CONFIDENTIAL L-17

February 9, 1933.

RECOMMENDATIONS OF THE FEDERAL RESERVE BOARD WHICH HAVE NOT BEEN ADOPTED IN THE GLASS BILL.

In its letter of March 29, 1932 addressed to Senator Norbeck, Chairman of the Committee on Banking and Currency of the United States Senate, the Federal Reserve Board made a number of recommendations with reference to the provisions of the Glass Bill, S. 4115. Some of these recommendations have been incorporated in the revised bill, S. 4412, and others have not. There are summarized below the recommendations contained in the Board's report of March 29, 1932, which have not been adopted substantially in the bill, S. 4412, in the form in which it was passed by the Senate on January 25, 1933. No mention is made of provisions of the bill which are substantially as recommended by the Board.

(Page and section numbers refer to the bill S. 4412 as it passed the Senate on January 25, 1933, unless otherwise indicated, and the bill in this form is referred to in this memorandum as "the present bill".)

SECTION 2.

Definition of the term "affiliate". (Pages 2,3)

The Board's recommendations on this subject have been incorporated in the present bill. It may be noted, however, that certain additional changes in the definition of the term "affiliate" have been made. The provision that this term shall include an organization of which a majority of the members of its executive committee are directors of a

member bank has been stricken from the present bill. Another change is the sub-division in the present bill of the several classes of institutions defined as affiliates so as to make a distinction between "affiliates" generally and "holding company affiliates".

SECTION 3.(b)

Voting by groups or chains in elections of Federal reserve bank directors. (Pages 4,5).

The Federal Reserve Board recommended the omission of a provision (contained in section 4 of S. 4115) which prohibited a bank which belongs to a group or chain or which is not controlled by local residents from voting for Federal reserve bank directors. The present bill provides that when two or more member banks are affiliated with the same holding company affiliate only one of such banks may participate in the nomination or election of Federal reserve bank directors.

In connection with its recommendation on this subject, the Board said that this section "prohibits banks that belong to a group or a chain from voting for Federal reserve bank directors. The wording of the section is such as not to confine the prohibition to group and chain banks, however, but to include all banks that are not controlled entirely by locally resident stockholders. Since the stock of many important banks is widely owned throughout the country, this might restrict the voting privilege to smaller and less important banks that are owned by local stockholders. It is to be feared that this section would bar from participation in the selection of Federal reserve directors many of the

better managed banks."

SECTION 4.

Distribution of earnings of Federal reserve banks. (Page 5)

The Federal Reserve Board recommended that the Secretary of the Treasury be authorized in his discretion to use the franchise tax received from Federal reserve banks for investment in obligations of the proposed Federal Liquidating Corporation, but the present bill provides that all net earnings of a Federal reserve bank after payment of dividends, claims and expenses shall be paid into the surplus fund of the bank.

In discussing the corresponding section of S. 4115, (Section 5), the Board said: "This section would amend the first paragraph of Section 7 of the Federal Reserve Act so that, after the payment of expenses and dividends, all of the net earnings of a Federal reserve bank over and above any amounts necessary to restore its surplus to the amount on December 31, 1931, would be paid to the Federal Liquidating Corporation. The amendment is also worded in such a way as to prevent the payment of any dividends out of surplus and to prevent the payment of dividends whenever the surplus of a Federal reserve bank is less than it was on December 31, 1931.

"A different method of financing the liquidating corporation is proposed and will be discussed under the appropriate section. For this reason a modification of Section 5 is suggested which would not change the provisions of the present law in regard to the surplus of the Federal reserve banks, but would authorize the Secretary of the Treasury to use the franchise tax received from the Federal reserve banks for the purpose

of supplementing the funds of the corporation."

SECTION 5(b).

Reports of affiliates of State member banks. (Page 6)

The Board stated in its letter that "With respect to affiliates, the Board believes that important reforms to be accomplished at the present times are the granting of power to the supervisory authorities to obtain reports and to make examinations of all affiliates of member banks and the prescribing of limitations on the loans that a member bank may make to its affiliates. The Board realizes that many evils have developed through the operation of affiliates connected with member banks, particularly affiliates dealing in securities."

The Board also recommended that, in dealing with affiliates, the following principles be observed: "(1) To require them to make reports and to submit to examination at the discretion of the Board or the Comptroller; (2) to limit the loans that can be extended to an affiliate by a member bank; and (3) to prohibit the tying up of capital stock of an affiliate with the capital stock of a member bank. In favoring these limitations, the Board has in mind that it may not be desirable to abolish all the existing relationships between member banks and their affiliates, but that it is desirable to protect the operations of the member banks from being unduly influenced by their affiliates. Recent experience has demonstrated that operations of the affiliates at times have unfavorable effects on the condition of member banks."

The Federal Reserve Board accordingly recommended that reports

of affiliates of State member banks "be required only when deemed necessary by the Federal Reserve Board." The present bill provides that a State member bank shall obtain from each of its affiliates, other than member banks, and furnish to the Federal reserve bank and the Federal Reserve Board, not less than three reports of condition each year on dates identical with the reports of the affiliated member bank and such additional reports as the reserve bank or the Board may deem necessary. The provision requiring such reports to be made is mandatory; but they are required to contain only such information as, in the judgment of the Federal Reserve Board, shall be necessary to disclose fully the relations between such affiliate and such bank and to enable the Board to inform itself as to the effect of such relations upon the affairs of such bank. The reports of affiliates are to be published by the bank under the same conditions as govern its own condition reports.

