

Minutes of actions taken by the Board of Governors of the Federal Reserve System on Tuesday, July 8, 1952. The Board met in the Board Room at 10:00 a.m.

PRESENT: Mr. Martin, Chairman  
Mr. Szymczak  
Mr. Mills

Mr. Carpenter, Secretary  
Mr. Kenyon, Assistant Secretary

Governor Vardaman advised the Secretary of the Board before this meeting that he would be unable to attend because of illness.

There were presented three letters, each addressed to Mr. Roger W. Jones, Assistant Director, Legislative Reference, Bureau of the Budget, Washington, D. C., prepared in response to the Bureau's request of July 3, 1952, for the views of the Board with respect to enrolled bills awaiting the signature of the President.

It being understood that the views set forth in the letters reflected no change from the views previously expressed by the Board with respect to the legislative proposals concerned, the letters were approved unanimously, as follows:

"This is in response to your request of July 3, 1952, for the views of the Board on the enrolled bill S. 2252 'To clarify the act of August 17, 1950, providing for the conversion of national banks into and their merger and consolidation with State banks.' The proposed bill would permit the conversion of a national bank into a State bank if the limitations or conditions of the State law are no more restrictive than those contained in section 2 of the act of August 17, 1950, with respect to the conversion of a national bank into a State bank under State charter.

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"The Board reported by letter dated August 7, 1951, a copy of which is attached for your ready reference, to the Bureau of the Budget on an identical proposal which had been submitted by the Treasury Department.

"For the reasons stated in the report referred to above, the Board has no objection to the approval of this bill."

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"This is in response to your request of July 3, 1952 for the views of the Board on the enrolled bill S. 2128 'To provide for the merger of two or more national banking associations and for the merger of State banks with national banking associations, and for other purposes'.

"The Board reported by letter dated July 26, 1951 to the Bureau of the Budget on this proposal which had been submitted by the Treasury Department. As stated in the Board's report at that time, this legislation would permit the merger of national banks with other national banks and of State banks with national banks under Federal charter without a right in dissenting stockholders of the absorbing bank to demand cash payment for their shares.

"The need for this legislation arises from the fact that there is presently a disadvantage, insofar as national banks are concerned, to consolidating under authority of Federal law as compared with consolidating under authority of certain State laws. This disadvantage results from the fact that in order to effect a consolidation or merger under certain State laws, it is not required that a cash payment be made for shares held by the dissenting stockholders of the absorbing bank. Such payment, however, is required under Federal law in the case of a consolidation of a State bank with a national bank under the charter of the national bank.

"For these reasons the Board has no objection to the approval of this bill."

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"This is in response to your request of July 3, 1952 for the views of the Board on the enrolled bill S. 2938 'To amend section 9 of the Federal Reserve Act, as amended, and

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" section 5155 of the Revised Statutes, as amended, and for other purposes.'

"The Board recommended the legislation provided by this bill to the Banking and Currency Committees of the Senate and House by letters dated March 18, 1952 which stated in part as follows:

"The primary purpose of the proposed legislation is to remove unnecessary obstacles to membership by State banks in the Federal Reserve System by eliminating certain arbitrary statutory requirements with respect to the capital stock required for the admission of State banks to membership and for the establishment and operation of domestic branches by member banks.

"In no sense would the proposed legislation impair the adequacy of the capital structure of member banks. With respect to membership of State banks in the System, the bill would merely repeal certain specific capital requirements now stated in the law which are based on population and are wholly unrelated to the capital needs of individual institutions but which prevent sound banks in many instances from becoming members of the System. As to the establishment of branches, the bill would repeal an equally unnecessary requirement as to capital which is more stringent than requirements of many State laws for the establishment of branches by State banks and which has, therefore, closed the door to membership of such banks in some instances or has caused member banks to withdraw from the System in order to establish out-of-town branches. Repeal of these unnecessary requirements of present law would not in any way jeopardize the condition of member banks. Adequate capital would continue to be required for insurance of deposits as well as for membership in the System.'

"Prior to requesting the Committees to consider the proposal, it was considered by the Bureau of the Budget as explained in a letter dated March 18, 1952 from the Board to the Director of the Bureau of the Budget, a copy of which is enclosed for your convenient reference.

