(CONFIDENTIAL) (C O P Y) X-4873

June 16, 1927. 392

To The Law Committee. SUBJECT: REVISION OF BOARD'S REGULATIONS.

From Mr. Wyatt, General Counsel.

In accordance with the Board's instructions, I have carefully considered all suggestions received from the Federal Reserve Banks and Federal Reserve Agents regarding the Board's Regulations, and respectfully submit herewith a final draft of a proposed revision of all the Board's printed regulations.

IMPORTANCE OF EARLY ACTION.

I respectfully call attention to the importance of amending the regulations as soon as possible so as to conform to the amendments made to the law by the McFadden Act of February 25, 1927.

REASON FOR DELAY.

The delay which has already occurred in the preparation of these regulations is regrettable; but has been due to causes beyond my control, as will be seen from the following chronology:

Feb. 25. - McFadden Act signed by President.
March 4. - Board requested Law Committee to prepare revision of Regulations.
March 4. - Circular letter (X-4804) sent to Governors and Chairmen of all Federal Reserve Banks inviting them to suggest amendments to Regulations.
April 12. - Board placed proposed revision of Regulations on program for discussion at Governors' Conference.
April 15. - Last of suggestions submitted pursuant to letter X-4804 received.
April 23. - Board mailed to each Governor tentative draft of revision of Regulations. (X-4830)
April 25. - Copy of tentative draft of revised Regulations delivered to each Board member.
May 2. - Board invited suggestions of all Federal Reserve Agents re tentative draft of revised Regulations.
May 9 to 13. - Governors' Conference met at Washington, failed to discuss Regulations, and suggested appointment of committee to confer with Board's Counsel on the subject.
May 18. - Law Committee requested to prepare and submit to Board for action proposed revision of Regulations after consideration of all suggestions received from Federal Reserve Agents and suggestions

filed with Secretary of Governors' Conference by individual Governors during the Conference.

May 18. - Secretary of Governors' Conference requested to send Board suggestions filed with him during Conference.

May 31. - Last suggestions re tentative draft received from Federal Reserve Agents.

June 11. - Suggestions filed at Governors' Conference received from Secretary of Conference.

From this it will be seen that most of the delay in the preparation of these regulations has resulted from the very material delay of the Federal Reserve Banks in submitting their suggestions to the Federal Reserve Board.

EXPLANATION OF PROPOSED CHANGES.

Each amendment incorporated in the attached draft of the regulations is explained below, and attention is especially called to every amendment which has been the subject of any serious difference of opinion. For the further information of the Law Committee, there are attached hereto all written suggestions regarding the regulations which have been received from any source, and my comments on each suggestion are noted on the margin.

REGULATION A.

Section I, page 1.

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

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

It is also proposed to eliminate from next to the last paragraph of this section the words "under the terms of Section 5200 of the United States Revised Statutes, as amended". This was suggested by Governor Harding for the following reason:

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"That portion of Section 9 of the Federal Reserve Act which applies to the subject makes no mention of Section 5200 and while it may be that as a practical matter this question would be determined only by the provisions of Section 5200, there might be a question whether Section 24 of the Federal Reserve Act regulating real estate loans by national banks, and Section 5136 of the Revised Statutes regulating the amount of investment securities of any one obligor or maker which a national bank may take, would have a bearing on the subject."

Section II, page 2.

The obsolete provisions regarding the bonds and 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 non-member bank.

It is also proposed to eliminate the words "under the terms of Section 5200 of the United States Revised Statutes, as amended", for the reason stated above under Section I.

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 non-member 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 climinate 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 $1000, instead of $5000 as heretofore. The Federal Reserve Bank of Minneapolis originally suggested that financial statements be required whenever the amount involved equals or exceeds $500, on the ground that that is the amount fixed by national bank examiners as the maximum amount of unsecured credit which should be extended unless supported by a signed financial statement. In the tentative draft of the new Regulation it was proposed to require such statements wherever the amount involved equals or exceeds $500, and this developed considerable difference of opinion among the Federal reserve banks. Some of them advocated it; others stated that they had been requiring it for some time wherever the amount involved exceeds $1000; and others opposed it on the ground that the change would be too drastic and that such statements are not really necessary. It is believed that it would be a fair compromise to require such statements wherever the amount involved exceeds $1000.

It is also proposed to change the first paragraph regarding financial statements in such a way as to clarify the meaning thereof without

making any change in the substance.

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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 containing 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.)

Section XI, page 7.

The change suggested in subdivision (3) is designed to conform the regulation to the rulings published on page 740 of the 1919 Bulletin and page 638 of the 1924 Bulletin. This was suggested by the Federal Reserve Bank of San Francisco.

