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THE BANKING ACT OF 1935

Harold James Kress *

THE purpose of this article is to consider in a non-technical manner the principal changes in federal central and commercial banking law which have been brought about by the enactment of the Banking Act of 1935,[1] and in that connection to take some account of the pre-existing law and the announced or ostensible reasons for the changes made.

One who hopes to gain a clear understanding of this legislation by merely reading the act itself is certain to be disappointed.

In the first place, the act is an omnibus one. It is divided into three titles, no one of which bears any distinct relationship to either of the others. Title I, "Federal Deposit Insurance," rewrites Section 12B of the Federal Reserve Act originally enacted as Section 8 of the Banking Act of 1933.[2] Title II, "Amendments to the Federal Reserve Act," deals, for the most part, with amending the powers of the Board of Governors of the Federal Reserve System (the new name of the Federal Reserve Board).[3] Title III, "Technical Amendments to the Banking Laws," consists of a number of miscellaneous provisions, certain of which affect only national banks, others of which affect member banks, and still others of which are of general application. In the bills originally introduced in Congress,[4] Title I was drafted by Chairman Crowley of the Federal Deposit Insurance Corporation and his general

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[1] Public No. 305, 74th Cong., 1st Sess. (1935).

[2] 48 Stat. 168, 12 U. S. C., § 264 (1933).

[3] Sec. 203(a).

[4] H. R. 5357, 74th Cong., 1st Sess. (1935); S. 1715, 74th Cong., 1st Sess. (1935).

counsel,[5] Title II was sponsored by Governor Eccles of the Federal Reserve Board,[6] and Title III was drawn in the office of Comptroller of the Currency O'Connor.[7]

In the second place, the act, except as to Title I, is not a codification or re-enactment of existing law, but consists for the most part of a series of amendments to that law, and consequently requires for a proper understanding either a general background of knowledge of the federal banking statutes, or frequent references to them.

However, the principal reason for the lack of a clear understanding of its provisions is to be found not in either the varied or partial nature of the act, but in the substantial changes made in Title II (the most important and far-reaching part of the bill) during its progress in the House of Representatives and in the Senate. The provisions of Title II in the original [8] bills brought forth a flood of comment, both in support of, and in denunciation against, them. Generally speaking, its defenders were those who believed in the advisability of attempting to use the banking and credit mechanism of the country to effect business stability and mitigate unstabilizing fluctuations in the general level of production, trade, prices, and employment.[9] Its earliest class of public challengers were not the bankers, but professors of money and banking in some of the leading universities, who saw in it the means of creating a politically controlled Federal Reserve Board which would possess far-reaching powers over the nation's credit, and who consequently exhorted the public, and especially the business men, to fight against its enactment.[10]

[5] Hearings before Subcommittee of Senate Committee on Banking and Currency on S. 1715 and H. R. 7617, 74th Cong., 1st Sess., p. 24 (1935). These hearings are hereinafter referred to as S. Hearings.

[6] See Hearings before House Committee on Banking and Currency on H. R. 5357, 74th Cong., 1st Sess., p. 179 et seq. (1935). These hearings are hereinafter referred to as H. Hearings. See also S. Hearings 279 ét seq.

[7] S. Hearings 62.

[8] Title II of bills H. R. 5357, S. 1715, and H. R. 7617, as the latter passed the House, became known generally as the Eccles bills.

[9] H. Hearings 251.

[10] Dr. H. Parker Willis in 94 N. Y. HERALD TRIBUNE, II, 1: 1 (Feb. 10, 1935). By March 7, 1935, fifty-nine of the leading economists had agreed upon a specifically worded statement criticizing Title II of the act. This report, issued by the Economists' National Committee on Monetary Policy entitled "Memorandum in Opposition to Title II of the Banking Bill of 1935" is reprinted in THE HOOSIER BANKER for April 1935, at pp. 18, 19. Certain leading newspapers also opposed it from the beginning. See, e.g., 94 N. Y. HERALD TRIBUNE, Editorial 16: 1 (Feb. 6, 1935); ibid., Editorial 14: 1 (Feb. 11, 1935); 105 WALL STREET JOURNAL, No. 31, Editorial, p. 4: 1 (Feb. 6, 1935); 140 COMM. AND FIN. CHRON., Editorial, 1013-1014 (Feb. 16, 1935).

General Legislative History

Despite the protests against Title II, however, the House of Representatives passed this part of the bill in the form which Governor Eccles is reported to have advocated. The original bill, H. R. 5357, after having been introduced on February 5, 1935, in the House by Representative Steagall, Chairman of the House Committee on Banking and Currency, was referred to that committee for consideration. Hearings, made up for the most part of testimony of proponents of the measures therein provided, were conducted by this committee from February 21 to April 8, 1935. On April 19 Chairman Steagall introduced a substitute bill, H. R. 7617, which, according to press reports, altered the provisions in the older bill so as to follow later suggestions made by Governor Eccles.[11] The House Committee reported the new bill favorably on the same day,[12] and after comparatively little debate the House passed it on May 9, 1935.[13]

A companion bill to H. R. 5357 (S. 1715) was introduced in the Senate on February 6, 1935, by Senator Fletcher, Chairman of the Senate Banking and Currency Committee, and referred to his committee. The Senate hearings, however, were conducted by a group of that committee known as the Subcommittee on Monetary Policy, Banking and Deposit Insurance, with Senator Glass as chairman. This subcommittee, and more specifically its chairman, in marked contrast to the attitude on the part of the majority of the House Committee, challenged the validity of the philosophy apparently underlying Title II of the bill, and in this connection solicited the views of a number of leading economists and bankers, not only as to the effect of the provisions under the bills introduced in the House, but also as to measures which might be substituted to improve the central banking system of the country. As a result of Senator Glass's leadership, Title II of the bill was substantially rewritten.[14] He submitted the amended bill on July 2, 1935, for the Senate Committee on Banking and Currency, and the bill was passed by the Senate on July 26 as the committee had reported it.

The House bill and the Senate amendment subsequently went to a Conference Committee consisting of three members of the House

[11] AM. BANKER 1:2 (April 23, 1935).

[12] H. Rep. 742, 74th Cong., 1st Sess. (1935), hereinafter referred to as H. Rep.

[13] The term "House bill," as hereinafter used, refers to H. R. 7617 as it passed the House, in the absence of some expression indicating a contrary intention.

[14] S. Rep. 1007, 74th Cong., 1st Sess. (1935), hereinafter referred to as S. Rep.

and six members of the Senate. This Conference Committee accepted the provisions of the Senate amendment in almost all of the important differences between the two bills, and on August 19 the Conference bill [15] was passed by both the Senate and the House. On August 23, 1935, the President signed it, and its provisions became, with certain exceptions, immediately effective.

Principal Results of Statute

In view of the changes which Title II of the bill underwent during its legislative history, it is desirable, before taking up the detailed discussion of the provisions of the act, to indicate, in a general way, the principal results which the enactment of this statute has brought about.

1. Greater powers have been given to the Board of Governors of the Federal Reserve System. Some of these represent the adoption by the permanent law of provisions which were born of the emergency and limited to such use. Others represent the granting of powers previously residing in the regional Federal Reserve banks. As no new powers of any consequence were given the latter, it necessarily follows that they are less autonomous than heretofore.

2. Although the President is to name all members of the new Board by February 1, 1936, measures have been provided to increase the independence of the governing board to a greater extent than heretofore.

3. The act divests the Federal Reserve banks of the right to determine whether to engage or refrain from engaging in the open market program approved by the Board, but measures have been provided to give commercial and financial interests some representation on the new Federal Open Market Committee which is to control the open market policy; furthermore, all considerations of policy adopted by the Committee or the Board, open market or otherwise, must be made public.

4. The "permanent" deposit insurance protection has been drastically reduced from that originally provided by the Banking Act of 1933, the amount of coverage having been limited to $5,000 for any one depositor.

5. Increased authority over banking practices has been granted, especially to the Federal Deposit Insurance Corporation with regard to insured banks. Additional powers over such practices have also been granted to the Comptroller of the Currency and to the Board of Gov-

[15] H. Rep. 1822, 74th Cong., 1st Sess. (1935), hereinafter referred to as Conf. Rep.

ernors of the Federal Reserve System. These powers are to be exercised for the most part by general regulations, although in certain instances they are given for use only in special cases. In general, these powers may be described as preventative in nature, designed especially to correct situations actually or potentially unsound.

6. A number of miscellaneous changes in the law have been made, probably the most noteworthy of which is the legislation permitting, if not encouraging, national banks to engage more extensively in real estate financing.

The above introduction, it is hoped, will furnish a sufficient foundation to give the reader some basis for understanding the more important specific provisions of the act which will now be considered. Inasmuch as no attempt was made by the draftsmen of the act to classify the sections by subject matter, it is proposed to use the order followed above in pointing out the principal effects of the act as a general guide in the more detailed discussion of it.

I

INCREASE IN CENTRAL BANKING POWERS

For the Federal Open Market Committee established by the Banking Act of 1933,[16] a new one is substituted, effective as of March 1, 1936, consisting of the seven members of the Board of Governors and five members elected by the Federal Reserve banks.[17] The old committee was also composed of twelve members, one member from each Federal Reserve district, selected annually by the Federal Reserve bank of such district. In practice, the Governors of the Reserve banks had been chosen. The former committee had merely advisory powers, the Federal Reserve Board being required to approve the program under which the Federal Reserve banks could engage in open market operations.[18] It should be noted, however, that if a Federal Reserve bank did not desire to participate in the open market operations recommended by the committee and approved by the Board it could give notice of such decision within thirty days after notification by the Board of the latter's action on the committee's recommendation.

Under the bill as passed by the House, the committee was to be reduced to five members, and the Reserve banks were to carry on open

[16] 48 Stat. 168, 12 U. S. C., § 263 (1933).
[17] Sec. 205.
[18] Federal Reserve Act, § 12A; 48 Stat. 168, 12 U. S. C., § 263 (1933).

market operations as directed by the Board.[19] The Senate Subcommittee considered quite exhaustively the wisdom of this proposed control by the Board.[20] After making provisions for greater insulation of the Board from political influence, the Senate Committee redrafted the section which was adopted in substance by the Conference Committee [21] and which consequently became the law. It provides that the new Federal Open Market Committee, and not the Board, is to prescribe the regulations under which the Reserve banks are to engage in open market operations. Like the House bill, however, it makes a very important change in the law in that it takes away the privilege of the Federal Reserve banks to decline to engage in open market operations.[22] Since under the act "No Federal Reserve bank shall engage *or decline to engage* in open-market operations under section 14 of this Act except in accordance with *the direction of* and regulations adopted by the Committee," [23] dominion over this most effective means of credit control passes from the regional Reserve banks to a central committee.

Section 207 of the act empowers the Board of Governors, upon the affirmative vote of four of its seven members, to change the requirements as to the amount of reserves to be kept against demand or time deposits by member banks. This provision is one of several instances where legislation, enacted only because of, and for use during, the emergency, has been incorporated as a permanent provision of law. In this instance, as in some others, fewer limitations have been provided than under the emergency legislation. A power such as the one under discussion has no known precedent in federal banking legislation other than that contained in the so-called "Thomas Amendment" to the Agricultural Adjustment Act.[24] The Thomas Amendment of 1933, which is replaced by the provision of the Banking Act of 1935, gave

[19] House bill, § 205. The provisions in the corresponding section of the earlier bill, S. 1715, are substantially different. See also certain testimony of Gov. Eccles in S. Hearings 287, 314 f.

[20] See, e.g., comments of Dr. Adolph C. Miller, S. Hearings 687 et seq.; comments of Mr. Geo. R. James, S. Hearings 927 et seq; comments of Dr. E. W. Kemmerer, S. Hearings 332 ff.; comments of Dr. O. M. W. Sprague, S. Hearings 225 et seq.; comments of Mr. W. W. Aldrich, S. Hearings 401 ff., 409.

[21] Conf. Rep., 49, 50.

[22] S. Rep., 12, 13.

[23] Sec. 205. Italics the author's.

[24] 48 Stat. 54, 12 U. S. C., § 462(b) (1933). It should be noted, however, that the Board has been empowered, since the establishment of the Federal Reserve System, to suspend any reserve requirement specified in the act for a period not exceeding 30 days, and to renew such suspension for periods not exceeding 15 days. 38 Stat. 262, 12 U. S. C., § 248(c) (1913).

the Board the power to increase or decrease reserve balances required to be maintained against demand or time deposits, but it could be exercised under that act only by the affirmative vote of not less than five members of the Board, with the approval of the President, that an emergency existed by reason of credit expansion, and such power to change reserve requirements existed only during such emergency. As the House bill provided for practically no bridle on the power of the Board to change reserve ratios, it was very naturally condemned as one which had far greater potentialities as an agency working against the public welfare than as one which would be used in its behalf.[25] The Senate Committee, likewise regarding restrictions as essential, provided, in addition to the requirement of the affirmative vote of five members, a further limitation to the effect that the amount of statutory reserves required to be maintained under existing law[26] could not be diminished, nor could they be increased to more than twice such amount.[27] The Conference Committee accepted the Senate amendment of this provision with the exception of requiring only four instead of five votes.[28]

Under Section 201 of the act, which becomes effective March 1, 1936, the president of each Federal Reserve bank is to be appointed by its board of directors with the approval of the Board of Governors of the Federal Reserve System. He is to be the chief executive officer of the bank and is to be appointed for a term of five years. Heretofore the selection of personnel and of officers was left to the discretion of the board of directors of each Federal Reserve bank. The practice each bank followed of electing a governor as its executive head will consequently be discontinued. The new provision was written into the bill by the Senate Committee[29] in lieu of the provision in the House bill, which latter, among other things, combined the offices of the chairman of the board of directors and governor of the bank, and made the appointment of the governor subject to approval every three years by the Federal Reserve Board. It will be realized the act does not provide

[25] See, e.g., S. Hearings 333-334, 417-419, 451, 633, 865.

[26] The amount of reserve which a member bank is required to maintain with the Federal Reserve bank against the former's demand deposits depends upon the member bank's location. Banks located in central reserve cities are required to maintain 13 per cent of net demand deposits as reserve, banks in reserve cities 10 per cent of net demand deposits, and banks located elsewhere maintain only a 7 per cent reserve. With regard to time deposits, member banks are required to keep a 3 per cent reserve regardless of location. Federal Reserve Act, § 19, 40 Stat. 970, 12 U. S. C., § 462 (1918).

[27] S. Rep. 13.

[28] Conf. Rep. 51.

[29] S. Rep. 10.

for as close a relationship between the Board and the Federal Reserve banks as the House bill would have given.

By virtue of Section 204 of the act, the Board of Governors is empowered to prescribe rules and regulations by which any Federal Reserve bank may make advances to any member bank upon its time or demand notes having maturities of not more than four months, and suitably secured, at a rate at least one-half of one per cent higher than the highest discount rate of that Reserve bank. This is another instance where emergency legislation has been enacted into the permanent law. It also represents a further departure from a cardinal principle of the framers of the Federal Reserve Act, that is, that credit accommodations to member banks should be limited to rediscounting self-liquidating commercial paper, or at most to making advances to a member bank on its promissory note for a period not exceeding fifteen days, provided the note was secured either by paper eligible for rediscount or open market purchase by Reserve banks or by bonds or notes of the United States.[30] Although it cannot be gainsaid that by a series of legislative acts the early restrictions of the Federal Reserve Act have been materially broken down,[31] nevertheless the doctrine that demand liabilities of commercial banks should be supported chiefly by quick assets of a self-liquidating character appears to be regarded by accredited experts as the soundest practice as well as the soundest theory.[32]

The emergency legislation which served as the precedent for this provision of the Banking Act of 1935 was added by the Glass-Steagall Act of 1932 to the Federal Reserve Act as Section 10(b) thereof.[33] This section, as amended, provided that "In exceptional and exigent circumstances, and when any member bank has no further eligible and acceptable assets available to enable it to obtain adequate credit accommodations through rediscounting at the Federal reserve bank or any other method provided by this Act other than that provided by Section 10(a)" (which latter section relates to emergency advances to groups of member banks) any Federal Reserve bank, under the Board's regulation, could lend to member banks at a rate not less than one per cent higher than the Reserve bank's highest discount rate. No advances were to be made after March 3, 1934, but the President had the power to

[30] STEINER, MONEY AND BANKING 729-731 (1933).

[31] See GARIS, PRINCIPLES OF MONEY, CREDIT, AND BANKING 844-865 (1934); "Memorandum," cited note 10, supra.

[32] S. Hearings 340; H. Hearings 712.

[33] 47 Stat. 56 (1932), amended by 47 Stat. 794 and 48 Stat. 7 (1933); 12 U. S. C., § 347(b).

extend the time to a period not exceeding March 3, 1935 (to which date he extended this provision by proclamation issued February 16, 1934[34]).

As great a departure from the theory of the original Federal Reserve Act as this provision is, it does not give nearly the latitude which would have been allowed had the related provision in the House bill been chosen by the Conference Committee.[35] Under the House bill the Federal Reserve Board would have been given an unfettered power to permit by regulation any Federal Reserve bank to discount "any commercial, agricultural, or industrial paper" and "make advances to any such member bank on its promissory notes secured by any sound assets of such member bank." This section of the House bill was vehemently denounced as giving to a politically controlled Board the sole judgment of the soundness of the assets to be admitted to the Federal Reserve banks and as opening the way to converting what should be a commercial banking system to an illiquid noncommercial system.[36]

It is worthy of note that the House bill also provided for the amendment of Section 16 of the Federal Reserve Act so as to repeal the requirements that Federal Reserve notes be secured at all times by the specific pledge of collateral. It also would have eliminated the provision of existing law prohibiting a Federal Reserve bank from paying out the notes of any such bank and would have made certain technical changes with respect to issue, redemption, and retirement of Federal Reserve notes.[37] This proposal to repeal the requirements with respect to commercial paper collateral for Federal Reserve notes, some economists contended, was unsound inasmuch as it would enable Federal Reserve banks to issue legal tender notes against frozen or illiquid assets admitted under the tolerance or policies of the Federal Reserve Board and would destroy the prospect of restoring the so-called "elastic" features of these notes which the Glass-Steagall amendment of 1932 [38] and the emergency banking legislation of 1933 [39] impaired in a substantial way.[40]

[34] 20 FED. RES. BUL. 182-183 (March 1934).

[35] House bill, § 206.

[36] "Memorandum," cited note 10, supra.

[37] S. Rep. 13, discussing § 208 of House bill.

[38] 47 Stat. 56, 12 U. S. C., §§ 347(a), 347(b), 412 (1932).

[39] 48 Stat. 6, 12 U. S. C., § 445 (1933); 48 Stat. 51-54, 31 U. S. C., §§ 462, 821, 822, 823 (1933); 48 Stat. 54, 12 U. S. C., § 462(b) (1933).

[40] The reasons given in the text in opposing this section of the act are taken from the "Memorandum," cited note 10, supra. The Memorandum continues as follows:

"Although the Glass-Steagall Amendment of 1932 and the emergency banking

II

INDEPENDENCE OF ADMINISTRATIVE AGENCIES

Agencies Controlling Federal Reserve System

Under Title II of the bill as it passed the House, the Federal Reserve Board would have been placed under the control of the Executive. The proponents of the bill did not attempt to deny this fact, but instead justified the necessity of executive domination. Governor Eccles, in testifying before the House Committee, said, "It seems to me that an administration is charged, when it goes into power, with the economic and social problems of the Nation. Politics are nothing more or less than dealing with economic and social problems. It seems to me that it would be extremely difficult for any administration to be able to succeed and intelligently deal with them entirely apart from the money system. There must be a liaison between the administration and the money system—a responsive relationship. That does not necessarily mean political control in the sense that it is often thought of." [41]

That the Federal Reserve Board should become less independent than it was under existing law seemed to the Chairman of the Senate Subcommittee [42] and to prominent witnesses before it to be the antithesis of the proper way to improve the workings of the Federal Reserve System. Senator Glass had on previous occasions called attention to

legislation of 1933 gave these notes what is commonly called an inelastic characteristic by permitting the use of government securities as collateral, it was supposed that this change was temporary and that efforts would be made, after the emergency had passed, to restore the 'elastic' feature of these notes. Instead of providing us with a note currency which bears the appropriate relation to the sound short-term needs of business, thus avoiding inflationary tendencies, the bill provides the means for the issue of notes against government bonds (and other assets, regardless of liquidity), and consequently opens the way for a huge bank note inflation in this country. The bill enables the government, through the banks, to convert the national debt into bank notes until the surplus banking reserves of the country are exhausted. The Federal Reserve Board, furthermore, is given the power to reduce the reserve requirements of member banks as it sees fit, thus increasing immeasurably the possibilities of inflating the currency. The passage of such a measure will invite ultimate disaster for this country."

[41] H. Hearings 191.

[42] Senator Glass gave as his observation, in connection with hearings on the Gold Reserve Act of 1934, that both the Federal Reserve banks and the Federal Reserve Board have done pretty much what the Secretary of the Treasury wanted them to do. Hearings before Senate Committee on Banking and Currency on S. 2366, 73rd Cong., 2d Sess., p. 335 (1934). See also the colloquy between Senator Glass and Dr. W. R. Burgess, id. 237-239. See in connection with the Banking Act of 1935, the colloquy between Senator Glass and Dr. A. C. Miller. S. Hearings 729-732.

the failure of the Board to act in what he regarded as a courageous manner.[43] Consequently, his point of view from the beginning, which was strongly supported by a number of prominent students,[44] was that if the Board were to be given greatly enlarged powers under a permanent law, even greater than those given for use during the emergency, it should be made not less but more independent than heretofore.

After hearings were concluded, the Senate Committee, under the leadership of Senator Glass, redrafted Title II with the paramount purposes in mind (a) of insulating the agencies controlling the central banking system from government or political pressure, and (b) of re-establishing it primarily as an agency designed to serve the needs of commerce, industry, and agriculture rather than as one "to promote conditions conducive to business stability and to mitigate by its influence unstabilizing fluctuations in the general level of production, trade, prices, and employment. . . ."[45] It has already been indicated that the Senate Committee's redraft of the bill was passed by the Senate and accepted in substance by the Conference Committee.

As a consequence of the act, a new Board of Governors of the Federal Reserve System possessing greater means of independence than under former law will be appointed by the President, by and with the advice and consent of the Senate, effective as of February 1, 1936.[46]

The Secretary of the Treasury and the Comptroller of the Currency will no longer be ex officio members of the Board after January 31, 1936. The new Board will be made up of seven appointive members, instead of six such members and the two officials named. The Governor of the Federal Reserve Board is to replace the Secretary of the Treasury as Chairman and is to take that title, and the Vice-Governor of the Federal Reserve Board is to be given the title of Vice-Chairman.[47] The removal of the Government officials, especially the Secretary of the Treasury, has been advocated for a number of years on the ground that the Board's policy has been too much influenced to follow the measures advocated by the Government.[48]

It will also be noticed that the term of the office has been increased

[43] See references by Senator Glass in S. Hearings 705, 752, 876.

[44] See, e.g., Dr. O. M. W. Sprague, S. Hearings 229, 236; Dr. E. W. Kemmerer, S. Hearings 330-340; Dr. A. C. Miller, S. Hearings 729-732, 754-757; Dr. H. Parker Willis, S. Hearings 874. Dr. Willis was among the earliest to point out dangerous political control under the terms of the Eccles bill. 94 N. Y. HERALD TRIBUNE, II, 1:1 (Feb. 10, 1935).

