BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

February 23, 1938.

Dear Sir:

There are being sent you under separate cover twenty-five copies of a talk made by Mr. Walter Wyatt, General Counsel of the Board of Governors, on February 21, 1938, before the Banking Forum of the St. Louis Chapter of the American Institute of Banking on the subject: "The Regulations of the Board of Governors of the Federal Reserve System". This talk is a current revision of the address made by Mr. Wyatt on May 20, 1936, before the Annual Convention of the Texas Bankers Association at Houston on "The Board of Governors of the Federal Reserve System" (X-9587).

Copies of the February 21 address are being forwarded to you for the purpose of making them available to the officers and directors of your bank and branches, if any, and to any member banks which may desire them. Additional copies will be furnished upon request.

It is the present practice to send to each Federal reserve bank twenty-five copies of speeches made by members of the Board and its staff as a matter of routine. Since the number of copies forwarded in the first instance is entirely arbitrary, it will be appreciated if you will advise whether your bank desires to receive a larger or smaller number of such copies in future routine shipments.

Very truly yours,

L. P. Bethea,
Assistant Secretary.

TO PRESIDENTS OF ALL FEDERAL RESERVE BANKS

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Z-82

# "THE REGULATIONS OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM"

Talk before the Banking Forum
of the
St. Louis Chapter
of the
American Institute of Banking

by

Walter Wyatt, General Counsel
Board of Governors of the Federal Reserve System

St. Louis, Missouri, February 21, 1938.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Mr. Chairman, Ladies and Gentlemen:

I have been asked to talk to you about the regulations of the Board of Governors of the Federal Reserve System; but before discussing the regulations I would like to say a few things about the Federal Reserve System.

The Federal Reserve System consists of three principal elements -- the member banks, the Federal Reserve banks, and the Board in Washington.

The member banks are as much a part of the Federal Reserve System as the Federal Reserve banks or the Board in Washington. It is principally through the member banks that the Federal Reserve banks serve the public.

The System is fundamentally a cooperative arrangement by which member banks join together and pool a portion of their resources for mutual assistance. The member banks in each district make their contributions by depositing their reserves in their own Federal Reserve bank; and, when any member bank needs assistance, it goes to its own Federal Reserve bank in its own district.

The Federal Reserve banks are neither Government institutions nor private institutions. They are privately owned but they are devoted entirely to the public service. They are not operated for profit and the dividends which they pay to their stockholders are limited by law to 6 per cent per annum. The remainder

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

of their net earnings is carried to a surplus fund which would be paid into the Treasury of the Federal Government if the Federal Reserve banks were liquidated.

The Federal Reserve System is not a central banking system but a regional banking system. This country is too vast and conditions in different parts of the country vary too much to make it feasible or desirable to have a single central bank for the entire country. Instead, therefore, we have twelve Federal Reserve banks, each serving a definite geographical area and managed by directors, officers and employees who live in and are familiar with the conditions in its district. However, each Federal Reserve bank is authorized, and may be required, to go to the assistance of any other Federal Reserve bank which needs assistance in handling any situation arising in its district.

With respect to matters affecting the country as a whole the activities of the twelve Federal Reserve banks are coordinated by the Board of Governors in Washington. The Board is given the broad power to exercise general supervision over the twelve Federal Reserve banks and certain specific powers designed to enable the Board to see that they pursue a banking policy which is uniform and harmonious for the country as a whole.

The fundamental characteristics of the Federal Reserve System were stated by Honorable Carter Glass in the official report which he made to the House of Representatives on the bill which became the original Federal Reserve Act. He said:

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

" * * * The only factor of centralization which has been provided in the committee's plan is found in the Federal reserve board, which is to be a strictly Government organization created for the purpose of inspecting existing banking institutions and of regulating relationships between Federal reserve banks and between them and the Government itself. Careful study of the elements of the problem has convinced the committee that every element of advantage found to exist in cooperative or central banks abroad can be realized by the degree of cooperation which will be secured through the reserve-bank plan recommended, while many dangers and possibilities of undue control of the resources of one section by another will be avoided. Local control of banking, local application of resources to necessities, combined with Federal supervision, and limited by Federal authority to compel the joint application of bank resources to the relief of dangerous or stringent conditions in any locality are the characteristic features of the plan as now put forward. * * * It is proposed that the Government shall retain a sufficient power over the reserve banks to enable it to exercise a directing authority when necessary to do so, but that it shall in no way attempt to carry on through its own mechanism the routine operations of banking which require detailed knowledge of local and individual credit and which determine the actual use of the funds of the community in any given instance. In other words, the reserve-bank plan retains to the Government power over the exercise of the broader banking functions, while it leaves to individuals and privately owned institutions the actual direction of routine."

