

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE: June 9, 1934.

FROM H. H. Edmiston

TO Mr. Eccles.

RE: Federal Reserve

Federal Reserve Board:

Membership:

Eight members: Secretary of the Treasury (The Board Chairman) and Comptroller of the Currency ex officio members; six others appointed by the President; no more than one from any single Federal reserve district. Members cannot be connected with any member bank while in office or for two years after resignation. Governor and vice-governor designated by the President. Term - 12 years.

Powers:

1. Rediscount rates:

- a. Law: The rates of the Federal Reserve Banks are subject to review and determination by the Federal Reserve Board.
- b. Actual Proceedings: The customary practice is for the Board of Directors of each Federal Reserve Bank to meet Thursday morning of each week, and either to continue the present rediscount rate or to vote a change. The results of the action are then wired to the Federal Reserve Board in Washington. In case of no change, the rate automatically remains the same, unless the Board decides to refuse to approve the rate. In that case the Reserve Bank is notified and must send in another rate which will meet the approval of the Board. In such circumstances I think it is customary for the Board to suggest a rate to the Bank in question which it will approve. When a rate change is made, the Board either approves or disapproves the rate and notifies the Bank by three o'clock Thursday afternoon. Thus it appears that the Board has almost complete control over rediscount rates, if they wish to use their powers under the law. However, in most cases the Banks have initiated rate changes. A notable exception was the Chicago case of 1927, when the Board refused to approve the existing rate of the Chicago Federal Reserve Bank and forced a lower rate over the objections of the Bank.

2. Open Market Operations:

- a. Ordinary Procedure: Under the Banking Act of 1933 a Federal Open-Market Committee was set up, consisting of twelve members, -- one from each Federal Reserve District, and appointed by the Board of Directors of the Federal Reserve Bank of the district. This Committee meets four times a year in Washington and also

may be required to sit at any time upon the request of the Federal Reserve Board. Members of the Federal Reserve Board may sit with the Committee at any of its meetings. This committee initiates changes in open-market policy of the Federal Reserve System. All of their actions, however, are subject to the review and approval of the Federal Reserve Board.

However, the law reads that the Federal Reserve Board shall set up the rules and regulations concerning open-market operations of the Federal Reserve banks, so the Board, perhaps, has the power to actually initiate and force through a change in open-market policy. However, at least officially all open-market operations have been proposed by the Open Market Committee, and hence this probable power of the Board has never been fully tested.

3. Eligible Paper:

The Board has the right to determine or define the character of "eligible paper" under the terms of the Act.

In unusual circumstances the Board may authorize Federal Reserve Banks to rediscount "eligible paper" for private businesses.

4. The Board may remove any officer or director of ~~the~~ Federal Reserve bank.
5. The Board has power to suspend any Federal Reserve bank for violation of the Act; to take possession thereof and administer during period of suspension, and when deemed advisable to liquidate or reorganize such bank.
6. The Board may suspend any reserve requirements of the Act; and in time of emergency, with the approval of the President, to increase or decrease reserve balances required of member banks.
7. The Board has several powers to control speculative use of credit by member banks on penalty of withholding the rediscount privileges.
8. The Board may permit or require Federal Reserve banks to rediscount for other Federal reserve banks at rates fixed by the Board.
9. There are many minor powers which the Act confers upon the Board, which I have not included in this survey.

Board of Directors of Federal Reserve Banks:

Membership: Nine members.

Class A: Three. Representatives of stock-owning member banks and selected by them.

Class B: Three. Must be actively engaged in agriculture, commerce or industry at time of election and cannot be connected with any bank. These also are elected by member banks.

Of the above six directors (2 are elected by the large banks; 2 by the middle-size banks, and 2 by the small banks of the district).

Class C: Three. Appointed by the Federal Reserve Board. (One to be F. R. Agent and Chairman of the Board). They must be residents of the district.

Term of Office: Three years.

Powers:

1. The Board of Directors shall perform the customary duties of directors of banking associations and all such duties as are prescribed by law.
2. Open-Market Operations:
The Board of Directors of each Bank appoint annually a member to the Federal Open-Market Committee and thus indirectly initiate changes in open-market policy.

A Federal reserve bank on vote of its Board of Directors may decide not to participate in open market operations approved by the Board. In that case it shall file notice with the Open-Market Committee and the Federal Reserve Board within 30 days. The Board of Directors also initiates changes in the bill buying rate of the Federal reserve banks, subject to the approval of the Federal Reserve Board. The procedure in purchasing bills is passive. The Banks taking all bills that are offered them by member banks and dealers and holding them until maturity. Of course, this policy may become active if the buying rate is out of line with the rate on bills in the open market.

3. Rediscount Rates:
Federal reserve banks may initiate changes, but to be effective the Federal Reserve Board must approve them as explained above.

It would appear from the provisions of the law that the board members of the Federal reserve banks do not have a great deal of discretionary power in the important matters of policy. However, among the directors and officials there are experienced bankers and highly paid men and their influence is therefore considerable in determining the policies of the System, although the Federal Reserve Board officially makes the final decisions.

Life of Federal Reserve Banks:

Federal reserve banks once franchised shall have continuous succession until dissolved by an act of Congress, or, until forfeiture of franchise for violation of the law.