[45] House bill, § 204.

[46] Sec. 203(b).

[47] Sec. 203(a), (b).

[48] See, e.g., S. Hearings 226.

from twelve to fourteen years, and the salary has been raised from $12,000 to $15,000 a year. Furthermore, members of the Board who have served a full term of fourteen years under the new law cannot be reappointed.[49] This latter provision has the obvious purpose of removing the temptation of currying favor of the political party in power as a means of procuring a reappointment.[50] However, its full effect will not be felt for some time to come because the President, in appointing all of the seven members to constitute the new Board, is to fix their terms of office from two to fourteen years, inasmuch as it is provided that their terms shall be fixed so that not more than one expires in any two years.

The Federal Reserve Act has been amended by Section 203(b) of the Banking Act of 1935 so that the members of the Board can be removed only for cause. The requirement of showing cause for removal was eliminated from the Federal Reserve Act by the Banking Act of 1933,[51] although the omission appears to have been inadvertent.[52] Regardless of this omission, however, the members of the Board might not, under the *Humphrey* case,[53] have been removable. Before that decision it was commonly thought, as was pointed out to the Senate Subcommittee,[54] that under the rule laid down in the *Myers* case[55] a member of the Board could have been removed without cause under the terms of the Federal Reserve Act as it existed from 1933 to 1935. While it may be said that the decision of the Supreme Court in the *Humphrey* case did much to establish the independence of the Federal Reserve Board, the present legislation makes entirely clear the necessity of more substantial grounds than a merely personal objection for removing a member of the Board.

Further checks are also provided against Treasury Department domination of the agencies administering control of Federal Reserve banking and credit.

It has already been pointed out that a new Federal Open Market Committee is set up as the directing agency with regard to the action to be taken by the Federal Reserve banks in connection with open

[49] Sec. 203(b).

[50] See comments of GARIS, PRINCIPLES OF MONEY, CREDIT, AND BANKING 762-764 (1934); STEINER, MONEY AND BANKING 626-627 (1933).

[51] 48 Stat. 166, 12 U. S. C., § 242 (1933).

[52] S. Hearings 398.

[53] Rathbun v. United States, (U. S. 1935) 55 S. Ct. 869.

[54] S. Hearings 396-398.

[55] Myers v. United States, 272 U. S. 52, 47 S. Ct. 21 (1926).

market operations. The new committee is to consist of the seven members of the Board (which, as has been noted, no longer includes the Secretary of the Treasury and the Comptroller of the Currency) and five other members elected by the board of directors of the Federal Reserve banks. Inasmuch as six of the nine members of the board of directors of each Federal Reserve bank are elected by the member banks,[56] it seems fair to presume that these five members of the Committee will reflect the views of the financial and commercial world and, although a minority, should be a very substantial factor in securing thorough deliberation of policies which the members of the Board of Governors may regard as desirable but which run contrary to the best judgment of private business.

A provision which should be helpful in inducing each member of the new Board and of the Committee to exercise his own best judgment is provided by Section 203(d) of the act. This subsection requires that the Board of Governors keep a complete record of the action taken by it and by the Open Market Committee "upon all questions of policy relating to open-market operations and shall record therein the votes taken in connection with the determination of open-market policies and the reasons underlying the action of the Board and the Committee in each instance." It provides further, "The Board shall keep a similar record with respect to all questions of policy determined by the Board, and shall include in its annual report to the Congress a full account of the action so taken during the preceding year with respect to open-market policies and operations and with respect to the policies determined by it and shall include in such report a copy of the records required to be kept under the provisions of this paragraph." These requirements were introduced by the Senate Committee in its amendment of the House bill.[57]

Although the Federal Reserve banks are allowed to purchase or sell obligations guaranteed by the United States, as well as direct obligations of the Government without regard to maturities, such transactions must be made only in the open market.[58] This latter requirement, also added by the Senate amendment,[59] would appear to repeal that provision in the so-called "Thomas Amendment" by which the Secretary of the Treasury was directed to enter into agreement with the several Federal Reserve banks and with the Board, whereby the latter was to permit the Reserve banks to agree that they would purchase

[56] Federal Reserve Act, § 4, 40 Stat. 967-969, 12 U. S. C., §§ 302, 304 (1918).
[57] S. Rep. 11. [58] Sec. 206(a). [59] S. Rep. 13.

directly and hold in portfolio for an agreed period Treasury bills or other obligations of the United States Government in an aggregate sum of $3,000,000,000 in addition to those which they then hold, unless prior to the termination of such period the Secretary shall consent to their sale.[60] Under the House bill Government or Government-guaranteed obligations would have continued to be eligible for direct purchase by the Reserve banks.

Comptroller of the Currency

By virtue of Section 209, the Comptroller of the Currency no longer is required to be recommended by the Secretary of the Treasury, and his salary is raised from $12,000 to $15,000 a year. This provision, first introduced by the Senate Committee, entitles the Comptroller to the same remuneration as the members of the Board of Governors. While it removes his obligation to the Secretary of the Treasury because of the appointment, it will be apparent that the Comptroller will still be in a position where he will desire continuing administrative approbation.

III

DEPOSIT INSURANCE

Probably the provisions of the act which are of greatest general interest, after those which relate to the central banking powers and the agencies which control them, are those which deal with the protection given depositors by virtue of the so-called deposit insurance.

Coverage and Assessments

The act establishes a permanent insurance fund into which the temporary funds (Temporary Federal Deposit Insurance Fund and the Fund for Mutuals) are consolidated and under which the net amount due to any depositor for deposits, after deducting offsets, is insured to a maximum of $5,000.[61] The rate of assessment for each bank is one-twelfth of one per cent per year of its average total deposits, less "float," payable in semi-annual installments.[62] It would appear that insured

[60] 48 Stat. 51, 31 U. S. C., § 821 (1933).

[61] Sec. 12B (c), Federal Reserve Act, as amended by Sec. 101 of the Banking Act of 1935. As the latter section is the only one in Title I of the act, references to provisions of this title will be made as Sec. 12B, Federal Reserve Act, as amended.

[62] Sec. 12B (h), Federal Reserve Act, as amended. The term "float," as used herein, refers to that portion of the amount deposited in a bank account which has not yet been collected by the bank. It arises on account of the time required for the bank to

banks are not subject to any additional legal liability for assessments.[63]

These provisions supersede the "permanent provisions" originally set up by the Banking Act of 1933 [64] but which never became effective. The earlier act provided for much greater coverage with relation to large deposits. Under it there was insurance coverage for 100 per cent of the first $10,000, 75 per cent of the next $40,000, and a 50 per cent coverage of the amount by which the deposit exceeded $50,000. Generally speaking, insured banks were required to subscribe to Class A stock of the Corporation in an amount equal to one-half of one per cent of its total deposit liabilities, one-half of the subscription to be paid in and the remainder left subject to call. The Corporation was required to levy an additional assessment whenever the net debit balance of the deposit insurance account of the Corporation equalled or exceeded one-quarter of one per cent of the total deposit liabilities of all Class A stockholders.

The amount of insurance under the Banking Act of 1935, therefore, is limited to the same amount as was provided under the temporary funds which it superseded.[65] The limitation of the coverage to $5,000 was recommended by Chairman Crowley as desirable, inasmuch as it would appear to fully cover approximately 98 per cent of all the depositors and would limit the maximum liability of the Corporation to approximately $16,500,000,000 as compared with an estimated $30,000,000,000 under the permanent plan of the Banking Act of 1933.[66]

It will be noted that assessments are to be made under the provisions of the Banking Act of 1935 not upon the amount of the deposits insured, but on the total amount of deposits regardless of the proportion which may be insured. This provision has been justified by Chairman

secure, in settlement of the checks or other cash items deposited, funds which are immediately usable by it.

[63] Cf. Willis, "A 'New Deal' in Banking," 141 COMM. AND FIN. CHRON. 1153-1157 (Aug. 24, 1935).

[64] 48 Stat. 173, 12 U. S. C., § 264(l) (1933).

[65] Under the Banking Act of 1933, the amount of deposits of any depositor insured under the temporary fund was limited to $2,500. 48 Stat. 179, 12 U. S. C., § 264(y) (1933). Except in the case of certain mutual savings banks, the limit was raised to $5,000, effective July 1, 1934. 48 Stat. 969, 12 U. S. C., § 264(y) (1934). The amendment of 1934 also provided for an additional temporary fund to be known as the "Fund for Mutuals." Insurance under the temporary funds was to terminate July 1, 1935, but on June 28, 1935, the provisions of the temporary funds were continued until Aug. 31, 1935. Public Res. No. 38, 74th Cong., 1st Sess. (1935).

[66] H. Hearings 17, 18.

Crowley on the grounds that to base assessments solely on the insured deposits would place an undue burden on the small banks, and further, that all banks, regardless of size, should be required to support the insurance system because of the social consequences involved in bank failures.[67] The large banks quite naturally have assailed this provision as unconstitutional, and, according to the press reports, a stockholder of the Manufacturers Trust Company of New York City has instituted suit in the Federal Court for the Southern District of New York seeking the issuance of an injunction by that court to restrain the Trust Company from filing with the Corporation a statement of assessment as required by law, and also from paying to it any assessment. The complaint is reported to allege the following grounds against the enforcement of Title I of the act:

(a) That the creation of a deposit insurance corporation is not within the powers granted by the Constitution to Congress, but is reserved to the states under the Tenth Amendment;

(b) That it is in violation of Section 8 of Article I of the Constitution which provides that all duties, imposts and excises shall be uniform throughout the United States;

(c) That it is invalid under the Fifth Amendment in that it violates the due process clause and permits the taking of private property for a public use without just compensation;

(d) That the amount of the assessment payable under the terms of the act is chargeable against the capital, surplus and undivided profits of the bank, and not against the amount due the depositors, which latter are the sole class of recipients of any benefits from the establishment of the Fund;

(e) That the assessment required to be paid by the defendant bank is not levied solely for the depositors of that bank, but is intended to afford an insurance fund for the purpose of making good losses sustained from any cause whatsoever by depositors of any and all other banks throughout all of the states of the Union;

(f) That the assessment required to be paid by defendant is computed upon the average of its total deposits, whereas its depositors are afforded the protection of insurance under the Federal Deposit Insurance Corporation to the extent of only $5,000 in the case of each depositor of the defendant.[68]

[67] H. Hearings 10; see also S. Hearings 29.

[68] 106 WALL STREET JOURNAL, No. 6, 1:6 (Sept. 12, 1935).

Banks Having Insured Status

Each bank insured under the temporary funds continues to be insured under the act without further application or approval.[69]

As was required under the Banking Act of 1933, national banks and state member banks must be members of the permanent fund.[70] Nonmember banks may elect not to continue under the permanent fund.[71]

A nonmember insured bank was permitted to terminate its insured status by giving notice prior to September 23, 1935, and its deposits would continue to have been insured until October 12, 1935. In all other cases of voluntary or involuntary termination of the insured status of a bank, it is provided that its deposits at that time, less subsequent withdrawals, shall continue to be insured for two years thereafter. Although no new deposits are to be insured, the full assessment liability continues for such two years. Depositors are to be notified in all cases of termination of insurance.[72]

With certain exceptions, a state bank which during 1941 or thereafter has average deposits of $1,000,000 or more may not be an insured bank after July 1 of the following year unless it is a member of the Federal Reserve System.[73] This provision substantially relaxes the requirement as to membership of the Federal Reserve System under the Banking Act of 1933. Under the former act all banks, the deposits of which were insured after July 1, 1936,[74] were required to be members of the Federal Reserve System. Under the House bill the requirement of membership in the Federal Reserve System as a condition precedent to the insurance of deposits was eliminated.[75] The Senate Committee amended the bill by requiring that any state bank organized on or before the effective date of the act, and which shall have average deposits of $1,000,000 or more during the calendar year 1936 or there-

[69] Sec. 12B (e), (f), Federal ReserveAct, as amended.

