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"THE BANKING ACT OF 1935"

ADDRESS OF

HONORABLE M. S. SZYMCZAK

NEW YORK BANKERS' CONVENTION

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Afternoon papers

It is the policy of the Federal Reserve Board not to have its individual Members speak publicly except when to speak publicly is a duty in the interest of furthering the purposes for which the Federal Reserve System was created. That policy is also my personal policy adopted firmly when I became a Member of the Federal Reserve Board two years ago. I take it, therefore, that it is my duty to speak here publicly on the subject of the Banking Act of 1935. It is, of course, a pleasure for me to see you and be with you.

Let me state at the outset that I speak here not for Governor Eccles, nor for the Federal Reserve Board - I speak only for myself. I did not write, nor did I help write the Banking Act of 1935. I shall therefore make no attempt to discuss the philosophy of the Act. However, I studied the bill with its specific amendments, and after a complete study of these, I expressed my opinion to the Senate Sub-committee of the Banking and Currency Committee on last Monday - June 3rd, 1935.

I said that it is essential to preserve our regional Federal Reserve System, which consists of twelve Federal Reserve banks with nine directors in each Bank, together with a Federal Reserve Board in Washington. In this particular respect, our System is different from that of most countries because of our extensive area, and because of our political and economic structure of states and districts - based upon industrial, agricultural, commercial and financial conditions and needs which are widely different in the various parts of the United States. The System is composed of separate essential parts. These parts, however, must be cohesive for the best functioning of the System.

To make for an efficient administration of the Act by the

System and to arrive at the purposes for which the Act was passed by Congress, it appears necessary for the Federal Reserve Board to have a more direct contact with the various sections of our extensive area.

"To be effective, the whole Federal Reserve System must be one. This end is not difficult to attain: personal contact of the members of the Board with the directors of the twelve Federal Reserve Banks seems one of the best direct avenues.

"Bank powers of the boards of directors of the twelve Federal Reserve banks should be retained, and in some respects, increased and extended, at least by regulation of the Federal Reserve Board.

While, of course, it is sound to have the Federal Reserve Board and its principal offices in Washington, and while it is sound for the Board to hold its meetings in the capital because of the national scope of its considerations, yet it would be desirable from a practical standpoint for the Federal Reserve Board to meet at least four times a year in at least four parts of the country - the East, West, North and South - to meet with and understand better the directors of the Federal Reserve banks and their officers; as well as the conditions and needs of commerce, industry, agriculture and finance in the respective Districts. It would also seem wise to provide by law that each Member of the Board should be assigned by the Federal Reserve Board to the task of keeping himself especially familiar with conditions in at least two of the Federal Reserve Districts each year, in order that he might act as a liaison officer between the Federal Reserve banks, their directors and officers, the representatives of commerce, industry, agriculture and finance, on the one hand, and the Federal Reserve Board in Washington, on the other hand. Provision could be made to have Members of the Board rotate in their District assignments, so that eventually each Member of the Board would have covered by direct contact all of the sections of the country and would know their needs thoroughly. Without this, it is next to impossible for the Board Members to appreciate fully the needs and requirements of the Federal Reserve banks and of the country as a whole; without this, the Federal Reserve Board inclines too much to theory and bureaucracy; and without this there is bound to be misunderstanding between the Federal Reserve banks and the Federal Reserve Board leading to differences of opinion on authority; and without this a cry is heard on the one hand that the private interests wish to control the System and direct its operations for their own selfish purposes; and that on the other hand, political interests wish to control the System and direct its operation in accordance with their own political ambitions.

Members of the Board, when assigned by the Board to several districts, would keep personally in touch with the boards of directors and the officers of the Federal Reserve banks in those districts. They would thus become familiar with the management of such Federal Reserve banks, with their viewpoints, and with the problems of their districts. They would also know men in the industrial, commercial, agricultural and financial fields of the districts. They would not be compelled to depend entirely on the Board's staff for information having to do with the internal management of the banks, as well as with the general agricultural, commercial, industrial and financial and banking conditions of the districts; thus there would be a better opportunity for sound and practical rulings of the Board on all questions when they are presented by the banks to the Federal Reserve Board under the law. It is specifically stated in the Act that the Federal Reserve Board has general supervisory responsibilities, but in order to supervise, one must be in direct contact with those supervised. Otherwise, one is compelled to act upon information obtained from other sources.

