FEDERAL RESERVE BOARD

WASHINGTON

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ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

X-4830

April 23, 1927

SUBJECT: Topic for Governors' Conference - Proposed Revision of Board's Regulations.

Dear Sir:

The Federal Reserve Board has placed on the program for discussion at the forthcoming Governors' Conference the proposed revision of the Board's regulations. In this connection there are enclosed herewith a copy of the Board's existing regulations with proposed changes noted thereon in red ink, and a memorandum containing the text of proposed new provisions to be inserted in the regulations, together with a brief explanation of the proposed changes.

It is important to note that the enclosed draft is merely a tentative draft prepared by the Board's Counsel after considering the changes made in the law by the McFadden Act and the various suggestions made by the Governors and Federal Reserve Agents in response to the Board's letter of March 4th (X-4804), and is intended primarily to serve as a basis for discussion. It has not been submitted to, or approved even tentatively by, the Federal Reserve Board. Constructive criticisms and suggestions are invited.

Very truly yours,

Walter L. Eddy,
Secretary.

Enclosures.

TO GOVERNORS OF ALL F. R. BANKS.

X-4830-a

TENTATIVE DRAFT OF AMENDMENTS TO REGULATIONS
(Confidential)

The attached draft of amendments to the Federal Reserve Board's Regulations is merely tentative and is intended primarily to serve as a basis for discussion. It has not been submitted to, or approved even tentatively by, the Federal Reserve Board. Constructive criticisms and suggestions are invited.

The changes in the existing regulations are noted in red ink, and the text of new provisions to be inserted is given below. Following this, there is a brief explanation of the changes proposed.

REGULATION A.

The following is the text of the new provisions to be inserted in Regulation A:

#1. To be inserted at place indicated on page 3.

(2) That such notes, drafts or bills of exchange have not been acquired from a nonmember bank, or, if so acquired, that the applying member bank has received permission from the Federal Reserve Board to discount with the Federal Reserve Bank paper acquired from nonmember banks.

#2. To be inserted at bottom of page 6.

SECTION IX. PAPER ACQUIRED FROM NONMEMBER BANKS.

(a) Except with the permission of the Federal Reserve Board, no Federal reserve bank shall discount any paper acquired by a member bank from a nonmember bank or bearing the signature or endorsement of a nonmember bank; except that Federal reserve banks may discount bankers' acceptances and other eligible paper bearing the signature or endorsement of a nonmember bank, if such paper was bought by the offering bank in good faith on the open market from some party other than the nonmember bank.

(b) Applications for permission to rediscount paper acquired from nonmember banks shall be made in writing by the member banks which desire to offer such paper for rediscount and shall state fully the facts which gave rise to each application and the reasons why the applying member banks feel justified in seeking such permission. Such applications shall be addressed to the Federal Reserve Board, but shall be filed with the Federal Reserve Agent, who shall forward them promptly to the Federal Reserve Board with his recommendations.

(c) As a general rule, the Federal Reserve Board will not permit member banks to rediscount paper acquired from nonmember banks which are eligible for membership, because such banks should join the Federal Reserve System if they desire to participate in its benefits. The Board will make exceptions to this rule in some cases in order to assist such banks in emergencies for a limited time; but such exceptions will be made only with the understanding that they will not be continued beyond the period when the nonmember bank concerned can qualify for admission to membership in the Federal Reserve System.

(d) The Federal Reserve Board hereby grants its permission for Federal reserve banks to discount for member banks paper bearing the signature or endorsement of Federal Intermediate Credit Banks, if such paper is otherwise eligible under the law and this regulation.

EXPLANATION OF CHANGES IN REGULATION A.

Section I, page 1.

The provisions regarding the rediscount of paper secured by bonds or notes of the War Finance Corporation is omitted; because, as a practical matter, it is obsolete. It appears that all such bonds are now overdue and that the amount outstanding is only about $17,000.

The phraseology of subdivision (c) is also changed to conform more closely to the language of the law.

Section II, page 2.

The obsolete provisions regarding the bonds or notes of the War Finance Corporation are omitted.

Section III, page 3.

It is suggested that there be incorporated in this section the requirement previously contained in Section IV(b) requiring the application for rediscount to state whether the paper offered was acquired from a nonmember bank.

Section IV(b), page 3.

