the Division of Examinations to be prepared to meet with members of the entire examining staffs of each of the Federal Reserve Banks at least once each year for the purpose of discussing any questions which they might wish to raise concerning, among other things
the policies of the Board of Governors, problem bank cases, new approaches to existing problems, and steps that might be adopted to improve the work of the System in the field of supervision and examination. It is contemplated that this program will not be launched until it has been discussed with the Presidents of the Federal Reserve Banks, but the Division should begin to prepare for it.

4. Take appropriate steps to have the Federal Reserve Banks promptly furnish the Division of Examinations with copies of all communications between them and member banks with respect to examination and supervisory problems and with analyses of all reports of examinations received by them from State authorities and from the Office of the Comptroller of the Currency so that the Board may have in its files an analysis sheet on each report of examination of each member bank received by a Federal Reserve Bank.

5. Establish in the Examination Department of each Federal Reserve Bank a uniform formula for rating member banks along the lines of the formula now in use by the Office of the Comptroller of the Currency in rating national banks (the largest portion of member banks). A copy of this formula is set forth below. The formula would be adopted as a matter of convenience to the Board in rating banks and the Federal Reserve Banks would be free to make their own ratings in such manner as they deemed appropriate.

**Composite or Group Rating**

**Rating No. 1**

Banks rated No. 1 should be sound institutions in every respect.

**Rating No. 2**

Banks rated No. 2 are those with (a) asset weaknesses ranging from relatively moderate to moderately severe, or (b) negligible asset problems but definitely undercapitalized, or (c) unsatisfactory managements, or (d) a modified combination of these and other weaknesses.

**Rating No. 3**

Banks should be rated No. 3 which have, in relation to capital pro-
tection, an immoderate volume of asset weaknesses which, in view of the (a) character of the asset problems, or (b) management deficiencies, or (c) economic conditions, or a combination of these and other points, could reasonably develop into a situation urgently requiring aid either from the shareholders or otherwise. Banks in this category require special attention.

Rating No. 4

Banks rated No. 4 are those confronted with asset weaknesses of a character and volume, in relation to capital protection and quality of management, urgently requiring aid from the shareholders or otherwise and whose failure, if such aid is not forthcoming, would appear to be probable. These are the serious or hazardous cases requiring constant supervisory attention.

Capital Position

Rating No. 1 or Roman Numeral No. I

Capitalization adequate in relation to
(a) volume of risk assets, and
(b) volume of marginal and inferior quality assets, and
(c) volume of deposits
(d) Points a, b, and c to be considered in relation to strength of management.

Capitalization will not be considered adequate unless in the judgment of the Vice President in Charge of Examinations it is adequate in relation to the above enumerated points. Consideration will, of course, be given to earnings retention capacity. Ratios are not the primary determinant of this rating. Judgment must be exercised in deciding whether capital-wise a bank comes within this category. Although some banks will be regarded as undercapitalized with better ratios, in general banks will be considered undercapitalized if their secondary risk asset ratios are (a) worse than $1. to $6., or (b) if their ratios of capital to deposits exceed $1. to $25. However, in any case where a bank has a higher ratio than $1. to $5, or $1. to $25., but the institution is nevertheless believed to be adequately capitalized and deserving of a number 1 rating, this judgment will be so indicated by using a Roman Numeral I.
Rating No. 2

Capitalization inadequate in relation to
(a) volume of risk assets, or
(b) volume of marginal and inferior quality assets, or
(c) volume of deposits
(d) Points a, b and c to be considered in relation to strength of management.

While adequate capitalization is based on adequacy in relation to points a, b and c, as a group, and the weighing of those three points in relation to management competency, capital inadequacy may exist because of the adverse relationship of the capital structure to any one of the first three points (a, b, or c), giving due weight to management as a possible mitigating factor, but not beyond a reasonable point. The least important factor is the relationship of capital to deposits unless extreme. The Federal Reserve Bank officials must exercise their own best judgment with reasonable emphasis on conservatism in determining capital adequacy or inadequacy for rating purposes. The exercise of judgment is required by the use of the Roman Numeral I for those banks considered adequately capitalized despite ratios that normally would be regarded as sufficiently adverse to warrant a 2 or inadequate capitalization rating.

Rating No. 3

Inadequate capitalization is worse than defined under No. 2 above and is regarded as hazardous. This normally will include all banks whose aggregate of classified assets is sufficient to impair the capital account.