Of course, in all cases, the Board, as a whole, would act officially on all these matters, but the Board would have the benefit of the information obtained by the individual Member assigned to the specific district.

It would also seem desirable to have the boards of directors of the Federal Reserve banks meet once every year with the Federal Reserve Board in Washington, or if this could not be accomplished with the directors who are farther removed from Washington, the Federal Reserve Board could arrange to meet them at a point more accessible at least once every two years to discuss frankly and completely matters pertaining to the operation of their banks and the conditions in their districts, as well as problems of a national character.

The execution of many of the powers vested in the Federal Reserve Board could, under the provisions of the Banking Act of 1935, be decentralized under regulations of the Federal Reserve Board so that they could be carried into effect by the Federal Reserve banks without the reference of many individual matters to Washington, and thus obtain desirable and effective administration. This will be facilitated by the provision in the bill authorizing the Board to delegate its powers to individual Members or other representatives. To make for a constancy and a permanency of the work of the Board by its individual Board Members, I recommend that there be a specific requirement in the law that the Board assign its work to individual Board Members, each Board Member to have a specific task assigned on which he is to specialize and through which he is to keep in touch with the Federal Reserve banks and the country, and on which he is to report to the Federal Reserve Board with recommendations. This seems to me to be very important, from the standpoint of good administration. This bill provides for that.

On the other hand, it has been my experience that the Federal Reserve Board does not wish to, nor should it, assume any more powers than it can properly use for the effective administration of the System, and whenever powers are granted to the Federal Reserve Board having to do with matters that could be handled better by the directors and officers of the Federal Reserve banks, the Federal Reserve Board should be able to give the twelve Federal Reserve banks the power of determination of many important matters.

It is good organization for the Federal Reserve Board to recognize this fact and to avail itself of the commercial, agricultural, industrial and financial experience of the directors of the twelve Federal Reserve banks, as well as the technical and banking experience of their officers, who are the vehicles through which the policies of the System are executed.

There are many powers now in the Federal Reserve Board, however, which in my opinion should be placed, now or later, in the regional Federal Reserve banks. This would expand the authority and responsibility of the directors of each Federal Reserve bank and make for more prompt and efficient administration of the Federal Reserve System. The general supervision should be retained, but the direct and ultimate action in these matters should be taken by the directors and officers of the Federal reserve banks.

The detailed matters which might be delegated to the Federal Reserve banks (or the Federal Reserve Agents, if their offices are not abolished) include the following:

1. Admission of State banks to membership in the Federal Reserve System.

2. Expulsion of such banks from membership for violations of the law or the Board's regulations.

3. Waiver of 6 months' notice of voluntary withdrawal of State banks from membership.

4. The granting of voting permits to holding company affiliates of member banks.

5. The revocation of voting permits for violations of the law or the regulations.

6. The issuance and revocation of permits authorizing officers, directors and employees of member banks to serve not more than two other banks (if the provision for individual permits is not repealed as proposed in the bill.)

7. The issuance and revocation of permits for officers, directors

and managers of security companies to serve as officers and directors of member banks (if the provision for individual permits is not repealed as proposed in the bill.)

8. The granting of trust powers to national banks.

9. The cancellation of such powers at the request of national banks.

10. Approval of reduction of capital stock by national banks (if the requirement of the Board's approval is not repealed as proposed in the bill.)

11. The granting of permission for member banks to invest amounts exceeding their capital stock in bank premises or in the stock of corporations holding their bank premises.

12. The approval of the establishment of branches by State member banks (if this power is transferred from the Comptroller of the Currency as proposed in the bill.)

13. Authorizing national banks to establish foreign branches.

14. Authorizing national banks to invest in the stock of banks or corporations principally engaged in international or foreign banking.