In this form of organization we have something which is characteristically American -- local management of local affairs, national management of national affairs, and the strength which lies in unity, coordination and cooperation.

The Board is an independent establishment of the Federal Government carefully safeguarded from political influence and pressure.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

It consists of seven members appointed by the President and confirmed by the Senate for terms of fourteen years each, so arranged that not more than one term will expire in any two years. Furthermore, a member who has served a full term of fourteen years is ineligible for reappointment, so that his actions while in office will not be influenced by the desire to be reappointed.

In selecting the members of the Board, not more than one of whom may be selected from any one Federal Reserve district, the President is required to have due regard to a fair representation of the financial, agricultural, industrial and commercial interests and geographical divisions of the country. Before taking office, the members of the Board are required to divest themselves of all interest in any bank, banking institution or trust company; and the members of the Board are made ineligible during the time they are in office and for two years thereafter to hold any office, position or employment in any member bank, except that this restriction does not apply to a member who has served the full term for which he was appointed.

Another feature of the original Federal Reserve Act, which has been preserved and which affords the Board very important protection against political pressure is the fact that it is not dependent upon Congress for appropriations but defrays all of its expenses out of assessments levied on the Federal Reserve banks.

In view of the vast injury which could be done if the official actions of the Board of Governors and the Federal Reserve banks were

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

influenced by politics or favoritism, it is vitally important that this independence be preserved. It is not only important to the public interest, but it is of especial importance to every member bank. It is vitally important to keep banking out of politics and politics out of banking.

The most important and most widely discussed powers of the Board relate to national credit policies. These include the power to approve or disapprove discount rates of the Federal Reserve banks, to change reserve requirements of member banks, to prescribe margin requirements for loans by brokers and dealers in securities and by banks for the purpose of purchasing or carrying securities, and to regulate the rates of interest which may be paid by member banks on time and savings deposits.

In addition, the Federal Open Market Committee, which consists of the seven members of the Board and five representatives of the Federal Reserve banks, is given control over the open market operations of the Federal Reserve banks - that is over the amount of credit which they can place in or remove from the money market through the purchase or sale of Government bonds, bankers' acceptances or other obligations of the kinds which Federal Reserve banks are authorized to purchase and sell in the open market.

The most numerous powers of the Board relate to the operations of the Federal Reserve banks and are a part of an intricate system of checks and balances designed to leave the management of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

local affairs and the granting of individual credits to the directors and officers of the Federal Reserve banks but at the same time to give the Board in Washington sufficient powers of general supervision and regulation to enable the Board to coordinate the activities of the twelve Federal Reserve banks and see that they carry out the purposes of the Federal Reserve Act and pursue policies which are harmonious for the country as a whole.

However, I promised to talk to you about the Board's regulations which member banks have been receiving in increasing numbers in recent years and a few of which affect the daily operations of member banks.

There have been complaints about the number of new regulations issued by the Board since the passage of the Banking Act of 1935, and I sympathize with the member banks; because they have been through very trying times since 1929. After all the troubles which they experienced in the unhappy years leading up to the banking holiday in March, 1933, and the very difficult months of reorganization and rehabilitation following that period, they had to contend with many perplexing new provisions of law imposed upon them by the Banking Act of 1933. That was a reform measure resulting from public resentment over certain practices which were brought to light by the large number of bank failures in the years immediately preceding.

The Banking Act of 1933 made it necessary for the Board to issue a number of new regulations; and, before the banks finished familiarizing themselves with these new laws and regulations and

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

adjusting themselves to them, we had the Banking Act of 1935 and a new set of regulations issued thereunder. The banks probably feel that they are being legislated and regulated to death; but an analysis of the situation will disclose that it is not as bad as it seems.