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.

REGULATION D.

In general, it may be said that both the original recommendations received from the Federal reserve banks and their comments on the first tentative draft of the regulations 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 classifyinf 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.

It is also proposed to insert at the end of Section II(d) a provision to the effect that, "Deposits of one bank in another shall not in any case be considered 'savings accounts' within the meaning of this regulation." This was suggested by the Federal Reserve Banks of New York and Chicago, and is designed to discourage the practice of some banks receiving so-called "savings account" deposits from other banks and classifying them as time deposits while the depositing banks treat them as "balances due from banks."

Section II(e), pages 16 and 17.

It is proposed to change the language of this subsection so as to clarify and strengthen the definition of "time certificates of deposit."

It is also proposed to insert at the end of subdivision (e) two new provisions:

(1) A statement to the effect that the retention of the certificate, or a duplicate of same, by the bank and the presentation of same by the bank to itself is not an"actual presentation" of same within the meaning of this regulation.

(2) A statement incorporating in the regulations the substance of

the Board's ruling published on page 655 of the 1919 Bulletin. 398

Section III(a), page 17½.

The new paragraph 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.

It is also proposed to insert as a foot-note at the bottom of page 17½ the definition of "outlying districts" recommended by Mr. Collins, Deputy Comptroller of the Currency, and the undersigned under date of June 11, 1927.

Section III(b), page 18.

This amendment was suggested by Mr. Smead, and is designed to make the regulation conform to the practice under the Board's existing forms of reports.

Section IV, pages 18 and 19.

The proposed revision of this Section is designed primarily 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 takes place." This was originally suggested by the Federal Reserve Bank of New York, and has given rise to much difference of opinion.

The difference of opinion which exists, however, is based largely on grounds of expediency and there is a surprising uniformity of opinion that some change along this general line is desirable. Four of the Federal reserve banks favor this amendment with a modification permitting daily reserve requirements to be based on deposit balances as of the previous day; four are

opposed to the change for practical reasons, most of which could be eliminated by the same modification; one favors the general idea but advises "making haste slowly"; and three suggest alternatives having the same general purpose.

The combined discussion of this subject by all the Federal reserve banks is quite voluminous, but the views expressed on behalf of each Federal reserve bank may be summarized very briefly as follows:

BOSTON — Suggests computation on daily basis for city banks and on average basis for country banks.

NEW YORK — Favors some change but suggests "making haste slowly" and discussing the subject with member banks before making such a change.

PHILADELPHIA — Favors adoption of proposed change with modification permitting reserves to be computed each day on basis of deposits for preceding day.

CLEVELAND — Believes computation on daily basis unworkable; but practical objections raised by Cleveland would be met by modification suggested by Philadelphia and Richmond.

RICHMOND — Favors computation on daily basis, provided reserves for each day are computed on basis of deposits for previous day.

ATLANTA — Favors the change without suggesting any modifications.

CHICAGO — Fears that computation on a daily basis would result in financial loss to member banks and suggests a substitute plan.

ST. LOUIS — Favors a change with the same modification as suggested by Philadelphia and Richmond.

MINNEAPOLIS — Opposes the requirement for computations on a daily

basis, "because it is practically impossible for bank to guess its reserve requirements before close of business." (This would be cured by modification suggested by Philadelphia and Richmond).

KANSAS CITY — Opposes the change because of practical difficulties, which would largely be obviated by the modification suggested by Philadelphia and Richmond.

DALLAS — Mildly opposed to the change for practical reasons; but suggests as alternative that reserves of banks in central reserve cities be computed on daily basis, that reserves of banks in reserve cities be computed on weekly basis, and that reserves of country banks be computed on monthly basis, provided compulsory progressive penalty is adopted.

SAN FRANCISCO — Points out practical difficulties, which would be overcome by the modification suggested by Philadelphia and Richmond.

In accordance with the suggestions made by the Federal Reserve Banks of Philadelphia, Richmond and St. Louis, the new Section IV, as submitted in the attached draft, is modified so as to permit the reserves for each day to be computed at the close of business each day on the basis of net deposit balances of the member bank for the preceding business day. This would give the member banks twenty-four hours in which to restore their reserves in the event of unexpected fluctuations, and it is believed that it would overcome most of the practical objections to the computation of reserves on a daily basis. I have talked with Governor Seay, Mr. Smead, Mr. Herson and several others about this, and they assure me that, with this modification, the requirement for daily computation of reserves is entirely practical and is

a big step in the right direction. It would impose no new burdens on member banks in the matter of making reports; because the reports now submitted are required to show deposit balances and reserves as of each day. It would increase to some extent the accounting work at the Federal reserve banks, but it is believed that this would be justified in view of the good it will accomplish.

If adopted as revised, this Section would also prescribe a compulsory progressive penalty for all Districts and relieve the Federal reserve banks of the necessity of taking the initiative in this matter.

There was some difference of opinion as to this provision for a compulsory progressive penalty; but only two Federal reserve banks (Minneapolis and New York) opposed it. Because of unfortunate experiences during the so-called "deflation period", Minneapolis is opposed to any progressive penalty. New York recognizes the merits of the suggested change, but believes that the old regulation "will permit of more flexibility in the treatment of individual cases". Of the other ten banks, seven favor the amendment, two suggest a clarification of its provisions, and one makes no comment.

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.

Subdivision 5 of the proposed new Section IV 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. An amendment for this general purpose was suggested by the Federal Reserve Bank of Philadelphia and favored by a majority of the Federal reserve banks. There was no strong opposition to it.

Section V, page 19½

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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 proposed new provision to be inserted at the end of this Section is designed to provide for the enforcement of the prohibition against member banks making loans or paying dividends while their reserves are deficient. None of the Federal reserve banks indicated much opposition to this provision; but three expressed doubts as to its wisdom and two considered it too rigid. One said it was "heartily in accord" with the idea; and the others made no comment. As now submitted, the provision has been slightly modified so as to require reports only in cases of "wilful disregard" of the law.

REGULATION E.

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

REGULATION F.

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.

Insofar as this pertains to applications for fiduciary powers by new national banks at the time of their organization, it is inconsistent with the Board's present practice of requiring new national banks to wait six months or a year before obtaining fiduciary powers. However, in view of the fact that State banks and trust companies may exercise fiduciary powers from the date they are open for business, and the adoption of the McFadden Act indicates

that it is the policy of Congress to place national banks on a better competitive basis with State institutions, it would seem that national banks should be given the same privilege. Moreover this provision of the Regulation would not prevent the Board from withholding action in any individual case if it doubts the wisdom of granting trust powers to the applying bank. None of the Federal reserve banks expressed opposition to this proposed change. 403

New Section III, page 25a.

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 25a.

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 25c.

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 Governors' Conference and by the conference of Federal Reserve Agents in the fall of 1926.

New Section VI, page 25c.

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 conference of Governors and by the conference of Federal Reserve Agents in the fall of 1926. 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 rewrite the entire section so as to cover more completely the handling of funds awaiting investment or distribution. The principal changes may be summarized briefly as follows:

(1) 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.

(2) 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.

(3) There is inserted as Subsection (c) 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 contemplates. 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 agreement; 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.

With reference to this proposed new Subsection (c), Mr. Austin makes the following comment, due to a peculiar local situation in Pennsylvania:

> "We very much regret that it was found necessary to put such a provision in the regulations; the Pennsylvania law requires that uninvested trust funds shall be deposited by the trustee bank with another banking institution, no securities are required from such institution, and the plan for many many years has worked well. To require national banks now to acquire collateral security from institutions with which they deposit uninvested trust funds is going to make no end of trouble and ill feelings, and we think will practically result in national banks keeping such trust funds in their own institutions and absolutely disregarding the Pennsylvania State law, which requires uninvested trust funds to be deposited in some other institution."

The Federal Reserve Board has consistently held, however, that national banks in Pennsylvania exercising trust powers may deposit their uninvested trust funds in their commercial departments under the terms and conditions prescribed in Section 11(k) of the Federal Reserve Act and the Board's regulations. The right of a national bank to do this, regardless of the requirements of State law, would seem to have been definitely settled by the case of In re Turner's Estate, decided by the Supreme Court of Pennsylvania in 1923.

It would seem unfortunate to omit a very wholesome provision from the Board's regulations merely because one State of the Union has an unsound statute with which national banks cannot be compelled to comply.

Old Section VI, new Section IX, page 26a.

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 26a.

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; and, on February 23, 1927, the Board requested the Law Committee to prepare such an amendment.

Old Section VIII, new Section XII, page 26b.

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 26b.

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.

It has been suggested by Mr. Awalt on behalf of the Comptroller of the Currency that there should be inserted at this point a provision for the winding up of the trust department of a national bank which voluntarily surrenders its trust permit and discontinues the exercise of trust powers. In view of the fact that this happens so seldom and the proper practice in

such cases has never been decided upon by the Federal Reserve Board, I doubt the advisability of attempting to promulgate a regulation on this subject at the present time. If, however, the Board desires to promulgate such a regulation, the following section could be inserted immediately after new Section XIII on page 27:

"SECTION XIV. DISCONTINUANCE OF THE EXERCISE OF TRUST POWERS.

"Whenever a national bank exercising fiduciary powers decides to discontinue exercising such powers and to terminate the operation of its trust department, it shall give written notice to that effect to the Federal Reserve Board. When such notice has been given, the bank shall thereupon proceed to settle the affairs of the trust department in the manner provided in the paragraphs numbered 1 to 4 of Section XIII (b) of this regulation.

"When the affairs of the trust department of such national bank have been finally settled and disposed of in accordance with the provisions of this regulation, the bank shall so advise the Federal Reserve Board."

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.

Section I, page 30.

It is proposed to amend Section I so as to permit the admission to the Federal Reserve System of State banks located in outlying districts of 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 a foot note at the bottom of the page defining "outlying districts."

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.

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Section III, page 32.

It is proposed to change the last paragraph of this Section so as to conform to the law as amended by the McFadden Act and also so as to conform to the Board's actual practice in approving applications for membership subject to conditions. Mr. Austin has twice called attention to the fact that the Board does not issue any formal certificate of approval until after the conditions of membership are accepted by the applying bank.

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. In the attached draft of the regulation only such changes are made in Section IV as are made necessary by the amendment contained in the McFadden Act. As an alternative, the following could be inserted in lieu of the present Section IV:

"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."

This 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. It 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.

Both alternative revisions of Section IV were submitted to the Federal Reserve banks; but only five of them stated their preference. New York, Philadelphia, and Minneapolis prefer the short form quoted above. Richmond and St. Louis prefer the longer form embodied in the attached draft of the regulations.

Section V, page 33.

If the shorter form of Section IV is adopted, Section V would have to be omitted altogether.

Regardless of which form of Section IV is adopted, there is very serious opposition to Section V on the part of the Federal Reserve Agents and Federal reserve banks, who claim that it is unworkable and causes them much embarrassment. I make no recommendation on this question; but suggest that while it has the regulations under consideration it would be advisable for the Board to weigh the practical advantages and disadvantages of this Section and decide whether or not to omit it.

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. The omission of this paragraph would not of itself make any change in the existing practice, but would merely leave the Board free to make such achange if and when it sees fit.

In the last paragraph of this Section it is proposed to eliminate all reference to Form 107a, because the Board no longer requires State member banks to furnish special notifications of dividends.

REGULATION I.

Section II(a), page 39.

It is proposed to amend this section so as to state the existing rule in the case where a member bank reduces its surplus.

Section II(b), page 39.

The elimination of the words "if earned" is suggested in order to make the Regulation conform to the ruling contained in the Board's circular letter of April 17, 1925, (X-4322).

Section II(c), pages 39 and 40.

At the suggestion of the Federal Reserve Bank of Chicago, it is proposed to amend this section so as to require the cancellation and surrender of Federal reserve bank stock by a member bank in voluntary liquidation, even though no liquidating agent is appointed. The law does not require the appointment of a liquidating agent; but it does require that sufficient legal steps be taken to place the bank in voluntary liquidation, and this latter requirement will have to be retained in the regulation. The amendment to the regulation, therefore, will not cure the situation where a member bank sells out its business but does not go into liquidation. It will require an amendment to the law to correct that situation.

The elimination of the words "if earned" is suggested in order to make the Regulation conform to the ruling contained in the Board's circular letter of April 17, 1925,(X-4322).

REGULATION J.

Regulation J, Series of 1924, has proven so satisfactory and has stood the test of the courts so well that no change appears to be necessary.

At the suggestion of Mr. Baker, however, it is proposed to change the period at the end of the second paragraph of Section II to a comma and add the following:

> "and each member bank and nonmember clearing bank shall cooperate fully in the system of check clearance and collection for which provision is herein made."

This can do no harm and might be very helpful in dealing with the practice of member banks stamping their checks, "Not payable through Federal Reserve Banks." Mr. Baker, Mr. Parker, and I are agreed that this practice should not be specifically mentioned, lest it serve to "educate the Devil".

REGULATION K.

It is proposed to incorporate in the new edition of the regulations the text of Regulation K as amended June 8, 1927, with only a few changes in capitalization, punctuation, and numbering to make it conform to the general style of the regulations.

REGULATION L.

It is not proposed to make any changes in Regulation 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 is to be eliminated.

CONCLUSION.

It is respectfully recommended that the new regulations be promulgated as soon as possible; because the existing regulations are in some respects in conflict with the law as amended by the McFadden Act of February 25, 1927.

Respectfully,

Walter Wyatt,
General Counsel.