Rating No. 4

Capital impaired by losses.

Quality of Assets

Rating A

Good. Ordinarily banks so classified will not have an aggregate total of (1) classified assets, plus (2) 50% of Other Loans Especially Mentioned, plus (3) unclassified speculative
bonds, stocks, and other real estate, that is in excess of 20% of the gross capital structure, and the character of the problems in such assets is not severe in the judgment of the Federal Reserve Bank officer making the rating. An aggregate total of such assets somewhat in excess of 20% of the gross capital structure will not preclude an A rating, provided the actual or potential seriousness of the problems in the assets concerned is regarded as relatively moderate. However, if the primary asset problems are regarded as severe, or if additional problems exist in large lines, bond concentrations, or a heavy investment in fixed assets, a less favorable rating should be used even though the aggregate total of primary asset problems is less than 20% of the gross capital structure.

Rating B

Fair. Instructions, and elasticity to exercise judgment through use of a more favorable or less favorable rating, are the same as noted under rating "A", except banks so classified ordinarily will not have an aggregate total of (1) classified assets, plus (2) 50% of other loans especially mentioned, plus (3) unclassified speculative bonds, stocks, and other real estate, that is in excess of 40% of the gross capital structure.

Rating C

Unsatisfactory. Instructions, and elasticity to exercise judgment through use of a more favorable or less favorable rating, are the same as noted under Rating A except banks so classified will not have an aggregate total of (1) classified assets, plus (2) 50% of other loans especially mentioned, plus (3) unclassified speculative bonds, stocks and other real estate, that is in excess of 80% of the gross capital structure.

Rating D

Hazardous. Any bank will be so classified when the total of (1) classified assets, plus (2) 50% of other loans especially mentioned, plus (3) unclassified speculative bonds, stocks, and other real estate, is in excess of 80% of the gross capital structure.
Management Rating

| S | Strong or Competent |
|   |                      |
| F | Fair                 |
| F | Poor, Incompetent, Integrity Questioned. |

It is desired that the Capital, Asset, Management ratings be entered at the bottom of Page D of the copy of each report of examination submitted to the Board of Governors by Vice Presidents in Charge of Examinations (initials opposite rating), as follows:

I - C - F (initials)

The Review Examiners in the Board's Division of Examinations will, in addition, show the composite or group rating and the ratios of capital to deposits, and to risk assets, primary and secondary, as follows:

\[
I - C - F
\]

\[
\frac{2}{12.6 - 7.2 - 6.4}
\]

6. Arrange for the inclusion in the confidential section of each report of examination of a State member bank, of a new sheet which would call for information along the lines of the following:

Name of Bank

ESTIMATED VALUE NON-LEDGER ASSETS

| Tax Reserve for bad debts (Net) | $.................. |
| Unallocated charge-off (Loans) | $.................. |
| Unallocated charge-off (Bonds) | $.................. |

*Since unallocated charge-off is reflected in the total market appreciation, it should be deducted from same when determining net bond appreciation to avoid duplication.*
Net Bond Appreciation
Other Real Estate
Other (Explain fully)

Total

CAPITAL RATIO

The ratio of adjusted capital structure to deposits is 1 to

RISK ASSETS RATIO

PRIMARY COMPUTATION

The ratio of adjusted capital structure to risk assets (assets other than cash, due from banks and U. S. Government bonds) is 1 to

SECONDARY COMPUTATION (To be completed in all cases where primary ratio is 1 to 6 or more; in other cases when examiner deems it advisable.)

The ratio of adjusted capital structure to risk assets (after deducting from total assets items listed below) is 1 to

TOTAL ASSETS

Cash and Sight Exchange
U. S. Government Bonds
Federal Corporation Bonds
Loans secured by U. S. Government bonds--portion covered
Commodity Credit Corporation Loans
Loans in which R.F.C. participates--guaranteed portion
Other loans made under Exception 10
Loans insured under Titles II and VI of the National Housing Act
G.I. Loans--guaranteed portion

$
Federal Reserve Bank Stock

Risk Assets

Examiner to include any other assets which he considers to be liquid and coming within the category of riskless assets, with suitable explanation.

The following additional actions were taken by the Board:

Minutes of actions taken by the Board of Governors of the Federal Reserve System on May 1, 1952, were approved unanimously.

