Copy L-32

April 14, 1933.

Mr. Sigurd Ueland,
800 Security Building,
Minneapolis, Minnesota.

Dear Sigurd:

Tremendous pressure of urgent business growing out of the recent banking crisis has prevented me from replying more promptly to your letter of March 3, 1933, inclosing for my information copies of three opinions which you had rendered to the Federal Reserve Bank of Minneapolis dealing with the subject of bank holidays. I have just now found an opportunity to read these opinions; and I find them very interesting, although I am not prepared to agree with all of the conclusions which you have expressed.

With reference to the question of the right of a Federal reserve bank to deal with a bank which has gone on a holiday or has otherwise suspended business temporarily but which has been permitted by the supervisory authorities to resume the transaction of a normal banking business, I note that you made no reference to the decision of the Circuit Court of Appeals in the case of Lucas et al v. Federal Reserve Bank of Richmond, wherein it seems to me that the Court intimated very strongly that, if the Comptroller of the Currency permits a national bank to remain open and continue to transact its normal business, the Federal reserve bank is justified in assuming that it is a solvent bank and in dealing with it as such.

In the light of the events which have transpired since your opinions were rendered, and especially in view of the unprecedented emergency situation confronting our banking system, I am inclined to believe that the courts will be disposed to go as far as possible in upholding the validity of transactions entered into in good faith by the Federal reserve banks in order to meet the emergency, especially where the Federal reserve banks acted reasonably and no great injustice resulted. In other words I think a lot of new case law will grow out of the recent banking emergency and that it is impossible to predict what the courts will hold were the respective rights of various parties in the light of the unprecedented situation that faced the country during the first three months of this year.

I am sending copies of your opinions to Counsel for all of the other Federal reserve banks and I am sure that they will read them with much interest.

Trusting that your Father's health has materially improved and with kindest personal regards to you both, I am,

Cordially yours,

(S) Walter Wyatt
General Counsel

WW/omc

Copy L-32-a

UELAND & UELAND
Attorneys and Counselors

800 Security Building
Minneapolis
March 3, 1933.

Walter Wyatt, Esq.,
Counsel Federal Reserve Board,
Washington, D. C.

Dear Walter:-

I enclose copies of three opinions I have given the Federal Reserve Bank of Minneapolis dealing with the subject of "bank holidays". I have not forwarded copies of these opinions to the counsel for the Federal reserve banks or to the Acting Comptroller of the Currency, because I am not sure that you agree with the views expressed in these opinions and would not wish to distribute the same except with your approval. If you wish to send out copies, I have no objection whatever.

Owing to the illness of my father, we are deprived of the benefit of his opinion during this vexatious period.

Very sincerely yours,

(Signed) Sigurd Ueland

SU*MS.

Copy L-32-b

February 24, 1933.

Federal Reserve Bank of
Minneapolis.

We have considered the question of "bank holidays" in our opinions to you dated December 1, 1932 and January 20, 1933. In these opinions we only considered questions arising while a bank is enjoying a "holiday"; we did not consider questions presented after such a bank has resumed ordinary banking business.

In our earlier opinions we came to the conclusion that for a national bank to declare a "bank holiday" was an "act of insolvency" within the meaning of the National Bank Act. The National Bank Act provides:

> "All transfers of the notes, bonds, bills of exchange, or other evidences of debt owing to any national banking association, or of deposits to its credit * * * made after the commission of an act of insolvency * * * made with a view to prevent the application of its assets in the manner prescribed by this chapter, or with a view to the preference of one creditor to another, except in the payment of its circulating notes, shall be utterly null and void * * *." United States Code, Title 12, Sec. 91.

Taking collateral for a present loan of money is not a preference in bankruptcy and the creditor is allowed to enforce the security against the trustee in bankruptcy of the borrower, even though the borrower was known to be insolvent at the time the loan was made. We understand that the lower federal courts have arrived at a similar result in cases of loans made on collateral

to insolvent national banks. However, under the National Bank Act not only transfers preferring one creditor over another are void; transfers after a national bank has committed an act of insolvency are void if -

> "made with a view to prevent the application of its assets in the manner prescribed by this chapter".

The application of assets here referred to is a ratable distribution among all the creditors of the Bank. Where a loan is made to a national bank the purpose of the borrower is usually, if not always, to use the proceeds to pay off certain depositors or other creditors of the bank. This being so, it seems to us that the Supreme Court might hold a pledge of collateral to secure a loan to a national bank, made after the commission of an act of insolvency, to be "utterly null and void".

