RECOMMENDATIONS FOR CHANGES IN THE FEDERAL RESERVE ACT

PART 1

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RECOMMENDATIONS FOR CHANGES IN THE FEDERAL RESERVE ACT

Introduction

This memorandum proposes numerous amendments to the Federal Reserve Act that would be reflected in a complete but essentially "technical" revision of the Act. The revision would be intended to eliminate obsolete or anachronistic provisions, correct inaccuracies, resolve inconsistencies, and clarify ambiguities that have become parts of the Act as a result of hundreds of amendments to the law enacted since the Act was originally adopted in 1913. The revision would also rearrange provisions of the present Act in a more logical and coherent manner.

While most of the suggested amendments would make no important changes of substance, a few of them might be regarded as substantive in nature. However, it is believed that even these amendments are relatively minor and should be noncontroversial. None is intended to make any major or basic change in the structure or operations of the Federal Reserve System. Nevertheless, in those cases in which a change might be regarded as at all controversial, the related catchline is preceded by an asterisk.

The specific recommendations are consecutively numbered. In general, but not in all instances, they are set forth according to sections of the present Federal Reserve Act. References in brackets in the left margin are to corresponding sections of the appended draft bill.

The recommendations do not specifically cover the deletion of sections of the original Federal Reserve Act amending other statutes, such as sections 8, 17, 20, 21, and 27 of the present Act. These sections, which have been executed, would naturally be omitted in any general revision of the Act.

As Appendix A to this memorandum, there is attached a draft of a proposed bill that would implement the recommendations herein contained. Section 1 of the bill would constitute the recommended revision of the Federal Reserve Act. The remaining sections would make necessary conforming amendments to provisions of other Federal statutes or would re-enact as separate statutes provisions that do not belong in the Federal Reserve Act. References to the numbers of the corresponding recommendations discussed in this memorandum are set forth in the left

margin of the text of the draft bill. References to corresponding sections or paragraphs of present law are set forth in the right margin of the bill. Unless otherwise indicated, section references are to sections of the present Federal Reserve Act.

Immediately following this Introduction is a Table of Contents for this memorandum. Because of its length, the memorandum is divided into two "Parts".

The appended draft bill is preceded by its own Table of Contents. Appendix B is a table indicating, in order, the disposition made of each paragraph of the present Federal Reserve Act.

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1. DEFINITIONS

The second and third paragraphs of section 1 of the Act (12 U.S.C. 221) read as follows:

> "Wherever the word 'bank' is used in this Act, the word shall be held to include State bank, banking association, and trust company, except where national banks or Federal reserve banks are specifically referred to.
>
> "The terms 'national bank' and 'national banking association' used in this Act shall be held to be synonymous and interchangeable. The term 'member bank' shall be held to mean any national bank, State bank, or bank or trust company which has become a member of one of the reserve banks created by this Act. The term 'board' shall be held to mean Board of Governors of the Federal Reserve System; the term 'district' shall be held to mean Federal reserve district; the term 'reserve bank' shall be held to mean Federal reserve bank; the term 'the continental United States' means the States of the United States and the District of Columbia."

The extent to which terms used in the Federal Reserve Act should be defined in the statute presents a difficult question of judgment. It would be possible to attempt to define many words that frequently give rise to questions of interpretation, such as the words "bank", "branch", "deposit", and "capital and surplus". However, it is believed that, as a general rule, it is preferable to avoid precise statutory definitions of such terms. It is not only difficult to define terms of this kind but it is desirable to afford the flexibility provided by interpretative or regulatory definitions. For example, any effort to define the word "bank" on the basis of functions and for all purposes would be extremely

difficult in the light of rapid developments in the banking industry. Thus, the day may come when, with changes in the payments mechanism, deposits in banks generally will no longer be withdrawn or transferred by "check".

For the reasons indicated, it is believed that section 1 of the Federal Reserve Act should contain, with one exception hereafter noted, only "descriptive" or "short-hand" definitions that would facilitate drafting and reference. At the same time, it would be desirable to incorporate at some place in the Act - perhaps in the section relating to the Board of Governors - a provision giving the Board general authority to define terms used in the Act in order to effectuate the purposes and prevent evasions of the Act.

A. "Bank"

[§ 102] The definition of the word "bank" presently contained in section 1 is inappropriate and misleading since it suggests that it usually refers only to State banks, whereas, of course, the term is frequently used to include national banks as well. In any event, this definition seems unnecessary since in practically all instances the word "bank" is preceded by a descriptive word or phrase, such as "national", "State", or "Federal Reserve".

B. "National bank"

[§ 102(a)] The term "national bank" should be defined as any national bank or national banking association organized under the National Bank Act.

C. "State bank"

[§ 102(b)] There should be included a definition of the term "State bank" as meaning any bank, banking association, savings bank, or trust company organized under the laws of any State or of the District of Columbia. The word "organized" should be used instead of "incorporated" in order to include an unincorporated private banker or banking association since, while such organizations are not eligible for membership in the System, there are certain provisions of the Act that should be applicable to them. For example, the Board has held that a private banker may be a "nonmember clearing bank" for purposes of the first paragraph of section 13 of the Act.

Such a definition of a "State bank" would not include a bank organized under the local laws of a territory, dependency, or insular possession of the United States. It would be possible to provide for the inclusion of such banks in the definition of a "State bank", as has been done in the Federal Deposit Insurance Act; but it seems preferable to avoid logically contradictory definitions. To the extent that banks organized under the local laws of the territories, dependencies, and insular possessions are permitted to become members of the Federal Reserve System, any problem involved would be resolved by requiring any such banks becoming members of the System to comply with all provisions applicable to State member banks.

The suggested definition of the term "State bank" would include savings banks as well as commercial banks even though, here again, savings banks are not members of the System, since it is desirable that they be included in the definition for certain purposes. The proposed definition would retain the reference to trust companies now included in the present definition of the word "bank". The Federal Deposit Insurance Act defines the term "State bank" in a manner that excludes any trust company that does not receive deposits; but non-deposit trust companies are presently permitted to become members of the Federal Reserve System and there appears to be no reason to exclude them.

D. "Member bank"

[§ 102(c)] The definitional section should include a definition of the term "member bank" as meaning any bank that becomes a member of the Federal Reserve System.

At this time, there appears to be no need to include definitions of the terms "insured bank" and "noninsured bank". However, if the Federal Reserve Act should be amended in any manner that would make certain provisions applicable to all insured banks (such as an extension of reserve requirements to all such banks), such definitions would become necessary.

E. "Continental United States"

[§ 102] The present definition of the term "continental United States" is now clearly inappropriate since Hawaii is a State although not a part of the continental United States. Moreover,

this term occurs only in the present first paragraph of section 2 of the Act and in section 19(h) of the Act. In accordance with other recommendations, these references would be omitted from the Act.

F. "Affiliate"

[§ 102(h)] (1) One exception might appropriately be made to the general rule of avoiding functional definitions. Section 2(b) of the Banking Act of 1933 defines the term "affiliate". Since the term is defined in relation to member banks and since the term occurs frequently in the Federal Reserve Act, it is believed that section 2(b) of the Banking Act of 1933 should be withdrawn and re-enacted, with necessary changes, as a part of the definitional section of the Federal Reserve Act.

[§ 102(h)(5)] *(2) At present, the definition of an "affiliate" includes a company that owns or controls 50 per cent or more of the stock of a member bank. Under the Bank Holding Company Act, a bank is a "subsidiary" of a holding company if 25 per cent or more of its stock is owned or controlled by such company. Section 23A of the Federal Reserve Act, relating to dealings by member banks with their affiliates, expressly provides that for purposes of that section the term "affiliate" shall include any bank holding company of which a member bank is a subsidiary and any other subsidiary of such holding company. There is no logical reason for which a company of this kind should be regarded as an affiliate of a member bank for purposes of section 23A and not

also for purposes of other sections of the Federal Reserve Act. Accordingly, the definition of the term "affiliate" should be expanded to include a bank holding company of a member bank or any other subsidiary of such holding company.

2. FEDERAL RESERVE DISTRICTS

The first paragraph of section 2 of the Act (12 U.S.C. 222, 223) reads as follows:

> "As soon as practicable, the Secretary of the Treasury, the Secretary of Agriculture and the Comptroller of the Currency, acting as 'The Reserve Bank Organization Committee,' shall designate not less than eight nor more than twelve cities to be known as Federal reserve cities, and shall divide the continental United States, excluding Alaska, into districts, each district to contain only one of such Federal reserve cities. The determination of said organization committee shall not be subject to review except by the Board of Governors of the Federal Reserve System when organized: Provided, That the districts shall be apportioned with due regard to the convenience and customary course of business and shall not necessarily be coterminous with any State or States. The districts thus created may be readjusted and new districts may from time to time be created by the Board of Governors of the Federal Reserve System, not to exceed twelve in all. Such districts shall be known as Federal reserve districts and may be designated by number. When the State of Alaska or Hawaii is hereafter admitted to the Union the Federal Reserve districts shall be readjusted by the Board of Governors of the Federal Reserve System in such manner as to include such State. Every national bank in any State shall, upon commencing business or within ninety days after admission into the Union of the State in which it is located, become a member bank of the Federal Reserve System by subscribing and paying for stock in the Federal Reserve bank of its district in accordance with the provisions of this Act and shall thereupon be an insured bank under the Federal Deposit Insurance Act, and failure to do so shall subject such bank to the penalty provided by the sixth paragraph of this section."

[§ 501] (1) Since not more than twelve Federal Reserve districts may be created, the provision of the above paragraph regarding creation of new districts by the Board is obsolete and should be

[Sec. 3] omitted. The present districts and Federal Reserve cities should be continued in effect.

[§ 501] (2) The specific reference to the admission of Alaska and Hawaii to the Union is now obsolete and should be replaced by a general provision requiring readjustment of districts when any new State is admitted to the Union.

3. MEMBERSHIP OF NATIONAL BANKS

The third, fifth, and sixth paragraphs of section 2 of the Act (12 U.S.C. 282, 501a), numbered for reference purposes, read as follows:

[3] "Under regulations to be prescribed by the organization committee, every national banking association in the United States is hereby required, and every eligible bank in the United States and every trust company within the District of Columbia, is hereby authorized to signify in writing, within sixty days after the passage of this Act, its acceptance of the terms and provisions hereof. When the organization committee shall have designated the cities in which Federal reserve banks are to be organized, and fixed the geographical limits of the Federal reserve districts, every national banking association within that district shall be required within thirty days after notice from the organization committee, to subscribe to the capital stock of such Federal reserve bank in a sum equal to six per centum of the paid-up capital stock and surplus of such bank, one-sixth of the subscription to be payable on call of the organization committee or of the Board of Governors of the Federal Reserve System, one-sixth within three months and one-sixth within six months thereafter, and the remainder of the subscription, or any part thereof, shall be subject to call when deemed necessary by the Board of Governors of the Federal Reserve System, said payments to be in gold or gold certificates.

* * * * *

[5] "Any national bank failing to signify its acceptance of the terms of this Act within the sixty days aforesaid, shall cease to act as a reserve agent, upon thirty days' notice, to be given within the discretion of the said organization committee or of the Board of Governors of the Federal Reserve System.

[6] "Should any national banking association in the United States now organized fail within one year after the passage of this Act to become a member bank or fail to comply with any of the provisions of this Act applicable thereto, all of the rights, privileges, and franchises of such association granted to it under the national-bank Act,

> or under the provisions of this Act, shall be thereby forfeited. Any noncompliance with or violation of this Act shall, however, be determined and adjudged by any court of the United States of competent jurisdiction in a suit brought for that purpose in the district or territory in which such bank is located, under direction of the Board of Governors of the Federal Reserve System, by the Comptroller of the Currency in his own name before the association shall be declared dissolved. In cases of such noncompliance or violation, other than the failure to become a member bank under the provisions of this Act, every director who participated in or assented to the same shall be held liable in his personal or individual capacity for all damages which said bank, its shareholders, or any other person shall have sustained in consequence of such violation."

[§ 701] (1) The provisions of the third paragraph of section 2, requiring every national bank in the United States to signify "within sixty days after the passage of this Act" its acceptance of the Act, obviously relate only to national banks in existence at the time of the original Act. The same is true as to the fifth paragraph of the section, regarding the effect of failure of a national bank to accept the terms of the Act within such sixty days. The first paragraph of section 2 was amended at the time of enactment of the 1958 Alaskan Statehood Act in order to make it clear that national banks organized since the original Federal Reserve Act must become members of the System. Consequently, the third and fifth paragraphs of section 2 should now be eliminated as obsolete.

[§ 702] (2) The sixth paragraph, regarding penalties for failure of a national bank to become a member of the System and to comply with the provisions of the Act, should be revised to make it clear

that it applies to all national banks and not merely to national banks existing at the date of the original Federal Reserve Act. As so revised, it should incorporate the substance of the sentence in the first paragraph of section 2 (quoted under Recommendation No. 2) regarding membership of national banks in new States admitted to the Union.

4. ORIGINAL ORGANIZATION OF RESERVE BANKS

A. Reserve Bank Organization Committee

[§ 502] The first paragraph of section 2 of the Act (12 U.S.C. 222, 223), quoted under Recommendation No. 2, provides that the Reserve Bank Organization Committee (consisting of the Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency) shall designate not less than eight nor more than twelve Federal Reserve cities and shall divide the continental United States (excluding Alaska) into Federal Reserve districts. In connection with the performance of these functions, the second paragraph of section 2 authorizes the Organization Committee to employ counsel, take testimony, and make investigations, and also to supervise the organization of the Reserve Banks. Other references to the Organization Committee appear in the third, fifth, eighth, tenth, and thirteenth paragraphs of section 2 (12 U.S.C. 282), and in the first, second, twelfth, and twenty-third paragraphs of section 4 (12 U.S.C. 302).

The functions of the Reserve Bank Organization Committee were fully discharged shortly after enactment of the Federal Reserve Act, and all references in the law to that Committee are therefore obsolete and should be eliminated.

B. Organizational provisions

[§ 502] (1) The first three paragraphs of section 4 of the Act (not in U. S. Code) relate to the original organization of the

Reserve Banks, including certification by the Comptroller of the Currency as to the geographical limits of Federal Reserve districts and designations of Federal Reserve cities, the execution of an organization certificate by each Reserve Bank, and the filing of the organization certificate in the Office of the Comptroller of the Currency. The provisions of these paragraphs have been executed and, since no new Reserve Banks may be created, these paragraphs are obsolete and should be eliminated.

[§ 502] (2) Elimination of the first three paragraphs would require elimination of the first clause of the fourth paragraph of section 4 (12 U.S.C. 341), which refers to the filing of the organization certificate of each Reserve Bank with the Comptroller of the Currency.

(3) The fifth paragraph of section 4 (12 U.S.C. 341), providing that no Reserve Bank shall transact business except that incidental to its organization until it has been authorized to commence business by the Comptroller of the Currency, is likewise obsolete.

(4) The second and third sentences of the twelfth paragraph of section 4 (12 U.S.C. 302), referring to the original organization of the Reserve Banks and the exercise by the Organization Committee of the duties of the office of chairman pending organization of each Reserve Bank, should also be omitted as obsolete.

[§ 504(f)] (5) The first sentence of the twentieth paragraph of section 4 (12 U.S.C. 305), regarding appointment of class C directors by the Board of Governors, should be omitted since it is a duplication of a similar provision in the first sentence of the twelfth paragraph.

(6) The twenty-third paragraph of section 4, relating to meetings of directors pending the organization of a Reserve Bank, should be omitted as obsolete.

[§ 504(b)] (7) The first sentence of the twenty-fourth paragraph of section 4 (12 U.S.C. 308), relating to the staggered terms of original directors of the Reserve Banks, is no longer of any significance and should be eliminated. However, the concept of staggered terms should be retained by incorporating in the ninth paragraph a clause indicating that the term of one director of each class shall expire at the end of each calendar year.

(8) The second sentence of the twenty-fourth paragraph of section 4 (12 U.S.C. 308), regarding the terms of office of directors, is a duplication of a provision contained in the ninth paragraph and therefore should be omitted.

[§ 504(c)] (9) The third and last sentence of the twenty-fourth paragraph of section 4 (12 U.S.C. 308), regarding the filling of vacancies in the several classes of directors, should be transferred to the ninth paragraph (12 U.S.C. 302), which relates to the composition of the board of directors.

C. Title of Federal Reserve Bank

That part of the last sentence of the second paragraph of section 2 (12 U.S.C. 225) which provides that each Reserve Bank shall include in its title the name of the city in which it is situated is no longer necessary and should be omitted.

D. Effect on status of reserve cities

The second sentence of the thirteenth paragraph of section 2 (12 U.S.C. 224) provides that the organization of reserve districts and Federal Reserve cities shall not be construed as changing "the present status of reserve cities". This provision obviously related to the status of reserve cities at the time of enactment of the original Act and has no significance at the present time. It should therefore be eliminated.

5. STOCK OF RESERVE BANKS

A. Minimum capital

[§ 503] The first sentence of the thirteenth paragraph of section 2 (12 U.S.C. 281) provides that no Reserve Bank shall commence business with a subscribed capital less than $4 million. This was a condition precedent to commencing business and was fully complied with by the Reserve Banks when they were organized. Consequently, there is no need to retain this provision in the law. The Attorney General has specifically held that the provision does not require the specified minimum capital to be preserved when member banks reduce their capital stock or surplus or cease to be members. (30 Op. Atty. Gen. 517 (1916)

B. Stock offered to public and U. S.

[§ 503] The eighth paragraph of section 2 provides that, if subscriptions by banks to Federal Reserve Bank stock are not sufficient, in the judgment of the Organization Committee, to provide the required amount of capital, then Reserve Bank stock may be offered to the public, with a limitation, contained in the ninth paragraph, that no individual, copartnership, or corporation other than a member bank should be permitted to hold more than $25,000 par value of such stock.

The tenth paragraph of section 2 provides that, if stock subscriptions by banks and the public are not sufficient,

in the judgment of the Organization Committee, to provide the required amount of Reserve Bank capital, the Committee shall allot such amount of said stock as it might determine to the United States.

The eleventh and twelfth paragraphs of section 2 (12 U.S.C. 285, 286), relating to voting rights and transfer of stock, refer only to stock held by the public and by the United States. Section 5 of the Act (12 U.S.C. 287) specifically provides that stock owned by member banks "shall not be transferred or hypothecated."

Since the required capital of the Federal Reserve Banks was fully subscribed by banks, it never became necessary to offer stock to the public or to allot stock to the United States. Consequently, the provisions above described are now obsolete and should be omitted.

C. Liability of shareholders

[§ 503] The fourth paragraph of section 2 (12 U.S.C. 502) reads as follows:

> "The shareholders of every Federal reserve bank shall be held individually responsible, equally and ratably, and not one for another, for all contracts, debts, and engagements of such bank to the extent of the amount of their subscriptions to such stock at the par value thereof in addition to the amount subscribed, whether such subscriptions have been paid up in whole or in part, under the provisions of this Act."

A provision regarding "double liability" of shareholders was a common feature of commercial bank stock at the

time of enactment of the original Federal Reserve Act. Section 23 of the Act imposed such liability on shareholders of national banks. However, that section was repealed by Act of September 8, 1959 (73 Stat. 457); and the double liability feature has been eliminated with respect to the stock of most State banks.

As a practical matter, Reserve Bank stock is subject to double liability quite apart from the provision of law above quoted, since member banks have never been required to pay more than one-half of the price of the Reserve Bank stock to which they must subscribe under the law, the remaining one-half being payable on call of the Board if needed.

Elimination of the double liability provision with respect to Reserve Bank stock literally would be a substantive change in the law. However, it seems clear that it would be a change of an inconsequential nature and without any significant effect. Elimination of this provision was recommended by the Board in 1956 in connection with the then-proposed "Financial Institutions Act".

D. Subscriptions to stock

The first seven sentences of section 5 of the Act (12 U.S.C. 287) read as follows:

> "The capital stock of each Federal reserve bank shall be divided into shares of $100 each. The outstanding capital stock shall be increased from time to time as member banks increase their capital stock and surplus or as additional banks become members, and may be decreased as member banks reduce their capital stock or surplus or cease to be members.

> Shares of the capital stock of Federal reserve banks owned by member banks shall not be transferred or hypothecated. When a member bank increases its capital stock or surplus, it shall thereupon subscribe for an additional amount of capital stock of the Federal reserve bank of its district equal to six per centum of the said increase, one-half of said subscription to be paid in the manner hereinbefore provided for original subscription, and one-half subject to call of the Board of Governors of the Federal Reserve System. A bank applying for stock in a Federal reserve bank at any time after the organization thereof must subscribe for an amount of the capital stock of the Federal reserve bank equal to six per centum of the paid-up capital stock and surplus of said applicant bank, paying therefor its par value plus one-half of one per centum a month from the period of the last dividend. When a member bank reduces its capital stock or surplus it shall surrender a proportionate amount of its holdings in the capital stock of said Federal Reserve bank. Any member bank which holds capital stock of a Federal Reserve bank in excess of the amount required on the basis of 6 per centum of its paid-up capital stock and surplus shall surrender such excess stock. . . ."

The fifth paragraph of section 9 of the Act (12 U.S.C. 323) reads as follows:

> "Whenever the Board of Governors of the Federal Reserve System shall permit the applying bank to become a stockholder in the Federal reserve bank of the district its stock subscription shall be payable on call of the Board of Governors of the Federal Reserve System, and stock issued to it shall be held subject to the provisions of this Act."

Section 5 of the Act provides that a bank applying for stock in a Reserve Bank "at any time after the organization thereof" (presumably referring to the organization of the Reserve Bank) shall subscribe to such stock in an amount equal to 6 per cent of the applicant bank's paid-up capital stock and surplus, "paying therefor its par value plus one-half of one per centum a month from the period of the last dividend." This provision seems to

imply that the member bank must pay the full amount of the stock subscribed for. However, other provisions of the Act contemplate that such stock need be only partly paid for at the time of subscription.

The third paragraph of section 2 (12 U.S.C. 282) provides that a national bank shall subscribe to Reserve Bank stock in an amount equal to 6 per cent of the capital stock and surplus of the national bank, with one-sixth to be paid on call of the Board, one-sixth within three months, and one-sixth within six months thereafter, with the remainder of the subscription subject to call by the Board.

The fourth sentence of section 5 of the Act provides that, when a member bank increases its capital stock or surplus, it shall subscribe for an additional amount of Reserve Bank stock equal to 6 per cent of the increase, with one-half paid at the time and the other half subject to call by the Board of Governors.

The fifth paragraph of section 9 of the Act provides that a State member bank's subscription to Reserve Bank stock "shall be payable on call of the Board of Governors", thus suggesting that the Board may require cash payment of only part, in fact even less than half, of the amount subscribed.

Despite these inconsistent provisions, the Board's Regulations H and I, relating to membership in the System and to the issue and cancellation of Reserve Bank stock, have

always provided that a bank becoming a member of the System, both State and national, shall pay to the Reserve Bank one-half of the amount of the subscription, with the remaining half subject to call when deemed necessary by the Board. Thus, the regulations have in effect followed the manner of subscription described in the fourth sentence of section 5 of the Act relating to subscriptions to additional Reserve Bank stock upon the increase of the capital stock or surplus of a member bank.

The law should be amended to include a single provision regarding subscriptions to Reserve Bank stock that would be in
[§ 503(b)] accordance with the practice, followed for many years, as set forth in the Board's regulations. At the same time, all other provisions of the Act relating to this subject should be omitted.

E. Effect of reduction of member banks' capital stock or surplus

The second sentence of section 5 of the Act provides that the stock of a Reserve Bank shall be increased as member banks increase their capital stock and surplus or as additional banks become members and that such stock "may" be decreased as member banks reduce their capital stock or surplus or cease to be members. Subsequently, in the same section, however, it is provided that when a member bank reduces its capital stock or surplus, it "shall" surrender a proportionate amount of its hold-
[§ 503(c)] ings of Reserve Bank stock. This inconsistency should be corrected so as to make it clear that a member bank must reduce its holdings of Reserve Bank stock when it reduces its own capital stock or surplus.

F. Cancellation of stock

The provisions of sections 5 and 6 of the Act, as well as section 9, regarding the procedure to be followed upon the cancellation of Reserve Bank stock are inconsistent in a number of respects.

With respect to cancellation of Reserve Bank stock upon the voluntary liquidation of any member bank, the last two sentences of section 5 (12 U.S.C. 287) provide as follows:

> "When a member bank voluntarily liquidates it shall surrender all of its holdings of the capital stock of said Federal Reserve bank and be released from its stock subscription not previously called. In any such case the shares surrendered shall be canceled and the member bank shall receive in payment therefor, under regulations to be prescribed by the Board of Governors of the Federal Reserve System, a sum equal to its cash-paid subscriptions on the shares surrendered and one-half of 1 per centum a month from the period of the last dividend, not to exceed the book value thereof, less any liability of such member bank to the Federal Reserve bank."

With respect to cancellation of Reserve Bank stock in the event of insolvency of any member bank, the first paragraph of section 6 (12 U.S.C. 288) provides:

> "If any member bank shall be declared insolvent and a receiver appointed therefor, the stock held by it in said Federal reserve bank shall be canceled, without impairment of its liability, and all cash-paid subscriptions on said stock, with one-half of 1 per centum per month from the period of last dividend, if earned, not to exceed the book value, thereof, shall be first applied to all debts of the insolvent member bank to the Federal reserve bank, and the balance, if any, shall be paid to the receiver of the insolvent bank."

With respect to the effect of discontinuance of banking operations by a national bank, the second paragraph of section 6 (12 U.S.C. 288) provides:

> "If any national bank which has not gone into liquidation as provided in section 5220 of the Revised Statutes (United States Code, title 12, section 181) and for which a receiver has not already been appointed for other lawful cause, shall discontinue its banking operations for a period of sixty days the Comptroller of the Currency may, if he deems it advisable, appoint a receiver for such bank. The stock held by the said national bank in the Federal reserve bank of its district shall thereupon be canceled and said national bank shall receive in payment therefor, under regulations to be prescribed by the Board of Governors of the Federal Reserve System, a sum equal to its cash-paid subscriptions on the shares canceled and one-half of 1 per centum a month from the period of the last dividend, if earned, not to exceed the book value thereof, less any liability of such national bank to the Federal reserve bank."

With respect to the effect of termination of membership of a State member bank, whether by order of the Board or voluntarily, the last sentence of the tenth paragraph of section 9 (12 U.S.C. 328) provides:

> "Whenever a member bank shall surrender its stock holdings in a Federal reserve bank, or shall be ordered to do so by the Board of Governors of the Federal Reserve System, under authority of law, all of its rights and privileges as a member bank shall thereupon cease and determine, and after due provision has been made for any indebtedness due or to become due to the Federal reserve bank it shall be entitled to a refund of its cash paid subscription with interest at the rate of one-half of one per centum per month from date of last dividend, if earned, the amount refunded in no event to exceed the book value of the stock at that time, and shall likewise be entitled to repayment of deposits and of any other balance due from the Federal reserve bank."

Obviously, there are several inconsistencies among these provisions regarding cancellation of stock. For example, in the case of insolvency of a member bank, discontinuance of banking operations by a national bank, and termination of membership of a State member bank, the relevant provisions refer to payment of interest from the date of the last dividend, "if earned". However, in the case of voluntary liquidation of a member bank, the words "if earned" are not used. In the case of voluntary liquidation, deduction is required to be made for "any liability of such member bank to the Federal Reserve bank"; in the case of insolvency of a member bank, the amount of cash-paid subscriptions to stock is required to be "first applied to all debts of the insolvent member bank to the Federal reserve bank"; in the case of a national bank discontinuing operations, deduction must be made for "any liability of such national bank to the Federal reserve bank"; and, in the case of termination of membership of a State member bank, it is provided that payment to such bank shall be made "after due provision has been made for any indebtedness due or to become due to the Federal reserve bank" and, in addition, that the member bank shall "be entitled to repayment of deposits and of any other balance due from the Federal reserve bank." Only in the last-mentioned instance, termination of membership, is there any provision in the law for repayment to the member bank of its deposits with the Reserve Bank.

Despite these discrepancies in provisions of the law regarding cancellation of Reserve Bank stock, the Board's Regulation I, "Issue and Cancellation of Capital Stock of Federal Reserve Banks", provides that, in all cases in which a bank ceases to be a member of the System, -

> ". . . the Federal Reserve Bank . . . will adjust accounts by applying to any indebtedness of the . . . bank to such Federal Reserve Bank all cash paid subscriptions made on the stock canceled plus one-half of one per cent a month from the period of the last dividend, not to exceed the book value thereof, and the remainder, if any, will be paid to the . . . [member] bank." (Reg. I, sec. 209.5(b))

It is recommended that a provision be included in the law that would generally follow the provision above quoted from [§ 503(d)] Regulation I, to be applicable in all cases of cessation of membership, and that all other provisions of the Act regarding the procedure to be followed upon cancellation of Reserve Bank stock be repealed.

G. Appointment of national bank receiver by Comptroller of the Currency

The first sentence of the second paragraph of section 6 (12 U.S.C. 288) provides that, if a national bank that has not gone into liquidation and for which a receiver has not been appointed for other cause shall discontinue its banking operations [Sec. 5] for a period of 60 days, the Comptroller of the Currency may appoint a receiver for such bank. This provision seems out of place in a section of the Federal Reserve Act relating primarily

to cancellation of Reserve Bank stock. It more appropriately belongs in section 191 of Title 12 of the U. S. Code relating to the general grounds for the appointment of receivers for national banks.

It is recommended, therefore, that the first sentence of the second paragraph of section 6 of the Federal Reserve Act be omitted and that section 191 of Title 12 of the U. S. Code be amended to make discontinuance of banking operations for a period of 60 days an additional ground for the appointment by the Comptroller of a receiver for a national bank.

6. FORFEITURE OF FRANCHISE OF RESERVE BANK

Subparagraph "Second" of the fourth paragraph of section 4 of the Act (12 U.S.C. 341) provides that each Reserve Bank shall have power "To have succession after the approval of this Act until dissolved by Act of Congress or until forfeiture of franchise for violation of law."

Insofar as this language appears to provide for succession after approval of the Federal Reserve Act, it is obviously incorrect since, under the original provisions of the Act, each Reserve Bank was not organized and did not become a corporate entity until several months after approval of the Act. Actually, the original Act provided only that each Reserve Bank should have succession for a period of 20 years from its organization. The present language resulted from an amendment made by Act of February 25, 1927. Apparently, therefore, the words "after the approval of this Act" refer to the 1927 amendment. [§ 502(b)] In any event, these words no longer appear necessary and should be omitted.

The reference to possible forfeiture of franchise for violation of law might be regarded as unrealistic and unnecessary. Actually, there is no provision in the Act expressly providing for the forfeiture of the franchise of a Reserve Bank for violation of law. Section 11(h) (12 U.S.C. 248(h)) authorizes the Board of Governors to suspend the operations of a Reserve Bank for violation of any provisions of the Act or "when deemed advisable, to liquidate or reorganize such bank."

7. REFERENCE TO EXECUTIVE OFFICERS OF FEDERAL RESERVE BANKS

The first sentence of subparagraph "Fifth" of the fourth paragraph of section 4 of the Act (12 U.S.C. 341) authorizes the board of directors of a Reserve Bank to appoint a president, vice presidents, and "such officers and employees" as are not otherwise provided for in the Act. The succeeding sentence states that the president shall be the chief executive officer of the Bank and that "all other executive officers" and all employees shall be directly responsible to him.

The use of the word "executive" in the last-mentioned provision could give the misleading impression that only the top officers, and not all officers, are responsible to the president of the Bank. It would be desirable to eliminate the modifying word "executive" in this provision.

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8. FEDERAL RESERVE BANK NOTES

Subparagraph "Eighth" of the fourth paragraph of section 4 (12 U.S.C. 341), relating to the issuance of circulating notes by the Reserve Banks, is obsolete and should be omitted. (See Recommendation No. 63, regarding omission of section 18 of the Act.)

9. DIRECTORS OF RESERVE BANKS

*A. Rotation of terms

The ninth paragraph of section 4 of the Federal Reserve Act (12 U.S.C. 302) provides that directors of the Federal Reserve Banks shall serve as such for terms of three years. There is no prohibition against the number of terms that a director may serve.

In connection with the appointment of class C directors, the Board of Governors, as a matter of policy, does not reappoint any such director who has served two full terms of three years, except that, if a director who has served more than three years as a class A, B, or C director is then designated by the Board of Governors as chairman of the board of directors, he is permitted to serve not to exceed one full three-year term as chairman for a total of not to exceed three full terms as a director.

Some degree of rotation in the terms of class A and class B directors, as well as those of class C directors, would be desirable in order to obtain the advantages of broader representation and wider experience over a period of time on the boards of directors of the Reserve Banks. At the same time, the length of service permitted for directors should be adequate to assure for the System and the public interest the benefits of suitable continuity of policy and acquired experience.

To accomplish these objectives, the law should be amended [§ 504(b)] so as to prohibit any director from serving more than two full

consecutive terms of three years each, except after an intervening period of not less than three years, and except that a director designated as chairman of the board of directors should be permitted to serve three full consecutive three-year terms without such an intervening period. Such changes in law were recommended by the Board in 1956 in connection with the then proposed "Financial Institutions Act".

B. Election

The seventeenth paragraph of section 4 of the Act (12 U.S.C. 304), relating to elections of class A and class B directors of the Reserve Banks, requires that an officer of a [§ 504(i)(2)] member bank "shall make a cross" opposite the name of first, second, and other choices. Instead of this arbitrary requirement, provision should be made for designation of such choices by a cross "or other mark".

*C. Residence

The twentieth paragraph of section 4 of the Act (12 U.S.C. 305) provides that class C directors "shall have been for at least two years residents of the district for which they are appointed". It is not clear whether this means that a class C director must have been a resident of the district for at least two years immediately preceding his appointment as a director. The provision may be, and has been, construed as permitting the appointment of a class C director who was not a resident of the district for the two years immediately preceding

his appointment but who had resided at some time in the past for at least two years within the district.

The law contains no requirement with respect to residence of class A and class B directors. Class A directors are required to be "chosen by and be representative of the stock-holding banks" and class B directors are required at the time of their election to be actively engaged "in their district" in commerce, agriculture, or some other industrial pursuit. Consequently, it appears to be contemplated that both class A and class B directors shall be residents of the district of the Reserve Bank for which they are elected, not only at the time of their appointment but also throughout their terms of office. Strictly speaking, however, there is nothing in the law that requires class A and class B directors to be residents of the district when they are elected or to continue as residents during their terms of office.

It is questionable whether there is any sound reason for requiring class C directors to have been residents of the district for two years prior to their appointment, and it is recommended that this requirement be eliminated. On the other [§ 504(h)] hand, the law should provide that all Reserve Bank directors shall be residents of the district at the time of their appointment or election and that they shall cease to be directors if they cease to be residents of the district.

10. FEDERAL RESERVE AGENTS AND ASSISTANT AGENTS

A. As "official representative" of the Board

The twentieth paragraph of section 4 of the Act (12 U.S.C. 305) provides that the chairman of the board of directors of a Reserve Bank shall also be designated as Federal Reserve agent and that he "shall be required to maintain, under regulations to be established by the Board of Governors of the Federal Reserve System, a local office of said board on the premises of the Federal reserve bank". It further provides that the agent "shall make regular reports to the Board of Governors of the Federal Reserve System and shall act as its official representative for the performance of the functions conferred upon it by this Act".

The Banking Act of 1935 amended the fourth paragraph of section 4 of the Federal Reserve Act (12 U.S.C. 341) to provide that the president of each Reserve Bank "shall be the chief executive officer of the bank". In the light of this change in the law, the Board of Governors in March 1936 transferred the nonstatutory duties previously performed by the Federal Reserve agent to the president of the Reserve Bank. The Board pointed out that this would mean that the technical duties of the office of the Federal Reserve agent could then "be performed by an Assistant Federal Reserve agent, making it possible for the chairman to discharge the important responsibilities of his

office without being required to devote more than a limited portion of his time to the bank." (1936 F.R. Bulletin, p. 145)

Since 1936, the Federal Reserve agent has not acted as the "official representative" of the Board of Governors in the performance of the Board's functions under the law. In actuality, the agent acts as the representative of the Board only in connection with the issuance of Federal Reserve notes under section 16 of the Act. The agent has no other specific statutory functions under the law.[1/]

[§ 505(a)] In order to bring the law into conformity with practice, the twentieth paragraph of section 4 of the Federal Reserve Act should be changed to provide simply that the Federal Reserve agent "shall act as the official representative of the Board of Governors in the performance of the functions conferred upon such agent by statute and shall make regular reports to the Board of Governors with respect to the performance of such functions".

1/ Under section 30 of the Banking Act of 1933, with respect to proceedings for the removal of directors and officers of member banks, the Federal Reserve agent is specifically required to issue a "warning" to any State member bank to discontinue any violations of law or unsafe or unsound practices. However, that section was repealed by the Financial Institutions Supervisory Act of October 16, 1966, for a period terminating on June 30, 1972. If that Act should be allowed to terminate on that date, section 30 of the Banking Act of 1933 would again become effective.

In addition, the requirement that the chairman of the board of directors of a Reserve Bank, acting also as Federal Reserve agent, must maintain a local office of the Board of Governors on the premises of the Reserve Bank is unnecessary and should be omitted.

B. Qualifications

The twentieth paragraph of section 4 of the Act (12 U.S.C. 305) requires that the class C director designated by the Board of Governors as chairman of the board of directors of a Reserve Bank and as Federal Reserve agent "shall be a person of tested banking experience". The twenty-first paragraph (12 U.S.C. 306) similarly requires that assistant Federal Reserve agents "shall be persons of tested banking experience".

The duties of the Federal Reserve agent under present law relate primarily to the issuance and retirement of Federal Reserve notes and the holding and releasing of collateral therefor. Such duties are largely of an administrative character and are not such as to require "tested banking experience". The requirement for such experience adds to the difficulty of finding qualified men to serve as chairmen of the boards of directors of the Reserve Banks.

Accordingly, it is believed that this requirement [§ 505(a)] should be eliminated from the law, leaving to the discretion of the Board of Governors the determination whether a person

to be appointed as Federal Reserve agent or assistant Federal Reserve agent is properly qualified for the position.

C. Compensation

The twentieth paragraph of section 4 of the Act (12 U.S.C. 305) provides that the Federal Reserve agent "shall receive an annual compensation to be fixed by the Board of Governors of the Federal Reserve System and paid monthly by the Federal reserve bank to which he is designated." For many years, the duties of the Federal Reserve agent, who is also chairman of the board of directors of the Reserve Bank, have not required the full time of such person, and, as a matter of practice, the Board of Governors has fixed the compensation of the Federal Reserve agent simply as the equivalent of fees paid to other Reserve Bank directors in connection with their attendance at meetings of the board of directors. Consequently, the provision for the fixing of the annual compensation of the Federal Reserve agent is no longer significant and should be omitted.

Similarly, the twenty-first paragraph of section 4 of the Act (12 U.S.C. 306) provides that assistants to the Federal Reserve agent "shall receive an annual compensation, to be fixed and paid in the same manner as that of the Federal reserve agent." The status of assistant Federal Reserve agents is somewhat different from that of the Federal Reserve agent since the assistants actually are employed on a full-time basis by the Reserve Bank

to which they are attached. Consequently, provision for compensation of the assistants is appropriate. However, if the provision

[§ 505(c)] for compensation of the Federal Reserve agents is eliminated as above recommended, the provision with respect to compensation of assistant agents should be changed to require such compensation to be fixed by the Board of Governors and paid monthly by the Reserve Bank to which the assistants are attached.

D. Service of assistant during vacancy

The twenty-first paragraph of section 4 of the Act (12 U.S.C. 306) provides that assistant Federal Reserve agents

[§ 505(b)] shall have power to act for the Federal Reserve agent "during his absence or disability". It should be made clear that an assistant Federal Reserve agent is also authorized to act as Federal Reserve agent in the event of a vacancy in that office.

E. Delegation of functions

The Federal Reserve agent is also chairman of the board of directors of the Reserve Bank and, in the latter capacity, must devote most of his attention to important matters of policy. His duties as Federal Reserve agent are largely of a ministerial nature and, as a matter of practice, many of such functions are delegated to his assistants. However, it would

[§ 505(b)] be desirable to make it clear in the law that such ministerial functions of the agent may be delegated to the assistant Federal Reserve agent.

11. "AGENCIES" OF FEDERAL RESERVE BANKS

Section 3 of the Act (12 U.S.C. 521) expressly authorizes the establishment of branches by the Reserve Banks, with the permission of the Board and subject to certain requirements regarding the number of directors of each branch.

On several occasions in the past, it has been found desirable for some Reserve Banks to establish currency depots or other offices for strictly limited functions. Such offices have not been regarded as "branches" subject to the provisions of section 3; the authority for establishment of such offices has been based on the implied powers of the Reserve Banks.

It may become desirable in the future for the Reserve Banks to establish offices solely for the purpose of providing regional check-clearing arrangements; and it is believed that such offices likewise would be permissible under the implied powers of the Reserve Banks. However, in order to avoid any [§ 509(d)] question, section 3 should include a provision specifically authorizing the establishment of limited-function offices without regard to the requirements applicable to branches.

12. RESERVE BANK EARNINGS

The first two paragraphs of section 7 of the Federal Reserve Act (12 U.S.C. 289, 290) read as follows:

> "After all necessary expenses of a Federal reserve bank shall have been paid or provided for, the stockholders shall be entitled to receive an annual dividend of 6 per centum on the paid-in capital stock, which dividend shall be cumulative. After the aforesaid dividend claims have been fully met, the net earnings shall be paid into the surplus fund of the Federal reserve bank.
>
> "The net earnings derived by the United States from Federal reserve banks shall, in the discretion of the Secretary, be used to supplement the gold reserve held against outstanding United States notes, or shall be applied to the reduction of the outstanding bonded indebtedness of the United States under regulations to be prescribed by the Secretary of the Treasury. Should a Federal reserve bank be dissolved or go into liquidation, any surplus remaining, after the payment of all debts, dividend requirements as hereinbefore provided, and the par value of the stock, shall be paid to and become the property of the United States and shall be similarly applied."

*A. Payment to Treasury

Prior to 1933, section 7 of the Act imposed a franchise tax on the Reserve Banks which in effect required them to pay to the United States annually an amount equal to 90 per cent of their net earnings after accumulation of surplus equal to subscribed capital. This provision was repealed by the Banking Act of 1933, when the Reserve Banks were required to subscribe to the capital stock of the Federal Deposit Insurance Corporation and the surplus of the Reserve Banks was thereby reduced to considerably less than half of their subscribed capital.

In 1947, when the accumulated earnings of the Reserve Banks had reached a high figure, the Board considered it appropriate to accomplish much the same result as a franchise tax by invoking a provision of section 16 of the Act (12 U.S.C. 414) that authorizes the Board to establish rates of interest to be paid by the Reserve Banks on outstanding Federal Reserve notes not covered by gold certificate collateral. The Board established a rate that resulted in the annual transfer to the Treasury of approximately 90 per cent of the earnings of the Reserve Banks after dividends and expenses and maintenance of the surplus of each Reserve Bank at 100 per cent of its subscribed capital. The formula has twice been modified by the Board and at present the rate established by the Board results in payment to the Treasury of all earnings of the Reserve Banks after dividends and expenses and maintenance of surplus at an amount equal to paid-in capital.

Although the utilization of the section 16 provision as authority for requiring the Reserve Banks to pay their net earnings to the Treasury in this manner is believed to be clearly authorized by the law, the procedure followed is at least awkward and extremely complicated and cumbersome.

When the "Financial Institutions Act" was under consideration in 1956, the Board recommended that section 7 of the Federal Reserve Act be amended either (1) to provide expressly for restoration of a 90 per cent franchise tax or (2) to authorize

the Board to require the Reserve Banks to transfer annually to the United States such portion of their earnings as the Board may deem appropriate in the circumstances.

It is believed that it would be desirable to amend the law along the lines of the second alternative proposed by the [§ 510(a)] Board in 1956, i.e., to authorize the Board in its discretion to require the Reserve Banks to make annual payments to the Treasury of such portion of their net earnings as the Board deems appropriate.

If such a change in the law should be adopted, the provision of section 16 of the Act regarding interest payments on Federal Reserve notes would no longer serve any useful purpose and should be omitted from the statute. (See Recommendation No. 60-E.)

B. Use by Treasury of funds received from Reserve Banks

The first sentence of the second paragraph of section 7 of the Act (12 U.S.C. 290) provides:

> "The net earnings derived by the United States from Federal reserve banks shall, in the discretion of the Secretary, be used to supplement the gold reserve held against outstanding United States notes, or shall be applied to the reduction of the outstanding bonded indebtedness of the United States under regulations to be prescribed by the Secretary of the Treasury."

In the original Act, this sentence immediately followed a provision that in effect required payment of a portion of the net earnings of the Reserve Banks to the Treasury as a franchise

tax. Presumably, the sentence above quoted regarding the use of net earnings derived by the United States from the Reserve Banks had reference to the earnings received by virtue of such franchise tax. However, the franchise tax provision was repealed in 1933, and there is now no provision of law expressly providing for payment of net earnings of the Reserve Banks to the United States. Since no Reserve Bank stock was ever allotted to the United States, no earnings in the form of dividends are received by the United States. So-called payments of "net earnings" paid to the Treasury as interest on Federal Reserve notes actually represent an expense of the Reserve Banks rather than payments of net earnings.

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Even if section 7 of the Act should be amended to provide for restoration of a franchise tax or to authorize the Board to require the Reserve Banks to pay a portion of their net earnings to the United States (as suggested in Recommendation No. 12-A), it is believed that the quoted sentence would be unnecessary. To the extent that the sentence provides for the use by the United States of net earnings derived from the Reserve Banks in order "to supplement the gold reserve held against outstanding United States notes", it no longer has any significance, since the requirement for the maintenance of gold reserves against such notes was repealed by the Act of March 18, 1968.

The remainder of the quoted sentence, regarding application of Reserve Bank earnings received by the United States to the reduction of the outstanding bonded indebtedness of the United States, is likewise unnecessary, since any practical effect that this provision might once have had on the use of funds by the Treasury appears to have been superseded by general statutes governing the administration of the public debt.

For the reasons indicated, it is believed that the first sentence of the second paragraph of section 7 should be deleted from the statute. If this is done, a change would be necessary in the second sentence of that paragraph, since it provides that,

[§ 510(b)] upon dissolution or liquidation of a Reserve Bank, any remaining surplus shall be paid to the United States and "shall be similarly applied."

13. TAXATION OF RESERVE BANKS

*A. Dividends on stock

The third paragraph of section 7 of the Act (12 U.S.C. 531) reads as follows:

> "Federal reserve banks, including the capital stock and surplus therein, and the income derived therefrom shall be exempt from Federal, State, and local taxation, except taxes upon real estate."

The Public Debt Act of March 28, 1942, provided that interest on obligations, and dividends, earnings, or other income from stock, issued on or after the effective date of that Act by any agency or instrumentality of the United States should not have any exemption from taxation, as such. The effect of this Act was to remove the exemption with respect to dividends on Reserve Bank stock issued after March 28, 1942, but to leave the exemption in effect with respect to dividends on such stock issued before that date.

In 1952, the Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report, of which Representative Patman was Chairman, recommended that the exemption of dividends on Reserve Bank stock from Federal taxation be removed entirely. In 1956, in connection with the then-pending "Financial Institutions Act", the Board of Governors likewise recommended that dividends on Reserve Bank stock, whether issued before or after 1942, should not enjoy an exemption from Federal taxation.

As pointed out by the Board in 1956, the present law results in a differentiation between banks admitted to membership after 1942 and those admitted previously. It also results in a differentiation between stock issued before and after that date in the case of banks that became members before 1942. Thus, the present law results in a certain inequity among member banks, depending upon when they became members of the System, and in a confusing and complicating situation with respect to banks that became members before 1942. While the change literally would be
[§ 514] of a substantive nature, it is recommended that the law be amended to provide that dividends on Reserve Bank stock, whether issued before or after 1942, shall not be exempt from Federal taxation.

B. Social security and unemployment compensation taxes

Although the third paragraph of section 7 of the Federal Reserve Act provides that the Reserve Banks shall be exempt from Federal taxation, they are clearly made subject to taxes imposed to finance operations under the Federal Social Security Act (42 U.S.C. chapter 7, subchapter II) and the Federal Unemployment Compensation Act (5 U.S.C. chapter 85). These taxes are imposed by chapters 21 and 23 of the Internal Revenue Code (26 U.S.C.), which are known, respectively, as the Federal Insurance Contributions Act and the Federal Unemployment Tax Act.

In order to clarify the tax status of the Reserve Banks, therefore, the third paragraph of section 7 of the Federal Reserve
[§ 514] Act should specifically indicate that the Reserve Banks are not exempt from taxation under the Acts just mentioned.

14. MEMBERSHIP OF STATE BANKS

The first two sentences and the last sentence of the first paragraph of section 9 of the Federal Reserve Act (12 U.S.C. 321) read as follows:

> "Any bank incorporated by special law of any State, or organized under the general laws of any State or of the United States, including Morris Plan banks and other incorporated banking institutions engaged in similar business, desiring to become a member of the Federal Reserve System, may make application to the Board of Governors of the Federal reserve system, under such rules and regulations as it may prescribe, for the right to subscribe to the stock of the Federal reserve bank organized within the district in which the applying bank is located. Such application shall be for the same amount of stock that the applying bank would be required to subscribe to as a national bank. . . . The Board of Governors of the Federal Reserve System, subject to the provisions of this Act and to such conditions as it may prescribe pursuant thereto may permit the applying bank to become a stockholder of such Federal reserve bank."

A. References to "membership"

The first sentence of the first paragraph of section 9, above quoted, provides in effect that a State bank "desiring to become a member of the Federal Reserve System" may make application for the right to subscribe to the stock of the Reserve Bank of its district, thus implying that such a bank becomes a member of the System by subscribing to the Reserve Bank's stock. However, there is a discrepancy among various provisions of the Act in describing membership in the System. For example, section 1 (12 U.S.C. 221) refers to a State bank becoming "a member of one of the reserve banks"; section 2 (12 U.S.C. 222) refers to

application by a national bank to "become a member bank of the Federal Reserve System by subscribing and paying for" Reserve Bank stock; and section 19(h) (12 U.S.C. 466) refers to banks becoming member banks "of the reserve districts". It would seem
[§ 801(a)] desirable in all cases to refer to "membership in the Federal Reserve System" and specifically, in the first sentence of section 9 above quoted, to refer to applications for membership rather than applications for the right to subscribe to Reserve Bank stock, even though membership is effected by payment for such stock.

The last sentence of the first paragraph of section 9, as above quoted, should be changed in conformity with the above suggestion to refer to approval by the Board of an application for membership, instead of an application to become a stockholder
[§ 801(a)] of the Reserve Bank; but it might be expanded to provide that, upon approval of the application, the bank shall subscribe to and pay for stock of the Reserve Bank in the manner and amount prescribed by section 5 of the Act.

B. Banks covered by section 9

The first sentence of the first paragraph of section 9, as above quoted, refers to any bank "incorporated by special law of any State, or organized under the general laws of any State or of the United States". Few, if any, banks today are incorporated by "special" laws of the States. Moreover, the reference to banks organized under the general laws "of the United States"

appears to have no relevance. National banks in States of the Union are required by section 2 of the Act to become members of the System and are therefore not covered by the provisions of section 9 regarding voluntary membership. Conceivably, the phrase could be regarded as including national banks located in dependencies or insular possessions of the United States. However, such banks are specifically authorized by section 19(h) of the Act either to remain nonmember banks or to become members of the System; and, if any such national bank should apply for membership, it would not be appropriate to make it subject to all of the restrictions that apply to State banks that become members under section 9. For example, that section makes a reduction of capital by a State member bank subject to the Board's approval; but reduction of capital by a national bank is subject to approval by the Comptroller of the Currency and other Federal statutes.

The first sentence of section 9 does not refer to banks organized under the laws of the District of Columbia. However,
[§ 801(a)] the term "State bank", as suggested heretofore under Recommendation 1-C, should be defined as including any bank organized under the laws of the District of Columbia.

For the reasons above stated, it is believed that the first clause of the first sentence of section 9 should be changed
[§ 801(a)] to refer simply to "any incorporated State bank".

C. Amount of stock subscription

[§ 801(a)] The second sentence of the first paragraph of section 9 of the Act, as above quoted, is unnecessary since section 5 of the Act (12 U.S.C. 287) prescribes the amount of stock of a Federal Reserve Bank that must be subscribed to by any member bank, whether national or State. Accordingly, this sentence should be omitted. (See Recommendation No. 5-D.)

15. MEMBERSHIP OF BANKS IN DEPENDENCIES AND INSULAR POSSESSIONS

Section 19(h) of the Act (12 U.S.C. 466) reads as follows:

> "National banks, or banks organized under local laws, located in a dependency or insular possession or any part of the United States outside the continental United States may remain nonmember banks, and shall in that event maintain reserves and comply with all the conditions now provided by law regulating them; or said banks may, with the consent of the Board of Governors of the Federal Reserve System, become member banks of any one of the reserve districts, and shall in that event take stock, maintain reserves, and be subject to all the other provisions of this Act."

A. Arrangement

This paragraph logically should not be in section 19, which relates principally to reserves of member banks and payment [§ 801(b)] of interest on deposits. It belongs with provisions of the Act, now in section 9, relating to voluntary membership in the Federal Reserve System.

B. National banks

If, as a matter of policy, membership of national banks in dependencies and insular possessions should continue to be on a voluntary basis, it should be made clear that any such bank that joins the System will be subject to provisions of the Act that apply to all member banks but not to those that apply specifically to State member banks. As heretofore noted, application to such national banks of the restrictions on State member [§ 801(b)] banks set forth in section 9 would result in duplication of

authority between the Board and the Comptroller of the Currency. This point is not clear under the present language of section 19(h), since it would seem to make any such national bank subject to all of the provisions of the Act.

C. Banks organized under local law

Conversely, it should be made clear that banks organized under local laws of dependencies and insular possessions, if they [§ 801(b)] elect to join the System, will be subject to the same restrictions as those applicable to State member banks, as well as those applicable to all member banks.

D. Determination of Federal Reserve district

The Federal Reserve districts do not embrace dependencies [§ 801(b)] and insular possessions. For this reason, section 19(h) provides that banks in such areas may, with the Board's consent, become "member banks of any one of the reserve districts". It should be made clear that the election rests not with the bank but with the Board of Governors.

E. Outside "continental" United States

Section 19(h) permits national banks located in "any part of the United States outside the continental United States" to remain nonmembers or voluntarily to join the System. Since Hawaii is not a part of the continental United States, this provision is obviously in conflict with the provision of section 2, as amended in 1958 and 1959, that requires every national bank

in any State to be a member of the System. Accordingly, the reference to parts of the United States outside the continental

[§ 801(b)] United States should be eliminated.

F. Inclusion of reference to Puerto Rico

For reasons set forth under Recommendation No. 72-F,

[§ 801(b)] specific reference to Puerto Rico should be inserted before the words "any dependency or insular possession".

16. REFERENCES TO CAPITAL NOTES AND DEBENTURES ELIGIBLE FOR PURCHASE BY RECONSTRUCTION FINANCE CORPORATION

The third sentence of the first paragraph of section 9 of the Act (12 U.S.C. 321) provides that, for purposes of membership of a State bank, "the terms 'capital' and 'capital stock' shall include the amount of outstanding capital notes and debentures legally issued by the applying bank and purchased by the Reconstruction Finance Corporation."

Section 345 of the Banking Act of 1935 (12 U.S.C. 51b-1), relating to impairment of capital of national banks and State member banks, contains the following sentence:

> "If any such bank or trust company shall have outstanding any capital notes or debentures of the type which the Reconstruction Finance Corporation is authorized to purchase pursuant to the provisions of section 304 of the Emergency Banking and Bank Conservation Act, approved March 9, 1933, as amended, the capital of such 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 or debentures and any obligations of the bank expressly subordinated thereto."

The Reconstruction Finance Corporation has been liquidated and few, if any, of the capital notes or debentures purchased by it from banks are now outstanding. Consequently, it is believed that, as recommended by the Board in 1956, in connection with the proposed "Financial Institutions Act", the above provisions should be eliminated from the law as obsolete. Moreover, as pointed out by the Board in 1956, "the reasons for which the purchase of such

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[§ 801(a)]

notes and debentures was authorized in the 1930's and for which they were allowed to be considered as part of a bank's capital have ceased to exist, and consequently the provisions of the statutes quoted above no longer have any real significance."

17. BRANCHES OF STATE MEMBER BANKS

The third paragraph of section 9 of the Act (12 U.S.C. 321) reads as follows:

> "Any such State bank which, at the date of the approval of this Act, has established and is operating a branch or branches in conformity with the State law, may retain and operate the same while remaining or upon becoming a stockholder of such Federal reserve bank; but no such State bank may retain or acquire stock in a Federal reserve bank except upon relinquishment of any branch or branches established after the date of the approval of this Act beyond the limits of the city, town, or village in which the parent bank is situated. Provided, however, That nothing herein contained shall prevent any State member bank from establishing and operating branches in the United States or any dependency or insular possession thereof or in any foreign country, on the same terms and conditions and subject to the same limitations and restrictions as are applicable to the establishment of branches by national banks except that the approval of the Board of Governors of the Federal Reserve System, instead of the Comptroller of the Currency, shall be obtained before any State member bank may hereafter establish any branch and before any State bank hereafter admitted to membership may retain any branch established after February 25, 1927, beyond the limits of the city, town, or village in which the parent bank is situated. The approval of the Board shall likewise be obtained before any State member bank may establish any new branch within the limits of any such city, town, or village (except within the District of Columbia)."

A. Clarification of language

(1) This paragraph, which was added by the so-called "McFadden Act" of 1927 and amended in 1933, 1935, and 1952, is not only complicated and difficult to read but contains certain [§ 804(a)] language that may reasonably be regarded as obsolete. It should be revised to state plainly that a State member bank may not

establish and operate domestic branches, wherever situated, i.e., in-town or out-of-town, except on the same terms and subject to the same limitations as branches may be established by national banks, except that the approval of the Board rather than the Comptroller of the Currency would be required. The present paragraph requires approval of the Board not only for the establishment of branches but also for the retention of any out-of-town branch established after February 25, 1927, in the case of a State bank being admitted to membership. This requirement probably could be omitted without any significant substantive change in present law; but its omission would theoretically give State member banks an advantage over national banks unless a similar change is made in section 5155 of the Revised Statutes (12 U.S.C. 36), which now requires the Comptroller's approval for the retention of branches established after 1927 by a national bank resulting from a conversion or consolidation.

(2) The third paragraph of section 9 refers to the establishment of foreign as well as domestic branches; and the Board's Regulation M expressly states in a footnote that the provisions of that Regulation relating to foreign branches of national banks apply also to State member banks. However, it would be in the interest of clarity to rephrase the third paragraph of section 9 so as to provide expressly that no State member bank may establish a branch in a foreign country or dependency or insular possession of the United States except in accordance with the

[§ 804(a)]

provisions of section 25 of the Federal Reserve Act. (It might be urged that section 25 of the Act should itself be amended to make it applicable to all member banks rather than only national banks. However, this would not be appropriate since section 25 not only provides limitations with respect to the establishment and operation of foreign branches but constitutes the basic authorization for the establishment of such branches by national banks.)

B. Factors to be considered

The fourth paragraph of section 9 of the Act (12 U.S.C. 322) reads as follows:

> "In acting upon such applications the Board of Governors of the Federal Reserve System shall consider the financial condition of the applying bank, the general character of its management, and whether or not the corporate powers exercised are consistent with the purposes of this Act."

This paragraph was added by the Act of June 21, 1917, immediately after the first paragraph of section 9, relating to applications by State banks for membership in the System. In 1927, the present third paragraph of section 9, relating to branches of State member banks, was inserted between the former first and second paragraphs. In 1950, the present second paragraph of section 9, relating to the continued membership of member banks following a marger or consolidation, was inserted immediately after the first paragraph of the section.

Although the present fourth paragraph, setting forth the factors to be considered by the Board in acting "upon such applications", is now usually regarded as referring to branch applications, it is clear that the paragraph was intended to relate only to applications for membership.

The Federal Deposit Insurance Act (12 U.S.C. 1816) requires the Board of Directors of the FDIC, in acting upon applications for insurance, to consider:

> "The financial history and condition of the bank, the adequacy of its capital structure, its future earnings prospects, the general character of its management, the convenience and needs of the community to be served by the bank, and whether or not its corporate powers are consistent with the purposes of this Act."

With respect to consent of the FDIC for the establishment of branches by State nonmember insured banks, the Federal Deposit Insurance Act (12 U.S.C. 1828(d)) provides:

> ". . . The factors to be considered in granting or withholding the consent of the Corporation under this subsection shall be those enumerated in section 1816 of this title."

The provisions of the National Bank Act regarding the establishment of branches by national banks (section 5155 of the Revised Statutes) contain no requirement as to factors to be considered by the Comptroller of the Currency in acting upon applications for such branches.

Considering the fourth paragraph of section 9 of the Federal Reserve Act as relating only to applications for membership, it is believed that it should be changed to parallel the

above-quoted provision of the Federal Deposit Insurance Act
[§ 801(c)] regarding the factors to be considered in connection with applications for deposit insurance. The statement of such factors to be considered in connection with applications for membership should then be placed immediately following the provisions of the first paragraph of section 9 relating to such applications.

With respect to branches of State member banks, it would be desirable to include in the paragraph of section 9 of the Act relating to such branches a sentence stating that, in
[§ 804(b)] considering applications for such branches, the Board of Governors shall consider the same factors as those set forth with respect to applications for membership and, in addition, the effect of the proposed branch upon competition. In this connection, it may be noted that the Board's Rules Regarding Delegation of Authority (12 C.F.R. 265) require a Federal Reserve Bank, in approving branches of State member banks under delegated authority, to consider not only the member bank's capitalization and management but also the convenience and needs of the community to be served and whether or not the establishment of the branch will tend to create an undesirable competitive situation.

18. REPORTS OF STATE MEMBER BANKS

The last four sentences of the sixth paragraph of section 9 of the Act (12 U.S.C. 324), relating to reports of State member banks, read as follows:

> ". . . Such banks and the officers, agents, and employees thereof shall also be subject to the provisions of and to the penalties prescribed by sections 334, 656, and 1005 of Title 18, United States Code, and shall be required to make reports of condition and of the payment of dividends to the Federal Reserve bank of which they become a member. Not less than three of such reports shall be made annually on call of the Federal Reserve bank on dates to be fixed by the Board of Governors of the Federal Reserve System. Failure to make such reports within ten days after the date they are called for shall subject the offending bank to a penalty of $100 a day for each day that it fails to transmit such report; such penalty to be collected by the Federal Reserve bank by suit or otherwise. Such reports of condition shall be in such form and shall contain such information as the Board of Governors of the Federal Reserve System may require and shall be published by the reporting banks in such manner and in accordance with such regulations as the said Board may prescribe."

A. Number and dates of condition reports

Section 7(a)(3) of the Federal Deposit Insurance Act, as amended by Act of July 14, 1960 (12 U.S.C. 1817), provides, among other things, that each State member bank "shall make to the Federal Reserve bank of which it is a member, four reports of condition annually upon dates which shall be selected by the Chairman of the Board of Directors [of the FDIC], the Comptroller of the Currency, and the Chairman of the Board of Governors of the Federal Reserve System, or a majority thereof." That section

also provides for similar reports by nonmember insured banks and national banks to the FDIC and the Comptroller of the Currency, respectively, on the dates so selected.

The Act of July 14, 1960, amended the first sentence of section 5211 of the Revised Statutes (12 U.S.C. 161), relating to reports of national banks, to read: "Every association shall make reports of condition to the Comptroller of the Currency in accordance with the Federal Deposit Insurance Act." However, no similar conforming amendment was made to the sixth paragraph of section 9 of the Federal Reserve Act. Consequently, the requirement of that paragraph that State member banks make not less than
[§ 805(a)] three condition reports annually on dates to be fixed by the Board of Governors is in conflict with the Federal Deposit Insurance Act. The conflict should be eliminated by an amendment to that paragraph similar to that made in 1960 to section 5211 of the Revised Statutes.

B. Publication of condition reports

The last sentence of the sixth paragraph of section 9 of the Federal Reserve Act requires that condition reports of State member banks shall be published in such manner and in accordance with such regulations as the Board may prescribe. In 1956, in connection with consideration of the proposed "Financial Institutions Act", the Board recommended that the absolute requirement for publication of condition reports be made permissive, so that the Board could waive publication of such reports. This

recommendation was intended to eliminate duplication, since nearly all States provide for the publication of condition reports by State banks.

Section 7(a)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1817) provides only that the Board of Directors of the FDIC "may require reports of condition [of nonmember insured banks] to be published in such manner, not inconsistent with any applicable law, as it may direct." The sixth paragraph of sec-
[§ 805(a)] tion 9 of the Federal Reserve Act should be amended to provide in similar manner that the Board of Governors may require publication of condition reports of State member banks.

C. Reports of dividends and other reports

The sixth paragraph of section 9 of the Federal Reserve Act specifically requires each State member bank to make reports of the payment of dividends and could be construed as requiring not less than three of such reports to be made annually. Until several years ago, income and dividend reports were required to be made by State member banks on a semiannual basis. Such reports are now required to be submitted only on an annual basis.

The Federal Deposit Insurance Act contains no specific provision with respect to reports of income and dividends of nonmember insured State banks. However, it does provide that the Board of Directors of the FDIC, in addition to authority to call for additional reports of condition, "may call for such other reports as the Board may from time to time require."

The sixth paragraph of section 9 of the Federal Reserve Act contains no corresponding provision authorizing the Board to require State member banks to submit, in addition to reports of condition, such other reports as the Board may require; but section 11(a) of the Federal Reserve Act (12 U.S.C. 248(a)) authorizes the Board to require from each member bank "such statements and reports as it may deem necessary." In view of the latter provision, it may not be essential to provide expressly for the submission of income and dividend reports by State member banks. On the other hand, the reference to such reports is now contained in the law and omission of this reference might be misinterpreted.

In connection with consideration of the proposed "Financial Institutions Act" in 1956, the Board recommended the inclusion in section 9 of a provision that would authorize the Board, when it deemed it appropriate, to require reports of condition on a sample basis and to prescribe different forms of reports and to make different requirements for different classes of banks. It is questionable whether such authority is essential. However, it would seem desirable to amend the sixth paragraph of section 9 of the Federal
[§ 805(a)] Reserve Act to provide, in a manner similar to that provided in the Federal Deposit Insurance Act, that the Board shall be authorized to require such additional condition reports and to call for such income and dividend reports and other reports as the Board may from time to time require. If such a provision is included in section 9, the provision in section 11(a), referred to

above, with respect to authority to require "such statements and reports" as the Board may deem necessary, would be a duplication and should be omitted.

Any redraft of the provisions regarding reports of State member banks should make it clear that the Board would have authority to require the publication, not only of condition reports, but also of income and dividend reports.

*D. Penalties

The sixth paragraph of section 9 of the Act provides that failure of a State member bank to make condition reports "within ten days after the date they are called for" shall subject the bank to a penalty of $100 a day for each day that it fails to transmit such report. With respect to reports of affiliates, however, section 9 provides that a member bank which fails to obtain and furnish a report of an affiliate shall be subject to a penalty of $100 for each day during which such failure continues; no reference is made here to a ten-day period for the submission of such reports.

Under section 5211 of the Revised Statutes, a national bank is subject to a penalty of $100 for each day "after the periods, respectively, therein mentioned [section 5211 of the Revised Statutes], that it delays to make and transmit its report." However, with specific reference to reports of affiliates of national banks, it is provided that a national bank that fails

to obtain and furnish any such report shall be subject to a penalty of $100 "for each day during which such failure continues".

The lack of uniformity is completed by the provision of section 7(a)(1) of the Federal Deposit Insurance Act which provides that every nonmember insured bank that fails to make "or publish" any condition report "within ten days" shall be subject to a penalty of not more than $100 a day; the provision does not specifically indicate from what date the ten-day period commences.

With respect to reports of State member banks and their affiliates, it would seem desirable to provide that the failure of such a bank to make, obtain, or publish any report as required by the Board within such time as the Board may specify shall subject such bank to a penalty of $100 a day for each day that such
[§ 805(b)] failure continues. This would mean that, if the Board required condition reports to be made by a specified date or to be published by a specified date, the penalty would begin to run after the date so specified. This might be regarded as a stricter requirement than that of present law if the present provision regarding condition reports of State member banks is construed as allowing a bank a ten-day "grace period" after the date a report is called for. However, the answer to any such objection lies in the fact that the member bank would be only "subject to" a penalty for failure to transmit a report by the date specified by the Board.

19. REPORTS OF AFFILIATES

With respect to reports of affiliates of State member banks, the seventeenth, eighteenth, and nineteenth paragraphs of section 9 of the Act (12 U.S.C. 334) read as follows:

> "Each bank admitted to membership under this section shall obtain from each of its affiliates other than member banks and furnish to the Federal reserve bank of its district and to the Board of Governors of the Federal Reserve System not less than three reports during each year. Such reports shall be in such form as the Board of Governors of the Federal Reserve System may prescribe, shall be verified by the oath or affirmation of the president or such other officer as may be designated by the board of directors of such affiliate to verify such reports, and shall disclose the information hereinafter provided for as of dates identical with those fixed by the Board of Governors of the Federal Reserve System for reports of the condition of the affiliated member bank. Each such report of an affiliate shall be transmitted as herein provided at the same time as the corresponding report of the affiliated member bank, except that the Board of Governors of the Federal Reserve System may, in its discretion, extend such time for good cause shown. Each such report shall contain such information as in the judgment of the Board of Governors of the Federal Reserve System shall be necessary to disclose fully the relations between such affiliate and such bank and to enable the Board to inform itself as to the effect of such relations upon the affairs of such bank. The reports of such affiliates shall be published by the bank under the same conditions as govern its own condition reports.
>
> "Any such affiliated member bank may be required to obtain from any such affiliate such additional reports as in the opinion of its Federal reserve bank or the Board of Governors of the Federal Reserve System may be necessary in order to obtain a full and complete knowledge of the condition of the affiliated member bank. Such additional reports shall be transmitted to the Federal reserve bank and the Board of Governors of the Federal Reserve System and shall be in such form as the Board of Governors of the Federal Reserve System may prescribe.

> "Any such affiliated member bank which fails to obtain from any of its affiliates and furnish any report provided for by the two preceding paragraphs of this section shall be subject to a penalty of $100 for each day during which such failure continues, which, by direction of the Board of Governors of the Federal Reserve System, may be collected, by suit or otherwise, by the Federal reserve bank of the district in which such member bank is located."

In addition, the eighth paragraph of section 5240 of the Revised Statutes (12 U.S.C. 486) provides as follows:

> "Whenever member banks are required to obtain reports from affiliates, or whenever affiliates of member banks are required to submit to examination, the Board of Governors of the Federal Reserve System or the Comptroller of the Currency, as the case may be, may waive such requirements with respect to any such report or examination of any affiliate if in the judgment of the said Board or Comptroller, respectively, such report or examination is not necessary to disclose fully the relations between such affiliate and such bank and the effect thereof upon the affairs of such bank."

A. Arrangement

As will be noted, the provisions of section 9 of the Federal Reserve Act, above quoted, with respect to reports of affiliates, for the most part parallel provisions of that section with respect to reports of State member banks themselves. Consequently, provisions with respect to reports of both the banks and their affiliates could easily be combined.

[§ 805(c)]

B. Number and dates of reports

The seventeenth paragraph of section 9 refers to the obtaining of "not less than three reports" each year from affiliates of State member banks and provides that they shall be

furnished as of dates identical with those fixed by the Board for reports of condition of the affiliated member bank. As previously indicated, State member banks are required under provisions of the Federal Deposit Insurance Act, as amended in 1960, to furnish four condition reports each year on dates selected by the Chairman of the FDIC, the Comptroller of the Currency, and the Chairman of the Board of Governors, or a majority thereof. Consequently, the provisions of the seven-
[§ 805(a)] teenth paragraph of section 9 regarding the number and dates of reports of affiliates have been superseded by these provisions of the Federal Deposit Insurance Act.

C. Waiver of reports

The eighth paragraph of section 5240 of the Revised Statutes relates to the waiver of reports and examinations of
[§ 805] affiliates of both national banks and State member banks. Insofar as it refers to affiliates of State member banks, the substance of that paragraph should be transferred to the Federal Reserve Act.

20. EXAMINATIONS OF MEMBER BANKS

With respect to examinations of State member banks, the seventh and eighth paragraphs of section 9 of the Act (12 U.S.C. 325, 326) provide as follows:

> "As a condition of membership such banks shall likewise be subject to examinations made by direction of the Board of Governors of the Federal Reserve System or of the Federal reserve bank by examiners selected or approved by the Board of Governors of the Federal Reserve System.
>
> "Whenever the directors of the Federal reserve bank shall approve the examinations made by the State authorities, such examinations and the reports thereof may be accepted in lieu of examinations made by examiners selected or approved by the Board of Governors of the Federal Reserve System: Provided, however, That when it deems it necessary the board may order special examinations by examiners of its own selection and shall in all cases approve the form of the report. The expenses of all examinations, other than those made by State authorities, may, in the discretion of the Board of Governors of the Federal Reserve System, be assessed against the banks examined and, when so assessed, shall be paid by the banks examined. Copies of the reports of such examinations may in the discretion of the Board of Governors of the Federal Reserve System, be furnished to the State authorities having supervision of such banks, to officers, directors, or receivers of such banks, and to any other proper persons."

The fourth paragraph of section 5240 of the Revised Statutes, as amended by section 21 of the Federal Reserve Act (12 U.S.C. 483), provides as follows for special examinations of all member banks:

> "In addition to the examinations made and conducted by the Comptroller of the Currency, every Federal reserve bank may, with the approval of the Federal reserve agent or the Board of Governors of the Federal Reserve System,

> provide for special examination of member banks within its district. The expense of such examinations may, in the discretion of the Board of Governors of the Federal Reserve System, be assessed against the banks examined, and, when so assessed, shall be paid by the banks examined. Such examinations shall be so conducted as to inform the Federal reserve bank of the condition of its member banks and of the lines of credit which are being extended by them. Every Federal reserve bank shall at all times furnish to the Board of Governors of the Federal Reserve System such information as may be demanded concerning the condition of any member bank within the district of the said Federal reserve bank."

A. Arrangement

The above provisions regarding examinations of member banks are overlapping and, to some extent, are inconsistent. As a matter of arrangement, it is obvious that the paragraph contained in section 5240 of the Revised Statutes with respect to [§ 806(c)] special examinations of member banks should be combined with the provisions of section 9 of the Federal Reserve Act regarding examinations of State member banks instead of being placed in a statute that relates primarily to national banks.

*B. Ordering of examinations

The seventh paragraph of section 9 provides for examinations of State member banks by direction of the Board of Governors or of the Federal Reserve Bank. The eighth paragraph of section 9 provides that the Board may order special examinations of State member banks. The fourth paragraph of section 5240 provides that every Federal Reserve Bank may, with the approval of the Federal Reserve agent or the Board of Governors, provide for special examination of member banks. Logically, there is no reason why

these provisions should not be consistent in respect to whether the examinations are ordered by the Board or are provided for by the Reserve Banks with the approval of the Board. Preferably, both as to regular and special examinations, it is believed that they should be made by direction or order or with the approval [§ 806(a)] of the Board of Governors by examiners selected or approved by the Board. Incidentally, this change would make it clear that such examiners would be acting on behalf of the Board, rather than the Reserve Banks, in making examinations.

C. Expenses of examinations

To the extent that the eighth paragraph of section 9 provides that the expenses of all examinations of State member banks may be assessed against the banks examined and that the fourth paragraph of section 5240 contains a similar provision with respect to expenses of special examinations of member banks, there is a duplication in the law. If the provisions of section 9 [§ 806(e)] and section 5240 were combined, a single provision with respect to examination expenses would be sufficient.

D. Approval by Federal Reserve agent

The reference in the fourth paragraph of section 5240 to "the approval of the Federal reserve agent" in the case of special examinations is now of no significance in view of the [§ 806(c)] changed functions of the Federal Reserve agent since 1936. It should be eliminated.

E. Administration of oaths and salaries of examiners

With respect to examinations of national banks, the first paragraph of section 5240 of the Revised Statutes (12 U.S.C. 481) specifically provides that examiners of such banks shall make a thorough examination of all the affairs of national banks and shall have power to administer oaths and examine officers and agents. The third paragraph of section 5240 (12 U.S.C. 482) authorizes the Comptroller of the Currency to fix salaries of national bank examiners. These provisions have no counterparts [§ 806(a)] with respect to Federal Reserve examiners; and, as a matter of consistency, similar provisions should be incorporated in the Federal Reserve Act with respect to such examiners.

*F. Acceptance of State examinations

Consistent with the concept that examinations of member banks should be made by order or direction of the Board of Governors, the provision contained in the eighth paragraph of section 9 regarding the acceptance of State examinations in lieu of Federal Reserve examinations should be changed to provide that such examinations may be accepted whenever approved by the Board of Governors rather than by the directors of the Reserve [§ 806(b)] Bank. It may be noted that until 1956 section 5240 of the Revised Statutes expressly provided that the Board might authorize acceptance of examinations by the State authorities.

The words "in any State" should be inserted after the words "State authorities" in the eighth paragraph of section 9 [§ 806(b)] in order to make it clear that the Board may decide to accept State examinations in one or more States without accepting them in all States.

G. Exemption of State member banks from examination by Comptroller

The first sentence of the thirteenth paragraph of section 9 of the Act (12 U.S.C. 330) reads as follows:

> "Banks becoming members of the Federal Reserve System under authority of this section shall be subject to the provisions of this section and to those of this Act which relate specifically to member banks, but shall not be subject to examination under the provisions of the first two paragraphs of section fifty-two hundred and forty of the Revised Statutes as amended by section twenty-one of this Act."

When this provision was first enacted in 1917, the first paragraph of section 5240 of the Revised Statutes, as amended by section 21 of the Federal Reserve Act (12 U.S.C. 481), provided literally for the examination of "member banks" by examiners appointed by the Comptroller of the Currency. However, this provision of section 5240 was amended in 1956 to refer only to national banks. Consequently, the last clause of the provision of section 9 above quoted is no longer necessary.

21. EXAMINATIONS OF AFFILIATES

The first sentence of the twenty-second paragraph of section 9 of the Act (12 U.S.C. 338) reads as follows:

> "In connection with examinations of State member banks, examiners selected or approved by the Board of Governors of the Federal Reserve System shall make such examinations of the affairs of all affiliates of such banks as shall be necessary to disclose fully the relations between such banks and their affiliates and the effect of such relations upon the affairs of such banks."

Waiver of examinations of affiliates of member banks is provided for in the eighth paragraph of section 5240 of the Revised Statutes (12 U.S.C. 486), which reads as follows:

> "Whenever member banks are required to obtain reports from affiliates, or whenever affiliates of member banks are required to submit to examination, the Board of Governors of the Federal Reserve System or the Comptroller of the Currency, as the case may be, may waive such requirements with respect to any such report or examination of any affiliate if in the judgment of the said Board or Comptroller, respectively, such report or examination is not necessary to disclose fully the relations between such affiliate and such bank and the effect thereof upon the affairs of such bank."

So much of the above-quoted paragraph of section 5240 as refers to waiver of examinations of affiliates of State member banks should be transferred to the Federal Reserve Act.

[§ 806(d)]

[Sec. 7(b)]

22. APPLICABILITY OF OTHER LAWS TO STATE MEMBER BANKS

A. Provisions applicable to member banks

(1) The first clause of the first sentence of the thirteenth paragraph of section 9 of the Act (12 U.S.C. 330) provides that -

> "Banks becoming members of the Federal Reserve System under authority of this section shall be subject to the provisions of this section and to those of this Act which relate specifically to member banks . . . ."

If this language is retained in the law, it should be changed to refer not only to provisions of the Federal Reserve Act but to any other provisions of Federal law relating specifically to member banks. However, it is believed that the language quoted serves no useful purpose and should be omitted. Obviously, a State member bank is subject to any provision of Federal law that specifically relates to member banks.

(2) The first part of the first sentence of the sixth paragraph of section 9 of the Act (12 U.S.C. 324) provides as follows:

> "All banks admitted to membership under authority of this section shall be required to comply with the reserve and capital requirements of this Act, ..."

For reasons similar to those stated above with respect to the first clause of the first sentence of the thirteenth paragraph of section 9, this language in the sixth paragraph is obviously unnecessary, since State member banks are "member banks"

and are therefore subject to the reserve and capital requirements of the Federal Reserve Act.

B. Retention of charter rights

The second sentence of the thirteenth paragraph of section 9 of the Act (12 U.S.C. 330) reads in part as follows:

> ". . . Subject to the provisions of this Act and to the regulations of the board made pursuant thereto, any bank becoming a member of the Federal Reserve System shall retain its full charter and statutory rights as a State bank or trust company, and may continue to exercise all corporate powers granted it by the State in which it was created, and shall be entitled to all privileges of member banks: . . . ."

Since the charter "rights" of a State member bank may be limited by provisions of Federal law other than those of the Federal Reserve Act, e.g., the bank merger provisions of the
[§ 802] Federal Deposit Insurance Act, the first clause of the sentence above quoted should refer not only to provisions of "this Act" but also to "other provisions of Federal law".

C. Applicability of certain criminal provisions

The second sentence of the sixth paragraph of section 9 of the Act (12 U.S.C. 324) reads in part as follows:

[§ 809(a)]

> ". . . Such banks and the officers, agents, and employees thereof shall also be subject to the provisions of and to the penalties prescribed by sections 334, 656, and 1005 of Title 18, United States Code, ..."

(1) Section 334 of the Criminal Code reads as follows:

> "Whoever, being a Federal Reserve Agent, or an agent or employee of such Federal Reserve Agent, or of the Board of Governors of the Federal Reserve System, issues or puts in circulation any Federal Reserve notes,

without complying with or in violation of the provisions of law regulating the issuance and circulation of such Federal Reserve notes; or

"Whoever, being an officer acting under the provisions of chapter 2 of Title 12, countersigns or delivers to any national banking association, or to any other company or person, any circulating notes contemplated by that chapter except in strict accordance with its provisions -

"Shall be fined not more than $5,000 or imprisoned not more than five years, or both."

The first paragraph of section 334 of the Criminal Code relates to the issuance of Federal Reserve notes without compliance with provisions of law relating thereto and, consequently, is clearly applicable to Federal Reserve agents and employees of such agents and of the Board of Governors. It is difficult to imagine, however, how it could in any way be applicable to an officer or employee of a State member bank. It is possible that the reference to this section of the Criminal Code was originally included in order to make clear that officers and employees of State member banks were prohibited from wrongfully issuing national bank notes, the matter covered by the second paragraph of section 334. Since national bank notes are no longer issued, that paragraph is clearly obsolete and inapplicable to officers and employees of State member banks. Consequently, the reference in section 9 to section 334 of the Criminal Code should be omitted.

(2) Section 656 of the Criminal Code relates to embezzlements by officers, directors, agents, or employees of any Federal Reserve Bank, member bank, national bank, or insured

bank. Section 1005 of the Criminal Code relates to false entries by any officer, director, agent, or employee of any Federal Reserve Bank, member bank, national bank, or insured bank. Since State member banks obviously are "member banks", the requirement of the sixth paragraph of section 9 that officers and employees of such banks shall be subject to the provisions of these sections of the Criminal Code is clearly a duplication and is therefore unnecessary. It may be noted that the Criminal Code provisions are broader than those of section 9 since they specifically cover directors of member banks as well as officers, agents, and employees.

23. FORFEITURE OF MEMBERSHIP

The ninth paragraph of section 9 of the Act (12 U.S.C. 327) reads as follows:

> "If at any time it shall appear to the Board of Governors of the Federal Reserve System that a member bank has failed to comply with the provisions of this section or the regulations of the Board of Governors of the Federal Reserve System made pursuant thereto, or has ceased to exercise banking functions without a receiver or liquidating agent having been appointed therefor, it shall be within the power of the board after hearing to require such bank to surrender its stock in the Federal reserve bank and to forfeit all rights and privileges of membership. The Board of Governors of the Federal Reserve System may restore membership upon due proof of compliance with the conditions imposed by this section."

A. Applicability only to State member banks

Although this paragraph refers to forfeiture of membership by a "member bank", it is clear that it is intended to refer [§ 812(b)] only to State banks admitted to membership under section 9, and the paragraph has always been so construed. Consequently, the paragraph should be changed to refer to "a State member bank".

B. Violations of any applicable law

The paragraph refers to failure to comply with "the provisions of this section or the regulations of the Board of Governors of the Federal Reserve System made pursuant thereto". [§ 812(b)] It should be changed to refer to failure to comply with the provisions "of this Act or any provision of Federal law applicable to member banks".

C. Violation of conditions of membership

It should be made clear that failure to comply with conditions of membership prescribed by the Board may subject a State member bank to forfeiture of membership.

[§ 812(b)]

D. Restoration of membership

The last sentence of the paragraph authorizes the Board to restore membership upon proof of compliance "with the conditions imposed by this section." In the interest of clarity and consistency, this sentence should refer to proof of "compliance with such provisions of law or regulations or conditions of membership".

[§ 812]

[§ 812(b)]

24. VOLUNTARY WITHDRAWAL FROM MEMBERSHIP

The tenth paragraph of section 9 of the Act (12 U.S.C. 328) reads as follows:

> "Any State bank or trust company desiring to withdraw from membership in a Federal reserve bank may do so, after six months' written notice shall have been filed with the Board of Governors of the Federal Reserve System, upon the surrender and cancellation of all of its holdings of capital stock in the Federal reserve bank: Provided, That the Board of Governors of the Federal Reserve System, in its discretion and subject to such conditions as it may prescribe, may waive such six months' notice in individual cases and may permit any such State bank or trust company to withdraw from membership in a Federal reserve bank prior to the expiration of six months from the date of the written notice of its intention to withdraw: Provided, however, That no Federal reserve bank shall, except under express authority of the Board of Governors of the Federal Reserve System, cancel within the same calendar year more than twenty-five per centum of its capital stock for the purpose of effecting voluntary withdrawals during that year. All such applications shall be dealt with in the order in which they are filed with the board. Whenever a member bank shall surrender its stock holdings in a Federal reserve bank, or shall be ordered to do so by the Board of Governors of the Federal Reserve System, under authority of law, all of its rights and privileges as a member bank shall thereupon cease and determine, and after due provision has been made for any indebtedness due or to become due to the Federal reserve bank it shall be entitled to a refund of its cash paid subscription with interest at the rate of one-half of one per centum per month from date of last dividend, if earned, the amount refunded in no event to exceed the book value of the stock at that time, and shall likewise be entitled to repayment of deposits and of any other balance due from the Federal reserve bank."

*A. Notice of withdrawal

The provision requiring six-months' notice of intention to withdraw from membership, unless waived by the Board, is not

[§ 812(d)] essential and should be omitted. In practice, the Board (or the Federal Reserve Bank under delegated authority) always waives the six-months' notice requirement.

B. Cancellation of Reserve Bank stock

(1) The second proviso of the first sentence of the paragraph prohibits a Reserve Bank from canceling more than 25 per cent of its capital stock during any calendar year as the result of voluntary withdrawals from membership, except with the express authority of the Board. It may have been the purpose of this provision to guard against sudden mass withdrawals of State banks from the System and the resulting substantial reduction in the

[§ 812(c)] capital of the Reserve Banks. However, it is questionable whether this limitation is any longer necessary and it should be omitted.

(2) The last part of the last sentence of the tenth paragraph of section 9, relating to the refund of a member bank's cash-paid subscription and repayment of deposits and other balances due from the Reserve Bank, would be covered by provisions of another section of the Act, relating to cancellation of Reserve Bank stock, if the law should be amended as proposed under Recom-

[§ 812(c)] mendation No. 5-F. Accordingly, that part of that sentence, beginning with the words "and after due provision has been made", should be omitted.

C. Consideration of withdrawal applications

The second sentence of the paragraph, requiring applications for withdrawal from membership to be dealt with in

the order in which filed, may originally have had some significance; but there appears to be no more reason for such a requirement in the case of withdrawals from membership than in the case of any other applications received by the Board.

[§ 812(a)]

25. WAIVER OF MEMBERSHIP REQUIREMENTS FOR CERTAIN INSURED BANKS

The twelfth paragraph of section 9 of the Act provides that the Board may waive requirements for membership in the System as to any State bank required by subsection (y) of section 12B of the Federal Reserve Act to become a member of the System in order to have its deposits insured. Subsection (y) of section 12B was repealed in 1939, and all of the former section 12B itself was withdrawn from the Federal Reserve Act and enacted as a separate Federal Deposit Insurance Act in 1950. Consequently, this paragraph of section 9, which is omitted from the United States Code, is clearly of no present significance and should be repealed.

26. FALSE CERTIFICATION OF CHECKS

The fourteenth paragraph of section 9 of the Act (12 U.S.C. 331), relating to false certification of checks by officers of State member banks, reads as follows:

> "It shall be unlawful for any officer, clerk, or agent of any bank admitted to membership under authority of this section to certify any check drawn upon such bank unless the person or company drawing the check has on deposit therewith at the time such check is certified an amount of money equal to the amount specified in such check. Any check so certified by duly authorized officers shall be a good and valid obligation against such bank, but the act of any such officer, clerk, or agent in violation of this section may subject such bank to a forfeiture of its membership in the Federal Reserve System upon hearing by the Board of Governors of the Federal Reserve System."

Section 5208 of the United States Revised Statutes (12 U.S.C. 501), relating to false certification of checks by officers, directors, or employees of Federal Reserve Banks and member banks, reads as follows:

> "It shall be unlawful for any officer, director, agent, or employee of any Federal reserve bank, or any member bank as defined in the Act of December 23, 1913, known as the Federal Reserve Act, to certify any check drawn upon such Federal reserve bank or member bank unless the person, firm, or corporation drawing the check has on deposit with such Federal reserve bank or member bank, at the time such check is certified, an amount of money not less than the amount specified in such check. Any check so certified by a duly authorized officer, director, agent, or employee shall be a good and valid obligation against such Federal reserve bank or member bank; but the act of any officer, director, agent, or employee of any such Federal reserve bank or member bank in violation of this section shall, in the discretion of the Board of Governors of the Federal Reserve System, subject such Federal reserve bank to the penalties imposed by section 11, subsection (h) of the Federal

> Reserve Act, and shall subject such member bank, if a national bank, to the liabilities and proceedings on the part of the Comptroller of the Currency provided for in section 5234, Revised Statutes, and shall, in the discretion of the Board of Governors of the Federal Reserve System, subject any other member bank to the penalties imposed by section 9 of said Federal Reserve Act for the violation of any of the provisions of said Act."

In addition, section 1004 of the Criminal Code (18 U.S.C. 1004) provides criminal penalties for false certification of checks by officers, directors, or employees of Federal Reserve Banks and member banks.

The paragraph of section 9 of the Federal Reserve Act, above quoted, was added in 1917. Subsequently, section 5208 of the Revised Statutes was revised to cover false certification of checks not only in the case of State member banks but in the case of all member banks, as well as Federal Reserve Banks. Thus, section 5208, as amended, completely duplicates and goes beyond the provisions of the fourteenth paragraph of section 9 of the Act. Consequently, the fourteenth paragraph of section 9 is unnecessary and should be repealed.

If that paragraph of section 9 should be repealed, however, it is believed that section 5208 should be incorporated in the Federal Reserve Act itself, most appropriately along with the provisions of section 22 relating to offenses of directors, officers, and employees of member banks. Its incorporation in the Federal Reserve Act seems logical and desirable because the provisions of section 5208 of the Revised Statutes relate to false certification of checks by officers, directors, and employees of Federal Reserve Banks and of member banks.

[§ 903(d)]

27. MEMBER BANKS AS DEPOSITORIES OF PUBLIC FUNDS

The fifteenth paragraph of section 9 of the Act (12 U.S.C. 332) reads as follows:

> "All banks or trust companies incorporated by special law or organized under the general laws of any State, which are members of the Federal reserve system, when designated for that purpose by the Secretary of the Treasury, shall be depositaries of public money, under such regulations as may be prescribed by the Secretary; and they may also be employed as financial agents of the Government; and they shall perform all such reasonable duties, as depositaries of public money and financial agents of the Government, as may be required of them. The Secretary of the Treasury shall require of the banks and trust companies thus designated satisfactory security, by the deposit of United States bonds or otherwise, for the safe keeping and prompt payment of the public money deposited with them and for the faithful performance of their duties as financial agents of the Government."

Section 10 of the Act of June 11, 1942 (12 U.S.C. 265), reads as follows:

> "All insured banks designated for that purpose by the Secretary of the Treasury shall be depositaries of public money of the United States (including, without being limited to, revenues and funds of the United States, and any funds the deposit of which is subject to the control or regulation of the United States or any of its officers, agents, or employees, and Postal Savings funds), and the Secretary is hereby authorized to deposit public money in such depositaries, under such regulations as may be prescribed by the Secretary; and they may also be employed as financial agents of the Government; and they shall perform all such reasonable duties, as depositaries of public money and financial agents of the Government as may be required of them. The Secretary of the Treasury shall require of the insured banks thus designated satisfactory security by the deposit of United States bonds or otherwise, for the safekeeping and prompt payment of public money deposited with them and for the faithful performance of

their duties as financial agents of the Government; Provided, That no such security shall be required for the safekeeping and prompt payment of such parts of the deposits of the public money in such banks as are insured deposits and each officer, employee, or agent of the United States having official custody of public funds and lawfully depositing the same in an insured bank shall, for the purpose of determining the amount of the insured deposits, be deemed a depositor in such custodial capacity separate and distinct from any other officer, employee, or agent of the United States having official custody of public funds and lawfully depositing the same in the same insured bank in custodial capacity. Notwithstanding any other provision of law, no department, board, agency, instrumentality, officer, employee, or agent of the United States shall issue or permit to continue in effect any regulations, rulings, or instructions or enter into or approve any contracts or perform any other acts having to do with the deposit, disbursement, or expenditure of public funds, or the deposit, custody, or advance of funds subject to the control of the United States as trustee or otherwise which shall discriminate against or prefer national banking associations, State bank members of the Federal Reserve System, or insured banks not members of the Federal Reserve System, by class, or which shall require those enjoying the benefits, directly or indirectly, of disbursed public funds so to discriminate. All Acts or parts thereof in conflict herewith are hereby repealed. The terms 'insured bank' and 'insured deposit' as used in this Act shall be construed according to the definitions of such terms in section 3 of the Federal Deposit Insurance Act, as amended (12 U.S.C., sec. 1813)."

The fifteenth paragraph of section 9 of the Federal Reserve Act, as above quoted, was added to the Act in 1928, prior to establishment of the Federal Deposit Insurance Corporation. It relates to the use of only State member banks as depositories of public money. However, section 10 of the 1942 Act, quoted above, enacted after establishment of the Federal Deposit Insurance Corporation, contains almost identical provisions

regarding the use of all insured banks as Government depositories. Since State member banks must be insured banks, the fifteenth paragraph of section 9 of the Federal Reserve Act is therefore unnecessary and should be omitted. Moreover, retention of that paragraph in the Federal Reserve Act can be misleading, since it does not provide, as does the subsequent 1942 enactment, that security for deposits of public money is not required to the extent that such deposits are insured under the Federal Deposit Insurance Act.

*28. MEMBERSHIP OF MUTUAL SAVINGS BANKS

The sixteenth paragraph of section 9 of the Act (12 U.S.C. 333), which was added by the Banking Act of 1933, reads as follows:

> "Any mutual savings bank having no capital stock (including any other banking institution the capital of which consists of weekly or other time deposits which are segregated from all other deposits and are regarded as capital stock for the purposes of taxation and the declaration of dividends), but having surplus and undivided profits not less than the amount of capital required for the organization of a national bank in the same place, may apply for and be admitted to membership in the Federal Reserve System in the same manner and subject to the same provisions of law as State banks and trust companies, except that any such savings banks shall subscribe for capital stock of the Federal reserve bank in an amount equal to six-tenths of 1 per centum of its total deposit liabilities as shown by the most recent report of examination of such savings bank preceding its admission to membership. Thereafter such subscription shall be adjusted semiannually on the same percentage basis in accordance with rules and regulations prescribed by the Board of Governors of the Federal Reserve System. If any such mutual savings bank applying for membership is not permitted by the laws under which it was organized to purchase stock in a Federal reserve bank, it shall, upon admission to the system, deposit with the Federal reserve bank an amount equal to the amount which it would have been required to pay in on account of a subscription to capital stock. Thereafter such deposit shall be adjusted semiannually in the same manner as subscriptions for stock. Such deposits shall be subject to the same conditions with respect to repayment as amounts paid upon subscriptions to capital stock by other member banks and the Federal reserve bank shall pay interest thereon at the same rate as dividends are actually paid on outstanding shares of stock of such Federal reserve bank. If the laws under which any such savings bank was organized be amended so as to authorize mutual savings banks to subscribe for Federal reserve bank stock, such savings bank shall

> thereupon subscribe for the appropriate amount of stock in the Federal reserve bank, and the deposit hereinbefore provided for in lieu of payment upon capital stock shall be applied upon such subscription. If the laws under which any such savings bank was organized be not amended at the next session of the legislature following the admission of such savings bank to membership so as to authorize mutual savings banks to purchase Federal reserve bank stock, or if such laws be so amended and such bank fail within six months thereafter to purchase such stock, all of its rights and privileges as a member bank shall be forfeited and its membership in the Federal Reserve System shall be terminated in the manner prescribed elsewhere in this section with respect to State member banks and trust companies. Each such mutual savings bank shall comply with all the provisions of law applicable to State member banks and trust companies, with the regulations of the Board of Governors of the Federal Reserve System and with the conditions of membership prescribed for such savings bank at the time of admission to membership, except as otherwise hereinbefore provided with respect to capital stock."

As far as is known, only three mutual savings banks have ever become members of the System; and for many years no mutual savings bank has been a member. Apparently, there is little or no incentive for such banks to join the System. Accordingly, it is believed that the special provisions of present law regarding membership of mutual savings banks serve no practical purpose and should be eliminated. It may be noted that these provisions would be repealed by pending proposed legislation regarding Federal chartering of mutual savings banks.

29. MEMBERS OF BOARD OF GOVERNORS

The first two paragraphs of section 10 of the Act (12 U.S.C. 241, 242) read as follows:

> "The Board of Governors of the Federal Reserve System (hereinafter referred to as the 'Board') shall be composed of seven members, to be appointed by the President, by and with the advice and consent of the Senate, after the date of enactment of the Banking Act of 1935, for terms of fourteen years except as hereinafter provided, but each appointive member of the Federal Reserve Board in office on such date shall continue to serve as a member of the Board until February 1, 1936, and the Secretary of the Treasury and the Comptroller of the Currency shall continue to serve as members of the Board until February 1, 1936. In selecting the members of the Board, not more than one of whom shall be selected from any one Federal Reserve district, the President shall have due regard to a fair representation of the financial, agricultural, industrial, and commercial interests, and geographical divisions of the country. The members of the Board shall devote their entire time to the business of the Board and shall each receive an annual salary of $15,000, payable monthly, together with actual necessary traveling expenses.
>
> "The members of the Board shall be ineligible during the time they are in office and for two years thereafter to hold any office, position, or employment in any member bank, except that this restriction shall not apply to a member who has served the full term for which he was appointed. Upon the expiration of the term of any appointive member of the Federal Reserve Board in office on the date of enactment of the Banking Act of 1935, the President shall fix the term of the successor to such member at not to exceed fourteen years, as designated by the President at the time of nomination, but in such manner as to provide for the expiration of the term of not more than one member in any two-year period, and thereafter each member shall hold office for a term of fourteen years from the expiration of the term of his predecessor, unless sooner removed for cause by the President. Of the persons thus appointed, one shall be designated by the President as chairman and one as vice chairman of the Board, to

serve as such for a term of four years. The chairman of the Board, subject to its supervision, shall be its active executive officer. Each member of the Board shall within fifteen days after notice of appointment make and subscribe to the oath of office. Upon the expiration of their terms of office, members of the Board shall continue to serve until their successors are appointed and have qualified. Any person appointed as a member of the Board after the date of enactment of the Banking Act of 1935 shall not be eligible for re-appointment as such member after he shall have served a full term of fourteen years."

The first three sentences and the last two sentences of the fourth paragraph of section 10 (12 U.S.C. 244) read as follows:

"The principal offices of the Board shall be in the District of Columbia. At meetings of the Board the chairman shall preside, and, in his absence, the vice chairman shall preside. In the absence of the chairman and the vice chairman, the Board shall elect a member to act as chairman pro tempore. . . . No member of the Board of Governors of the Federal Reserve System shall be an officer or director of any bank, banking institution, trust company, or Federal Reserve bank or hold stock in any bank, banking institution, or trust company; and before entering upon his duties as a member of the Board of Governors of the Federal Reserve System he shall certify under oath that he has complied with this requirement, and such certification shall be filed with the secretary of the Board. Whenever a vacancy shall occur, other than by expiration of term, among the six members of the Board of Governors of the Federal Reserve System appointed by the President as above provided, a successor shall be appointed by the President, by and with the advice and consent of the Senate, to fill such vacancy, and when appointed he shall hold office for the unexpired term of his predecessor."

The fifth paragraph of section 10 (12 U.S.C. 245) reads as follows:

"The President shall have power to fill all vacancies that may happen on the Board of Governors of the Federal Reserve System during the recess of the Senate by granting commissions which shall expire with the next session of the Senate."

A. Obsolete references to Banking Act of 1935

The first paragraph of section 10 of the Act, relating to the appointment and qualifications of members of the Board, is in the form in which it was amended by the Banking Act of [§ 201(a)] 1935, when the composition of the Board was drastically changed. Much of the language of this paragraph, necessary in 1935, is now obsolete, such as the provision for the continued service of the Secretary of the Treasury and the Comptroller of the Currency as members of the Board until February 1, 1936. Similarly, the second sentence of the second paragraph of section 10, providing for the appointment of successors to appointive members in office on the date of enactment of the Banking Act of 1935, and the last sentence of the same paragraph, regarding reappointment of Board members, should be recast to eliminate references to the Banking Act of 1935.

*B. Qualifications of members

The original Federal Reserve Act, in addition to providing that not more than one member should be appointed from any Federal Reserve district, required the President, in appointing Board members, to have due regard to a fair representation of the different "commercial, industrial and geographical divisions of the country" and further provided that at least two of the members should be "persons experienced in banking or finance." In 1922, the law was amended to add a

requirement for representation of "financial" and "agricultural" interests and, at the same time, the provision requiring two members to be experienced in banking or finance was eliminated.

In his replies to the questions submitted in 1952 by the Subcommittee on General Credit Control and Debt Management of the Joint Economic Committee (the "Patman Questionnaire"), Chairman Martin of the Board recommended elimination of the restriction on appointment of more than one member from any Federal Reserve district and the restoration of the earlier provision requiring two members to be experienced in banking or finance. (Joint Committee Print of Joint Committee on the Economic Report regarding "Monetary Policy and the Management of the Public Debt", Part 1, 1952, p. 300) However, the Subcommittee, in its Final Report of June 26, 1952 (p. 56), recommended removal from the law of both the restriction on appointments from a single district and the provision regarding representation of various interests. In this connection, the Subcommittee's Report stated:

> "The geographic portions of this provision have reduced the flexibility of the appointing authority in seeking the best possible membership for the Board, while its non-geographical portions reflect in part the older concept of the Federal Reserve System as simply an organization for the 'accommodation of commerce and industry' rather than one whose primary responsibility is the formulation of monetary policy in the public interest. It is, of course, important that the Board include in its membership persons understanding of and sympathetic to the various interests in the county [sic], and the President and the Senate may be expected to

> insist upon this, but it is also important that men be appointed with a broad understanding of the economic bases of monetary policy. The Subcommittee believes that, in the long run, the quality of membership of the Board would be improved if the present qualifications were removed and the appointments left to the full discretion of the President and the Senate."

The provision with respect to representation of various interests of the country has never been regarded as meaning that Board members, in their capacity as members, actually represent any particular interests; they have always been regarded as representing the public interest generally. Nevertheless, the provision can be misunderstood as suggesting such representation of special interests; and indeed it has been suggested that the law be amended to add reference to representation of labor. Actually, the statutory requirement has probably not had any great signifi-
[§ 201(b)] cance. It might be questioned whether professional economists appointed to the Board in fact represent "financial, agricultural, industrial, and commercial" interests. This requirement of the law should be omitted.

While the President should, of course, and as a practical matter would be inclined to, avoid appointing a preponderance of Board members from any particular geographical section of the
[§ 201(b)] country, the present limitation on the appointment of more than one member from any Federal Reserve district constitutes an unnecessary restriction upon the President's discretion. It should likewise be omitted.

C. Salaries of members

The last sentence of the first paragraph of section 10 specifically refers to the salary of Board members as being $15,000. This is, of course, incorrect and misleading, since salaries of Board members are now governed by the Executive Pay Act. Consequently, the sentence should be omitted. In this connection, see also Recommendation No. 55.

*D. Terms of Chairman and Vice Chairman

The third sentence of the second paragraph of section 10 of the Act provides that the Chairman and Vice Chairman of the Board shall be designated by the President to serve as such for terms of four years. When this provision was added by the Banking Act of 1935, it was apparently contemplated that the terms of the Chairman and Vice Chairman would be approximately coterminous with the term of the President and that this arrangement would afford a new President an opportunity to designate these officers of the Board. Assuming such a purpose, however, the provision has not operated to bring about this result.

In 1952, in his replies to the questionnaire submitted by Chairman Patman of the Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report, Chairman Martin of the Board suggested that the law be changed so as to make the terms of the Chairman and Vice Chairman coincide roughly with the term of the President. Such an amendment to the

law was recommended by President Kennedy in 1962 in a message to Congress:

> ". . . As has been recognized throughout the history of the Federal Reserve, the principal officer of the System must have the confidence of the President. This is essential for the effective coordination of the monetary, fiscal, and financial policies of the government. It is essential for the effective representation of the Federal Reserve System itself in the formulation of Executive policies affecting the System's responsibilities."

In a letter dated October 6, 1966, to Chairman Multer of the Subcommittee on Bank Supervision and Insurance of the House Banking and Currency Committee, the Board recommended that the terms of the Chairman and Vice Chairman should be related to the President's term of office and that the terms of Board members should be adjusted so that a new President would be able to appoint a Chairman and Vice Chairman of his own choice without being limited in his selection to incumbent Board members.

The law should be amended to provide that terms of Board members shall expire in odd-numbered years, rather than even-numbered years, so that a vacancy would occur in the year
[§ 201(c)] of a President's inauguration, thus permitting him to appoint a Chairman from outside the existing membership. Any such amendment should also provide for a reasonable time lag between the date of the President's inauguration and the expiration of the terms of the incumbent Chairman and Vice Chairman. Terms of
[Sec. 2] members in office on the date of the amendment should be adjusted to expire in the year following that in which they would otherwise expire.

E. Inaccurate reference to number of members

The last sentence of the fourth paragraph of section 10 of the Act provides that, whenever a vacancy shall occur, other than by expiration of term, "among the six members of the Board of Governors of the Federal Reserve System appointed by the President as above provided", a successor shall be appointed by the President for the unexpired term.

Originally, the Board consisted of seven members, five appointed by the President plus the Secretary of the Treasury and the Comptroller of the Currency as ex officio members. Consequently, in the original Act, the provision above quoted referred to the "five" members of the Board appointed by the President. In 1922, the law was changed to provide for six appointed members with the Secretary of the Treasury and the Comptroller of the Currency continuing to serve as ex officio members; and at that time the language above quoted was changed to refer to the "six" members appointed by the President. By the Banking Act of 1935, the Secretary of the Treasury and the Comptroller of the Currency were removed from the Board and provision was made for a Board of seven members, all appointed by the President.

Obviously, the present reference to the "six" members of the Board appointed by the President is obsolete. It should be changed to refer simply to the "members" of the Board.

F. Rearrangement

Provisions relating to the qualifications, appointment, and terms of Board members are scattered among several paragraphs [§ 201] of section 10, along with material relating to other matters. The provisions regarding Board members logically should be arranged together.

*30. SIMPLE MAJORITY FOR ALL BOARD ACTIONS

In several instances, the Federal Reserve Act requires certain actions by the Board to be taken only with the affirmative vote of a specified number of members.

Thus, section 10(a) of the Act (12 U.S.C. 347a) provides that a Reserve Bank may make advances to groups of member banks under certain conditions, but only upon receiving the consent of not less than five members of the Board of Governors.

Section 11(b) of the Act (12 U.S.C. 248(b)) provides that, on the affirmative vote of at least five members of the Board, the Board may require a Reserve Bank to rediscount the discounted paper of another Reserve Bank.

Section 11(m) of the Act (12 U.S.C. 248(m)) provides that, upon the affirmative vote of not less than six of its members, the Board shall have power to fix for each Federal Reserve district the percentage of individual bank capital and surplus that may be represented by loans secured by stock or bond collateral made by member banks within the district.

The third paragraph of section 13 (12 U.S.C. 343) provides that, in unusual and exigent circumstances, and by the affirmative vote of not less than five of its members, the Board may authorize a Reserve Bank to discount eligible paper for any individual, partnership, or corporation under certain circumstances.

Section 19(b) (12 U.S.C. 462) provides that reserve requirements of member banks shall be determined by the affirmative vote of not less than four members of the Board.

The actions of the Board authorized by section 10(a), section 11(m), and the third paragraph of section 13 have never been taken by the Board since the enactment of those provisions. In any event, the requirement that Board actions of the kinds above described be taken only with the affirmative vote of a specified number of Board members appears to be no more necessary with respect to such actions than with respect to other equally important actions taken by the Board as to which there is no specific statutory requirement for the concurrence of a specified number of Board members. There is no sound reason for which all actions of the Board should not be taken in accordance with the general rule that the action of a board or commission may be taken by a majority of a quorum of such board or commission.

It is recommended, therefore, that the provisions of the Federal Reserve Act above mentioned be amended to eliminate the requirement for concurrence of a specified number of Board members.[2/] Although not essential, it might be desirable to

2/ Such an amendment to section 10(a) would be unnecessary if either Recommendation No. 33 or No. 46 should be adopted. Amendments to section 11(b) and the third paragraph of section 13 would be unnecessary if Recommendation No. 46 should be adopted.

include at an appropriate place in the Act a provision explicitly stating that any action which the Board is authorized to take may be taken by the affirmative vote of a majority of the members of the Board present at any meeting at which there is a quorum.

31. RESERVATION OF POWERS OF THE SECRETARY OF THE TREASURY

The sixth paragraph of section 10 of the Federal Reserve Act (12 U.S.C. 246) reads as follows:

> "Nothing in this Act contained shall be construed as taking away any powers heretofore vested by law in the Secretary of the Treasury which relate to the supervision, management, and control of the Treasury Department and bureaus under such department, and wherever any power vested by this Act in the Board of Governors of the Federal Reserve System or the Federal reserve agent appears to conflict with the powers of the Secretary of the Treasury, such powers shall be exercised subject to the supervision and control of the Secretary."

In 1956, in connection with the then-pending "Financial Institutions Act", the Board recommended the elimination of the last part of the above paragraph, specifically the language reading "and wherever any power vested by this Act in the Board of Governors of the Federal Reserve System or the Federal reserve agent appears to conflict with the powers of the Secretary of the Treasury, such powers shall be exercised subject to the supervision and control of the Secretary."

In explanation of this recommendation, the Board stated:

> "This provision was included in the original Federal Reserve Act in 1913, which provided for a Federal Reserve Board on which the Secretary of the Treasury and Comptroller of the Currency were members ex-officio. The provision appears to reflect some uncertainty on the part of Congress in 1913 as to the possibility of overlapping authority between the Treasury and the Federal Reserve System. However, the meaning and intent of the language suggested for repeal are not at all clear. The language apparently refers only to powers of the Secretary relating to the supervision, management, and control of the Treasury Department and its

> bureaus, although it is possible to interpret it as applying to other powers vested by the original Federal Reserve Act in the Federal Reserve Board and the Federal Reserve agent. It is not believed that Congress intended that this provision should be more broadly interpreted and, in any event, the removal of the Secretary of the Treasury and the Comptroller of the Currency from membership on the Federal Reserve Board by the Banking Act of 1935 clearly indicated an intent that the Board should perform its functions according to its own best judgment. Moreover, as far as is known, this provision has never had any significant effect on any of the operations or authority exercised by the Federal Reserve System or of the Secretary of the Treasury. It is believed that it is in the category of obsolete or unnecessary provisions and should be repealed." ("Study of Banking Laws", Committee Print of Senate Banking and Currency Committee, Oct. 12, 1956, p. 87.)

Actually, the first part as well as the last part of the paragraph in question serves no present purpose. There is clearly nothing in the Federal Reserve Act that impairs in any way the powers of the Secretary of the Treasury with respect to his supervision, management, or control of his Department.

Accordingly, the entire sixth paragraph of section 10 of the Act should be omitted.

RECOMMENDATIONS FOR CHANGES IN THE FEDERAL RESERVE ACT

PART 2

Recommendations 32 - 80

(Pages 114 - 235)

January 15, 1969

*32. LIMITATION ON COST OF RESERVE BANK BRANCH BUILDINGS

The ninth paragraph of section 10 of the Act (12 U.S.C. 522) reads as follows:

> "No Federal reserve bank shall have authority hereafter to enter into any contract or contracts for the erection of any branch bank building of any kind or character, or to authorize the erection of any such building, if the cost of the building proper, exclusive of the cost of the vaults, permanent equipment, furnishings, and fixtures, is in excess of $250,000: Provided, That nothing herein shall apply to any building under construction prior to June 3, 1922: Provided further, That the cost as above specified shall not be so limited as long as the aggregate of such costs which are incurred by all Federal Reserve banks for branch bank buildings with the approval of the Board of Governors after the date of enactment of this proviso does not exceed $60,000,000."

Limitation on the cost of Reserve Bank branch buildings was first enacted in 1922, when the cost of any such building was limited to $250,000. In 1947, the law was amended to provide an aggregate limitation of $10 million, and this limitation was increased to $30 million in 1953 and to $60 million in 1962.

It is believed that such an arbitrary statutory limitation on the cost of Reserve Bank branch buildings is unnecessary.

The Reserve Banks use their own funds in the construction and improvement of their physical facilities, including their branch buildings and equipment; no appropriation of Government funds is involved. While the major needs for physical expansion at Reserve Bank branches during the next few years appear to have been taken care of, it is probable that improvement and modernization will be necessary from time to time in the future, with

the result that it would again be necessary to request Congress for a change in the statutory dollar limitation on such expenditures. It would clearly be preferable to eliminate such a dollar limitation and to require only that the approval of the Board shall be required in each instance. This would mean that, as in the past, the Board would need to consider every proposed construction or improvement in the light of the needs of the particular branch, the type of construction, the reasonableness of the cost, and whether the proposed construction would be generally consistent with the prevailing economic situation.

Such a change in the law would be accomplished simply by repealing the ninth paragraph of section 10 of the Federal Reserve Act, since the third paragraph of section 3 of the Act [§ 509(c)] (12 U.S.C. 521) provides that no contract for the erection of any branch building shall be entered into without the approval of the Board.

33. EMERGENCY ADVANCES TO GROUPS OF MEMBER BANKS

Section 10(a) of the Act (12 U.S.C. 347a) reads as follows:

"Upon receiving the consent of not less than five members of the Board of Governors of the Federal Reserve System, any Federal reserve bank may make advances, in such amount as the board of directors of such Federal reserve bank may determine, to groups of five or more member banks within its district, a majority of them independently owned and controlled, upon their time or demand promissory notes, provided the bank or banks which receive the proceeds of such advances as herein provided have no adequate amounts of eligible and acceptable assets available to enable such bank or banks to obtain sufficient credit accommodations from the Federal reserve bank through rediscounts or advances other than as provided in section 10(b). The liability of the individual banks in each group must be limited to such proportion of the total amount advanced to such group as the deposit liability of the respective banks bears to the aggregate deposit liability of all banks in such groups, but such advances may be made to a lesser number of such member banks if the aggregate amount of their deposit liability constitutes at least 10 per centum of the entire deposit liability of the member banks within such district. Such banks shall be authorized to distribute the proceeds of such loans to such of their number and in such amount as they may agree upon, but before so doing they shall require such recipient banks to deposit with a suitable trustee, representing the entire group, their individual notes made in favor of the group protected by such collateral security as may be agreed upon. Any Federal reserve bank making such advance shall charge interest or discount thereon at a rate not less than 1 per centum above its discount rate in effect at the time of making such advance. No such note upon which advances are made by a Federal reserve bank under this section shall be eligible under section 16 of this Act as collateral security for Federal reserve notes.

"No obligations of any foreign government, individual, partnership, association, or corporation organized under the laws thereof shall be eligible as collateral security for advances under this section.

"Member banks are authorized to obligate themselves in accordance with the provisions of this section."

Originally enacted as an emergency measure, the authority contained in this section has never been utilized. Presumably, the reason is that at the same time that section 10(a) was enacted Congress also added section 10(b) (12 U.S.C. 347b) to the Federal Reserve Act, under which the Reserve Banks are authorized to make advances to any individual member bank on any "satisfactory security".

In the circumstances, it seems clear that the authority contained in section 10(a) serves no useful purpose and should be repealed.

34. CONDITION REPORTS OF FEDERAL RESERVE BANKS

Section 11(a) of the Act (12 U.S.C. 248(a)) provides that condition statements of the Reserve Banks, among other things,

[§ 512(b)] shall furnish full information regarding "the character of the money held as reserve". Since enactment of the "Gold Cover Act" of March 18, 1968, no reserves are required to be maintained by the Federal Reserve Banks. Consequently, the language above quoted is now obsolete and should be omitted.

35. SUSPENSION OF RESERVE REQUIREMENTS

Section 11(c) of the Act (12 U.S.C. 248(c)) authorizes the Board -

> "To suspend for a period not exceeding thirty days, and from time to time to renew such suspension for periods not exceeding fifteen days, any reserve requirements specified in this Act."

Since enactment of the Act of March 18, 1968, repealing provisions of the Federal Reserve Act with respect to reserve requirements of Federal Reserve Banks, the above provision is applicable only to reserve requirements of member banks. As a matter of arrangement, the provision should be included, not among

[§ 901(e)] the general powers of the Board, but along with those provisions of the Act relating to member bank reserve requirements.

In times of local or regional emergency, such as floods or earthquakes, it may sometimes be appropriate to suspend reserve requirements only for member banks in a certain area. It should be made clear in the law that this may be done, in other words, that reserve requirements need not be suspended for all member banks.

36. SUPERVISION OF ISSUANCE AND RETIREMENT OF FEDERAL RESERVE NOTES

Section 11(d) of the Act (12 U.S.C. 248(d)) empowers the Board -

> "To supervise and regulate through the bureau under the charge of the Comptroller of the Currency the issue and retirement of Federal reserve notes, except for the cancellation and destruction, and accounting with respect to such cancellation and destruction, of notes unfit for circulation, and to prescribe rules and regulations under which such notes may be delivered by the Comptroller to the Federal reserve agents applying therefor."

The above provision, as a matter of arrangement, should be set forth in connection with provisions of the law relating to [§ 604(1)] Federal Reserve notes rather than in a section regarding the general powers of the Board.

37. INCORRECT REFERENCE TO SECTION 20 OF THE ACT

Subsection (e) of section 11 of the Act (12 U.S.C. 248(e)) authorizes the Board -

> "To add to the number of cities classified as reserve cities under existing law in which national banking associations are subject to the reserve requirements set forth in section twenty of this Act; or to reclassify existing reserve cities or to terminate their designation as such."

The reference in this provision to the reserve requirements set forth in section 20 of the Act (12 U.S.C. 121) obviously is inaccurate, since reserve requirements are contained in section 19 of the Act (12 U.S.C. 462). Moreover, the reference to "national banking associations" should be changed to refer to "member banks", since the reserve requirements of the Act apply to all member banks and not merely to national banks.

If Recommendation No. 64-A, regarding reserve requirements of member banks, should be adopted, the paragraph above quoted should be eliminated.

38. BONDS OF FEDERAL RESERVE AGENTS

Section 11(i) of the Act (12 U.S.C. 248(i)) authorizes the Board of Governors -

> "To require bonds of Federal reserve agents, to make regulations for the safeguarding of all collateral, bonds, Federal reserve notes, money or property of any kind deposited in the hands of such agents, and said board shall perform the duties, functions, or services specified in this Act, and make all rules and regulations necessary to enable said board effectively to perform the same."

The first part of this paragraph, relating to the Board's authority to require bonds of Federal Reserve agents, may not be necessary, since the agents and assistant agents are covered by a bankers' blanket bond. However, if the provision is retained in [§ 505(c)] the law, it should be set forth along with those provisions of the Act relating to the appointment and functions of the Federal Reserve agent.

39. PERFORMANCE OF DUTIES BY BOARD

Section 11(i) of the Act (12 U.S.C. 248(i)) provides that the Board "shall perform the duties, functions, or services specified in this Act". Since it is obvious that the Board must comply with all requirements of the Act, this language is unnecessary and should be eliminated.

40. AUTHORITY OF BOARD TO ISSUE REGULATIONS AND DEFINE TERMS

Section 11(i) of the Federal Reserve Act (12 U.S.C. 248(i)) authorizes the Board of Governors to "make all rules and regulations necessary to enable" the Board "effectively to perform" the duties, functions, or services specified in the Act.

This provision should be broadened to make it clear that the Board may issue such regulations as may be necessary [§ 204] to effectuate the purposes of the Act and prevent evasions thereof, and also to define terms used in the Act in a manner not inconsistent therewith.

Section 19(a) of the Act (12 U.S.C. 461) authorizes the Board, for the purposes of that section, to define the terms used in that section and to prescribe "such regulations as it may deem necessary to effectuate the purposes of this section and to prevent evasions thereof." There is no logical reason for which the Board should not have similar authority to define terms and prescribe regulations for purposes of all sections of the Act. (In this connection, see Recommendation No. 1.)

41. LOANS ON STOCK OR BOND COLLATERAL

Section 11(m) of the Federal Reserve Act (12 U.S.C. 248(m)) reads as follows:

> "Upon the affirmative vote of not less than six of its members the Board of Governors of the Federal Reserve System shall have power to fix from time to time for each Federal reserve district the percentage of individual bank capital and surplus which may be represented by loans secured by stock or bond collateral made by member banks within such district, but no such loan shall be made by any such bank to any person in an amount in excess of 10 per centum of the unimpaired capital and surplus of such bank: Provided, That with respect to loans represented by obligations secured by not less than a like amount of bonds or notes of the United States issued since April 24, 1917, certificates of indebtedness of the United States, Treasury bills of the United States, or obligations fully guaranteed both as to principal and interest by the United States, such limitation of 10 per centum on loans to any person shall not apply, but State member banks shall be subject to the same limitations and conditions as are applicable in the case of national banks under paragraph (8) of section 5200 of the Revised Statutes, as amended (U.S.C., Supp. VII, title 12, sec. 84). Any percentage so fixed by the Board of Governors of the Federal Reserve System shall be subject to change from time to time upon ten days' notice, and it shall be the duty of the Board to establish such percentages with a view to preventing the undue use of bank loans for the speculative carrying of securities. The Board of Governors of the Federal Reserve System shall have power to direct any member bank to refrain from further increase of its loans secured by stock or bond collateral for any period up to one year under penalty of suspension of all rediscount privileges at Federal reserve banks."

*A. Limitation on loans to one person

The specific 10 per cent limit on loans to a single borrower collateraled by stocks or bonds is more restrictive

than comparable limits imposed on State banks in many States and, consequently, results in a competitive disadvantage, though a minor one, for member banks.

To the extent that the 10 per cent limit is designed to prevent excessive concentration of securities loans to individual borrowers, that purpose is largely accomplished by the general one-borrower limitation imposed on national banks by Federal law and similar limitations imposed on State banks under State laws. To the extent that section 11(m) was designed to prevent the excessive use of credit for the purchase and carrying of securities, the margin regulations of the Board are directed to the same purpose.

It is recognized, however, that the Board's margin regulations do not limit the total amount of securities loans that may be made by banks and that there may be occasions in the future when the authority of the Board to fix limits on such loans may be a useful supplement both to the margin regulations and to the general one-borrower loan limitations prescribed by Federal and State laws.

Accordingly, it is recommended that, while the specific 10 per cent limit should be omitted, section 11(m) [§ 906] should be revised to authorize the Board to fix limits on securities loans by member banks, both to a single borrower

and to all borrowers, with such exceptions as the Board may by regulation prescribe. This would permit the Board, if deemed appropriate, to make exceptions not only for direct or guaranteed obligations of the United States but for obligations of Federal agencies or even of States and municipalities. For similar reasons, the last sentence of the present paragraph authorizing the Board to direct a bank to refrain from increasing its securities loans should be retained.

B. Unnecessary reference to date and to certificates of indebtedness and Treasury bills

The date reference to April 24, 1917 (the date of enactment of the First Liberty Bond Act) in the proviso in section 11(m) is no longer necessary. Moreover, section 5(c) of the Second Liberty Bond Act of September 24, 1917 (31 U.S.C. 745(c)), expressly provides that the words "bonds or notes of the United States" shall be held to include certificates of indebtedness and Treasury bills issued under that Act. Consequently, the reference in section 11(m) of the Federal Reserve Act to certificates of indebtedness and Treasury bills of the United States is unnecessary.