"The Board feels strongly that this legislation is desirable and recommends that it be approved by the President."

Reference was then made to the joint statement prepared by an ad hoc committee of representatives of Federal and State bank supervisory agencies,

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on which Mr. Powell had served as the representative of the Board, relating to the supervisory practices of the several agencies in fields of mutual responsibility. Copies of this statement had been sent to the members of the Board on July 3, 1952, for their information prior to consideration at a meeting of the Board.

Reviewing developments in this connection, Governor Mills stated that on June 30 Mr. Leete, Secretary of the National Association of Supervisors of State Banks, advised Mr. Powell by telephone that the Executive Committee of the Association had ratified the statement. He said that Mr. Powell so advised Chairman Martin by memorandum of the same date in which he stated that he had transmitted copies of the final draft of the statement to Messrs. Delano, Comptroller of the Currency, Harl, Chairman of the Federal Deposit Insurance Corporation, and Lyon, President of the National Association of Supervisors of State Banks, with the suggestion that they exchange letters among themselves indicating the approval of the statement by their respective organizations. Governor Mills went on to say that Mr. Delano called on the telephone on July 2 to ask whether the Board had given its approval to the statement and that he responded by saying that the Board probably would wish to send copies to the Federal Reserve Banks to ascertain whether there were any major objections to the language, but that in his opinion, unless the Reserve Banks voiced some objection, the approval of



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the Board could be anticipated, particularly because of the participation of Mr. Powell in the work of the ad hoc committee and the fact that Governor Robertson had approved the statement. He said Mr. Harl telephoned later to ask for ten copies of the statement and these were sent to his office, following which Director Cook, of the Corporation, called to ask if the form of statement which had been transmitted in response to Mr. Harl's request was identical to that previously approved by the ad hoc committee and was assured that the two statements were identical.

Knowing that Mr. Powell was anxious to have the joint statement formally approved by the respective agencies at as early a date as possible, Governor Mills had asked members of the staff to draft a letter to the Presidents of all Federal Reserve Banks requesting their comments on the statement by telegram not later than Friday, July 11. However, there appeared in the Congressional Record for Saturday, July 5, the text of the joint statement, together with the text of a transmittal letter from Mr. Harl to Senator Maybank, Chairman of the Banking and Currency Committee, indicating that the statement had received the approval of the participating bank supervisory agencies.

Governor Mills said that Mr. Harl apparently had taken this action without consulting any of the other parties concerned. He presumed that inasmuch as the work of the ad hoc committee had its genesis in a request made by the Banking and Currency Committee last fall at the time of the

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hearings regarding the confirmation of Messrs. Harl and Cook to be directors of the Federal Deposit Insurance Corporation, Mr. Harl desired to furnish the statement to Senator Maybank before the end of the current session of Congress.

There followed a discussion of the circumstances which led to the preparation of the joint statement and of the reasons which might have impelled Mr. Harl to send the statement to Senator Maybank before it had been formally approved by the other Federal bank supervisory agencies concerned, at the conclusion of which Governor Mills said that he considered the statement to be in satisfactory form and pointed out that it contained provision for the establishment of a standing committee consisting of one representative of each of the four supervisory agencies which would be required to meet at least twice each year in Washington. He suggested that if the Reserve Banks found the statement to be objectionable in any respect, their objections could be referred to the standing committee. Governor Mills also pointed out that if the President should sign the enrolled bill S.2938, relating to capital requirements for membership in the Federal Reserve System and for the establishment of branches by State member banks, certain portions of the joint statement would have to be revised but that this could be done by the standing committee.

Thereupon, unanimous approval was given to the joint statement, and to the statement of procedure to supplement the joint statement, in the following form:

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"JOINT STATEMENT OF THE  
EXECUTIVE COMMITTEE OF THE NATIONAL ASSOCIATION OF SUPERVISORS OF STATE BANKS,  
THE FEDERAL DEPOSIT INSURANCE CORPORATION, THE COMPTROLLER OF THE CURRENCY,  
AND THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM.