Since the passage of the Banking Act of 1935, the Board has issued eleven regulations under that Act and two under the Securities and Exchange Act of 1934, making thirteen in all. Of these thirteen only three are new or additional regulations. Ten of them are merely revisions of pre-existing regulations, and most of the changes made are in the direction of greater liberality, simplicity and clarity.

In view of the fact that the Board designates its various regulations by the letters of the alphabet and has now reached the letter U, you may wonder what the Board will do when it has exhausted the alphabet. I personally hope that the Board will never exhaust the alphabet, but that it will be able in time to work out ways and means of simplifying its regulations and greatly diminishing their number.

The Board has outstanding at the present time twenty-one different regulations. This sounds like a tremendous volume of regulations; but it is not really as formidable as it sounds. Each regulation is limited to a particular subject and only a few affect the operations of member banks to any material extent. A quick review of the list of regulations will illustrate my point. With

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

your indulgence, I shall take them up in alphabetical order and run through the entire list from A to U.

Regulation A relates to discounts and advances by Federal Reserve banks to member banks; but it does not affect member banks unless they are discounting with, or obtaining advances from, the Federal Reserve banks. It was revised effective October 1, 1937, in a form which makes the credit facilities of the Federal Reserve banks available to member banks on a much more liberal and practical basis than ever before.

Regulation B relates to the purchase of bills of exchange, trade acceptances and bankers' acceptances by Federal Reserve banks on the open market. It only affects indirectly those member banks who issue bankers' acceptance credits or have occasion to sell bills of exchange, trade acceptances or bankers' acceptances on the open market.

Regulation C relates to the granting of bankers' acceptance credits by member banks, but affects only the relatively small number of member banks which issue such credits.

Regulation D relates to the reserves of member banks. It affects all member banks; but, it is something to which they have become adjusted over a long period of time and is of little practical importance at a time like the present when most member banks have reserves greatly in excess of the legal requirements.

Regulation E relates to the purchase of State and municipal warrants by Federal Reserve banks on the open market and has practically no effect on member banks.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Regulation F relates to trust powers of national banks. It was revised, effective June 1, 1936, and amended again effective December 31, 1937 so as to provide for the establishment and operation of common trust funds. It states the procedure under which national banks obtain and surrender permits to exercise trust powers and a few general principles regarding the management of the trust department, the investment of trust funds, and similar matters.

Regulation G relates to the rediscount by Federal Reserve banks of notes secured by veterans' bonus certificates and is practically a dead letter today.

Regulation H relates to the membership of State banks in the Federal Reserve System, but has no effect whatever upon national banks. Even as to State banks, it relates only to such matters as the procedure for obtaining or relinquishing membership in the System, the conditions upon which such banks will be admitted to the System, the circumstances under which they will be permitted to establish or maintain branches, and the publication of reports of member banks and their affiliates.

Regulation I relates to the increase or decrease of holdings by member banks of capital stock of Federal Reserve banks. It affects member banks only at the time of their organization or admission to the Federal Reserve System and at times when they increase or decrease their capital or surplus, consolidate with other banks, become insolvent, go into voluntary liquidation, or withdraw from membership in the Federal Reserve System.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Regulation J relates to the clearance and collection of checks by Federal Reserve banks. It affects all member banks, but only with respect to the terms and conditions upon which Federal Reserve banks receive checks from them for collection and make the credits therefor available to them.

Regulation K relates to the organization and regulation of foreign banking corporations, and is of no interest to member banks except the few owning stock in such foreign banking corporations or contemplating the organization of such corporations.

Regulation L relates to interlocking bank directorates under the Clayton Act and affects only those member banks which have directors, officers or employees serving also as directors, officers or employees of other banks.

Regulation M consists of only one paragraph and relates only to foreign branches.

Regulation N pertains only to the relations of Federal Reserve banks with foreign banks and bankers, and has no effect upon member banks.

Regulation O relates to loans by member banks to their executive officers, but was issued to relieve the member banks from the more onerous provisions of the pre-existing criminal statute on this subject.

Regulation P relates to holding company affiliates of member banks and affects only indirectly those member banks which are controlled by bank holding companies.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Regulation Q relates to the payment of interest on deposits by member banks and affects all member banks.

Regulation R relates only to those member banks who desire to have security dealers or underwriters serving as their officers, directors or employees.

Regulation S relates to loans by Federal Reserve banks to furnish working capital to established industries and affects only those member banks which participate in such loans or which make such loans themselves and obtain commitments from the Federal Reserve banks to take them off of their hands.

Regulation T relates to the extension and maintenance of credit by brokers, dealers and members of national securities exchanges, and does not affect any member banks except a very few which are members of national securities exchanges. Incidentally, it prescribes the procedure under which nonmember banks may qualify to make advances to brokers and dealers in securities.

Regulation U relates to loans by banks for the purpose of purchasing or carrying stocks registered on a national securities exchange but this regulation has little effect on the operations of any member banks except those located in the large financial centers.

Out of twenty-one regulations which the Board has in effect at the present time, therefore, I think it is fair to state that five of them have no effect whatever upon member banks, eleven of them affect the member banks only occasionally or affect only a few of them, and only five of them materially affect the ordinary operations of all member banks.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Of these five, Regulation D, relating to reserves of member banks and Regulation J, relating to the clearance and collection of checks by Federal Reserve banks, are so well-established and so well known to all member banks that they require no further discussion at this time.

That leaves Regulation O, relating to loans to executive officers of member banks, Regulation Q, relating to the payment of interest on deposits, and Regulation U, relating to loans by banks for the purpose of purchasing or carrying stocks registered on a national securities exchange. I shall discuss these three regulations a little further.

Regulation O, relating to loans by member banks to their executive officers may not have gone as far in the direction of liberality as some member banks desired; but it is much more liberal and practical than what preceded it.

When the Banking Act of 1933 was under consideration by Congress there was much public resentment over the fact that a number of banks which had failed in the years immediately preceding had sustained large losses on loans made to their own executive officers. This resulted in a provision in the Banking Act of 1933 making it a criminal offense, punishable by fine or imprisonment, for any executive officer of a member bank to borrow from or otherwise become indebted to such bank or for any member bank to make any loan or extend credit in any other manner to any of its own executive officers.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The term "executive officer" was not defined, and the Board received a large number of requests for rulings as to what officers of member banks should be considered "executive officers" within the prohibitions of the Act. Unfortunately, the Board had to decline to express any opinion on these questions, because the enforcement of Federal criminal statutes is entirely within the jurisdiction of the Department of Justice and any opinion expressed by the Board would not have been binding upon that Department.

If the Board had expressed the opinion that certain officers of member banks were not "executive officers" within the meaning of the statute, they might have obtained loans from their banks in good faith and in reliance upon the Board's opinion. If the Department of Justice had subsequently adopted a different interpretation of the law such officers might have been prosecuted for obtaining loans which the Board had told them were entirely lawful. In the circumstances, the only thing the Board could do was to decline to express opinions on such questions.

It was contrary to the established policy of the Department of Justice to issue rulings interpreting penal statutes; and there was no place for the member banks to go to obtain authoritative rulings on such questions.

The situation was extremely unsatisfactory; and the Board and the Comptroller of the Currency jointly sought relief for the member banks in the Banking Act of 1935. As a result of their efforts, the section was rewritten by the Banking Act of 1935 so as to repeal the criminal penalties, thus withdrawing the subject entirely from

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the jurisdiction of the Department of Justice. It also authorized the Board to define the term "executive officer", to determine what should be deemed a borrowing, indebtedness, loan, or extension of credit and to prescribe rules and regulations to effectuate the purposes of the section and prevent evasions thereof. In addition, certain exceptions were made to the prohibitions of the section, one of which permits any member bank with the approval of a majority of its own board of directors, to extend credit to any executive officer thereof in an amount not exceeding $2,500.

Regulation O issued by the Board pursuant to the provisions of this section adds nothing whatever to the restrictions contained in the law itself, but consists principally of a definition of the term "executive officer" and answers to other questions on which member banks had been clamoring for interpretative rulings. Instead of creating additional burdens for the member banks, therefore, this regulation should be of great assistance to them.

