

Office Correspondence

FEDERAL RESERVE
BOARD

Date April 25, 1935.

To Governor Eccles

Subject:

From Mr. Wyatt, General Counsel

REC'D IN FILES SECTION

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In accordance with the request which you made during our conference last night, I am handing you herewith the following:

1. Copy of letter written by Honorable Carter Glass, then Secretary of the Treasury, to the Attorney General holding that the Board has the power to initiate changes in discount rates, and copies of opinions to same effect by Acting Attorney General and Board's Consulting Counsel.
2. A memorandum regarding additional changes in the bill which you asked me to list for further consideration.
3. Quotation from the provision of Section 4 of the Federal Reserve Act, as amended by the Banking Act of 1933, which authorizes the Federal Reserve Board to suspend from the credit facilities of the Federal Reserve System any member bank which makes undue use of bank credit to finance speculation in securities, real estate or commodities, or for any other purpose inconsistent with the maintenance of sound credit conditions.

I invite your especial attention to the following paragraph near the bottom of page 3 of Senator Glass's letter:

"Section 14 of the Act, dealing with open market operations, authorizes Federal reserve banks, in accordance with rules and regulations prescribed by the Federal Reserve Board, to engage in a variety of business transactions, the purpose being to enable these regional banks, by the permission or under the direction of the Federal Reserve Board, to exercise a power on discount rates throughout the various regions or throughout the country tantamount to the power exercised over the money market by the Bank of England when it goes into the open market to enforce its discount rates."

This is excellent authority for the view that, under the original Federal Reserve Act, the open market powers were supplementary to the power to overdiscount rates and that the Federal reserve banks could not engage in such operations without the permission of the Federal Reserve Board and must do so when directed by the Federal Reserve Board. I do not think the language of the law was adequate to carry out this intent; but this paragraph of the letter furnishes an excellent answer to any objection which Senator Glass might make to vesting such power in the Board.

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Governor Eccles -- 2

I also invite your attention to the following statement commencing at the bottom of page 3 of the opinion of the Acting Attorney General:

"The scheme of the entire act is to have Federal reserve banks in different parts of the country so that their operations may be accommodated to the business needs of each section, and to vest final power in the Federal Reserve Board, so as to insure a conduct of business by each bank which will not be detrimental to the carrying out of the entire plan."

Respectfully,

Walter Wyatt,
General Counsel.

Attachments.

(Copy)

X-4945
(See X-3107a)

December 4, 1919.

Dear Mr. Attorney-General:

I am attaching a copy of an opinion of M. C. Elliott, Consulting Counsel of the Federal Reserve Board, concerning the powers of the Board with respect to discount rates, with a view to asking you to investigate the question and to let me have your opinion on the subject as Attorney-General.

I may say that, while I concur fully with the opinion of Mr. Elliott as far as it goes, I think it could have been made even stronger had he known the facts as I know them. My recollection is especially clear in regard to all of the circumstances connected with this feature of the Federal Reserve Act and there can be no question of the intention of Congress to give the Federal Reserve Board complete power in the matter of fixing the rate of rediscount.

Since the rate was not necessarily to be uniform throughout the country, the right to initiate and propose rates was given to the regional banks respectively upon the presumption that each bank would have intimate knowledge of usages and conditions in its own territory; but it was also intended that the Federal Reserve Board should have complete jurisdiction over the whole subject of rates, as it was realized by the proponents of the act that rate-making might, and frequently would, affect the commerce and industry of the entire country. As originally drawn, the Federal Reserve Bill, enumerating the powers of the Federal reserve banks (subsection (d), Section 14), made rediscount rates "subject to review" by the Federal Reserve Board. This term was thought by some members of the committee to be broad

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enough in that definition of Webster's Dictionary, which says: "Review---A looking over or examination with a view to amendment or improvement." But some members of the committee contended that the power of the Board should be stated as even more explicit and final; hence we added the words "and determination," so as to make the subsection read:

"To establish from time to time, subject to review and determination of the Federal Reserve Board, rates of discount to be charged by the Federal reserve bank for each class of paper, which shall be fixed with a view of accommodating commerce and business."

In my report to Congress on the Bill itself (H. R. 7837) I said, in elucidating this power of the Federal Reserve Board:

"The power granted in subsection (d) to fix a rate of discount is an obvious incident of the existence of the reserve banks, but the power has been vested in the Federal Reserve Board to review this rate of discount when fixed by the local reserve bank at its discretion. This is intended to provide against the possibility that the local bank might be establishing a dangerously low rate of interest, which the reserve board, familiar as it would be with credit conditions throughout the country, would deem best to raise."