15. Permitting interlocking directorates between member banks and foreign banking corporations in which they own stock.

16. Approval of compensation of officers and employees of Federal Reserve banks.

In addition to the above, where action by the Board is required under the law, numerous matters are presented to the Board for consideration in connection with banking supervision and requiring action on individual cases; for example, reductions of capital stock of State member banks, consolidations of State member banks with other banks, and whether or not individual banks should increase the amount of their capital and surplus in relation to their deposit liabilities. In some cases of this character, the Board has already authorized the Federal Reserve Agents to act on its behalf in the individual cases within certain prescribed limitations.

Some, or perhaps all, of the powers enumerated above, and perhaps others too, it seems to me, should be vested directly and ultimately in the Federal Reserve banks. This would make for efficiency and good relations between the Federal Reserve Board and the Federal Reserve banks. It is quite natural that the Federal Reserve banks know more about that subject-matter because they are directly and constantly in contact with it. It is also natural, however, that the Federal Reserve Board should supervise and co-ordinate and bring to the attention of the Federal Reserve banks any incorrect or improper administration of these powers. This would make for unity.

I also stated that:

I can understand that this Banking Act offers much opportunity for extreme interpretation. However, with the amendments offered, it seems to me to meet existing conditions and to serve a definite purpose without being extreme in either direction. It deserves at least having each section considered on its merits. It seems to serve the definite purpose of a better administration of the Federal Reserve Act.

Now to proceed, I have been taught that to know a thing one must know the parts of which it is composed. Let us, therefore, take this bill apart and look at the parts separately.

Section 202 of the Banking Act of 1935 is related to a section in the Banking Act of 1933, which provides that all insured nonmember banks shall become members of the Federal Reserve System by July, 1937. This provision of the Act of 1933 was repealed in the House bill, but it should be restored because it is of great importance that all banks which are insured be subject to Federal supervision. It is a step in the direction of unification of bank supervision which is an essential to the proper discharge of the responsibilities of both the Federal Deposit Insurance Corporation and the Federal Reserve System.

It has been said that the provision for giving the Board authority to waive requirements for admission under this bill would lower the standards of the Federal Reserve System and that it might be better to retain those standards and have the Federal Deposit Insurance Corporation bring the banks up to the standard before they are admitted. The weakness of this argument is in the fact that the Federal Reserve banks and member banks are affected by conditions that develop in nonmember banks. An unsound banking situation affects the entire community, and since the Federal Reserve System has to stand the consequences of unsoundness in nonmember banks, it should have authority to admit all insured banks and gradually to bring them up to its standard.

The suggestion that has been made that banks with deposits of less than $500,000 be permitted to remain outside of the System, even though they are insured, may be a reasonable compromise because it would bring into the Federal Reserve System about 97 percent of all the deposits and would leave outside only such small banks as may find it difficult to earn expenses without charging for exchange, which the Federal Reserve System does not permit. This compromise would also provide for keeping within the System banks with $500,000 or more of deposits that are now members. It would no doubt be better to have all the banks come into the System, but the compromise would be an important step in that direction and would appear to be the minimum of what ought to be required at this time.

Section 203 of the proposed bill provides that members of the Federal Reserve Board shall be persons well qualified by education or experience, or both, to participate in the formulation of national economic and monetary policies. This is a change from the existing requirement of law which reads: "In selecting the six appointive members of the Federal Reserve Board . . . the President shall have due regard to a fair representation of the financial, agricultural, industrial and commercial interests and geographic divisions of the country." This enumeration of interests does not give the President any definite directions and does not appear to be the proper principle on which Board members should be selected. It would seem that they should be selected on the basis of their qualifications to perform the functions that the Board is required to perform rather than on the basis of representing certain interests. The worst composition of a Board would be in the nature of a group of representatives of special interests who might be at odds with each other. It is vastly better to say that Board members shall be qualified to do their work. While this is not a guarantee of the appointment of efficient Board members, it may exert an influence in that direction and make it difficult to appoint persons without appropriate training or experience.