Telegrams to the Federal Reserve Banks of Boston, New York, Philadelphia, Chicago, Kansas City, and San Francisco stating that the Board approves the establishment without change by the Federal Reserve Bank of Boston on April 28, by the Federal Reserve Bank of San Francisco on April 29, by the Federal Reserve Banks of New York, Philadelphia, and Chicago on May 1, and by the Federal Reserve Bank of Kansas City on May 2, 1952, of the rates of discount and purchase in their existing schedules.

Approved unanimously.

Memorandum dated April 25, 1952, from Mr. Young, Director, Division of Research and Statistics, recommending that the resignation of Lois I. Steidel, Clerk in that Division, be accepted to be effective in accordance with her request at the close of business April 25, 1952.

Approved unanimously.
Letter to Mr. Latham, Vice President, Federal Reserve Bank of Boston, reading as follows:

"In accordance with the request contained in your letter of April 28, 1952, the Board approves the appointment of William Carleton Butler as an assistant examiner for the Federal Reserve Bank of Boston. Please advise us of the date upon which the appointment becomes effective."

Approved unanimously.

Letter to the Board of Directors, Rushville State Bank, Rushville, Illinois, reading as follows:

"In a letter dated April 29, 1952, Vice President Diercks of the Federal Reserve Bank of Chicago transmitted the request of the Rushville State Bank for permission to assume the deposit liabilities of the Camden State Bank, Camden, Illinois, under the terms of a contract prepared for that purpose by the Federal Deposit Insurance Corporation, a party at interest.

The Board of Governors hereby gives its written consent pursuant to Section 18(c) of the Federal Deposit Insurance Act for the Rushville State Bank to assume the deposit liabilities of the Camden State Bank without the capital and surplus of the continuing institution being increased to an amount equal to the aggregate capital and aggregate surplus of the two banks involved. It is understood, however, the Rushville State Bank will increase its capital stock to not less than $100,000 at the time of its annual shareholders' meeting in December 1952. It is also understood that the transaction has the approval of the Auditor of Public Accounts for the State of Illinois and the Federal Deposit Insurance Corporation."

Approved unanimously, for transmittal through the Federal Reserve Bank of Chicago.
Letter to Mr. Olson, Vice President, Federal Reserve Bank of Chicago, reading as follows:

"Receipt is acknowledged of your letter of April 17, 1952, concerning the Packard Des Moines Co., Inc., Des Moines, Iowa, a registrant under Regulation W, recommending that the Board take no action concerning violations reported by your investigators.

"The Board concurs in this recommendation."

Approved unanimously.

Letter to Mr. Everson, Assistant Vice President, Federal Reserve Bank of San Francisco, reading as follows:

"This is in response to your letter of April 23, 1952, with which you enclosed a copy of a letter from the Confederated Tribes of Umatilla Reservation, Pendleton, Oregon, in which you raise the question as to whether the Confederated Tribes should be required to file registration statements under Regulations W and X.

"The Board is of the opinion that since the loan program of the Confederated Tribes is subject to regulations of the Secretary of the Interior, the program is entitled to exemption under section 7(e)(3) of Regulation W, provided, of course, that no loans are made except under that program. A person need not register as required under section 2(b) of the regulation if every extension of consumer credit made by him is exempt from the provisions of the regulation by section 7. (W-17; 1948 Bulletin 1470: W-97; 1950 Bulletin 1614)

"However, if the Tribes are to engage in extending real estate credit whether or not such credit is exempted under Regulation X, the Tribes are required to file registration statements."

Approved unanimously.

Letter to Mr. Everson, Assistant Vice President, Federal Reserve Bank of San Francisco, reading as follows:
"This is in response to your letter of April 25, 1952 in which you raise a question as to the application of Regulation Y to the following situation.

A real estate broker who has arranged a sale agrees to accept all or part of his commission in the form of a note in his favor executed by the seller. The question is whether in these circumstances the credit extended by the broker to the seller is 'real estate credit' and also 'real estate construction credit' as defined in section 2(e) of the regulation.

The Board is of the view that in such a case, where no credit is extended by the broker to the purchaser and where the fee charged by the broker is the customary and usual fee for arranging residential sales, the credit extended by the broker to the seller is not 'real estate credit' or 'real estate construction credit'."

Approved unanimously.

[Signature]

Secretary.