June 22, 1942.

Federal Reserve Bank of New York,
Federal Reserve Station,
New York City.

Attention: Reference Library

Gentlemen:

This is to acknowledge your request of June 20 for a copy of Chairman Eccles' testimony before the House Banking and Currency Committee on the proposed amendments to the Federal Reserve Act.

We do not have copies available for distribution of his entire testimony. No doubt the complete hearings can be obtained directly from the Committee when they are printed. I am, however, enclosing a copy of "Explanation of Proposed Amendments" which Mr. Eccles read to the Committee.

Sincerely yours,

(Signed) Elliott Thurston

Elliott Thurston,
Special Assistant
to the Chairman.

Enclosure

b

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

R. L. 4.1 1M 7-41

REFERENCE LIBRARY
FEDERAL RESERVE BANK OF NEW YORK
FEDERAL RESERVE STATION
NEW YORK, N. Y. June 20, 1942

If available for Free Distribution will you please furnish us with the following for our files, using the above address.

Mr. Eccles testimony before the House Banking Committee on behalf of the Federal Reserve Act.

This courtesy will be appreciated:

REFERENCE LIBRARY

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Board of Governors of the Federal Reserve System,

Washington, D. C.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

COPY

EXPLANATION OF PROPOSED AMENDMENTS

Sec. 1 - Federal Open Market Committee

The Federal Open Market Committee consists of the seven members of the Board of Governors of the Federal Reserve System and five representatives of the twelve Federal Reserve Banks, and the proposed amendment would regroup the Federal Reserve Banks for the purpose of electing their five representatives on the Committee. The principal change which would be effected by the proposed regrouping is to provide that a representative of the Federal Reserve Bank of New York be a member of the Committee at all times. The regrouping would also provide for one representative to be selected by the Boston, Philadelphia, and Richmond Reserve Banks; one by the Cleveland and Chicago Reserve Banks; one by the Atlanta, Dallas, and St. Louis Reserve Banks; and one by the Minneapolis, Kansas City, and San Francisco Reserve Banks.

Under the present statute a representative is elected by the Boston and New York Reserve Banks. As this has worked out in practice, the Federal Reserve Bank of Boston has not had its President or other representative serve as a member of the Committee but only as an alternate to the President of the New York Bank, who has served continuously. This situation has been unsatisfactory, and the directors of the Boston and New York Reserve Banks have agreed that remedial legislation is necessary. As indicated below, it is desirable in the public interest that a representative of the Federal Reserve Bank of New York be on the Committee at all times. At the same time, the Federal Reserve Bank of Boston should have the opportunity for its President to serve from time to time as a member of the Committee, as do the Presidents of the other Reserve Banks.

The Federal Reserve Bank of New York occupies a unique position with respect to the Federal Reserve System, the Treasury and the banking system of the country. Its resources total approximately 40 per cent of the aggregate of the twelve Federal Reserve Banks. It is located at the money market and at the principal market for Government securities; its operations as fiscal agent of the United States and its transactions with foreign governments, foreign central banks and bankers, as well as its operations in foreign exchange, are in far greater volume than those of any other Federal Reserve Bank. It is clearly in the public interest that the Federal Open Market Committee be given at all times the benefit of counsel of the Reserve Bank possessed of this sort of experience and in current touch with such affairs.

It may be suggested that the advice of the Federal Reserve Bank of New York would be available even if it were not represented on the Federal Open Market Committee. Admittedly, regardless of the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

composition of the Committee, the Treasury in discharging its responsibility respecting the Government securities market would still wish to confer with the Federal Reserve Bank of New York. Thus as a practical matter the New York Bank would be inevitably drawn into discussions regarding Government financing as well as open market operations. But advice obtained unofficially is a different matter from full-fledged participation in the Committee's work. Sound policy dictates that participation by the New York Bank be through its representative on the Federal Open Market Committee rather than on a voluntary or unofficial basis.

Although it is clear from the hearings and debates that Congress intended the Reserve Banks to be represented on the Federal Open Market Committee by their Presidents, this was not specified in the Act, and efforts have been made to elect officers of commercial banks. Hence it is proposed to specify in the law that the Reserve Banks must be represented by their Presidents or First Vice Presidents and that the details of their election may be governed by regulations prescribed by the Committee.

