January 3, 1923. X-3611

To: The Federal Reserve Board.

From: Mr. Wyatt - General Counsel.

Subject: Reserves against so-called "Special Savings Deposits".

A formal opinion has been requested on the question whether so-called "Special Savings Deposits" of certain State Member Banks in California can properly be classified as "savings accounts" in computing the reserves which such member banks are required to maintain under the terms of Section 19 of the Federal Reserve Act.

These so-called "special savings deposits" are represented by pass books and bear interest, and the banks receiving them expressly reserve the right to require thirty days' notice before withdrawal. Under the California law, as it has been construed by the State authorities, these accounts are also required to be segregated in separate savings departments the assets of which constitute trust funds for the protection of savings depositors; they can be invested only in a restricted class of securities and loaned only in a restricted manner; and they are subject to many other special safeguards not applicable to ordinary commercial deposits. It appears, however, that they do not represent the savings of persons of small means, but interest is paid only on amounts in excess of $500, and such deposits usually consist of surplus funds of persons of large means who wish to obtain interest upon them and at the same time enjoy the privilege of checking against them. Furthermore, they are normally subject to with-

drawal by check without the presentation of the pass books, and normally an unlimited number of checks can be drawn against them at the same time, although the bank reserves the right to require the presentation of the pass books. In practice, therefore, they are subject to check and constitute interest-bearing checking accounts.

Before they applied for membership in the Federal Reserve System, the California State banks raised the question whether they could treat such deposits as savings accounts in computing the reserves which they would be required to maintain under the terms of the Federal Reserve Act. At that time Mr. Perrin, the Board's local representative at San Francisco, took the position that such accounts should be treated as savings accounts and urged the Federal Reserve Board to adopt the same view. Apparently without obtaining an opinion from its Counsel as to whether this could be done legally, the Board addressed a circular letter to all Federal Reserve Agents under date of December 26, 1917, requesting their views as to whether it should amend its Regulation D so as to permit such deposits to be treated as savings accounts. The great majority of the Federal Reserve Agents opposed such an amendment to Regulation D on the ground that it would lead to abuse, and the Board refused to amend its Regulation. With full knowledge of this action, the California State banks applied for, and received, admission to membership in the Federal Reserve System.

According to a statement contained in the brief of Mr. Edward Elliott, representing the Security Trust and Savings Bank of Los Angeles,

however, all the California State Banks having such accounts have always carried reserves of only three per cent against them, and the practice ~~may~~ was first called into question in the autumn of 1921, following an examination by Federal Reserve Bank examiners of the Los Angeles Trust and Savings Bank. * * * Apparently, it was not called to the attention of the Board, however, until the spring of 1922, when it was brought to the attention of Messrs. Miller and Mitchell of the Federal Reserve Board by the Los Angeles Trust and Savings Bank, during the visit of those gentlemen to California in March and April.

At that time the question whether such deposits could be treated as savings accounts in computing reserves was again raised in a telegram addressed to the Board under date of April 15. Governor Harding replied under date of April 19 that such deposits could not be made subject to 3% reserves without an amendment to the Board's regulations and that the Board felt that such an amendment would lead to abuse and that it could not properly make a special regulation or exception applicable only to banks in California.

Several of the State Banks then requested a hearing, which was granted on June 14 and at which Mr. Edward Elliott, formerly of the Federal Reserve Bank of San Francisco, appeared as their representative, filed an elaborate brief together with one written by Mr. William G. McAdoo, formerly Secretary of the Treasury and ex-officio chairman of the Federal Reserve Board, and strongly urged the Board to permit only 3% reserves to

be carried against such accounts. Apparently, the Board took no action at that time but took the matter under advisement. The matter was discussed several times at Board meetings; several other informal conferences were had with Mr. Elliott; a report was requested and obtained from Mr. Perrin (in which he advocated the granting of the request of the State Banks); and finally, on December 6, the Board voted not to amend its Regulation D and that such deposits must be treated as demand deposits in computing reserves. In advising its agent, Mr. Perrin, of this action, the Board specifically advised him of its expectation that he would see that this ruling was strictly complied with.

It appears, however, that this ruling is not being complied with and that Mr. Perrin has requested a hearing at which he may appeal from the Board's ruling and again advocate the granting of the request of the California State Banks. Before deciding whether or not to grant this hearing, the Board desires a formal opinion on the question whether it can legally grant the request of the State banks and permit such deposits to be treated as savings accounts in computing reserves.

When this question was originally submitted to me I was unwilling to say dogmatically that the term "savings accounts" as used in Section 19 of the Federal Reserve Act could not be construed to include such deposits without making a thorough investigation of the subject. I did express serious doubts, however, as to the propriety of so construing the term "savings accounts". I have been giving the problem further study and deliberation for several months, and when Mr. Platt informed me that the

matter was again coming up for consideration I concentrated the efforts of this office on the problem and made a thorough investigation of the authorities, a careful analysis of the briefs submitted by Messrs. McAdoo and Elliott and of the report submitted by Mr. Perrin, and a painstaking study of the language, philosophy, history and underlying purpose of the law. On account of pressure of other work I was unable to render a written opinion on the subject at that time, but I advised Mr. Platt orally that such deposits could not properly be classified as "savings accounts" within the meaning of Section 19 of the Federal Reserve Act.

THE TERMS OF THE LAW.

In prescribing the amount of reserves to be maintained by member banks, Section 19 of the Federal Reserve Act makes a distinction between "time deposits" and "demand deposits"; and requires smaller reserves to be maintained against the former than against the latter. The first paragraph of that section defines "demand deposits" and "time deposits" as follows:

> "Demand deposits within the meaning of this Act shall comprise all deposits payable within thirty days, and time deposits shall comprise all deposits payable after thirty days, all <u>savings accounts</u> and certificates of deposit which are subject to not less than thirty days' notice before payment, and all postal savings deposits".

It will be noted that the term "time deposits" comprises:

(1) All deposits payable after thirty days.

(2) Savings accounts which are subject to not less than thirty days' notice before payment.

(3) Certificates of deposit which are subject to not less than thirty days' notice before payment, and

(4) Postal savings deposits.

The deposits under consideration are not "payable after thirty days"; because they are not payable on a definite date nor a specified number of days after date, nor only after thirty days' notice which is actually required. The mere fact that they are subject to not less than thirty days' notice before payment is not sufficient to make them deposits "payable after thirty days"; because the Act clearly makes a distinction between deposits payable after thirty days and those which are merely subject to thirty days' notice before payment. Mr. McAdoo admits this in his brief. It is obvious that they are neither certificates of deposit nor postal savings deposits.

If they are to be classified astime deposits, therefore, they must be brought within the term "Savings accounts"; and this discussion will be confined to the question whether they can properly be deemed to be included in that term.

THE BOARD'S REGULATIONS.

The Board's Regulation D, Series of 1920, defines "Savings Accounts", as follows:

> "The term 'Savings Accounts' shall be held to include those accounts of the bank in respect to which, by its printed regulations, accepted by the depositor at the time the account is opened -

(a) the pass book, certificate or other similar form of receipt must be presented to the bank whenever a deposit or withdrawal is made, and

(b) the depositor may at any time be required by the bank to give notice of an intended withdrawal not less than thirty days before a withdrawal is made."

The deposits in question comply with requirement (b), but they do not comply with requirement (a) because the pass books are not actually required to be presented whenever deposits or withdrawals are made. It has been argued on behalf of the California banks that requirement (a) is not essential to a proper definition of the term "savings accounts" as used in Section 19, and the Board has been urged to amend Regulation D so as to permit such deposits to be classified as "savings accounts". Even if requirement (a) could be eliminated or waived, however, it would not necessarily follow that these deposits can properly be considered "savings accounts" within the meaning of Section 19, because they differ in other respects from ordinary savings accounts.

The question to be determined, therefore, is whether, regardless of the provisions of the Board's regulations, such deposits can properly be deemed to be "savings accounts" within the meaning of the first paragraph of Section 19 of the Federal Reserve Act.

In attempting to answer this question it is necessary to observe two fundamental rules of statutory construction: (1) That the words used should be given their ordinary and commonly accepted meaning unless it appears that a different meaning was intended; and (2) that the stat-

ute should be construed in the light of its reason and purpose and in such a way as to carry out the intention of the legislature.

WHAT ARE "SAVINGS ACCOUNTS"?

The ordinary and commonly accepted meaning of any term is to be sought first of all in a general dictionary, but neither Webster's Unabridged Dictionary nor the Standard Dictionary defines the term "savings accounts". Likewise, in seeking for the meaning given by the legal authorities, it was found that neither the reported decisions nor the legal treatises contain any definition or direct discussion of the term "savings accounts".

There are many decisions dealing with the nature and operation of savings banks, however, which throw much light on this question. It is proper to assume that the savings accounts which Congress had in mind were the accounts commonly received as savings accounts by savings banks and by commercial banks and trust companies having savings departments. As such accounts originated with savings banks and were developed by them, a discussion of the nature and functions of savings banks is necessary to an understanding of the proper meaning of savings accounts.

In Corpus Juris (Vol. 7, p. 851) it is said that, "A savings bank is an institution * * * the purpose of which is to promote the prosperity of persons of small means and limited opportunities of investing them by receiving their savings in even trivial sums and lending them in larger amounts, whereby interest may be gained."