If the Federal Reserve Board has the power to alter a rate of discount proposed by a Federal reserve bank for the reason that it might be a dangerously low rate, it would, by the same token, have authority to reduce the discount rate for the reason that it might be dangerously high.

Furthermore, in subsection (b) of Section 11 the Act confers even greater power upon the Federal Reserve Board than that of reviewing and determining the discount rate of the Federal reserve banks. It authorizes the Board:

"To permit, or, on the affirmative vote of at least five members of the reserve board, to require Federal reserve banks to rediscount the discounted paper of other Federal reserve banks at rates of interest to be fixed by the Federal Reserve Board."

It is inconceivable that a board having complete authority to

3. The Attorney-General.

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(See X-3107)

regulate the rediscount rates between Federal reserve banks themselves should not have the lesser authority to regulate the discount rates tentatively fixed and proposed by Federal reserve banks.

Again in paragraph 2 of Section 12 of the Federal Reserve Act it will be noted that among the authorized functions of the Federal Advisory Council is power "(3) to call for information and to make recommendations in regard to discount rates, rediscount business, note issues, etc." If the Federal Reserve Board is not authorized to alter and amend and finally determine discount rates, why should the Federal Advisory Council have been empowered "to make recommendations in regard to discount rates" to the Federal Reserve Board? How idle it would be for the Federal Advisory Council to be making recommendations to a board which has no authority to apply or carry into effect the recommendations thus made! It will be observed that the Federal Reserve Council is not authorized to make recommendations as to discount rates or anything else to Federal reserve banks, but only to the Federal Reserve Board.

Section 14 of the Act, dealing with open market operations, authorizes Federal reserve banks, in accordance with rules and regulations prescribed by the Federal Reserve Board, to engage in a variety of business transactions, the purpose being to enable these regional banks, by the permission or under the direction of the Federal Reserve Board, to exercise a power on discount rates throughout the various regions or throughout the country tantamount to the power exercised over the money market by the Bank of England when it goes into the open market to enforce its discount rates.

Finally, in Section 13 of the Act, it is provided:

4. The Attorney-General

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(See X-3107-c)

"The discount and rediscount and the purchase and sale by any Federal reserve bank of any bills receivable and of domestic and foreign bills of exchange and of acceptances authorized by this act shall be subject to such restrictions, limitations and regulations as may be imposed by the Federal Reserve Board."

Thus all through the Act this complete power of review and determination and regulation of discount and rediscount rates is explicitly and implicitly given the Federal Reserve Board. Without it the Board would be powerless to control operations of any regional bank in the system which might engage in transactions perilous to the entire system and to the commerce and industry of the country.

I would be obliged if you would carefully consider the matter and give me your conclusion at as early a day as possible.

Sincerely yours,

(s) Carter Glass,

Secretary of the Treasury.

The Honorable,
The Attorney General,
Washington, D. C.

COPY.

X-3107a

DEPARTMENT OF JUSTICE,
WASHINGTON.

December 9, 1919.

Dear Mr. Secretary:

In response to your request for my opinion concerning the powers of the Federal Reserve Board to regulate discount rates of the several reserve banks, I reply as follows:

By section 14 of the Act of Congress, designated by the short title "Federal Reserve Act" (Act of Dec. 23, 1913, 38 Stat. 251), it is provided that "every Federal reserve bank shall have power" -

(d) to establish from time to time, subject to review and determination of the Federal Reserve Board, rates of discount to be charged by the Federal reserve bank for each class of paper which shall be fixed with a view of accommodating commerce and business.

By section 4 of said act each Federal reserve bank is under the supervision and control of its own board of directors, subject, however, to the provision of section 11 of said act which provides, in part, that

The Federal Reserve Board shall be authorized and empowered * * * (j) to exercise general supervision over said Federal reserve banks.

Said Federal Reserve Board is also further authorized and empowered to examine at its discretion the accounts, books and affairs of each Federal reserve bank * * * and to require such statements and reports as it may deem necessary. (Sec.11. subdiv.a.)

By section 12 there is also created a Federal Advisory Council composed of representatives chosen in the manner prescribed in said section, which is to confer directly with the Federal Reserve Board. Among its powers it is authorized to "call for information, to make recommendations in regard to discount rates, rediscount business", etc.

The question for determination is whether, taking into consideration the language of section 14 (d), giving the power to the Federal reserve banks to establish from time to time rates of discount, "subject to review and determination of the Federal Reserve Board", and the further power of the Federal Reserve Board to exercise general supervision over said Federal reserve banks, the power of the Federal Reserve Board is limited to reviewing and approving or disapproving rates of discount made by such banks, or whether said Board may, in the exercise of its powers, from time to time review the rates of discount in use and direct specific changes and alterations thereof.

The legislative history of the act shows that as originally drawn section 14, subsec. (d) conferred the power upon the Federal reserve banks to make discount rates "subject to review" by the Federal Reserve Board, and that said section was amended in committee by adding the words "and determination" after the word

"review", so as to make said section read as now enacted.

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It is quite evident that if the Federal Reserve Board is confined to the power to review and approve or disapprove rates of discount made by the Federal reserve banks, and is without power to itself direct specific changes, the words "and determination" are wholly without significance. The very signification of the word "determination" used in such a connection, carries with it the right to pass upon and to decide and fix, and thus determine what should be done. Coupling this with the power given the Federal Reserve Board to supervise the business of each Federal reserve bank, taking also into consideration the recommendations contemplated by the Advisory Council to the Federal Reserve Board in regard to discount rates, such power would be futile if such Federal Reserve Board could not, if agreeing to such recommendations, direct them to be carried out. I think it is quite clear that the Federal Reserve Board is the ultimate authority in regard to rediscount rates to be charged by the several Federal reserve banks and may prescribe such rates.

This is in all cases necessarily a review of rates existing at the time in the bank, and therefore strictly calls for the exercise of this power; the determination reached by the Board carries with it the exercise of the power of determination specified in sec. 14, subdiv. (d); and also exercises the power of supervision granted in sec. 11, subdiv. (j).

The scheme of the entire act is to have Federal reserve banks in different parts of the country so that their operations may be accommodated to the business needs of each section, and to vest final

power in the Federal Reserve Board, so as to insure a conduct of business by each bank which will not be detrimental to the carrying out of the entire plan. The powers of the Federal Reserve Board are therefore to be exercised in regard to each reserve bank as the conditions surrounding said bank may dictate, keeping in view the general purpose and plan of the Federal Reserve Act. Bearing in mind such general purpose, I am of the opinion that the Federal Reserve Board has the right under the powers conferred by the Federal Reserve Act, to determine what rates of discount should be charged from time to time by a Federal reserve bank, and under their powers of review and supervision, to require such rates to be put into effect by such bank.

Very respectfully,

(Signed) Alex. C. King

Acting Attorney General.

Hon. Carter Glass,
The Secretary of the Treasury,
Washington, D. C.

October 30, 1919.

My dear George:

I have your memorandum of the 29th, which refers to the right of the Federal Reserve Board to initiate and control discount rates of Federal reserve banks, and note that the Board desires my opinion on this subject:

The determination of this question involves an interpretation of that part of Section 14 which reads as follows:

"Every Federal reserve bank shall have power ****-
(d) to establish from time to time, subject to review and determination of the Federal Reserve Board, rates of discount to be charged by the Federal reserve bank for each class of paper which has been fixed with a view of accommodating commerce and business."

It is, of course, clear from this that any rate established by a Federal reserve bank is subject to review and determination of the Federal Reserve Board, but the question you have under consideration is whether the Board, on its own motion, may initiate or establish discount rates for Federal reserve banks, or if a rate has been established, reviewed and approved by the Board, whether the Board subsequently may require the bank to change this rate. This involves a consideration of the relative powers of the Federal Reserve Board and of the board of directors of a Federal reserve bank to control and supervise the operations of the bank. Section 4 of the Federal Reserve Act provides in part as follows:

"Every Federal reserve bank shall be conducted under supervision and control of a Board of Directors. The Board of Directors shall perform the duties usually appertaining to the office of directors of banking associations, and all such duties as are prescribed by law. Said board shall administer the affairs of said bank fairly and impartially and without discretion in favor of or against any member bank or banks, and shall, subject to the provisions of law and the orders of the Federal Reserve Board, extend to each member bank such discounts, advancements and accommodations as may be safely and reasonably made, with due regard for the claims and demands of other banks."

Section 11 of the Federal Reserve Act, which deals with the powers of the Federal Reserve Board, provides in part as follows:

"The Federal Reserve Board shall be authorized and empowered ***** (j) to exercise general supervision over said Federal reserve banks."