[70] Sec. 12B (e), Federal Reserve Act, as amended.

[71] Sec. 12B (i), Federal Reserve Act, as amended.

[72] Sec. 12B (i), Federal Reserve Act, as amended.

[73] Sec. 12B (y), Federal Reserve Act, as amended.

[74] This requirement was later deferred to July 1, 1937. 48 Stat. 970, 12 U. S. C., § 264 (y) (1934).

[75] The report indicated that this would exempt more than 7,500 insured banks from joining the Federal Reserve System. H. Rep. 3. It might be noted in this connection that Mr. Crowley testified that as of June 30, 1934, there were 2,134 insured state banks which could not qualify as to capital requirements of the Federal Reserve System. S. Hearings 55.

after, must become a member of the Federal Reserve System or cease to have its deposits insured after July 1 of the year following any such calendar year during which it shall have had such amount of average deposits.[76] As has been already noted, however, the Conference Committee deferred the time for required membership to not earlier than July 1, 1942.

Banks Applying for Insured Status

Banks not insured under the temporary funds which apply for insurance coverage under the permanent fund must be tested and passed by the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, or the Federal Deposit Insurance Corporation, as appropriate, under rather broad discretionary powers. The appropriate supervisory authority is to consider: (a) The financial history and condition of the bank; (b) the adequacy of its capital structure; (c) its future earnings prospects; (d) the general character of its management; (e) the convenience and needs of the community to be served by the bank; (f) whether or not its corporate powers are consistent with the purposes of the deposit insurance section of the Federal Reserve Act.[77] The Senate Committee enlarged upon the requirements of the bill as it passed the House by including other factors for consideration in determining whether the applying bank should be insured so as to make the considerations similar to those which the Comptroller of the Currency makes in determining whether a national bank should be authorized to commence business.[78]

That the requirements imposed on state banks desiring insurance protection are not wholly designed to maintain or improve the standards of bank management previously in effect, is indicated by the provision of the act which enables the Board of Governors to waive a part or all of the requirements of the Federal Reserve Act as to qualifications for membership in the System of any state bank which is required to become a member of the System in order to be or remain an insured bank.[79] The Conference Committee acepted the above provision, which was reported by the Senate Committee, in lieu of Section 202 of the House bill which provided that the Federal Reserve Board could waive in whole or in part the requirements of state banks applying for membership if the applicant at the time of its petition for membership is

[76] S. Rep. 9.
[77] Sec. 12B (e), (f), (g), Federal Reserve Act, as amended.
[78] S. Rep. 3.
[79] Sec. 202.

insured by the Federal Deposit Insurance Corporation. The purpose of the House provision was to facilitate the admission of small banks into the Federal Reserve System, but since banks with average deposits of less than $1,000,000 are not required under the law to become members of the Federal Reserve System, the Senate limited this relaxation to only those banks which require membership for insurance protection.[80]

Controls over Banking Practices Vested in the Insurance Corporation

The most noteworthy control of the Insurance Corporation over banking practices is that which enables it, after notice and hearing, to terminate the insurance of any bank for continuing "unsafe or unsound practices" or for permitting officers or agents to violate any law or regulation to which the bank is subject. If a national bank is involved, notice must be given to the Comptroller of the Currency; if a state member bank is involved, notice must be given to the Board of Governors; and in the case of a state nonmember bank, notice must be given to the state banking authority. If a correction of the practice is not made within the time specified by the supervisory authority (the Comptroller, Board of Governors, or the state banking authority, as appropriate), thirty days' notice of hearing must be given to the bank and written findings of the Corporation are to be deemed conclusive. Failure of such bank to appear is deemed consent to the termination. Upon the termination of the status of the bank as a member of the fund, the Corporation may publish notice of such termination and the bank shall give notice of such termination to each of its depositors as and when the Corporation shall direct. After the termination of the insured status of such bank, the insured deposits of each depositor on the date of termination, less his subsequent withdrawals, shall continue to be insured for a period of two years, and the bank shall continue to pay into the Corporation assessments as in the case of an insured bank during the two year period, as has already been explained.[81]

This provision gives to the directors of the Insurance Corporation drastic corrective powers. Although more nearly plenary in nature, these powers are somewhat similar to those first given in the Banking Act of 1933 [82] to the Federal Reserve Board, to remove any officer or director of a national or state member bank, which shall have continued

[80] S. Rep. 10.
[81] Sec. 12B (i), Federal Reserve Act, as amended.
[82] 48 Stat. 193, 12 U. S. C., § 77 (1933).

to violate any law relating to the bank or shall have continued unsafe or unsound practices in conducting the business of the bank after having been warned, by the Comptroller of the Currency if a national bank, or by the Federal Reserve agent of the district if a state member bank, to discontinue such violations of law or such unsafe or unsound practices.

Should any insured state bank fail to comply within 120 days after written notice of recommendations of the Corporation, based upon a report of its examination of such bank, is received, the Corporation is given the power to publish, after 90 days' notice of intention to the bank, such part of the report as relates to the recommendation.[83] The Comptroller of the Currency does not appear to possess any similar power with respect to national banks.

Consent of the Insurance Corporation is necessary if a nonmember insured bank desires to establish any new branch after September 23, 1935, or to change the location of a branch after that date.[84] The consent and approval of the Comptroller of the Currency has been required for the establishment or change in location of a branch of a national bank.[85] Although under the Federal Reserve Act state member banks cannot operate branches established after February 25, 1927, beyond the limits of the city, town or village in which the parent bank is situated, it is provided that nothing therein is to prevent any state member bank from establishing and operating branches under the same terms and conditions as are applicable to the establishment of branches by national banks.[86] Section 338 of the Banking Act of 1935 has amended this provision, but only in so far as substituting the Board of Governors' approval for that of the Comptroller of the Currency.

The prior consent of the Corporation is also required for any insured bank to enter into any consolidation or merger with an uninsured bank, or to assume liability for deposits of an uninsured bank, or to transfer funds to an uninsured bank in consideration of assumption of deposit liability. Furthermore, no state nonmember bank, without the consent of the Corporation, may reduce the amount or retire any part of its common or preferred capital stock, or retire any part of its capital notes or debentures.[87]

Mention might also be made of the Corporation's power until July

[83] Sec. 12B (v) (7), Federal Reserve Act, as amended.

[84] Sec. 12B (v) (5), Federal Reserve Act, as amended.

[85] 48 Stat. 189, 190, 12 U. S. C., § 36 (1933).

[86] Federal Reserve Act, § 9, 44 Stat. 1229, 48 Stat. 164, 12 U. S. C., § 321 (1933).

[87] Sec. 12B (v) (4), Federal Reserve Act, as amended.

1, 1936, to make loans secured by, or purchase assets of, an open or closed insured bank, or guarantee an insured bank assuming the liabilities of another open or closed insured bank. This power may be exercised whenever in the judgment of its board of directors "such action will reduce the risk or avert a threatened loss to the Corporation and will facilitate a merger or consolidation of an insured bank with another insured bank, or will facilitate the sale of the assets of an open or closed insured bank to and assumption of its liabilities by another insured bank." [88] Mr. Crowley pointed out that in the exercise of this power the Corporation could (a) by sustaining a comparatively small loss, avert a more serious one, (b) complete the rehabilitation of all insured banks by July 1936.[89]

The Insurance Corporation may require any insured bank to provide insurance against burglary, defalcation or similar insurable losses, and should such insured bank refuse to comply, the Corporation may contract for the protection and indemnity and add the cost to the assessment payable to the Corporation.[90]

The Insurance Corporation is required to prohibit the payment of interest on demand deposits in insured nonmember banks, with such exceptions from the prohibition as are prescribed by the Federal Reserve Act or by the Board of Governors of the Federal Reserve System for demand deposits in member banks. In addition, the Insurance Corporation is given substantially the same powers to limit the rates of interest which may be paid on time and savings deposits by insured nonmember banks as the Board of Governors possesses with respect to payment of interest on time and savings deposits by member banks.[91] Such powers of the Board of Governors, as provided by Section 324 of the act, are discussed later in this article.

No insured bank is allowed to pay dividends on its capital stock or interest on its capital notes or debentures (if such interest is required to be paid only out of net profits) while in default in payment of any assessment due the Insurance Corporation.[92]

The Insurance Corporation is to be the exclusive receiver for insolvent national banks and is directed to accept appointment as receiver of insolvent insured state banks if the state law permits.[93] Making the

[88] Sec. 12B (n) (4), Federal Reserve Act, as amended.
[89] S. Hearings 34.
[90] Sec. 12B (v) (6), Federal Reserve Act, as amended.
[91] Sec. 12B (v) (8), Federal Reserve Act, as amended. See infra, p. 187.
[92] Sec. 12B (v) (3), Federal Reserve Act, as amended.
[93] Sec. 12B (l) (3), Federal Reserve Act, as amended.

Corporation the exclusive receiver for insolvent national banks takes such administration away from the Comptroller of the Currency and was enacted in spite of his disapproval.[94]

IV
OTHER PROVISIONS OF INTEREST

Real Estate Loans by National Banks

Probably the most important among the miscellaneous provisions of the act is that which substantially relaxes the conditions under which national banks may make real estate loans. Loans with approved real estate as security may be made by a national bank to run for a period up to ten years if the mortgage provides for a 40 per cent amortization within a period of ten years or less. Such a loan is not to exceed 60 per cent of the appraised value of the property against which it is made, nor is the aggregate sum of a national bank's real estate loans to exceed its capital and surplus, or more than 60 per cent of its time and savings deposits, whichever is greater. These limitations, however, are not to prevent the renewal or extension of loans heretofore made, nor do they apply to real estate loans insured under Title II of the National Housing Act.[95]

Under the previous law, except as to loans insured under the National Housing Act, a national bank could not make loans upon a mortgage for a period exceeding five years and in an amount exceeding 50 per cent of the actual value. The aggregate amount of such loans could not exceed 25 per cent of the bank's paid-in capital and surplus, or one-half of its savings deposits, as it may elect. The property securing the loan also had to be within 100 miles of the location of the bank.[96]

The liberalization of the conditions for lending on real estate was sponsored by Governor Eccles on the grounds that it would encourage activity in the construction industry and thus promote recovery, and that it would contribute effectively to the earnings of banks throughout the country. Under the original House bill such loans could be made, not only by national banks but by state member banks, for a period up to twenty years in an amount not exceeding 75 per cent of the actual value of the real estate and if they were required to be amortized within

[94] S. Hearings 105-109.

[95] Sec. 208.

[96] Federal Reserve Act, § 24, 44 Stat. 1232, 48 Stat. 1263, 12 U. S. C., § 371 (1934).

twenty years. Governor Eccles later proposed an amendment to this bill so as to give very broad powers to the Board of Governors to regulate real estate loans.[97] The real estate provisions in the House bills provoked considerable criticism from a number of economists for two principal reasons: (a) that under the proposed legislation the Board of Governors would be politically minded and not independent, and (b) that the conditions under which commercial banks could make loans on real estate ought to be more, rather than less, stringent inasmuch as such lending is contrary to the principles of sound commercial banking.[98]

The restrictions and limitations of the Federal Reserve Act with respect to loans secured by real estate are expressly excepted in the case of loans made to established industrial or commercial businesses (a) which are in whole or in part discounted or purchased, or loaned against as security by a Federal Reserve bank under the provisions of Section 13b of the Federal Reserve Act relating to direct loans to industry, (b) for any part of which a commitment has been made by a Federal Reserve bank under such provisions, (c) in the making of which a Federal Reserve bank participates under the provisions of such section, or (d) in which the Reconstruction Finance Corporation cooperates or purchases a participation under the provision of Section 5d of the Reconstruction Finance Corporation Act, relating to loans to industry.[99]

Dealing in Investment Securities

Section 5136 of the Revised Statutes[100] has been further amended so as to give express permission to national banks to buy and sell stocks for the accounts of customers if done without recourse, but in no case for their own account.[101] Although national banks were permitted by the Comptroller, under the former law, to engage in such business for customers on a non-profit basis,[102] their right to handle such transactions has not been clear.[103] In recommending the amendment, the Comp-

[97] S. Hearings 320, 323.