There was one respect in which the Board could not see its way clear, in defining the term "executive officer", to make a concession which many banks desired but which others felt could not properly be made -- namely, the proposal to exempt honorary or inactive officers. After hearing all of the arguments on both sides, the Board adopted the view that a person who accepts the title of an executive officer and holds himself out to the public as an executive officer should be required to comply with the rules governing

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

executive officers. I know that there are some who differ with this view; but I have never heard any one who could successfully answer the moral arguments upon which it is based.

Regulation Q relates to the payment of interest on deposits by member banks and also grows out of provisions added to the Federal Reserve Act by the Banking Act of 1933, which were later amended and modified by the Banking Act of 1935.

The underlying purposes which Congress had in mind when it enacted these provisions have never been authoritatively stated; but it is my personal opinion that they were two-fold: First, to put an end to cut-throat competition for deposits, which frequently led the banks to pay higher rates of interest than they could afford to pay and thus tended to weaken their financial condition; and, second, to compensate the banks somewhat for the assessments, which under another provision of the Banking Act of 1933, they were required to pay for the insurance of their deposits. The section was adopted for the benefit and protection of the banks; and it is in the interest of every bank to cooperate with the Board in its efforts to obtain compliance with the spirit as well as the letter of this law and to eliminate every form of unfair competition for bank deposits. The sole purpose of Regulation Q is to accomplish this result.

Regulation U, which was issued pursuant to the Securities Exchange Act of 1934, governs loans by banks for the purpose of purchasing or carrying stocks registered on national securities exchanges. Unlike the Board's other regulations, it applies to nonmember banks as well as member banks.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The Board could have spared itself a great amount of trouble and expense by leaving this subject to regulation by the Federal Trade Commission or the Securities and Exchange Commission, as proposed in the original bill. But the Board at that time felt that the banks were already subject to regulation by too many different supervisory authorities and that they would fare better if this additional duty were performed by the Board instead of some other agency less familiar with practical banking problems. Congress was persuaded, therefore, to impose this duty upon the Board instead of the Securities and Exchange Commission, even though, in order to accomplish this result, the Board also had to accept the burden of regulating the extension of credit by brokers, dealers and members of national securities exchanges, which it was very reluctant to do.

In the preparation of Regulation U every effort was made to make it as short and simple as possible and to interfere no more with the ordinary operations of the banks than is absolutely necessary to accomplish the purpose of the regulation, which is to prevent the excessive use of bank credit for the purchasing or carrying of securities.

The regulation applies to no loans except those which are secured by stocks and are made for the purpose of purchasing or carrying stocks registered on a national securities exchange.

If a loan is not secured directly or indirectly by stocks, the regulation has no application to it and the bank need not inquire into the purpose of the loan. It is recognized that this leaves the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

regulation open to the possibility of some evasion; but it was believed better to accept this risk than to affect every loan a bank makes in order to regulate a relatively small portion of them. It is believed that most of the bankers will endeavor in good faith to comply with the regulation and will not make loans for the purpose of purchasing or carrying stocks without requiring the customers to pledge such stocks as collateral.

Even if a loan is secured by stocks the regulation does not apply to it if the loan is made for a commercial, agricultural or industrial purpose or for any other purpose except the purpose of purchasing or carrying listed stocks. If the bank desires to do so for its own protection, it can obtain a written statement from the borrower or from one of the bank's own officers that the loan is not for the purpose of purchasing or carrying stocks. If such a statement is obtained in good faith the loan is completely exempted from the regulation.

Even if a loan is secured by stocks and the bank is unwilling to inquire into its purpose, the regulation will not be violated if the amount of the total loans to that customer does not exceed sixty per cent of the current market value of the stocks pledged as collateral.

The net practical result is that a bank need not think about the regulation except with respect to loans that are secured directly or indirectly by stocks when the amount of the borrower's

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

indebtedness exceeds sixty per cent of the current market value of the stocks securing such indebtedness. Even with respect to this limited class of loans, the banker can forget about the regulation if he obtains in good faith a written statement from the customer or from one of the bank's own officers that the loan is not for the purpose of purchasing or carrying stocks.

I think it is fair to say, therefore, that the Board succeeded in promulgating a regulation which does not interfere with the ordinary operations of the banks any more than is absolutely necessary to accomplish the purposes of the regulation.

