

Confidential

STATEMENT OF REASONS FOR PROPOSALS

Administrative Changes

1 & 2. It was the original intention of the framers of the Federal Reserve Act that the Chairman of the Board of Directors in each Reserve bank should be the principal executive officer, but in practice it has developed that the Directors appoint the Chief Executive Officer, to whom they assign the title of Governor. The chief executive officer of the bank, therefore, is not an appointee of the Federal Reserve Board, and is not responsible to that Board. As a consequence largely of his independent position, he has in the course of time acquired great influence in the determination of the System's policies. Instead of the Federal Reserve Board being the supreme authority, it has appeared that authority and responsibility have been divided between the Board, Boards of Directors of the individual reserve banks, and the Governors. The further consequence of this diffusion of authority is the danger that the public point of view with which the Reserve Board is charged may not be as adequately represented as the banking viewpoint which is more strongly represented by the reserve banks. For these reasons it is proposed that the offices of chairman and governor be consolidated and that the governor be an appointee of the Federal Reserve Board and be the head of the bank. The governor and chairman is to be relieved of the duties of the Federal Reserve agent, which are largely routine in character. This is for the purpose of giving him an opportunity to concentrate on the important functions of his office.

3. As a part of the plan for eliminating duplication of functions, it is proposed that the Federal Deposit Insurance Corporation, which has a particular interest in maintaining the solvency of banks, have full control over the examining functions which have been distributed between the Federal Deposit Insurance Corporation, the Comptroller of the Currency, the Federal Reserve Board, and the Reconstruction Finance Corporation. It is proposed, however, that the Federal Reserve Board have full control of the chartering of national banks, of admissions to the Federal Reserve System, and of consolidations, mergers, etc. The Board's interests in the matter are broader than the Federal Deposit Insurance Corporation's, which is primarily concerned with solvency. The Board, in addition, has the responsibility for enforcement of uniform rules and requirements on all banks that are members of the System. It is also interested, not only in the solvency of the banks, but in the existence of adequate banking facilities for the public as well, and the maintenance of the banking structure in a condition that would enable it to render the best possible service to the public and to be responsive to credit policies adopted by the Board.

4. It is recognized that in the final analysis the quality of the members of the Board depends on appointments made by the President and that no qualifications written into the law can give assurance that the men selected will be such as to meet the exacting requirements of the office. It is recognized, however, that the qualifications as laid down in the present law are a handicap to the President in the

selecting of members because he is limited to one member from any one district. If the best available man in the country happens to be a resident of a district which is already represented, the President does not have the privilege of appointing him, unless he can prevail upon an existing member to resign. The purpose of the geographical limitation was probably to prevent the concentration on the Board of representatives from a particular section of the country, but this can be left to the discretion of the President, who is in the habit of considering matters of this sort in appointing his cabinet and other responsible groups of men.

The present provisions of the law also require the Board's members to be selected with due regard to a fair representation of the financial, agricultural, industrial, and commercial interests and geographical divisions of the country. From the point of view of monetary control it is not desirable to have a requirement that the different borrowing interests be represented on the Board. The primary objective of the Federal Reserve Board should be to promote conditions making for general business stability and it should not be concerned with arbitrating the different interests of particular groups. All members of the Board should represent the nation, rather than any particular interest in the nation, and for this reason it is proposed to state in the law that the members of the Board shall be qualified by education or experience or both to participate in the formulation of national economic and monetary policies. It is proposed, however, to require that

at least two members of the Board shall have had experience as executive officers of Federal Reserve banks. This is for the purpose of assuring that the Board shall always have some members who have familiarity with the problems arising at the Reserve banks, with the operations of these banks, and with the nature of the relationships between Reserve banks and their member banks.

5. The increase in the importance and responsibility of the Federal Reserve Board necessitates provisions that would tend to secure the services of the persons best qualified for the work. In order to make it possible to obtain such persons it is necessary to provide for them an adequate salary. Otherwise the System would be in danger of losing the services of valuable men who could not afford to continue as members of the Board, a circumstance that has occurred in the past. It would not be feasible to make the salaries comparable with salaries for equivalent positions in the banking and commercial world, but it would seem best to provide for salaries which coupled with pension provisions make it feasible for a person to accept a position on the Board and to continue in office during his active life without financial worry. This situation would be similar to that existing in the Supreme Court. It is for this reason that a salary of \$20,000 a year and a system of pensions for the Board members is proposed. The salary appears adequate for a dignified life in Washington and the provisions of a pension removes the necessity of concern about support in declining years. It is worth noting that salaries and pensions of members

of the Board are not a charge on the general revenues of the Government, but are paid out of the earnings of the Reserve banks.