(Substantially the same provisions are contained in Section 24 of the present bill with reference to reports of affiliates of national banks, except that the reports are made to the Comptroller of the Currency instead of the Federal Reserve Board.)

SECTION 5(b).

Dealings in stocks and investment securities by State member banks. (Page 8)

The present bill contains a provision to the effect that State member banks shall be subject to the same limitations and conditions as are national banks with respect to the purchase, sale, underwriting

and holding of investment securities and stock. There was no such provision in S. 4115; but the Board recommended that the provision in Section 15 of S. 4115, which restricted dealings in investment securities by national banks, be omitted entirely.

(The provisions on this subject regarding national banks are in Section 15 of the present bill.)

SECTION 5(b).

Divorce of stock of State member bank from stock of other corporations. (Page 8)

The present bill contains a provision to the effect that, after five years from the passage of the Act, no certificate of stock of a State member bank shall represent the stock of any other corporation except a member bank, nor shall the ownership or transfer of the stock certificate of such a bank be conditioned upon the ownership or transfer of a certificate of stock of another corporation, except a member bank. S. 4115 contained no such provision regarding the stock of State member banks. There was a similar provision regarding the stock of national banks (Section 17 of S. 4115), which would have become effective immediately, and the Board recommended that it be retained but that it be made effective after three years. The Board also recommended in connection with its discussion of affiliates that the bill "prohibit the tying up of capital stock of an affiliate with the capital stock of a member bank."

(The provision on this subject applicable to the stock of national banks is found in Section 17 of the present bill.)

SECTION 5 (b).

Right of an affiliate of a State member bank to vote stock held by it in such bank. (Page 8)

Under the present bill, each State member bank affiliated with a holding company affiliate is required to obtain from such affiliate, within a period prescribed by the Board, an agreement that the affiliate will be subject to the same conditions and limitations with respect to voting stock in the bank as are applicable in the case of holding company affiliates of national banks (under Section 18 of the bill); and for failure so to do the membership of the State bank in the Federal Reserve System may be forfeited. If the Board revokes the voting permit (required by Section 18) of any holding company affiliate, the membership of any State member bank affiliated with it may be forfeited.

Section 20 of S. 4115 contained provisions with reference to the conditions under which holding company affiliates of national banks may obtain permits to vote stock owned by them in such banks, but these provisions were not made applicable to State member banks. The Board recommended a number of changes in these provisions, and that substantially the same provisions, with the changes recommended, be made applicable also to affiliates of State member banks. The provisions applicable to affiliates of national banks, however, (to which affiliates of State member banks are also subject) have not, except in a few respects, been made to conform to the recommendations of the Board on the subject.

(The provisions referred to are described below more in detail in Section 18 hereafter.)

SECTION 5(b).

Examination of the affiliates of State member banks. (Page 9)

The Federal Reserve Board recommended "in order that suitable provision may be made for the examination of affiliates of State member banks when deemed necessary" that such examinations be authorized to be made when deemed necessary in order to inform the Board or the Federal reserve bank of the relations between the affiliate and the member bank and the effect of such relations; that the examiner be authorized to examine officers and employees of the affiliate under oath; that the expenses of the examination be assessed, in the discretion of the Board, against the affiliate; and if not paid by the affiliate, against the member bank; and that a refusal by the affiliate to permit an examination or to give necessary information be penalized by a fine against the member bank of $100 per day.

The present bill requires such examinations of affiliates of State member banks to be made in connection with the examinations of such banks as shall be necessary to disclose fully the relations between such banks and their affiliates and the effect of such relations; the expenses of such examination may, in the discretion of the Board, be assessed against the bank examined; and, in the event of the refusal of the affiliate to give information or to permit an examination, or in the event of the failure of the bank to pay the cost thereof, the membership of the bank may be forfeited. The provisions recom-

mended by the Board as to examinations under oath, payment of expenses of examination by the affiliate, and penalties of $100 a day, are omitted.

(Provisions with reference to examinations of affiliates of national banks are contained in Section 25 of the present bill.)

SECTION 6.

Offices of the Federal Reserve Board. (Pages 10-13).

The Federal Reserve Board recommended that if the authority of the Secretary of the Treasury, contained in existing law, to assign quarters to the Federal Reserve Board is repealed, "it would seem that the Board should be authorized to purchase or construct a building for its own use and that, in the interest of convenience and efficiency, space should be provided in such building for the Comptroller of the Currency and his staff and for the proposed Federal Liquidating Corporation." The Board, however, is not given authority to purchase or erect a building in the present bill, and the provision of existing law authorizing the Secretary of the Treasury to assign offices to the Board has been omitted.

SECTION 7.

Open Market Committee. (Page 13)

The provisions of Section 10 of S. 4115 creating the Federal Open Market Committee have, with some changes, been retained in the

present bill.