Although it does not directly affect the ordinary operations of member banks at a time like the present when most of them have substantial amounts of excess reserves and very few, if any, are borrowing from the Federal Reserve banks, you may also be interested in some discussion of the new Regulation A, which became effective on October 1, 1937, and which relates to discounts and advances by Federal Reserve banks for member banks. This new regulation superseded the 1930 edition of Regulation A and incorporated various legislative changes on this subject which had been made since the beginning of the depression.

The first part of the regulation deals with the requirement as to eligibility for discount of notes, drafts, and bills arising out of commercial, agricultural, and industrial transactions and contains relatively few substantial changes from the old regulation. The legal limitation of maturities to 90 days, except in the case of agricultural

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

paper where it is 9 months, remains unchanged.

An important change, however, occurs with regard to paper the proceeds of which are advanced or loaned to some other borrower. The Board had previously held that paper the proceeds of which were advanced or loaned to some other borrower, such as paper made by finance companies, was ineligible for discount at Federal Reserve banks, with the exception of paper of cooperative marketing associations and of certain factors which had been specifically made eligible by the law. In the new regulation the requirement that the proceeds of eligible paper must be used "in the first instance" for the purpose of producing, purchasing, carrying, or marketing goods has been eliminated, and it is likewise no longer required that the proceeds of eligible paper must not be advanced or loaned to some other borrower. Under the new regulation, therefore, notes, drafts, or bills the proceeds of which have been advanced or loaned to some other borrower for a commercial, agricultural, or industrial purpose are eligible for discount, provided they comply with the usual requirements as to maturity. The principle underlying this interpretation by the Board is that paper whose proceeds are used for an eligible purpose in the hands of a second borrower is not rendered ineligible by the intervening transaction. This makes eligible for discount a large amount of paper of commission merchants and finance companies, including paper drawn to finance installment sales of a commercial character.

Another change in the sections dealing with eligible paper is based on the National Housing Act of June 27, 1934, which makes

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

eligible for rediscount notes with short maturities representing loans made to finance the construction of residential or farm buildings, if accompanied by a valid and binding agreement to advance the full amount of the loan upon the completion of the building, entered into by persons acceptable to the discounting Federal Reserve banks. This provision of the law was intended to encourage loans by banks for construction purposes with a view to promoting recovery of the building industry.

A more fundamental change in the regulation appears in section 2, which incorporates for the first time provisions regarding advances to member banks under section 10(b) of the Federal Reserve Act, which was added to the law by the so-called Glass-Steagall Act of February 27, 1932, for the purpose originally of making it possible in exceptional and exigent circumstances for member banks to receive credit accommodation from Federal Reserve banks on their promissory notes collateraled by any security acceptable to the Federal Reserve bank. This action was taken to relieve a situation existing during the deflationary period when many banks with sound assets in their possession were obliged to close their doors because they did not have paper eligible for rediscount at the Federal Reserve bank. The inability of Federal Reserve banks to discount sound paper unless it complied with the eligibility requirements of the law was one of the conditions that aggravated the deflationary movement.

Section 10(b) was first enacted as a temporary emergency measure to overcome this situation and its duration was originally

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

limited to March 3, 1933, but was later extended to March 3, 1935. It was originally restricted to banks with a capital not exceeding $5,000,000, and each loan had to be authorized by the affirmative vote of not less than five members of the Federal Reserve Board. These latter restrictions were eliminated by the Emergency Banking Act of March 9, 1933, but there still remained provisions of the original law to the effect that this section could be used only in exceptional and exigent circumstances and only by member banks having no further eligible and acceptable assets available to enable them to obtain adequate credit accommodations under the regular discount provisions of the law. In view of the temporary nature of the legislation, the provisions of this section were not covered by a formal amendment to the regulation but only by circular letters sent by the Board to all Federal Reserve banks outlining the procedure for making such loans.