It has been said that under the proposed bill the President will have the power to appoint all the members of the Board from one district, but there is nothing in the bill to justify this statement. The requirement that not more than one member be from the same district is retained, with only the exception that it need not apply to the Governor of the Board. The reason for that is that the President ought not to be prevented from appointing as Governor a man preeminently qualified for the position, merely because some other member of the Board may be from the same district.

While it would seem that the proposed qualifications of Board members are desirable, it might be wise in addition to provide that at least two of them shall have had experience as executive officers in a Federal Reserve bank or a commercial bank. There was a provision requiring two trained bankers in the original act, but it was repealed in 1923. In view of the necessity of deciding many technical banking problems, and particularly technical Federal Reserve banking problems, it might be a useful indication to the President to say that at least two members shall have had that background. It may also be desirable to say that the Board members shall be qualified by education or experience to participate in the formulation of national economic, monetary and banking policies. The addition of the words "and banking" would be a recognition of the numerous duties of the Federal Reserve Board that deal with technical banking problems and of the general responsibility of the Board for doing what it can to maintain sound banking conditions.

There has been a good deal of criticism of the provisions relating to the position of the Governor of the Federal Reserve Board. This criticism has been directed at provisions that exist in the present law as much as at those in the proposed bill. The President always has had the power to designate a member of the Board as Governor and to terminate this designation. In drafting the bill this power of terminating the designation has been stated a little more clearly. In the bill as originally introduced the President was given the power to remove the Governor not only from the Governorship, but also from membership on the Board. This has been changed in the bill as it passed the House, a change which would seem to be desirable. In the form in which the bill passed the House there is no increase of the power of the President over the Governor of the Board, and the only change in the matter is that a Governor, who resigns, upon not being redesignated as Governor, would not be obliged to stay out of the banking business for two years, but would be permitted to resume it at once. This is desirable in the interest of obtaining successful men from the banking field as Governors of the Federal Reserve Board.

In view of all the outcry against the proposed increase of political domination of the Federal Reserve System, it is worth repeating that the provision about the Governor in the bill as originally introduced was the only shadow of an excuse for this criticism, and that with the elimination of this provision, which was not intended to increase political power, but could be so interpreted, there is nothing in the bill that in any way increases the power of the Administration over the Federal Reserve Board. There is, on the other hand, a great deal that increases the Board's independence - increased salaries, retirement allowances, definition of qualifications, with other amendments offered such as: removal only by impeachment, appointment for a term longer than 12 years. All these and others add to the possibilities of having an independent Board in law as well as in fact. In addition to that the Board is given a definite objective, and this increases the Board's power to resist political pressure because this pressure is likely to be exercised in a direction that is not consistent with the objective to be prescribed by law as a guide to Federal Reserve policy. Other very good amendments to make the Board independent in law have been offered to the Senate Sub-committee.

All of the Federal Reserve Board Members have testified before the Senate Sub-committee of the Banking and Currency Committee. Certainly no one can say that they did not show independence.

Section 204a of the Banking Act of 1935 provides that the Federal Reserve Board may assign to its members or its representatives the performance of such of its duties as do not involve the formulation of national policies. On the face of it this is a minor provision, but it has important consequences, because it will enable the Board to be relieved of a large amount of routine duties which do not permit it to give its entire time to the study of economic conditions and the formulation of credit policies. It is expected that this provision would help to make the Board more of a policy making body and less of an administrative organization. It will also enable the Board to delegate duties to the Reserve banks and thus to increase their responsibility and independence in local matters.

Section 204b of the Banking Act of 1935 provides the objective towards which the powers of the Federal Reserve Board shall be used. This objective reads as follows: "It shall be the duty of the Federal Reserve Board to exercise such powers as it possesses in such manner as to promote conditions conducive to business stability and to mitigate by its influence unstabilizing fluctuations in the general level of production, trade, prices, and employment, so far as may be possible within the scope of monetary action and credit administration."