It is proposed to eliminate from this section the requirement that the application for rediscount shall state whether the note offered for rediscount has been discounted for a depositor other than a bank or for a nondepositor and, if discounted for a bank, whether for a member or a nonmember bank. This suggestion was originally made by the Federal Reserve Bank of San Francisco as a result of the decision

in the Grimm Alfalfa Case. It will be remembered that, in a circular letter addressed to all Federal reserve banks under date of February 27, 1926, (X-4544), the Board waived compliance with this requirement, on condition that the application for rediscount should require member banks to designate whether the paper offered for rediscount, if any, was acquired from nonmember banks and should contain a certificate that none of the paper offered for rediscount, except that so designated, was acquired from nonmember banks. It is proposed to eliminate the old requirement entirely from Section IV(b) and, in lieu thereof, to insert in Section III a requirement that the bank certify that the paper offered for rediscount has not been acquired from a nonmember bank, or if so acquired, that the applying member bank has received permission from the Federal Reserve Board to rediscount with the Federal reserve bank paper acquired from nonmember banks.

It is also proposed to amend subdivision (2) of Section IV(b) so as to require financial statements whenever the amount involved equals or exceeds $500, instead of $5,000 as heretofore. This was recommended by the Federal Reserve Bank of Minneapolis, on the ground that $500 is the amount fixed by the National Bank Examiners as the maximum amount of unsecured credit which should be extended unless supported by a signed financial statement.

It is also proposed to eliminate from Section IV an obsolete proviso to the paragraph regarding statements of borrowers having closely affiliated or subsidiary corporations or firms.

New Section IX.

It is proposed to insert in Regulation A a new section IX con-

taining the substance of the Board's existing rulings with reference to the rediscount of paper acquired from nonmember banks. (See rulings published on page 891 of the 1923 Bulletin and page 252 of the 1926 Bulletin.)

REGULATION B.

It is not proposed to make any changes in this regulation.

REGULATION C.

It is not proposed to make any changes in this regulation.

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REGULATION D.

The following is the text of the new provisions proposed to be inserted in Regulation D:

#3. To be inserted at place indicated on page 16.

Deposits which are permitted to be withdrawn by check or otherwise, without the actual presentation of the pass-book, certificate, or other similar form of receipt whenever a withdrawal is made, shall not be considered "savings accounts" within the meaning of this regulation.

#4. To be inserted at place indicated on page 17.

A member bank exercising trust powers need not carry reserves against trust funds which it keeps segregated and apart from its general assets or which it deposits in another institution to the credit of itself as trustee or other fiduciary. If, however, such funds are mingled with the general assets of the bank, as permitted to national banks under authority of Section 11(k) of the Federal Reserve Act, a deposit liability thereby arises against which reserves must be carried. In computing reserve requirements, trust funds deposited in a member bank by another bank to the credit of such other bank as trustee or other fiduciary must be classified by the member bank as individual deposits rather than bank deposits.

#5. To be inserted at place indicated on page 18.

Balances which are not payable on demand shall not be considered balances due to or balances due from banks within the meaning of this regulation.

#6A. Either this or 6B to be substituted for Section IV, pages 18 and 19.

SECTION IV. PENALTIES FOR DEFICIENCIES IN RESERVES.

(a) Basic Penalty. Inasmuch as it is essential that the law in respect to the maintenance by member banks of the required minimum reserve balance shall be strictly complied with, the Federal Reserve Board, under authority vested in it by section 19 of the Federal reserve act, hereby prescribes a basic penalty for deficiencies in reserves according to the following rules:

(1) Deficiencies in reserve balances of all member banks will be computed on the basis of actual daily net deposit balances at the close of business each day.

(2) Penalties for such deficiencies will be assessed monthly on the basis of actual daily deficiencies during the preceding month.

(3) A basic rate of 2 per cent per annum above the Federal reserve bank discount rate on 90-day commercial paper will be assessed as a penalty on deficiencies in reserves of member banks.

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(b) Progressive penalty. - The Federal Reserve Board will also prescribe for any Federal reserve district, upon the application of the Federal reserve bank of that district, an additional progressive penalty for continued deficiencies in reserves, in accordance with the following rule:

When a member bank has had an actual deficiency in reserves for six consecutive weeks, a progressive penalty, increasing at the rate of one-fourth of 1 per cent for each week thereafter during which the actual reserve balance is deficient, will be assessed on daily deficiencies until the required reserve has been restored and maintained for four consecutive weeks; provided that the maximum penalty charged shall not exceed 10 per cent.

6B. Either this or 6A to be substituted for Section IV, pages 18 and 19.

SECTION IV. PENALTIES FOR DEFICIENCIES IN RESERVES.