It is believed that, instead of referring to bonds or notes of the United States, section 11(m) should simply refer, like the thirteenth paragraph of section 13 (12 U.S.C. 347c) and

the proviso in section 14(b)(1) of the Act (12 U.S.C. 355), to "direct obligations of the United States". Along with such a change, it would be appropriate to repeal section 5(c) of the Second Liberty Bond Act of September 24, 1917.

These changes in section 11(m) would be unnecessary if Recommendation No. 41-A, above, should be adopted.

42. RECAPTURE OF GOLD BY SECRETARY OF THE TREASURY

Subsection (n) of section 11 of the Act (12 U.S.C. 248(n)), added by the Emergency Banking Act of March 9, 1933, authorizes the Secretary of the Treasury to require delivery to
[Sec. 15] the Treasurer of the United States of all gold coin, gold bullion, and gold certificates owned by individuals, partnerships, associations, and corporations. These provisions do not properly belong in the Federal Reserve Act and should be re-enacted as a separate statute.

*43. ROTATION OF MEMBERSHIP ON FEDERAL ADVISORY COUNCIL

The first paragraph of section 12 of the Act (12 U.S.C. 261), regarding the organization of the Federal Advisory Council, provides that each Reserve Bank by its board of directors shall annually select one member of the Council. There is no limitation on the number of consecutive terms that may be served by a member of the Council.

Some degree of rotation in membership of the Council is desirable in order to obtain the advantages of broader representation and wider experience over a period of time. At the same time, the length of service permissible should be adequate to assure the benefits of continuity of policy and acquired ex-
[§ 301] perience. Both of these objectives would be accomplished by a provision specifically prohibiting a member of the Council from serving more than six full consecutive terms of one year each.

44. ELECTION OF MEMBERS OF FEDERAL OPEN MARKET COMMITTEE

The second sentence of subsection (a) of section 12A of the Act (12 U.S.C. 263) provides that representatives of the Reserve Banks on the Open Market Committee, "beginning with the
[§ 401] election for the term commencing March 1, 1943", shall be elected annually. The quoted language is obviously now obsolete and should be deleted.

*45. RESERVE BANK DEPOSITS AND COLLECTIONS

The first paragraph of section 13 and the thirteenth and fourteenth paragraphs of section 16 of the Federal Reserve Act, relating to the receipt of deposits by the Reserve Banks, collections, exchange and collection charges, and transfers of funds, contain some of the most ambiguous language in the Act. These paragraphs should be drastically simplified and combined. Section 15, relating to Government deposits in the Reserve Banks, should also be considered in this connection.

The first paragraph of section 13 (12 U.S.C. 342) reads as follows:

> "Any Federal reserve bank may receive from any of its member banks, and from the United States, deposits of current funds in lawful money, national-bank notes, Federal reserve notes, or checks, and drafts, payable upon presentation, and also, for collection, maturing notes and bills; or, solely for purposes of exchange or of collection, may receive from other Federal reserve banks deposits of current funds in lawful money, national-bank notes, or checks upon other Federal reserve banks, and checks and drafts, payable upon presentation within its district, and maturing notes and bills payable within its district; or, solely for the purposes of exchange or of collection, may receive from any nonmember bank or trust company deposits of current funds in lawful money, national-bank notes, Federal reserve notes, checks and drafts payable upon presentation, or maturing notes and bills: Provided, Such nonmember bank or trust company maintains with the Federal reserve bank of its district a balance sufficient to offset the items in transit held for its account by the Federal reserve bank: Provided further, That nothing in this or any other section of this Act shall be construed as prohibiting a member or nonmember bank from making reasonable charges, to be determined and regulated by the Board of Governors

of the Federal Reserve System, but in no case to exceed 10 cents per $100 or fraction thereof, based on the total of checks and drafts presented at any one time, for collection or payment of checks and drafts and remission therefor by exchange or otherwise; but no such charges shall be made against the Federal reserve banks."

The thirteenth and fourteenth paragraphs of section 16 (12 U.S.C. 360, 248(o)) read as follows:

"Every Federal reserve bank shall receive on deposit at par from member banks or from Federal reserve banks checks and drafts drawn upon any of its depositors, and when remitted by a Federal reserve bank, checks and drafts drawn by any depositor in any other Federal reserve bank or member bank upon funds to the credit of said depositor in said reserve bank or member bank. Nothing herein contained shall be construed as prohibiting a member bank from charging its actual expense incurred in collecting and remitting funds, or for exchange sold to its patrons. The Board of Governors of the Federal Reserve System shall, by rule, fix the charges to be collected by the member banks from its patrons whose checks are cleared through the Federal reserve bank and the charge which may be imposed for the service of clearing or collection rendered by the Federal reserve bank.

"The Board of Governors of the Federal Reserve System shall make and promulgate from time to time regulations governing the transfer of funds and charges therefor among Federal reserve banks and their branches, and may at its discretion exercise the functions of a clearing house for such Federal reserve banks, or may designate a Federal reserve bank to exercise such functions, and may also require each such bank to exercise the functions of a clearing house for its member banks."

With respect to deposits of Government funds, section 15 of the Federal Reserve Act (12 U.S.C. 391-393) provides as follows:

"The moneys held in the general fund of the Treasury, except the five per centum fund for the redemption of outstanding national-bank notes may, upon the direction of the Secretary of the Treasury, be deposited in Federal reserve banks, which banks, when required by the Secretary of the Treasury, shall act as fiscal agents of the United States; and the revenues of

the Government or any part thereof may be deposited in such banks, and disbursements may be made by checks drawn against such deposits.

"No public funds of the Philippine Islands, or of the postal savings, or any Government funds, shall be deposited in the continental United States in any bank not belonging to the system established by this Act: Provided, however, That nothing in this Act shall be construed to deny the right of the Secretary of the Treasury to use member banks as depositories.

"The Federal reserve banks are hereby authorized to act as depositories for and fiscal agents of any National Agricultural Credit Corporation or Federal Intermediate Credit Bank."

A. Description of "deposits"

The first clause of the first paragraph of section 13, relating to the receipt of deposits from member banks, refers to deposits of "current funds in lawful money, national-bank notes, Federal reserve notes, or checks, and drafts, payable upon presentation". The second clause of the paragraph, relating to the receipt of deposits from other Reserve Banks, refers to deposits of "current funds in lawful money, national-bank notes, or checks upon other Federal reserve banks", as well as checks and drafts and maturing notes and bills. The third clause of the paragraph, relating to receipt of deposits from nonmember banks, refers to deposits of "lawful money, national-bank notes, Federal reserve notes, checks and drafts payable upon presentation, or maturing notes and bills".

Apart from inconsistencies in language, it seems unnecessary for these provisions to describe deposits of current

funds with such particularity. Moreover, the reference to national bank notes is obsolete for all practical purposes, and the references to both "lawful money" and "Federal reserve notes" could imply that Federal Reserve notes do not constitute lawful money. It would seem preferable in all three instances to refer simply to the receipt of "deposits" without further description. [§ 601(a)]

B. Collections for member banks

The first clause of the first paragraph of section 13 authorizes a Reserve Bank to receive from its own member banks checks and drafts payable upon presentation and, for collection, maturing notes and bills. The first sentence of the thirteenth paragraph of section 16 of the Act, however, provides that every Reserve Bank "shall receive on deposit at par from member banks or from Federal reserve banks checks and drafts drawn upon any of its depositors", as well as checks and drafts drawn by any depositor in any other Reserve Bank or member bank when remitted by another Reserve Bank. This provision, although mandatory in nature, appears to be unnecessary in view of the provisions of the first paragraph of section 13. [§ 601(a)]

C. Collections for other Reserve Banks

The second clause of the first paragraph of section 13 authorizes a Reserve Bank, solely for purposes of exchange or of collection, to receive from other Reserve Banks deposits of current funds, including checks upon other Federal Reserve Banks and

checks and drafts and maturing notes and bills payable within the receiving Reserve Bank's district. This clause would be

[§ 601(a)] unnecessary if the first paragraph of section 13 were revised, as hereafter suggested, to contain broad authorization for the Reserve Banks, under regulations of the Board, to collect checks and other items received from member banks, other Federal Reserve Banks, nonmember banks, and others.

D. Place of payment of items

The first clause of the first paragraph of section 13 refers to the receipt by a Reserve Bank from its own member banks of checks and drafts "payable upon presentation" and of "maturing notes and bills" without reference to payment upon presentation. However, the second clause provides that checks and drafts received from other Reserve Banks shall be "payable upon presentation within its [the receiving Reserve Bank's] district" and also that maturing notes and bills shall be "payable within its district". Nevertheless, the third clause of the paragraph, relating to the collection of items for nonmember banks, provides only that checks and drafts shall be "payable upon presentation" and does not provide that maturing notes and bills shall be so payable. These inconsistencies should be

[§ 601(a)] eliminated by omitting entirely any reference to the place at which items are payable. This is a matter that can be covered, if necessary, by regulations of the Board of Governors.

E. Collections for organizations other than banks

The first paragraph of section 13 provides for the collection of items received from member banks, the United States, other Reserve Banks, and nonmember banks. It contains no reference to the collection of items received from other organizations, such as foreign banks or foreign correspondents of the Reserve Banks, international organizations, or Edge Act corporations, all of which are permitted to maintain accounts with the Reserve Banks. The Board's Regulation J, as revised effective September 1, 1967, specifically contemplates that the "sender" of an item to a Reserve Bank for collection may embrace any international organization, foreign correspondent, or Edge Act corporation that maintains an account with the Reserve Bank. In the interest of completeness, [§ 601(a)] it would be desirable to amend the first paragraph of section 13 to make it clear that the Reserve Banks are authorized to collect items for such organizations.

F. Exchange and collection charges

The last proviso in the first paragraph of section 13 in effect reserves to member and nonmember banks the right to make reasonable charges, to be regulated by the Board but not to exceed a certain amount, for the "collection or payment of checks and drafts and remission therefor by exchange or otherwise", with a specific provision that no such charges shall be made against the Reserve Banks.

This provision, known as the "Hardwick Amendment", was added to the Act in 1917, at the same time as the enactment of the preceding clause authorizing the collection of items for nonmember banks. It was apparently prompted by the fear of opponents of par clearance that the authority for collection of checks for nonmember banks would be used by the System as a means of inducing nonmember banks to discontinue the practice of making "exchange charges", i.e., charges for the payment of checks when presented through the mails. However, the proponents of par clearance were successful in amending the amendment by the addition of the last clause prohibiting the making of exchange charges against the Reserve Banks.

The Board's authority under the proviso to regulate exchange charges has never been utilized; and indeed the exercise of the authority would probably be ineffective since it has been interpreted as applying only to member banks and to those nonmember banks that have asked for and been given permission to open nonmember clearing accounts with the Reserve Banks.

It has been the consistent position of the Board that the practice of making exchange charges is unwarranted. In recent years, several States have enacted par clearance statutes; and the total number of so-called "nonpar banks" has steadily decreased. Accordingly, the last proviso in the first paragraph of section 13 [§ 601(b)] appears to be unnecessary and inappropriate, with the exception of the clause prohibiting the charging of exchange against the Reserve Banks.

Since 1943, the Board has construed this proviso as not relating to charges made by banks for the cashing and collection of checks drawn on other banks. However, the thirteenth paragraph of section 16 provides that the Board "shall" fix the charges to be collected by a member bank from its patrons whose checks are cleared through a Federal Reserve Bank. Despite the mandatory language of this provision, the Board has not attempted to fix collection charges made by member banks, principally because the thirteenth paragraph of section 16 specifically provides that nothing therein shall be construed as prohibiting a member bank from charging its "actual expense" in collecting and remitting funds and because it would be practically impossible to fix uniform charges that would be equitable for all banks. It might be desirable, therefore, to repeal the provision regarding the fixing of collection charges. In any event, if it is retained in the
[§ 601(c)] law, the word "shall" should be changed to "may".

The same paragraph of section 16 requires the Board to fix the charges that may be imposed "for the service of clearing or collection rendered by the Federal reserve bank." This authority likewise has never been exercised. Nevertheless, it might
[§ 601(c)] be desirable to retain the authority on a permissive basis.

*G. Transfers of funds and securities

The first part of the fourteenth paragraph of section 16 provides that the Board of Governors "shall make and promulgate from time to time regulations governing the transfer of funds

and charges therefor among Federal reserve banks and their branches". Implicit in this provision is the authority of the Reserve Banks

[§ 601(a)] to make such transfers, but it would be desirable to restate the provision in terms of an express authorization. Furthermore, such a restatement of the provision should be expanded to confer upon the Reserve Banks general authority to make transfers of funds and securities, whether or not for their member banks,

[§ 601(a)] along with authority to make appropriate arrangements to establish mechanisms to effectuate such transfers. Such authority might be useful as removing any legal doubt regarding the power of Reserve Banks at some time in the future to make electronic transfers of credit or securities in connection with the development of a sophisticated payments mechanism.

H. Exercise of clearing house functions

The last part of the fourteenth paragraph of section 16 provides that the Board of Governors may exercise the functions of a clearing house for the Reserve Banks, or designate a Reserve Bank to exercise such functions, and may also require each Reserve Bank to exercise the functions of a clearing house for its member banks. This provision should be reworded and combined with a revision of the first paragraph of section 13 of the Act. It

[§ 601(c)] might be expanded to authorize the Board to require Reserve Banks to exercise clearing functions for groups of member banks.

I. Deposits of the United States

The first clause of the first paragraph of section 13 of the Act includes authority for the receipt by the Reserve Banks of deposits from the United States. This authority is unnecessary in view of the fact that section 15 of the Act expressly provides for deposits of funds of the United States in the Reserve Banks.

In order that all provisions regarding receipt of deposits by the Reserve Banks may be together, it would be desirable to transfer the provisions of section 15 regarding Government deposits to a place in the Act immediately preceding or immediately following provisions relating to receipt of deposits from member
[§ 601(d)] banks and others. In making such a transfer, however, the provisions of section 15 should be revised to eliminate obsolete references. (See Recommendation No. 59.)

J. Deposits of Government agencies

The last paragraph of section 15 of the Act authorizes the Reserve Banks to act as depositories and fiscal agents for any National Agricultural Credit Corporation or Federal Intermediate Credit Bank. As indicated in Recommendation No. 52, National Agricultural Credit Corporations are no longer in existence and the reference to such Corporations therefore should be eliminated.

The authority of the Reserve Banks to act as depositories and fiscal agents for Federal Intermediate Credit Banks is the only provision of the Federal Reserve Act currently in force

relating to fiscal agency operations by the Reserve Banks for Government agencies. However, provisions authorizing the Reserve Banks to act as fiscal agents for numerous other Government agencies are scattered throughout Federal statutes relating specifically to such agencies. For example, the Reserve Banks are authorized to act as depositories and fiscal agents for the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation, the Federal Home Loan Banks, the Public Housing Administration, the Small Business Administration, Commodity Credit, the International Fund, the International Bank for Reconstruction and Development, and the Inter-American Development Bank.

Logically, all provisions regarding fiscal agency activities of the Reserve Banks for Government agencies should be either in the Federal Reserve Act itself or in the statutes specifically relating to such agencies. Placing all of such provisions in the Federal Reserve Act would require numerous amendments to other statutes. Moreover, it would seem desirable for one who is dealing with the activities of a particular Government agency, such as the Federal Deposit Insurance Corporation or a Federal Intermediate Credit Bank, to have available in the statutes relating to that agency a provision authorizing the Reserve Banks to act as fiscal agents for such agency.

Accordingly, it is recommended that the provision of section 15 authorizing the Reserve Banks to act as depositories [Sec. 16]

and fiscal agents for Federal Intermediate Credit Banks be eliminated from the Federal Reserve Act and re-enacted as a separate statute.

K. Arrangement

Section 15 and the thirteenth and fourteenth paragraphs [§ 601] of section 16 of the Federal Reserve Act should be repealed and the first paragraph of section 13 should be rewritten as four paragraphs. These new paragraphs, respectively, would -

(1) Broadly authorize the Reserve Banks, subject to regulations of the Board, to receive deposits from member banks, to collect checks and other items received from member banks, nonmember banks, and others, and to make transfers of funds and securities;

(2) Prohibit the making of exchange charges against the Reserve Banks;

(3) Repeat, with some modifications, the present provisions of section 16 authorizing the Board to regulate collection charges, to prescribe charges for transfers of funds by the Reserve Banks, and to exercise the functions of a clearing house for the Reserve Banks and require each Reserve Bank to exercise such functions for its member banks; and

(4) Repeat, with modifications, the provisions of the first paragraph of section 15 with respect to deposits of Government funds.

*46. ADVANCES BY FEDERAL RESERVE BANKS

In 1963, the Board of Governors recommended to Congress legislation that would permit member banks of the Federal Reserve System to borrow from the Federal Reserve Banks on the security of any satisfactory security, without being required to pay a "penalty" rate of interest whenever technically ineligible paper is presented as security for such borrowings. Such legislation would replace present provisions of the Federal Reserve Act that permit borrowings without a penalty rate only on the security of Government obligations or on paper that meets certain outmoded "eligibility" requirements.

The Board has reiterated its recommendation for such legislation in each of its Annual Reports since 1963. Bills to implement the Board's proposal passed the Senate in 1965 and 1967.

Briefly, the legislation heretofore recommended by the Board would (1) broadly authorize any Federal Reserve Bank to make advances to its member banks secured to the satisfaction of the Reserve Bank, subject to such regulations as may be prescribed by the Board; (2) authorize advances to individuals, partnerships, and corporations on the security of direct obligations of the United States, subject to Board regulation; (3) provide greater flexibility in the fixing of different interest rates on advances; and (4) make conforming amendments to various provisions of the Act.

[§ 602]

The legislation would repeal sections 10(a) (12 U.S.C. 347a), 10(b) (12 U.S.C. 347b), 11(b) (12 U.S.C. 248(b)), 13a (12 U.S.C. 348-352), the second, third, fourth, fifth, sixth, eighth, tenth, and thirteenth paragraphs of section 13 (12 U.S.C. 343-347c), and the last sentence of the third paragraph of section 24 (12 U.S.C. 371). It would amend the eighth paragraph of section 4 (12 U.S.C. 301), the thirteenth paragraph of section 9 (12 U.S.C. 330), section 11(m) (12 U.S.C. 248(m)), the second paragraph of section 12 (12 U.S.C. 262), the first paragraph of section 14 (12 U.S.C. 353), section 14(c) (12 U.S.C. 356), section 14(d) (12 U.S.C. 357), the second paragraph of section 16 (12 U.S.C. 412), section 19(e) (12 U.S.C. 374), and the second paragraph of section 23A (12 U.S.C. 371c).

A discussion of the origin and history of present provisions of the law in this area and of the reasons for which the law should be modernized was contained in the 1963 Federal Reserve Bulletin at page 1235. A concise statement of the reasons was set forth in the following paragraphs from a letter addressed by the Board to the Banking and Currency Committees of Congress on March 1, 1967:

> "For many years, it has been generally recognized that the concept of an elastic currency based on short-term, self-liquidating paper is no longer in consonance with banking practice and the needs of the economy. It has long been apparent that the narrow requirements of the law regarding 'eligible paper' serve no useful purpose and that it would be preferable to place emphasis on the soundness of the paper offered as security for

advances and the appropriateness of the purposes for which member banks borrow. The one-year paper of many bank customers that is not now eligible for discount may be as satisfactory collateral as the 90-day notes of other customers. Moreover, the nature of the collateral provides no assurance that the borrowing bank will use the proceeds for an appropriate purpose.

"As long as member banks hold a large enough volume of Government securities, they need not, of course, be particularly concerned as to the eligibility for discount with the Reserve Banks of customers' paper held by them. Since World War II, however, there has been a sharp net decline in the aggregate holdings of Government securities by member banks. Consequently, a number of banks are being obliged to tender other kinds of collateral when they seek to obtain Federal Reserve credit, and this development will be sharply accelerated if a further substantial increase in economic activity should cause banks further to reduce their holdings of Government securities in order to meet increased credit demands."

Three changes should be made in the provisions of the legislation originally recommended by the Board, the latest version of which was reflected by the bill S. 966, 90th Congress, that was passed by the Senate on April 17, 1967:

1. Section 5 of the bill S. 966, amending section 11(c) of the Federal Reserve Act (12 U.S.C. 248(c)), is no longer necessary in view of amendments made to that section by the so-called "Gold Cover Act" of March 18, 1968.

2. Subsection (c) of the new section 13A, that would be added to the Federal Reserve Act by S. 966, would authorize any Reserve Bank to make advances to individuals, partnerships, or corporations only on the security of direct obligations of the United States. It would be desirable to make this authority more

[§ 602(c)] flexible by permitting such advances to be made on any security satisfactory to the lending Reserve Bank. At the same time, however, this provision should be amended to authorize such advances to others than member banks only in "exigent circumstances".

3. Section 10 of S. 966 would amend section 14(d) of the Federal Reserve Act (12 U.S.C. 357), regarding the establishment of discount rates, to provide that, in the case of advances to member banks, interest rates shall be established by the Reserve Banks subject to review and determination by the Board of Governors, with a view of accommodating commerce, business, and agriculture, and with authority for the fixing of different rates for different classes of paper according to such basis or bases as may be deemed necessary. In a separate clause, this section of the bill would provide for the establishment of rates of interest to be charged on advances to individuals, partnerships, and corporations. These

[§ 602(d)] two provisions with respect to establishment of interest rates should be combined. Otherwise, the language of the bill might be construed as not requiring that rates on advances to individuals, partnerships, and corporations shall be established with a view to accommodating commerce, business, and agriculture, and also as not providing the same flexibility for the establishment of different rates on such advances as is provided with respect to advances made to member banks.

47. DISCOUNTS FOR INDIVIDUALS, PARTNERSHIPS, AND CORPORATIONS

The third paragraph of section 13 of the Act (12 U.S.C. 343), added by the Act of July 21, 1932, provides that, in unusual and exigent circumstances, the Board may authorize a Federal Reserve Bank to discount "eligible paper" for any individual, partnership, or corporation, where the borrower is unable to secure adequate credit accommodations from other banking institutions.

This paragraph, enacted in an emergency situation, has never been utilized and appears to have no real importance at the present time. It should be repealed.[3/]

3/ This recommendation is unnecessary if Recommendation No. 46 is adopted.

*48. BANK ACCEPTANCES

The seventh paragraph of section 13 of the Act (12 U.S.C. 372) reads as follows:

"Any member bank may accept drafts or bills of exchange drawn upon it having not more than six months sight to run, exclusive of days of grace, which grow out of transactions involving the importation or exportation of goods; or which grow out of transactions involving the domestic shipment of goods provided shipping documents conveying or securing title are attached at the time of acceptance; or which are secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title covering readily marketable staples. No member bank shall accept, whether in a foreign or domestic transaction, for any one person, company, firm, or corporation to an amount equal at any time in the aggregate to more than ten per centum of its paid-up and unimpaired capital stock and surplus, unless the bank is secured either by attached documents or by some other actual security growing out of the same transaction as the acceptance; and no bank shall accept such bills to an amount equal at any time in the aggregate to more than one-half of its paid-up and unimpaired capital stock and surplus: Provided, however, That the Board of Governors of the Federal Reserve System, under such general regulations as it may prescribe, which shall apply to all banks alike regardless of the amount of capital stock and surplus, may authorize any member bank to accept such bills to an amount not exceeding at any time in the aggregate one hundred per centum of its paid-up and unimpaired capital stock and surplus: Provided, further, That the aggregate of acceptances growing out of domestic transactions shall in no event exceed fifty per centum of such capital stock and surplus."

The twelfth paragraph of section 13 reads as follows:

"Any member bank may accept drafts or bills of exchange drawn upon it having not more than three months' sight to run, exclusive of days of grace, drawn under regulations to be prescribed by the Board of Governors of the Federal Reserve System by banks or bankers in foreign countries or dependencies or insular possessions

of the United States for the purpose of furnishing dollar exchange as required by the usages of trade in the respective countries, dependencies, or insular possessions. Such drafts or bills may be acquired by Federal reserve banks in such amounts and subject to such regulations, restrictions, and limitations as may be prescribed by the Board of Governors of the Federal Reserve System: Provided, however, That no member bank shall accept such drafts or bills of exchange referred to[1/] this paragraph for any one bank to an amount exceeding in the aggregate ten per centum of the paid-up and unimpaired capital and surplus of the accepting bank unless the draft or bill of exchange is accompanied by documents conveying or securing title or by some other adequate security: Provided further, That no member bank shall accept such drafts or bills in an amount exceeding at any time the aggregate of one-half of its paid-up and unimpaired capital and surplus."

"1/ So in statute as enacted.

The first sentence of the seventh paragraph of section 13, quoted above, purports to authorize any member bank to make acceptances of certain specified types. The twelfth paragraph of section 13 similarly purports to authorize any member bank to accept dollar exchange drafts. However, the Board of Governors has consistently taken the position that State member banks are not limited by these provisions as to the types of acceptances they may make; and the Comptroller of the Currency has taken a similar position with respect to the acceptance authority of national banks.

The limitations with respect to types of acceptances may be regarded as having some significance in that the sixth paragraph of section 13 (12 U.S.C. 346) authorizes the Federal Reserve Banks to discount only acceptances "of the kinds hereinafter described". However, if the law is amended to authorize

the Reserve Banks to make advances on any satisfactory security (see Recommendation No. 46), the present limitations regarding the types of acceptances eligible for discount would have no significance at all. Even under present law, the limitations on the types of acceptances eligible for discount have little practical significance, since the Board has ruled that acceptances are eligible for purchase by the Reserve Banks whether or not eligible for discount and since, under the eighth paragraph of section 13, advances may be made by the Reserve Banks on any acceptances eligible for purchase by the Reserve Banks.

The twelfth paragraph of section 13 appears to limit dollar exchange acceptances to those instances in which they are "required by the usages of trade". As a practical matter, this requirement means little, if anything, today in view of developments in recent decades in the areas of international exchange and communication.

Under the Board's Regulation C, member banks are required to obtain the Board's prior approval in order to accept dollar exchange drafts. It is questionable, however, whether this requirement has any valid statutory basis.

Both the seventh and the twelfth paragraphs of section 13 prescribe limits on the amount of acceptances therein described that may be made for one person and on the aggregate amount of such acceptances. It is believed that such quantitative limitations should be retained but that the law should be

changed to make them applicable to all acceptances of whatever kind that are made by member banks.

The second sentence of the twelfth paragraph of section 13 provides that dollar exchange drafts may be acquired by Federal Reserve Banks subject to regulations of the Board. However, the first paragraph of section 14 of the Act (12 U.S.C. 353) similarly provides for the acquisition of bankers' acceptances by the Federal Reserve Banks. Consequently, it appears that the second sentence of the twelfth paragraph of section 13 is unnecessary.

For the reasons indicated, it is believed that the twelfth paragraph of section 13 should be repealed and that the seventh paragraph should be revised to eliminate mention of specific kinds of acceptances and to provide only for quantitative limitations in the manner now provided but with such limitations made applicable to all member bank acceptances.

[§ 907]

49. AGGREGATE LIABILITIES OF NATIONAL BANKS

Section 5202 of the Revised Statutes, as amended by the ninth paragraph of section 13 of the Federal Reserve Act (12 U.S.C. 82), limits the aggregate amount for which a national bank may at any time be indebted, with 10 enumerated exceptions. The tenth of these exceptions refers to "Liabilities incurred under the provisions of section 13b of the Federal Reserve Act." Section 13b was repealed by Act of August 21, 1958, effective

[Sec. 6] August 21, 1959. Consequently, exception "Tenth" in section 5202 of the Revised Statutes is obsolete and should be omitted.

50. NATIONAL BANKS AS INSURANCE AGENTS OR REAL ESTATE LOAN BROKERS

The eleventh paragraph of section 13 of the Act authorizes national banks, subject to certain conditions, to act as insurance agents or real estate loan brokers. This paragraph, since it relates only to the powers of national

[Sec. 12] banks, does not properly belong in the Federal Reserve Act and should be re-enacted as a separate statute.

51. OBSOLETE REFERENCES TO OBLIGATIONS OF HOME OWNERS' LOAN CORPORATION

The eighth paragraph of section 13 of the Act (12 U.S.C. 347) authorizes the Reserve Banks to make advances to member banks on their notes secured by various types of collateral, including -

> ". . . the deposit or pledge of bonds issued under the provisions of subsection (c) of section 4 of the Home Owners' Loan Act of 1933, as amended . . . ."

Section 14(b) of the Federal Reserve Act (12 U.S.C. 355) authorizes each Federal Reserve Bank to buy and sell certain types of obligations, including -

> ". . . bonds issued under the provisions of subsection (c) of section 4 of the Home Owners' Loan Act of 1933, as amended . . . ."

The Home Owners' Loan Corporation was dissolved effective February 3, 1954, and no bonds of that Corporation are outstanding. Consequently, references to such bonds should be eliminated.

[§ 603(a)]
[§ 904(b)]

52. OBSOLETE REFERENCES TO NATIONAL AGRICULTURAL CREDIT CORPORATIONS

The third paragraph of section 13a of the Federal Reserve Act (12 U.S.C. 350) authorizes any Federal Reserve Bank to buy and sell debentures and other such obligations issued by "a National Agricultural Credit Corporation".

Section 14(f) of the Federal Reserve Act (12 U.S.C. 359) authorizes any Federal Reserve Bank to purchase and sell in the open market acceptances "of National Agricultural Credit Corporations".

The third paragraph of section 15 of the Federal Reserve Act (12 U.S.C. 393) authorizes the Federal Reserve Banks to act as depositories and fiscal agents for "any National Agricultural Credit Corporation".

[§ 601(d)] [§ 603(a)] Section 77 of the Act of June 16, 1933 (12 U.S.C. 1151a), provided that after the date of that Act "no national agricultural credit corporation shall be formed under the provisions of this chapter." No such corporations are now in operation. Consequently, references in the Federal Reserve Act to these corporations are obsolete and should be repealed.

53. REGULATION OF OPEN MARKET OPERATIONS

The tenth paragraph of section 13 of the Act reads as follows:

> "The discount and rediscount and the purchase and sale by any Federal reserve bank of any bills receivable and of domestic and foreign bills of exchange, and of acceptances authorized by this Act, shall be subject to such restrictions, limitations, and regulations as may be imposed by the Board of Governors of the Federal Reserve System."

The first paragraph of section 14 (12 U.S.C. 353) reads as follows:

> "Any Federal reserve bank may, under rules and regulations prescribed by the Board of Governors of the Federal Reserve System, purchase and sell in the open market, at home or abroad, either from or to domestic or foreign banks, firms, corporations, or individuals, cable transfers and bankers' acceptances and bills of exchange of the kinds and maturities by this Act made eligible for rediscount, with or without the indorsement of a member bank."

Subsection (b)(1) of section 14 (12 U.S.C. 355) provides for the purchase and sale by the Federal Reserve Banks of various types of paper in the open market "in accordance with rules and regulations prescribed by the Board of Governors of the Federal Reserve System".

Subsection (f) of section 14 (12 U.S.C. 359) authorizes the Reserve Banks to purchase and sell in the open market acceptances of Federal Intermediate Credit Banks and National Agricultural Credit Corporations "whenever the Board of Governors of the Federal Reserve System shall declare that the public interest so requires."

Since enactment of the provisions cited above, Congress has enacted section 12A of the Federal Reserve Act (12 U.S.C. 263), which contains the following paragraph:

> "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. The Committee shall consider, adopt, and transmit to the several Federal Reserve banks, regulations relating to the open-market transactions of such banks."

It seems clear that all open market operations by the Reserve Banks are now subject to direction and regulation by the Federal Open Market Committee and that all references to regulation of such operations by the Board of Governors should be deleted, with substitution of reference to the Open Market Committee where appropriate.

[§ 603]

54. EXCHANGE OF FEDERAL RESERVE NOTES FOR GOLD

Under subsection (a) of section 14 of the Act (12 U.S.C. 354), Reserve Banks are authorized to "exchange Federal reserve notes for gold, gold coin, or gold certificates". Since Federal Reserve notes are no longer redeemable in gold or gold certificates, this language is obsolete and should be deleted.

[§ 606]

55. EMPLOYEES OF BOARD OF GOVERNORS

*A. Exemption from Civil Service

Section 11(1) of the Federal Reserve Act (12 U.S.C. 248(1)) authorizes the Board of Governors:

> "To employ such attorneys, experts, assistants, clerks, or other employees as may be deemed necessary to conduct the business of the board. All salaries and fees shall be fixed in advance by said board and shall be paid in the same manner as the salaries of the members of said board. All such attorneys, experts, assistants, clerks, and other employees shall be appointed without regard to the provisions of the Act of January sixteenth, eighteen hundred and eighty-three (volume twenty-two, United States Statutes at Large, page four hundred and three), and amendments thereto, or any rule or regulation made in pursuance thereof: Provided, That nothing herein shall prevent the President from placing said employees in the classified service."

This provision was a part of the original Federal Reserve Act and has never been specifically amended. Nevertheless, as it appears in the 1964 edition of the United States Code, this paragraph has been revised to eliminate the provision for exemption of Board employees from the Civil Service. As so revised, section 11(1), according to the Code, now provides only that the Board is authorized:

> "To employ such attorneys, experts, assistants, clerks, or other employees as may be deemed necessary to conduct the business of the board. All salaries and fees shall be fixed in advance by said board and shall be paid in the same manner as the salaries of the members of said board."

In explanation of this revision, an annotation by the codifier (as revised in the 1967 Pocket Part to title 12 of the U.S.C.A.) states:

> "Provisions of subsec. (1), which authorized appointment of attorneys, experts, assistants, clerks and other employees without regard to the provisions of the act of January sixteenth, eighteen hundred and eighty-three, and amendments thereto, or any rule or regulation made in pursuance thereof, were omitted since the employees referred to are now in the classified civil service and subject to the applicable compensation schedules.
>
> "The authority for covering excepted positions into the classified civil service was given the President by former section 631a of Title 5, Executive Departments and Government Officers and Employees. By Executive Order 8743, Apr. 25, 1941, the President exercised this authority with respect to many previously excepted positions.
>
> "For positions now covered by the Classification Act of 1949, see section 5101 et seq. of Title 5, Government Organization and Employees."

It seems clear beyond doubt that the codifier was in error and that employees of the Board of Governors under present law are not covered by the classified Civil Service. Moreover, it may be questioned whether the President now has authority to place employees of the Board in the classified service.

The Banking Act of 1933 amended section 10 of the Federal Reserve Act to add the following sentence:

> ". . . The Board shall determine and prescribe the manner in which its obligations shall be incurred and its disbursements and expenses allowed and paid, and may leave on deposit in the Federal Reserve banks the proceeds of assessments levied upon them to defray its estimated expenses and the salaries of its members and employees, whose employment, compensation, leave, and expenses shall be governed solely by the provisions of this Act, specific

> amendments thereof, and rules and regulations of the Board not inconsistent therewith; and funds derived from such assessments shall not be construed to be Government funds or appropriated moneys. . . ."

The Report of the Senate Banking and Currency Committee stated that this provision "leaves to the Board the determination of its own internal management policies." (Report No. 77, 73d Cong., May 17, 1933, p. 14) Since the new provision made the employment and compensation of Board employees subject "solely" to the provisions of the Federal Reserve Act and regulations of the Board, it could reasonably be regarded as having superseded the earlier provisions of section 11(1) of the Act apparently authorizing the President to place such employees in the classified service.

However, the so-called Ramspeck Act of November 26, 1940 (54 Stat. 1211) authorized the President, "Notwithstanding any provisions of law to the contrary, . . . to cover into the classified civil service any offices or positions in or under an executive department, independent establishment, or other agency of the Government". This authority was sufficiently broad to permit the President to bring Board employees under the classified service. However, on December 27, 1940, shortly after enactment of the Ramspeck Act, the President wrote the following letter to the Civil Service Commission:

> "The Chairman of the Board of Governors of the Federal Reserve System has conferred with me regarding the possibility of action under the Ramspeck Civil Service Act of November 26, 1940, to place the employees of his Board under the classified civil service and the Classification Act of 1923, as amended.

> "I have advised him that it is not my intention to place the employees of the Board of Governors of the Federal Reserve System under the classified civil service or the Classification Act, as amended, in view of the desirability of avoiding a condition under which the employees of the Board of Governors would be placed in a different status in this regard from those of the Federal Reserve Banks and their branches, and in view also of the fact that the salaries of the Board's employees are paid from funds derived from assessments on the Federal Reserve Banks and not from appropriations by Congress."

On January 3, 1941, the Chairman of the Civil Service Commission replied to the President as follows:

> "The Commission has received your letter of December 27, 1940, to the effect that it is not your intention to place the employees of the Board of Governors of the Federal Reserve System under the classified Civil Service Act or the Classification Act, as amended. The Commission, of course, will be guided accordingly."

Subsequently, on April 23, 1941, the President issued Executive Order 8743 pursuant to the Ramspeck Act, placing under the classified service all offices and positions in the "executive civil service of the United States" except those of a temporary nature, those expressly excepted from the provisions of the Ramspeck Act [exceptions that did not cover the Board's employees], those excepted under Schedules A and B of the Civil Service Rules, and those already having a classified status. While the Board's employees were not specifically exempted by the Executive Order, that Order was never regarded as having brought the Board's employees under the classified service. Actually, in December 1941, the Civil Service Commission issued

its Schedule A showing that all positions of the Board were excepted from the classified service.

In 1966, title 5 of the United States Code was recodified as positive law by Act of September 6, 1966 (P.L. 89-554). This recodification omitted the earlier provisions of the Ramspeck Act (formerly carried as 5 U.S.C. 631a) authorizing the President to place positions in the classified service. The codifier, in his annotation to section 11(1) in the 1967 Pocket Part to title 12 of the U.S.C.A., expressly recognized that that authority of the President had ceased to exist and that the coverage of the Classification Act is now determined by section 5101 et seq. of the recodified title 5.

Section 5102(c) of the recodified title 5 of the U. S. Code expressly exempts from the chapter relating to classification of Government positions -

> "(14) Employees whose pay is not wholly from appropriated funds of the United States, . . ."

Since Board employees are not paid from appropriated funds of the United States, it seems fairly clear that they are not covered by provisions of present law relating to the classified service. Moreover, as previously noted, there is now no express provision of the law authorizing the President to bring employees under the classified service.

In these circumstances, section 11(1) of the Federal Reserve Act should be revised to conform to present law so as

to continue to provide that employees of the Board are not
[§ 202(a)] subject to provisions of law or regulations relating to the classified service but to omit any provision authorizing the President to place such employees in the classified service.

B. Manner of payment of salaries

The second sentence of section 11(1) of the Act, as previously quoted, provides that all salaries and fees of Board employees "shall be fixed in advance by said board and shall be paid in the same manner as the salaries of the members of said board."

The provision for fixing of salaries in advance does not appear necessary. The requirement that salaries of employees be paid in the same manner as salaries of members of the Board has not been adhered to, as a technical matter, for many years. Although section 10 of the Act specifically provides that salaries of Board members shall be "payable monthly", employees have been paid on a biweekly basis. Accordingly, the second
[§ 202(a)] sentence of section 11(1) should be omitted from the law.

C. Arrangement

The provisions of section 11(1), revised in accordance
[§ 202(a)] with the foregoing recommendations, should be combined with provisions of section 10 relating to salaries and leave of Board employees.

56. PURCHASE AND SALE OF BILLS OF EXCHANGE

Subsection (c) of section 14 of the Act (12 U.S.C. 356) authorizes each Reserve Bank -

> "To purchase from member banks and to sell, with or without its indorsement, bills of exchange arising out of commercial transactions, as hereinbefore defined;".

Since the first paragraph of section 14 (12 U.S.C. 353) expressly authorizes the Reserve Banks to purchase and sell bills of exchange, it appears that the above-quoted subsection (c) is redundant and should be omitted from the law.

57. FOREIGN ACCOUNTS AND CORRESPONDENTS

Section 14(e) of the Act (12 U.S.C. 358) reads as follows:

> "(e) To establish accounts with other Federal reserve banks for exchange purposes and, with the consent or upon the order and direction of the Board of Governors of the Federal Reserve System and under regulations to be prescribed by said board, to open and maintain accounts in foreign countries, appoint correspondents, and establish agencies in such countries wheresoever it may be deemed best for the purpose of purchasing, selling, and collecting bills of exchange, and to buy and sell, with or without its indorsement, through such correspondents or agencies, bills of exchange (or acceptances) arising out of actual commercial transactions which have not more than ninety days to run, exclusive of days of grace, and which bear the signature of two or more responsible parties, and, with the consent of the Board of Governors of the Federal Reserve System, to open and maintain banking accounts for such foreign correspondents or agencies, or for foreign banks or bankers, or for foreign states as defined in section 25(b) of this Act. Whenever any such account has been opened or agency or correspondent has been appointed by a Federal reserve bank, with the consent of or under the order and direction of the Board of Governors of the Federal Reserve System, any other Federal reserve bank may, with the consent and approval of the Board of Governors of the Federal Reserve System, be permitted to carry on or conduct, through the Federal reserve bank opening such account or appointing such agency or correspondent, any transaction authorized by this section under rules and regulations to be prescribed by the board."

The opening clause of this paragraph authorizes a Reserve Bank to establish accounts with other Reserve Banks for "exchange purposes". Whatever may have been the original intent of this provision, it seems unnecessary in view of the authority contained in the first paragraph of section 13 of the Act (12 U.S.C. 342) for every Reserve Bank to receive deposits from other Reserve Banks.

Apart from the clause just mentioned, the paragraph in question relates entirely to foreign operations of the Reserve Banks. To a large extent, the language of the paragraph is inconsistent or overlapping. For example, it refers without uniformity to actions that may be taken "with the consent or upon the order and direction of the Board", "with the consent of the Board", and "with the consent and approval of the Board". In the first part of the paragraph, reference is made to the appointment of correspondents and the establishment of agencies in foreign countries, whereas subsequently the paragraph refers to the appointment of correspondents or agencies. It is not clear from this language whether "agencies" could be offices actually established by a Reserve Bank in foreign countries or whether the term is intended to refer only to agents in such countries appointed by the Reserve Bank. These inconsistencies should be resolved.

[§ 607]

If legislation should be enacted to authorize the Reserve Banks to make advances on any satisfactory assets (Recommendation No. 46) and thus eliminate provisions of present law based upon the original concept that Reserve Bank credit should be extended only on short-term, self-liquidating commercial paper, it may be questioned whether the authority of the Reserve Banks under this paragraph to purchase bills of exchange and acceptances should be limited to paper arising out of "actual commercial transactions" with maturities of not more than 90 days.

*58. INVESTMENT BY RESERVE BANKS IN OBLIGATIONS OF FOREIGN GOVERNMENTS

Section 14(e) of the Federal Reserve Act (12 U.S.C. 358) authorizes the Reserve Banks, with the consent of the Board of Governors, to open and maintain accounts in foreign countries and to buy and sell through foreign correspondents "bills of exchange (or acceptances) arising out of actual commercial transactions which have not more than ninety days to run, exclusive of days of grace, and which bear the signature of two or more responsible parties . . . ."

Since February 1962, under regulations and directions of the Federal Open Market Committee, the Federal Reserve Bank of New York has engaged in foreign currency operations on behalf of the System Open Market Account; and these operations have helped to safeguard the value of the dollar in international exchange markets. Such operations have been implemented in part by the establishment of reciprocal credit balances or "swap" arrangements between the New York Reserve Bank and foreign central banks. Idle amounts held by the New York Reserve Bank in an account with a foreign bank may be placed in an interest-bearing time account with such foreign bank or some other foreign bank or, under section 14(e) of the Federal Reserve Act above quoted, they may be invested in bills of exchange and acceptances arising out of actual commercial transactions and having maturities of not more than 90 days. In some instances, however, there has

been a scarcity of such paper for investment, and interest-bearing time deposit facilities with foreign banks have not always been conveniently available. In such cases, idle balances in such foreign accounts could not be invested in obligations of foreign governments, even though a foreign central bank having a balance with the New York Reserve Bank may invest idle funds in its account in interest-bearing United States securities.

The resulting operational disadvantage would be remedied by an amendment to section 14(e) of the Federal Reserve Act that would specifically authorize the Reserve Banks to buy and sell [§ 607(a)] securities of foreign governments that have maturities not exceeding 12 months and are payable in convertible currencies.

The Board of Governors has recommended such an amendment to section 14(e) (see Board's Annual Report for 1967, p. 332), and a bill for this purpose (S. 965) was passed by the Senate on April 14, 1967.

59. GOVERNMENT DEPOSITS

Section 15 of the Act, as amended (12 U.S.C. 391-393), reads as follows:

> "The moneys held in the general fund of the Treasury, except the five per centum fund for the redemption of outstanding national-bank notes may, upon the direction of the Secretary of the Treasury, be deposited in Federal reserve banks, which banks, when required by the Secretary of the Treasury, shall act as fiscal agents of the United States; and the revenues of the Government or any part thereof may be deposited in such banks, and disbursements may be made by checks drawn against such deposits.
>
> "No public funds of the Philippine Islands, or of the postal savings, or any Government funds, shall be deposited in the continental United States in any bank not belonging to the system established by this Act: Provided, however, That nothing in this Act shall be construed to deny the right of the Secretary of the Treasury to use member banks as depositories.
>
> "The Federal reserve banks are hereby authorized to act as depositories for and fiscal agents of any National Agricultural Credit Corporation or Federal Intermediate Credit Bank."

A. Redemption fund for national bank notes

The first paragraph of section 15 was in effect amended by the Act of May 29, 1920, the so-called "Subtreasury Act", which authorized the Secretary of the Treasury to utilize any of the Federal Reserve Banks as depositories or fiscal agents of the United States for the purpose of performing the duties and functions previously performed by the Assistant Treasurers of the United States and subtreasuries, "notwithstanding the limitations of section 15 of the Federal Reserve Act". Consequently, the prohibition in section 15 with respect to deposits in the Reserve Banks of moneys in the 5 per cent redemption fund for national bank notes is no longer applicable and should be omitted

[§ 601(d)]

from the paragraph. In any event, this exception is of no significance since national bank notes are no longer issued and only a nominal amount of such notes is outstanding.

B. Funds of Philippines

Since the independence of the Philippine Islands was recognized by Presidential Proclamation of July 4, 1946, the [§ 601(d)] words "of the Philippine Islands, or" in the second paragraph of section 15 are clearly obsolete and have been omitted from the United States Code.

C. Deposits in nonmember banks

The prohibition contained in the second paragraph of section 15 against the deposit of Government funds in any bank not belonging to the Federal Reserve System has been superseded by provisions of later law authorizing the deposit of Government [§ 601(d)] funds in any insured bank, including insured banks that are not members of the Federal Reserve System. (See particularly section 10 of the Act of June 11, 1942 (12 U.S.C. 265).)

60. FEDERAL RESERVE NOTES

The first twelve paragraphs of section 16 of the Federal Reserve Act, as amended by the Act of March 18, 1968 (P.L. 90-269), and by the Special Drawing Rights Act of June 19, 1968 (P.L. 90-349) (12 U.S.C. 411-421), are set forth below, numbered for convenience of reference.

[1] "Federal reserve notes, to be issued at the discretion of the Board of Governors of the Federal Reserve System for the purpose of making advances to Federal reserve banks through the Federal reserve agents as hereinafter set forth and for no other purpose, are hereby authorized. The said notes shall be obligations of the United States and shall be receivable by all national and member banks and Federal reserve banks and for all taxes, customs, and other public dues. They shall be redeemed in lawful money on demand at the Treasury Department of the United States, in the city of Washington, District of Columbia, or at any Federal Reserve bank.

[2] "Any Federal Reserve bank may make application to the local Federal Reserve agent for such amount of the Federal Reserve notes hereinbefore provided for as it may require. Such application shall be accompanied with a tender to the local Federal Reserve agent of collateral in amount equal to the sum of the Federal Reserve notes thus applied for and issued pursuant to such application. The collateral security thus offered shall be notes, drafts, bills of exchange, or acceptances acquired under the provisions of section 13 of this Act, or bills of exchange endorsed by a member bank of any Federal Reserve district and purchased under the provisions of section 14 of this Act, or bankers' acceptances purchased under the provisions of said section 14, or gold certificates, or Special Drawing Right certificates, or direct obligations of the United States. In no event shall such collateral security be less than the amount of Federal Reserve notes applied for. The Federal Reserve agent shall each day notify the Board of Governors of the Federal Reserve System of all issues and withdrawals of Federal Reserve notes to and by the Federal Reserve bank to which he is accredited. The said Board of Governors of the Federal Reserve System may at any time call upon a Federal Reserve bank for additional security to protect the Federal Reserve notes issued to it.

[3] "Federal Reserve notes shall bear upon their faces a distinctive letter and serial number which shall be assigned by the Board of Governors of the Federal Reserve System to each Federal Reserve bank. Federal Reserve notes unfit for circulation shall be canceled, destroyed, and accounted for under procedures prescribed and at locations designated by the Secretary of the Treasury. Upon destruction of such notes, credit with respect thereto shall be apportioned among the twelve Federal Reserve banks as determined by the Board of Governors of the Federal Reserve System.

[4] "The Board of Governors of the Federal Reserve System shall have the right, acting through the Federal Reserve agent, to grant in whole or in part, or to reject entirely the application of any Federal Reserve bank for Federal Reserve notes; but to the extent that such application may be granted the Board of Governors of the Federal Reserve System shall, through its local Federal Reserve agent, supply Federal Reserve notes to the banks so applying, and such bank shall be charged with the amount of the notes issued to it and shall pay such rate of interest as may be established by the Board of Governors of the Federal Reserve System on only that amount of such notes which equals the total amount of its outstanding Federal Reserve notes less the amount of gold certificates held by the Federal Reserve agent as collateral security. Federal Reserve notes issued to any such bank shall, upon delivery, together with such notes of such Federal Reserve bank as may be issued under section 18 of this Act upon security of United States 2 per centum Government bonds, become a first and paramount lien on all the assets of such bank.

[5] "Any Federal Reserve bank may at any time reduce its liability for outstanding Federal Reserve notes by depositing with the Federal Reserve agent its Federal Reserve notes, gold certificates, Special Drawing Right certificates, or lawful money of the United States. Federal Reserve notes so deposited shall not be reissued, except upon compliance with the conditions of an original issue. The liability of a Federal Reserve bank with respect to its outstanding Federal Reserve notes shall be reduced by any amount paid by such bank to the Secretary of the Treasury under section 4 of the Old Series Currency Adjustment Act.

[6] "Any Federal reserve bank may at its discretion withdraw collateral deposited with the local Federal reserve agent for the protection of its Federal reserve notes issued to it and shall at the same time substitute therefor other collateral of equal amount with the approval of the Federal reserve agent under regulations to be prescribed by the Board of Governors of the Federal Reserve System. Any Federal reserve bank may retire any of its Federal reserve notes by depositing them with the Federal reserve agent or with the Treasurer of the United States, and such Federal reserve bank shall thereupon be entitled to receive back the collateral deposited with the Federal reserve agent for the security of such notes. Any Federal Reserve bank shall further be entitled to receive back the collateral deposited with the Federal Reserve agent for the security of any notes with respect to which such bank has made payment to the Secretary of the Treasury under section 4 of the Old Series Currency Adjustment Act. Federal reserve notes so deposited shall not be reissued except upon compliance with the conditions of an original issue.

[7] "All Federal Reserve notes and all gold certificates, Special Drawing Right certificates, and lawful money issued to or deposited with any Federal Reserve agent under the provisions of the Federal Reserve Act shall hereafter be held for such agent, under such rules and regulations as the Board of Governors of the Federal Reserve System may prescribe, in the joint custody of himself and the Federal Reserve bank to which he is accredited. Such agent and such Federal Reserve bank shall be jointly liable for the safekeeping of such Federal Reserve notes, gold certificates, Special Drawing Right certificates, and lawful money. Nothing herein contained, however, shall be construed to prohibit a Federal Reserve agent from depositing gold certificates and Special Drawing Right certificates with the Board of Governors of the Federal Reserve System, to be held by such Board subject to his order, or with the Treasurer of the United States for the purposes authorized by law.

[8] "In order to furnish suitable notes for circulation as Federal reserve notes, the Comptroller of the Currency shall, under the direction of the Secretary of the Treasury, cause plates and dies to be engraved in the best manner to guard against counterfeits and fraudulent alterations, and shall have printed therefrom and numbered such quantities of such notes of the denominations of $1, $2, $5, $10, $20,

$50, $100, $500, $1,000, $5,000, $10,000 as may be required to supply the Federal reserve banks. Such notes shall be in form and tenor as directed by the Secretary of the Treasury under the provisions of this Act and shall bear the distinctive numbers of the several Federal reserve banks through which they are issued.

[9] "When such notes have been prepared, they shall be deposited in the Treasury, or in the subtreasury or mint of the United States nearest the place of business of each Federal reserve bank and shall be held for the use of such bank subject to the order of the Comptroller of the Currency for their delivery, as provided by this Act.

[10] "The plates and dies to be procured by the Comptroller of the Currency for the printing of such circulating notes shall remain under his control and direction, and the expenses necessarily incurred in executing the laws relating to the procuring of such notes, and all other expenses incidental to their issue and retirement, shall be paid by the Federal reserve banks, and the Board of Governors of the Federal Reserve System shall include in its estimate of expenses levied against the Federal reserve banks a sufficient amount to cover the expenses herein provided for.

[11] "The examination of plates, dies, bed pieces, and so forth, and regulations relating to such examination of plates, dies, and so forth, of national-bank notes provided for in section fifty-one hundred and seventy-four Revised Statutes, is hereby extended to include notes herein provided for.

[12] "Any appropriation heretofore made out of the general funds of the Treasury for engraving plates and dies, the purchase of distinctive paper, or to cover any other expense in connection with the printing of national-bank notes or notes provided for by the Act of May thirtieth, nineteen hundred and eight, and any distinctive paper that may be on hand at the time of the passage of this Act may be used in the discretion of the Secretary for the purposes of this Act, and should the appropriations heretofore made be insufficient to meet the requirements of this Act in addition to circulating notes provided for by existing law, the Secretary is hereby authorized to use so much of any funds in the Treasury not otherwise appropriated for the purpose of furnishing the notes aforesaid: Provided, however, That nothing in this section contained shall be construed as exempting national banks or Federal reserve banks from their liability to reimburse the United States for any expenses incurred in printing and issuing circulating notes."

A. Purpose of issuance

The first sentence of the first paragraph of section 16 indicates that Federal Reserve notes are to be issued "for the purpose of making advances to Federal reserve banks". This language is clearly misleading. If any provision as to the purpose of issuance of Federal Reserve notes is to be included

[§ 604(a)] in the statute, it should more appropriately refer to the issuance of such notes "for the purpose of meeting the currency needs of the public". A similar change in language was suggested by the Board in connection with consideration of the proposed "Financial Institutions Act" in 1956.

B. Legal tender status

The statement in the second sentence of the first paragraph of section 16 that Federal Reserve notes shall be

[§ 604(a)] receivable for all taxes, customs, and other public dues is unnecessary. The point is covered by section 102 of the Coinage Act of 1965 (31 U.S.C. 392), which provides:

> "All coins and currencies of the United States (including Federal Reserve notes and circulating notes of Federal Reserve banks and national banking associations), regardless of when coined or issued, shall be legal tender for all debts, public and private, public charges, taxes, duties, and dues."

C. Redemption in lawful money

[§ 604(a)] The third sentence of the first paragraph of section 16, stating that Federal Reserve notes shall be redeemed in "lawful money" on demand at the Treasury or at any Federal Reserve Bank,

is misleading and unnecessary. Originally, the law provided that Federal Reserve notes should be redeemable in gold, but that provision was changed by the Gold Reserve Act to provide for redemption in lawful money instead of in gold. Since Federal Reserve notes themselves are legal tender, a term generally considered equivalent to lawful money, by virtue of the Coinage Act of 1965, the provision for redemption in lawful money has no real significance.

*D. Collateral security

The third sentence of the second paragraph of section 16 describes the types of collateral security that must be offered for Federal Reserve notes as including notes, drafts, bills of exchange, or acceptances acquired under section 13 of the Act or bills of exchange endorsed by a member bank and purchased under section 14, or bankers' acceptances purchased under section 14. If the provisions of the Act regarding discounts and advances by the Reserve Banks should be revised as proposed under Recommendation No. 46, this description of collateral security for Federal Reserve notes would need to be changed to refer to notes of member banks or others acquired under the provisions of the amended law or bills of exchange or bankers' acceptances purchased under section 14 of the Act.

However, if there is any logical need for any form of collateral security for Federal Reserve notes (and such need is doubtful except perhaps for psychological reasons), there appears

to be no reason for including "eligible paper" or paper discounted or purchased by the Reserve Banks. The only form of security specified in the original Federal Reserve Act was paper discounted under section 13 of the Act. The theory of this requirement was that the elastic nature of Federal Reserve currency would be assured if it were issued only on the security of short-term commercial paper. This theory, however, has long since been abandoned. At the present time, no part of the collateral security for Federal Reserve notes consists of eligible paper; it consists solely of Government obligations and gold certificates.

[§ 604(c)] Accordingly, it is suggested that such collateral security be limited to Government obligations, gold certificates, and Special Drawing Right certificates.

*E. Interest on Federal Reserve notes

The first sentence of the fourth paragraph of section 16 provides for the payment of interest on the amount of Federal Reserve notes outstanding less the amount of gold certificates held by the Federal Reserve agent as collateral security. If section 7 of the Act should be amended as proposed in Recommendation No. 12-A to provide for the payment to the Treasury of such portion of the net earnings of the Reserve Banks as the Board of Governors may determine, this provision of section 16 would duplicate the source of authority for requiring payment of such earnings to the Treasury.

The legislative history of this provision of the original Federal Reserve Act indicates that its principal purpose was to

enable the Board, by fixing the rate of interest on outstanding Federal Reserve notes, to control the volume of such notes in circulation. Thus, Senator Swanson stated that through this means the Board could "retard excessive inflation or in time of gloom or depression give needed encouragement and stimulation." (51 Cong. Rec. 431) Similarly, Senator Owen stated that the provision was designed "to prevent the possibility of expanding those notes to excess." Experience since enactment of the original Act has shown that this provision is of no avail in controlling currency in circulation or in preventing inflation or deflation. Consequently, if the provision should no longer be necessary as a source of authority for requiring the Reserve Banks to pay net earnings to the Treasury, the provision would serve no useful purpose and should be omitted.

F. Reference to notes issued under section 18

The last sentence of the fourth paragraph of section 16 provides that Federal Reserve notes, together with notes of a Federal Reserve Bank issued under section 18 of the Act, shall become a first and paramount lien on the assets of the Reserve

[§ 604(a)] Bank. The reference to notes issued under section 18 is obsolete for reasons indicated in Recommendation No. 63 and should be omitted.

G. Liability for "old series" currency

The Old Series Currency Adjustment Act of 1961 (31 U.S.C. 911-917) provided that the Board of Governors, with

the approval of the Secretary of the Treasury, might require any Federal Reserve Bank to pay to the Secretary an amount equal to the amount of Federal Reserve notes of any series prior to the series of 1928 issued to such Bank and outstanding at the time of such payment. The same Act amended the fifth paragraph of section 16 of the Federal Reserve Act to provide that the liability of a Reserve Bank with respect to outstanding notes should be reduced by any amount so paid to the Secretary, and also amended the present sixth paragraph of section 16 to provide for the return to a Federal Reserve Bank of collateral deposited by it for the security of any such notes with respect to which the Reserve Bank had made such payment to the Secretary.

The payments to the Secretary of the Treasury provided for by the Old Series Currency Adjustment Act with respect to old series Federal Reserve notes were made. Consequently, the provisions of section 16 just mentioned with respect to reduction [§ 604(c)] of liability of the Reserve Banks for old series notes and the return of collateral deposited for such notes are no longer of any significance and should be deleted.

H. Reduction of liability for outstanding notes

The first sentence of the fifth paragraph of section 16 provides that a Reserve Bank may reduce its liability for outstanding Federal Reserve notes by depositing with the Federal Reserve agent its Federal Reserve notes, gold certificates,

Special Drawing Right certificates, or lawful money. This sentence appears to have been related to the first sentence of what formerly was the sixth paragraph of section 16, which was repealed by the Act of March 18, 1968, repealing gold reserve requirements. That sentence had provided that the Federal Reserve agent shall hold gold certificates or lawful money available exclusively for exchange for outstanding Federal Reserve notes when offered by the Reserve Bank. Apparently, this was the method by which gold certificates or lawful money deposited under the fifth paragraph would reduce a Reserve Bank's liability on outstanding notes. Since this sentence has been repealed, there appears to be no longer any need for the authority under the first sentence of paragraph 5 for a Reserve Bank to deposit gold certificates or lawful money with the agent in order to reduce its note liability. It may be noted further that the retirement of fit Federal Reserve notes is specifically provided for under the present sixth paragraph of section 16.

With deletion of the first sentence of the fifth paragraph of section 16, the second sentence of that paragraph, providing that Federal Reserve notes deposited thereunder shall not be reissued except upon the same conditions as the original issue, should also be deleted.

I. Holding of unissued notes

The present ninth paragraph of section 16 states that, when Federal Reserve notes have been prepared, they shall be deposited in the Treasury "or in the subtreasury or mint of the

United States nearest the place of business of each Federal reserve bank" and held for use subject to order of the Comptroller of the Currency for their delivery.

The reference to deposit of unissued notes in a sub-treasury or mint is obsolete and should be deleted. In practice today, Federal Reserve notes are held by the Treasury until order for their delivery to the Reserve Banks. The law should be changed to refer to such delivery upon order of the Board of Governors.

[§ 604(i)]

J. Examination of plates, dies, etc.

The present eleventh paragraph of section 16 provides that the provisions of section 5174 of the Revised Statutes regarding the examination of plates, dies, bed pieces, and so forth, of national bank notes are extended to cover Federal Reserve notes. Although national bank notes are no longer issued, section 5174 of the Revised Statutes (12 U.S.C. 108) provides that the Comptroller of the Currency shall annually cause to be examined the plates, dies, bed pieces, and other material from which such notes are printed. Because of the obsolete nature of national bank notes and because the provision with respect to Federal Reserve notes should be self-contained, the eleventh paragraph of section 16 should be revised to provide simply that the Comptroller of the Currency shall annually cause to be examined the plates, dies, bed pieces, and other material from which Federal Reserve notes are printed.

[§ 604(j)]

K. Appropriations for Federal Reserve notes

The present twelfth paragraph of section 16, relating to appropriations for the engraving and printing of Federal Reserve notes, is now obsolete and should be deleted from the law.

Section 1(a) of the Permanent Appropriations Repeal Act of 1934, approved June 26, 1934 (48 Stat. 1224), provided that effective July 1, 1934, such portions of any act as provided permanent or continuing appropriations from the general funds of the Treasury to be disbursed under the appropriation accounts appearing on the books of the Government and listed in subsection (b) of that section of the Act, should be repealed. Among the appropriation accounts listed in such subsection (b) of section 1 of the Permanent Appropriations Repeal Act of 1934 was the account for the preparation and issue of Federal Reserve notes. Accordingly, it seems clear that the provisions of the twelfth paragraph of section 16, with respect to appropriations out of the general funds of the Treasury for the purpose of furnishing Federal Reserve notes, were repealed by the 1934 statute.

L. Credits payable in gold certificates

Since the Gold Reserve Act of 1934, as amended, provides for credits payable in gold certificates, all references to gold certificates in section 16 should be deemed to include credits payable in gold certificates. A parenthetical clause to that effect should be added after the reference to gold certificates

[§ 604(c)] in the first place in which it occurs in that section, i.e., the third sentence of the second paragraph of section 16.

M. Redemption of notes unidentifiable as to bank of issue

Under an Act of June 13, 1933, as amended in 1966 (12 U.S.C. 121a and 122a), national bank notes, Federal Reserve Bank notes, and Federal Reserve notes that are presented to the Treasurer of the United States for "redemption" and that cannot be identified as to bank of issue may be redeemed under rules and regulations prescribed by the Secretary of the Treasury. In the case of Federal Reserve notes of this kind, charges for such notes redeemed by the Treasurer are required to be apportioned among the twelve Reserve Banks as determined by the Board of Governors.

Section 16 no longer contains provisions for a Federal Reserve note redemption fund; and the provision of the first paragraph of that section regarding redemption of notes at the Treasury or at any Federal Reserve Bank would be omitted under Recommendation No. 60-C as having no significance. Actually, the provisions of the statute above mentioned for "redemption" of Federal Reserve notes unidentifiable as to Bank of issue mean simply that such notes may be exchanged for good currency at such proportion of the face value of the mutilated notes as the Secretary of the Treasury prescribes. It is understood that such notes in practice are being presented for such exchange and that small amounts of national bank notes and Federal Reserve Bank notes, although no longer issued, are likewise presented for such exchange.

In order that all provisions relating to Federal Reserve notes may be set forth in the Federal Reserve Act, it would be desirable to amend the 1933 statute to eliminate therefrom all

[§ 604(h)] references to Federal Reserve notes and to include at the end of

[Sec. 10] section 16 of the Federal Reserve Act a paragraph relating to such exchange of Federal Reserve notes that cannot be identified as to the Reserve Bank of issue.

N. Supervision and regulation by the Board

As suggested in Recommendation No. 36, the substance of section 11(d) of the present Federal Reserve Act, relating

[§ 604(1)] to the supervision and regulation by the Board of Governors of the issue and retirement of Federal Reserve notes, should be included in a revised section of the Act regarding Federal Reserve notes.

O. Arrangement

Section 16 contains provisions on the same subject in several different paragraphs. For example, provisions regarding the form of Federal Reserve notes are contained in the third and eighth paragraphs. The section, therefore, should be reorganized

[§ 604] with a more logical arrangement of provisions.

61. SETTLEMENT FUND

The present fifteenth paragraph of section 16 of the Act (12 U.S.C. 467) reads as follows:

> "The Secretary of the Treasury is hereby authorized and directed to receive deposits of gold or of gold certificates or of Special Drawing Right certificates with the Treasurer or any Assistant Treasurer of the United States when tendered by any Federal Reserve bank or Federal Reserve agent for credit to its or his account with the Board of Governors of the Federal Reserve System. The Secretary shall prescribe by regulation the form of receipt to be issued by the Treasurer or Assistant Treasurer to the Federal Reserve bank or Federal Reserve agent making the deposit, and a duplicate of such receipt shall be delivered to the Board of Governors of the Federal Reserve System by the Treasurer at Washington upon proper advices from any Assistant Treasurer that such deposit has been made. Deposits so made shall be held subject to the orders of the Board of Governors of the Federal Reserve System and deposits of gold or gold certificates shall be payable in gold certificates, and deposits of Special Drawing Right certificates shall be payable in Special Drawing Right certificates, on the order of the Board of Governors of the Federal Reserve System to any Federal Reserve bank or Federal Reserve agent at the Treasury or at the subtreasury of the United States nearest the place of business of such Federal Reserve bank or such Federal Reserve agent. The order used by the Board of Governors of the Federal Reserve System in making such payments shall be signed by the chairman or vice chairman, or such other officers or members as the Board may by regulation prescribe. The form of such order shall be approved by the Secretary of the Treasury."

A. Deposits of gold

Although the fund provided for in the above-quoted paragraph was once called the "Gold Settlement Fund", no gold is, or legally could be, deposited in that fund under present law. The paragraph should be changed to refer only to deposits of gold

[§ 605(a)] certificates and Special Drawing Right certificates, with an express indication that the term "gold certificates" includes credits payable in gold certificates.

B. References to Assistant Treasurer and subtreasuries

The several references in the fifteenth paragraph of section 16 to the Assistant Treasurer of the United States and to the subtreasuries of the United States are obsolete and should

[§ 605(a)] be omitted from the law, since the subtreasuries were discontinued pursuant to the Act of May 29, 1920 (41 Stat. 654).

C. Deposits by the Treasurer of the United States

The paragraph in question refers only to deposits in the fund by a Federal Reserve Bank or a Federal Reserve agent. Actually, deposits are also made by the Treasurer of the United States from time to time for credit to his account at one or more of the Reserve Banks. Likewise, withdrawals from the account are made not only by delivery of gold certificates to a Federal Reserve Bank or Federal Reserve agent, but through release of gold certificates to the Treasurer upon reduction of his deposit balance with a Federal Reserve Bank. Consequently, the paragraph should be amended to provide specifically that deposits in the fund may include deposits by the Treasurer for the credit of any Reserve

[§ 605(a)] Bank and that withdrawals may be made in the form of payments to the Treasurer as well as to a Reserve Bank or Federal Reserve agent.

D. Signing of orders

The next-to-the-last sentence of the paragraph in question provides that orders by the Board on the fund shall be signed by the Chairman or Vice Chairman or such other officers or members as the Board may by regulation prescribe. This provision should be simplified to eliminate requirement for action [§ 605(a)] by "regulation" and to provide simply that such orders shall be signed by such persons as the Board may designate.

62. PRESERVATION OF PROVISIONS OF ACT OF MARCH 14, 1900

The last paragraph of section 16 of the Act (12 U.S.C. 467) reads as follows:

> "Nothing in this section shall be construed as amending section six of the Act of March fourteenth, nineteen hundred, as amended by the Acts of March fourth, nineteen hundred and seven, March second, nineteen hundred and eleven, and June twelfth, nineteen hundred and sixteen, nor shall the provisions of this section be construed to apply to the deposits made or to the receipts or certificates issued under those Acts."

Section 6 of the Act of March 14, 1900, as amended (31 U.S.C. 429), authorizes the Secretary of the Treasury to receive deposits of gold coin and to issue gold certificates. It seems reasonably clear that these provisions are obsolete, particularly in the light of provisions of the Gold Reserve Act of 1934 that provided for the withdrawal of gold coin from circulation and the issuance of gold certificates only for limited purposes. In any event, it is obvious that the last paragraph of section 16 of the Federal Reserve Act, preserving the provisions of the Act of 1900, is no longer necessary and should be omitted.

63. FEDERAL RESERVE BANK NOTES

The first four paragraphs of section 18 of the Act (12 U.S.C. 441-443) provide that, after two years from the passage of the original Act and "at any time during a period of twenty years thereafter", any member bank desiring to retire its circulating notes may sell United States bonds securing such circulation; that the Board of Governors may require the Reserve Banks to purchase such bonds from member banks; and that, upon notice from the Treasurer of the United States, each member bank will transfer such bonds to the Reserve Banks purchasing them. By reason of the time limitation, these provisions expired on December 23, 1935. Moreover, no U. S. bonds bearing the circulation privilege are any longer outstanding. Accordingly, these paragraphs of section 18 are obsolete.

The fifth paragraph of section 18 (12 U.S.C. 444) authorizes the Reserve Banks to issue "circulating notes", i.e., Federal Reserve Bank notes, against the U. S. bonds purchased by them pursuant to the above provisions. Since the authority to purchase such bonds has expired, this paragraph is likewise obsolete.

The sixth paragraph of section 18 authorizes the Reserve Banks to issue Federal Reserve Bank notes against obligations of the United States and notes, drafts, bills of exchange, and

bankers' acceptances acquired under the provisions of the Act. However, this authority was specifically repealed by the Act of June 12, 1945 (59 Stat. 238). It is not carried in the U. S. Code.

The remaining three paragraphs of section 18 (12 U.S.C. 446-448) provide for the exchange of United States 2 per cent gold bonds bearing the circulation privilege for either one-year gold notes or 30-year 3 per cent gold bonds, and for the exchange of one-year notes for 3 per cent bonds. However, in 1935, the Secretary of the Treasury called for redemption all bonds bearing the circulation privilege, and, consequently, the provisions of these paragraphs are no longer of any significance.

For similar reasons, it has heretofore been recommended that the fourth paragraph of section 4 of the Act (12 U.S.C. 341), regarding the issuance by the Reserve Banks of circulating notes, also be repealed. (See Recommendation No. 8.)

64. RESERVE REQUIREMENTS

*A. Graduated requirements

Section 19(b) of the Act (12 U.S.C. 461) reads as follows:

> "Every member bank shall maintain reserves against its deposits in such ratios as shall be determined by the affirmative vote of not less than four members of the Board within the following limitations:
>
> "(1) In the case of any member bank in a reserve city, the minimum reserve ratio for any demand deposit shall be not less than 10 per centum and not more than 22 per centum, except that the Board, either in individual cases or by regulation, on such basis as it may deem reasonable and appropriate in view of the character of business transacted by such bank, may make applicable the reserve ratios prescribed for banks not in reserve cities.
>
> "(2) In the case of any member bank not in a reserve city, the minimum reserve ratio for any demand deposit shall be not less than 7 per centum and not more than 14 per centum.
>
> "(3) In the case of any deposit other than a demand deposit, the minimum reserve ratio shall be not less than 3 per centum and not more than 10 per centum."

Section 11(e) of the Act (12 U.S.C. 248(e)) authorizes the Board -

> "To add to the number of cities classified as reserve cities under existing law in which national banking associations are subject to the reserve requirements set forth in section twenty of this Act; or to reclassify existing reserve cities or to terminate their designation as such."

These provisions of present law, basing reserve requirements on the location of member banks, represent an anachronism that derives from provisions of the original National Bank Act. Classification of banks into "reserve city" and "country" banks has

become increasingly arbitrary and inequitable, since the differences between such banks have decreased substantially in both size and functions. Moreover, difficult problems of judgment are involved in the exercise of the Board's authority under the law to permit individual member banks in reserve cities to carry the lower reserve requirements applicable to "country" member banks.

The law should be amended to provide for the fixing of [§ 901(a)] reserve requirements on a graduated basis according to the amount of a bank's deposits, irrespective of its location. A smoothly graduated system would permit each bank to maintain a relatively low reserve against a specified dollar amount of its net demand deposits, a higher reserve against its deposits above such a minimum and up to a substantial figure, and a still higher reserve against its demand deposits, if any, above the latter amount. Under such a structure, all banks of the same size in terms of deposits would carry equal reserves. As a bank grew in size and passed into a higher reserve bracket, its reserve-requirement percentage would rise smoothly and gradually, because the higher requirement would apply only to its marginal demand deposits.

Such a change in the statutory structure of reserve requirements was proposed by the President's Committee on Financial Institutions in 1963; and the Board has recommended such a structure in its Annual Reports to Congress for 1964, 1965, 1966, and 1967.

A bill to implement the Board's recommendation (S. 1298) was introduced in the 90th Congress. Specifically, that bill would

authorize the Board to fix reserve requirements for time and savings deposits within a range of 3 to 10 per cent. With respect to demand deposits, the Board would be authorized to fix ratios of between 7 and 14 per cent for deposits up to $5 million, between 8 and 20 per cent for deposits between $5 million and $100 million, and between 10 and 22 per cent for deposits exceeding $100 million.

In principle, member bank reserve requirements should be made applicable to all insured banks, and the Board has so recommended to Congress. Such a change in the law would, of course, be basic in nature. However, the elimination of reserve cities and basing member bank reserves upon size rather than location, the changes here recommended, would not be basic. They could be regarded as little more than technical changes.

B. National bank notes redemption fund as reserve

Section 20 of the original Federal Reserve Act amended an 1874 statute to eliminate the authority of national banks to count the redemption fund for national bank notes as part of their reserves. This amendment was "executed" by the Federal Reserve Act and should now be omitted from the Act. The last sentence of section 20, however, was not in the form of an amendment to the 1874 statute. That sentence provides that, after the passage of the Federal Reserve Act, the redemption fund for national bank notes shall not be counted by national banks as part of their reserves. In view of the amendment to the 1874 statute, this sentence is clearly redundant and should be eliminated. Moreover, reserves of national banks are now governed solely by provisions of the Federal Reserve Act.

65. INTEREST ON DEPOSITS

A. Demand deposits of savings banks and public funds

Subsection (i) of section 19 of the Federal Reserve Act (12 U.S.C. 371a) includes a proviso to the effect that the prohibition of that subsection against the payment of interest by member banks on demand deposits shall not apply, for a period of two years after enactment of the Banking Act of 1935, to deposits made by savings banks or mutual savings banks or to deposits of public funds where the payment of interest on such public funds is required by State law.

Since by its terms this proviso ceased to be effective in 1937, it is obsolete and should be repealed.

[§ 902(a)]

B. Deposits of Philippine Islands

The last sentence of section 19(i) of the Act (12 U.S.C. 371a) provides as follows:

> "So much of existing law as requires the payment of interest with respect to any funds deposited by the United States, by any Territory, District, or possession thereof (including the Philippine Islands), or by any public instrumentality, agency, or officer of the foregoing, as is inconsistent with the provisions of this section as amended, is hereby repealed."

Since the independence of the Philippine Islands was recognized by Presidential Proclamation of July 4, 1946, the reference to deposits by the Philippine Islands is obsolete and should be omitted.

[§ 902(a)]

C. Authority of Board to regulate payment of interest

The first two sentences of section 19(j) of the Act (12 U.S.C. 371b) now read as follows:

> "The Board may from time to time, after consulting with the Board of Directors of the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board, prescribe rules governing the payment and advertisement of interest on deposits, including limitations on the rates of interest which may be paid by member banks on time and savings deposits. The Board may prescribe different rate limitations for different classes of deposits, for deposits of different amounts or with different maturities or subject to different conditions regarding withdrawal or repayment, according to the nature or location of member banks or their depositors, or according to such other reasonable bases as the Board may deem desirable in the public interest. . . ."

However, by virtue of section 7 of the Act of September 21, 1966 (P.L. 89-597), as amended by Act of September 21, 1968 (P.L. 90-505), these sentences, unless further amended, will read as follows effective September 22, 1969:

> "The Board of Governors of the Federal Reserve System shall from time to time prescribe rules governing the payment and advertisement of interest on deposits, including limitations on the rate of interest which may be paid by member banks on time and savings deposits, and shall prescribe different rates for such payment on time and savings deposits having different maturities, or subject to different conditions respecting withdrawal or repayment, or subject to different conditions by reason of different locations, or according to the varying discount rates of member banks in the several Federal Reserve districts."

It is desirable that the Board's authority with respect to regulation of interest on deposits be continued on a permissive or stand-by, rather than a mandatory, basis, and that the Board continue to have the flexibility provided by the temporary

[§ 902(b)] provisions of present law in fixing different rate ceilings. Accordingly, the law should be amended to make permanent the present first and second sentences of section 19(j).

D. Interest on foreign official time deposits

The last sentence of section 19(j) of the Act (12 U.S.C. 371b), exempting certain foreign time deposits

[§ 902(b)] from interest rate limitations, expired by its terms on October 15, 1968. It is therefore obsolete and should be omitted.

66. SALARIES OF BANK EXAMINERS

The third paragraph of section 5240 of the Revised Statutes, as amended by section 21 of the Federal Reserve Act and the Banking Act of 1935 (12 U.S.C. 482), contains the following sentence:

> "The Comptroller of the Currency shall fix the salaries of all bank examiners and make report thereof to Congress."

Although clearly this provision is intended to refer only to salaries of national bank examiners, it could literally be construed as applying to salaries of examiners appointed by the Board of Governors of the Federal Reserve System or by the Federal Deposit Insurance Corporation. This provision should be clarified to make it clear that it refers only to national bank examiners.

[Sec. 7]

67. EXAMINATIONS OF FEDERAL RESERVE BANKS

The sixth paragraph of section 5240 of the Revised Statutes, as amended by section 21 of the Federal Reserve Act (12 U.S.C. 485), reads as follows:

> "The Board of Governors of the Federal Reserve System shall, at least once each year, order an examination of each Federal reserve bank, and upon joint application of ten member banks the Board of Governors of the Federal Reserve System shall order a special examination and report of the condition of any Federal reserve bank."

Section 11(a) of the Act (12 U.S.C. 248(a)) authorizes the Board to examine Federal Reserve Banks and require from them such statements and reports as the Board may deem necessary. The sixth paragraph of section 5240 should be consolidated with the provision of section 11(a). The reference in the latter section to examinations and reports of member banks should be omitted, since such examinations and reports are covered by other provisions of the Act.

[§ 512(a)]
[Sec. 4(e)]

68. DEALINGS WITH DIRECTORS

Section 22(d) of the Act (12 U.S.C. 375) reads as follows:

> "Any member bank may contract for, or purchase from, any of its directors or from any firm of which any of its directors is a member, any securities or other property, when (and not otherwise) such purchase is made in the regular course of business upon terms not less favorable to the bank than those offered to others, or when such purchase is authorized by a majority of the board of directors not interested in the sale of such securities or property, such authority to be evidenced by the affirmative vote or written assent of such directors: Provided, however, That when any director, or firm of which any director is a member, acting for or on behalf of others, sells securities or other property to a member bank, the Board of Governors of the Federal Reserve System by regulation may, in any or all cases, require a full disclosure to be made, on forms to be prescribed by it, of all commissions or other considerations received, and whenever such director or firm, acting in his or its own behalf, sells securities or other property to the bank the Board of Governors of the Federal Reserve System, by regulation, may require a full disclosure of all profit realized from such sale.
>
> "Any member bank may sell securities or other property to any of its directors, or to a firm of which any of its directors is a member, in the regular course of business on terms not more favorable to such director or firm than those offered to others, or when such sale is authorized by a majority of the board of directors of a member bank to be evidenced by their affirmative vote or written assent: Provided, however, That nothing in this subsection contained shall be construed as authorizing member banks to purchase or sell securities or other property which such banks are not otherwise authorized by law to purchase or sell."

As a matter of statutory form, the above provisions should be in the form of limitations upon member banks rather than what appear to be authorizations. The Federal Reserve Act,

of course, cannot confer any powers upon State member banks that they do not possess under their respective State laws. Moreover, other provisions of the Act, including those of section 22(e) and section 22(g), are in terms of prohibiting member banks from doing certain things except under specified conditions.

Consequently, the opening clause of the first paragraph of section 22(d) should read "No member bank may contract for, or purchase from, any of its directors or from any firm of [§ 903(b)] which any of its directors is a member, any securities or other property unless such purchase is made in the regular course of business upon terms not less favorable to the bank than those offered to others, or unless such purchase is authorized . . . ."

Similarly, the second paragraph of section 22(d) should begin with the following language: "No member bank may sell securities or other property to any of its directors, or to a firm of which any of its directors is a member, unless such sale is made in the regular course of business upon terms not more favorable to such director or firm than those offered to others, or unless such sale is authorized . . . ."

*69. TRANSACTIONS WITH AFFILIATES

Section 23A of the Federal Reserve Act (12 U.S.C. 371c) limits certain transactions by member banks 4/ with their affiliates, subject to numerous exceptions. In addition to the specific changes hereafter suggested, this section should be rewritten in a less complicated manner and certain unnecessary and overlapping provisions should be eliminated.

Section 23A, with the paragraphs numbered for convenient reference, reads as follows:

[1] "No member bank shall (1) make any loan or any extension of credit to, or purchase securities under repurchase agreement from, any of its affiliates, or (2) invest any of its funds in the capital stock, bonds, debentures, or other such obligations of any such affiliate, or (3) accept the capital stock, bonds, debentures, or other such obligations of any such affiliate as collateral security for advances made to any person, partnership, association, or corporation, if, in the case of any such affiliate, the aggregate amount of such loans, extensions of credit, repurchase agreements, investments, and advances against such collateral security will exceed 10 per centum of the capital stock and surplus of such member bank, or if, in the case of all such affiliates, the aggregate amount of such loans, extensions of credits, repurchase agreements, investments, and advances against such collateral security will exceed 20 per centum of the capital stock and surplus of such member bank.

[2] "Within the foregoing limitations, each loan or extension of credit of any kind or character to an affiliate shall be secured by collateral in the form of stocks, bonds, debentures, or other such obligations having a market value at the time of making the loan

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4/ Under section 18(j) of the Federal Deposit Insurance Act, the provisions of section 23A are made applicable to nonmember insured banks as if they were member banks.

or extension of credit of at least 20 per centum more than the amount of the loan or extension of credit, or of at least 10 per centum more than the amount of the loan or extension of credit if it is secured by obligations of any State, or of any political subdivision or agency thereof: Provided, That the provisions of this paragraph shall not apply to loans or extensions of credit secured by obligations of the United States Government, the Federal intermediate credit banks, the Federal land banks, or the Federal Home Loan Banks, or by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for rediscount or for purchase by Federal reserve banks. A loan or extension of credit to a director, officer, clerk, or other employee or any representative of any such affiliate shall be deemed a loan to the affiliate to the extent that the proceeds of such loan are used for the benefit of, or transferred to, the affiliate.

[3] "The provisions of this section shall not apply to any affiliate (1) engaged solely in holding the bank premises of the member bank with which it is affiliated; (2) engaged solely in conducting a safe-deposit business or the business of an agricultural credit corporation or livestock loan company; (3) in the capital stock of which a national banking association is authorized to invest pursuant to section 25 of this Act, as amended, or a subsidiary of such affiliate, all the stock of which (except qualifying shares of directors in an amount not to exceed 10 per centum) is owned by such affiliate; (4) organized under section 25(a) of this Act, as amended, or a subsidiary of such affiliate, all the stock of which (except qualifying shares of directors in an amount not to exceed 10 per centum) is owned by such affiliate; (5) engaged solely in holding obligations of the United States or obligations fully guaranteed by the United States as to principal and interest, the Federal intermediate credit banks, the Federal land banks, the Federal Home Loan Banks; (6) where the affiliate relationship has arisen out of a bona fide debt contracted prior to the date of the creation of such relationship; or (7) where the affiliate relationship exists by reason of the ownership or control of any voting shares thereof by a member bank as executor, administrator, trustee, receiver, agent, depositary, or in any other fiduciary capacity,

except where such shares are held for the benefit of all or a majority of the stockholders of such member bank; but as to any such affiliate, member banks shall continue to be subject to other provisions of law applicable to loans by such banks and investments by such banks in stocks, bonds, debentures, or other such obligations. The provisions of this section shall likewise not apply to indebtedness of any affiliate for unpaid balances due a bank on assets purchased from such bank or to loans secured by, or extensions of credit against, obligations of the United States or obligations fully guaranteed by the United States as to principal and interest.

[4] "For the purposes of this section, (1) the term 'extension of credit' and 'extensions of credit' shall be deemed to include (A) any purchase of securities, other assets or obligations under repurchase agreement, and (B) the discount of promissory notes, bills of exchange, conditional sales contracts, or similar paper, whether with or without recourse, except that the acquisition of such paper by a member bank from another bank, without recourse, shall not be deemed to be a 'discount' by such member bank for such other bank; and (2) non-interest-bearing deposits to the credit of a bank shall not be deemed to be a loan or advance or extension of credit to the bank of deposit, nor shall the giving of immediate credit to a bank upon uncollected items received in the ordinary course of business be deemed to be a loan or advance or extension of credit to the depositing bank.

[5] "For the purposes of this section, the term 'affiliate' shall include, with respect to any member bank, any bank holding company of which such member bank is a subsidiary within the meaning of the Bank Holding Company Act of 1956, as amended, and any other subsidiary of such company.

[6] "The provisions of this section shall not apply to (1) stock, bonds, debentures, or other obligations of any company of the kinds described in section 4(c)(1) of the Bank Holding Company Act of 1956, as amended; (2) stock, bonds, debentures, or other obligations accepted as security for debts previously contracted, provided that such collateral shall not be held for a period of over two years; (3) shares which are of the kinds and amounts eligible for investment by national banks under the provisions of section 5136 of the Revised Statutes; (4) any extension of credit by a member bank to a bank holding

company of which such bank is a subsidiary or to another subsidiary of such bank holding company, if made within one year after the effective date of this amendment to section 23A and pursuant to a contract lawfully entered into prior to January 1, 1966; or (5) any transaction by a member bank with another bank the deposits of which are insured by the Federal Deposit Insurance Corporation, if more than 50 per centum of the voting stock of such other bank is owned by the member bank or held by trustees for the benefit of the shareholders of the member bank."

A. Exemption of loans on Government obligations from security requirement

The proviso in the first sentence of the second paragraph of the section exempts from the collateral security requirement of that paragraph loans secured by obligations of the United States, the Federal Intermediate Credit Banks, the Federal Land Banks, or the Federal Home Loan Banks.

The exemption for loans secured by obligations of the [§ 904(b)] United States is unnecessary, since the third paragraph exempts from all provisions of the section any extension of credit secured by obligations of the United States. The specific exemption in the proviso with respect to obligations of Intermediate Credit Banks, the Federal Land Banks, and the Home Loan Banks is likewise unnecessary, since the proviso also exempts obligations eligible for purchase by the Reserve Banks and since obligations of the agencies named, as well as all other Federal Government agencies, are now eligible for purchase by the Reserve Banks under section 14(b)(2) of the Federal Reserve Act (12 U.S.C. 355).

In the light of the apparent inclination of Congress to place obligations issued or guaranteed by Government agencies on

the same basis as direct Government obligations, it would be logical and desirable to expand the present exemption of direct Government obligations contained in the third paragraph to exempt [§ 904(c)] also obligations issued or guaranteed by Government agencies. This would then make unnecessary any specific exemption in the second paragraph for obligations of specific Government agencies.

*B. Exemption of loans on "eligible paper" from security requirement

The proviso in the second paragraph exempts from the collateral security requirements any loan secured by "such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for rediscount or for purchase by Federal reserve banks." If, as proposed in Recommendation No. 46, the provisions of the Act relating to discounts and advances by the Reserve Banks should be changed to eliminate rediscounting and to authorize advances on any security satisfactory to the Reserve Banks, this exemption might be changed to refer to paper eligible "as security for advances" by the Reserve Banks. Such a change, however, would be subject to two objections.

In the first place, it would mean that a loan to an affiliate would be exempted from the collateral security requirements if it were secured by any paper that would be satisfactory security for an advance by a Reserve Bank, and, consequently, the exemption would be considerably broadened, perhaps to an extent that would render the security requirements practically meaningless. In the second place, it would apparently be necessary for

a member bank, in every case, to request advice from its Federal Reserve Bank as to whether the particular paper securing a proposed loan to an affiliate is of a kind that would be acceptable to the Reserve Bank as collateral for an advance by it. In these circumstances, it is recommended that the exemption in the proviso in the second paragraph for loans secured by paper eligible for discount or purchase be eliminated. [§ 904(b)]

C. Exemptions from investment limitations

The third paragraph of section 23A makes the provisions of the section inapplicable to certain types of affiliates and certain types of credits. The resulting exemptions are applicable not only to the limitations on loans under clause (1) of the first paragraph but also to the "investment" limitations in clauses (2) and (3) of that paragraph. In contrast, the first three clauses of the sixth paragraph of section 23A exempt from the provisions of the section the "stock, bonds, debentures, or other obligations" or the "shares" of certain types of companies. Although it may not have been the intent of Congress, these exemptions appear to be applicable only to the investment limitations contained in clauses (2) and (3) of the first paragraph and not to the loan limitations in clause (1) of that paragraph.

There appears to be no logical reason why these exemptions in the sixth paragraph should not be applicable to all of the limitations of the section. It is apparent that an exemption from the limitation of clause (2) of the first paragraph with respect to

investment in obligations of an affiliate can be used so as to result in practice in an exemption also from the lending limitation in clause (1) of that paragraph. For example, instead of making an ordinary loan to an affiliate, a member bank could purchase from the affiliate an instrument denominated a "debenture". It is recommended therefore that the exemptions in the first three [§ 904(c)] clauses of the sixth paragraph, with such changes as may be desirable in the light of other recommendations herein, be made applicable to all provisions of section 23A.

D. Exemptions based on Bank Holding Company Act provisions

Clause (1) of the sixth paragraph in effect exempts from the "investment" limitations any stock, bonds, debentures, or other obligations of companies of the kinds described in section 4(c)(1) of the Bank Holding Company Act (12 U.S.C. 1843). The companies there referred to are companies -

> ". . . engaged or to be engaged solely in one or more of the following activities: (A) holding or operating properties used wholly or substantially by any banking subsidiary of such bank holding company in the operations of such banking subsidiary or acquired for such future use; or (B) conducting a safe deposit business; or (C) furnishing services to or performing services for such bank holding company or its banking subsidiaries; or (D) liquidating assets acquired from such bank holding company or its banking subsidiaries or acquired from any other source prior to May 9, 1956, or the date on which such company became a bank holding company, whichever is later."

All of the companies mentioned, except those in clause (B), are described in terms of relations to a bank holding company or its banking subsidiaries; and, consequently, the exemptions for

the companies described would not literally be applicable in the case of affiliates of a member bank that is not a subsidiary of a holding company. It is reasonable to assume, however, that Congress intended the exemptions in clause (1) of the sixth paragraph of section 23A to apply in the case of a member bank that is not associated with a holding company, as well as in the case of a bank subsidiary of a holding company. For this reason, it is believed that, instead of providing the exemptions by a cross-reference to the Holding Company Act, section 23A should itself [§ 904(c)] set forth descriptions of the companies in terms of their relations to a member bank. For example, the section should refer to a company engaged or to be engaged solely in "furnishing services to or performing services for a member bank".

E. Exemption for bank premises companies

Clause (1) of the third paragraph of section 23A exempts from all provisions of the section any affiliate "engaged solely in holding the bank premises of the member bank with which it is affiliated". Clause (1) of the sixth paragraph, by virtue of its reference to section 4(c)(1) of the Holding Company Act and specifically to clause (A) of that section, exempts from the "investment" limitations of the first paragraph of section 23A a company engaged or to be engaged solely in "holding or operating properties used wholly or substantially" by a member bank. While the exemptions in paragraphs 3 and 6 cover the same general

type of company, the coverage of the exemption in paragraph 6 appears to be broader.

Thus, under paragraph 3, a company holding a large office building partly but substantially occupied by a member bank would not be engaged solely in holding the bank's premises and thus would not be exempt; whereas such a company would fall within the exemption provided by the sixth paragraph, since it would be solely engaged in holding properties "substantially" used by the member bank. Again, a company engaged solely in "operating" properties used substantially as bank premises would be exempt under the sixth paragraph but not under the third. Finally, a company holding property intended for "future use" as premises of a member bank would not be exempt under the third paragraph but would be exempt under the sixth.

There appears to be no good reason why the exemption for bank premises companies in the third paragraph (from all provisions of the section) should not be as broad as that contained in the sixth paragraph. It is suggested therefore that clause (1) of the third paragraph be changed to refer to an affiliate "engaged or to be engaged solely in holding or operating properties used wholly or substantially by the member bank in its operations or acquired for such future use". This change would make unnecessary the exemption for bank premises companies provided by the sixth paragraph.

[§ 904(c)]

F. Exemption for safe deposit companies

The second type of company described in section 4(c)(1) of the Holding Company Act, the shares of which would be exempted by clause (1) of the sixth paragraph of section 23A, is a company engaged or to be engaged solely in "conducting a safe deposit business". Since clause (2) of the third paragraph uses identical language in exempting such companies from all provisions of the section, the exemption for such companies provided in the sixth paragraph is unnecessary and should be eliminated.

[§ 904(c)]

*G. Exemption of stock eligible for investment by national banks

Clause (3) of the sixth paragraph exempts shares of the kinds and amounts eligible for investment by national banks under section 5136 of the Revised Statutes. If this is a desirable exemption, it should be made applicable, for reasons already indicated, not only to the "investment" limitations of the first paragraph of section 23A but also to the limitation on extensions of credit. However, it is believed that such an exemption might go too far in the direction of relaxing limitations on dealings with affiliates.

The "section 5136 exemption" was placed in section 23A in 1966, when section 6 of the Bank Holding Company Act, prohibiting loans by subsidiary banks to their holding company or other subsidiaries, was repealed. However, there is no indication in the legislative history of the reasons for which the section 5136 exemption was incorporated in section 23A.

In recent years Congress has expressly authorized national banks to invest in stock of various types of corporations. Moreover, in recent months it has become established that, under their "incidental powers", national banks and State member banks (if State law does not preclude) may invest in "operations subsidiaries" formed to conduct a type of business in which the bank itself could directly engage. In the light of these developments, it may be more necessary than it appeared to be even in 1933, when section 23A was first enacted, to limit the extent to which member banks may extend credit to or invest their funds in their affiliates.

Instead of the unduly broad exemption provided by the "section 5136 exemption", it would be more logical to exempt dealings with affiliates that are wholly owned by a member bank, since in such a situation there is little likelihood of any serious conflict of interest. It may be noted that this was part of the rationale underlying the exception in clause (5) of paragraph 6 of section 23A with respect to loans to an affiliated banking institution that is a controlled subsidiary of the lending bank. With respect to this exemption, the Report of the Senate Banking and Currency Committee regarding the 1966 amendments to the Holding Company Act stated that "the abuses at which the section [section 23A] is directed are not likely to arise where the affiliate is a controlled subsidiary of the lending or investing bank."

In the circumstances, it is suggested that the "section 5136 exemption" be eliminated from section 23A and that in its [§ 904(c)] place there be inserted an exemption from all limitations of the section with respect to any affiliate all of the stock of which (except for directors' qualifying shares) is owned by the member bank.

H. Obsolete exemption

Clause (4) of the sixth paragraph of section 23A exempts extensions of credit made to a bank holding company of which the member bank is a subsidiary or to another subsidiary of such holding company, but only if made within one year after July 1, 1966, and pursuant to a contract entered into before January 1, 1966. By its terms, this clause is now obsolete and should be omitted.

I. Meaning of "affiliate"

The fifth paragraph of section 23A provides that for purposes of this section the term "affiliate" shall include any bank holding company of which the member bank is a subsidiary within the meaning of the Holding Company Act and any other subsidiary of such company. This is a broader definition of the term "affiliate" than that presently contained in section 2 of the Banking Act of 1933 (12 U.S.C. 221a), since the latter definition requires majority ownership, whereas the fifth paragraph of section 23A would apply the 25 per cent test of the Holding Company Act.

As suggested in Recommendation No. 1-F, there appears to be no reason why the term "affiliate" should not include a bank holding company or other subsidiary of such a company for the purposes of all provisions of the Federal Reserve Act rather than only for purposes of section 23A. Under that recommendation, the definition of "affiliate" in the Banking Act of 1933 would be expanded in this manner and would be transferred to the definitional section at the beginning of the Federal Reserve Act. If that recommendation is adopted, the fifth paragraph of section 23A would be unnecessary and should be omitted.

70. REAL ESTATE LOANS BY NATIONAL BANKS

A. Rearrangement

Section 24 of the Act (12 U.S.C. 371) relates entirely to activities by national banks. Most of the section deals with limitations on real estate loans by such banks. One sentence, the last sentence of the first paragraph, limits the rate of interest that national banks may pay on time and savings deposits to the maximum rate allowed to be paid on such deposits by State banks under State law.

Because it relates only to national banks, section 24 [Sec. 13] should be withdrawn from the Federal Reserve Act and re-enacted as a separate statute. While this memorandum does not generally purport to cover changes in laws relating to national banks, any such re-enactment of section 24 of the Federal Reserve Act should include the technical changes hereafter suggested in Recommendations 70-B and 70-C.

B. Eligibility for discount of loans for construction of residential or farm buildings

The last sentence of the third paragraph of section 24 of the Federal Reserve Act (12 U.S.C. 371) provides as follows:

> "Notes representing loans made under this section to finance the construction of residential or farm buildings and having maturities of not to exceed nine months shall be eligible for discount as commercial paper within the terms of the second paragraph of section 13 of this Act if accompanied by a valid and binding agreement to advance the full amount of the loan upon the completion of the building entered into by an individual, partnership, association, or corporation acceptable to the discounting bank."

Read literally, this provision might be regarded as applicable only to the discounting of such paper for national banks, since it refers to notes representing loans made "under this section", and the section relates only to the making of real estate loans by national banks. Nevertheless, the Board's Regulation A makes paper of the kind described eligible for discount when offered by any member bank, whether national or State (Reg. A, § 201.3(d)). To avoid any ambiguity on this point, the provision of section 24 here in question should be amended to eliminate the words "under this section".

[Sec. 13]

The sentence in question should be omitted entirely if Recommendation No. 46 is adopted.

C. Loans to industrial or commercial businesses as real estate loans

The first sentence of the fourth paragraph of section 24 of the Federal Reserve Act (12 U.S.C. 371) reads as follows:

> "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 this Act, (b) for any part of which a commitment shall have been made by a Federal Reserve bank under the provisions of said section, (c) in the making of which a Federal Reserve bank participates under the provisions of said section, or (d) in which the Reconstruction Finance Corporation or the Secretary of Housing and Urban Development cooperates or purchases a participation under the provisions of the Reconstruction Finance Corporation Act, as amended, or of section 102 or 102a of the Housing Act of 1948, as amended, shall not be subject to the restrictions or limitations of this section upon loans secured by real estate. . . ."

Section 13b of the Federal Reserve Act, relating to advances by the Federal Reserve Banks to industrial or commercial businesses, was repealed by the Act of August 21, 1958 (72 Stat. 689), effective August 21, 1959. Accordingly, the references to

[Sec. 13] such advances in the above-quoted sentence of section 24 of the Act and to commitments and participations by the Reserve Banks are now obsolete and should be omitted.

The Reconstruction Finance Corporation was liquidated a number of years ago and, consequently, references to loans in

[Sec. 13] which the RFC participates are also obsolete and should be omitted.

71. INVESTMENTS IN BANK PREMISES

Section 24A of the Federal Reserve Act (12 U.S.C. 371d) reads as follows:

> "Hereafter no national bank, without the approval of the Comptroller of the Currency, and no State member bank, without the approval of the Board of Governors of the Federal Reserve System, shall (1) invest in bank premises, or in the stock, bonds, debentures, or other such obligations of any corporation holding the premises of such bank or (2) make loans to or upon the security of the stock of any such corporation, if the aggregate of all such investments and loans, together with the amount of any indebtedness incurred by any such corporation which is an affiliate of the bank, as defined in section 2 of the Banking Act of 1933, as amended, will exceed the amount of the capital stock of such bank."

*A. Base for limitation

Under present law, a national or State member bank must obtain the approval of the Comptroller of the Currency or the Board of Governors, as the case may be, for any investment in bank premises that will exceed the amount of the bank's "capital stock". This limitation appears to be unduly restrictive and should be liberalized. The proposed "Financial Institutions Act" of 1956 would have required agency approval only if such investments exceed "100 per centum of the capital stock or 50 per centum of the capital and surplus of such bank, whichever is greater." A more practical limitation would be one based simply upon 50 per cent [§ 808] of the bank's capital stock and surplus. Basing the limitation on both capital stock and surplus would be comparable to other limitations of the law, such as those on the amount of extensions of credit that may be made by member banks to their affiliates.

B. Investment through subsidiaries

In construing section 24A, the Board has regarded an investment in bank premises by a majority-controlled subsidiary of a member bank as constituting an investment by the bank itself. Otherwise, it is obvious that the purposes of the statute could be evaded. In order to confirm this interpretation, the law should be amended to make the section applicable to investments in bank premises by a member bank "directly or indirectly".

[§ 808]

*C. Value of past investments

In determining the amount of past "investments" in bank premises for purposes of the limitation of the statute, the Board has taken the position that its approval is required in any case in which the aggregate of a proposed investment plus the "book value" of past investments will exceed the amount of the bank's capital stock. However, this makes it possible for a bank to make arbitrary write-offs of its past investments and thus reduce their "book value" and avoid the necessity of obtaining Board approval. Such arbitrary write-offs are contrary to the Board's Regulation F, which requires fixed assets to be carried at cost "less accumulated depreciation".

It is recommended that section 24A be clarified in order to indicate clearly that, as under Regulation F, the amount of past investments in bank premises shall be the amount of such investments "less accumulated depreciation as determined in accordance with generally accepted accounting principles."

[§ 808]

D. Reference to "affiliate"

The last clause of section 24A refers to a bank premises corporation which is an "affiliate" of the bank, "as defined in section 2 of the Banking Act of 1933". Under Recommendation No. 1-F, the definition of affiliate now contained in the Banking Act of 1933 would be transferred to the definitional section of the Federal Reserve Act, with a modification expanding the definition to include any bank holding company of which the member bank is a subsidiary and any other subsidiary of such holding company. If that recommendation is adopted, section 24A would need to refer only to an "affiliate", without any reference to the Banking Act of 1933, since the term would be defined in the Federal Reserve Act itself.

[§ 808]

E. Investments by national banks

As a matter of organization and arrangement, a revision of section 24A should be in terms of its applicability only to State member banks and, to the extent that the section applies also to national banks, it should be withdrawn from the Federal Reserve Act and re-enacted as a part of the national banking laws in terms of applicability only to national banks. Any such re-enactment should include the changes in the law above recommended.

[Sec. 14]

72. FOREIGN ACTIVITIES OF MEMBER BANKS

Section 25 of the Federal Reserve Act (12 U.S.C. 601-604a) deals with the authority of national banks to establish foreign branches, to invest in stock of foreign banking corporations, and to acquire stock of foreign banks. Although by its terms the limitations of the section apply only to national banks, they are made applicable also to State member banks by provisions of section 9 of the Federal Reserve Act.

*A. Board approval of investments in stock of foreign banking corporations

The third paragraph of section 25 (12 U.S.C. 601) authorizes a national bank, with the permission of the Board of Governors -

> "To invest an amount not exceeding in the aggregate ten per centum of its paid-in capital stock and surplus in the stock of one or more banks or corporations chartered or incorporated under the laws of the United States or of any State thereof, and principally engaged in international or foreign banking, or banking in a dependency or insular possession of the United States either directly or through the agency, ownership, or control of local institutions in foreign countries, or in such dependencies or insular possessions."

Foreign banking corporations organized under section 25(a) of the Federal Reserve Act - so-called "Edge Act corporations" - are chartered "under the laws of the United States". Accordingly, the above-quoted paragraph literally appears to require approval by the Board for investment by a national bank in the stock of such a foreign banking corporation. However, paragraph 12 of

section 25(a) (12 U.S.C. 618) authorizes such investments without the Board's prior approval. The last sentence of that paragraph reads:

> "Any national banking association may invest in the stock of any corporation organized under the provisions of this section [an "Edge Act" corporation], but the aggregate amount of stock held in all corporations engaged in business of the kind described in this section and in section 25 of the Federal Reserve Act as amended shall not exceed 10 per centum of the subscribing bank's capital and surplus."

Where a national bank invests in the stock of an Edge Act corporation at the time of the organization of such corporation, such investment implicitly requires approval of the Board since the chartering of the Edge Act corporation must itself be approved by the Board. However, because of the provision of paragraph 12 of section 25(a) above quoted, no Board approval is required where a national bank wishes to invest in the stock of an already-organized Edge Act corporation. It seems desirable that Board approval be obtained in any such case. Consequently, to achieve this objective and, at the same time, to eliminate
[§ 1002(1)] the repetitious amount limitations contained in the third paragraph of section 25 and the twelfth paragraph of section 25(a), it is recommended that the last sentence of the twelfth paragraph of section 25(a) be omitted from the statute.

B. Authority for investment in Edge Act corporations

The third paragraph of section 25, heretofore quoted, authorizes national banks to invest in the stock of corporations

that are chartered under the laws of the United States or of any State and that are "principally engaged in international or foreign banking, or banking in a dependency or insular possession of the United States". Edge Act corporations organized under section 25(a) of the Act are "chartered under the laws of the United States", but they may engage in "financial" as well as "banking" business. The first paragraph of section 25(a) (12 U.S.C. 611) refers to them as being organized for the purpose of "engaging in international or foreign banking or other international or foreign financial operations, or in banking or other financial operations in a dependency or insular possession of the United States". In order to clarify the authority of national banks under section 25, the third paragraph of that section should be expanded to refer specifically to [§ 1001(a)] investment in stock of corporations organized under section 25(a). This would mean that investments in State-chartered corporations - so-called "Agreement corporations" - would continue to be limited to corporations engaged in a foreign or international banking business.

C. Limitation on ownership of stock of foreign banks

The fourth paragraph of section 25 authorizes a national bank, with the Board's approval -

> "To acquire and hold, directly or indirectly, stock or other evidences of ownership in one or more banks organized under the law of a foreign country or a dependency or insular possession of the United States and not engaged, directly or indirectly, in any activity in the United States except as, in the judgment of the

Board of Governors of the Federal Reserve System, shall be incidental to the international or foreign business of such foreign bank; and, notwithstanding the provisions of section 23A of this Act, to make loans or extensions of credit to or for the account of such bank in the manner and within the limits prescribed by the Board by general or specific regulation or ruling."

When this paragraph was enacted in 1966, Congress specified no amount limitation, as it had done in 1916 with respect to investments in "Agreement" corporations under the third paragraph of section 25, or as it had done in 1919 with respect to both "Edge Act" and "Agreement" corporations in the twelfth paragraph of section 25(a). Thus, it seems reasonably clear that investments in stock of foreign banks were not intended to be subject to the 10 per cent limitation contained in the twelfth paragraph of section 25(a); and the Board has so interpreted the law in its Regulation M. Any ambiguity in this respect should be removed by repeal of the last sentence of the twelfth paragraph of section 25(a), as already recommended for other reasons under A above. If that change should be made, it would then be clear, under the amended third paragraph of section 25, that the 10 per cent limitation applies only to the aggregate investments of a national bank in foreign banking corporations chartered under State law ("Agreement" corporations) and under Federal law ("Edge Act" corporations) and not to investments in foreign banks.

[§ 1002(1)]

D. Loans to foreign banks

The fourth paragraph of section 25 of the Act, previously quoted, provides that, "notwithstanding the provisions of section 23A of this Act," a national bank may make loans and extensions of credit to foreign banks in which it has invested in the manner and within the limits prescribed by the Board by general or specific regulation or ruling. Section 23A of the Federal Reserve Act, limiting loans to affiliates, by its terms exempts all loans by a member bank to any "affiliate" in the capital stock of which a national bank is authorized to invest under section 25 of the Act. If a foreign bank in which a national bank invests constitutes an "affiliate" (and this may not always be the case), the limitations of section 23A would not be applicable even without the provision of the fourth paragraph of section 25 referred to above. Thus, that pro-
[§ 1001(a)] vision is unnecessary and should be eliminated in order to avoid the implication that section 23A would otherwise be applicable.

E. Obsolete authority to invest in foreign "financial" corporations

The fifth paragraph of section 25 of the Act reads as follows:

> "Until January 1, 1921, any national banking association, without regard to the amount of its capital and surplus, may file application with the Board of Governors of the Federal Reserve System for permission, upon such conditions and under such regulations as may be prescribed by said board, to invest an amount not exceeding in the aggregate 5 per centum of its paid-in capital and surplus in the stock of one or more corporations chartered or incorporated under the laws of the United States or of any State thereof and, regardless of its location, principally engaged in such phases of international or foreign financial

> operations as may be necessary to facilitate the export of goods, wares, or merchandise from the United States or any of its dependencies or insular possessions to any foreign country: Provided, however, That in no event shall the total investments authorized by this section by any one national bank exceed 10 per centum of its capital and surplus."

Although this paragraph is presently included in the United States Code, it is clearly obsolete. The temporary authority provided by the paragraph to invest in foreign "financial" corporations expired by its terms on January 1, 1921. The proviso limiting total investments by a national bank to 10 per cent of its capital and surplus could be regarded as not having expired because it refers to investments "authorized by this section". However, the third paragraph of section 25 specifically limits investments by national banks under section 25 to 10 per cent of their capital stock and surplus. Consequently, the proviso in the fifth paragraph of section 25 is unnecessary.

[§ 1001]

F. Agreement required of State foreign banking corporations

The first sentence of the eighth paragraph of section 25 (12 U.S.C. 603) reads as follows:

> "Before any national bank shall be permitted to purchase stock in any such corporation the said corporation shall enter into an agreement or undertaking with the Board of Governors of the Federal Reserve System to restrict its operations or conduct its business in such manner or under such limitations and restrictions as the said board may prescribe for the place or places wherein such business is to be conducted. . . ."

It is clear that this sentence is not intended to require the specified agreement with respect to an Edge Act corporation

organized under section 25(a) or with respect to a foreign bank in which a national bank makes a direct investment under the fourth paragraph of section 25, even though both might literally be regarded as covered by the reference to "any such corporation". In order to clarify this matter, the sentence should be amended to refer to

[§ 1001(d)] "stock of any corporation described in the third paragraph of this section other than a corporation organized under section 25(a) of this Act."

G. Coverage of Puerto Rico

Sections 25 and 25(a) of the Act refer in a number of places to "dependencies or insular possessions of the United States". The provisions of these sections with respect to foreign branches, as well as foreign banking corporations, have been regarded as applicable to Puerto Rico. Nevertheless, as a Commonwealth, Puerto Rico enjoys a unique legal status; and it is not strictly accurate to consider Puerto Rico as a dependency or insular possession.

To remove any ambiguity in this respect, specific

[§§ 1001, 1002] reference to Puerto Rico should precede the words "dependencies or insular possessions" wherever they occur in sections 25 and 25(a) of the Act.

H. Meaning of "foreign" branch

Although the second paragraph of section 25 of the Act refers to branches in dependencies or insular possessions of the United States as well as branches in foreign countries, the seventh,

ninth, and tenth paragraphs of the section refer in several places to "foreign branches". These references have been regarded as including branches in Puerto Rico and dependencies and insular pos-

[§ 1001(a)] sessions of the United States. To avoid any question, however, the second paragraph of section 25 should be amended to insert after the words "dependencies or insular possessions of the United States" a parenthetical clause reading "(hereafter referred to as foreign branches)".

73. FOREIGN BANKING CORPORATIONS AS DEPOSITARIES IN PANAMA AND PHILIPPINES

The first paragraph of section 25(a) of the Act (12 U.S.C. 611), relating to the organization of "Edge Act" corporations, provides:

> ". . . That nothing in this section shall be construed to deny the right of the Secretary of the Treasury to use any corporation organized under this section as depositaries in Panama and the Panama Canal Zone, or in the Philippine Islands and other insular possessions and dependencies of the United States."

The references to the use of such corporations as depositaries in Panama and the Philippine Islands are now obsolete. Panama is, of course, now an independent country and the independence of the Philippine Islands was recognized by Presidential Proclamation of July 4, 1946.

[§ 1002(a)]

74. JURISDICTION OF SUITS

The first two paragraphs of section 25(b) of the Act (12 U.S.C. 632), added by the Banking Act of 1933, relate, respectively, to jurisdiction of suits arising out of foreign banking business and of suits involving Federal Reserve Banks.

As a matter of arrangement, the first of these paragraphs should be added at the end of section 25(a) of the Act, relating to foreign banking and financial corporations, or set forth as a separate section; and the second paragraph should be transferred to and grouped with provisions relating to the organization of the Federal Reserve Banks.

[§ 1003]

[§ 515]

75. RECEIPT OF PROPERTY OF FOREIGN STATES

The last four paragraphs of section 25(b) of the Federal Reserve Act (12 U.S.C. 632), added in 1941 after the outbreak of World War II, relate to the receipt of property of foreign states by Federal Reserve Banks and insured banks.

A. Rearrangement of provisions

As a matter of logical arrangement, the provisions relating to the receipt of property of foreign states by the Federal Reserve Banks should be grouped with provisions of the Act relating to the activities and functions of the Federal Reserve Banks, preferably in proximity to provisions regarding the foreign operations of the Reserve Banks. Logically also, the provisions of section 25(b) regarding the receipt of foreign property by insured banks should be included in the Federal Deposit Insurance Act rather than the Federal Reserve Act. However, the fifth and sixth paragraphs of the section, providing for licenses to act in connection with such property of foreign states and setting forth definitions, relate to the receipt of such foreign property by both the Reserve Banks and insured banks. Consequently, if the fourth paragraph of the section, dealing with receipt of such property by insured banks, were transferred to the Federal Deposit Insurance Act, it would be necessary to include in that Act, as well as the Federal Reserve Act, the provisions of the fifth and sixth paragraphs of present section 25(b).

[§ 609]

This is an instance in which some compromise with principles of logical arrangement seems desirable. Accordingly, while it would mean the retention in the Federal Reserve Act of provisions relating to all insured banks, it is suggested that
[§ 609] the last four paragraphs of section 25(b) be incorporated in a separate section following those sections of the Act that deal with the powers and functions of the Federal Reserve Banks.

B. Reference to Silver Purchase Act

The first sentence of the fifth paragraph of section 25(b) (12 U.S.C. 632) provides that nothing in that section shall be deemed to repeal or modify provisions of certain acts, including the Silver Purchase Act of 1934. The latter Act was repealed
[§ 609(c)] by Act of June 4, 1963 (77 Stat. 54) and, accordingly, the reference to the Silver Purchase Act should be omitted.

C. Obsolete reference to section 12B of Federal Reserve Act

The sixth paragraph of section 25(b) of the Federal Reserve Act (12 U.S.C. 632) provides that the term "insured bank" for purposes of that section shall have the meaning given to it in section 12B of the Federal Reserve Act.

Section 12B of the Federal Reserve Act was withdrawn from that Act and enacted as a separate Federal Deposit Insurance Act in 1950. Consequently, the reference to section 12B above
[§ 609(d)] mentioned should be changed to refer to the "Federal Deposit Insurance Act".

76. REPEALER CLAUSE; PRESERVATION OF GOLD PARITY PROVISIONS OF ACT OF 1900

Section 26 of the Act (31 U.S.C. 409) provides as follows:

> "All provisions of law inconsistent with or superseded by any of the provisions of this Act are to that extent and to that extent only hereby repealed: Provided, Nothing in this Act contained shall be construed to repeal the parity provision or provisions contained in an Act approved March fourteenth, nineteen hundred, entitled 'An Act to define and fix the standard of value, to maintain the parity of all forms of money issued or coined by the United States, to refund the public debt, and for other purposes,' and the Secretary of the Treasury may for the purpose of maintaining such parity and to strengthen the gold reserve, borrow gold on the security of United States bonds authorized by section two of the Act last referred to or for one-year gold notes bearing interest at a rate of not to exceed three per centum per annum, or sell the same if necessary to obtain gold. When the funds of the Treasury on hand justify, he may purchase and retire such outstanding bonds and notes."

All of the provisions of this section appear to be obsolete or of no present significance and should be repealed.

The first clause of the section, down to the proviso, is a "repealer clause" that no longer serves any purpose and is not presently carried in the United States Code.

The first part of the proviso, stating that nothing in the Federal Reserve Act shall be construed to repeal the parity provisions of the Act of March 14, 1900, was probably unnecessary at the time of enactment of the Federal Reserve Act and, in any event, has since been superseded by other statutes.

This proviso was added to the bill that became the Federal Reserve Act near the conclusion of debates on the bill

in the House. According to Carter Glass, a group of Republican members had argued that the note issue provisions of the bill would rescind the gold parity provisions of the Act of March 14, 1900. Insisting that this objection was without foundation, Mr. Glass explained why the proviso was nevertheless adopted as a tactical measure:

> ". . . Challenged over and over again to point out the provision of the bill which could be so construed, they talked a lot of fudge about the 'lawful money' redemption feature, as if lawful money were not synonymous with gold under existing law. It was so entirely clear that there was not a thing in the bill that adversely affected the gold standard, that the managers of the measure were not a little perplexed to know the covert meaning of this tail-end clatter. We were forced to believe that it was invented as an excuse to vote against the bill; and, so suspecting, all but one member of the Banking Committee urged the chairman to accept an amendment offered by Mr. Fess (Rep.) of Ohio, explicitly declaring that nothing in the bill should be construed to repeal the act of March, 1900, providing a gold parity for all forms of money." (Glass, An Adventure in Constructive Finance (1927), p. 153)

Whether or not the proviso was necessary, it appears to have been superseded by provisions of the so-called "Thomas Amendment" of May 12, 1933. The Act of 1900 had provided that the dollar should consist of 25.8 grains of gold nine-tenths fine and should be the standard unit of value and that all forms of money issued or coined by the United States should be maintained at a parity of value with this standard. It further provided that it should be the duty of the Secretary of the Treasury to maintain such parity. However, section 43 of the

Act of May 12, 1933, authorized the President to fix the weight of the gold dollar and provided that the gold dollar, the weight of which was so fixed, should be the standard unit of value, that all forms of money issued or coined by the United States should be maintained at a parity with this standard, and that it should be the duty of the Secretary of the Treasury to maintain such parity. By Proclamation of January 31, 1934, the President fixed the weight of the gold dollar at 15-5/21 grains of gold nine-tenths fine.

The last clause of the proviso in section 26 and the final sentence of the section are obsolete, since they are dependent upon section 2 of the Act of March 14, 1900, and since that section was repealed by section 10 of the Act of March 18, 1968 (P.L. 90-269).

77. TAX ON NATIONAL BANK NOTES

Section 27 of the Federal Reserve Act extended the provisions of the Act of May 30, 1908 (the Aldrich-Vreeland Act) until June 30, 1915, and amended section 9 of that Act, with respect to the rate of taxation on national bank notes not secured by United States bonds, to read as set forth in the second paragraph of section 27 of the Federal Reserve Act. Consequently, the second paragraph of section 27 expired by its terms on June 30, 1915, and should, therefore, be eliminated as obsolete.

Section 27 of the Federal Reserve Act also re-enacted sections 5153, 5172, 5191, and 5214 of the Revised Statutes, which had been amended by the Act of May 30, 1908, to read as such sections read prior to that date. Accordingly, this part of section 27 has been effectuated and is no longer of any significance.

All of section 27 is omitted from the United States Code. It should not, of course, be included in any revision of the Federal Reserve Act.

78. NUMBER OF DIRECTORS OF MEMBER BANKS

Section 31 of the Banking Act of June 16, 1933 (12 U.S.C. 71a), reads as follows:

> "After one year from the date of enactment of this Act, notwithstanding any other provision of law, the board of directors, board of trustees, or other similar governing body of every national banking association and of every State bank or trust company which is a member of the Federal Reserve System shall consist of not less than five nor more than twenty-five members. If any national banking association violates the provisions of this section and continues such violation after thirty days' notice from the Comptroller of the Currency, the said Comptroller may appoint a receiver or conservator therefor, in accordance with the provisions of existing law. If any State bank or trust company which is a member of the Federal Reserve System violates the provisions of this section and continues such violation after thirty days' notice from the Board of Governors of the Federal Reserve System, it shall be subject to the forfeiture of its membership in the Federal Reserve System in accordance with the provisions of section 9 of the Federal Reserve Act, as amended."

Insofar as this section refers to directors of State member banks, it should be transferred to an appropriate place in the Federal Reserve Act. Insofar as the section relates to directors of national banks, it should be amended to refer only to such banks.

[§ 807]

[Sec. 8]

The amended section 31, as well as the incorporation in the Federal Reserve Act of so much of the section as relates to directors of State member banks, should be modified to eliminate the obsolete and unnecessary phrase at the beginning of the section which reads: "After one year from the date of enactment of this Act".

79. AFFILIATIONS WITH SECURITIES COMPANIES

Section 20 of the Banking Act of 1933 (12 U.S.C. 377), prohibiting the affiliation of any member bank with a securities company, reads as follows:

> "After one year from the date of the enactment of this Act, no member bank shall be affiliated in any manner described in section 2(b) hereof with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities: Provided, That nothing in this paragraph shall apply to any such organization which shall have been placed in formal liquidation and which shall transact no business except such as may be incidental to the liquidation of its affairs.
>
> "For every violation of this section the member bank involved shall be subject to a penalty not exceeding $1,000 per day for each day during which such violation continues. Such penalty may be assessed by the Board of Governors of the Federal Reserve System, in its discretion, and, when so assessed, may be collected by the Federal reserve bank by suit or otherwise.
>
> "If any such violation shall continue for six calendar months after the member bank shall have been warned by the Board of Governors of the Federal Reserve System to discontinue the same, (a) in the case of a national bank, all the rights, privileges, and franchises granted to it under the National Bank Act may be forfeited in the manner prescribed in section 2 of the Federal Reserve Act, as amended (U.S.C., title 12, secs. 141, 222-225, 281-286, and 502), or (b) in the case of a State member bank, all of its rights and privileges of membership in the Federal Reserve System may be forfeited in the manner prescribed in section 9 of the Federal Reserve Act, as amended (U.S.C., title 12, secs. 321-332)."

Section 32 of the Banking Act of 1933 (12 U.S.C. 78), relating to interlocking directorates between member banks and

securities companies, reads as follows:

> "No officer, director, or employee of any corporation or unincorporated association, no partner or employee of any partnership, and no individual, primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities, shall serve[1] 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 when in the judgment of the said Board it would not unduly influence the investment policies of such member bank or the advice it gives its customers regarding investments."

"1 So in statute as enacted.

Since both of these sections in terms relate to all member banks, they should logically be incorporated in the Federal Reserve Act among other provisions imposing restrictions upon [§ 905] member banks. In transferring these sections to the Federal Reserve Act, the language of the present section 20 of the Banking Act of 1933 should be modified to eliminate the obsolete phrase at the beginning of the section reading: "After one year from the date of the enactment of this Act".

*80. LOANS TO EXAMINERS

Section 212 of the United States Criminal Code (18 U.S.C. 212) prohibits any insured bank from making any loan to any person who examines or has authority to examine such bank. Section 213 of the Code (18 U.S.C. 213) prohibits any examiner from obtaining a loan from any insured bank examined by him.

These provisions, designed to prevent conflicts of interest, are based upon sound principles. However, they unduly and unfairly place bank examiners at a serious disadvantage in the obtaining of financing for the purchase or construction of homes. The law should be modified to permit insured banks to make home mortgage loans to examiners up to some maximum amount, such as $30,000. Such a modification would not defeat or impair the accomplishment of the purposes of these provisions, particularly if the examiner is expressly precluded by the amendment from examining the lending bank during the life of the loan.

[Sec. 11]

The Board has recommended such an amendment to the law in its Annual Reports to Congress (see Annual Report for 1967, page 332). An amendment of the kind proposed would be in general conformity with the principle applied by Congress in a 1967 amendment to provisions of the Federal Reserve Act relating to loans by member banks to their executive officers. That amendment expressly permitted home mortgage loans to executive officers not exceeding $30,000, if specifically approved by the board of directors of the member bank involved.