The Board said in its letter "With respect to the section of the bill dealing with open market operations, the Board calls attention to the fact that there is already in existence an open market committee on which each of the Federal reserve banks has representation. This has come about as the result of natural development. The Board believes that it would be inadvisable to disturb this development by crystalizing into law any particular procedure. The Board believes that nothing further is necessary or advisable at this time than an amendment clarifying its power of supervision over open market operations of the Federal reserve banks and their relationships with foreign banks, as set out in the memorandum attached."

The Board suggested as a substitute for the provisions on this subject certain amendments to Section 14 of the Federal Reserve Act: (1) clarifying the Board's power over open market operations, and (2) improving and clarifying one of the provisions of the bill with respect to the considerations which should govern purchases and sales on the open market, so as to apply not only to purchases and sales "of paper" but to any open market transactions. The first of these suggested amendments is not incorporated in the

present bill and while the phraseology of the provision with respect to the considerations governing open market operations has been changed, it has not been altered in the manner suggested by the Board.

The Federal Reserve Board pointed out that the statement in Section 10 of S. 4115 that "No Federal reserve bank shall engage in open market operations * * * except after approval and authorization by the Committee", appears to be too rigid. The Board said that this provision "deprives an individual reserve bank of all authority to make purchases in the open market except after obtaining the consent of both the Board and the committee. The open market committee would have no authority to act without approval of the Board and the Board would have no authority to act without approval of the committee. This would result in the possibility of obstruction of any system program and would tend to make the operation of the Federal reserve system less timely and less efficient." In the present bill the provisions referred to have been changed slightly in form, but little in effect.

SECTION 7.

Federal Liquidating Corporation. (Pages 14-28).

The Board said in its letter that it "is in favor of establishing a liquidating corporation, but proposes to limit the scope of its operations to member banks and suggests a different method of financing it, together with certain changes in the provisions for its administation."

Accordingly, the Board suggested in lieu of the provisions of section 10 of S. 4115 on this subject, a proposed substitute which provided a number of material changes. In submitting this substitute the Board said: "The substitute would confine the benefits of the liquidating corporation to member banks. Provision is made for assistance to nonmember banks in the Reconstruction Finance Corporation Act, and it would render membership in the System more attractive if the benefits of the Corporation were confined to member banks. In the substitute it is proposed that $100,000,000 of the capital of the liquidating corporation be subscribed by the Treasury. This subscription to capital may be considered as being derived from the franchise tax previously paid to the Treasury by the reserve banks. In addition, it is proposed that the corporation be authorized to issue debentures up to twice the amount of its subscribed capital and that the Federal reserve banks be given authority to purchase those de-

bentures up to one-fourth of their surplus. This is not a propitious time to ask the member banks to contribute to the liquidating corporation. The banks are going through a very difficult period and to tax them for this purpose would be a considerable hardship on them.

"In order to make the operations of the corporation more easily manageable, it is proposed that the directorate be comprised of five members instead of fourteen as proposed in the bill."

Some of the suggestions of the Board mentioned in the above quotation have been adopted in the present bill. The provisions of the present bill confine the benefits of the liquidating corporation to member banks (paragraph (a)) and debentures may be issued by the corporation up to twice the amount of its capital (and this would seem to mean "subscribed capital", though it is not clear) (paragraph (m)). The directorate of the corporation is to consist of five members (paragraph (b)). The other recommendations of the Board, mentioned in the above quotation, namely, as to capital stock and the purchase of debentures of the corporation by Federal reserve banks, have not been adopted.

The present bill provides for three classes of capital stock; Class A stock, to be subscribed by member banks in an amount equal to one-fourth of one per cent of their deposits; Class B stock, to be subscribed by the Federal reserve banks in an amount equal to one-fourth of their surplus (paragraphs (d) and (e)); and stock in the amount of $125,000,000, to be subscribed by the United States (paragraph (c)). One-half of the

Class A stock (paragraph (e)) and of the Class B stock (paragraph (d)) is apparently required to be paid in on the organization of the corporation and the remainder is subject to call (paragraphs (d) and (e)). None of the stock subscribed by the United States is to be paid in on organization, but is subject to call by the board of directors of the corporation; and $125,000,000 is authorized to be appropriated for payment for the stock (paragraph (c)).

In addition to the points mentioned above, there are a number of other differences between the provisions of the present bill and the Board's suggested substitute. Many of these are differences of relatively slight importance or of language only. Others, however, are more substantial and those which appear to be material will be noted here:

The Board's suggested substitute provided that debentures issued by the corporation should be guaranteed by the United States and paid by the United States if the corporation should be unable to pay them, but this amendment has not been adopted.

The present bill (paragraph (b)) contains a provision (not found in the Board's proposed substitute) that no member of the board of directors of the corporation (consisting of the Comptroller of the Currency, a member of the Federal Reserve Board and three members appointed by the governors of the Federal reserve banks) shall receive any additional compensation for his services as such member.

Both under the present bill (paragraph (h)) and the Board's proposed substitute, an officer or employee of the United States may be an officer or employee of the corporation; but the present bill does not specifically authorize an officer or employee of the United States to be a director of the corporation as does the Board's substitute.