Inasmuch as it is essential that the law in respect to the maintenance by member banks of the required minimum reserve balance shall be strictly complied with, the Federal Reserve Board, under authority vested in it by section 19 of the Federal Reserve Act, hereby prescribes the following rules governing deficiencies in reserves:

1. Deficiencies in reserve balances of all member banks will be computed on the basis of actual net deposit balances at the close of business each day;

2. Penalties for such deficiencies will be assessed monthly on the basis of actual daily deficiencies during the preceding month;

3. Such penalties shall be assessed at a basic rate of 2% per annum above the Federal Reserve Bank discount rate on commercial paper;

4. When a member bank has an actual deficiency in reserves for six consecutive weeks, there shall be assessed, in addition to the penalty at the basic rate, a progressive penalty increasing at the rate of one-fourth of 1% for each week thereafter during which the actual reserve balance is deficient, until the required reserve balance has been restored and maintained for four consecutive weeks; provided that the maximum penalty charged shall not exceed 10%;

5. Whenever the daily reserve balance of any member bank has been deficient for a time sufficient to subject such bank to the maximum penalty of 10%, the Federal Reserve Agent shall promptly report the fact to the Federal Reserve Board with a recommendation as to whether or not the Board should:

(a) In the case of a national bank, direct the Comptroller of the Currency to bring a suit to forfeit the charter of such national bank under the provisions of Section 2 of the Federal Reserve Act; or

(b) In the case of a State member bank, institute proceedings to require such bank to surrender its stock in the Federal reserve bank and to forfeit all rights and privileges of membership, pursuant to the provisions of Section 9 of the Federal Reserve Act; or

(c) In either case, to take such other action as the Federal Reserve Agent may recommend or the Federal Reserve Board may consider advisable.

#7. To be added at the end of Section V, page 19.

The Federal Reserve Agent in each District shall promptly report to the Federal Reserve Board all violations of this prohibition by member banks in his District and shall in each case recommend whether or not the Board should:

(a) In the case of a national bank, direct the Comptroller of the Currency to bring suit to forfeit the charter of such national bank under the provisions of Section 2 of the Federal Reserve Act; or

(b) In the case of a State member bank, institute proceedings to require such bank to surrender its stock in the Federal reserve bank and to forfeit all rights and privileges of membership pursuant to the provisions of Section 9 of the Federal Reserve Act; or

(c) In either case take such other action as the Federal Reserve Agent may recommend or the Federal Reserve Board may consider advisable.

EXPLANATION OF PROPOSED CHANGES IN REGULATION D.

In general, it may be said that the recommendations received from the Federal reserve banks evidenced more interest in the tendency of member banks to evade the reserve requirements than in any other subject. Numerous suggestions were made to remedy this situation; but, unfortunately, many of them could not be adopted without an amendment to the law. Such of these suggestions as are believed to be consistent with existing law were incorporated in the tentative draft, however, and the entire regulation was considered with a view of strengthening the enforcement of the reserve requirements and checking the tendency of member banks to evade them.

Section II(d), page 16.

The amendments are designed to check the tendency of member banks to evade the reserve requirements by classifying as "savings accounts" deposits which are permitted to be withdrawn at will, by check or otherwise, without the actual presentation of the pass-book. (See the Board's ruling on page 677 of

the 1923 Bulletin.) Amendments of this general character were suggested by the Federal Reserve Banks of Boston and Chicago.

Section III(a), page 17.

This amendment was suggested by the Federal Reserve Bank of New York and is designed to incorporate in the Regulation the substance of the ruling on page 572 of the 1922 Bulletin with reference to reserves against trust funds.

Section III(b), page 18.

This amendment was suggested by the Federal Reserve Bank of Chicago, and is designed to discourage the practice of some banks treating as balances due from banks time deposits carried with other banks against which such other banks carry only 3% reserves.

Section IV, pages 18 and 19.

Two alternative substitutes, designated as "6A" and "6B", are suggested.

The proposed substitute designated as "6A" is designed merely to base the computation of reserves for the purpose of assessing penalties on actual daily balances, instead of average balances for weekly or semi-monthly periods, in order to "prevent some of the wide fluctuations in actual reserves which now take place." This was suggested by the Federal Reserve Bank of New York, and it is understood that such a proposal has been made a separate subject for discussion at the Governors' Conference.

The proposed substitute designated as "6B" is designed to accomplish the same object and, in addition thereto, to strengthen in other respects the enforcement of the reserve requirements of the law. In accordance with a suggestion made by the Federal Reserve Bank of Philadelphia, it is designed to correct the view entertained by some member banks that, so long as they pay the penalties, they have a right to permit their reserves to remain deficient.

It would also prescribe a progressive penalty for all Districts and relieve the Federal Reserve Banks of the necessity of taking the initiative in this matter. The duty of prescribing penalties for deficiencies in reserves is placed by the law on the Federal Reserve Board, and it is believed that the Board rather than the Federal reserve banks should take the initiative in the matter, especially in view of the fact that at times there has been a feeling on the part of some member banks that the Federal reserve banks are influenced by the possibility of increasing their profits.

Section V, page 19.

The elimination of the last sentence of the present regulation is suggested in order to harmonize this section with the proposed amendments to Section IV.

The addition of the proposed new provision designated as "Insert #7" is designed to call forcibly to the attention of member banks the prohibition against making loans or paying dividends while their reserves are deficient and to provide more adequately for its enforcement.

REGULATION E.

It is not proposed to make any changes in this Regulation.

REGULATION F.

The following is the text of the proposed new provisions to be inserted in Regulation F:

#8. Insert on page 25.

Section 3 of the Act of November 7, 1918, as amended by Section 1 of the Act of February 25, 1927, which authorizes any bank, trust company, savings bank, or other banking institution incorporated under the laws of any State or of the District of Columbia to be consolidated directly with a national bank located in the same city, town or village under the charter of such national bank, provides in part that when such consolidation is effected:

> "* * * all the rights, franchises, and interests of such State or District bank so consolidated with a national banking association in and to every species of property, real, personal, and mixed, and choses in action thereto belonging, shall be deemed to be transferred to and vested in such national banking association into which it is consolidated without any deed or other transfer, and the said consolidated national banking association shall hold and enjoy the same and all rights of property, franchises, and interests including the right of succession as trustee, executor, or in any other fiduciary capacity in the same manner and to the same extent as was held and enjoyed by such State or District bank so consolidated with such national banking association."
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> "The words 'State bank', 'State banks', 'bank', or 'banks' as used in this section, shall be held to include trust companies, savings banks, or other such corporations or institutions carrying on the banking business under the authority of State laws."

#9. Insert at end of Section II, page 25.

In the case of the organization of a new national bank, the conversion of a State bank or trust company into a national bank, the consolidation of two national banks, or the consolidation of a State bank or trust company with a national bank under the charter of the latter, application for such a permit may be made in advance on behalf of the new, converted, or consolidated national bank, and the permit may be issued simultaneously with

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the consummation of such organization, conversion or consolidation. In the case of the organization of a new national bank, the application may be made on behalf of the new national bank by the organizers thereof. In the case of the conversion of a State bank or trust company into a national bank, the application may be made by the State bank or trust company on behalf of the national bank into which it is to be converted. In the case of the consolidation of two or more national banks or the consolidation of a State bank or trust company with a national bank under the charter of the latter, the application may be made by the national bank the charter of which is to be retained.

#10. Insert after Section II, page 25.

SECTION III. - CONSOLIDATION OF TWO OR MORE NATIONAL BANKS.

Where two or more national banks consolidate under the provisions of the Act of November 7, 1918, and any one of such banks has, prior to such consolidation, received a permit from the Federal Reserve Board to act in fiduciary capacities, the rights existing under such permit pass by operation of law to the consolidated bank and the consolidated bank may exercise such fiduciary powers in the same manner and to the same extent as the bank to which such permit was originally issued. In order that the consolidated bank's records may be complete and its right to exercise such fiduciary powers may not be questioned, however, it is advisable for the consolidated bank to obtain from the Federal Reserve Board a permit to exercise fiduciary powers in its own name. Such a permit may be applied for in advance of the consolidation and may be issued in the name of the consolidated bank effective when the consolidation is consummated.

#11. Insert after new Section III, page 25.

SECTION IV. - CONSOLIDATION OF STATE BANK WITH NATIONAL BANK.

Section 3 of the Act of November 7, 1918, as amended by Section 1 of the Act of February 25, 1927, which authorizes any bank, trust company, savings bank, or other banking institution incorporated under the laws of any State or of the District of Columbia to be consolidated directly with a national bank located in the same city, town or village under the charter of such national bank, provides in part that when such consolidation is effected:

> "* * * all the rights, franchises, and interests of such State or District bank so consolidated with a national banking association in and to every species of property, real, personal, and mixed, and choses in action thereto belonging, shall be deemed to be

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transferred to and vested in such national banking association into which it is consolidated without any deed or other transfer, and the said consolidated national banking association shall hold and enjoy the same and all rights of property, franchises, and interests including the right of succession as trustee, executor, or in any other fiduciary capacity in the same manner and to the same extent as was held and enjoyed by such State or District bank so consolidated with such national banking association."