6. The power to delegate specific duties to members of the Board or its representatives is essential for the purpose of relieving the Board members of a large amount of routine duties which are likely to absorb more of their time than in the national interest they can afford to spare. By delegating to one member of the Board or of the staff, or to such representatives at the Reserve banks as have the Board's confidence, the Board will be able to give its attention to matters of general national importance and to leave the detailed carrying out of its policies to others. The delegation of specific duties to individuals would also result in expediting matters that require immediate decision. It should be provided, however, that the Board shall not delegate to others any actions that involve determination of national policies.

7. This proposal is for the purpose of making it possible for the Board to make such changes in personnel and organization as may be necessary for the purpose of carrying out the policies laid down in the other proposals.

#### Credit Administration

8. As stated above, the desirable objective should be to concentrate all matters pertaining to the public interest in general in the Federal Reserve Board. It has been demonstrated again and again

that the effect of open market operations is nation-wide and cannot be localized. It is therefore desirable that the Federal Reserve Board should have full control and responsibility for the open-market operations of the System.

The repeal of the section of the law creating the open-market Committee as a statutory body is desirable because the law as framed deprives the Board of powers which it had prior to the adoption of this section. It is also preferable to have more flexibility in the System's internal organization in connection with the formulation of policies. A clear statement of the fact that the Federal Reserve Board has the power to initiate and influence changes in discount and open market rates as well as open-market operations is fundamental to the establishment of a system that can carry out a national policy speedily and efficiently. It is probably true that the Board has the necessary powers now, particularly in regard to rates, and that it could influence open-market policies by the use of its incidental powers over personnel, salaries, and general management. It is, however, desirable to make these powers entirely unequivocal so that there could be no argument about them. It is also psychologically desirable in order to state clearly the intent of Congress that the Federal Reserve Board be responsible for national policies in the administration of credit.

9. The insertion of a clause requiring the Reserve System to promote business stability is for the purpose of indicating to the System the objective toward which it must strive. The System has vast

powers and responsibilities and it seems proper that the general direction in which these powers are to be used be indicated by the people through Congress. Business stability is not a definite term, but it indicates that wide fluctuations in industrial activity and in employment should be prevented by credit policy insofar as it is possible.

10-12.. This group of proposals attempts to correct some of the defects in the existing methods of calculating reserves. The limitation of deductions of amounts due from other banks from the total of amounts held for other banks has worked in the interest of the city banks as against the country banks. Country banks have deposits with city banks but are not able to deduct them from their deposits because they hold no deposits for other banks. It is better logic as well as better equity to permit such balances to be deducted in toto in the calculation of reserves. The establishment of reserves on Government deposits similar to those on other deposits is obviously fair because Government deposits both from the point of view of purchasing power and from the point of view of possible drains on the banks are in the same class with other demand deposits.

The counting of vault cash as a part of reserves is also both logical and equitable. Under existing law member banks located in the Federal Reserve bank cities can operate with a very small volume of vault cash, whereas banks away from Federal Reserve bank cities have to carry a considerable volume of vault cash. This operates as a hardship on the country banks.

This group of proposals is also desirable on the grounds of promoting uniformity in reserve requirements. Without such uniformity, fortuitous shifts in deposits between different classes of banks may result, because of changed reserve requirements, in a change in the volume of deposits. Such changes may not be in accord with the general policies of the System.

Proposals 10-12 in this section are all in accordance with the recommendations of the Federal Reserve System Committee on Reserves whose report explains the reasons for the proposals in detail.

13. The power of defining demand and time deposits is necessary in order to make evasions of the law more difficult. The arbitrary definition now in the law has not worked satisfactorily.

14. This proposal constitutes a liberalization of a section now incorporated in the so-called Thomas Amendment, which authorizes the Board to change member bank reserve requirements, but only with the approval of the President. Aside from the fact that the law is so worded as to make it almost impossible to lower requirements previously raised, it makes it necessary for the President to assume the odium of raising reserve requirements at a time when credit conditions may demand it. Since the Federal Reserve System has the responsibility for credit administration, it seems more appropriate and more effective to give the Board all the powers necessary to discharge its duties.

This would be in the nature of an emergency power. It probably would not ordinarily be invoked but it would prove of the greatest importance at a time when the reserve banks' portfolio of securities

and acceptance was exhausted, the member banks were out of debt to the reserve banks and they were either gaining reserves or already possessed of large volume of excess reserves. At such a time raising the reserve requirements against deposits subject to check would absorb the excess reserves and force member banks into debt to the reserve banks. Raising or lowering reserve requirements would, in other words, be approximately as effective as the sale or purchase of government securities by the reserve banks in the open market.

#### Unification of the banking system

15. As a part of the plan for bringing about a unification of the banking system, it is proposed that all insured banks shall be admitted to membership in the Federal Reserve System prior to July 1, 1937. This proposal will remove all the technical difficulties about joining the Federal Reserve System and it is expected that it will remove a good deal of the objection that nonmember banks have to joining the System. It will also help to combat the movement for modifying the provision of existing law that no bank can remain in the insurance fund after July 1, 1937, unless it is a member of the Federal Reserve System. It is proposed, however, that the banks within five years put themselves into the proper condition for membership by complying with all the regular requirements. The five-year period will enable the banks and the authorities to work out ways and means for accomplishing this purpose. In case, however, in particular instances it turns out to be impossible

to accomplish this in five years, the Federal Reserve Board will have authority to extend the period.

16. It is proposed not to change the existing minimum capital requirement because experience has shown that banks with less than \$50,000 capital have a poor chance of surviving. The larger minimum which the present law prescribes for banks in different classes of cities, however, seem to be unnecessarily arbitrary and it is best to leave this matter in the discretion of the Federal Reserve Board. The Board would be in a position to prescribe other requirements than an absolute minimum, such as adequate capitalization in relation to the volume of deposits.

17. The branch banking proposals are based on the theory that branch banking areas should roughly correspond to trade areas and that the Federal Reserve branch zones tend to correspond to such areas. This would not make possible a rapid extension of branch banking over wide geographic areas, but it would make it possible to establish branches wherever there is local need for them, and no injustice is done to existing institutions. The assumption is that smaller cities, those with a population of less than 100,000 people, cannot be in great need of additional banking facilities if they have a bank in full operation. For that reason it is proposed that in such communities no branch be authorized unless it be established by taking over an existing bank, or on the basis of consent of all the banks in the community. In order to make it impossible to have a new bank established temporarily for the purpose of converting it into a

branch, it is proposed that no bank hereafter organized shall be converted into a branch for five years after its organization. If a community has only a branch of a bank, the Federal Reserve Board may authorize the establishment of an additional branch if there appears to be need for additional banking service.

The present law in regard to capitalization of branches is retained for the purpose of assuring that only banks with adequate capital shall engage in branch banking.

18. The adoption of the Omnibus Bill which failed to pass in the last session of Congress would be helpful in clarifying a lot of confusing sections in recent banking legislation and eliminating such sections or portions of sections as were adopted inadvertently or have proved to be impractical in operation.

19. The proposal that the definition of eligibility of paper for discount at the Federal Reserve banks be left to the Federal Reserve Board is based on the fact that in times of emergency, the Federal Reserve banks have found it necessary in the public interest to extend accommodation to banks on paper that ordinarily would not be eligible. In the past it has been necessary for that purpose to obtain special legislation from Congress which entailed delay and contributed to banking difficulties. If the Board had the power to define eligibility, it could be trusted in ordinary times to define it in such a manner as to protect the reserve banks, and in times of need to make the necessary relaxations. This is in accordance with the general practice in foreign central banks. Since in practice existing restrictions must be relaxed

whenever they become really restrictive, it is best not to have them in the law, but to place full responsibility on the Board which is always in session and in a position to take prompt action when it is required.

20. Current reports by banks are one of the principal sources of information on which the Federal Reserve Board must base its credit policy. It is, therefore, essential that the Board have charge of the bank reporting services. The Board's needs in this matter are more current and more urgent than those of any other agency. The Board has a staff that has been trained to collect this information and an established relationship with the banks that file the reports. A change in this respect would entail a loss of motion and deprive the Board of control over one of its important tools. Since it is essential to concentrate the reporting services in one agency and not have banks be compelled to fill out reports for several agencies it is proposed that all insured banks, whether they are members of the Federal Reserve System or not, make their reports to the Federal Reserve Board. At the same time, in order to assure the Federal Deposit Insurance Corporation that it shall be in possession of such facts about the banks as it may require, it is proposed that the Board be under obligation to furnish to the Federal Deposit Insurance Corporation such information about the banks as the Corporation may request.

21. The proposal to place common stock of all national banks, both those that are newly organized and those in operation, on a par in relation to double liability is obviously proper. At the present time

stock of new national banks bears no double liability, while that of existing banks does. Consequently double liability can be avoided through reorganization and issuance of new stock. Uniform treatment would be more equitable and would do away with reorganization for the sole purpose of avoiding double liability.