In the case of Hirning vs. Federal Reserve Bank of Minneapolis, 52 Fed. (2d) 382, the United States Circuit Court of Appeals for this Circuit held that a person dealing with a national bank after an act of insolvency is liable if such person participates in transactions which result in other creditors receiving a preference. If your Bank should lend money to a national bank knowing that it had committed an act of insolvency, and knowing or having good reason to suspect that the proceeds of the loan would be used to prefer certain creditors of the national bank, we do not feel at all confident that your Bank would

be able to hold and enforce the collateral given for such loan.

The next question is - when a bank has committed an act of insolvency, how long does that fact operate as a danger signal to all who do business with the bank? Neither the statutes nor the decisions seem to throw much light on this question. Certainly the act of insolvency can be cured by the restoration of the bank to actual solvency. But the situation you will be confronted with is one where there has been an act of insolvency by a bank which subsequently resumes doing business, but remains in fact insolvent. In this situation the fact that the banking authorities have failed to perform their duty and appoint a receiver for the bank would hardly constitute a shield behind which others could hide. On the other hand the courts would hardly assert that a transfer was "utterly null and void" because of an act of insolvency ten years prior thereto. It is a question of degree where no definite boundary line can be drawn. In the earlier stages, however, after an act of insolvency has been committed we think you cannot deal with the bank in question without considerable risk until it has been examined by the proper banking authorities and found to be in a solvent condition.

In conclusion, we think that where a bank has gone on a "holiday" and then resumes the transaction of general banking business, being in fact insolvent, and the banking officials shut their eyes to the situation, you incur considerable risk of legal liabil-

ity: (1) if you forward checks drawn on such bank direct to it for payment; (2) if you pay drafts drawn by such bank on its reserve account with your bank; or (3) if you make new loans or discounts for such bank. (In the case of drafts drawn on the reserve account you are confronted with a real dilemma because you may incur liability by refusing to pay such drafts, if the member bank is in fact solvent.) As we indicated in our earlier opinions, there may be less risk in cases (2) and (3) where you are dealing with a state bank organized in a state in your district, other than Michigan, than in the case of a national bank.

Whether you should assume any or all of these risks or whether you should take the position that these banks coming out of the "holiday" condition should first have their solvency passed upon by those officials who were charged by law with this duty, are questions of policy outside of our jurisdiction.

UELAND & UELAND,

By

SU*MS.

L-32-c

January 20, 1933

Mr. A. R. Larson,

Assistant Cashier.

Answering your memorandum dated January 18, 1933 with reference to so called bank holidays. Where the banking authorities permit such an anomalous, if not illegal, situation to exist, it creates a very embarrassing situation for your bank.

I should think that in such instance of a member national bank, or a member state bank located in Michigan, which goes on a "holiday", your bank should immediately notify such member that you will not honor drafts on the reserve account and your bank should further ask for instructions as to collections.

I think bonds can safely be surrendered to the bank itself but not to others. Indeed I see no reason why currency payments might not be made to the bank itself, or why moneys in the reserve account might not be paid to the bank itself by means of your bank's draft or cashier's check. In such a case I see no reason why liability should attach to your bank under the preference statute (U.S.C. title 12, sec. 91 in the case of national banks) unless your bank in some way is a party to a plan whereby some creditor or creditors of the member bank are to receive a preference. If your bank should issue its cashier's check to the member bank and it should make a preferential transfer

of the same which should subsequently be held void, your bank, if it had paid the check, could, I assume, fall back on your endorser.

The reason why your bank cannot safely pay drafts on the reserve account is because in that case you are put on notice that the bank, which has committed an act of insolvency, is transferring funds, presumably to creditors. In the case of payments made to the bank itself no preference would result by reason of such payments, but could arise only by reason of some subsequent disposition made of the money by the recipient bank.

In view of the fact that the situation is loaded with dynamite, it would seem a wise policy to keep transactions with a bank in this moribund condition to a minimum.

UELAND & UELAND

By

SU/MG

L-32-d

December 1, 1932.

Mr. Harry Yaeger, Deputy Governor,
Federal Reserve Bank of
Minneapolis.