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"The words 'State bank', 'State banks', 'bank', or 'banks', as used in this section, shall be held to include trust companies, savings banks, or other such corporations or institutions carrying on the banking business under the authority of State laws."

The purpose of this provision is to make clear the right of such a consolidated national bank to succeed to the specific trusteeships, executorships, and other fiduciary appointments under which the State institution was acting prior to the consolidation or in which it had been appointed or designated to act under wills or other instruments which had not become effective at the time of consolidation through the death of a testator, the probate of a will or otherwise; but it does not confer upon such national banks the right to act generally in fiduciary capacities or to undertake any new trust business. It is necessary for the consolidated national bank to have a permit from the Federal Reserve Board to act in fiduciary capacities, therefore, before undertaking to act generally in fiduciary capacities or to accept any new trust business. If the national bank does not desire to act generally in fiduciary capacities or to accept any new trust business, but desires merely to continue to execute the specific trusteeships, executorships and other fiduciary affairs which were actually being executed by the State institution at the time of the consolidation or which the State institution had been designated to execute under wills or other instruments which had not yet become effective through the death of the testator, the probate of the will or otherwise, it is not technically necessary for the national bank to have a permit from the Federal Reserve Board in order to execute such specific trusts; but it is advisable for the national bank to have such a permit, in order that its right to continue to execute these trusts may not be questioned. In all cases involving the consolidation of a State institution having a trust business with a national bank under the provisions of the above mentioned act, therefore, the national bank should obtain from the Federal Reserve Board a permit to act in fiduciary capacities before the consolidation becomes effective, unless such national bank already has such a permit.

#12. Substitute for old Section III, page 25.

SECTION V. SEPARATE TRUST DEPARTMENTS.

Every national bank which obtains from the Federal Reserve Board a permit to act in fiduciary capacities shall establish a separate trust department within six months after the issuance of such permit. Such department shall be established before such bank undertakes to act in any fiduciary capacity and shall be placed under the management of an officer or officers whose duties shall be prescribed by the Board of Directors of the bank, either by an amendment to the by-laws of the bank or by a resolution duly entered in the minutes of the Board of Directors.

#13. Insert on page 25.

SECTION VI. DEPOSIT OF SECURITIES WITH STATE AUTHORITIES.

Whenever the laws of a State require corporations acting in a fiduciary capacity to deposit securities with the State authorities for the protection of private or court trusts, every national bank in such State which obtains a permit from the Federal Reserve Board to act in fiduciary capacities shall, before undertaking to act in such capacities, and at all events within six months after the issuance of such permit, make a similar deposit of securities. Such securities shall be deposited with the State authorities, unless the State authorities refuse to accept them. If the State authorities refuse to accept such securities, they shall be deposited with the Federal Reserve Agent of the District in which such national bank is located. Securities so deposited shall be held for the protection of private or court trusts, as provided by the State law.

#14. Substitute for old Section V, page 26.

SECTION VIII. FUNDS AWAITING INVESTMENT OR DISTRIBUTION.

(a) In General. Funds received or held in the trust department of a national bank awaiting investment or distribution shall be invested or distributed as soon as practicable and shall not be held uninvested by the bank any longer than is reasonably necessary.

(b) Deposits in Commercial or Savings Department of Trustee Bank. - Funds received or held in the trust department of a national bank awaiting investment or distribution may be deposited in the commercial department or savings department of the bank to the credit of the trust department; provided that the bank first delivers to the trust department, as collateral security:

(1) Bonds or certificates of indebtedness of the United States; or

(2) Other readily marketable securities of the classes in which State trust companies or State banks exercising trust powers are authorized or permitted to invest trust funds under the laws of the State in which such bank is located; or

(3) Other readily marketable securities of the classes defined as "investment securities" under the regulations of the Comptroller of the Currency issued pursuant to Section 5136 of the Revised Statutes of the United States as amended by the Act of February 25, 1927.

The United States bonds or other securities so deposited as collateral shall be owned by the bank and shall at all times be at least equal in market value to the amount of trust funds so deposited in the commercial department.

(c) Deposits in other Banks. If funds received or held in the trust department of a national bank awaiting investment or distribution are deposited in another bank, they shall be deposited to the credit of the said national bank as trustee or other fiduciary and the said national bank shall first require the bank in which such funds are deposited to deliver to the said national bank, as collateral security, United States bonds or other readily marketable securities of the kinds specified in Subsection (a) above, which securities shall be owned by the depositary bank, and shall at all times be equal in market value to the amount of funds so deposited. Such collateral security shall be held in the trust department of the said national bank in the manner provided in Section IV of this regulation for the security of the owners of the funds so deposited.