[98] S. Hearings, 340, 419, 863, 906-913; H. Hearings 714.

[99] Sec. 328.

[100] 12 U. S. C., § 24.

[101] Sec. 308(a).

[102] See text of Comptroller's ruling in AM. BANKER, 1: 2 (July 10, 1934).

[103] In his 1933 Annual Report, page 11, the Comptroller of the Currency indicated that he thought the law did not give a national bank the right to purchase corporate stocks for the account of one of its customers. See also 1 DIGEST OF DECISIONS RELATING TO NATIONAL BANKS 501 (1927), citing cases in support of the proposition that the selling of stock by a national bank for another person is outside the banking business and its chartered powers. Since under Sec. 5(c) of the Banking Act of 1933, state member

troller pointed out that it was important, particularly in communities remote from financial centers, to provide such a service for the accommodation of the bank's customers. He also pointed out that such purchases were made without investment of bank funds.[104]

Underwriting by national banks of either stock or securities is, with certain exceptions, prohibited. Under Section 308(a) of the bill as amended by the Senate, national banks would have been allowed to underwrite bonds, debentures and notes under the limitations and restrictions prescribed by the Comptroller of the Currency provided, however, that the association could not underwrite more than $100,000 or 20 per cent of an issue, whichever was larger, nor could its underwriting engagements with regard to the obligations of any one issuer exceed 10 per cent of its capital and surplus, nor could the aggregate of such engagements exceed 200 per cent of its capital and surplus. These general underwriting provisions were eliminated in conference.[105]

It should, however, be kept in mind that a national bank has not been prohibited from underwriting as well as dealing in or purchasing obligations of the United States, general obligations of any state or political subdivisions thereof, obligations issued under the Federal Farm Loan Act, or issued by the Federal Home Loan Banks, or Home Owners Loan Corporation. To this list has been added obligations insured by the Federal Housing Administration pursuant to the low-cost housing insurance provision of the National Housing Act.[106]

The provision that a national bank may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may prescribe is retained. However, the prior limitation against a national bank's purchasing and holding for its own account more than 10 per cent of a particular issue of securities has been eliminated and the limitation against a bank's purchasing and holding securities of any obligor in excess of 15 per cent of capital and

banks became on June 16, 1934, subject to the same limitations and restrictions as govern national banks with regard to the purchase and sale of securities, the Federal Reserve Board issued its telegram on April 28, 1934, that after June 16, 1934, a state member bank could not buy or sell stocks for its customers. The Board reconsidered its ruling, however, and held that there was no prohibition in the federal statutes against banks buying and selling corporate stocks solely upon order and for the account of customers. AM. BANKER 4:1 (May 22, 1934). This was followed by the ruling of the Comptroller, cited note 102, supra.

[104] S. Hearings 153.

[105] Conf. Rep. 53.

[106] Sec. 308(c), amending Rev. Stat. 5136, as amended by 42 Stat. 767, 44 Stat. 1226, 48 Stat. 184, 12 U. S. C., § 24 (1933).

25 per cent of surplus has been reduced to 10 per cent of each. This reduction, however, will not require the sale of any securities lawfully held on August 23, 1935.[107]

Not only national banks but state member banks are affected by these changes since by virtue of Section 5(c) of the Banking Act of 1933 state member banks are subject to the same limitations and conditions with respect to purchasing, selling, underwriting and holding of investment securities and stock as are applicable to national banks under Section 5136 of the Revised Statutes.[108]

Section 21(a) (1)[109] of the Banking Act of 1933 has been amended to make clear that it is not to prohibit any financial institution or private banker from dealing in, underwriting, purchasing, and selling investment securities to the same extent permitted national banks under Section 5136 of the Revised Statutes, amendments to which have been pointed out in the paragraphs immediately preceding.[110] It is further provided that nothing in this section of the Banking Act of 1933 shall be construed as affecting "in any way such right as any bank, banking association, savings bank, trust company, or other banking institution, may otherwise possess to sell, without recourse or agreement to repurchase, obligations evidencing loans on real estate."

Interlocking Personnel

Section 8A of the Clayton Act has been repealed.[111] This section, enacted as Section 33 of the Banking Act of 1933,[112] prohibited interlocking personnel between a national bank and another bank or other concern making loans on stock or bond collateral. Part of Section 8 of the Clayton Act dealing with interlocking personnel between a national bank and another banking institution, whether or not a national bank, is also repealed. Under the new law no private banker or director, officer, or employee of a member bank may be a director, officer, or employee of another bank, savings bank, or trust company which is a national bank, or organized under the laws of a state or the District of Columbia, except that the Board of Governors may permit such service with respect to not more than one other such institution. This prohibition,

[107] Sec. 308(a).

[108] 48 Stat. 165, 12 U. S. C., § 335 (1933).

[109] 48 Stat. 189, 12 U. S. C., § 378 (1933).

[110] Sec. 303(a).

[111] Sec. 329.

[112] 48 Stat. 194, 15 U. S. C., § 19a (1933).

however, is not to apply in the case of any one or more of the following institutions or branches thereof:

(a) A bank with no office in the same community as that in which the member bank has an office or in a community contiguous or adjacent thereto.
(b) A bank not engaged in a class of business in which the member bank is engaged.
(c) A bank more than 50 per cent of the common stock of which is owned by persons who own more than 50 per cent of the common stock of the member bank.
(d) A mutual savings bank.
(e) A corporation engaged principally in foreign banking which has entered into an agreement with the Federal Reserve Board of Governors pursuant to Section 25 of the Federal Reserve Act.
(f) A bank more than 90 per cent of the stock of which is owned by the United States or by any corporation of which the United States owns more than 90 per cent of the stock.
(g) A bank in liquidation or in the hands of a receiver, conservator, or other similar official.

A person lawfully serving a member bank and also acting as private banker or serving another institution on August 23, 1935, is not prohibited from continuing such service until February 1, 1939.[113]

Effective January 1, 1936, no person connected with any organization primarily engaged in the issue, flotation, underwriting, public sale or distribution of securities may serve at the same time as an officer, director or employee of any member bank, except in limited classes of cases in which the Board of Governors of the Federal Reserve System may allow such service by general regulations. Such interrelationships will be permitted only when, in the Board's judgment, such service would not unduly influence the investment policies of the member bank or the advice it gives its customers regarding investments.[114]

The Comptroller of the Currency recommended the adoption of this provision in lieu of Section 32 of the Banking Act of 1933, so as to remove the burden of the Board of Governors under the latter law of looking into each individual case instead of turning such matters over to its staff.[115] It might be noted, however, that, in revising the law, changes were made in the description of the particular personnel of

[113] Sec. 329. [114] Sec. 307. [115] S. Hearings 151-152.

member banks and dealers in securities included in the prohibition as well as in the statutory definition of a dealer in securities.

Affiliates of Banks

The provisions of the Banking Act of 1933 dealing with affiliates of member banks have been amended in a number of instances either with a view to relaxing the restrictions, or for the purpose of clarifying the law. Perhaps the most noteworthy of these amendments is the one amending Section 23A of the Federal Reserve Act.[116] That section limits loans by a member bank to an affiliate and upon its securities and the bank's investment in such securities; it requires certain types of securities as collateral upon a loan to an affiliate. Under the section as amended, the limitations prescribed are not to apply in the case of former exceptions or in the following situations:

(a) An affiliate engaged on June 16, 1934, in holding the bank premises of the member bank with which it is affiliated or in maintaining and operating properties acquired for banking purposes prior to such date.
(b) A subsidiary of an affiliate, in the capital stock of which a national bank is authorized to invest pursuant to Section 25 of the Federal Reserve Act.
(c) A subsidiary of an affiliate organized under Section 25(a) of the Federal Reserve Act.
(d) An affiliate engaged solely in holding obligations fully guaranteed by the United States.
(e) Where the affiliate relationship has arisen out of a bona fide debt contracted prior to the date of such relationship.
(f) Where the affiliate relationship exists by reason of the ownership or control of any voting shares by a member bank in a fiduciary capacity, except where such shares are held for the benefit of all or a majority of the stockholders of such member bank.

Furthermore, the provisions of Section 23A of the Federal Reserve Act shall not apply hereafter to indebtedness of any affiliate for unpaid balances due a bank on assets purchased from the bank or to loans secured by obligations of the United States or obligations fully guaranteed by the United States.[117]

These changes were recommended by the Comptroller of the Currency as making the law more practical.[118]

[116] 48 Stat. 183, 12 U. S. C., § 371c (1933).
[117] Sec. 327.
[118] S. Hearings 170-171.

After June 16, 1938, a holding company affiliate of a member bank which owns or controls shares of bank stock as to which there is no statutory liability, is required as to such shares to establish and maintain out of net earnings above 6 per cent per annum, reserves of readily marketable assets equal to but 12 per cent of the aggregate par value of such stocks controlled by it.[119] Under the Banking Act of 1933, reserves equal to 25 per cent of the aggregate par value of all bank stocks controlled by such affiliate were required to be established over a period of years.[120]

The definition of holding company affiliate is changed so as to exclude a corporation of which the United States owns all the stock, and the Board of Governors of the Federal Reserve System is empowered to exclude from this definition any organization which it determines is not engaged, directly or indirectly, as a business in holding the stock of, or managing or controlling, banking institutions. This change in definition does not apply for the purpose of loans to or upon the securities of, or investments in, affiliates.[121]

The Board of Governors or the Comptroller of the Currency may waive any required report or examination of an affiliate of a state member or a national bank, respectively, if in the judgment of the Board or of the Comptroller such report or examination is not necessary to disclose fully the relations between the affiliate and the bank, and the effect thereof upon the affairs of the bank.[122]

Section 5144 of the Revised Statutes [123] is further amended to eliminate the necessity for a voting permit in cases where shares of a member bank held by a holding company affiliate are to be voted merely in favor of placing the bank in voluntary liquidation or taking any other action in connection with such liquidation.[124]

A holding company affiliate possessing a voting permit may vote the shares of a national bank cumulatively. The Board of Governors may issue both limited and general voting permits.[125]

Section 20 of the Banking Act of 1933 has been amended to make

[119] Sec. 311(c), amending 48 Stat. 187, 12 U. S. C., § 61(c) (1933). Although the statute refers only to holding company affiliates of national banks, by virtue of Sec. 5(c) of the Banking Act of 1933 such affiliates of state member banks are required to agree to be bound by the same conditions and limitations. 48 Stat. 166, 12 U. S. C., § 337 (1933).

[120] 48 Stat. 187, 12 U. S. C., § 61(b) (1933).

[121] Sec. 301.

[122] Sec. 325.

[123] 48 Stat. 186, 12 U. S. C., § 61 (1933).

[124] Sec. 311(a). [125] Sec. 311(b).

clear that member banks need not divorce security affiliates in formal liquidation transacting only business incidental thereto.[126] This provision conforms with rulings by the Federal Reserve Board and the Comptroller's office under the former law.[127]

Capital, Surplus and Dividends

A national bank or a bank in the District of Columbia may terminate the double liability on its stock on and after July 1, 1937, by publication of an appropriate newspaper notice.[128] Under Section 22 of the Banking Act of 1933 national bank stock issued after June 16, 1933, is not subject to double liability. The reasons for repealing the remaining liability were given by the Comptroller of the Currency as follows: (a) the stockholders usually suffer greatly by the closing of the bank and are usually less able subsequently to respond to double liability;[129] (b) other provisions of the act[130] require the setting aside of one-tenth of the bank's profits each year until its surplus equals its capital; (c) the awkwardness, since the Banking Act of 1933, of having some stock subject to double liability when other stock of the same bank is free from such obligation. Since its effective date is postponed until July 1937, the proponents of this provision consider it to be free from any constitutional objection, arguing that it gives presumptive notice to all creditors, and an ample opportunity to act.[131] The House Committee inserted the further requirement of six months' notice by publication.[132]

Under Section 5143 of the Revised Statutes, as amended by Section 334 of the Banking Act of 1935, the approval of the Comptroller of the Currency is required before a national bank can reduce its capital stock. Heretofore the approvals of both the Comptroller and the Federal Reserve Board to such reduction were necessary. Section 5143 is further amended so as to provide that a distribution to stockholders of cash or other assets by reason of a reduction in common capital will not be permitted except upon the approval of the Comptroller of the Currency and the affirmative vote of at least two-thirds of the shares of each class of stock outstanding, voting by classes. The necessity of a nonmember state bank securing the consent of the Insurance Corporation before reducing its capital stock has been referred to previously.[133]

When a member bank, or a bank applying for membership in the

[126] Sec. 302.
[127] S. Hearings 113.
[128] Secs. 304, 337.
[129] The Comptroller has estimated that his office has collected about 49 per cent of the stock liability. S. Hearings 149.
[130] Secs. 315, 337.
[131] S. Hearings 149.
[132] S. Hearings 150.
[133] Supra, p. 174.

Federal Reserve System, has preferred stock outstanding, the determination of whether or not the capital of such bank is impaired is to be based upon the par value of its stock, although the outstanding preferred stock entitles the holders thereof to receive an amount in excess of the par value of such stock upon retirement or liquidation. If any such bank shall have outstanding any capital notes or debentures of the type which the Reconstruction Finance Corporation is authorized to purchase, the capital of the bank may be deemed to be unimpaired if the sound value of its assets is not less than its total liabilities, including capital stock but excluding such capital notes and debentures and any obligations of the bank expressly subordinated thereto.[134]

No issue of preferred stock by a national bank is to be valid until (a) notice has been given to the Comptroller of the Currency that the par value thereof has been paid in, and (b) the Comptroller's certificate has been obtained specifying the amount of such issue, his approval thereof, and that the amount has been duly paid in.[135]

Section 309 of the act provides that no newly organized national bank shall commence business until it shall have a paid-in surplus equal to 20 per cent of its capital. This merely enacts into law the present requirements of the Comptroller of the Currency's office, adopted as a matter of policy, that such amount of surplus shall be paid in before a newly organized national bank is authorized to do business.[136] Under this section, however, the Comptroller may waive the requirement in the case of a state bank converting into a national bank, but until its surplus equals 20 per cent of its capital it is required to carry not less than one-half of its net profits of the preceding half year to surplus before declaring a dividend.

As already noted, a national bank or a bank in the District of Columbia is required to carry not less than one-tenth of its net profits of the preceding half year to surplus before the declaration of a dividend until the surplus equals the amount of its common capital.[137] Under the former law such additions to surplus were required only to bring it up to 20 per cent of capital. This change is deemed desirable in connection with the provision that the assessment liability be eliminated from bank stock, and further, from the standpoint of building up a proper capital structure.[138]

Holders of preferred stock issued by a national bank are not entitled to receive cumulative dividends in excess of 6 per cent per annum of

[134] Sec. 345.

[135] Sec. 336.

[136] S. Hearings 114.

[137] Secs. 315, 337.

[138] S. Hearings 115.

the purchase price received by the bank for such stock. In the event of retirement or liquidation the holders of such stock are to be entitled to receive amounts provided by the articles of association but not in excess of the purchase price of such stock plus accumulated dividends.[139]

Loans and Discounts

Section 22(g) of the Federal Reserve Act forbidding executive officers of member banks to borrow from their banks is amended by giving the Board of Governors power to remove such officers for violation rather than subjecting them to the penalty of $5,000 or a year in prison, or both, and the $10,000 fine against the bank is eliminated.[140] Under Section 12 of the Banking Act of 1933 member banks were forbidden to loan to executive officers, and loans then in effect were required to be liquidated by June 16, 1935. The Comptroller of the Currency recommended a three-year extension of time within which to pay off the outstanding loans, pointing out that the executive officers had made a very good showing in repayment of the loans and that it would be to the interest of the banks, as well as the officers, to allow them an additional period.[141] As a consequence, under Section 326(c) of the Banking Act of 1935 such loans as were outstanding on June 16, 1933, may be extended or renewed to June 16, 1938, if a finding by the bank directors that such a renewal is in the bank's interest and that the officer has made reasonable effort to reduce his obligations is spread on the bank's minute book. This section amended the former provision also in that it removed the absolute prohibition of an executive officer borrowing from his bank and permitted a loan, if not exceeding $2,500, to be made by a member bank to an executive officer with the prior approval of a majority of the bank's directors. Borrowings by a partnership in which one or more executive officers have individually or collectively a majority interest are stated to be within the prohibition, whereas the old law was construed to prohibit loans to a partnership in which an executive officer had any interest. In order to clarify the existing uncertainty as to the meaning of the term "executive officer," the Board of Governors has been given power to define this term and to prescribe regulations to effect the purposes of this section.[141a]

[139] Sec. 345.

[140] Sec. 326(c), amending 48 Stat. 182, 12 U. S. C., § 375a (1933).

[141] H. Hearings 676-677.

[141a] The Board of Governors has issued Regulation O, effective January 1, 1936, dealing with loans to executive officers by member banks. It defines, among other things, the term "executive officer." For definitions of the term under the Banking Act of 1933, see 19 FED. RES. BUL. 501, 569 (1933).

Loans to one borrower by a state member bank on obligations issued or fully guaranteed by the United States Government are no longer limited to 10 per cent of the bank's capital and surplus, but such banks are permitted the 25 per cent limitation allowed national banks under paragraph 8 of Section 5200 of the Revised Statutes.[142] This provision is intended to remove a discrimination against the state member banks.

A Federal Reserve bank may discount for individuals or private business concerns eligible paper endorsed or secured to its satisfaction.[143] The prior law required both an adequate endorsement and security. It should be noted, however, that such discounting is permitted only when "in unusual and exigent circumstances" the Board of Governors, by an affirmative vote of not less than five members, so authorizes the Federal Reserve bank, during a limited period, and the Federal Reserve bank is required before discounting the paper to obtain evidence that the applicant is unable to secure adequate credit accommodations from other banking institutions.[144]

Each Federal Reserve bank is required to establish its rates of discount every 14 days, or oftener if deemed necessary by the Board of Governors.[145] This provision was added by the Senate amendment.[146]

Regulation of Deposits

The statutory definitions of demand deposits and time deposits set up in Section 19 of the Federal Reserve Act are repealed and the Board of Governors is authorized to define these and other terms and limit the rate of interest which shall be paid by member banks on time and savings deposits. The Board is also required to prescribe different rates for such payment on time and savings deposits having different maturities, or subject to different conditions respecting withdrawal or repayment, or by reason of different locations, or according to varying discount rates of member banks in the several Federal Reserve districts.[147]

[142] Sec. 321.

[143] Sec. 322.

[144] Federal Reserve Act, § 13, 47 Stat. 715, 12 U. S. C., § 343 (1932).

[145] Sec. 206(b).

[146] S. Rep. 13.

[147] Sec. 324. The Board of Governors has issued a new Regulation Q, effective January 1, 1936, dealing with the payment of interest on deposits, together with a Supplement to the regulation, which Supplement is also made effective January 1, 1936. Changes are made in the definition of and withdrawal practices concerning "savings deposits." Member banks are limited in their interest rates on time and savings deposits to the maximum allowed for state banks. Under the Supplement no member may pay interest in excess of 2½ per cent per year on any savings deposits. On time deposits the

Section 19 of the Federal Reserve Act is amended to add to the exemptions from the prohibition against the payment of interest by member banks on demand deposits (a) contracts existing when a bank joins the System, and (b) deposits payable outside the states of the United States and the District of Columbia (rather than merely those payable in foreign countries). The existing exemptions of deposits made on behalf of any state or other such subdivision as to which interest is required by state law, and of deposits made by mutual savings banks, is terminated August 23, 1937, and until this time there is added to those exemptions deposits made by savings banks and deposits of trust funds on which interest is required by state law. So much of existing law as requires the payment of interest on funds deposited by the United States or any territory or possession thereof as is inconsistent with the provisions of Section 19 is repealed.[148]

Section 8 of the Postal Savings Depository Act of June 25, 1910, as amended by Section 11(c) of the Banking Act of 1933,[149] is amended to clarify the provisions regarding the payment of interest on postal savings deposits; to prevent the rate of interest paid on such deposits exceeding the rates which may lawfully be paid on savings deposits by member banks located in or nearest to the place where the depository office is situated; and to authorize postal savings depositories to deposit funds on time with member banks subject to the provisions of the Federal Reserve Act and regulations thereunder regarding the payment of time deposits and interest thereon.[150]

Under Section 303(b) of the act, the receipt of deposits from other than officers, agents, and employees of the depository is made a criminal offense, except by:

(a) Corporations authorized by law to receive deposits.
(b) Institutions permitted by state, territory or district to receive deposits, and subject under its law to examination and regulations.
(c) Institutions submitting to periodic examination by banking authority of state, territory or district, and making and publishing condition reports.

following schedule of maximum rates has been prescribed: On time deposits payable in not less than 6 months, 2½ per cent per year; on time deposits payable in less than 6 months and not less than 90 days, 2 per cent per year; on time deposits payable in less than 90 days, 1 per cent per year.

[148] Sec. 324(c).

[149] 48 Stat. 182, 39 U. S. C., § 758 (1933).

[150] Sec. 341. See Regulation Q, cited note 147, supra.

This amends Section 21(a) (2) of the Banking Act of 1933,[151] which prohibited any person not subject to examination and regulation under state or federal law from engaging in the business of receiving deposits unless such person submitted to examination by the Comptroller of the Currency or the Federal Reserve Board of the district. The changes in the law were made (a) to plainly exempt business institutions who accept deposits only from their own officers, agents or employees from submitting to examination and publication of reports of condition, (b) because of lack of power in the Comptroller to correct a bad situation existing in the private banks examined, and (c) because of the inference from the published report that the private bank was under the supervision of the Comptroller.[152]

Computation of Reserves

Two changes have been made with respect to the reserves member banks must carry at the regional Reserve bank.

In the first place, member banks are to maintain the same reserves against deposits of the United States as against other deposits,[153] thus repealing the contrary provisions in the Liberty Loans Acts.[154]

In the second place, in determining the amount of reserves to be kept, the amounts due from other banks (except Federal Reserve banks and foreign banks) and certain cash items in process of collection may be deducted from gross demand deposits rather than from amounts due to other banks.[155] Under the law as amended, a bank should be able to deduct all of its "float" and its balances with other banks before determining the amount of reserves required. Heretofore it could deduct only so much of its items "due from banks" as could be set off against the amount "due to banks." This change will be of greatest benefit to "country" banks.[155a]

Statements of Condition

Section 9 of the Federal Reserve Act is amended so as to authorize the Board of Governors to prescribe the information to be contained in, and the form of, condition reports of state member banks and to require

[151] 48 Stat. 189, 12 U. S. C., § 378 (1933).

[152] S. Hearings 139-141.

[153] Sec. 324(d).

[154] First Liberty Bond Act, § 7, 40 Stat. 37 (1917); Second Liberty Bond Act, § 8, 40 Stat. 291 (1917); Third Liberty Bond Act, § 8, 40 Stat. 504 (1918).

[155] Sec. 324(b).

[155a] The Board of Governors has issued a new Regulation D, effective January 1, 1936, dealing with the reserves of member banks.

publication of such reports under regulations of the Board.[156] Although the Federal Reserve Board has secured from member banks reports of condition which are identical with those required by the Comptroller of the Currency for national banks, there was no authority under previous law to require publication unless the state law required it.[157] The Federal Deposit Insurance Corporation is given similar powers with respect to nonmember insured banks.[158] It seems not improbable, therefore, that the public will shortly have available rather complete data on the financial condition of all banks and those qualified to interpret the statements should be able to make substantially better comparative analyses.

Seasonal Bank Agencies

Section 5155 of the Revised Statutes is amended to permit a national bank, in a state which by statute permits state banks to maintain branches within county or greater limits, to establish with the approval of the Comptroller of the Currency, without regard to the capital requirements of the section, a "seasonal agency in any resort community" in the same county as the main office of such bank. However, the privilege applies only if no other bank is doing business in the place where the agency is to be located, and any permit for such an agency must be revoked upon the opening of a state or national bank in the community.[159]

Miscellaneous

To facilitate the conversion of a state bank into a national bank, the Comptroller of the Currency is empowered to permit such a bank to retain and carry at a value to be determined by him assets which are not permitted to be acquired or held by national banks.[160]

The provisions regarding consolidations of national banks[161] are brought into conformity with those governing the consolidation of a state with a national bank[162] and dissenting stockholders in each case are given the right to request the Comptroller to appoint an appraiser to act on the appraisal committee where the directors fail to appoint an appraiser within 30 days after notice of stockholders' dissent.

A procedure is also outlined in connection with the voluntary liquidation of national banks. Liquidation may be accomplished by a liqui-

[156] Sec. 320, amending 40 Stat. 233, 12 U. S. C., § 326 (1917).
[157] S. Hearings, 163, 164.
[158] Sec. 12B (k) (3), Federal Reserve Act, as amended.
[159] Sec. 305. [160] Sec. 312. [161] Sec. 330. [162] Sec. 331.

dating agent or a committee which will be responsible to the bank's directors and stockholders, and the bank will remain subject to examination by the Comptroller of the Currency.[163]

The prohibition against member banks acting as correspondent banks of dealers in securities is removed, effective January 1, 1936.[164] It was the judgment of the Federal Reserve Board that there was no abuse there.[165]

Security is no longer required to be given by an insured bank in connection with the deposits of bankruptcy funds or in connection with the deposits of national bank receivership funds as to those parts of such deposits which are insured under Section 12B of the Federal Reserve Act.[166]

A number of sections extend federal criminal provisions. The federal criminal offenses relating to embezzlement, false entries, etc., by personnel of member banks are extended to apply to the officers, directors, employees and others of insured nonmember banks.[167] The Act of May 18, 1934,[168] punishing robberies of member banks and of banking institutions organized and operating under federal law is amended to extend such protection to insured banks.[169]

The use of the word "national," "Federal," or "United States" is prohibited under Section 5243 of the Revised Statutes as amended, as a part of the name or title of any person, firm or corporation doing the business of bankers, brokers, or trust or savings institutions unless they are organized under the laws of the United States or permitted by such laws to use such name, or now lawfully using such name.[170] Unauthorized use of the term "deposit insurance" is also prohibited.[171]

Section 22(a) of the Federal Reserve Act is amended to make clear that the prohibition against loans and gratuities to bank examiners by member banks, and their officers and employees, applies only to banks subject to examination by such examiner; and also to make clear that these prohibitions and the prohibitions against theft apply to either state or federal examiners examining member banks, but not private

[163] Sec. 317.

[164] Sec. 307, amending 48 Stat. 194, 12 U. S. C., § 78 (1933).

[165] S. Hearings 152.

[166] Secs. 339, 340. These sections amend respectively Rev. Stat., § 5234, 12 U. S. C., § 192 (1916), and Bankruptcy Act, § 61, 30 Stat. 562, 11 U. S. C., § 101 (1898).

[167] Sec. 316.

[168] 48 Stat. 783, 12 U. S. C., § 588 (b) (1934).

[169] Sec. 333.

[170] Sec. 318.

[171] Sec. 332.

examiners. The prohibitions are extended to cover all insured banks.[172] Section 22(b) of the Federal Reserve Act prohibiting a national bank examiner receiving compensation from any bank or officer or employee thereof is extended to the Deposit Insurance Corporation examiners and the restrictions against disclosure by examiners of the borrowers or collateral of member banks is extended to cover insured banks.[173]

V

GENERAL CONCLUSIONS

It has already been made clear that the members of the Board of Governors of the Federal Reserve System have been vested with far-reaching discretionary powers which have been substituted for previous statutory limitations. In fact, its personnel largely controls the instrumentalities which actuate the supply of credit of the nation. These men represent a majority of the members of the Federal Open Market Committee which is empowered to direct the investment of the reserves of member banks upon which the bank deposit structure of the nation rests. This Committee may use these reserves in the purchase and sale of Government obligations and thereby, to the extent that it desires, facilitate or impede the flotation and maintenance of a market for Government obligations.[174] The Board has the power to raise reserve rates to double the existing requirements, which, if done, would, except under highly abnormal situations, curtail lending and initiate on a wholesale scale the calling of loans.[175] The Board determines ultimately the discount rates at which credit is granted to member banks and others, thereby also influencing credit generally.[176]

As has already been pointed out, the law provides for the appointment of an entirely new Board of Governors of the Federal Reserve System.[177] To place powers of the kind referred to above in the hands of any except the most competent men of character would be to court disaster for the nation. It is essential, therefore, that the members of the Board be chosen with exceedingly great care. They must be of as high character and capacity as members of the United States Supreme Court. They must be competent, not merely well-intentioned, courageous in initiative, but disciplined enough to keep constantly in mind

[172] Sec. 326(a).
[173] Sec. 326(b).
[174] S. Hearings 332-333.
[175] S. Hearings 416-419.
[176] STEINER, MONEY AND BANKING 853 (1933).
[177] Of course, members of the old Board may be reappointed.

that their purpose is not reform, but the proper accommodation of commerce, industry and agriculture, with due regard to the credit situation of the country. They must be above party, section, or class prejudice, insensible alike to banking or governmental pressure,[178] yet possessing the confidence of all classes.

If only properly qualified men are selected, the insulation provided for by the act should result in an improved administration by the Board. Absence of governmental representation, the decision in the *Humphrey* case,[179] lengthened terms, higher salaries and ineligibility for reappointment should increase the independence of the Board. The more definite fixing of responsibility for action taken by the members on all questions of policy, by virtue of the disclosure to be made in the Board's annual report, should be very effective in inhibiting measures generally regarded as unsound, although it may also deter the initiation of apparently sound but untried practices.

However, if the public would adopt and maintain an insistence for not only high standards of selection, but also for the Board's freedom from influence of all kinds, there would be no great cause for alarm in substituting discretionary powers of the Board and of the Open Market Committee for statutory limitations. In England less restrictions are to be found either on the central bank or on the commercial banks than now exist with respect to the controlling agencies of the Federal Reserve System or the commercial banks in the United States. It is primarily by the force of banking tradition and a well-rooted public opinion that the English institutions adhere to sound banking practices,[180] yet their history for a constant adherence to sound banking is probably without a parallel. To build up in this country within a few years both banking tradition and public opinion to substantially the degree existing in England would be a remarkable accomplishment, but it is a necessary one if we are to have a wholly satisfactory administration of credit and of banking under the Banking Act of 1935.

Since it might be fairly said that the Board of Governors of the Federal Reserve System and the Federal Open Market Committee collectively possess to a considerable degree the powers of a central

[178] S. Hearings, 336, 337.

[179] Rathbun v. United States, (U. S. 1935) 55 S. Ct. 869, cited note 53, supra.

[180] PHILLIPS, READINGS IN MONEY AND BANKING 454 (1916); WILLIS and BECKHART, FOREIGN BANKING SYSTEMS 1166 (1929); 1 TAUSSIG, PRINCIPLES OF ECONOMICS, 3rd ed., 359, 364 (1921); GARIS, PRINCIPLES OF MONEY, CREDIT, AND BANKING 891 (1934).

bank,[181] it would appear to follow under the present state of the law that they are in a position to control entirely the credit of the country. This is not the case, however, because of the powers of credit control vested in the Treasury Department of the Government. Dr. A. C. Miller, a member of the Federal Reserve Board, brought this matter clearly to the attention of the Senate Subcommittee in connection with the hearings on the bill. The Senate Hearings report the following discussion:

> "Mr. Miller. There is one further thing I want to call your attention to that I have not mentioned so far, and that is the new position that the United States Treasury has in recent years come to assume as a factor in the money market, and that is something beyond anything in extent that we have ever had before. I have just looked up to see what the powers of the Treasury are to increase or decrease member-bank reserves and deposits. Mr. Thomas has made certain computations and assembled certain material for me. In the matter of increasing reserves it has the power now to issue $3,000,000,000 of greenbacks. And it has about $1,800,000,000 of stabilization funds with Reserve banks which it can use. . . . There would be two vast sources of inflation; and when you realize that [when] things are moving in their ordinary way a dollar of reserve money multiplies itself to $10, and you can see what the Treasury could do there, that the Board would be helpless to counteract unless it is given some authority; and I confess that I view the future in that respect with at least perplexity. And it can issue more silver certificates. That again has the same effect as an open-market operation. It could also further devalue the dollar and spend the profits. That again would be an open-market operation. In other words, they have

[181] "The Governor of the Bank of England, in the course of his evidence before the Royal Commission on Indian Currency and Finance, gave the following reply to the question as to the duties of a Central Bank:

" 'It should have the sole right of note issue; it should be the channel, and the sole channel, for the output and intake of legal tender currency. It should be the holder of all the Government balances; the holder of all the reserves of the other banks and branches of banks in the country. It should be the agent, so to speak, through which the financial operations at home and abroad of the Government would be performed. It would further be the duty of a central bank to effect, so far as it could, suitable contraction and suitable expansion, in addition to aiming generally at stability, and to maintain that stability within as well as without. When necessary it would be the ultimate source from which emergency credit might be obtained in the form of rediscounting of approved bills, or advances on approved short securities, or Government paper.' " KISCH and ELKIN, CENTRAL BANKS, 4th ed., 105 (1932). See also STEINER, MONEY AND BANKING 616-619 (1933).

the power to go into the open market to an extent that makes Federal Reserve banks seem like a toy pistol alongside the modern revolving six-shooter.

"The Treasury has the power, on the other hand, to decrease member banks' reserves. It can draw down its own balances at commercial banks and transfer the proceeds to Reserve banks.

"Senator Glass. Well, any private depositor has the power to do that.

"Mr. Miller. Except that he can not deposit it in the Reserve banks?

"Senator Glass. No.

"Mr. Miller. He cannot get rid of it except by moving it out of the country. He can take it out in the form of currency and lock it up or take it out of the country. The Treasury can do the same thing with its trust-fund balances, to the extent that they are carried with member banks. And it can sell securities to the member banks or the public and place the proceeds on deposit with Federal Reserve banks.

"These are very extensive monetary powers and could be operated to produce some startling things. Similarly the Treasury could increase the deposits of member banks without the knowledge or cooperation of the Federal Reserve banks, by spending money raised either by sale of securities to member or Reserve banks, by use of stabilization fund, by issue of United States notes, or by printing silver certificates against silver bullion already in the Treasury.

"So that you really have two colossal sources of banking power in the United States, one being the Federal Reserve System, and the other being the Treasury." [182]

Inasmuch as the new Board has yet to prove its capacity to administer credit wisely and the Treasury remains in a position to nullify any credit policy adopted by the Board, it is apparent that the country has not arrived at a satisfactory solution of its credit and banking problems by the enactment of the Banking Act of 1935.

Aside from the matters contained in this legislation, however, a number of other banking problems still await solution. For example, standards for national banks have been relaxed for a number of years in order to meet the more lenient requirements in effect in a number of the states. It has been contended, and it seems well supported by experience, that to procure sound commercial banking standards it is

[182] S. Hearings 774-775.

necessary for the country to have a unified commercial banking system of nationally chartered banks.[183] Legislators have considered the desirability of having all commercial banks operate under a national charter but have questioned the constitutionality of a law which would require it.[184] The "insurance of deposits" provided for in the Banking Act of 1933 was acquiesced in by the present administration and by Senator Glass only because they regarded this measure as a means of bringing about some approximation to a unified banking system and without constitutional objection—that is, by requiring all insured banks to become members of the Federal Reserve System by July 1, 1936.[185]

Under the Banking Act of 1935, however, deposit insurance has been retained, but the expected *quid pro quo* has been lost. Under the terms of the act, a nonmember bank can obtain insurance protection until July 1942 without becoming a member of the Federal Reserve System, and if the deposits of such a bank do not exceed $1,000,000 during 1941 or thereafter, it may have its deposits insured without ever becoming a member of the System. It seems not entirely unlikely that the law may be amended later so as to permit other nonmember banks to retain federal deposit insurance without requiring Federal Reserve membership.[186]

If the accepted banking doctrine of requiring each bank, by its own assets and by its own prudent management, to be the sole guarantor of its own solvency is to be forsaken, and in its place a system of federal deposit insurance is to be provided, it is to be genuinely regretted that all banks which enjoy the benefits of such insurance are not required to comply with the statutory standards and restrictions prescribed for membership in the Federal Reserve System. Such membership would also have made them contributors to a common fund of reserves and would have given them access to a central supply of credit so as to be

[183] See testimony of Mr. Owen D. Young, Hearings before Subcommittee of Senate Committee on Banking and Currency on S. Res. 71, 71st Cong., 3rd Sess. (1931) 353-369.

[184] See colloquy between Senator Glass and Gov. Eugene Meyer, Hearings before Subcommittee of Senate Committee on Banking and Currency on S. 4115, 72d Cong., 1st Sess., p. 395 (1932). See Opinion of Mr. Walter Wyatt, General Counsel, Federal Reserve Board, suggesting methods of creating a unified commercial banking system in the United States, which methods he regards as invulnerable to attack on constitutional grounds. Dec. 5, 1932, 19 REP. FED. RES. BD. 229-259 (1932).

[185] S. Hearings 85, 147.

[186] See AM. BANKER, 1:4 (Aug. 24, 1935).

in a position to furnish the legitimate seasonal or extraordinary requirements of the community.

The requirements and restrictions of member banks seem all the more desirable for all insured banks inasmuch as the Insurance Corporation was very much limited in its ability to select its risks during the operation of the temporary insurance funds. It would appear that a bank which had assets sufficient to pay its depositors and other creditors was eligible for such insurance even though it had no protective cushion of capital and surplus.[187] It is only as to those banks which are newly admitted to the benefits of insurance under the permanent fund that the Insurance Corporation has the ability to demand higher standards for admission, as all banks which were insured under the temporary funds were *ipso facto* made eligible for insurance under the permanent fund.[188]

The Insurance Corporation has assumed a guaranty of the payment of deposits of approximately $16,500,000,000. To this end the Government has practically contributed $150,000,000, and approximately $139,300,000 has been taken from the surplus of the Federal Reserve banks.[189] To these are to be added the assessments of banks having the insurance protection. Although the federal plan has advantages over those previously in effect in certain states,[190] one cannot forget that the state measures have proved to be only fair weather remedies[191] which during a period of depression have had to be terminated because of the overwhelming liability. How the federal plan will work, it is, of course, impossible to foretell.[192] It would seem, however, that the inherent

[187] S. Hearings 56. REP. FED. DEPOSIT INS. CORP. 50-51 (1934).

[188] It should be noted, however, that the Insurance Corporation has had under way for some time a capital rehabilitation program for insured nonmember banks. REP. FED. DEPOSIT INS. CORP. 50-54 (1934).

[189] Sec. 12B (d), Federal Reserve Act, as amended. REP. FED. DEPOSIT INS. CORP. 8 (1934). Although these payments are, in form, subscriptions for capital stock, they amount to a contribution. See S. Hearings 146.

[190] (a) For example, the federal plan is nation wide in scope and consequently there is a greater diversification of risk; (b) heavy bank failures prior to January 1, 1934, have eliminated the weaker banks; (c) the federal plan was inaugurated with substantial contributions from the Government and from the surplus of the Federal Reserve banks.

[191] No state guaranty of deposits is now operative, the eight states which adopted such plans during the period 1907-1917 having abandoned them either formally or informally. STEINER, MONEY AND BANKING 197-198 (1933). For a discussion of the benefits and shortcomings of the guaranty of bank deposits, see ROBB, THE GUARANTY OF BANK DEPOSITS (1921); Am. Bankers Assn., THE GUARANTY OF BANK DEPOSITS (1933); Assn. of Res. City Bankers, THE GUARANTY OF BANK DEPOSITS (1933); STEINER, MONEY AND BANKING 195-202 (1933); GARIS, PRINCIPLES OF MONEY, CREDIT, AND BANKING 667-687 (1934).

[192] The estimates of losses of depositors during the period July 1, 1864–June 30,

weakness in these guarantees is that of encouraging a lack of vigilance on the part of both the bankers and the depositors, which, in turn, encourages the former to seek investments of the greatest risks permitted because of the highest rates of return thereby afforded.[193] The other factors of safety and liquidity may therefore become matters of secondary concern.

To this objection of weakness it may be answered that the Banking Act of 1935 sets up rather virile powers in the hands of the Federal Deposit Insurance Corporation to prevent unsound banking. Admitting this contention to be true, and admitting further that the Insurance Corporation has from all appearances been well administered, it seems not unlikely that, over a period of years, considerable pressure may be brought to bear by bankers to adopt standards low enough so as not to interfere with the promise of higher returns on commitments. This pressure might be exerted (a) to frustrate any attempts on the part of the Corporation to establish and maintain high standards, or (b) upon the Congress itself for the purpose of having it relax the standards set up by the Corporation in the interest of sound banking. Under our "dual system" of banking the difficulty of the Insurance Corporation's maintaining high standards would seem to be formidable.

The difficulty may prove the more real inasmuch as the means of independence afforded the Board of Governors under the Banking Act of 1935 is not provided for with reference to the Federal Deposit Insurance Corporation. Its directors are appointed for a term of only six years by the President with the advice and consent of the Senate.[194]

1934, on account of all suspended commercial banks during that period are not without interest. Such data were furnished by Chairman Crowley of the Insurance Corporation to the House Committee and the Senate Subcommittee. H. Hearings 5-10; S. Hearings 25-27. He pointed out that "The experience of the past 70 years indicates that to repay losses suffered by all depositors in our suspended commercial banks, an assessment of 33 cents per $100 of total deposits . . . in all open commercial banks, would have been necessary." For the losses occurring during three depression periods the average loss per year for each $100 of deposits in active commercial banks was 35 cents in 1873-78; 23 cents in 1892-97; and $1.28 in 1931-34. S. Hearings 27. The estimates indicated further that during the 70 years the average loss per year to those having unsecured deposits under $5000 was 24 cents per $100 of the total deposits in active commercial banks. Excluding the effect of the losses during the 14 years of the three crises, the annual loss during the remaining 56 years with respect to deposits under $5000 was estimated to be 9 cents per $100 of all deposits in active commercial banks. The act provides for assessments amounting to but 8.3 cents per year for each $100 of deposits.

[193] The termination of the double liability of national bank stockholders provided for by § 304 of the act will remove the incentive for the stockholders to demand a conservative investment and lending policy.

[194] Sec. 12B (b), Federal Reserve Act, as amended.

Of its three members, one—the Comptroller of the Currency—is a Government official. There is no statutory requirement that any cause be assigned, much less established, to effect the removal of any of the board except the Comptroller.[195] Should the pressure on the board of directors of the Corporation come from the Government instead of from the bankers, the Corporation is in a position to promulgate rules which may aid the Government in its financial program in such a way as would be considered undesirable by expert authorities on banking.

Another matter which the Banking Act of 1935 fails to remedy is the administration over banking matters by three separate and distinct departments of the Government, namely, the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation. There would seem to be no good reason why the federal administration over banking should not be limited to one authority to prevent duplication of effort, variations in point of view, and the removal of many questions of overlapping or border-line authority.[196]

Another problem which still remains unsettled is the formulation of a national policy with respect to branch banking.[197] The settlement of this problem seems unlikely until some means is found for effecting a unified national banking system.

[195] The Comptroller of the Currency holds his office for a term of 5 years "unless sooner removed by the President, upon reasons to be communicated by him to the Senate." Rev. Stat., § 325, 12 U. S. C., § 2. To what extent the doctrine of the Humphrey case applies to the members of the board is not clear.

[196] For example, the Comptroller prescribes the attributes of "investment securities" for state member banks. Rev. Stat. 5136, as amended by 48 Stat. 184-185, 12 U. S. C., § 24 (1933). The Board of Governors is the only administrative agency vested with authority (a) to remove an officer or director of a national bank, 48 Stat. 193, 12 U. S. C., § 77 (1933); (b) to authorize the establishment of foreign branches of national banks or the investment of capital in banks domestically organized but engaged principally in foreign or international banking, Federal Reserve Act, § 25, 39 Stat. 755, 41 Stat. 286, 12 U. S. C., § 601 (1919); (c) to grant to a national bank the right to act as trustee or other fiduciary, Federal Reserve Act, § 11 (k), 40 Stat. 968, 46 Stat. 814, 12 U. S. C., § 248 (k) (1930). The board of directors of the Insurance Corporation is empowered, under certain conditions, to throw a national bank into receivership, and in the case of a state member bank to terminate its membership in the Federal Reserve System. Sec. 123 (i) (2), Federal Reserve Act, as amended. It will be apparent, therefore, that not only are national and state member banks governed by more than a single federal agency, but also that the powers vested in one federal agency conflict, in effect, with those vested in another.

[197] For a discussion of branch banking see CARTINHOUR, BRANCH, GROUP AND CHAIN BANKING (1931); STEINER, MONEY AND BANKING 600-609 (1933); GARIS, PRINCIPLES OF MONEY, CREDIT, AND BANKING 586, 623-625, 724-740 (1934).

Inasmuch as (a) the country is still lacking both a unified banking system and a unified federal administrative agency over banks, (b) there is uncertainty as to how the administration of credit and of deposit insurance may work under the provisions of the Banking Act of 1935, and (c) the Treasury Department still possesses overwhelming powers of credit control, it would seem well for Congress to appoint a competent committee of experts to study these matters and, by working in conjunction with acknowledged leaders of commerce, finance, industry and agriculture, develop proposed legislation which would offer some promise of settling these problems on a satisfactory basis.[198] The temper of the country during the consideration of the Banking Act of 1935 was not conducive to the soundest sort of legislation. However, viewing the matter realistically, the enactment of a well considered banking and credit system seems unlikely until the Government balances its budget, and commerce and agriculture are on a more even keel.

[198] The suggestion of a commission to study the entire central and commercial banking problem was made by the Committee on Finance and Currency of the New York Chamber of Commerce, in a report presented to the Chamber on February 7, 1935, which was in the nature of an answer to a questionnaire of Senator Fletcher. 140 COMM. AND FIN. CHRON. 886 (Feb. 9, 1935). Accredited students also urged the advisability of such a commission during the Congressional hearings. See, e.g., H. Hearings 706 et seq; S. Hearings 860-861.