The Banking Act of 1935 made this section permanent and further liberalized it by removing the requirements that in order for a bank to borrow under this section there must be exceptional and exigent circumstances and that the bank must be unable to obtain adequate credit accommodations under other provisions of the Federal Reserve Act. The minimum rate of interest on these advances was reduced from 1 per cent to 1/2 per cent above the highest discount rate. A four months' limit on the maturity of advances under this section was provided.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

It is for advances under the authority of section 10(b) of the Federal Reserve Act that provision is made in section 2 of the new Regulation A. This regulation authorizes the use as collateral for advances, in addition to Government securities and eligible paper which could serve as a basis for advances under the old law, the various classes of paper that underlie the financing of the country's principal economic activities. In addition to certain specified classes of assets, the regulation provides further that, when in the judgment of a Federal Reserve bank circumstances make it advisable to do so, it may accept as security for an advance under this section any assets satisfactory to the Federal Reserve bank. The regulation, therefore, bars no paper from use as collateral for advances but merely indicates a class of preferred paper which covers all the principal fields of financing.

In establishing rules, which in effect make all sound assets of member banks a potential basis of advances by the Federal Reserve banks, the Board had in mind the fact recognized by Congress in the Banking Act of 1935, that under our banking system member banks carry time deposits as well as demand deposits, and since these banks are custodians of the funds representing the savings or capital accumulation of the people, they properly invest a part of their funds in long-time paper, and consequently provision should be made for using them in case of need as a basis of advances from the Federal Reserve banks.

The principles underlying the new regulation are the same as those underlying recent modifications of the Federal Reserve Act.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Experience has demonstrated that the solvency of banks is better safeguarded by careful regard to the quality of the paper that they acquire than by strict observance of the form that this paper takes. Strict eligibility requirements in the past did not save the banking system from collapse. Greater emphasis on soundness and less emphasis on form is, therefore, a sound banking principle.

The Board was also guided in its determination of eligibility requirements by the recognition of the fact that at a time of a deflationary trend it is important for the Federal Reserve System to lend with the greatest freedom consistent with safety. At such times technical limitations on the character of eligible paper endanger rather than protect the safety of the banking structure. By describing in the regulation the character of paper that will have first claim for advances the Board hopes to encourage better and safer banking practices. At the same time the Board believes that the assurance of support in case of need given to member banks with sound assets will encourage these banks to give their communities the financial services that they require.

While I am on the subject of regulations, I would like to tell you something about the procedure followed in preparing them.

A tentative draft of each proposed regulation is sent to all the Federal Reserve banks with a request that they give the Board the benefit of their criticisms and suggestions. In addition to studies and discussions by their officers and counsel, the Federal Reserve banks frequently consult some of the member banks about these tentative drafts. The criticisms and suggestions resulting from these studies,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

discussions and consultations are transmitted to the Board in writing.

Copies of the tentative drafts of all regulations affecting member banks are also sent to the American Bankers Association for study by a committee representing the Association. Special committees are appointed by the President of the Association for this purpose and the members of each special committee are practical operating officers of member banks carefully selected on the basis of outstanding ability and special familiarity with the particular subject dealt with in the regulation. If there is anything impractical or undesirable in the proposed regulation these men are sure to find it and bring it to light.

And, believe me, these committees really work. After each member has made a thorough study of the tentative draft sent to him for that purpose, they meet, exchange views on the subject and formulate their tentative views as a committee. After it has finished its own deliberations, the committee has a joint conference with the members of the Board and its staff, at which there is a full and free round table discussion of every point about which any question has been raised.

Following this joint conference the committee prepares and files its written report and copies are furnished to every member of the Board and every division of its staff. Furthermore, in our final report to the Board, the staff has to tell the Board what it thinks should be done about every definite recommendation made by the American Bankers Association committee.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

After all of this study, the regulations are taken up by the Board for final action; and there is a further discussion of the regulation between the members of the Board and the members of the staff and frequently further changes are made in the regulation before it is finally adopted.

While it is impossible to reconcile all conflicting viewpoints or to adopt all suggestions made from these various different sources, nevertheless it is believed that this thorough discussion and the attending criticisms and suggestions from so many different sources tend to produce regulations which are as reasonable and workable as it is possible to produce by any method. Certainly it provides elaborate safeguards against the danger of the issuance of regulations which are undesirable or unworkable from a practical banking standpoint.

In conclusion, please permit me to remind you that the Federal Reserve System is not something separate and apart from the member banks. They are as much a part of it as the Federal Reserve banks or the Board in Washington; and it is very much in their interest and in the public interest for them to cooperate with the Board in every possible way and to join with the Board and the Federal Reserve banks in their efforts to improve our banking system, in order that it may render to this great country of ours the greatest possible public service.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis