X-7177

April 7, 1932

Mr. L. R. Rounds, Deputy Governor,
Federal Reserve Bank of New York,
New York, New York.

Dear Mr. Rounds:

I have examined the forms prepared by Mr. Logan for use in connection with loans under Sections 10(a) and 10(b) of the Federal Reserve Act and have certain suggestions to offer in connection with those prepared for use under Section 10(a). I inclose herewith one set of those forms on which I have noted a number of suggestions, and I wish to offer the following additional comments.

In our discussions of this subject, I think all of us agreed that, if the provisions of Section 10(a) are availed of to any material extent, there are two different types of groups which might be organized, (1) groups organized for the specific purpose of affording assistance to particular banks which are in difficulties, and (2) more or less permanent groups organized for the mutual benefit of all their members without reference to any particular application for a loan. I think we all agreed that the first type probably will be the one most frequently organized and that the forms should be prepared with a view to being used by such groups. I think we also agreed that it is unlikely that any groups of the second type will be organized and that, if any groups of this type are organized, the attorneys for the banks involved will have their own ideas as to the provisions which should be incorporated in the resolutions of directors, organization agreements and other forms and that it would not be worth while to endeavor to prepare in advance any forms for use by such groups.

It seems to me, however, that a middle course has been adopted in the preparation of the forms and that they would not be entirely suitable for use by groups of either class. If permanent groups are organized, it would seem that provision should be made for a loan committee or some other machinery for action on behalf of the group as a whole in applying for and obtaining loans from the Federal Reserve Bank and that it would be possible to avoid having separate action by the directors of every bank in the group on each application for a loan. On the other hand, if groups are organized for the specific purpose of assisting particular banks which are in difficulties, the situation probably would require prompt action and it would be appropriate and desirable to have each bank adopt only one resolution covering the entire case.

Under the procedure proposed in the forms that have been prepared, the board of directors of each bank joining a loan group would first meet and adopt a resolution authorizing the bank to join the group and, subsequently, at the time of the application for a group loan, it would be necessary for the board of directors of each such bank to meet again and adopt a resolution authorizing the application for the loan from the Federal reserve bank and approving the application of the borrowing bank for a loan from the group. The necessity for this second meeting would result in much delay in obtaining advances from the Federal reserve bank under Section 10(a) and might frequently make it impossible to obtain the necessary credit in time to meet the emergency confronting the borrowing bank. In order to eliminate the necessity for this second meeting, it is suggested that

the two proposed resolutions be consolidated into one and adopted at the time of the formation of the group. In addition to authorizing the bank to become a member of the group such a resolution could also authorize certain officers of the bank to approve an application of the borrowing bank for a loan from the group, to join in making an application to the Reserve Bank for a group loan and to execute on behalf of the bank a group note evidencing such loan.

I do not understand the theory underlying the provisions in the first part of paragraph 6 on page 6 of the agreement covering the organization of the loan group and especially the reference to funds under the control of the trustee which are security, or represent the proceeds of any security, for a note of the borrowing bank. I thought that it was contemplated that all security for the note of the borrowing bank would be pledged and delivered to the Federal reserve bank and that no security would be left in the hands of the trustee. If this is the case, then it would seem that the Federal reserve bank would be entitled to a first claim on the proceeds of the note and should apply such proceeds to the indebtedness represented by the note of the borrowing bank and also to the reduction of the pro rata liability of all banks on the group note. If, however, the trustee holds any funds or security other than that delivered to the Federal reserve bank as security for the note of the borrowing bank, it would seem that the proceeds should be applied first to the payment or reimbursement of the trustee for any expenses incurred by him in connection with the performance of any of his duties and that anything remaining should be paid to the Federal reserve bank and applied in the manner suggested above.

Both the note of the borrowing bank and the note of the group provide for the payment of interest at maturity at a certain rate per annum from the date of the note. It seems probable, however, that in a great majority of cases, advances under Section 10(a) would be handled on a discount basis and interest deducted in advance; and it would seem desirable for these note forms to be changed so that they will be appropriate for use in cases where the notes are discounted as well as in cases where interest is paid at maturity.

These forms seem to contemplate that the note of the group and the security therefor will not be forwarded to the Federal reserve bank until after the reserve bank has considered the application and has actually made the loan. It would seen advisable to have the note and the collateral securing it accompany the application to the Federal reserve bank, in order that the latter may inspect the collateral before approving the loan and in order that the proceeds of the loan may be made available as soon as it is approved. I understand that this is the established procedure regarding discounts and advances to member banks under Section 13 and it seems to me that it should properly be followed in this case also.

The form of note of the borrowing bank, which has been revised so as to omit many of the provisions which were included in the note as first drafted, still contains a number of provisions which do not appear to me to be essential. As I have previously written Mr. Logan, I feel that it would be advisable to

use a simple, straight note, incorporating in the application all necessary provisions as to the rights of the holder, effect of insolvency, etc. The second paragraph of the note especially seems to me to be unnecessary. The reference to the group agreement in the first sentence of that paragraph might affect the negotiability of the note in some jurisdictions, and the certification contained in the second sentence of the paragraph as to the amount of eligible and acceptable assets of the borrowing bank seems unnecessary in view of the fact that such a certification is contained in the application of the borrowing bank. The first paragraph of the note states that copies of the application for the loan and of the schedule of collateral security are attached to the note and made a part thereof. This would appear to have the same effect upon the negotiability of the note as the specific inclusion of each of the provisions of the application and, as this provision does not seem necessary, I think it might wisely be omitted.

The note of the Member Bank Loan Group provides that any member except a borrowing bank may pay the amount of its liability at any time and shall not thereafter be liable. I see no reason why a borrowing bank should not be permitted to anticipate and discharge all or any part of its liability to the Federal reserve bank. It might be provided, however, that any payment made by the borrowing bank shall be applied on its individual note to the

group rather than on its pro rata share of the liability on the group note and shall also be applied in reducing pro rata the liabilities of all banks on the group note. It might also be well to add that, in the event of such anticipation of liability by any member of the group, the note and other agreements shall remain in full force and effect as to all other members of the group and that any rights of the bank which has anticipated its liability in the collateral security pledged with the Federal reserve bank shall be subordinated to the rights of the latter.

These suggestions are submitted for your consideration, and I think they deserve careful attention; but, in order to avoid further delay, I suggest that you transmit directly to the other Federal reserve banks any further modifications or revisions of these forms which you or your committee may decide upon and that they not be held for further consideration by this office. For the Board's information, however, we would like to have copies of any further communications on this subject which you or your committee may transmit to the other banks.

With kindest personal regards, I am,

Cordially yours,

(Signed*) Walter Wyatt
General Counsel

WW/gc/4/7/32

March 9, 1932.

Mr. Walter S. Logan, Counsel,
Federal Reserve Bank of New York,
New York, New York.

Dear Walter:

Confirming the conversations you and I had yesterday and today, regarding the forms for use in connection with loans under Sections 10(a) and 10 (b) of the Federal Reserve Act as amended by the Act of February 27, 1932, I have not yet finished my study of these forms; but, in order to expedite matters, I am sending you herewith such suggestions as I have ready at the present moment. There is inclosed a memorandum making detailed suggestions regarding certain of the forms, and I shall incorporate in this letter more general suggestions regarding other forms.

In view of the fact that these forms are being prepared for use throughout the United States, it would seem that, as suggested by Governor Calkins, the form of note to be used by a bank borrowing from a group should be a simple, straight note, in order that there might not be any question about its negotiability, and that the provisions regarding the pledge of collateral and the other details of the contract of the borrowing bank should be incorporated in a separate agreement. Inasmuch as it is probable that these notes will be discounted, like member bank 15-day

notes under Section 13, it would seem that they should provide for the payment of interest after maturity rather than interest from the date of the note.

Assuming that the provisions regarding the pledge of collateral and other similar provisions will be transferred to a separate document (which might be the application of the borrowing bank to the group), I would suggest that, wherever the payee is referred to in the provisions which are now incorporated in the body of the note, the holder of the note rather than the payee be referred to.

In view of the provisions of the statute regarding the pledge of security for the protection of the group of banks, it would also seem advisable to make it clear that such security may not be applied on other indebtedness to the Federal reserve bank until after the borrowing bank's obligation to the group has been satisfied in full. It would also seem that the borrowing bank should specifically authorize the group or the trustee representing the group to pledge to the Federal reserve bank all collateral or other security pledged by the borrowing bank to the group, in order that the borrowing bank might be estopped from claiming that such security was intended only for the protection of the group and not for the protection of the Federal reserve bank.

Since the group's note will be made payable directly to the Federal reserve bank and presumably will not be transferred

to any other holder, it would not seem important for it to be negotiable. Therefore, there would seem to be no objection to incorporating in the note of the group the various provisions regarding the pledge of collateral and certain additional provisions which are discussed below; but I think that careful consideration should be given to the question whether it would not be more advisable to incorporate such provisions in the application of the group to the Federal reserve bank for a loan. On this question, however, I have no definite opinion.

During our discussions with the Committee on Sunday, March 7th, it was tentatively agreed that the note, application or some other agreement of the group of banks with the Federal reserve bank should contain provisions along the following lines:

1. That, with respect to the note of the borrowing bank and the security therefor the Federal reserve bank may exercise all of the powers of ownership without foreclosure.

2. That the group assigns to the Federal reserve bank all other rights and claims against the borrower arising out of such borrowing.

3. That, in the case of the insolvency of the borrowing bank, the Federal reserve bank is authorized to file a claim against the borrowing bank in its own name and for its own benefit for the full amount of the principal and interest of the group note and that for this purpose, the group assigns to the Federal reserve bank all

of its rights against the borrowing bank; Provided, however, That the Federal reserve bank shall hold the note of the borrowing bank as a holder in due course and not as assignee. (I have not attempted to state this in proper legal form but have simply dictated it from the rough notes which I made at our meeting on Sunday. The purpose of the provision, of course, is to enable the Federal reserve bank to file with the receiver of the borrowing bank a claim for the full amount of the borrowing, since otherwise the claim of the Federal reserve bank against the borrowing bank on the note of the group would only be for the borrowing bank's pro rata share of the amount of the group note. Of course, the Federal reserve bank, after foreclosing on the collateral, and taking over the note of the borrowing bank in its own right, could file a claim on that note with the receiver of the borrowing bank; but in some States and under some circumstances this might be undesirable. It might also be claimed that the Federal reserve bank would have to credit the amount realized in this manner against the pro rata liability of the other banks in the group.)

4. The above provisions, however, shall not affect the right of the Federal reserve bank to enforce the liability of the other banks in the group on the group note without first proceeding against the borrowing bank.

5. The Federal reserve bank may grant renewals, extensions and other indulgences to any member of the group without affecting its rights against any other member of the group.

It would seem also that the contract of both the borrowing bank and the contract of the group with the Federal reserve bank should provide that, after the borrower's obligation and the obligation of the group have been satisfied in full, any remaining collateral held by the Federal reserve bank may be utilized by it to satisfy any other obligation of the borrowing bank. In both agreements, it would also seem advisable to provide that any other security held by the Federal reserve bank for other obligations of the borrowing bank may first be applied on other indebtedness of the borrowing bank to the Federal reserve bank, but that any surplus remaining after all such other indebtedness has been satisfied in full may, in the discretion of the Federal reserve bank, be utilized to satisfy the obligation of the group or the obligation of the borrowing bank.

It would also seem advisable, in the contract of the group, to provide specifically for the right of any bank to anticipate and discharge its liability to the Federal reserve bank; but with a proviso that, in such event, the note and other agreements shall remain in full force and effect as to all other members of the group and that any rights of such bank (i.e., the bank which anticipates and discharges its liability) in the collateral or other security pledged with the Federal reserve bank shall be subordinated to the rights of the Federal reserve bank.

In the note of the loan group it would seem advisable to provide for the payment of interest after maturity, instead of interest from the date of the note, for the reasons indicated above in connection with the note of the borrowing bank.

In the note or other contract of the group, the provisions regarding the method of determining the pro rata liability of each member of the group should be changed in accordance with the change recommended in the inclosed memorandum with regard to the agreement to form the loan group.

In the application of the loan group to the Federal reserve bank for a loan (paragraph II) you apparently contemplate that the note of the group and the security therefor would not be forwarded to the Federal reserve bank until after the Federal reserve bank has considered the application and approved the loan. In accordance with the established procedure regarding rediscounts and advances to member banks under Section 13, would it not be better to have the note and collateral accompany the application to the Federal reserve bank, in order that the Federal reserve bank may inspect the collateral before approving the loan and in order that the proceeds may be made immediately available as soon as the loan is approved?

In the application for a loan under Section 10(b), it would seem that, in view of the fact that the Federal Reserve Board probably will not prescribe any regulations defining the classes of assets which may be pledged as collateral, it would be advisable to strike out the

certificate to the effect that the collateral listed in Schedule A is eligible and to substitute therefor a statement to the effect that none of the collateral listed in Schedule A is the obligation of any foreign government, individual, partnership, association, or corporation organized under the laws thereof. It would also seem advisable to insert in this form a certificate to the effect that the statement of the exceptional and exigent circumstances which is incorporated in the application or attached thereto is a true statement and is believed to be sufficient to justify the granting of the advances applied for.

As soon as I can complete my study of your tentative drafts of the forms, I shall forward such additional suggestions as may occur to me; and I would like to have you consider them before you deliver your final draft of the forms to the Committee. It is also understood, of course, that the Committee will submit all of the forms to the Federal Reserve Board for its consideration before transmitting them to the Federal reserve banks.

Regretting that we were unable to see more of you during our recent visit to New York and with kindest personal regards, I am

Cordially yours,

Walter Wyatt,
General Counsel.

Inclosure.

(Mr. Wyatt's Tentative Suggestions re forms for use in making Advances under Sections 10(a) and 10(b).)

RESOLUTION AUTHORIZING BANK OR TRUST COMPANY TO BECOME MEMBER OF LOAN GROUP.

Last line of first paragraph, omit word "unanimously", since the resolution may not be adopted unanimously.

AGREEMENT TO FORM LOAN GROUP

Suggest omission of first two "Whereas" clauses, as being unnecessary and unduly lengthening the agreement.

Suggest that latter part of first paragraph on page 2 be changed to read as follows: "deem it advisable to form themselves into a group of member banks for the purpose of availing themselves of the benefits of Section 10(a) of the Federal Reserve Act;"

Page 2, paragraph numbered 1: Change latter part to read as follows: "When this agreement has been properly executed by all members named in the next succeeding paragraph hereof". It would seem inadvisable to require the approval of such agreement by the Federal reserve bank; since such approval might be considered to carry with it an implied commitment to make loans to the group organized thereunder.

Page 3, paragraph numbered 3: Commencing with the word "unless" change to read "unless there is a notation to the contrary following its name in paragraph 2 hereof."

Paragraph numbered 4 on page 3: change to read as follows:

"4. The liability of each member of the loan group for advances made by the reserve bank to the loan group shall be limited, in accordance with the provisions of Section 10(a) of the Federal Reserve Act, 'to such proportion of the total amount advanced to such group as the deposit liability of the respective banks bears to the aggregate deposit liability of all banks in such group'; and the liability of each member on each note of the Loan Group shall be determined on the basis of its gross deposit liabilities at the opening of business on the date of the written application by the Loan Group to the Federal Reserve Bank for the advance evidenced by such note, which shall be computed by adding together, (1) in the case of a national bank, the figures corresponding to those called for by items 21, 22, 23 and 24 on the Comptroller of the Currency's Call Report Form No. 2130, as revised in November, 1931, or (2) in the case of a State member bank, the figures corresponding to those called for by items 19, 20, 21 and 22 on the Federal Reserve Board's Call Report Form No. 105, as revised in November, 1931."

Page 3, paragraph numbered 5: Strike out the words "and agent" in two places.

Page 3, paragraph numbered (a): Strike out the words "collateral" and place quotation marks before and after the words "Borrowing Bank".

Page 4, lines 1 and 2: Strike out the words "collateral" and substitute therefor the word "securities". Strike out the words "as security".

Page 4, line 3: Strike out the words "not an" and substitute the word "no".

Page 4, paragraph (b) line 2: After word "applications" insert "by or on behalf".

Page 4, paragraph (b) line 7: After word "aggregate" insert word "amount".

Page 4, paragraph (b) line 9: Change word "are" to "shall be".

Page 4, paragraph (b) line 14: Strike out words "secured by the collateral" and substitute "and the security".

Page 4, paragraph (b) line 15: Strike out words "as security". Strike out word "collateral" and substitute therefor the word "security".

Page 4, paragraph (b) line 18: Strike out words "Loan Group" and substitute "Federal reserve bank".

Page 4, paragraph (b), five lines from the bottom: Strike out word "collateral".

Page 4, paragraph (b): At end of paragraph, add the following: "When a member has signed and delivered to the trustee a note of the Loan Group, such members shall, by such action, be deemed to have authorized or ratified, (1) the making of a loan or loans by the loan group to the member or members named in the application of such Loan Group to the Federal reserve bank, and (2) the signing and delivering to the Federal reserve bank on behalf of the Loan Group of the application of such Loan Group for the loan described in such application on the terms and conditions stated therein."

Page 5, paragraph (c) lines 5, 6 and 7: Strike out the words "collateral offered as security for said note or notes of the borrowing bank or banks and" and substitute therefor the word "security".

Page 5, paragraph (c) line 12: Strike out the words "without recourse".

Page 5, paragraph (c) lines 16 and 17: Strike out words "with collateral security for said loan or loans" and substitute therefor the words "security therefor".

Page 5, paragraph (d): Strike out the word "collateral" in four places. Also after the word "return" in the fifth line of the paragraph, insert the words "or release".

Page 6: Immediately before paragraph 6, insert a new paragraph absolving the trustee from all personal liability for any and all acts done by him on behalf of the Loan Group pursuant to the terms of this agreement and within the scope of his authority.

RESOLUTION OF BORROWING BANKS.

Immediately after the words "NOW, THEREFORE, BE IT RESOLVED," insert the following "that _____ "(name and title of officer _____ is authorized other than the one signing attached certificate.)" and directed:"

At end of paragraph 2, strike out the word "and".

At end of paragraph 3, insert the word "and".

Add a new paragraph as follows, immediately after paragraph 3:

"4. To give such other or additional security as may be necessary for the purpose of obtaining such advance."