I recommended the striking out of the following:

"to promote conditions conducive to business stability and"

The wording of this objective is not necessarily the best that can be devised. The general purpose of it, however, is clearly in line with what every other central bank does, what the more recent ones are being required to do by their charters, and what the Federal Reserve System has tried to do without specific legislative direction. The criticism that has been made of this objective has been entirely unjustified. There is nothing in it that will give the Board any power to limit the amount of credit to be extended to any one industry or to expand it for another industry. The authority of the Board over the loaning activities of the member banks will not be in any way affected. The objective is merely a statement of a direction by Congress that the Federal Reserve Board must do what can be done through its powers towards bringing about a sounder and more stable condition of business. It has also been suggested that the objective should be modified to read: "It shall be the duty of the Federal Reserve Board to exercise such powers as it possesses to aid in the maintenance of sound banking conditions and business stability and to mitigate by its influence injurious fluctuations in the general level of production, trade, prices, and employment, so far as may be possible within the scope of monetary action and credit administration." The purpose of this change is to introduce into the objective the requirement that the Federal Reserve System shall work towards sound banking conditions as well as towards business stability. This has always been one of the functions of the System, and while it would be understood to continue to be one without being included in the objective, it should be stated explicitly.

Section 205 of the Banking Act of 1935 provides for giving the Federal Reserve Board full authority over open-market operations after consultation with a committee of five governors of the Federal Reserve banks, elected by the twelve governors. This provision has been subjected to severe criticism on the ground that it increases the powers of the Board as against the powers of the Reserve banks. It is true that this proposal adds open-market operations to the instruments of monetary policy, which are now possessed by the Federal Reserve Board. This is done on the theory that the three principal instruments, namely, raising or lowering of the discount rate, changes in reserve requirements, and open-market operations should all be in one body that is clearly defined and that has inescapable responsibility for the policies it adopts.

There has been criticism of this provision on the ground that the Federal Reserve Board, which has no financial interest in the Reserve banks, will by this provision acquire control over their funds. This would seem to be a good argument for those who advocate having the Government buy the stock in the Federal Reserve banks. It could be argued that, if an investment of $146,000,000 with an assured 6 per cent return entitles the member banks to have a dominant say in the formulation of national monetary policies, then the only rational conclusion would be that they must not be permitted to hold the stock.

While this is not my argument, nor am I using it, it is nevertheless an argument that is used by those who advocate the Government purchasing the stock in the Federal Reserve banks from the member banks.

At the time the Federal Reserve Act was enacted, the conception of money was largely limited to currency, and over currency the Federal Reserve

Board was given complete control. This conception has since had to be expanded to include bank deposits as money, and the Board's power to regulate the volume of deposits is in harmony with its power over currency issues. The fact is that it was intended in 1933 to give the Board this power, but in the course of legislation the section dealing with this matter was distorted and there was created what appears to be an impossible situation where the governors on the Open Market Committee are the only ones who can initiate an open-market policy. The Board has the power to approve or disapprove of the policy, and the policy after having been recommended by the governors and approved by the Board may still be nullified by refusal of the directors of the Reserve banks to participate in its execution. At present the following are included in the open-market operations of the Federal Reserve System:

1) The twelve Governors of the twelve Federal Reserve Banks
2) The eight Federal Reserve Board Members at Washington
3) The 108 directors in each of the twelve different Federal Reserve banks of the country.

In a matter which is of vital national importance and in which timeliness and speed may be decisive, it is obviously undesirable to have a complicated machinery calculated to bring about delay; it is better to have a clear-cut fixation of responsibility on a national body appointed for that purpose.

There has been criticism on the ground that this bill would give the Board the right to authorize or even compel the Reserve banks to buy obligations directly from the United States Government. That is another line of criticism that is not in any way related to the bill. There is nothing in the bill that changes the situation in this respect. The power to buy directly from the Government now exists: it has been used regularly but never for extended periods. There is nothing in the proposed bill that would change the legal situation in this respect. If the critics wish to prohibit direct borrowing, they should offer an amendment to the Federal Reserve Act to that effect.

