

Office Correspondence

FEDERAL RESERVE
BOARD*W. Clayton*Date January 5, 1935C o p y

Subject: _____

To Mr. MorrillFrom Mr. Goldenweiser

GPO 16-852

I understand that Mr. Currie sent to the Governor, to you and Mr. Wyatt copies of the legislative proposals in which the latest revisions were incorporated. I am sending you four copies of the revised brief statement of reasons for these proposals. That is, copies for the Governor, yourself, Mr. Wyatt and Mr. Clayton.

I am also sending you another set of copies in which I have combined the proposals and the reasons, giving the reasons for each proposal immediately after the statement of the proposal. This document makes a little over five pages and in some respects may be more convenient than the two separate documents.

Would you be good enough to distribute this material among the members of the Legislative Committee?

January 4, 1935

LEGISLATION RECOMMENDED BY THE FEDERAL RESERVE BOARD

AND REASONS THEREFOR

Federal Reserve
Banks

Proposals 1 and 2

1. The offices of Chairman of the Board and Governor or a Reserve bank shall be combined. The Chairman and Governor shall be appointed annually by the Federal Reserve Board. He shall be relieved of the detailed duties of Federal Reserve agent, shall be ex officio Chairman of the Executive Committee, and all other officers and employees shall be directly responsible to him. He shall be a Class C director, but his term as director shall terminate whenever he is not reappointed as Chairman; this provision shall apply to present Chairmen. There shall also be a vice-governor in each Federal Reserve bank to be appointed annually by the Federal Reserve Board. He shall exercise all the powers of the Governor during his absence and perform such duties as may be assigned to him by the Governor or the board of directors. In the discretion of the Federal Reserve Board, he may be a Class C director and may be designated deputy chairman of the board of directors. In case he is appointed a Class C director, his term as director shall terminate whenever he is not reappointed vice-governor. The salaries of the Governor and vice-governor shall be fixed by the Federal Reserve Board, and residence requirement for Class C directors shall not apply to them.

2. Members of the Board of a Federal Reserve bank shall not be eligible for more than two full consecutive three-year terms as directors. This provision shall not apply to the Governor or vice-governor and shall not apply to any director now in office until the expiration of his present term.

Reasons

The purpose of the first two proposals is to increase the authority of the Federal Reserve Board over the Federal Reserve banks without giving up the advantages of the regional character of the Federal Reserve System.

By combining the offices of chairman of the Board and Governor of the Reserve banks and providing that the appointment to the combined office be made by the Federal Reserve Board, as the appointment of the Chairman has always been, this proposal would strengthen the influence of the Board over the Federal Reserve banks, but since the method of selecting the banks' directors would remain unchanged, regional management in local matters would be retained. Provisions about the vice-governor are similar to those in regard to the Governor. Re-

Repeal of the requirement that these officials be residents of the district would remove an obstacle in the selection of the best available men.

Provision for rotation in the boards of directors is for the purpose of preventing the crystallization in the banks' management of the influence of any special interests.

Federal Reserve
Board

Proposals 3, 4, 5

3. The qualifications for appointive members of the Federal Reserve Board shall be changed to be as follows: They shall be persons well qualified by education or experience or both to participate in the formulation of national economic and monetary policies. At least two appointive members of the Board should be qualified by experience as executive officers of Federal Reserve banks, but this qualification should not prevent reappointment of present members of the Board and should not be mandatory but should be a declaration of general policy. The President shall, as now, designate the Governor of the Board to serve at his pleasure. The Governor's membership on the Board shall expire when he is no longer designated as Governor by the President.

4. Increase the salaries of the appointive members of the Federal Reserve Board hereafter appointed to those now paid the Associate Justices of the Supreme Court, which is \$20,000 per annum. Present appointive members of the Board may retire on their full pay at any time after reaching the age of 70; any members hereafter appointed must retire at such age and shall receive pensions equal to the present salary of board members. Appointive members having served less than twelve years shall have pensions in proportionately reduced amount, and no member shall be entitled to a pension unless he has served at least five years. If a member's term expires after he reaches the age of 65, and he is not reappointed, he shall be eligible for a pension on the same basis as a member retiring at 70.

5. The Board shall be empowered to delegate specific powers and duties not involving the determination of national or System policies to individual members of the Board and/or its representatives, but the power to make rules or regulations shall not be delegated.

Reasons

With the increased powers to be vested in the Board, it becomes essential to make service on the Board more attractive to men of the highest caliber. For this purpose it is proposed to repeal all geographical restrictions on membership, to specify the qualifications that Board members must have, and to lay down the principle that at least two of the members should have had practical experience as executive officers of

Federal Reserve banks. It is further proposed that the members of the Board to be appointed in the future shall receive a compensation adequate for dignified living in Washington and the assurance of a pension upon retirement. The salaries of members of the Board would be similar to those that are now received by members of the Supreme Court.

Authority for the Board to delegate specific powers and duties not involving the determination of national or system policies to individual members of the Board or to its representatives is for the purpose of relieving the Board of a large mass of details and thus to give it an opportunity to concentrate on problems of policy. This provision will also tend to expedite the business of the Board and to make immediate action possible in matters where it is essential.