In your memorandum dated November 29, 1932, you inquire as to the duties and liabilities of the Federal Reserve Bank of Minneapolis with respect to banks in the Ninth Federal Reserve District which have declared what is termed "a bank holiday". Our understanding is that during a certain period one or more banks in a town endeavor to get their depositors to agree to extend the time of payment of a given percentage of their deposits or to release such given percentage entirely or look only to certain charged off assets for the payment of the same. During such period the banks are not open for ordinary business and do not permit withdrawals through the teller's window. We assume in what follows that the fact that the holiday has been declared is known to the officers of your bank.

In our opinion if your bank continues to forward checks drawn on a bank which is enjoying a "holiday" directly to such bank for payment and remittance by it, your bank may incur liability if loss thereby results. When a bank declares a holiday it is tantamount to an admission that the bank is in an insolvent condition. Forwarding to a bank known to be in a weakened condition, in our opinion, is negligence, and neither Regulation J of the Federal Reserve Board, your current check collection circular, the statute governing bank collections in Minnesota

(Mason's Statutes, Sec. 7233-1), nor the Uniform Bank Collection Code which is in force in Michigan and Wisconsin, exempts a collecting bank from liability for loss due to negligence.

The next question to be considered is whether when the bank declaring a holiday is a member bank, your bank should continue to honor drafts on the reserve account or permit the transfer of reserve balances by other methods.

The National Bank Act provides that "all transfers * * * of deposits" to the credit of a national banking association and "all payments of money" to its creditors "made after the commission of an act of insolvency, or in contemplation thereof, made with a view * * * to the preference of one creditor to another, * * * shall be utterly null and void". U. S. C., Title 12, Sec. 91. In our opinion when a national bank ceases to pay its depositors in the usual course of business, that is an "act of insolvency" within the meaning of the statute. *

Market National Bank v. Pacific National Bank,
30 Hun. 50, Aff. 93 N. Y. 648;

First National Bank of Ortonville v. Andresen,
57 Fed. (2d) 17 (C. C. A. 8).

Accordingly in the case of a national bank we do not see how your bank can safely continue to honor drafts after knowledge received by the officers of your bank that the national bank in question has declared a holiday. Such drafts and other transfers of credit in the reserve account would almost inevitably have the effect of preferring creditors of the national bank. Under the National Bank Act such payments or transfers would be void and your bank

Harry Yaeger - #3

might be held liable to a subsequently appointed receiver of the national bank to the same extent as if the drafts had not been paid and the transfers had not been made. See Hirning, Receiver, v. Federal Reserve Bank of Minneapolis, 52 Fed. (2d) 382.

In the case of state banks in states in the Ninth Federal Reserve District, we have made a hasty examination of the state statutes and do not find any provision similar to Title 12, Sec. 91 of the U. S. Code except in Michigan. Section 11946 of the Compiled Laws of Michigan, 1929, is almost identical with the provision in the National Bank Act on the subject of preferences. Accordingly we think you should treat member state banks located in Michigan in the same manner as national banks.

When a national bank or a state member bank in Michigan goes on a bank holiday it would seem advisable to notify the officers by telephone not to draw drafts or attempt to make transfers because the same cannot be honored.

As to state member banks in the other states of the Ninth District, we think you can safely continue to pay drafts until the bank is actually closed by its board of directors or by the banking authorities.

The question remains as to the proper course to be followed by your bank with respect to checks drawn on banks which have declared a holiday. We think it would not be safe for your bank to receive payment of checks drawn on national bank or state

banks in Michigan. Under the doctrine of the Hirning case your bank might thereby render itself liable for having received an unlawful preference. Accordingly it seems to us that in the case of these banks your bank should return the items to its endorsers advising them that the bank in question is reported on a "bank holiday", or words to that effect. As to checks on other banks, we think you have the alternative of having them presented over the counter by an agent or of returning them to your endorsers, as suggested in the case of national banks. We assume that non-member banks going on a holiday would be taken off your par list.

We do not consider in this opinion under what circumstances or in what manner acts of insolvency of a bank can be cured so that your bank could safely resume the transaction of ordinary business with such bank.

UELAND & UELAND

By

SU*MS.

* In McDonald, Receiver, vs. Chemical National Bank, 174 U. S. 610, it was held that the mere fact that a correspondent of a national bank had refused to pay its draft was not sufficient proof of an "act of insolvency". But in our opinion this is quite a different thing from the refusal of a national bank itself to pay its obligations in the usual course of business.