Savings banks "are banks established for the receipt of small sums deposited by the poorer class of persons for accumulations at interest." Bank for Savings v. Collector, 70 U. S. 495.

In Mercantile Bank v. N. Y., 121 U. S. 138, the Supreme Court of the United States said that savings banks "are what their name indicates, banks of deposit for the accumulation of small savings belonging to the industrious and thrifty."

In National Bank v. Boston, 125 U. S. 60, the Supreme Court said, "They are substantially institutions, under public management, in pursuance of a great and beneficial public policy, organized for the purpose of investing the savings of small depositors, and not as banking institutions in the commercial sense of that phrase."

The two cases cited are particularly valuable for the purpose of this discussion, because they contain such a forceful distinction between savings banks and commercial banks, which distinction is equally applicable between savings accounts and ordinary checking accounts in commercial banks. Both these cases were based upon an alleged discrimination in taxing national banks under Section 5219 of the Revised Statutes, one ground of the alleged discrimination in each case being that savings banks were not taxed at the same rate as national banks. The court held in each case that no discrimination could be predicated upon different rates of taxing national banks and savings banks, because of the great dissimilarity between such classes of banks. It can properly be said, therefore, that savings accounts are inherently different from commercial accounts, and it would seem

to follow that if certain accounts partake of the nature of commercial accounts, they cannot pass muster as savings accounts.

Another fact indicative of this characteristic of savings accounts is that a number of States limit by law the amount which may be received from any one savings depositor. Thus Massachusetts limits it to $2,000, excepting deposits from religious, charitable or similar corporations. (Gen. Laws, Chap. 168, Sec. 31); Connecticut limits the amount which may be received from a single depositor in any three years to $3,000 (Sec. 3981, Gen.Stat. of 1918); the laws of North Dakota provide that the directors may limit the amount received from any one depositor (Sec. 5196, Comp. Bk. Laws 1913); the Minnesota statute authorizes savings bank to receive "all sums of money offered for deposit in amounts * * * fixed by the by-laws, which shall in no case exceed five thousand dollars". (Gen. Stat. 1913, 6388); the Missouri statute limits the amount to $4,000with certain exceptions (R.S. 1909, Sec. 1154); and the Banking & Trust Co. laws of the State of Washington, (Sec. 143) limit the amount to $3,000. These are not all of the States whose laws contain such a limitation but they are sufficient to indicate that the usual or ordinary conception of a savings account does not include surplus funds of large corporations or firms, or of wealthy individuals, temporarily deposited at interest with the bank pending investment by the owner.

Other illustrations of this well established meaning are numerous and they need not be given here. Running through all these laws

and decisions is the basic idea that savings banks, and accounts carried by them, are essentially devoted to the small depositor, and that the primary purpose of savings banks is to receive, protect and increase the savings of persons of small means.

In 7 Corpus Juris, p. 867, it is said, "A very general rule of savings banks is that deposits will be paid only when the pass book of the depositor is presented with the order for payment", citing Mitchell v. Home Savings Bank, 38 Hun. (N.Y.) 255, and Rosenthal v. Dollar Savings Bank, 113 N. Y. S. 787.

And Morse in his work on Banks & Banking (5th Ed., Section 620 (b) says, "One of the commonest rules (of savings banks) is that the bank book must be produced in order to draw the deposit."

The laws of Georgia define a savings bank as one whose deposits are not subject to check. See Dottenheim v. Union Savings Bank, (Ga.) 40 S. E. 825.

In Whalen v. Milholland, (Md.) 43 Atl. 45, the court said that, "A savings bank book has a peculiar character. It is not a mere pass book or the statement of an account * * * * the book is the instrument by which alone the money can be obtained."

And in Jones v. Weakly, (Ala.) 12 So. 420, the court distinguished between savings pass books and commercial bank pass books and held that a commercial account could not be transferred by the transfer of the pass book, because "the money could be withdrawn from the bank, not by

production of the pass book, but on the check of the depositor." The necessary implication of this holding is that a savings account may be transferred by a transfer of the pass book, because such an account is not subject to check, and this is recognized generally by the courts.

It is believed, therefore, that the term "savings accounts" as it is commonly understood means generally accounts consisting of the savings or accumulations of small depositors which bear interest, are represented by pass books, and are not subject to check but can be withdrawn only upon the presentation of the pass book. Furthermore, it is believed that Congress had this concept in mind when it used that term in Section 19 of the Federal Reserve Act.

SUCH DEPOSITS NOT "SAVINGS ACCOUNTS."

It is understood that these so-called "special savings deposits" are received in unlimited amounts and do not consist of the accumulations or savings of persons of small means but are surplus funds of wealthy persons carried in the bank as a temporary form of investment. These accounts are popular with such people because they bear interest and are not subject to the inconvenience of ordinary savings accounts in that withdrawals may be made by check and without presentation of the pass book. It is understood also that they appeal exclusively to large depositors because no interest is paid on balances of less than $500, which is entirely inconsistent with the idea of savings accounts but is a very common characteristic of interest-bearing checking accounts against which most

banks maintain 10% reserves without question.

