OFFICE CORRESPONDENCE. (COPY) May 26, 1925.

To The Federal Reserve Board. SUBJECT: Proof of Claims against in-

From Mr. Wyatt - General Counsel. solvent national banks.

The attached letter addressed by Governor Harding to Mr. Hamlin calls attention to an apparent lack of uniformity in the requirements of the Comptroller's office with regard to the matter of proving claims against insolvent national banks.

At Mr. Hamlin's request, this office made a preliminary investigation of the subject from which it appeared that formerly the usual practice was for a Federal reserve bank holding rediscounted paper on which an insolvent national bank was liable as endorser to file a single claim with the receiver covering the aggregate amount of such rediscounted paper and that all dividends paid by the receiver were based on the total amount so proved. It appears, however, that late in 1924 the Comptroller's office inaugurated a new method based on a comparatively recent opinion of the United States District Court for the Northern District of North Dakota in the case of Federal Reserve Bank of Minneapolis v. First National Bank of Eureka, 277 Fed.300, whereby a Federal reserve bank holding a number of rediscounted items on which an insolvent national bank is liable as endorser is not permitted to file a single claim against the insolvent bank covering the entire amount of such rediscounted items, but is required to file a separate claim for each and every item. Furthermore, if at the time a dividend is declared a particular rediscounted item has been paid in full, no dividends are allowed under the new practice on the claim based on that particular rediscounted item.

The Board considered our preliminary report to Mr. Hamlin and requested this office to take the matter up with counsel to all Federal reserve banks and obtain from them an expression of their opinions on the questions involved. The letters from Counsel to all the Federal reserve banks discussing the subject in more or less detail are respectfully submitted herewith.

Eight of the Counsel for the Federal reserve banks agree with the position of the Comptroller or to the principle underlying his new requirement, that is, that a rediscounted item which has been paid in full should not be entitled to participate in any subsequent dividends paid by the insolvent bank. Only two of the Counsel express themselves as disagreeing with this principle. A number of those who believe that the position of the Comptroller's office is well founded suggest or contend that the purpose of the Comptroller may be accomplished by the filing of one claim covering all the rediscounts but treating them separately. Such an arrangement would be much simpler and would avoid much trouble both for the Federal reserve bank and for the receiver.

The view of the majority of the Counsel seems to be that each of several rediscounted items held by a Federal reserve bank are

distinct and separate items of indebtedness and when any one of these rediscounts has been paid in full or otherwise extinguished, it should no longer be considered an existing claim for the purpose of procuring greater dividends on other rediscounts not yet satisfied. To do so would, of course, benefit the Federal reserve bank but would prejudice the other creditors of the insolvent bank pro tanto. It does not seem equitable to ask or expect any dividend upon an item of indebtedness which has been paid in full merely because the creditor happens to have other separate and distinct claims against the insolvent bank. On this point, then, in my opinion, the position of the Comptroller is correct and rediscounts which have been paid in full should not participate in or be made the basis of any dividends subsequently declared by the insolvent bank. I feel, however, that in the interests of simplification of procedure and to avoid much clerical inconvenience Federal reserve banks should be permitted to file one claim covering all rediscounts, each rediscount so covered to be described and treated separately for all purposes.

Up to this point, the discussion has been confined to the proof of claims involving rediscounts. The case is somewhat different, however, as to indebtedness secured by collateral. It is well settled by cases in the Supreme Court of the United States, chiefly the case of Merrill v. National Bank of Jacksonville, 173 U. S. 131, that a secured creditor of an insolvent national bank may prove and receive dividends upon the face of his claim as it stood at the time of the declaration of insolvency, without crediting either his collaterals, or collections made therefrom after such declaration, subject to the proviso that dividends must cease when from them and from collateral realized, the claim has been paid in full.

