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X-4357

FEDERAL RESERVE BANK
OF DALLAS.

428

June 10, 1925.

Federal Reserve Board,
Washington, D.C.

Gentlemen: Attention Mr. Walter Wyatt, General Counsel.

I have your letter of May 28 with inclosures, which I have carefully considered with Mr. R. B. Coleman, our Deputy Governor in charge of insolvent bank matters, and Mr. T. E. Parks, the chief of our insolvent bank department. We have given careful consideration to the letters from the various attorneys of the Federal reserve banks and also the letter from the office of the Comptroller of Currency of date May 15, 1925.

You have asked me to call your attention to any points in addition to those covered in the Comptroller's letter of May 15, and also to any points mentioned in that letter which I consider ambiguous or incorrectly stated. I am departing somewhat from your request and have prepared and am submitting you herewith suggestions for topics to be discussed at the proposed conference.

While many of the topics suggested in this outline are simple and will be relatively easy to dispose of, I think that in order to have a complete and harmonious understanding it would be well to discuss each and all of them even though only perfunctorily. I have also included in these topics a good many questions which do not technically come within the scope which you have outlined for this conference. Many of these topics have reference to the liquidation of an insolvent bank's affairs but they are so interwoven with the general question of claims against insolvent banks, especially when considered in connection with final settlement of these claims, that I do not think any conference would be complete without including a discussion of these things.

There are many problems in connection with claims against insolvent banks which are more problems of accounting than law. It is often easy to arrive at a correct legal determination of the question but when putting same into operation the system of accounting

used by the various Federal reserve banks and receivers often makes it impractical to handle things exactly according to law.

As an illustration, I call your attention to the question of expense. Theoretically and legally, where certain expense has been incurred in the collection of a collateral note, this expense should be deducted from the total amount collected and the receiver credited with the net amount. As a practical matter of accounting, however, should this be attempted it would lead to endless trouble in correcting book entries and arriving at agreements with the receivers in each particular instance as to the proper expense chargeable. It has been considered by us, therefore, to be the better practice to credit the insolvent bank with the gross amount of each collection, maintaining in our bank complete records as to all expense incurred, this item being taken care of at one time upon final settlement with the receiver. I mention this illustration and could point out others.

For this reason I am of the opinion that in addition to the attorneys for the various Federal reserve banks it would not be a bad idea to have as many banks as seem proper send along with their attorney some officer fully acquainted with the practical method of accounting so that in the event any question should be raised along this line the same could be properly disposed of at the conference which you contemplate having.

I have been informed that there is to be a conference in Washington some time around the middle of July between representatives of the various Federal reserve banks and the Treasury Department concerning the currency program. Our Deputy Governor in charge of insolvent banks expects to attend this conference, and doubtless other Federal reserve banks will have representatives there who occupy similar relation to insolvent bank work as Mr. Coleman. It has occurred to me, therefore, that if your conference could be arranged so as to follow the conference to which I have referred, possibly we might have the benefit of the experience of some of the operating officers of the various Federal reserve banks. I merely mention this because it has occurred to me that it might add to the successful results of the conference.

I have taken the liberty, in the list which I submit, of giving a brief statement of our views in connection with each topic in order that you may fully understand the scope thereof.

With kindest regards, I am,

Very truly yours,

(Signed) E. B. Stroud, Jr.

EBS-cc Office Counsel.

Suggested Topics for Discussion

at Joint Conference of Counsel for Federal Reserve Banks

and Representatives of the Comptroller of Currency

In Connection with Claims against Insolvent National Banks

I.

CLAIMS EVIDENCED BY MEMBER BANK PROMISSORY NOTES

A. Amount of Claim

(1) Time of determining amount.

(It is our view that this question has been finally decided by the Supreme Court of the United States and that the claim should be filed for the amount of the indebtedness on the date of insolvency.)

(2) Interest.

(This topic raises two questions. First, interest which should be included in the amount of the claim filed. As to this it is our view that unearned interest should be deducted from the amount of claim and that past due interest should be included at the going discount rate rather than at the contractual rate specified in the note. Of course in those cases where the note has been endorsed and it is necessary to sue endorsers, if the receiver is a necessary party to such suit, interest should be asked for at the same rate as claimed against endorsers.

(The second part of this topic refers to interest charged insolvent bank upon claim in final settlement. While we hold to the view that the promissory note is a written contract enforcible as against the receiver, we do not feel that it would be good policy, in arriving at a final settlement, to charge a greater rate of interest to the insolvent bank than our going discount rate, and as an offset against this interest we feel that a credit should be allowed the receiver at the same rate upon all collections made upon collateral notes from the date of each respective collection.)

(3) Attorney's fees.

(Where a member bank's promissory note provides for payment of attorney's fees if placed in the hands of an attorney for collection, we are of the opinion that this item should be remitted except when it is necessary to actually institute suit in order to effect collection of the note.

(4) Offsets.

a. Is the refund of capital stock and accrued dividends an item of offset?

(It is our view that these sums are not items of offset but on the contrary are held in the nature of collateral.)

b. Ledger balance.

(We are of the opinion that ledger balance is an item of offset, although by express contractual agreement the same might be converted to collateral.)

B. Dividends

(1) Amount upon which dividend should be paid.

(It is our view that every dividend paid by the receiver should be based upon the amount of the claim as originally filed and allowed, and that no deductions should be made for collections received upon collateral, or otherwise, between the payment of any two dividends.)

(2) When Federal reserve bank no longer entitled to dividends.

(It is our view that we are entitled to dividends upon the full amount of the claim as originally filed and allowed until such time as the dividends, plus collections on collateral and offsets, equal one hundred per cent of the indebtedness, together with interest thereon, and also until we have been fully reimbursed for the expense to which we have been incident in the collection of the paper.)

II.

CLAIMS EVIDENCED BY REDISCOUNTED NOTES:

A. Whether proven collectively or singly.

(It is our view that claims on rediscounted notes should be filed singly; that is, a separate claim upon each rediscounted note. We think it is merely a matter of convenience as to whether separate claims are filed on each note or all claims are included on one general claim. As a matter of our own personal convenience, we feel it is much simpler to file a separate claim upon each rediscounted note.)

B. Amount of claim.

(1) Time of determining amount.

(It is our view that the amount of claim should be determined at the date of the maturity of the note for the reason that the secondary liability of the endorsing bank does not become fixed until the maturity of the note. However there is a great deal of weight in the contention that the amount of claim should be determined on the date of insolvency, and we are quite agreeable to determining the amount of our claims on rediscounted notes at this time.)

(2) Interest.

(It is our view that if the time of fixing claim is at the maturity of the note no rebate should be made for unaccrued interest. If the time is to be fixed as of the date of insolvency, then on notes which have not matured at that time interest should be rebated, and on those that are past due it should be added in at the current rediscount rate. We think that after claim has been established it should draw interest thereafterwards at our current rediscount rate. While, as a matter of law, no contention could possibly be raised that we were not entitled to past due interest collected from the maker in accordance with the contract specified in the note, still as a matter of policy we believe it is well to take the after-maturity interest collected

from the maker, placing an amount thereof equivalent to the amount which would have been collected had we charged him only our current rediscount rate in our profit account, holding balance as a collateral item to be applied against the indebtedness of the receiver.)

(3) Attorney's fees.

(This topic brings up a very interesting question for consideration. We do not believe, as an ordinary proposition, that attorney's fees should be included in the claim upon a rediscounted note. However in many instances it becomes necessary to sue the maker in order to effect collection of the note, and frequently a sufficient sum is not collected from the maker to pay a Federal reserve bank the principal, interest, and attorney's fees. Consequently in such cases it is often difficult to determine the amount to be credited the insolvent bank. We think this question can be avoided by proper agreements with member banks constituting expense of collecting rediscounted notes an indebtedness of the member bank, thus fixing an obligation against which collateral can be applied.

(It has been our practice in those cases involving litigation with the makers, where the collection is less than the principal and interest of the note, to always deduct the attorney's fees actually incurred from the amount collected and credit the insolvent bank with only the difference.)

(4) Offsets.

a. How applied.

(It is our view that Federal reserve banks have the right to apply offsets as they deem advisable.)

b. Capital stock and accrued dividends thereon.

(We believe this item to be an item of collateral and not of offset.)

c. Ledger balance.