It is generally assumed that the Federal Reserve Board is responsible for open-market policies. Few people, even today, are aware of the fact that the present Open Market Committee consists of twelve men who represent the twelve Federal Reserve banks, and that the Federal Reserve Board merely approves or disapproves, but does not initiate open-market policies. Few people also realize that each Federal Reserve bank has the right to refuse to participate in an open-market operation after it has been adopted by the twelve Governors and approved by the Federal Reserve Board. It may be contended that the Federal Reserve Board should not have this power because it is in Washington - the Government's capital - and because its members are appointed by the President with the advice and consent of the Senate. It may be said that political pressure might be used against the Board and that the Board might be influenced by such pressure in its monetary control. On the other hand, it is argued that the Governors are appointed by the directors of the Federal Reserve banks, six of whom are elected by member banks, private interests, and that such Governors may be guided in determining open-market policies by the private interests of the member banks, and not by national needs and requirements of the country. Both views are most extreme. Authority must be vested where responsibility rests. That is logical. Since open-market policy is a national question, authority as well as responsibility for this policy should be located in one place, and in the Federal Reserve Board, which is a national body. This seems to be in the essence of the purposes of a Federal Reserve Board. This seems to be the surest way of establishing the fact whether the System or the Board is, or is not, functioning in accordance with the purposes for which it was created. It removes the opportunity for excuses.

Of course, the Board would feel that its own research organization should be extended and strengthened and given more active functions to perform and the membership of the Board would feel the need of keeping more closely in touch with current developments which might affect open-market policy and the interpretation thereof, but the Board would be in far better position to determine when and in what circumstances to initiate an open-market policy on the basis of a coordinated view of all the factors entering into the monetary situation - reserve requirements, discount rates, lendings of member banks, the Government's fiscal policies, etc., - and could take action promptly on its own responsibility in whatever direction seemed best to meet the needs of the situation at the time.

However, to make the parts of the System more cohesive a provision might be made for a sufficient representation of the Regional Banks on this committee for the sake of unity in the System so long as the tendency is in the direction of making the System one and not two.

In the interest of unity, the Open Market Committee might consist of the six appointive Members of the Board and five Governors - and five Governors are to be designated by the twelve Governors of the twelve Federal Reserve banks and to be chosen from five sections of the country - namely - the North, South, East, Middle West and the Far West. While the Secretary of the Treasury and the Comptroller of the Currency might continue as Members of the Board they should have no vote on Open Market Committee policies. Their membership on the Federal

Reserve Board is valuable in many respects, especially at this time, but the Act might provide that they have no power of a vote on open market operations, but might be called by the Open Market Committee for information that the Committee might wish to have in the consideration of adopting open market policies. I so testified before the Senate Sub-committee last Monday.

Section 206 of the Banking Act of 1935 relates to eligibility of paper for discount at the Reserve banks. In place of elaborately defined and restrictive rules prescribed by law about the character and maturity of paper available for discount, the bill proposes to give power to the Reserve Board to prescribe by regulation the kind of commercial, agricultural and industrial paper that will be eligible for rediscount by a member bank with the Reserve banks and also authorizes a member bank, subject to the Board's regulations, to make advances to any member bank on a promissory note secured by any sound asset of such member bank.

This proposal in some respects represents the greatest departure in the bill from the conceptions that prevailed at the time that the Federal Reserve Act was adopted in 1913. Even though there is considerable merit to this amendment, yet because it is so radical a departure from the Federal Reserve Act as originally written, and because it affords an element that might tend toward an extreme, which perhaps would be undesirable, I made the following recommendation to the Senate Sub-committee:

> "Notwithstanding any other provision of law, when it deems it in the public interest, a Federal Reserve <u>bank</u> may recommend, and by an affirmative vote of not less than <u>five</u> of its <u>appointive</u> Members, the Federal Reserve Board may authorize any Federal Reserve bank, for limited periods to be recommended by the Federal Reserve bank and prescribed by the Board, but which may be extended by the Board from time to time upon application of the Federal Reserve bank,

"to make advances to member banks which have no further eligible and acceptable assets available to enable them to obtain adequate credit accommodations through rediscounting at the Federal Reserve bank or by any other method provided by this Act. Such advances may be made on the promissory notes of such member banks secured to the satisfaction of the Federal Reserve bank, and shall be subject to such regulations and shall bear such rates of interest as may be prescribed from time to time by the Federal Reserve Board upon recommendation of the Federal Reserve bank." My recommendation places in the Federal Reserve banks the power of making the request.