The present bill (paragraph (i)) requires the board of directors to administer the affairs of the corporation fairly and impartially and without discrimination among member banks and to extend to member banks such accommodations as may be safely and reasonably made with due regard for the claims and demands of other member banks. This provision was not contained in the Board's substitute.

The present bill, in providing for Class A stock to be subscribed by the member banks and Class B stock (paragraphs (d) and (e)) to be subscribed by Federal reserve banks, contains a number of provisions with reference to the attributes of this stock and the manner in which Class A stock shall be increased or decreased according to increases or decreases in the amount of deposits of member banks or in the number of member banks (paragraph (f)).

The Board's proposed substitute authorized the dealing in real or personal property to the extent necessary or convenient for the transaction of the corporation's business, but this provision is not included in the present bill.

The present bill does not contain the provision suggested by the Board that the corporation be authorized to appoint

its employees without regard to the provisions of other laws applicable to the employment and compensation of officers and employees of the United States.

The present bill contains a provision (not found in the Board's proposed substitute) for a valuation committee (which includes the receiver, a representative of the insolvent bank and a third member, selected by these two, but does not include a representative of the corporation). Loans on and purchases of the assets of the closed member banks by the corporation are to be made on the basis of valuations made by this committee (paragraph (j)).

The present bill does not contain a provision (suggested by the Board) that in no case shall the corporation make any loan or purchase any assets in an amount which shall not fully protect the corporation.

The present bill requires the corporation to pay to the receiver any excess realized upon the assets purchased (paragraph (j)), but does not contain such a requirement as to an excess realized upon assets on which a loan has been made (as provided in the Board's substitute.)

The present bill provides for the deduction of a liquidation fee of 8% of the amount realized upon the assets purchased (paragraph (j)); whereas the Board suggested the deduction of the expenses of

liquidating the assets and an amount equal to interest at the rate of 6% per annum, and required that all loans made by the corporation to receivers bear interest at 6% per annum.

The present bill contains a provision authorizing the corporation to purchase the assets of banks in the hands of receivers on the date of the organization of the corporation on the same general terms and conditions as are applicable in the case of banks closed after that date (paragraph (k)). This provision appears to be unnecessary; and the same effect is accomplished by the provisions of the Board's proposed substitute, although an express provision of this kind is not found in the substitute.

The present bill also recognizes the right of the corporation to enter into negotiations to secure the reopening of closed member banks (paragraph (k)). Express authority for this purpose is not given in the Board's proposed substitute.

SECTION 8.

Loans on member banks' collateral notes. (Page 28)

The present bill providesthat, if a member bank, while indebted to a Federal reserve bank on a fifteen day collateral note and despite a warning of the Federal reserve bank or of the Federal Reserve Board, increases its outstanding loans for the purpose of purchasing or carrying stocks or investment securities (except obligations of the United States), its note shall be immediately due and payable and the member bank shall be ineligible to borrow on such fifteen day notes for such period as the Federal Reserve Board shall determine.

The Federal Reserve Board recommended that the provisions of Section 11 of S. 4115 on this subject be omitted and that an amendment be adopted increasing the maximum maturity of advances to member banks on their promissory notes secured by eligible paper from 15 to 90 days; but, except for the omission of two provisions of S.4115 to which the Board objected, the Board's recommendationson this subject have not been adopted.

In this connection the Board said: "The Board is not in sympathy with the provisions of the bill discriminating against member bank collateral notes. Experience shows that the particular instrument on which Federal reserve credit is obtained is not an adequate test of the use to be made by the member bank of the proceeds of the credit and that an attempt to control speculation through restrictions on member bank collateral notes would not be effective in accomplishing the purpose of this section of the bill. Indeed, it probably would interfere seriously with the convenient and economical operation of the system. In this connection, the Federal Reserve Board desires to

renew the recommendation made in its annual reports for several years, that the maturity for which advances may be made to member banks on their promissory notes secured by paper which is eligible for discount be increased from fifteen to ninety days. Such an amendment would be especially helpful to country banks."

The Board also said that the theory underlying this section (Section 11 of S.4115) namely, "that there is a more direct connection between member bank collateral notes and the use of reserve credit for speculative activity than between other borrowings and this activity is unfounded. Member banks borrow on 15-day notes, because of the greater convenience both to them and to the Federal reserve bank; and, if this form of borrowing were prohibited or made more expensive, they would merely substitute the procedure of rediscounting eligible paper without any change in the use of the proceeds. For these reasons, it is believed that this section would make the operation of the Federal reserve banks less efficient and more expensive."

(It may be noted that the present bill amends the seventh paragraph of Section 13 of the Federal Reserve Act; but, due to the insertion of another paragraph in section 13 by the Act of July 21, 1932, the paragraph intended to be amended is not now the seventh paragraph, but the eighth paragraph. Furthermore, the enactment of the present bill would repeal the amendment to the paragraph in question which was contained in the Act of May 19, 1932, and which authorized the use of obligations of Federal intermediate credit banks as security for member bank 15 day notes.)

SECTION 9.

Foreign Transactions of Federal reserve banks (Pages 29,30)

The principal recommendations which the Board made with respect to Section 12 of S. 4115 dealing with the supervision of the Federal Reserve Board over foreign transactions and relationships of Federal reserve banks have been adopted in the present bill. One point of difference, however, may be noted. S. 4115 provided that a report of all conferences or negotiations and material facts appertaining thereto be filed with the Federal Reserve Board in writing and signed by all representatives of the Federal reserve bank attending such conferences or negotiations. The Board recommended the omission of the clause requiring the representatives of the Federal reserve bank to sign the report. The present bill requires that a report of such conferences or negotiations be filed with the Board in writing by a duly authorized officer of each Federal reserve bank which shall have participated therein.

SECTION 10.

Reserves of member banks(page 30)

Section 13 of S. 4115 contained a revision of the provisions with reference to the reserve requirements of member banks; and the Board recommended that these provisions be stricken out and that there be substituted a revision of Section 19 of the Federal Reserve Act in accordance with the recommendations of the System's Committee on Reserves, with some modifications. The provisions of S. 4115 have been omitted from the present bill; but the Board's recommended substitute (with the exception of a provision forbidding a member bank to act as the medium

or agent of a non-banking institution in making collateral loans to brokers or dealers in investment securities) has not been incorporated therein. The present bill does not contain any provision with reference to reserve requirements of member banks.

On this subject the Board stated that it was "of the opinion that the adoption of a system of reserves based on velocity of accounts as well as on their volume as recommended by the System's Committee on Reserves, would be an important step in strengthening the influence that the Federal Reserve System could exert in the direction of sound credit conditions."

The Board also said in this connection, "Any thorough-going revision of Section 19 of the Federal Reserve Act should base required reserves, in so far as practicable, upon the activity of the business handled through each bank, rather than on an arbitrary classification of banks according to location. A proposal submitted in the 'Report of the Committee on Bank Reserves of the Federal Reserve System' embodies a method of calculating required reserves which is believed to be sound in principle and which would make fluctuations in the volume of required reserves exert an influence in the direction of sound credit conditions and would also eliminate many inequitable and unfair features of the present law."

SECTION 11

Loans by Member Banks to Executive Officers or Relatives. (Pages 30-32)

There is a provision in the present bill, not contained in S.4115 and not recommended by the Federal Reserve Board, which forbids a member bank to loan to its executive officers and forbids them to borrow from the bank. It also requires an executive officer of a

bank who borrows from any other bank to make a report thereof to the chairman of the board of directors of his bank; and further, that if a spouse, brother, sister, lineal ancestor or direct descendant of an executive officer of any member bank borrow from such bank, the officer shall make report thereof to the chairman of the board of directors. Violation of this section is made a crime, subject to fine or imprisonment.

SECTION 12.

Loans to or investments in stock of affiliates. (Pages 32-34)

The provisions recommended by the Federal Reserve Board with respect to the limitations upon loans or extensions of credit to affiliates by member banks and upon investments in the stock or obligations of such affiliates by member banks have been adopted substantially in the present bill. One exception to this statement, however, may be noted.

Among the limitations provided by this section is a requirement that a loan or extension of credit to an affiliate of a member bank be secured by collateral having a market value of at least 20% more than the amount of the loan or extension, except loans or extensions secured by obligations of the United States, Federal intermediate credit banks, Federal land banks or paper eligible for rediscount by Federal reserve banks. The Board recommended that an exception to this limitation be made also in favor of loans secured by obligations of the Reconstruction Finance Corporation, but such an exception is not contained in the present bill.

SECTION 13.

Limitation on Investments in Bank Premises. (Page 34)

The Federal Reserve Board recommended a provision that no national bank, without the permission of the Comptroller of the Currency, and no State member bank, without the permission of the Board, shall invest in bank premises, or in stock or obligations of, or in loans to, any corporation owning or holding its bank premises, a sum exceeding the amount of the bank's capital stock.

The present bill adopts in substance this provision recommended by the Board, but the language of the provision is somewhat changed and loans upon the security of the stock of any such corporation holding bank premises are included within the investments to which the limitation applies.

SECTION 14.

Jurisdiction of Federal Courts over cases involving foreign banking transactions. (Page 35)

The present bill contains a provision, not found in S.4115 and not recommended by the Federal Reserve Board, which confers upon District Courts of the United States jurisdiction over any case to which a corporation organized under the laws of the United States is a party and which arises out of transactions involving international or foreign banking, either directly or through the agency, ownership or control of branches or of local institutions in foreign countries.

SECTION 15.

National Banks granted all powers of State Banks. (Page 36.)

The Federal Reserve Board recommended the omission of a provision of Section 15 of S.4115 authorizing a national bank to engage in all forms of banking business permitted by the laws of the State in which it is located to "banks of deposit and discount" organized under

such State laws, except to the extent that the exercise of such powers is forbidden by the laws of the United States. The Board said in this connection that this provision "apparently is intended to enable national banks to compete more effectively with State banks. Its tendency would be to lower the standards of banking in the national banking system to the standard of the State banks, where more liberal powers are granted to State banks by State law."

The provision in question, however, has been retained in the present bill, with the qualification that this section shall take effect five years after the date of the approval of the Act.

SECTION 15.

Dealings in investment securities. (Pages 36-38)

The Board recommended that a number of provisions, contained in Section 15 of S.4115, which referred to dealings in investment securities by national banks and prescribed certain limitations thereon, be omitted from the bill. In this connection the Board said: "This section would make it necessary for member banks to dispose of a large amount of securities at this time which would be very unfortunate. Since it is aimed generally at investments in securities, it is believed that its purpose is covered sufficiently by the proposed substitute for Section 3 of the Bill.

"The definition of investment securities which is contained in the law, as amended by the Act of February 25, 1927, would be stricken out and apparently the Comptroller would be given unlimited power to prescribe his own definition except that stocks could not be included. This modification is undesirable.

"For the reasons stated, it is recommended that this section be omitted entirely."

The definition of investment securities contained in existing law has been restored in effect in the present bill. The other provisions on this subject, however, which the Board recommended be omitted, have been retained in the present bill with certain changes and with the qualification that the section shall not take effect until five years after the approval of the Act. Under Section 5 of the present bill, furthermore, these provisions are applicable also to State member banks.

The present bill provides in effect that:

Dealings in investment securities are limited to the purchase and sale of such securities, without recourse, solely upon the order and for the account of customers, except that a member bank may purchase and hold for its own account investment securities under limitations and restrictions prescribed by regulation of the Comptroller of the Currency.

No member bank shall underwrite any issue of securities.

The total amount of any one issue of investment securities of any one obligor purchased after this section takes effect and held by a member bank for its own account shall not exceed 10 per cent of the total amount of such issue outstanding, but this limitation does not apply to any issue not in excess of $100,000 and not in excess of 50 per cent of the capital of the bank; and the total amount of investment securities of any one obligor purchased after this section takes effect and held by a member bank for its own account shall not exceed 15 per cent of the paid-up unimpaired capital of the bank and 25 per cent of its unimpaired surplus.

No member bank may purchase the stock of any corporation, except as otherwise permitted by law, and except that a bank may invest not more than

15 per cent of its unimpaired capital and surplus in the stock of safe deposit companies. These limitations do not apply to obligations of the United States, to obligations (whether general or special) of any State or any subdivision thereof, or to obligations issued under the authority of the Federal Farm Loan Act.

SECTION 16(b)

Capital Requirements of State Member Banks. (Page 39).

The present bill contains a provision, not found in S. 4115 and not recommended by the Federal Reserve Board, which amends Section 9 of the Federal Reserve Act so as to eliminate the provision of existing law under which a State bank is permitted to become a member of the Federal Reserve System with a capital equal to only 60 per cent of the amount required for the organization of a national bank in the place in which it is situated. The capital of State member banks hereafter admitted to the System, therefore, would be required in all cases to be equal to that required of national banks located in places of like size.

SECTION 17.

Divorce of Stock of National Banks from stock of other corporations. (Page 39).

The present bill provides that, after five years from the passage of the Act, no certificate of stock of a national bank shall represent the stock of any other corporation "except a member bank"; nor shall ownership or transfer of a stock certificate of a national bank be conditioned upon the ownership or transfer of a certificate of stock of another corporation "except a member bank".

This provision is as recommended by the Federal Reserve Board except that (1) the Board suggested that it become effective three years after the passage of the Act instead of five years thereafter; and (2) the qualifying phrase "except a member bank" was not contained in the Board's recommendation.

(Similar provisions regarding certificates of stock of State member banks are included in Section 5(b) of the present bill).

SECTION 18.

Right of an affiliate of a national bank to vote stock held by it in such bank. (Pages 39-45).

The Federal Reserve Board recommended a number of changes in the provisions which appeared in sections 19 and 20 of S. 4115 with reference to the conditions under which an affiliate of a national bank might vote stock held by it in such bank, and also recommended that a new section be added imposing similar requirements upon affiliates of State member banks. The present bill does not contain the provisions recommended by the Board on this subject, although, as explained heretofore under Section 5(b), a State member bank is required to obtain from its holding company affiliates an agreement to comply with the same requirements which are applicable to national bank affiliates under this section. In this connection the Board said:

"Under the definition of 'affiliate' contained in Section 2 and under the provisions of Sections 6, 27, and 28 of the Bill (S. 4115), if amended in accordance with the recommendations contained in this report, all holding companies which control member banks and all banks owned or

controlled by such holding companies will be affiliates of such member banks and will be required to make reports and submit to examinations whenever deemed necessary or advisable by the Comptroller of the Currency, the Federal Reserve Board or examiners appointed by them; and, therefore, it is suggested that the provisions regarding examinations and condition reports of holding companies be omitted from this section and from the corresponding sections regarding holding companies which own or control State member banks.

"It is also suggested that there be inserted in Section 19 and in the proposed new Section 20 certain additional provisions providing for the regulation and supervision of holding companies and requiring all eligible State banks controlled by them to be members of the Federal Reserve System."