(We consider this item an item of offset which may be applied in any manner deemed advisable by the Federal reserve banks, although we think that by express contractual agreement ledger balance might be made collateral item.

C. Dividends

(1) Amount upon which dividends should be paid.

(It is our opinion that dividends should be paid on the amount of the claim as originally filed and allowed without deducting collections on collateral or partial payments made by parties liable on the note.)

(2) When no longer entitled to dividends.

(We are of the opinion that we are entitled to dividends upon each of the rediscounted notes for the full amount of claim as originally filed and allowed until such time as the dividends, plus collections made from parties liable upon the rediscounted note, equal one hundred per cent thereof with interest and expense of collection.)

a. Do payments made subsequent to the maturity of the note or date of insolvency effect the amount of dividends?

(It is our view that a claim once having been filed and allowed subsequent payments made by parties liable on the note should not be deducted from the amount of the claim when dividends are paid. In other words, the claim once having been filed and established, we think we are entitled to dividends on the full amount of the claim until such time as those dividends, plus payments, equal to one hundred per cent of the note.)

D. Compromises and Settlements.

(1) Right to make.

(It is our view that before any compromise or settlement is made upon a rediscounted note that the consent and acquiescence of the receiver should be obtained. In the event the receiver refuses to give his consent or acquiescence to the settlement, then he should be given an opportunity to take the rediscounted note up for the amount offered in settlement, permitting the claim to stand and continuing to pay dividends on the amount as originally filed and allowed until such time as it is fully paid.)

(If the receiver does not care to take the note up and the Federal reserve bank is still of the opinion that the settlement is a good one, we think it has the right to make such settlement with the parties prior to the insolvent bank, provided that when doing so recourse is expressly reserved on said note against the receiver of the insolvent bank.)

(2) In cases of compromises and settlements of rediscounted notes, what authority needed by the receiver?

(It is our view that whenever a receiver consents to the settlement of a rediscounted note, he should obtain an order of a court of competent jurisdiction permitting same.)

E. Expenses of Preservation and Collection of Rediscounted Notes.

(It is our view that proper contractual agreement with member banks will make such expenses indebtednesses of the bank and, therefore, collectible from collateral which might be held.)

III.

COLLATERAL:

A. Right of Compromise and Settlement.

(It is our view that a Federal reserve bank has no right to settle or compromise notes held as collateral. However they would be liable only for the value of each collateral note, and if a settlement or compromise should be effected whereby the Federal reserve bank obtained the full value of the note, there would be no liability upon its part. Hence, we think that when such settlements are made without reserving right of recourse against party secondary liable, consent of receiver should be obtained.)

B. Authority needed by Receiver to Compromise Settlement of Collateral Note.

(It is our view that it is not necessary for the receiver to have court order in connection with settlements of notes pledged as collateral. Where the receiver consents to the settlement, this is prima facie evidence that the pledgee has received full value for the note, and even though unauthorized to make the settlement the trust would have no legal rights against the pledgee. Where convenient, it might be better practice for the receiver to obtain court order.)

C. How and When Applied.

(1) Collateral to member bank's promissory note.

(In the Comptroller's letter of May 15 he states that collections made on notes held as collateral to bills payable should be applied immediately upon collection. Theoretically this is true. The difficulty comes, however, in determining the amount to be credited on account of expense, etc. We think it is the better practice to make these credits with the understanding and agreement between the receiver, the Comptroller's office, and the Federal reserve bank involved that such credits shall in no wise prejudice the right to recover legitimate expense incurred.)

(2) Collateral to Rediscounts.

(We are of the opinion that collections on collateral to rediscounts should not be applied until final settlement with the receiver.)

(3) Where insolvent bank's indebtedness consists of both rediscounts and collateral.

(We are of the opinion that collections should be applied, first, to member bank's promissory notes with the agreement and understanding referred to in subparagraph (1) above. After the indebtedness evidenced thereby has been fully discharged, together with interest and expense, the balance, if any, should be used upon final settlement toward retiring rediscounts.)

(4) Expense of preservation and collection.

(We are of the opinion that the legitimate expense incurred by Federal reserve banks in the preservation and collection of collateral notes is a recoverable expense and can best be handled upon final settlement rather than as each note is collected.)

(5) Special advances necessary for collection of collateral notes.