Sec. 2. - Reserve Requirements

Section 2 of the Bill would amend section 19 of the Federal Reserve Act so as to authorize the Board of Governors of the Federal Reserve System to change the reserve requirements of member banks in central reserve cities, within the limitations of the present law, without necessarily making a change in the reserve requirements of member banks in reserve cities.

Under the present law the Board of Governors of the Federal Reserve System, upon the affirmative vote of not less than four of its members, in order to prevent injurious credit expansion or contraction, may change the requirements as to the maintenance of reserves against deposits by member banks in reserve and central reserve cities or by member banks located elsewhere. It does not have authority to change the reserve requirements of member banks in central reserve cities without at the same time changing those of member banks in reserve cities. No change in reserve requirements may be made if the result is to decrease the requirements of a member bank below the amount specified in the statute or to increase them to more than twice that amount. At present reserve requirements of all member banks are at the maximum to which they can be raised under the law.

Because of the recent increases in the amounts of Federal taxes, it is probable that there will be a heavy withdrawal of deposits from banks throughout the country in order to meet tax liabilities at or around the quarterly dates on which Federal tax payments are due. In order to meet these withdrawals many banks will find it necessary

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

to draw upon their balances with their correspondent banks, and these in turn upon their balances with banks in central reserve cities, particularly New York City. The excess reserves of member banks located in New York City have been ranging from $630,000,000 to $1,212,000,000 since January 1, 1942, and this amount may not be sufficient to meet the withdrawal of deposits from these banks which may be expected at tax payment periods. If this situation should arise, the banks in New York City may find it necessary to sell United States obligations in considerable amounts. Such action might have a depressing effect upon the Government security market at a time when this would be contrary to the public interest.

In order to avoid such a contingency it may be desirable to reduce reserve requirements of member banks in central reserve cities. It may not be advisable at the same time, however, to reduce the requirements of member banks in reserve cities and, accordingly, in order to provide the necessary flexibility to meet the situation, it is felt that the Board of Governors should be empowered to change the reserve requirements of member banks in central reserve cities without at the same time changing the reserve requirements of other member banks.

Sec. 3 - Making Loans and Paying Dividends While Reserves Are Deficient

Section 3 of the Bill would amend section 19 of the Federal Reserve Act by repealing the provision which prohibits member banks of the Federal Reserve System from making new loans or paying dividends while their reserves are deficient, retaining in the law, however, the power of the Board of Governors of the Federal Reserve System to prescribe penalties for deficiencies in reserves.

One of the difficulties leading to the enactment of the Federal Reserve Act was the fact that bank reserves were unavailable in times of stress and one of the reforms incorporated in the Federal Reserve Act was a provision permitting reserves to be checked against and withdrawn for the purpose of meeting existing liabilities, subject to regulations and penalties to be prescribed by the Reserve Board.

The addition of a proviso prohibiting the making of new loans and the payment of dividends while reserves are deficient is not consistent with this purpose of this provision. On the basis of this proviso, a recent decision of the United States District Court for the Southern District of New York held a bank director personally liable for losses sustained on loans made by the bank while its reserves were deficient. Although this is in conflict with an earlier decision of a Circuit Court of Appeals in another circuit, it creates a fear of personal liability which may prevent banks from availing themselves of the privilege of utilizing their reserves in times of need.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

If the proviso were repealed, the Reserve Board would still retain the power to prescribe penalties for deficiencies in reserves and this would be a sufficient deterrent for willful neglect of reserve requirements. The Board's present regulations prescribe a penalty in the form of an interest charge amounting to 2 per cent more than the Federal Reserve Bank discount rate, so that it is cheaper for a member bank to borrow from the Reserve Bank in order to maintain its reserves than it is to become deficient in its reserves and pay the penalty.

Owing to the fact that large tax collections and the flotation of large amounts of Government securities during the present emergency may cause wide fluctuations in available reserves, especially in the money centers, it is particularly important during the emergency period to avoid any stringency in the money market resulting from the rigid and unnecessary prohibition upon making loans while reserves are deficient.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis