

FEDERAL RESERVE
BOARDDATE October 12, 1928TO Federal Reserve BoardSUBJECT: Examination of State MemberFROM Governor YoungBanks

I believe the resolution adopted by the Board last Wednesday morning is an excellent statement of the responsibilities of the Federal Reserve Board with reference to State member bank examinations, and it seems to me that it is now the duty of the Board to consider the mechanics by which it will discharge its responsibility. Obviously, it was not the intention of Congress that the detailed work was to be actually done by members of the Federal Reserve Board, but that they could employ assistants or delegate appointees to see that the responsibilities are administered properly. Therefore, the problem from now on is one of mechanical administration, and in an effort to avoid duplications, triplications and unnecessary expense of operation which now exist, I make the following proposals:

1. That the present set-up of the Federal Reserve Board, known as the Department of State Bank Examination, be abolished.
2. That the Federal reserve agents be acquainted by letter with the responsibilities of the Federal Reserve Board as the Board sees them, and that the agents be charged with the duty of seeing to it that the Board's views are carried out.
3. As protection to the Board that the agents function properly, I propose that this responsibility be placed under the Chief Examiner, who now does a good deal of this work, and that a qualified man travel with the examining force and spend sufficient time in the agents' departments of the reserve banks visited to investigate the agents' bank examination departments to see that the instructions of the Board are being carried out.
4. That the Federal reserve agents be instructed to discontinue their present practice of furnishing the Board with reports of examination of State member banks, except in extreme cases where the agents may wish to ask for advice or request the Board to cancel membership. In lieu of the complete report of examination, I suggest that the agents furnish the Board with a modified analysis of the bank's condition, a written statement as to its general condition, a list of violations of the law, and other violations affecting the terms of membership of the bank. This report should also be accompanied, if necessary, by a letter from the agent stating the corrective measures that have been taken by State authorities or by the Federal reserve agent himself.
5. That a letter of instruction be given to Mr. Herson as to what the Board wants him to watch particularly, and at any time he has a case where he feels everything is not being done that could be done by the agent, or where he feels the State member bank is in such a condition that its membership is not desirable, he should bring such situation to the attention of either the Governor or the Vice Governor for determination as to whether or not the matter should go before the Federal Reserve Board.

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In order to carry this program out, I propose that the attached letter be sent to the Federal reserve agents.

October 12, 1928

Dear Sir:

The Federal Reserve Act requires that the cost of examinations of member banks made by the Federal reserve banks or the Federal Reserve Board through the Federal reserve agents, be assessed against the member bank examined. The Board has already recommended to Congress that the law be amended in such a way as to make the charges for member bank examinations discretionary with the Board. It will again present the amendment at the opening of Congress in December.

Upon several occasions in the past the Board has attempted, by circular letter, to define a credit investigation, but after several years experience it has arrived at the conclusion that a far too liberal interpretation has been placed upon credit investigations by the agents; in fact, those we have in our possession bear such a close resemblance to an examination that we are unable to distinguish the difference, except by the label. This procedure has developed an expense of approximately \$630,000 a year with reimbursement for assessments against member banks of approximately \$24,000.

The Board has had this matter under review for some time and on October 10 passed the following resolutions which deal with the responsibility of the Federal Reserve Board in reference to member banks as it interprets the law:

"BE IT RESOLVED, That the Federal Reserve Board recognizes its duty under the Federal Reserve Act to keep itself informed as to the condition of all member banks;

"BE IT FURTHER RESOLVED, That the Board is of the opinion that it is justified in relying upon the Comptroller of the Currency for such information as to National banks;

"BE IT FURTHER RESOLVED, That whenever the reports of examination of State member banks furnished by the State authorities are not deemed satisfactory either to the Federal reserve bank of the district concerned or to the Federal Reserve Board, the Federal reserve bank or the Board shall cause to be made at least one examination or investigation each year of such character as to furnish satisfactory information, the cost of such examinations to be assessed against the member banks examined."

In order to avoid duplications, triplications, unnecessary expense of operation, which now exist, the Board has instructed me to advise you that the Department of State Bank Examination, now in operation in the Board's quarters in Washington, will be abolished and that you are charged with the duty of seeing to it that the Board's views, as covered in the above resolutions, are carried out in your district. This does not mean that the Board is attempting to relieve itself of all responsibility, and you are advised that through its examining force it will check carefully your bank examination department.

The following instructions will serve as a guide to you in performing your duties:

1. The Comptroller of the Currency is a member of the Federal Reserve Board and under the law is charged with the responsibility of enforcing the terms of the National Bank Act and also of the Federal Reserve Act. The Board therefore relies upon the Comptroller of the Currency to perform his duties and it will not be necessary for the Federal reserve agents to duplicate the work.

2. In our opinion, State reports of examination can be relied upon in the great majority of cases to furnish the necessary information to the agents.

3. If a State examination is unsatisfactory, a credit investigation will not be sufficient information for the agents to act intelligently upon and a complete examination should be made for which the member bank should be charged. This does not prohibit investigations of member banks by Federal reserve banks or Federal reserve agents without cost, because the Board realizes that unusual situations require unusual action. Therefore, the Board will act promptly by approving or disapproving the request of any Federal reserve bank or any Federal reserve agent for permission to make an investigation without cost. The Federal reserve banks, however, and the Federal reserve agents, in making such request for investigation without cost must bear in mind that if the investigation contemplates anything covered by the following language, which appears in Section 21 of the Federal Reserve Act, the Board cannot waive the cost: "The expense of such examinations shall be borne by the bank examined. Such examination shall be so conducted as to inform the Federal reserve bank of the condition of its member banks and of the lines of credit which are being extended by them."

4. If Federal reserve agents have evidence in the form of letters or otherwise, that officers and directors of State member banks have had their attention called to violations of the law and unsound banking practices by State authorities, it is not necessary for agents to duplicate this work.

5. If this supervision is not conducted by State authorities Federal reserve agents are directed to take such action, as in their opinion, will discharge the responsibilities of the Board.

6. When a State member bank fails to show any disposition whatever to correct these irregularities within a reasonable time so as to show improvement in its condition, the Federal reserve agent will be expected to lay the information before the directors of his bank and ask them to make a formal recommendation to the Federal Reserve Board, with reasons, as to whether or not the State member bank should continue as a member.

7. Federal reserve agents are instructed to discontinue their present practice of furnishing the Federal Reserve Board with reports of examination of State member banks, except in extreme cases where they

may wish to ask for advice or request the Board to cancel membership. In lieu of these reports, agents will furnish the Board with an analysis of each report received or made by them (form of analysis enclosed).

The Federal reserve agents are advised that the Board thoroughly realizes that it is utterly impossible to lay down uniform, detailed procedure in each and every district because of the local conditions which exist in the 48 states. It does believe, however, that certain fundamental policies can be laid down and asks your cooperation toward that end.

Yours very truly,

R. A. Young,
Governor.

TO ALL FEDERAL RESERVE AGENTS.