(We think, in most instances, the receivership is primarily interested in working out as large a sum as possible upon collateral notes. Especially is this true where the line of indebtedness is amply margined. Therefore it follows that where special advances are called for, these advances should be made by the receiver with proper subrogation agreement entitling the receiver to reimbursement out of the first proceeds of the collection.)

IV.

CLAIMS ON ACCOUNT OF UNPAID CASH OR COLLECTION LETTERS:

A. Amount of Claim

(This topic necessarily depends upon the facts of each individual case, but it is suggested primarily because frequently a claim is filed which does not include certain items afterwards requested to be included. Sometimes the receivers indicate an unwillingness to increase the amount of the claim. It is our view that in such instances the original claim should be increased rather than a separate claim filed.)

B. Proof Required

(We are of the opinion that the affidavit of the Federal reserve bank in connection with the claim is sufficient proof. However some receivers are disposed to be technical in this regard, and we think a full discussion of the matter would be of interest.)

C. Duplicate Claims

(It frequently happens that a certain check will be included in the claim of the Federal reserve bank upon authorizations furnished it. The drawer of the check will also file a claim. In such instances the receiver frequently advises the Federal reserve bank that he cannot allow its claim for the amount of this check due to the other claim having been filed. It occurs to us that the better practice would be to advise the Federal reserve bank that a duplicate claim has been filed covering this amount, and request the Federal reserve bank to trace the item back and determine whether the Federal reserve bank is entitled to file the claim or the drawer of the check. In this way all conflicting interests can usually be adjusted. Whereas if the receiver arbitrarily takes the position that the drawer's claim is the proper one to be allowed, uncertainty and confusion results, and in some cases unnecessary litigation might ensue.)

D. Offsets

(Under this topic we think an interesting discussion could be had as to the proper action of Federal reserve banks with reference to using capital stock refund and ledger balances as an offset against cash letter claims. It might be that this would not be a proper question for general discussion in view of the fact that each Federal reserve bank might prefer to handle these matters as they arise rather than along uniform line.)

E. Application of Collateral

(The remarks in the topic next preceding are applicable here.)

F. Whether General or Preferred Claims

(We think a general discussion of this question would be of material benefit and interest due to the fact that some of the later decisions by state courts have departed from the rigid rule of tracing trust funds--notably the case of Federal Reserve Bank of Richmond vs Peters.

V.

MISCELLANEOUS CLAIMS

A. Claims on account of rediscounted or Collateral Notes sent for Collection and remittance which are collected but not remitted for.

(We suggest a general discussion of this question.)

B. Claims on behalf of makers of notes who pay amount thereof to insolvent bank not knowing the note has been rediscounted or pledged as collateral.

(We think in such cases where it is thought necessary to enforce collection of such notes as against the maker, the Federal reserve banks should first advise the makers of their rights and attempt to assist them in establishing preferred claims if the facts so justified. We think a general discussion of this topic would be of interest.

C. Claims on behalf of the United States.

(We think a discussion of the various claims of this character which have been filed by the several Federal reserve banks would be of general interest.)

D. Renewal Notes in hands of Receiver evidencing same indebtedness as notes held by Federal reserve bank under rediscount or as collateral.

(It not infrequently happens that a bank, before its failure, takes a renewal note covering a certain indebtedness, telling the maker that his old note will be mailed him later. The bank fails before the old note has been obtained from the Federal reserve bank. In such cases, the receiver not infrequently takes the position that his note is a valid note and as a result much trouble is experienced. We think in such cases as these the receiver should be instructed that after he has satisfied himself that the note in his possession really evidences the same indebtedness as the note in the possession of the Federal reserve bank he should turn over to the Federal reserve bank the renewal note.)

E. Claims for Forgeries.

(Under the blanket bonds carried by all Federal reserve banks, forged notes taken under rediscount or as collateral are covered. In the event of such a contingency, where a Federal reserve bank has collected from the bonding company, it is our view that no collateral should be surrendered to the receiver until sufficient amount has been collected therefrom to fully reimburse the bonding company as well as the Federal reserve bank. We think a discussion of the proper method of handling such a transaction would be of general interest.)

VI.

FINAL SETTLEMENTS WITH RECEIVERS

A. General Discussion