The salient features of the provisions recommended by the Board on this subject were as follows: Shares owned or controlled by an affiliate of a national bank or any representative or agent of such affiliate shall not be voted unless such affiliate has filed an agreement with the Comptroller of the Currency to comply with the provisions of this section. Within one year from the date of any such agreement each nonmember State bank owned or controlled by such affiliate, if eligible, shall apply for membership in the Federal Reserve System and if not admitted or, if after admission, it ceases to be a member, such affiliate shall divest itself of all interest in such bank. Each such affiliate shall, on and after January 1, 1934, hold unpledged readily marketable assets, other than bank stock, equal to 15 per cent of bank stocks held by it and shall

reinvest its net earnings above 6 per cent in such assets until they amount to 25 per cent of bank shares held by it; with a proviso that, in computing the amount of such assets, credit shall be given for contributions made during the preceding three years to banks owned or controlled by the affiliate. Failure on the part of any such affiliate to comply with the provisions of the section or of the agreement is ground for the termination of the agreement by the Comptroller of the Currency. No national bank shall make any loan on the security of the stock of, or be the purchaser or holder of the stock of, any such affiliate which owns or controls such bank, or make any loan to any such affiliate on the security of the stock of a corporation owned or controlled by such affiliate, unless necessary to prevent loss upon a debt previously contracted in good faith; and stock so acquired shall be disposed of within two years. The voting of stock held by affiliates when an agreement of the kind mentioned is not in effect is made a crime punishable by fine; and officers and employees of affiliates which have entered into such an agreement with the Comptroller of the Currency are made subject to certain criminal provisions with reference to false entries.

The provisions recommended by the Board with reference to affiliates of State member banks were in large measure similar to those with reference to national banks except that the Federal Reserve Board is substituted for the Comptroller of the Currency. Under the Board's recommendations, no State member bank might remain a member after one year unless affiliates of such bank file the required agreements with the Board.

The provisions of the present bill with reference to the voting rights of affiliates of national banks, which do not contain

the provisions as recommended by the Board, are in brief form set forth in the following paragraphs.

Shares of a national bank controlled by a holding company affiliate, including those held by a trustee for the benefit of the shareholders of such affiliate, shall not be voted unless such affiliate shall have obtained a voting permit from the Federal Reserve Board; and in acting upon an application for such permit, the Board shall consider the financial condition of the applicant, the general character of its management and the probable effect of the granting of the permit upon the affairs of such bank. No permit shall be granted except upon the following conditions:

(a) Each such holding company affiliate shall agree: to submit to examinations, at its own expense, disclosing fully the relationship between such affiliate and such bank; that such examinations may be made of each bank owned or controlled by the affiliate; and that publication of statements of condition of such banks may be required.

(b) After five years after the passage of the Act, every such holding company affiliate shall possess unpledged readily marketable assets other than bank stock in an amount not less than 12% of the par value of all bank stocks controlled by such affiliate, which amount shall be increased by not less than 2% annually up to 25% thereof and by re-investing in such readily marketable assets net earnings in excess of 6% annually until such 25% requirement is reached.

(c) However, where the shareholders of the affiliate are themselves liable under the double liability provisions on the bank stock held by the affiliate, the latter shall be required only to establish, out of its net earnings in excess of 6%, a reserve of readily marketable assets equal to 12% of the par value of bank stocks controlled by it, and readily marketable assets required of such affiliate may be used for replacement of capital in, or losses incurred by, banks affiliated with it; but any deficiency so incurred shall be made up within such period as the Federal Reserve Board may prescribe.

(d) That officers, directors, agents and employees of such a holding company affiliate shall be subject to the same penalties for false entries as officers and employees of member banks are subject to under Section 5209 of the Revised Statutes.

(e) That every such holding company affiliate shall show that it does not have any interest in and is not participating in the management of any securities company and that it will not acquire such an interest or participation; that, if it has such an interest or participation it will, within five years, divest itself thereof; and that it will declare dividends only out of actual net earnings.

If any holding company affiliate violates any of the provisions of this act, the Federal Reserve Board may revoke its voting permit after notice, and thereafter no national bank whose stock is controlled by such affiliate shall receive Government deposits or pay any dividend to such affiliate.

Where such a voting permit of an affiliate has been revoked, the franchise of any national bank controlled by such an affiliate shall be subject to forfeiture.

SECTION 19.

Relationships between member banks and securities dealers or corporations making collateral loans. (Pages 45, 46)

Section 18 of S. 4115 contained provisions prohibiting directors, officers or employees of member banks to be directors, officers or employees of certain other specified classes of business enterprises and prohibiting a member bank from clearing checks or doing the ordinary banking business of a correspondent for any business enterprises of the classes mentioned. The Board recommended the omission of these provisions and they are not found in the present bill.

The Board suggested, however, a substitute paragraph on this subject and said in this connection:

"It has been clearly demonstrated that affiliations between member banks and security companies have contributed to undesirable banking developments. There are, however, difficulties in the way of accomplishing a complete divorce of member banks from their affiliates arising from the fact that a law intended for that purpose is likely to be susceptible of evasion or else to apply to many cases to which it is not intended to apply. Therefore, the Board is not prepared at this time to make a definite recommendation, but submits, for the consideration of the Committee on Banking and Currency, a substitute for Section 18 which is designed to provide for the divorce of security affiliates from member banks after three years."

