

July 3, 1940

STRICTLY CONFIDENTIAL

To: Board of Governors

Subject: Banking legislation

From: Staff

In accordance with the Board's instructions, the staff has reviewed the problem of possible banking legislation. There are transmitted herewith a number of suggested changes in the law. This is not a comprehensive plan but is limited to the principal changes that appear to the staff to be desirable. The staff believes, however, that there is nothing in these proposals inconsistent with a more comprehensive program that may be formulated later. Drafts of bills to carry out such of the present suggestions as the Board may adopt can be prepared without delay.

In addition to the measures proposed in the attached program, the staff has considered the desirability of devising means for applying selective credit control to credit extension in fields other than registered securities for which such a control now exists. A committee of the staff has been appointed to explore the possibility of control over real estate loans, installment loans to consumers, and loans on unlisted securities. The reason for undertaking this exploration is the staff's belief that, in addition to control over the total volume of credit through the regulation of reserves, a need for selective means of control of credit expansion in specific fields may develop.

A committee has also been appointed to review banking laws with a view to recommending elimination of unnecessary restrictions and extension of necessary ones to all insured banks. Unless the Board objects, this committee will consult the Federal Reserve Banks in this matter.

When the Board decides to take up this program for consideration, the staff would appreciate an opportunity to discuss it with the Board.

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PROGRAM OF LEGISLATION

I. Control of member bank reserves

1. Remove limits on Board's authority to raise reserve requirements and authorize Board to classify banks and deposits and to change reserve requirements for any class or classes of banks or deposits.^{1/}
2. Make reserve requirements applicable to all insured banks.
3. Provide that banks which find themselves short of reserves because of an increase in requirements or because existing requirements have been made applicable to them could, without odium or penalty other than an interest rate, carry the deficiency for a period of time and at a rate of interest, if any, to be determined by the Board. (This would require legislation repealing liability of directors for loans made when reserves are deficient and provision that member banks cannot pay dividends while reserves are deficient. Aside from this, the purpose of this recommendation can be accomplished by amendment of Regulation D.)
4. Vault cash to be included as a part of the member banks' required reserves.
5. Provide for deduction of cash in vault and balances with Federal Reserve Banks from gross deposits on which assessment for deposit insurance is based.
6. It is suggested that consideration be given to asking for authority for Federal Reserve Banks, subject to approval or direction by the Board, to pay interest on excess reserves. Such authority might be used at a time when positive restraint seems premature but a slowing down of expansion is desirable. A return on idle reserves would tend to diminish the banks' eagerness to expand to the limit of their resources.
7. Authorize the Board of Governors to require that all deposits of foreign central banks and governments be carried with the Federal Reserve Banks.

^{1/}We propose no limitation on this authority, but if it be decided that a limitation is necessary, we recommend that the limitation be in terms of a maximum permissible requirement, such as, for example, 50 per cent on demand deposits and 10 per cent on time deposits.

8. Provide that the Treasury's authority to issue silver certificates be limited to an amount sufficient to cover the price paid for the silver. This would eliminate authority to issue a billion and a half of silver certificates to cover seigniorage.
9. Repeal provision authorizing Treasury to issue three billion dollars of greenbacks.

II. Blanketing in of all insured banks

1. All insured banks, having been subjected to Federal Reserve reserve requirements, to be given access to borrowing and other facilities of the Federal Reserve System. This should be accompanied by elimination of eligibility requirements and of obligatory penalty rates on any discounts or advances.
2. Provide that no bank shall be subjected by this legislation to restrictions to which it is not now subject and no banks shall be relieved of any restrictions to which it is now subject. This includes capital requirements for banks and branches. It is a temporary provision pending revision of banking laws.
3. In making this recommendation to Congress, the Board should state that it is making a thorough-going review of existing regulations and restrictions applicable both to national and state member banks with a view to recommending elimination of all unnecessary restrictions and extension of necessary ones to cover all insured banks. The ultimate aim is to have all insured banks have the same privileges and be subject to the same restrictions.
4. Until this has been achieved the Board to have authority to waive any requirement for any group of banks in cases where inequities develop.
5. Exchange charges to be treated in the same way as other existing restrictions; namely, permit all banks which have been charging exchange prior to some fixed date before the introduction of this legislation to continue to charge exchange, and continue the prohibition against exchange charges for banks that are not now charging them. The only legislation this will require is an amendment authorizing those banks that will be permitted to charge exchange to charge it against the Federal Reserve Banks as well and requiring the Federal Reserve Banks to charge them back to the banks from which the checks were received for collection.

III. Increasing public character of Federal Reserve System

1. Have the Federal Reserve Banks pay back to member banks the face value of their Federal Reserve Bank stock with accrued dividends and abolish the stock.
2. The six directors that are now elected by member banks to be elected by all insured banks classified into large, middle-sized, and small banks, as at present.
3. Make active bankers ineligible as directors of Federal Reserve Banks so that all the directors elected by the insured banks will be like Class B directors under present law.
4. Provisions under 2 and 3 to become effective as the terms of present directors expire.
5. Give to the Board authority, by regulation, to limit the number of consecutive terms that any director may serve.
6. Transfer powers of Federal Open Market Committee to the Board of Governors.

IV. Treasury representative on Board of Governors

The staff recognizes the desirability of a statutory connection between the Board and the Treasury but does not recommend the re-introduction of an ex-officio member. The staff has no definite recommendation on this point, but suggests for consideration that one member of the Board be appointed by the Secretary of the Treasury and be his representative on the Board. This member to be subject to the same requirement about giving his entire time to the work of the Board as present members and to draw from the Board the same salary as other members.

V. Merger of Federal supervisory agencies

The three principal Federal agencies that have to do with banking, the Board of Governors, the Comptroller's Office, and the Federal Deposit Insurance Corporation, to be merged into one Federal banking authority. This agency to take over preferred stock and debentures of insured banks now held by R. F. C., as well as loans to such banks. Authority of Treasury to license banks to be repealed.

VI. Miscellaneous

1. Provision for decentralization of the Board's authority, so as to have as much as practicable of the direct supervisory and administrative powers over member banks in the hands of the Federal Reserve Banks.

2. Repeal collateral requirements for Federal Reserve notes or, failing that, remove time limit (June 1941) on eligibility of United States Government obligations as collateral.
3. Repeal prohibition against paying out of Federal Reserve notes of another Federal Reserve Bank.
4. Separate Chairman and Federal Reserve Agent.