#15. Insert on page 26.

SECTION X. COMPENSATION OF BANK.

A national bank acting in a fiduciary capacity is entitled to receive for its services such fee or compensation as may be allowed by State law or provided for in the will, deed, court order or other instrument creating the trust. If the amount of such fee or compensation is not regulated by State law or stipulated or provided for in the instrument creating the trust, the national bank may charge or deduct not more than a reasonable fee or compensation. Where the bank is acting in a fiduciary capacity under appointment by a court, it may receive such fee or compensation as shall be allowed or approved by that court.

After the deduction of a proper fee or compensation, determined in the manner prescribed above, all income derived from the investment of the funds of a trust shall be paid over to, or credited to the account of, such trust.

#16. Insert on page 27.

SECTION XIII. INSOLVENCY OR VOLUNTARY LIQUIDATION OF BANK.

(a) Insolvency. Whenever a national bank exercising fiduciary powers, becomes insolvent and a receiver is appointed therefor by the Comptroller of the Currency, such receiver will, pursuant to the instructions of the Comptroller of the Currency and to the orders of the court or courts of appropriate jurisdiction, proceed to close such trusts and estates as can be closed promptly and transfer to substitute fiduciaries all trusts and estates which cannot be closed promptly.

(b) Voluntary liquidation. Whenever a national bank exercising fiduciary powers is placed in voluntary liquidation, the liquidating agent shall, in accordance with the laws of the State in which such national bank is located, proceed at once to liquidate the affairs of the trust department as follows:

1. All voluntary trusts which can be cancelled shall be cancelled as soon as possible and all assets and papers thereof shall be delivered to the rightful owner or owners;

2. All court trusts and estates under the jurisdiction of a court shall be closed or disposed of as soon as possible in accordance with the orders or instructions of the court having jurisdiction;

3. All other trusts which can be closed promptly shall be closed as soon as possible and final accounting made therefor;

4. All other trusts which cannot be closed promptly shall be transferred by appropriate legal proceedings to substitute trustees or other fiduciaries.

EXPLANATION OF CHANGES IN REGULATION F.

Section I, page 25. There is inserted at the end of this section the provisions contained in Section 1 of the McFadden Act with reference to the effect of the consolidation of a State bank having trust powers

with a national bank. This was suggested by the Federal Reserve Banks of Boston and St. Louis.

Section II, page 25. There is inserted at the end of this section an explanation of the manner in which applications should be made for trust powers in cases where a new national bank is being organized, a State bank is converted into a national bank, two or more national banks are consolidated, or a State bank is consolidated with a national bank under the charter of the latter.

New Section III, page 25. It is proposed to insert a new Section III stating the effect of the consolidation of two or more national banks one of which has trust powers and the advisability of the consolidated bank obtaining a new fiduciary permit.

New Section IV, page 25. It is proposed to insert a new Section IV stating the effect of the consolidation of a State bank having trust powers with a national bank under the charter of the latter. This was suggested by the Federal Reserve Banks of Boston and St. Louis.

Old Section III, new Section V, page 25. It is proposed to redesignate old Section III as Section V, and to amend the section so as to require every national bank which obtains from the Federal Reserve Board a permit to act in fiduciary capacities to establish a separate trust department within six months after issuance of such permit. This was recommended by the last Governors' Conference and by the last conference of Federal Reserve Agents.

New Section VI, page 25. It is proposed to insert at this place a new section with reference to the deposit of securities with State

authorities which will require such deposits to be made within six months after the issuance of a fiduciary permit. This was suggested by the last conference of Governors and by the last conference of Federal Reserve Agents. It is also proposed to insert here a provision covering the situation where the State law requires a deposit of securities but the State authorities refuse to accept such deposits from national banks.