It is quite clear from a consideration of these general characteristics that such accounts are not savings accounts within the commonly accepted meaning of that term but are rather specially privileged checking accounts; and the Board might well refuse to recognize them as savings accounts for this reason alone.

They are lacking in another and more important characteristic of savings accounts, however, which is believed to be an essential characteristic of "savings accounts" within the meaning of that term as used in Section 19 of the Federal Reserve Act, i.e., the bank does not require the presentation of the pass book at each withdrawal but in practice permits an unlimited number of checks to be drawn against them at any time. It has been shown above that the requirement that the pass book must be presented at each withdrawal is one of the distinguishing characteristics of savings accounts within the meaning of that term as it is commonly understood. A consideration of the reason why Congress permitted such accounts to be classified astime deposits for the purpose of computing reserves, even though they are "payable in less than thirty days", further demonstrates that this is an absolutely essential characteristic of "savings accounts" within the meaning of that term as used in Section 19.

THE REASON OF THE LAW.

When Congress enacted Section 19 of the Federal Reserve Act it was for the first time in the history of the reserve requirements of the

Federal law making a distinction between various classes of deposits and requiring less reserves to be maintained against one class than against another. This would be an unjustifiable discrimination if it did not bear some reasonable relation to the purpose of reserves.

It will be conceded that time deposits require a less reserve than demand deposits because by their very nature they are not subject to such large and frequent withdrawals, and the purpose of reserves is to put a bank in a position to meet withdrawals by its depositors. Ordinary savings accounts clearly have this characteristic of time deposits. They are, as we have seen above, savings of small depositors, put aside in small amounts from time to time to accumulate and remain intact so far as possible for emergency uses and for future investment and, therefore, normally have a great degree of stability. This inherent stability is further enhanced by mechanical devices designed to minimize the ease of withdrawals. The commonest of such devices is the requirement that no withdrawal can be made unless the withdrawal order is accompanied by the pass book. This requirement is so common as to be recognized as an essential characteristic of savings deposits. The laws of several States, including New York, make this requirement in regard to savings accounts, and, as pointed out above, it has been frequently held that the pass book so far represents the right to withdraw a savings account that a transfer of the pass book effects a transfer of the right to the account itself.

Furthermore, it is evidenced from an analysis of the statute that Congress had this very characteristic of savings accounts in mind when it

enacted Section 19. In the first paragraph of that Section, Congress made a clear distinction between accounts payable after thirty days, and those which are merely subject to thirty days' notice before payment. All deposits of the former class are classified as time deposits, while the only deposits of the latter class which are classified as time deposits are "savings accounts" and "certificates of deposit". If a deposit is by its terms payable after thirty days the bank will not be expected topay it before the specified date has arrived or the specified time has elapsed and is fully protected against withdrawals. Where a bank merely reserves the right to require thirty days' notice of the withdrawal of a deposit, however, it ordinarily permits withdrawals to be made without any notice and it usually is reluctant to require notice, because this displeases the depositor and may cause some unfavorable comment. Furthermore, it is probable that a bank in a "shaky" condition would not dare to exercise such right for fear of precipitating a run by its demand depositors. While the reservation of this right is probably intended to protect a bank against withdrawals, therefore, it is not always effective. In classifying only savings accounts and certificates of deposit as time deposits when they were merely subject to thirty days' notice before payment, therefore, Congress must have relied upon something inherent in the nature of such deposits to afford the bank some additional protection. One does not have to search long to find a common characteristic of these two classes of deposits which afford very effective protection against

frequent withdrawals - neither savings accounts norcertificates of deposit are ordinarily subject to check, and it is inconvenient to withdraw them because the certificate or pass book usually has to be presented at the time of each withdrawal.

It is thus seen that the requirement in the definition of savings accounts contained in the Board's Regulation D, that "the pass book, certificate, or other similar form of receipt must be presented to the bank whenever a * * * withdrawal is made", is not an arbitrary requirement, but is in entire accord with the accepted meaning of the term "savings accounts" and the considerations which led Congress to classifying such accounts as time deposits.