The present bill provides, in substantial accordance with the provision recommended by the Board, that no member bank shall be affiliated with a securities corporation in the manner described in Section 2(b) of the present bill (where the word "affiliate" is defined so as not to include holding company affiliates). A violation of this provision subjects the member bank to a penalty of $1,000 a day, in the discretion of the Federal Reserve Board, and if the violation is continued for six months after warning from the Board, the bank's franchise may be forfeited, if a national bank, or its membership in the Federal Reserve System may be forfeited, if a State bank. The Board recommended that this provision be effective three years after the passage of the Act, but the present bill provides a period of five years before the provision becomes effective. Under the Board's recommendation the franchise of a national bank might be forfeited for violation of this provision in accordance with Section 5239 of the Revised Statutes, but under the present bill the forfeiture would be under Section 2 of the Federal Reserve Act, (under which suit for forfeiture may be brought by direction of the Federal Reserve Board.)

SECTION 20.

Branches of National Banks. (Pages 46, 47)

The recommendations made by the Federal Reserve Board with respect to the provisions of Section 21 of S. 4115 regarding branches of national banks have been incorporated in the present bill. Certain provisions of the present bill, however, regarding

matters concerning which the Board recommended no changes, may be noted:

1. The present bill requires the approval of the Comptroller of the Currency instead of that of the Federal Reserve Board for the establishment of a new branch by a national bank.

2. Out of town branches may be established only in those States where the law expressly authorizes State banks to establish them and in accordance with the restrictions of State law as to location, and in no case outside of the State in which the bank is located.

3. An exception is made to the requirement that a national bank have $500,000 capital stock in order to establish an out of town branch, so as to provide that where the bank is located in a State having a population of less than 1,000,000 and in which there is no city with a population exceeding 100,000, the required capital for the establishment of an out of town branch shall be $250,000.

(The provisions as to the establishment of branches of State member banks, in the form recommended by the Board, are contained in Section 5(b) of the present bill.)

SECTION 24

Reports of affiliates of national banks. (Pages 49,50).

The Federal Reserve Board recommended a change in Section 27 of S. 4115 on this subject, "in order that reports of affiliates of

national banks may be required only when deemed necessary and to clarify the provisions of the bill with respect to such reports". The present bill provides that a national bank shall obtain from each of its affiliates, other than member banks, and furnish to the Comptroller of the Currency not less than three reports each year on the same dates on which condition reports are required of the bank and such additional reports as the Comptroller may deem necessary. The term "affiliate" includes holding company affiliate. The provision requiring such reports is still mandatory; but they are required to contain only such information as in the judgment of the Comptroller shall be necessary to disclose fully the relations between such affiliate and such bank and as to the effect of such relations upon the affairs of such bank. Such reports of affiliates shall be published by the bank on the same conditions as govern its own condition reports. The bank is subject to a penalty for failure to render such reports.

(Substantially the same provisions are contained in Section 5(b) of the present bill with reference to reports of affiliates of State member banks, except that the reports are to be made to the Federal Reserve Board instead of to the Comptroller of the Currency.)

SECTION 25.

Examinations of affiliates of national banks. (Pages 50-52)

The Federal Reserve Board recommended a substitute for the provisions of Section 28 of S. 4115 with respect to examinations of affiliates of national banks. Some of the provisions of the Board's substitute have been adopted in the present bill and others have not.

The Federal Reserve Board's substitute authorized the examination of affiliates of national banks to be made when deemed necessary to obtain adequate information regarding the relations between the bank and the affiliate and the effect of such relations upon the bank. The present bill requires that examiners in making the examination of any national bank shall include such an examination of the affairs of all of its affiliates, other than member banks, as shall be necessary to disclose fully the relations between the bank and its affiliates and the effect thereof; and authorizes the forfeiture of the franchise of the bank in the event of the refusal of the affiliate to give information or to permit such an examination.

The present bill authorizes the publication of an examination report of a national bank or affiliate after 90 days' notice if the bank or affiliate fails to comply within 120 days with the

recommendations of the Comptroller of the Currency based on such examination. This provision, while contained in S. 4115, was omitted in the suggestion of the Board on this subject.

The Federal Reserve Board suggested certain other detailed provisions, authorizing the examiner to examine officers and employees of affiliates under oath; providing that the expenses of the examination be assessed by the Comptroller against the affiliate and, if not paid by the affiliate, against the national bank; and providing that a refusal by the affiliate to permit an examination or to give information be penalized by a fine against the national bank of $100 per day. These suggestions of the Board have been substantially adopted in the present bill, but the bill provides that the $100 penalty may be assessed and collected by the Comptroller of the Currency whereas the Board suggested that it be assessed by the Board and collected by the Federal reserve bank.

(Somewhat similar provisions with reference to examinations of affiliates of State member banks are contained in Section 5(b) of the present bill.)

SECTION 26.

Resumption of business by closed national banks. (Pages 52, 53)

The present bill contains a provision, not found in S. 4115

and not recommended by the Board, under which, in any case where, in the opinion of the Comptroller of the Currency, it would be to the advantage of depositors and unsecured creditors of a closed national bank for it to resume business upon the retention for a reasonable period, of all or a part of its deposits, the Comptroller may permit such resumption of business if 85% in amount of depositors and unsecured creditors consent in writing to such retention of deposits. It is provided that this section shall not affect any powers which the Comptroller now has with respect to the reorganization of national banks.