Old Section V, new Section VIII, page 26. It is proposed to designate old section V as Section VIII and to re-write the entire section so as to cover more completely the handling of funds awaiting investment or distribution. There is incorporated in this section a statement of the principle that funds held awaiting investment or distribution should be invested or distributed as soon as practicable and should not be held by the bank uninvested any longer than is reasonably necessary. The provision with reference to deposits of trust funds in the banking department of the trustee bank to the credit of the trust department is amplified and made more definite. This was suggested by the Federal Reserve Banks of New York and Cleveland. There is inserted a new provision covering deposits of trust funds in other banks and requiring that when this is done the trustee bank shall require the bank in which such funds are deposited to pledge securities with the trustee bank for the protection of such deposits. This is believed to be absolutely necessary in order to afford trust funds the protection which the Federal Reserve Act obviously intended should be afforded. If the trustee deposits trust funds in another bank to the credit of itself as trustee it incurs no liability therefor except in the case of actual negligence or violation of the terms of the trust agree-

ment; and, if the bank in which such funds are deposited should fail, the trust estate would have no prior lien on such funds but would be in the position of a general creditor. Such a result is clearly contrary to the intent of that provision of Section 11(k) which provides that if trust funds are used in the business of the trustee bank the bank shall pledge securities with the trust department for their protection.

Old Section VI, new Section IX, page 26. It is proposed to amend this section so as to state explicitly that funds held in trust must be invested as soon as practicable; and, also, so as to authorize investments to be approved by a committee of directors appointed for that purpose, instead of requiring them to be approved by the entire Board of Directors.

New Section X, page 26. It is proposed to insert a new Section X stating what compensation the bank may receive for acting in fiduciary capacities and providing that, after the deduction of a proper fee or compensation, all income derived from the investment of trust funds shall be paid over or credited to the account of such trust. This is intended to prevent a practice such as that which exists in Kentucky, whereby some banks hold trust funds uninvested, employ them in their business, pay the trust estate a penalty of 5% as required by the State law, and retain for themselves all earnings in excess of 5%. This was suggested by the Federal Reserve Bank of St. Louis.

Old Section VIII, new Section XII, page 27. It is proposed to amend this section so as to authorize separate examinations of the trust department to be made at any time. This was suggested by the Federal Reserve Bank of Minneapolis.

New Section XIII, page 27. It is proposed to insert a new section XIII providing for the winding up of the affairs of the trust department of a national bank which is placed in voluntary liquidation or in the hands of a receiver.

Old Section X, page 27. It has been suggested by the office of the Comptroller of the Currency that there should be eliminated entirely the existing Section X, whereby the Board now reserves the right to revoke permits to act in fiduciary capacities for violations of law; because it is believed that the reservation of this right by the Federal Reserve Board is inconsistent with the policy of Congress as indicated in the McFadden Act. The McFadden Act contains a provision granting national banks indeterminate charters, and it is clear that the purpose of Congress in enacting this provision was to enable national banks to compete with trust companies having indeterminate or perpetual charters. It is argued that this purpose of Congress would be defeated if the Federal Reserve Board should continue to reserve the right to revoke fiduciary permits. While it is believed that the Board technically has such a right under the existing regulations, the legality of this section of the regulations is at least open to doubt, especially since the enactment of the McFadden Act. Moreover, this power has never been exercised, and an equally effective remedy lies in the Board's power to direct the Comptroller of the Currency to bring suit to forfeit the charter of a national bank for violation of law.

REGULATION G.

It is proposed to eliminate entirely the old Regulation G dealing with loans by national banks on farm land and other real estate; since this is a matter within the jurisdiction of the Comptroller of the Currency, and it is understood that he is preparing to issue regulations on this subject.

In order to avoid changing the familiar and well known designation of other existing regulations, it is proposed to redesignate Regulation M as Regulation G and insert it at this place.

REGULATION H.

The following is the text of the proposed new provisions to be inserted in Regulation H:

#17. Insert in table on page 30.

In an outlying district of a city with a population exceeding 50,000 inhabitants; provided State law permits organization of State banks in such location with a capital of $100,000 or less.	$100,000	$60,000

#18. Insert on page 31 at end of Section I.

(c) Branches. - In order to be eligible for membership in a Federal reserve bank, a State bank or trust company must relinquish any branch or branches established by it after February 25, 1927, beyond the limits of the city, town or village in which the parent bank is situated.

#19. Alternative substitute for Section IV, page 32.

SECTION IV. CONDITIONS OF MEMBERSHIP.

Pursuant to the authority contained in the first paragraph of Section 9 of the Federal Reserve Act, which provides that the Federal Reserve Board may permit applying banks to become members of the Federal Reserve System "subject to the provisions of this Act and to such conditions of membership as it may prescribe pursuant thereto", the Federal Reserve Board will prescribe for each bank or trust company hereafter applying for admission to the Federal Reserve System such conditions of membership pursuant to the provisions of the Federal Reserve Act as the Board may consider necessary or advisable in the particular case, and such bank or trust company will be required to agree to such conditions of membership prior to its admission to the Federal Reserve System.

#20. Substitute for Section VI, page 34.

SECTION VI. ESTABLISHMENT OR MAINTENANCE OF BRANCHES.

Every State bank which is, or hereafter becomes, a member of the Federal Reserve System will be required to comply strictly with the following provision of Section 9 of the Federal Reserve Act as amended by the Act of February 25, 1927:

> Any such State bank which, at the date of the approval of this Act, has established and is operating a branch or

branches in conformity with the State law, may retain and operate the same while remaining or upon becoming a stockholder of such Federal reserve bank; but no such State bank may retain or acquire stock in a Federal reserve bank except upon relinquishment of any branch or branches established after the date of the approval of this Act beyond the limits of the city, town, or village in which the parent bank is situated.

This has been interpreted to mean that:

1. Any State member bank which, on February 25, 1927, had established and was actually operating a branch or branches in conformity with the State law is permitted to retain and operate the same while remaining a member of the Federal Reserve System, regardless of the location of such branch or branches.

2. Any nonmember State bank which, on February 25, 1927, had established and was actually operating a branch or branches in conformity with State law may, if otherwise eligible, become a member of the Federal Reserve System and retain and operate such branches, regardless of their location.

3. In order to remain a member of the Federal Reserve System, every State member bank must relinquish any branch or branches established after February 25, 1927, beyond the limits of the city, town or village in which the parent bank is situated.

4. Any State member bank which establishes any branch or branches after February 25, 1927, beyond the limits of the city, town or village in which the parent bank is situated must either (a) relinquish such branch or branches or (b) forfeit all rights and privileges of membership and surrender its stock in the Federal reserve bank.

5. No State bank which has established any branches subsequent to February 25, 1927, beyond the limits of the city, town or village in which the parent bank is situated may become a member of the Federal Reserve System except upon relinquishment of every such branch.

6. State member banks may establish branches within the limits of the city, town or village in which the parent bank is situated without obtaining permission of the Federal Reserve Board.

EXPLANATION OF PROPOSED CHANGES IN REGULATION H.

Section 1, page 30. It is proposed to amend Section 1 so as to permit the admission to the Federal Reserve System of State banks located in outlying districts of the cities having a population exceeding 50,000 inhabitants with a capital of $100,000 or $60,000, in view of the amendment contained

in the McFadden Act permitting national banks so situated to be organized with a capital of only $100,000. It is also proposed to insert at the end of this section a provision conforming to the provisions of the McFadden Act insofar as it affects the eligibility for membership in the Federal Reserve System of State banks having branches.

Section IV, page 32. It is necessary to change this section to conform to the amendment contained in the McFadden Act which authorizes the Board to prescribe only such conditions of membership as are "pursuant to" the provisions of the Federal Reserve Act. Two proposed revisions of this section are submitted. One of them would require certain changes in the existing text of this section, and such changes are noted in red ink on the old regulations. The other alternative draft is submitted herewith as proposed insert number 19. This proposed revision of Section IV would omit entirely the text of all conditions of membership, and probably would lessen materially the antagonism to the Board's practice of prescribing conditions of membership. Such a revision of this section would not prevent the Board from prescribing any condition of membership which it may now prescribe under Section 9 as amended by the McFadden Act, nor would it prevent the Board from adopting a definite policy with reference to conditions of membership, which policy might be incorporated in a resolution to be adopted by the Board or in a circular letter addressed to all Federal Reserve Agents.

Section V, page 33. If the text of Condition Number 1 is omitted from Section IV, it is suggested that Section V should be omitted altogether and the remaining sections renumbered accordingly.

Section VI, page 34. It is proposed to eliminate altogether the old section VI containing "Principles Governing Establishment of Branches", and to substitute therefor the text of the provision of the McFadden Act pertaining to branches of State member banks, together with a statement of the interpretation which has been given to that provision.

Section VIII, page 36. It is proposed to omit entirely the second paragraph of this section, in view of the fact that the Board or the Federal reserve banks may wish to change the existing practice with respect to examinations of State member banks.

REGULATION I.

The few slight changes proposed to be made in Regulation I are noted in red ink on the text of the old regulation and are believed to be self-explanatory. It may be stated, however, that the elimination of the words "if earned" from subdivisions (b) and (c) of Section II are intended to make the regulation conform to the ruling contained in the Board's circular letter of April 17, 1925 (X-4322).

REGULATIONS J, K, AND L.

It is not proposed to make any changes in Regulations J, K, and L.

REGULATION M.

It is not proposed to make any change in Regulation M, except to redesignate it as Regulation G and transfer it to the place formerly occupied by old Regulation G, which it is proposed to eliminate.