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To: Federal Reserve Board March 24, 1927.

From: Mr. Wyatt - General Counsel. Subject: Power to Prescribe Conditions of Membership for State Banks under Section 9 as amended by McFadden Act.

Before admitting any more State banks to membership in the Federal Reserve System, it will be necessary for the Board to decide the most important question presented for its consideration by the amendments contained in the McFadden Act, - - i.e., what conditions of membership may the Board legally and properly prescribe in admitting State banks to the Federal Reserve System under the provisions of Section 9 of the Federal Reserve Act as amended by the McFadden Act?

The first paragraph of Section 9 of the Federal Reserve Act as amended by the McFadden Act of February 25, 1927, reads as follows, the words underlined having been inserted by the McFadden Act:

> "Sec. 9. Any bank incorporated by special law of any State, or organized under the general laws of any State or of the United States, desiring to become a member of the Federal reserve system, may make application to the Federal Reserve Board, under such rules and regulations as it may prescribe, for the right to subscribe to the stock of the Federal reserve bank organized within the district in which the applying bank is located. Such application shall be for the same amount of stock that the applying bank would be required to subscribe to as a national bank. The Federal Reserve Board, subject to the provisions of this Act and to such conditions as it may prescribe pursuant thereto may permit the applying bank to become a stockholder of such Federal reserve bank."

Upon a plain reading of the Act, it would seem that the Board may in its discretion prescribe any reasonable conditions which are "pursuant to" provisions of the Federal Reserve Act. The question arises, however, what conditions may be said to be pursuant to the provisions of the Federal Reserve Act?

WHAT CONDITIONS ARE "PURSUANT TO" THE ACT?

It may be argued that, technically, any condition of membership which the Board might prescribe would be "pursuant to" the last sentence of the

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first paragraph of Section 9, which authorizes the Board to prescribe conditions of membership pursuant to the provisions of the Federal Reserve Act. Such a construction, however, would not be justified because it would give no effect whatever to the amendment adding to this sentence the words "pursuant thereto". It is a well-recognized rule of statutory construction that where the legislature amends a statute by adding certain new language it is presumed to have intended to make some change in the law, and some effect must be given to the new language added by the amendment.

I am of the opinion, therefore, that the Act as amended must be construed as authorizing the Board to prescribe only such conditions of membership as are "pursuant to" other provisions of the Federal Reserve Act.

The question then arises what conditions of membership may be said to be pursuant to provisions of the Federal Reserve Act other than the last sentence of the first paragraph of Section 9?

CONDITIONS "PURSUANT TO" SPECIFIC PROVISIONS OF THE ACT.

Conditions of membership which merely state or carry out certain specific provisions of the Federal Reserve Act obviously are conditions made pursuant to the provisions of the Federal Reserve Act within the meaning of the Act as amended.

Within this class would obviously be included the 7th and 8th conditions of membership set forth in Section IV of Regulation H. The 7th condition is merely designed to carry out that provision of Section 19 which forbids any member bank to keep on deposit with any State bank or trust company which is not a member bank a sum in excess of 10% of its own paid-up capital and surplus; and the 8th condition merely sets forth the substance of the provisions of Section 13 respecting the power of

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State member banks to issue bankers' acceptances.

Likewise, it may be said that the 9th condition of membership set forth in Section IV of Regulation H, which provides that:

> "The Board of directors of said bank or trust company shall adopt a resolution authorizing the interchange of reports and information between the Federal Reserve Bank of the district in which such bank or trust company is located and the banking authorities of the State in which such bank is located ",

is prescribed pursuant to the provision of Section 9 of the Federal Reserve Act which authorizes Federal reserve banks to accept examinations and reports made by the State authorities in lieu of examinations made by examiners selected or approved by the Federal Reserve Board. The State authorities might well hesitate to disclose reports of examinations of State banks to Federal reserve banks unless authorized to do so by the banks examined. Hence, it may be said that the power to require State member banks to authorize the State authorities to furnish reports of examinations to the Federal reserve banks is incidental to the specific statutory authority for the Federal reserve banks to accept State examinations in lieu of examinations made by Federal Reserve Examiners. The statute does not expressly authorize Federal reserve banks to furnish the State authorities with copies of reports of examinations of State banks made by Federal Reserve Examiners; but the State authorities might refuse to furnish copies of their examinations to the Federal reserve banks unless the Federal reserve banks furnish them with reports of Federal reserve examinations of State banks. Hence, it may be said that the power to require State member banks to authorize the Federal reserve banks to furnish the State authorities with copies of reports of examinations of such State banks made by the Federal Reserve Examiners is necessarily incidental to the statutory authority for the Federal reserve banks

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to accept State examinations in lieu of Federal reserve examinations. Moreover, this is an obviously reasonable condition to which no one could object.

It may be argued that the 3rd condition of membership set forth in Section IV of Regulation H, which provides that:

> "Such bank or trust company shall not reduce its capital stock except with the permission of the Federal Reserve Board",

is pursuant to that provision of Section 9 of the Federal Reserve Act which provides that:

> "All banks admitted to membership under authority of this section shall be required to comply with the reserve and capital requirements of this Act and to conform to those provisions of law imposed on national banks which prohibit such banks from lending on or purchasing their own stock, which relate to the withdrawal or impairment of their capital stock, and which relates to the payment of unearned dividends ".

A reduction of the capital stock, however, does not necessarily involve a withdrawal or impairment of the capital stock nor reduce the capital below the capital requirements prescribed by the Federal Reserve Act. This condition of membership, therefore, goes beyond the above quoted provision of the Federal Reserve Act and cannot properly be said to be "pursuant thereto". For this reason, I am of the opinion that the Board may no longer prescribe this condition.

CONDITIONS RE BRANCHES.

The 4th and 5th conditions set forth in Section IV of Regulation H, which deal with the establishment of branches by State member banks and the absorption of, or the acquisition of an interest in, other banks for the purpose of converting such other banks into branches, are superseded by the following provisions of law, which was inserted in Section 9 of the Federal Reserve Act by an amendment contained in the McFadden Act:

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"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".

By enacting this provision, Congress undoubtedly intended to deal completely with the subject of branches of State member banks. I am of the opinion, therefore, that the Board no longer has power to prescribe any conditions respecting branches of State member banks.

CONDITIONS RE FINANCIAL CONDITION OR MANAGEMENT.

The remaining conditions set forth in Section IV of Regulation H (i.e., the 1st, 2nd and 6th conditions) present more difficulty. These conditions read as follows:

"(1) Except with the permission of the Federal Reserve Board, such bank or trust company shall not cause or permit any change to be made in the general character of its assets or in the scope of the functions exercised by it at the time of admission to membership, such as will tend to affect materially the standard maintained at the time of its admission to the Federal reserve system and required as a condition of membership.

"(2) Such bank or trust company shall at all times conduct its business and exercise its powers with due regard to the safety of its customers.

"(3) Such bank or trust company shall reduce to, and maintain within, the limits prescribed by the laws of the State in which it is located, any loan which may be in excess of such limits".

I know of no provision of the Federal Reserve Act to which these conditions may be said to be pursuant unless it be that provision of Section 9 which provides that, in acting upon applications of State banks for membership in the Federal Reserve System:

" * * * the Federal Reserve Board shall consider the financial condition of the applying bank, the general character of its management, and whether or not the corporate powers exercised

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are consistent with the purposes of this Act".

Is a condition of membership which has a bearing upon the financial condition of the applying bank, the general character of its management or upon the question whether the corporate powers exercised by such bank are consistent with the purposes of the Federal Reserve Act a condition prescribed "pursuant to" a provision of the Federal Reserve Act?

The above quoted provision of Section 9 does not require the performance of any particular acts by member banks nor does it forbid the performance of any particular act by member banks. It does, however, impose a mandatory duty upon the Federal Reserve Board which must be discharged by the Board in acting upon every application of a State bank for membership in the Federal Reserve System.