Credit control

Proposals 6, 7, 8, 9, 10

6. Change Section 12A of the Federal Reserve Act so as to provide for an open-market committee to consist of the Governor of the Board, two members of the Board elected annually by the Board, and two governors of Federal Reserve banks elected annually by the governors of the Federal Reserve banks in a manner prescribed by the Federal Reserve Board. This committee shall make recommendations about discount rate policy and formulate the System's open-market policy which, when approved by the Federal Reserve Board, shall be binding on the Federal Reserve banks.

7. Make bonds and notes fully guaranteed by the United States as to principal and interest eligible for purchase by Federal Reserve banks without regard to the six months' limitation as to maturity.

8. Subject to limitations prescribed by the Federal Reserve Board, the Reserve banks shall have authority to discount or make advances on any sound assets of a member bank. Limitations on the maturity of advances to member banks shall be made discretionary with the Federal Reserve Board.

9. Collateral requirements for Federal Reserve notes shall be repealed, and the office of Federal Reserve agent shall be abolished. The prohibition against paying out of Federal Reserve notes of another Reserve bank shall be repealed.

10. In order to prevent injurious credit expansion or contraction, the Federal Reserve Board, in its discretion, may change reserve requirements as to any or all Federal Reserve districts and/or any or all classes of cities, and as to time and/or demand deposits.

Reasons

Proposal 6, which provides for an open-market committee consisting of three members of the Board, including the Governor, and two governors of Federal Reserve banks, elected by the banks, is for the purpose of concentrating the responsibility for the formulation of national credit policies in a small body that could act effectively, and in which the point of view of the banks would be represented, but control would be in the Board.

Proposal 7 is for the purpose of placing obligations fully guaranteed by the United States Government on the same basis with direct obligations of the Government in respect to eligibility for purchase by the Federal Reserve banks.

Proposal 8 is for the purpose of empowering the Board to relax or tighten eligibility requirements in accordance with changes in economic and credit conditions, and to remove mandatory limitations on maturity of advances to member banks. Existing limitations had to be suspended during the emergency, but only after they had done a great deal of harm.

Proposal 9 would repeal the present provisions for collateral against Federal Reserve notes on the theory that, since these notes are prior liens on the assets of the Federal Reserve banks, and are in addition obligations of the United States Government, specific pledging of collateral adds nothing to their safety. At the same time the collateral requirements have hampered open-market operations and have had to be belatedly relaxed during the emergency to admit United States Government obligations. The prohibition against paying out of Federal Reserve notes of other Reserve banks is to be repealed because it has served no useful purpose and has caused the System a considerable unnecessary expense.

Proposal 10 represents a clarification and modification of a power which the Board now possesses under the Thomas amendment. It is essential in view of the possibility of dangerous credit expansion on the basis of existing reserves.

Suspension of capital require- ments for mem- bership

Proposal 11

11. At any time prior to July 1, 1937, the Federal Reserve Board, in its discretion, may admit any insured nonmember bank to membership in the Federal Reserve System; and, in order to facilitate such admission, may waive the legal capital requirements for admissions. Provided, That such bank shall comply with all of the regular requirements of members within such time as the Federal Reserve Board shall prescribe.

Reasons

In order to make it possible for thousands of small nonmember banks to join the System, authority is given to the Board to waive until July, 1937, when all insured banks must become members of the Federal Reserve System, capital requirements for admission to membership and to make such arrangements as it deems best for ultimate compliance with these requirements.

Real estate
loans

Proposal 12

Amend Section 24 of the Federal Reserve Act so as to eliminate the restriction regarding the limitation of real estate loans as to maturity and as to percentage of the value of the property.

Reasons

Proposal 12 would remove the arbitrary requirements about maturity and percentage of value of permissible real estate loans. This proposal would enable national banks better to meet the credit needs of many communities and would remove the necessity of organizing other institutions to perform this service.

Technical pro-
visions

Proposal 13

(1) The Board shall have the power to define the different classes of deposits; and the provisions relating to reserves shall be changed as follows: (a) Member banks shall be permitted to deduct the "due from" item from gross deposits in calculating net demand deposits; and (b) Demand deposits of the United States Government at member banks shall carry the same reserves as individual demand deposits. (2) Repeal Section 8A of the Clayton Act and revise Section 8 so as to eliminate the permit provisions. Prohibit all interlocking directorates except to the extent allowed by general regulations of the Federal Reserve Board. (3) Amend Section 11 (m) of the Federal Reserve Act so as to permit State member banks to lend as much to individual borrowers on security of Government bonds as national banks are permitted to lend under Section 5200 of the Revised Statutes. (4) Require State member banks to publish their reports of condition. (5) Permit the supervisory authorities in their discretion to waive examinations and reports of affiliates when they are not necessary to disclose the relations between such affiliates and member banks. (6) Revise the provisions of the Federal Reserve Act regarding payment of interest on deposits by member banks so as to clarify them and allow more flexibility. (7) Exempt from voting permit provisions organizations which are not primarily engaged in the business of holding bank stocks of controlling banks. (8) Repeal criminal penalties in

*Already covered
in 10?*

Section 21 of the Banking Act of 1933 and Section 22 (g) of the Federal Reserve Act.