Considering these two provisions of the Act which relate to the supervision and control of the operations of the Federal reserve banks, it appears that the directors of the bank are intrusted with the operations or management of the bank's affairs; that they are vested with the power to perform the usual ordinary duties of bank directors. In the exercise of these powers, however, they are subject to the orders and to the general supervision of the Federal Board.

serve Board. Considering the context and the general purposes of the Act, it may be assumed that Congress did not intend that the Federal Reserve Board should perform the functions usually performed by the board of directors of a bank. Congress however, did give the Federal Reserve Board very broad general powers to supervise the operations of a bank and to see that these operations are conducted in strict accordance with the provisions of the Act and with those regulations and rulings which the Federal Reserve Board, under the terms of the Act, is authorized to make and enforce. 16

It is hardly necessary to call attention to the various provisions in the Act which sustain the theory, but to illustrate the extent of the control over the bank's operations that is vested in the Federal Reserve Board, it will be recalled that one of the powers enumerated in Section 11, is the power "to suspend or remove any officer or director of any Federal Reserve Bank, the cause of such removal to be forthwith communicated in writing to the Federal Reserve Board, to the removed officer, or director, and to said bank."

To sum up briefly the relative powers of the Federal Reserve Board and of the Board of Directors of a bank, it appears-

- (a) That the Board of directors of a bank may supervise and control the operations of the bank so long as its affairs are conducted in accordance with the provisions of law, the regulations of the Board authorized by law, and such orders issued by the Board as the Board is authorized by law to issue;
- (b) That the Federal Reserve Board is vested with power to see that the operations of the bank are conducted in strict accordance with the law, its authorized regulations and orders, to impose penalties for violations of the law, even to the extent of removing offending officers and directors.

Coming now to consider the particular provision of the Act involved in the pending question, it is necessary to determine first to what extent and subject to what limitations the Board of Directors of a bank is given control over the establishment of discount rates.

Sec. 4, which prescribes the general corporate powers of the bank, contains among others, the following

Seventh.- To exercise by its board of directors, or duly authorized officers or agents, all powers specifically granted by the provisions of this Act, and such incidental powers as shall be necessary to carry on the business of banking within the limitations prescribed by this Act."

If no limitations were prescribed by the Act and no specific reference had been made to the fixing of discount rates, it would seem to be clear that the Board of Directors would have power from time to time to establish discount rates as an incidental power necessary to carry on the business of banking within the limitations prescribed by the Act.

If no limitations were prescribed by the Act and no specific reference had been made to the fixing of discount rates, it would seem to be clear that the Board of Directors would have power from time to time to establish discount rates as an incidental power necessary to carry on the business of banking within the limitations prescribed by the Act.

Section 14, however, which enumerates certain special powers of the Federal reserve banks, imposes two limitations or restrictions on the power to fix discount rates. It provides in terms that rates so established by the bank

- (a) shall be subject to review and determination of the Federal Reserve Board.
- (b) shall be fixed with a view of accommodating commerce and business.

Any rate established must, therefore, conform to these two conditions and if the directors of the bank fix a rate which fails to conform to either of these conditions, the establishment of such rate becomes a violation of the provisions of the act and the Board under its supervisory power may clearly require the readjustment or reestablishment of such rate. In other words, whenever in the opinion of the Board, an established rate does not accommodate commerce and business, it may require the directors of the bank to change the rate so as to meet this requirement.

It may be argued that the discretion is vested in the board of directors of the bank to determine whether or not a rate fixed is fixed with a view of accommodating commerce and business.

Considering, however, the context and general purposes of the Act it is not believed that this view can be maintained. Congress clearly intended this discretion to be vested in the Federal Reserve Board. To assist the Board in the control of this and other matters, it created by Section 12, the Federal Advisory Council, and authorized that Council "to confer directly with the Federal Reserve Board on general business conditions * * *; to call for information and to make recommendations in regard to discount rates." A centralized control of the discount rates is fundamental to the purposes of the Act and provision was accordingly made to furnish the Federal Reserve Board with the best possible information to enable it to exercise a proper discretion in this important matter. It is hardly necessary to emphasize the importance of this control. It affects international as well as our domestic banking and trade relations.

My conclusions, therefore, are, first, that the discretion is vested in the Federal Reserve Board to determine whether any discount rate of a Federal reserve bank accommodates commerce and business; second, that the power to review and determine discount rates is a continuing power, which may be exercised at any time. It necessarily follows from this that the Board of its own motion may require a Federal reserve bank to change an existing rate at any time, if in the opinion of the Board such rate does not meet the requirements of the statute.

Very sincerely yours,