The Executive Committee of the National Association of Supervisors of State Banks and the Federal Deposit Insurance Corporation have considered, through joint conferences, matters of mutual interest touching upon bank capitalization, meetings of bank examiners with boards of directors, problem banks, and internal audit and controls of banking institutions. While the matters which gave rise to these conferences concerned only the Supervisors of State Banks and the Federal Deposit Insurance Corporation, the Comptroller of the Currency and the Federal Reserve Board were invited and participated in the discussions and lent valuable advice and counsel during the conferences and join in the understandings reached as a matter of desirable public policy.

In preparing this statement with respect to the coordination of the practices of the several agencies in fields of mutual or joint responsibility, it is intended, of course, that each agency will fully carry out the duties and responsibilities vested in it by statute, and all the agencies mutually recognize the statutory prerogatives of the others.

State banking authorities have the sole right to charter State banks, the right to authorize or deny branches of such banks if permitted by State law. Federal Deposit Insurance Corporation, in the case of nonmember insured State banks, must give its prior approval to the establishment and operation of any new branch of such banks, and in the case of out-of-town branches of State member banks, the Board of Governors must authorize any new branch of such banks. State banking authorities have the primary power over State banks as to solvency, capital adequacy, and sound management, including disciplinary action. State authorities also have the final sanction of revocation of State bank charters. State banking authorities recognize the protection and benefits derived from Federal Deposit Insurance Corporation insurance and Federal Reserve membership and will conduct their supervisory powers with a view to minimizing the insurance risks of the Federal Deposit Insurance Corporation and maximizing the ability of those State banks which are Federal Reserve members to take advantage of their Federal Reserve membership.

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"The Comptroller of the Currency has the sole charter power over national banks, the sole right to authorize or deny branches of such banks if permitted by State law, and the primary power over national banks as to solvency and sound management, including disciplinary action. In case of deliberate violation of law by a national bank, suit may be brought in the name of the Comptroller of the Currency for the forfeiture of the bank's charter. He has special and additional concern for adequate capitalization and sound management due to the obligations of his office to the Federal Deposit Insurance Corporation and the Federal Reserve System which agencies are automatically involved when a national bank is chartered and which normally do not examine or exert disciplinary action over national banks.

The Federal Deposit Insurance Corporation has the sole responsibility for granting to or withholding deposit insurance from nonmember State banks and of withdrawing insurance protection from insured banks. Normally, the Federal Deposit Insurance Corporation examines only insured State nonmember banks and normally it exerts influence toward adequate bank capitalization and sound management of such banks through State banking departments in the interest of protecting depositors and reducing the loss exposure of the Federal Deposit Insurance Corporation.

The Board of Governors of the Federal Reserve System has the sole power to grant to or to withhold Federal Reserve membership from State banks and to withdraw membership privileges from State banks. Federal Reserve authorities normally examine only State member banks and normally exert influence towards adequate capitalization and sound management of such banks through State banking departments in the interest of maintaining a sound credit structure and maximizing the ability of State member banks to use their membership privileges. They recognize a special and additional concern as to adequate capitalization and sound management of State member banks due to their obligation to the Federal Deposit Insurance Corporation which agency is automatically involved by the granting of Federal Reserve membership to a State bank and which normally does not examine or exert disciplinary action over State member banks.

In the case of problem banks, it should be the objective of the agencies directly concerned to achieve and maintain close



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"liaison in working out solutions of the problems. Periodic consultations should be held to lay plans for such disciplinary or corrective action as may be necessary. It would be expected that the State supervisory authority would take the lead in carrying out the appropriate disciplinary or corrective policies where State-chartered institutions are concerned, although the Federal agency involved would retain its right to act independently if circumstances warranted.