When a bank applies for membership in the Federal Reserve System, the Board, in its discretion, may disapprove such application, or it may approve such application subject to the provisions of the Federal Reserve Act and such conditions of membership as the Board may prescribe pursuant thereto; and the law provides that, in acting upon such application, the Board "shall" (i.e., must) consider the financial condition of the applying bank, the general character of its management, and whether or not the corporate powers exercised are consistent with the purposes of the Federal Reserve Act.

What is the purpose of this requirement and what practical application should be given to it?

Reading the entire Act together and giving it a practical interpretation, it would seem to contemplate that if the Board is dissatisfied with the financial condition of the applying bank or the general character of its management or feels that the corporate powers exercised by it are not con-

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sistent with the purposes of the Federal Reserve Act, the Board should either (a) disapprove the application in toto and deny the bank the privileges of membership in the Federal Reserve System, or (b) admit the bank to membership subject to conditions designed to correct the matters found to be unsatisfactory.

This has always been the Board's practice, and the legislative history of this provision of the Federal Reserve Act (which is set forth on pages 5 to 9 of a letter attached hereto) demonstrates beyond any possibility of doubt that when Congress wrote this provision into the Federal Reserve Act (by the amendment of June 21, 1917), it thereby sanctioned such practice. Moreover, Congress did not by the amendment contained in the McFadden Bill clearly indicate an intent to prohibit such practice. On the contrary, as will hereinafter be shown, it rejected a specific amendment which would have stopped such practice.

I am of the opinion, therefore, that a condition of membership designed to correct an unsatisfactory financial condition of the applying bank or anything unsatisfactory in the general character of its management, or designed to restrict the bank to the exercise of such corporate powers as are consistent with the purposes of the Federal Reserve Act is a condition prescribed pursuant to the above quoted provision of the Federal Reserve Act.

I am also of the opinion that any condition of membership designed to preserve a satisfactory financial condition or satisfactory management for the applying bank or to keep the corporate powers exercised by the applying bank consistent with the purposes of the Federal Reserve Act is likewise a condition prescribed pursuant to this provision of the Federal Reserve Act.

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In deciding whether or not to admit a particular bank to membership in the Federal Reserve System and if so what conditions of membership should be prescribed, the Board is required by law to consider the financial condition of such bank, the character of its management, and whether or not the corporate powers exercised by it are consistent with the purposes of the Federal Reserve Act. It would be futile for the Board to assure itself that the financial condition and management of the bank are satisfactory and that its corporate powers are consistent with the purposes of the Federal Reserve Act before admitting such bank to the Federal Reserve System if, on the very day after it is admitted to the System, such bank could materially impair its financial condition, lower the character of its management, and assume corporate powers inconsistent with membership in the Federal Reserve System. It would seem, therefore, that the Board is clearly justified in prescribing a condition of membership designed to require a bank to maintain the standard on the basis of which it was admitted to membership.

Condition No. 1, quoted above, is a condition designed to preserve a satisfactory financial condition of the applying bank and to keep it within the scope of the functions exercised by it at the time it was admitted to membership and which served as a basis for the Board's decision as to whether the corporate powers exercised by the bank were at that time consistent with the purposes of the Federal Reserve Act. For this reason, I am of the opinion that condition no. 1 is a condition prescribed "pursuant to" the provisions of the Federal Reserve Act.

Conditions Nos. 2 and 6 also relate to the financial condition of the applying bank and the general character of its management and are designed to preserve for such bank a satisfactory financial condition and satisfactory management. Any bank which exercises its powers without due

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regard to the safety of its customers is obviously mismanaged and is very likely to get into a bad financial condition. And any bank which violates the loan limitations prescribed by the State laws is obviously mismanaged and is likely to get into a bad financial condition. I am of the opinion, therefore, that conditions no. 2 and 6 are conditions prescribed "pursuant to" the provisions of the Federal Reserve Act.

For the reasons set forth above, I am also of the opinion that special conditions of membership prescribed from time to time which require particular banks upon being admitted to the Federal Reserve System to agree to charge off worthless assets, to reduce certain lines of credit, or to make other adjustments which are necessary to improve the financial condition or management of the bank are conditions prescribed "pursuant to" the above quoted provision of the Act.

CONDITIONS RESTRICTING EXERCISE OF CORPORATE POWERS.

For the reasons set forth above, I am also of the opinion that special conditions of membership prescribed by the Board from time to time restricting or prohibiting the exercise by particular banks of specific corporate powers which the Board considers inconsistent with the purposes of the Federal Reserve Act are conditions prescribed "pursuant to" the above quoted provision of the Federal Reserve Act.

Owing to certain factors in the legislative history of the amendment contained in the McFadden Bill inserting the words "pursuant thereto" in the last sentence of the first paragraph of Section 9 of the Federal Reserve Act, however, it may be argued that this amendment was intended to have the effect of prohibiting the Federal Reserve Board from prescribing any conditions of membership which restrict in any way the exercise by State member banks of the corporate powers granted to them by the States of their

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creation.

It is a fundamental rule of statutory construction that the intention of the legislature is to be sought first in the language of the statute, and if that language is clear and unambiguous it is improper to seek elsewhere for the intent of the legislature or to have recourse to the debates or other extraneous matters for that purpose.

> "If the language of the statute is plain and free from ambiguity, and expresses a single, definite, and sensible meaning, that meaning is conclusively presumed to be the meaning which the legislature intended to convey. In other words, the statute must be interpreted literally. Even though the court should be convinced that some other meaning was really intended by the law-making power, and even though the literal interpretation should defeat the very purposes of the enactment, still the explicit declaration of the legislature is the law, and the courts must not depart from it". - Black, Interpretation of Laws, (2 ed), p. 45.

While opinions on this subject may differ, it is my opinion that the language of this amendment is sufficiently clear to exclude any consideration of its legislative history from a strictly legal construction of the statute.

It is not improper, however, in administering a statute for an administrative body to consider the legislative history of the statute or any other relevant facts and to have a due regard to such considerations in formulating its administrative policy with respect to matters as to which its powers are discretionary. For this reason it is important to consider the legislative history of that provision of the McFadden Bill which inserted the words "pursuant thereto" in Section 9 of the Federal Reserve Act. Incidentally, a consideration of such legislative history will demonstrate that it was not the intent of Congress as a whole to forbid the Board to prescribe conditions of membership restricting the exercise of corporate powers inconsistent with membership; but, on the

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contrary. Congress rejected a proposed amendment which would have had this effect.

LEGISLATIVE HISTORY OF THIS AMENDMENT.

Inasmuch as it was at the instance of Senator Glass that this amendment was added to the McFadden Bill, it is appropriate to consider first of all the individual views of Senator Glass on this subject.

It may be recalled that, during the hearings conducted by the Joint Congressional Committee appointed under Section 506 of the Agricultural Credits Act of 1923 for the purpose of investigating the reasons why State banks fail to become members of the Federal Reserve System, this question was discussed at a hearing held by the Committee at which several members of the Federal Reserve Board were present. Senator Glass, who was a member of the Committee, questioned the Board's right to prescribe conditions of membership restricting the establishment of branches. He contended that the Board had no right to prescribe any conditions of membership except such as were pursuant to specific provisions of the Federal Reserve Act. He based his contention upon the following provision of Section 9:

> "Subject to the provisions of this Act and to the regulations of the Board made pursuant thereto, any bank becoming a member of the Federal Reserve System shall retain its full charter and statutory rights as a State bank or trust company, and may continue to exercise all corporate powers granted it by the State in which it was created, and shall be entitled to all privileges of member banks".

In reply to Senator Glass' contention, I pointed out that one of the provisions of the Federal Reserve Act to which the rights of State member banks were subjected was the provision of Section 9 which at that time authorized the Board to prescribe conditions of membership without any specific limitation as to the conditions that might be prescribed.

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Senator Glass, however, continued to maintain the view that the intent of Congress was to permit State banks to exercise unimpaired the rights granted to them under State law, except where the exercise of such rights was in conflict with specific provisions of the Federal Reserve Act.

The following statement made by Senator Glass on the floor of the Senate (page 3933 of the Congressional Record for February 16, 1927) is also pertinent:

> "Then, in another very important respect, I direct the attention of the Senator from Montana to the bill as it came from the House. It was a shocking invasion of the rights of the State banks of the country."
>
> "Mr. WHEELER. It is strange how many State banks wanted the bill with Hull amendments, if the Senator is correct.
>
> "Mr. GLASS. So much so that the State banks were utterly opposed to the bill until the Senate made a satisfactory adjustment of that controverted point. In other words, in some way of which I have no knowledge, at some time, there were dropped out of the original Federal reserve act certain words which constituted a guarantee to the State banks throughout the country that their charter rights might not be invaded; and the Federal Reserve Board, assuming legislative functions which it had no right to do, made regulations for the admission of State banks to the Federal reserve system which were not authorized by the act itself and were made under an interpretation of an exceedingly refined and dubious nature. The Senate committee, in the bill now before us, had restored those words, making regulations by the Federal Reserve Board subject to the provisions of the act itself. Not until these words were restored did the National Association of State Bank Superintendents come here and advocate the passage of the bill as amended by the Senate committee. So when it comes to respecting the rights of the States, when it comes to the question of preserving the charter integrity of State banks, the Senate bill is infinitely superior to the bill which the Senator from Montana is advocating."

From this it would appear that Senator Glass was of the opinion that Congress intended by this amendment to prevent the Board from prescribing any conditions of membership restricting the exercise by State banks of the corporate powers granted to them by the States of

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their creation. If such was the legislative intent, it is my opinion that Congress failed to use language adequate to carry out that intent. (See the above quotation from Black on Interpretation of Laws.)

Moreover, Congress rejected a proposed amendment which would have specifically forbidden the Federal Reserve Board to promulgate any "conditions or rules or regulations" which would "limit or impair the charter or statutory rights and powers of such banks", thus indicating that Congress as a whole did not intend the amendment actually adopted to have such effect.

While the McFadden Bill was being considered by the Banking and Currency Committee of the House, representatives of the National Association of Supervisors of State Banks appeared before the Committee and urged it to insert into the McFadden Bill an amendment which would change the last sentence of the first paragraph of Section 9 of the Federal Reserve Act to read as follows; the words underlined being added:

> "The Federal Reserve Board, subject to the provisions of this Act and to such conditions as it may prescribe pursuant thereto, may permit the applying bank to become a stockholder of such Federal Reserve Bank; Provided, however, that such conditions or rules or regulations prescribed shall not limit or impair the charter or statutory rights and powers of such banks nor shall the Federal Reserve Board impose any conditions or restrictions other than those under which national banks shall operate."

Being somewhat dubious as to the advisability of adopting such an amendment, Congressman McFadden, Chairman of the Banking and Currency Committee of the House, arranged a conference between the representatives of the National Association of Supervisors of State Banks and the Federal Reserve Board. The conference took place in the offices of the Federal Reserve Board on December 30, 1925, with Congressman McFadden present, and this subject was fully discussed. The discussion developed the fact

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that the criticisms of the Board's Regulations and practices which gave rise to this suggested amendment were based upon a misapprehension of the facts and were totally unfounded. Subsequently, Congressman McFadden asked the Board for a written statement of its views with reference to this proposed amendment and such a statement was furnished in a letter addressed to him by the Board, under date of February 2, 1926, which was published in the report of the hearings held by the Senate Committee on Banking and Currency on February 16, 17, 18 and 24, 1926, pages 38 et seq. A copy of that letter is attached hereto for the Board's further information.

As a result of this conference with the Federal Reserve Board, and of the letter addressed to Mr. McFadden by the Board, the House Committee rejected the amendment proposed by the National Association of Supervisors of State Banks. This appears from the following statement made by Congressman McFadden during a hearing conducted by the Banking and Currency Committee of the Senate on February 16, 1926. (page 20 of the report):

> "Since this bill has been before Congress there has been a persistent attempt by Mr. Sims, vice president of the Hibernia Trust & Savings Bank, of New Orleans, and also secretary of the National Association of Supervisors of State Banks, to insert an amendment which would deprive the Federal Reserve Board of all discretionary authority to impose any condition of membership upon State banks which would in any way limit the exercise of their charter powers. In other words, if a State bank under the State laws possessed the charter powers to engage in the insurance business, or the warehouse business, the public utility business, or the automobile business, the Board would have to permit them as Federal reserve members to continue to carry on these enterprises, although they can not be said to constitute the banking business. As chairman of the House Committee, I had a conference with Mr. Sims and two of his associates and arranged for a special hearing before the Federal Reserve Board. In the meantime there was inserted in the bill an amendment appearing as a new section 10, designed to meet this situation. This language, however, proved to be unsatisfactory to Mr.