Reasons

These are technical provisions, largely non-controversial, and are designed to increase the System's efficiency and to eliminate ambiguities. Many of these provisions were in the Omnibus Banking Bill in 1934.

STATEMENT OF REASONS FOR PROPOSALSProposals 1, 2 -- Federal Reserve banks

The purpose of the first two proposals is to increase the authority of the Federal Reserve Board over the Federal Reserve banks without giving up the advantages of the regional character of the Federal Reserve System.

By combining the offices of chairman of the board and governor of the Reserve banks and providing that the appointment to the combined office be made by the Federal Reserve Board, as the appointment of the chairman has always been, this proposal would strengthen the influence of the Board over the Federal Reserve banks, but since the method of selecting the banks' directors would remain unchanged, regional management in local matters would be retained. Provisions about the vice-governor are similar to those in regard to the governor. Repeal of the requirement that these officials be residents of the district would remove an obstacle in the selection of the best available men.

Provision for rotation in the boards of directors is for the purpose of preventing the crystallization in the banks' management of the influence of any special interests.

Proposals 3, 4, 5 -- Federal Reserve Board

With the increased powers to be vested in the Board, it becomes essential to make service on the Board more attractive to men of the highest caliber. For this purpose it is proposed to repeal all geographical restrictions on membership, to specify the qualifications that Board members must have, and to lay down the principle that at least two of the members should have had practical experience as executive officers of Federal Reserve banks. It is further proposed that the members of the Board to be

appointed in the future shall receive a compensation adequate for dignified living in Washington and the assurance of a pension upon retirement. The salaries of members of the Board would be similar to those that are now received by members of the Supreme Court.

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Proposals 6,7,8,9,10 -- Credit control

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Proposal 9 would repeal the present provisions for collateral against Federal Reserve notes on the theory that, since these notes are prior liens on the assets of the Federal Reserve banks, and are in addition obligations of the United States Government, specific pledging of collateral adds nothing to their safety. At the same time the collateral requirements have hampered open-market operations and have had to be belatedly relaxed during the emergency to admit United States Government obligations. The prohibition against paying out of Federal Reserve notes of other Reserve banks is to be repealed because it has served no useful purpose and has caused the System a considerable unnecessary expense.

Proposal 10 represents a clarification and modification of a power which the Board now possesses under the Thomas amendment. It is essential in view of the possibility of dangerous credit expansion on the basis of existing reserves.

Proposal 11 -- Suspension of capital requirements for membership

In order to make it possible for thousands of small nonmember banks to join the System, authority is given to the Board to waive until July, 1937, when all insured banks must become members of the Federal Reserve System, capital requirements for admission to membership and to make such arrangements as it deems best for ultimate compliance with these requirements.

Proposal 12 -- Real estate loans

Proposal 12 would remove the arbitrary requirements about maturity and percentage of value of permissible real estate loans. This proposal would enable national banks better to meet the credit needs of many communities and would remove the necessity of organizing other institutions to perform this service.

Proposal 13 -- Technical provisions

(1) Is for the purpose of eliminating undesirable technical provisions in existing reserve requirements, which work to the disadvantage of country banks, to place deposits of the United States Government on the same basis as regards reserves as other deposits, and to give the Federal Reserve Board authority to define different classes of deposits. (2) The purpose of this proposal is to relieve the Board of the burden of passing on innumerable individual applications for permits by providing that the matter be dealt with through general regulations. (3) and (4) Are for the purpose of placing State member banks on the same basis as national banks in regard to lending on security of Government bonds and in regard to publication of reports. (5) Is for the purpose of making it unnecessary to require examinations and reports of bank affiliates when the affiliation has no bearing on the condition of the banks. (6) Is in the nature of clarification of the legal provisions relating to the payment of interest on deposits by member banks. (7) Is for the purpose of changing the definition of holding company affiliates so as to confine the statutory requirements as to voting permits, examinations, reports, and other matters to companies that are engaged in the business of holding bank stock - and ~~excluding~~ companies that are engaged in other business and whose possession of a controlling interest in a bank is only incidental. (8) Provides for the repeal of criminal provisions in Section 21 of the Banking Act of 1933 and Section 22(g) of the Federal Reserve Act and thereby makes it possible for the Board to regulate certain bank practices by regulation - without the possibility of subjecting them to prosecution by the Department of Justice in case that Department should interpret the law differently from the Federal Reserve Board.

January 8, 1935.

Governor Eccles.

Mr. Wyatt, General Counsel.

Mr. Morrill and I have revised the draft of the proposed Federal Reserve legislation in accordance with the changes agreed upon at the last meeting of our Committee and I am submitting herewith a copy of the revised draft.

Respectfully,

Walter Wyatt,
General Counsel.

Copy to: Dr. Goldenweiser,
Dr. Currie,
Mr. Morrill,
Mr. Clayton.