As to new banks, the State banking authority has the power to charter any new State bank which has capital funds sufficient to meet requirements of State law and the commissioner's judgment as to adequacy, likewise, in such circumstances, to authorize any new branch of a State bank when permitted by State law. Federal Deposit Insurance Corporation, in the case of nonmember insured State banks, must give its prior approval to the establishment and operation of any new branch of such banks, and, in the case of out-of-town branches of State member banks, the Board of Governors must authorize any new branch of such banks. The Comptroller of the Currency has the power to charter any national bank which has capital funds sufficient to meet the requirements of the National Bank Act and the Comptroller's judgment; also, in such circumstances, to authorize any national bank branch if permitted by State law. Before approving the application of a State nonmember bank for deposit insurance, the Board of Directors of the Federal Deposit Insurance Corporation is required by statute to give consideration to the adequacy of the bank's capital structure as well as to the other factors specified in the law. The Federal Reserve authorities have the power to admit any newly chartered State bank to membership if it has minimum capital funds required by the National Bank Act or they can refuse to admit to membership a newly chartered bank whose capital funds seem inadequate in their judgment. There should be consultation between appropriate Federal and State authorities if the prospective bank is to have a State charter and is to become an insured bank or a member of the Federal Reserve System and between all Federal authorities if the bank is to have a national charter.

In determining the adequacy of capital of new institutions the agencies should use at least a three-year projection

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"of the probable amount of deposits and should take into account other factors, such as type of community, overbanking, ability to generate earnings sufficient to provide adequate compensation for good management and the accumulation of additional capital funds for future growth, risk asset ratio, etc., as well as any other factors required by law.

We believe that much good can come from consultations between supervisory agencies on matters of mutual interest. To better provide for such consultations, it is agreed that a standing committee, consisting of one official representative of each of the four supervisory entities referred to in the first paragraph of this statement, shall be organized and that this committee shall hold at least two meetings a year in Washington, D. C.

We acknowledge also the benefits that may often flow from conferences between bank managements and bank examiners or other agency officials. Where these conferences are sought by institutions at the conclusion of examinations or at other times, their requests should be readily granted.

The primary responsibility for calling disciplinary conferences with problem institutions rests with the supervisory agency primarily responsible for solvency and sound management, that is, the Comptroller of the Currency or the State banking department. Where the problem bank is a State member bank or a nonmember insured State bank, the appropriate Federal agency may call a disciplinary meeting, if the State banking authority does not call such a meeting.

Boards of directors of banks should be encouraged through the examination procedure to interest themselves in the adequate audit and internal control of their institutions. Boards of directors of banks too small to maintain competent internal audit staffs should be encouraged to employ qualified outside auditors for periodic inspection of their banks' affairs.

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#### PROCEDURES TO IMPLEMENT THE JOINT STATEMENT.

1. Circumstances under which examiners or supervisors hold meetings with boards of directors of banks.

1(a) Whenever a board of directors or a group of directors requests a meeting with the bank examiners at the

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"close of an examination, the requests should be granted.

1(b) The supervisory agencies may well consider encouraging boards of directors to take advantage of visits by examiners to obtain the first-hand views of the examiner as to the condition of their bank. Much valuable information can be gained from an informal discussion during which the examiner would have an opportunity to bring to bear his broad experience in the examination of banks of many kinds in a way which he would not feel free to do in a formal examination report.

2. In the case of problem State banks, it should be an objective of the agencies to achieve even closer liaison between the State banking supervisor and the appropriate Federal agency in working out solutions of the problems. A problem bank may be in that category for a variety of causes, such as management deficiencies, weak assets, insufficient capital funds, lack of adequate internal audit controls, etc.

The State agency and the appropriate Federal agency should compare their lists of problem banks and the reasons why the banks are on the problem list. It would be hoped that the thinking of the State and Federal agencies would be alike in the great majority of cases although each agency would retain its independence of judgment where there might be differences of opinion.

The State agency and the appropriate Federal agency would discuss the desirable steps to be taken to correct the problem situation. It would be expected that the State supervisory authority would take the lead in disciplinary or corrective action although the Federal agency involved would retain its right to act independently if circumstances warranted.

3. In problem banks a decision as to whether a disciplinary conference should be held is usually made after the examination report is filed. For problem State banks the decision as to where the conference is to be held would normally be made by the State bank supervisor. Normally, the Federal Reserve Bank or the Federal Deposit Insurance Corporation would be invited to have a representative at such disciplinary conference, depending on whether the bank is a State member bank or a nonmember insured State bank. The appropriate Federal agency has the power to call a disciplinary meeting at a place which it may decide, if the State banking authority does not call such a meeting for a problem bank. In such a case the State authority would be invited to participate.