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Sims. Upon consideration of the bill in committee, this section was stricken out by a committee amendment, and the House sustained the committee and declined to approve the language desired by Mr. Sims. In the meantime, on February 2, 1926, I received a letter from the Federal Reserve Board, in which they set forth at length their views in opposition to the so-called Sims amendment, a copy of this letter I herewith submit as a part of my remarks."

In spite of the rejection of this amendment by the Committee, Congressman Celler of New York offered the amendment on the floor of the House when the bill was under consideration there, and the amendment was rejected without a record vote. This appears from the following quotation from the Congressional Record of February 3, 1926, pages 2937 and 2938:

"Mr. CELLER. Mr. Chairman, I offer an amendment.

"The CHAIRMAN. The gentleman from New York offers an amendment, which the Clerk will report.

"The Clerk read as follows:

"Amendment offered by Mr. Celler: Page 15, line 25, after the word 'Board', insert:

"'And provided further, The Federal Reserve Board, subject to the provisions of this act and to such conditions as it may prescribe pursuant thereto, may permit the applying bank to become a stockholder of such Federal reserve bank; Provided, however, That such conditions or rules or regulations prescribed shall not limit or impair the charter or statutory rights and powers of such banks, nor shall the Federal Reserve Board impose any conditions or restrictions other than those under which national banks shall operate."

"(Cries of 'Vote!' 'Vote!)

"Mr. CELLER. Mr. Chairman and gentlemen of the committee, I will only keep you a few seconds to explain that this amendment has been suggested by the National Association of Supervisors of Banks and is very similar to the amendment I offered previously in the debate. It seeks to put the national banks and State banks upon a parity with reference to regulations which might be prescribed for the opening of branches by the Federal Reserve Board, and for that reason I offer it and urge its adoption.

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"Mr. BRAND of Georgia. Will the gentleman yield?

"Mr. CELLER. Yes.

"Mr. BRAND of Georgia. Is not this what is known as the Sims amendment?

"Mr. CELLER. That is correct.

"Mr. McFADDEN. Mr. Chairman, I think there is a little time remaining, and I want to say to the Members of the House that this is a proposition which the Federal Reserve Board very strenuously oppose. It would take all discretionary power away from the Federal Reserve Board, and in my opinion the amendment should not be adopted.

"The CHAIRMAN. The question is on the amendment offered by the gentleman from New York (Mr. Celler).

"The amendment was rejected."

I have been unable to ascertain whether this amendment was formally presented to the Banking and Currency Committee of the Senate; but I do know that the above facts were explained to the Banking and Currency Committee of the Senate by Congressman McFadden during the hearing held by that Committee on February 16, 1926 (page 20) and that a copy of the Board's letter quoting this proposed amendment and explaining its objections thereto was incorporated in the reports of that hearing. (Pages 38 to 45).

In spite of the fact that this very specific amendment was thus called to its attention, the Senate Committee did not adopt it or recommend any other amendment which would specifically and clearly forbid the Federal Reserve Board to prescribe any conditions, rules or regulations which would "limit or impair the charter or statutory rights and powers of such banks". On the contrary, the Senate Committee inserted into the McFadden Bill only the first part of the amendment recommended by the National Association of Supervisors of State banks, which

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merely amended Section 9 so as to provide that the conditions of membership prescribed by the Federal Reserve Board must be "pursuant to" the provisions of the Federal Reserve Act.

This apparently was intended as a compromise between the extreme demands of the National Association of Supervisors of State Banks and the view of the House of Representatives that no restriction whatever should be placed upon the power of the Federal Reserve Board to prescribe conditions of membership; and this compromise was ultimately adopted by both houses and incorporated into the McFadden Act.

Thus, both houses of Congress rejected an amendment which would specifically have forbidden the Federal Reserve Board to prescribe any "conditions, rules or regulations" which would "limit or impair the charter or statutory rights and powers of such banks," and, in lieu thereof, adopted an amendment which merely provided that the conditions of membership prescribed by the Federal Reserve Board must be "pursuant to" the provisions of the Federal Reserve Act.

Regardless of the personal intention of Senator Glass or the individual views which he might hold as to the purpose or effect of this amendment, the fact that Congress rejected the specific language proposed by the National Association of Supervisors of State Banks shows clearly that Congress as a whole did not intend to prevent the Federal Reserve Board from prescribing any conditions of membership, restricting the exercise of corporate powers inconsistent with the purposes of the Federal Reserve Act. In my opinion, therefore, Congress did not intend to impose any such restriction on the Federal Reserve Board; and to construe the amendment which Congress did adopt as having this effect would be to give the amendment actually adopted an effect which Congress intended it not to

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have.

QUESTION OF POLICY.

The question remains, however, whether the Board, as a matter of policy, should comply with the views of Senator Glass and the views of the National Association of Supervisors of State Banks in this matter and discontinue the practice of prescribing conditions of membership restricting the exercise of particular corporate powers by State member banks. This is a question of policy for the Board's determination.

In this connection, I respectfully suggest that it would not be inappropriate for the Board to discuss this question frankly with Senator Glass and ascertain his views as to what conditions of membership the Board should prescribe. If this matter is discussed with Senator Glass, it is highly important that he should be acquainted with the practical difficulty confronting the Board when a desirable State bank applies for membership in the Federal Reserve System, and the Board finds that such bank has the corporate power to write surety bonds, to insure titles to real estate, to write fidelity insurance or to do anything else which in the Board's opinion is inconsistent with the purposes of the Federal Reserve Act. In such a case, if the Board can not properly prescribe a condition of membership restricting the exercise of such inappropriate power by the applying bank, the Board must adopt one of two very undesirable alternatives: It must either exclude the bank from membership altogether or permit it to come into the Federal Reserve System with the unrestricted right to exercise powers which may endanger the bank's solvency and which the Board considers inconsistent with the purposes of

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the Federal Reserve Act.

Such a case was recently pending before the Board. A national bank in New Jersey, which had long been a member of the Federal Reserve System, the financial condition of which appeared to be sound, which appeared to be properly managed, and which had resources aggregating approximately $20,000,000. was about to "convert" into a State trust company, and application for membership in the Federal Reserve System had been made on behalf of the proposed new trust company. Under the laws of New Jersey, however, this trust company would have the corporate power to examine and guarantee titles to real estate, to write surety bonds, and to insure the faithful performance of their duties by any persons holding positions of public or private trust. If this trust company were admitted to membership in the Federal Reserve System without any conditions restricting the exercise of these powers, it could incur liabilities of this character in amounts equalling many times the amount of its deposit liabilities. This might seriously endanger the solvency of the institution and the interests of its depositors, and the Federal Reserve Board would be powerless to prevent it or even to expel the bank from the Federal Reserve System. What, then, was the Board to do? It must adopt one of these three alternatives:

1. Refuse to admit the bank to the Federal Reserve System;

2. Admit it to the System with the unrestricted right to exercise these powers which the Board has always considered inconsistent with membership in the Federal Reserve System; or

3. Admit it to the System subject to a condition of membership prohibiting the exercise of these powers or restricting it to reasonable and safe limits.

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If the Board decides to discuss this subject with Senator Glass, I respectfully suggest that it lay this actual case before him and request his views as to what should be done in such a case.

CONCLUSION.

This subject is one which cannot safely be reduced to a "rule of thumb". Each condition of membership must be considered individually and in the light of the provisions of the Federal Reserve Act, the purpose of such provisions, and the spirit and purpose of the Act as a whole. Moreover, the problem is of such a nature that neither the legal principles involved nor the questions of policy involved can be adequately comprehended without some familiarity with the legislative history of this subject, the practical situation, and the various other considerations discussed above. For the convenience of the Board, however, I shall summarize as briefly as possible my conclusions.

I. In general, it may be said that the Board may no longer prescribe any conditions of membership except such as are "pursuant to" provisions of the Federal Reserve Act other than the provision authorizing the Board to prescribe conditions.

II. As to the nine conditions set forth in Section IV of Regulation H, my conclusions are as follows:

1. The Board may continue to prescribe Condition No. 1, which relates to changes in the character of the bank's assets or the scope of the powers exercised by it, such as would tend to affect materially the standard required as a condition of membership; because such condition is pursuant to that provision of Section 9 which requires the Board in admitting a bank to membership to consider the financial condition of the applying bank,

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the character of its management, and whether or not the corporate powers exercised are consistent with the purposes of the Federal Reserve Act.

2. The Board may continue to prescribe Condition No. 2, which requires the bank to conduct its business with a due regard to the safety of its customers, because such condition is pursuant to that provision of the Federal Reserve Act which requires the Board in acting upon applications for membership to consider the financial condition of the applying bank and the general character of its management.

3. The Board may no longer prescribe Condition No. 3, forbidding the bank to reduce its capital without the Board's permission; because this goes beyond those provisions of the Federal Reserve Act which pertain to the capital of State member banks.

4. The Board may no longer prescribe Condition No. 4, restricting the establishment of branches; because Congress has dealt completely with this subject by an amendment contained in the McFadden Bill and such amendment supersedes such conditions.

5. The Board may no longer prescribe Condition No. 5, forbidding consolidations, etc., for the purpose of acquiring branches; because Congress has completely dealt with the subject of branches by the amendment contained in the McFadden Act and this amendment supersedes such condition.

6. The Board may continue to prescribe Condition No. 6, requiring the bank to reduce all loans in excess of the limits prescribed by State law; because such condition is pursuant to that provision

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of the Federal Reserve Act which requires the Board in acting upon applications for membership to consider the financial condition of the applying bank and the general character of its management.

7. The Board may continue to prescribe Condition No. 7, which requires the bank to reduce to an amount equal to 10% of its capital and surplus all balances in excess thereof carried with nonmember banks; because this merely states the substance of the specific provision of Section 19 on this subject.

8. The Board may continue to prescribe Condition No. 8; because such condition merely sets forth the substance of the provisions of Section 13 regarding the issuance of bankers' acceptances by member banks.

9. The Board may continue to prescribe Condition No. 9, requiring such banks to adopt resolutions authorizing the interchange of reports and information between the Federal reserve bank and the State authorities; because this is necessarily incidental to that provision of the Federal Reserve Act which authorizes Federal reserve banks to accept reports of examinations made by State authorities in lieu of examinations made by Federal reserve examiners.

III. The Board may continue to prescribe special conditions of membership requiring particular banks upon being admitted to the Federal Reserve System to agree to charge off worthless assets, to reduce certain lines of credit, or to make other adjustments which are necessary to improve the financial condition or management of such bank; because such conditions are pursuant to that provision of the Federal Reserve Act which requires the

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Board in acting upon applications for membership to consider the financial condition and management of the applying bank.

IV. The Board may continue to prescribe conditions of membership restricting the exercise of corporate powers inconsistent with the purposes of the Federal Reserve Act; because such conditions are pursuant to that provision of the Federal Reserve Act which requires the Board in acting upon applications for membership to consider whether the corporate powers exercised by the applying bank are consistent with the purposes of the Federal Reserve Act.

V. The legislative history of this amendment indicates that Senator Glass felt that it would prevent the Board from prescribing any conditions of membership restricting the exercise by State banks of the corporate powers granted to them by the States. Congress, however, did not express any such intent; but on the contrary, rejected an amendment which would specifically have done so.

VI. The views of Senator Glass may properly be taken into consideration by the Board in determining its administrative policy; and it would not be inappropriate for the Board to discuss this subject with Senator Glass.

VII. If this subject is discussed with Senator Glass, I respectfully suggest that the Board lay before him an actual case illustrating the importance of this power to the Board and ask his views as to what should be done in such a case.

Respectfully,

(S) Walter Wyatt.
General Counsel.

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