It is argued on behalf of the California banks that there is no magic in the presentation of the pass book whenever withdrawals are made, that this requirement is an unessential, a mere matter of procedure and has no relation to the amount of reserve which a bank should keep against such deposits. Magic does not enter into the question of what is a savings account, but clearly the requirement of presentation of the pass book has infinitely more importance than the mere name by which an account is called. The requirement that the pass book must be presented when withdrawals are made is a most effective means of preventing frequent withdrawals and thus preserving the inherently stable character of savings deposits; and because of this it does have a very real relation to proper reserve requirements. A provision that the pass book must be presented when withdrawals are made is a more important element in characterizing savings

accounts as time deposits than the provision that thirty days' notice of withdrawal may be required, because even if such notice is not required, - and as a practical matter it rarely is - the presentation of the pass book at each withdrawal protects the accounts from too frequent withdrawals and prevents it from degenerating from a savings account into a checking account.

An account which may be withdrawn without presentation of the pass book and is subject to be checked against, is not, for that very reason, properly a savings account. As we have seen, a savings account is intended as a means of gradual accumulation of savings. It is a capital account and properly is subject to withdrawal only when the occasion justifies an expenditure from capital account. An account which is subject to check, however, is intended to be a liquid fund, from which the depositor's current and ordinary expenses may be met - the checking privilege in itself makes the account essentially adapted to this purpose and is the one outstanding distinction between a savings account and an ordinary checking account. It would be as reasonable to say that a checking account may not be withdrawn except upon presentation of the pass book as to say that a savings account is subject to check. The idea of checking is utterly repugnant to the idea of a savings account, and the two cannot exist together.

While the State Banks argue at some length that these accounts are relatively inactive and say that they carefully prevent them from be-

ing used as commercial accounts, there is some testimony to the contrary. Thus, one of the replies to a circular letter which Mr. Perrin sent to a number of prominent bankers in California requesting their views with reference to these so-called "special savings deposits" contains the following statement:

> "Of course, you and I know, as a matter of fact that depositors who carry these special savings accounts check on them just the same as a commercial account, and they are in fact, in many cases, business accounts where the depositor does not require lending facilities and expects to check on them freely at all times. I doubt whether many of the depositors of these accounts really understand that they are subject to a notice. It is certain that if one were required at any time it would undoubtedly create a great deal of trouble for the bank which might demand such notice."

The representatives of the State Banks argue that there is no difference between their special savings accounts and their ordinary savings accounts, except that in the case of the former, the requirement that the pass book must be presented is waived. In my opinion, that one difference is fundamental and is alone sufficient to preclude these special savings accounts from being classified as time deposits within the meaning of Section 19 of the Federal Reserve Act. I am unable to reach any conclusion in this matter except that these so-called "special savings deposits" are essentially checking accounts and should be considered as demand deposits for the purpose of computing the reserves to be maintained under Section 19 of the Federal Reserve Act.

ARGUMENTS ON BEHALF OF CALIFORNIA STATE BANKS.

Most of the arguments advanced on behalf of the California State banks may be divided into three classes:

(1) Those based purely upon considerations of policy and which are designed to show why such accounts are morally entitled to be classified as savings accounts for the purpose of computing reserves. These arguments have no direct bearing on the legal question whether or not such accounts can properly be considered "savings accounts" under existing law and they need not be answered here. It is the function of Congress rather than the Board to pass on the question of policy whether or not the law should be amended so as to permit such deposits to be classified as savings accounts.

(2) Those arguments based upon the allegation that such deposits are treated as savings deposits by the State law and by the State banking authorities. This also has no bearing on the question whether such accounts are "savings accounts" within the meaning of Section 19 of the Federal Reserve Act. Otherwise, the California Legislature could in effect amend Section 19 of the Federal Reserve Act by declaring anything it chose to be savings accounts. Thus, it could provide that ordinary commercial checking accounts should be considered savings accounts if they are invested in a certain way, are received from red-headed men, or comply with some other whim of the State Legislature.

(3) Those which are based upon the fact that savings deposits in California State banks are subject to certain safeguards which the California law throws about savings deposits, and, therefore, are safer than ordinary checking accounts. Such safeguards consist principally of restrictions on the kinds of loans and investments that may be made by savings banks and on the power of such banks to borrow money and rediscount paper. This argument has more force, because such protection is a fairly common attribute of savings deposits generally and, therefore, might be considered a proper element of a definition of the term "savings accounts". This feature, however, has no reasonable relation to the theory on which Congress made a distinction between the reserves which should be carried against time deposits and those which should be carried against demand deposits. This distinction was not based on the theory that time deposits are safer than demand deposits but on the theory that time deposits are subject to less frequent withdrawals than demand deposits. Congress did not have in mind the safe investment of time deposits but rather the ability of a bank to meet the demand of its depositors.

Furthermore, these special safeguards which are applicable to savings accounts in California state banks did not constitute one of the characteristics of the class of savings accounts that Congress had most prominently in mind when it enacted Section 19 of the

Federal Reserve Act. This appears very clearly from a consideration of the history of the enactment of that provision. The first paragraph of that Section, which defines time and demand deposits, was contained in the Federal Reserve Act as originally enacted December 23, 1913, and has never been amended. At the time of the enactment of the Federal Reserve Act it was certain that all national banks in the continental United States would become members of the Federal Reserve System, because they were required to do so; but it was uncertain whether any State banks would become members. Furthermore, the reserve requirements of Section 19 of the Federal Reserve Act superseded the previously existing reserve requirements of the National Bank Act which were the only reserve requirements applicable to national banks; while State banks, on the other hand, were subject to reserve requirements of the State laws which were not superseded by the provisions of Section 19 but remained in full force and effect until amended by the State legislatures. It is clear, therefore, that the class of banks which Congress had most prominently in mind when it enacted Section 19 of the Federal Reserve Act and which were to be most surely and most seriously affected by the provisions of that Section were national banks. But savings deposits in national banks are not restricted as to investment in any way different from any other deposits of the national banks nor are they required to be segregated in separate departments and held as a trust fund for

savings depositors. Nor have they any of the other peculiar characteristics pertaining to savings accounts in California State banks upon which the representatives of the State banks lay such great stress. It is obvious, therefore, that such safeguards and restrictions are not the distinguishing characteristics of the kind of "savings accounts" which Congress had most prominently in mind when it enacted Section 19 of the Federal Reserve Act.

I do not deny that Congress also had in mind State banks and trust companies with savings departments, but it can hardly be doubted that it had national banks most prominently in mind and intended to use language applicable to them as well as to State institutions.

Mr. Elliott's brief contains the surprising statement that, "This discussion cannot be based upon the conditions surrounding 'savings accounts' in any other State or upon the general character of such deposits elsewhere, but must be predicated solely upon an understanding of the distinctive character of 'savings deposits' under the California Bank Act." In this Mr. Elliott is manifestly wrong. The question at issue depends, not upon any interpretation of the California Bank Act, but upon the proper interpretation of term "savings accounts" as used in the Federal Reserve Act. When it enacted the Federal Reserve Act Congress was not legislating for California alone but for the whole United States, and when it used the term "savings accounts"

it did not have in mind any unique kind of accounts in California or any other single State but a broad class of accounts which are commonly known as savings accounts all over the country. This is too obvious to require any further argument.

Much stress is laid on the fact that the California Act provides that whenever there is a call by savings depositors for repayment of a greater amount than the bank may have disposable for that purpose, the directors or other officers of the bank must not make any new loan or investment of the funds of such depositors or of the earnings thereof until such excess of call has ceased. For the reasons set forth above, it is not believed that this unique provision of the California law has any real bearing on the question at issue. Furthermore, this provision would seem quite superfluous. It is nothing more than a common-sense rule which any banker in his right mind would observe in the absence of a statute requiring him to do so. It amounts merely to saying that a savings department should not tie up any more of its available funds or investments when it is unable to pay its depositors and, therefore, is in danger of a run and consequent insolvency. There is about as much reason to put such a provision into the law as there is for putting in a provision that the bank shall not make loans to a hopelessly insolvent corporation.

It is also urged that this provision prevents a bank from being insolvent when it is unable to meet the demands of its depositors. It is not seen how such a provision has any bearing on the legal

question whether or not a bank is insolvent under such circumstances, but even if it did have this effect it would not have any important bearing on the question now under consideration.

Mr. Elliott states that in compliance with a requirement of the State Banking Department, the checks used by "special savings depositors" bear on their faces the words, "Subject to Rules Governing Special Savings Accounts". While this renders such checks technically non-negotiable, it appears that in practice they circulate freely and are handled through the clearing houses like any ordinary commercial checks.

Mr. Elliott's brief also contains the following statement:

> "The use of this special form of check is permitted at the option of the bank and not at the option of the depositor and we believe that the depositors are well aware of the fact that this privilege may be withdrawn at the option of the bank and that it will be withdrawn if checking against such an account becomes active. The termination by the bank of a special savings account is usually by transfer to an ordinary commercial account."

I do not quite see what Mr. Elliott was trying to prove by this statement, but to my mind it shows very clearly that these accounts resemble commercial accounts much more than savings accounts, and that their tendency is to become commercial accounts.

It is intimated that a strict enforcement of the Board's Regulation D requiring such deposits to be treated as demand deposits in computing reserves would amount to a discrimination in favor of

national banks. This could not possibly be so, because Regulation D applies equally to all member banks, national as well as State, and if any national bank maintains such accounts it also must treat them as demand deposits for the purpose of computing reserves. But it is said that national banks have no such accounts because savings deposits in national banks are not subjected by the National Bank Act to the same safeguards as are thrown about savings deposits by the California Bank Act. This being true, it is manifest that it would be a discrimination against national banks to amend Regulation D so as to make a special exception favoring accounts which meet the peculiar requirements of the California Bank Act which cannot possibly be met by national banks.

Another argument advanced by Mr. Elliott is that these deposits should be treated as savings accounts because the State banks involved always have treated them as savings accounts in computing their reserves and have carried only 3% reserves against them. As shown above, however, this was directly contrary to the Board's ruling on the subject and constituted a violation of the Board's regulations and the terms of the Federal Reserve Act. It is manifestly absurd to argue that the Board's regulations ought to be amended because the parties desiring to see them amended have wilfully and consistently violated them. This is like a man attempting to lift himself by his own boot-straps.

One of the arguments of policy advanced by the representative of the State banks which deserves special mention is that if the same reserves must be maintained against these deposits as against demand deposits several of the largest State member banks in California may withdraw from the System rather than maintain the increased reserves.***

Under date of May 5, 1919, Mr. Perrin addressed a letter to Governor Harding which contained the following statement:

> "In the campaign upon which we are entering to bring in California State banks as members, we may find it an important obstacle if 'special savings' deposits are held to be demand deposits and whether it will prove an insuperable obstacle in many cases cannot, of course, be foretold".

In reply, Governor Harding stated the Board's position, in part, as follows:

> "The Board is of the opinion, therefore, that the present regulations should not be amended and that in any case where notice of withdrawal is not mandatory the pass book must be presented at the time of withdrawal if the account is to be considered a time deposit.
>
> "The Board appreciates that this may deter some of your State banks from joining the System just as it made certain State institutions in New York hesitate about becoming member banks, but it does not feel that it can properly change its position in the matter merely on that account though it hopes that something may be done to persuade those institutions in California to join even though the special savings account as handled at the present time cannot properly be classified as time deposits."

Both Mr. Elliott and Mr. McAdoo question the Board's jurisdiction "to deny their character to deposits which comply with all the requirements of the California Bank Act for savings deposits and which have been recognized and treated as such by the State Banking Department ever since these deposits have been in existence." They quote

Section 9 of the Federal Reserve Act to the effect that, "Subject to the provisions of this Act and to the regulations of the Board made pursuant thereto, any bank becoming a member of the Federal Reserve System shall retain its full charter and statutory rights as a State Bank or trust company and may continue to exercise all corporate powers granted it by the State in which it was created, and shall be entitled to all privileges of member banks", and argue that it is open to serious question whether the Board can by regulation prescribe a definition of savings accounts which is in conflict with the State law. They say that to treat special savings deposits as commercial deposits for the purposes of computing reserves is to disregard the California Bank Act. The question at issue, however, is what are the correct reserves to be maintained under the provisions of the Federal Reserve Act? and no right derived from State law is involved. If the State banks had any right (which they have not) to treat so-called special savings deposits as savings accounts for the purpose of computing reserves, such right would be derived from the terms of Section 19 of the Federal Reserve Act and not from any provision of the State law. The Board's regulations do not purport to say that such deposits are not "savings deposits" within the meaning of the California Bank Act but merely that they are not "savings accounts" within the meaning of the Federal Reserve Act. Manifestly, the classification of such accounts as demand deposits within the meaning of the Federal Reserve Act does not deny to State banks the

right to maintain such accounts; and, even if it did, it would be excepted from the above restriction of Section 9 by the plain terms of the words underlined.

Both Mr. McAdoo and Mr. Elliott argue that the true purpose of a reserve against deposits is to insure a reasonable ability on the part of the bank to meet withdrawals, and to that extent I agree with them. Mr. Elliott argues further that the presentation of the pass book has little or nothing to do with the ability of the bank to meet withdrawals. As demonstrated above, however, the presentation of a pass book has a very vital bearing on the frequency of withdrawals, because it prevents the accounts involved from becoming mere checking accounts which everyone admits are subject to more frequent withdrawals than strictly savings accounts, and this directly affects the bank's ability to meet withdrawals.

Mr. McAdoo argues that the true distinction between a savings account and a commercial account lies in the difference in the relation which the bank holds to the deposit - a savings bank being a trustee whose power over its deposits is limited and restricted by law in special ways as compared with the powers of a commercial bank. While this may be true in one sense, this distinction has no direct relation to the amount of reserves which should be maintained against savings deposits. It has not nearly such an important bearing on the frequency of withdrawals as the question whether or not such accounts

are permitted to be checked against or whether they can be withdrawn only upon the presentation of the pass book.

Mr. McAdoo continues this line of argument as follows:

> "The true test of a Savings Deposit is therefore whether or not the deposit is made in an institution which is subject to the requirements and restrictions placed by law on savings banks and which, in consequence, must reserve to itself, with respect to such deposits, the right to receive prior notice of withdrawal. It is submitted that if a commercial bank, not subject to the laws regulating savings banks, instituted a form of deposit which met both the requirements of Regulation 'D'*** which required both presentation of pass book and notice of withdrawal, such a deposit would still not be a 'Savings Deposit' because not subject to the protection and guarantees with which the law surrounds the relation between a savings bank and its depositors."

While this may be true as to the meaning of the term "savings deposits" as used in the California Bank Act, it cannot be true as to the meaning of the term "savings accounts" as used in the Federal Reserve Act, which is the statute under consideration. Otherwise national banks (which undoubtedly were the banks which Congress had most prominently in mind when it enacted Section 19 of the Federal Reserve Act) could not have any savings accounts.

Mr. McAdoo calls attention to the fact that, under the terms of Section 19 "savings accounts" are to be considered as "time deposits" where they are merely "subject to not less than thirty days notice before payment", whereas other time deposits must be "payable after thirty days". He says, "all that is required is that the savings bank should reserve to itself the right at any time to insist upon such

period of notice and to postpone payment until its expiration" and that "other accounts are to be treated as 'time deposits' only where there is a flat postponement of payment for thirty days or more." He then argues that this distinction between time deposits and savings accounts rests on the fact that the laws governing the operations of savings banks limit the power of withdrawal by depositors in such a way as to throw around funds of the savings bank, even where no notice of withdrawal is actually required, a protection which the funds of a commercial bank do not enjoy. He illustrates this by reference to a number of peculiar provisions of the California Bank Act. He sums up this argument with the statement that "It, therefore, seems to follow that the words 'Savings Accounts' as used in Section 19 of the Federal Reserve Act, mean nothing more than 'accounts in savings bank.'" This argument also is open to the objection that it is entirely inapplicable to savings accounts in national banks, and if Mr. McAdoo's view were accepted it would be impossible for national banks to maintain savings accounts within the meaning of Section 19 of the Federal Reserve Act, which right they have exercised for years without question.

Mr. McAdoo contends that Regulation D adds some additional requirements to those prescribed by Section 19 and questions the Board's right to change the meaning of Section 19 by regulation. I agree with him that the Board has no right to enact a regulation which is inconsistent with the plain terms of the Act, but I believe that the Board's Regulation D is nothing more than a reasonable interpretation of the mean-

ing of the Act, and that that part of it which defines "savings accounts" is entirely consistent with the language and philosophy of the Act and the intent of Congress in enacting it. Furthermore, I am of the opinion that any attempt on the part of the Board to amend its Regulation D so as to waive the presentation of the pass book and require only 3% reserves against these so-called "special savings deposits", which are in reality specially privileged checking accounts, would be inconsistent with the law and, therefore, would be entirely unauthorized.

The fact that the Board's present definition of savings accounts has been in force for over eight years and has not been questioned except by these few California banks and by them only as to its effect on this peculiar class of deposits would be given great weight by a court as indicating the proper construction of that term as used in the Federal Reserve Act.

> "It is a rule, announced by the Supreme Court of the United States at an early day, and which has since been followed in numerous cases both in the federal and state courts, that the contemporaneous construction put upon a statute by the officers who have been called upon to carry it into effect, made the basis of their constant and uniform practice for a long period of time, and generally acquiesced in, and not questioned by any suit brought, or any public or private action instituted, to test and settle the construction in the courts, is entitled to great respect, and if the statute is doubtful or ambiguous, such practical construction ought to be accepted as in accordance with the true meaning of the law, unless there are very cogent and persuasive reasons for departing from it". (Black, Interpretation of Laws, Second Edition, p. 301.)

CONCLUSION.

In conclusion, I am of the opinion that:

1. The Federal Reserve Board did not exceed its powers when it prescribed in Regulation D that in order for a deposit to be considered a "savings account" in computing reserves it must be a deposit which is not subject to withdrawal without the presentation of a pass book, certificate, or other similar form of receipt.

2. The Federal Reserve Board would exceed its powers if it amended its Regulation D so as to permit deposits which are subject to withdrawal by check without the presentation of a pass book, certificate of deposit or similar receipt to be classified as "savings accounts" for the purpose of computing reserves.

3. The so-called "special savings deposits" of California banks cannot properly be considered "savings accounts" within the meaning of Section 19 of the Federal Reserve Act, not only because they are subject to withdrawal without the presentation of the pass book but also because they are checking accounts and differ essentially from that class of accounts which is generally known and recognized as savings accounts.

4. Such deposits must be classified as demand deposits in computing the reserves to be maintained under the terms of Section 19, because they are essentially checking accounts; and the Board would fail in the performance of its duty if it permitted only 3% reserves to be maintained against them.

5. The only manner in which such deposits can legally be made subject to 3% reserves without changing the terms on which they are received is by an amendment to the law.

Respectfully submitted,

(Signed) Walter Wyatt

General Counsel.