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"4. In unusual circumstances, where an immediate conference is needed with a board of directors of a State bank, the State bank examiner would normally take the initiative. If the State bank examiner declines to do so, the appropriate Federal examiner is free to call such a meeting, in which case he would notify his district chief and the State bank supervisor's office.

II. Methods of providing adequate bank capital funds.

A. In the case of a new bank--

1. There should be consultation between appropriate Federal and State authorities if the prospective bank is to have a State charter and is to become an insured bank or a member of the Federal Reserve System and between all Federal authorities if the bank is to have a national charter.

2. In determining the adequacy of capital of new institutions the agencies should use at least a three-year projection of the probable amount of deposits and should take into account other factors, such as type of community, overbanking, ability to generate earnings sufficient to provide adequate compensation for good management and the accumulation of additional capital funds for future growth, risk-asset ratio, etc., as well as any other factors required by law.

3. The State banking authority has the power to charter any State bank which has capital funds sufficient to meet requirements of State law and the commissioner's judgment as to adequacy.

4. Before approving the application of a State nonmember bank for deposit insurance, the Board of Directors of the Federal Deposit Insurance Corporation is required by statute to give consideration to the adequacy of the bank's capital structure as well as to the other factors specified in the law.

5. The Federal Reserve authorities have the power to admit any newly chartered State bank to membership if it has the minimum capital funds required by the National Bank Act or they can refuse to admit to membership a newly chartered bank whose capital funds seem inadequate in their judgment. Usually the Federal Reserve authorities agree with the Federal Deposit Insurance Corporation judgment as to minimum adequate capital funds, but in doubtful cases, they discuss the merits carefully with the Federal Deposit Insurance Corporation and act independently in unusual cases.



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"6. The Comptroller of the Currency has the power to charter any national bank which has capital funds sufficient to meet requirements of the National Bank Act and the Comptroller's judgment.

B. In the case of moderately under-capitalized banks--

1. The Comptroller of the Currency endeavors to obtain additional capital through the sale of new common stock, or to obtain correction through a reduction in the volume of those risk assets subject to the greatest degree of risk plus such correction as may be possible in the form of retained earnings.

2. For State banks the State bank supervisor would normally see to it that steps are taken to improve the protection afforded depositors either through special attention devoted to strengthening capital or through urging upon the institutions a lesser degree of risk taking in loans and investments.

C. In the case of problem banks due to insufficient capital funds--

1. In the case of a national bank, if the under-capitalized position cannot be corrected through use of the measures utilized in the case of moderately under-capitalized banks, the Comptroller of the Currency must weigh the risk inherent in a specific situation and determine whether a closer degree of supervision is required.

2. The State supervisor normally would take corrective action in the case of State banks but would welcome support from the appropriate Federal agency. Under such circumstances the Federal authority would act independently only in the event that its statutory responsibility is not fully discharged by the action of the State agency. In the latter case, the Federal agency would keep the State agency informed as to its recommendations and plan of action.

III. Methods of improving bank audit and control procedures.

1. An important part of the solution of obtaining better internal controls in banks is to achieve a greater understanding on the part of some directors and officers as to what are adequate methods. There is need for a long-range program on this score. The matter should be brought to the attention of bank directors and officers repeatedly and a good vehicle for such education is the examination report of the bank.

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"2. The board of directors of a bank can maintain better control of the bank's operation with a view to honesty, efficiency and accuracy if experienced outside auditors are occasionally employed to audit the balance sheet, systems and controls and preferably to verify loans, mortgages and deposits. It is not proposed that external audits be used as a substitute for internal auditing in banks which are large enough to maintain an audit staff but rather as a supplementary procedure for the more complete protection of the bank and its directors. For banks too small to have a regular audit staff, it is obvious that a periodic inspection by qualified outside auditors should be of great value. The cost of such outside audits for the typical small bank would seem a small annual figure to pay for providing this valuable additional measure of protection to the bank and its board of directors, and from the standpoint of increasing the efficiency of the bank's operations."

In connection with the foregoing action, unanimous approval was given to a letter to all Federal Reserve Banks reading as follows:

"An ad hoc committee of representatives of Federal and State bank supervisory agencies has been working on a joint statement relating to the supervisory practices of the several agencies in fields of mutual responsibility. The committee has submitted a draft of the statement for approval by the supervisory agencies and it has been approved by the other agencies. Five copies of the draft of statement are attached. In the event S. 2938, relating to capital requirements for membership in the System and for the establishment of branches by State member banks, is signed by the President, it is assumed that at the appropriate time the statement will be revised to conform to these new provisions of law.

"As you will realize, the draft is the result of painstaking negotiation over a considerable period of time. It had been the intention of the Board in approving the statement to seek the counsel of the Federal Reserve Banks as to their judgment and recommendations on its effects. Because of the pressure of time this guidance was to have been requested by wire communication. However, the statement (without the statement of procedures to implement the joint statement) was sent by

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"the Chairman of the Federal Deposit Insurance Corporation to the Chairman of the Senate Banking and Currency Committee before this action could be taken and as having been approved by the supervisory agencies. It was printed in the Congressional Record for Saturday, July 5. A copy of Chairman Harl's letter to Chairman Maybank is also attached.

"In the circumstances, the Board has approved the statement and it is being sent to you for the information and guidance of your Bank. Should you see any major defects in the joint statement in its present form, the Board would be pleased to have you bring them to the attention of the Board so that they may be given consideration by the standing committee referred to on page 5 of the statement."

Chairman Martin referred to a letter dated July 1, 1952, from Mr. Gilbert, President of the Federal Reserve Bank of Dallas, stating that the executive committee of his Bank had approved his acceptance of an invitation to attend the annual meetings of the Boards of Governors of the International Monetary Fund and the International Bank for Reconstruction and Development, to be held in Mexico City in September.

Following a brief discussion, during which it was stated that apparently invitations of the type sent to President Gilbert had been sent to the Presidents of all Federal Reserve Banks and that those who accepted would not attend as members of the official United States delegation, it was agreed that no objection should be interposed to the acceptance of the invitation by President Gilbert.

Governor Szymczak stated that one of the matters to be taken up during the meetings at Mexico City would be the proposed establishment of a Center for Latin American Monetary Studies and that this raised the question

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whether any member of the staff should accompany Chairman Martin to the meetings to participate in the discussions relating to this matter.

Chairman Martin said that a letter had been received from the Bank of Mexico inquiring whether the Federal Reserve System desired to take membership in the Center, that he was referring the matter to Governor Szymczak for recommendation to the Board, and that, following action by the Board on Governor Szymczak's recommendation, the necessity of sending a member of the staff to Mexico City for further discussions concerning the Center could be considered.

Before this meeting there had been circulated among the members of the Board a draft of letter to Mr. Joseph C. Duggan, Assistant Attorney General, Executive Adjudications Division, Department of Justice, Washington, D. C., reading as follows:

"This is in response to your letter of June 16, 1952, addressed to the Board's General Counsel, inquiring whether the Board has any proposals for State legislation which it desires to present through the Department of Justice and the Council of State Governments for consideration at 1953 sessions of the State legislatures.

"This matter has been given careful consideration and it has been concluded that there are no such proposals for State legislation which the Board would wish to submit for consideration at this time."

Following a discussion, the letter was approved unanimously.

Governor Szymczak referred to an informal suggestion at a previous meeting of the Board that consideration be given by the Board over the next



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several months to a legislative program which it might wish to present at the forthcoming session of Congress. He stated that in view of the recommendations contained in the recent report of the Patman Subcommittee it would appear especially appropriate and desirable to begin at this time a study of the proposals which the Board would like to see enacted.

Chairman Martin said that he concurred in this suggestion and there followed a discussion as to the best method by which such a program might be formulated. During the course of this discussion Mr. Vest, General Counsel, was called into the meeting.

Following a review by Mr. Vest of some of the legislation in which the Federal Reserve System would have a direct interest, during which he mentioned the possibility of incorporating various items in an omnibus bill, Chairman Martin suggested that as a first step Mr. Vest make a comprehensive review and submit to the Board a compilation of all of the legislative proposals which the Board might wish to submit for the consideration of Congress, with the thought that the Board would discuss the various items and determine the action to be taken with respect to them.

Chairman Martin's suggestion was approved unanimously.

  
Secretary.