

Confidential

STATEMENT OF REASONS FOR PROPOSALS

Administrative Changes

1. A rotation in the boards of directors is considered desirable in order not to provide an opportunity for crystallizing the influence of any special interest in the boards. Six years is considered to be a sufficiently long time to insure continuity in the boards and the limitation to six years is likely to work out in the interest of greater flexibility and closer responsiveness to changes in public opinion. This limitation, however, should not apply to the governor and the vice-governor for whom their offices should represent a culmination of their careers and who should not be obliged to leave the System if their services are satisfactory. Their positions, however, are to be held at the pleasure of the Federal Reserve Board.

2. In order to assure uniformity in the by-laws of the Reserve banks as well as consistency of these by-laws with the Board's policies, it is proposed that the by-laws be subject to the Board's approval.

3. It is proposed that collateral requirements for Federal Reserve notes be abolished and that the appointment of the Federal Reserve agent be optional with the Federal Reserve Board. The theory of special collateral for Federal Reserve notes was based on the idea that there is a distinct separation between currency policy and credit policy; in practice there is no such distinction.

From the technical banking point of view the requirement of collateral has been entirely unnecessary and has at times caused considerable difficulty because it has absorbed gold that might have been used for the

purpose of serving as a reserve against deposits. Furthermore, the collateral requirement has worked contrary to the policies of the Board because collateral has been plentiful at times when credit was expanding and there was a large amount of discounts from member banks and has been scarce at times when the amount of eligible paper was reduced through open market purchases by the Reserve banks and the consequent liquidation of discounts. Federal Reserve notes are a prior lien on all of the assets of the Reserve bank and are also an obligation of the United States Government. Their quality gains nothing by having specific assets assigned to them as collateral because being a prior lien they are guaranteed by the proceeds of the best assets that the bank holds. The place at which the assets held by a bank should be controlled is at the discount and open market windows of the bank, rather than at the desk of the Federal Reserve agent.

If collateral requirements against Federal Reserve notes are repealed, there will be no particular reason for keeping the office of Federal Reserve agent, as his statutory function of trustee of the collateral shall no longer exist. It is proposed, however, that the Board in its discretion should determine whether the Federal Reserve agent be needed at any Federal Reserve bank.

The plan in general provides that the Federal Reserve banks shall act as a unit and that the banks proper and the agents' departments be combined. It has in the past proved to be somewhat unwieldy, expensive, and unnecessary.

Credit Administration

4. The power to issue debentures is for the purpose of enabling the Reserve banks to contract deposits even after they have sold all their holdings of Government securities and acceptances. It is possible, in view of the existing excess reserves and in view of the possible additions to these reserves through the use of the Treasury's gold and the purchase of silver, that the portfolios of the Reserve banks may not be sufficient to absorb existing reserves when control of deposit expansion may become essential. It is true that provision is made elsewhere for raising reserve requirements, but this may prove to be undesirable or difficult to accomplish, while the sale of debentures is in the

nature of an open market operation which is much more easily consummated. In short, this power is intended to supplement the open-market powers of the Federal Reserve Board.

5. It is thought desirable to have available in case of national emergency a form of currency that would enable the Federal Reserve banks to meet an unusual demand for currency without being forced to suspend reserve requirements. It is for this purpose that Federal Reserve bank note provisions were liberalized during the emergency in the spring of 1933 and this emergency power should continue to be available without the need for legislation at the time when the emergency occurs.

6. The purpose of this provision is to make it impossible for agencies of the Government to counteract open-market policies of the Federal Reserve banks through the handling of their funds. If the Federal Deposit Insurance Corporation or the Reconstruction Finance Corporation, for example, should build up large balances with the Federal Reserve banks, this would have the same effect as sales of securities by the Reserve banks in the open market. It ought not to be possible for another agency of the Government, unwittingly or otherwise, to act contrary to the credit policy adopted by the Federal Reserve System. This involves no particular authority over the Governmental agencies because they can always accumulate their funds in the hands of a private bank where they would not constitute a withdrawal of reserve funds from the market.

7. The System's history has demonstrated that it is desirable to have some supervision and regulation over the building up of foreign

balances in this country. The accumulation of more than \$3,000,000,000 of such balances prior to 1929 was one of the causes of the violent deflation which followed when these balances were being withdrawn. Current publication of the volume of balances is a desirable thing because it would enable the Government, the bankers, and the public to be informed about capital movements in and out of the country.

8. The success of Federal Reserve policy in the future will be in large part dependent on the quality of its information. The information at present at the disposal of the Board is insufficient. It has been gathered by many agencies for many different purposes. In the interests of economy it is desirable that the Federal Reserve Board should not duplicate work done by other agencies of the Government. The alternative is greater cooperation in gathering and analyzing statistical data. The adoption of this proposal would give the Board some legal support in making suggestions to other Departments of the Government in connection with obtaining such statistics as may be necessary to form a basis for formulating policy.

9. This is for the purpose of making rules about interest on deposits uniform for all banks whether they are members of the Federal Reserve System or not. It legalizes what has been done in practice by the Federal Deposit Insurance Corporation.

Other Proposals

10. The elimination of permit provisions from the Clayton Act is for the purpose of relieving the Federal Reserve Board of the heavy burden of passing on a large number of individual requests for permits to serve as directors in several banks. The proposal is to prohibit interlocking directorates, except in accordance with general regulations which the Board will draft. These regulations will be applicable to all situations

of the same character and will do away with the necessity of specific action in individual cases by the Federal Reserve Board.

11. The repeal of Section 32 is recommended on the ground that it has caused a great deal of difficulty and has served no useful purpose. While it is recognized that a close affiliation between banks and security companies is not desirable, the elimination from directorates of banks of all persons who are connected with an investment or security company has resulted in the necessity of prohibiting many desirable men from acting as directors of banks. The Board under the statute has found no sufficient grounds for discriminating between applicants and, therefore, pursued the policy of issuing practically no permits. Repeal of the section would be in the public interest.

12. The prohibition of specific pledges of collateral to secure public deposits is proposed in the interests of equity. It is not fair in case of a bank failure to make the Government, either local or national, a preferred creditor as against the local depositors. The Government is in a better position to select trustworthy banks than are individual depositors and special protection for public funds is not justified. Deposit insurance reduces the importance of special collateral for any class of deposits.

13. In view of the multiplicity of banking laws, some of which are recent and others of long standing, it is highly desirable to have a competent body appointed for the purpose of reconciling differences, eliminating duplications, clarifying the law, and codifying it. To such

a commission might also be referred detailed problems about the regulation of bank assets and bank operations which cannot be settled satisfactorily in time to be incorporated in this year's legislative program.