On account of this well established principle, the question arises whether Federal reserve bank stock outstanding in the name of the insolvent member bank is to be treated by the Federal reserve bank as collateral, or as a set off to be applied against the indebtedness of the insolvent bank, claim being made for the net difference only. Under the recent instructions of the Comptroller, Federal reserve bank stock is required to be treated as a set off and not as collateral. This regulation is based on a portion of the opinion in the case of Federal Reserve Bank of Minneapolis v. First National Bank of Eureka, above referred to: but it does not appear that this was one of the contested points in the case. On the contrary it seems to have been conceded. The opinion, therefore, cannot be considered as of much importance on this point.

Most of the Counsel who expressed an opinion on this point feel that Federal reserve bank stock should be treated as collateral and not as a set off. Section 6 of the Federal Reserve Act provides that upon the insolvency of a member bank the Federal reserve bank stock held by it shall be cancelled and the proceeds applied first to the debts of the insolvent bank and the balance, if any, paid to the receiver. Prior to insolvency the member bank has no claim against the Federal reserve bank on the stock; it merely has an interest in the Federal reserve bank as represented by the stock. On the date

of insolvency also there is no debt due the member bank from the Federal reserve bank on the stock because the stock has not been cancelled. Certainly up to the time of cancellation, there is no debt due the member bank on such stock, and since the claims are proven as of the date of insolvency it does not seem that the proceeds of Federal reserve bank stock is a proper item for set off. Furthermore, it seems to be the intention of Section 6 of the Federal Reserve Act that the proceeds of Federal reserve bank stock shall be used to save the Federal reserve bank from loss, as far as possible in cases of insolvency, only the remainder after paying the debts of the insolvent bank being paid to the receiver. It is apparently the intention that the Federal reserve bank shall not account to the receiver for anything due on the stock until all the claims of the Federal reserve bank against the insolvent bank have first been satisfied.

Summarizing the conclusions of the majority of the Counsel of the Federal reserve banks, with which conclusions I concur, it may be said:

(1) That the position of the Comptroller of the Currency is correct in that no rediscount which has been paid in full or otherwise satisfied should be permitted to participate in dividends subsequent to the satisfaction of the rediscount; but that this purpose may be accomplished much more conveniently and with less trouble to all parties concerned by the filing of one claim for all rediscounts but treating and describing each separately.

(2) The proceeds of Federal reserve bank stock should not be considered as a set-off to be applied against the indebtedness of the insolvent national bank to the Federal reserve bank, but should be considered in the same category as collateral; and the Federal reserve bank should be permitted to file its claim for the entire amount of indebtedness and to receive dividends thereon without deducting anything for the proceeds of the Federal reserve bank stock with the proviso, of course, that the total amount of dividends plus the proceeds of such stock shall not exceed the amount of the claim of the Federal reserve bank.

Under date of May 15th the Comptroller's office issued a circular letter to all Federal reserve banks outlining a uniform practice with respect to claims by Federal reserve banks against insolvent national banks which the Comptroller's office proposed to put into effect. A copy of this circular letter is respectfully submitted herewith. It re-affirms the Comptroller's view that separate claims must be filed with regard to each rediscounted item; and that the Federal reserve bank stock held by an insolvent bank should be offset against the claims held by that bank. The circular also states that a Federal reserve bank is entitled to interest on its claims only at a rate equivalent to its current discount rate,

and it is believed that this is not strictly correct, though it is understood that Federal reserve banks frequently have waived their right to any interest on such claims in excess of their going rediscount rates. The circular goes into much detail, is not entirely clear, and may be incorrect in other respects also.

In view of all these circumstances, and in order that a complete understanding may be arrived at between the Federal reserve banks and the Comptroller's office with regard to this entire subject, it is respectfully recommended that a conference be arranged between the Comptroller's office and Counsel to all interested Federal reserve banks to discuss the Comptroller's circular of May 15th, and if possible to agree upon such modifications and clarifications thereof as may be necessary.

A draft of a letter to the Governors of all Federal reserve banks suggesting that such conference be arranged and transmitting a copy of this memorandum together with copies of letters received from Counsel to all Federal reserve banks is respectfully submitted herewith.

Respectfully,

Walter Wyatt,
General Counsel.

Papers attached.

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