Section 208 of the Banking Act of 1935 deals with the question of collateral against Federal Reserve notes. It follows the example of practically all central banks, except the Bank of England, in providing that all the assets of the Federal Reserve banks shall be the collateral back of all of its liabilities. The segregation of collateral against notes has not served a useful purpose and so far as one can predict never will, because it becomes restrictive only at a time when restriction is harmful and does not in any way restrict at a time when restriction may be desirable. It has, therefore, a perverse restrictive effect. The reason for that is that at a time when credit expansion is proceeding at a rapid rate there is plenty of commercial paper available as collateral, because the banks are borrowing heavily from the Reserve banks. Therefore, collateral requirements do not restrict. At a time, however, when the Reserve banks are pursuing a liberal policy of purchases in the open market, in order to prevent deflation, as was the case in 1931, a point is soon reached where there is a shortage of collateral and gold has to be impounded back of Federal Reserve notes, and then the deflationary process is aggravated by technical restrictions on the Reserve banks. That is exactly what had happened prior to February 1932, when the Congress had to adopt the Glass-Steagall Act which permitted temporarily the use of Government securities as collateral against Federal Reserve notes. Collateral requirements against Federal Reserve notes should be abolished. If it is the wish of Congress to restrict the amount of Government securities that Federal Reserve banks may purchase, that should be done directly, as is done in some of the foreign central banks. To aim at it through indirection by requiring commercial collateral or gold against Federal Reserve notes works at the wrong time and in the wrong circumstances. It does not protect the Reserve bank against excessive holdings of Government securities, and does prevent them from doing their share in fighting a deflationary movement.

Section 209 of the Banking Act of 1935 clarifies the power of the Reserve Board to raise or lower reserve requirements of member banks. This power was granted to the Reserve banks under the Thomas amendment to the Agricultural Adjustment Act of 1933, but under the provisions of that act the Reserve banks can change reserve requirements only when the President proclaims an emergency and gives his approval to the action. To proclaim an emergency in banking, as Mr. Owen D. Young said the other day, is to bring about an emergency. It should not be necessary to proclaim one. It is, therefore, best to give the Board authority in the matter and to make that authority as elastic as possible by permitting changes in reserve requirements in financial centers alone when a speculative situation may develop there without having developed in the country districts.

Fantastic interpretations of this reserve requirement provision have been made by opponents. Some believe that this is a move to establish a 100 percent reserve plan without direct authorization by Congress. A 100 percent reserve plan is an absolute impossibility without a very large amount of readjustment in a great many lines of banking legislation and the danger of it being introduced surreptitiously by this provision is purely imaginary. Limitations on the extent to which the Reserve Board could raise or lower these requirements may be devised and have been proposed. I feel that some ceiling should be established. It would be reassuring.

On March 4, 1935 the demand plus time deposits, calculated in accordance with the provisions of Section 324 of House Bill 7617, were approximately twenty-nine billion, five hundred million dollars. If the maximum limitation were fixed at, say 25%, the required reserve would work out at about seven billion, four hundred million dollars, which is about five and one half billion dollars more than the existing reserve requirements.

Others feel it would be better to have no such limitations, however, because in the face of the enormous possibilities of expansion on the basis of existing excess reserves and potential additions to them, the amount by which reserve requirements may have to be raised to combat inflation is hard to predict. It may be best to leave the matter flexible in the hands of the Federal Reserve Board. My position is clear - I prefer a formula of some kind, or at least a ceiling.

There has also been the theory expressed that through this method of increasing reserves the Reserve Board may acquire the power to tell the member banks how to invest their deposits. This statement is based on a complete misunderstanding of our financial mechanism. Take, for example, the present situation. The member banks have about $2,400,000,000 of excess reserves. If the Federal Reserve Board should decide that reserve requirements be increased by that amount, then these reserves instead of being excess reserves would become required reserves. This would in no way change the Reserve banks' ability to discount paper or purchase Government securities.

The proposals about real estate loans are in the nature not only of liberalization, but also of increased flexibility by permitting the Federal Reserve Board to prescribe rules and regulations under which real estate loans may be made. This proposal is in line with the proper functioning of our banking system.

The real estate provisions of this bill appear to be clearly in the right direction and would serve the public good. More specifically they might contribute to revival in the building industry, which at this time is a fundamental requisite of recovery.

Because there are so many wrong impressions on this particular amendment, let me read it as it now appears in the House Bill that has been passed.

"Subject to such regulations as the Federal Reserve Board may prescribe, any national banking association may make real estate loans secured by first liens upon improved real estate, including improved farm land and improved business and residential properties. The amount of any such loan hereafter made shall not exceed 60 per centum of the appraised value of the real estate; but this limitation shall not prevent the renewal or extension of loans heretofore made and shall not apply to real estate loans which are insured under the provisions of Title II of the National Housing Act. No bank shall make such loans in an aggregate sum in excess of the amount of the capital stock of such association paid in and unimpaired plus its unimpaired surplus fund, or in excess of 60 per centum of the amount of its time and savings deposits, whichever is the greater. The Federal Reserve Board is authorized to prescribe from time to time regulations defining the term 'real estate loans' and other terms used in this section and regulating and limiting the making of real estate loans by member banks, with a view to preventing an unreasonably large proportion of each bank's assets from being invested in real estate and real estate loans, preventing such loans from exceeding a reasonable percentage of the appraised value of the real estate in view of the circumstances existing at the time and otherwise requiring the banks to conform to sound practices in making real estate loans."

Because this particular amendment has received more attention from Governor Eccles than from anybody else responsible for the writing of the Bill, and because you were expecting to hear Governor Eccles here today, I should like, with your permission, to quote Governor Eccles' testimony on this amendment before the Senate Sub-committee of the Banking and Currency Committee:

"As you know, real estate loans are not a new form of investment for our commercial banks. They have been lending on real estate mortgage security for decades. Liberalization of the real estate loan provisions, combined with the broadened eligibility requirements for borrowing at the Federal Reserve banks, may encourage activity in the construction industry, which is essential to recovery.

"Criticism of these provisions has come largely from those who believe in the separation of savings banking from commercial banking. Whatever may be said in favor of such a separation as a desirable thing in theory, it is not feasible so long as we have thousands of small banks that cannot make a living on the basis of their demand deposits alone. The member banks have 10 billion dollars of time deposits which represent the people's savings. So long as they have time deposits for which they must pay interest, they of necessity must participate in financing long-term undertakings that will yield enough to pay for doing the business. The law places no limits on what the banks may do in the purchase of bonds or of other long-time paper; there is no reason for singling out real estate loans for special restrictions.

"Our banks have been losing a large part of their business to the Government, which has sold its bonds to the banks and has used the funds to make mortgage and other loans, many of which the banks should be in a position to make themselves. Unless the banks regain some of the business which has been taken over by the Government credit agencies, there will not be sufficient business to support the banking system. There will also be great pressure for a constantly growing public debt incurred in part in taking over business that could be done by the banks.

"I note that the Banking and Currency Committee of the House in reporting out the bill has made two changes in the recommendations on real estate loans. In the first place a limitation has been inserted that aggregate real estate loans shall not exceed 100 per cent of the capital and surplus or 60 per cent of savings deposits, whichever is the greater. I think this rigid limitation is undesirable. It would be much better to leave this matter to the discretion of the Federal Reserve Board because the aggregate amount that may be safely loaned on real estate varies with banks, localities and periods of time.

"The second change in the bill as reported by the House Committee is "the elimination of the provision applying the regulations on real estate loans to State member banks, as well as to national banks. This is a serious omission, because under it national banks would be at a competitive disadvantage as against State member banks, many of which are under little or no limitation in regard to their real estate loans. Furthermore, the Federal Reserve System, which has a vital interest in the solvency of State member banks, would be given no authority over real estate loans that the State member banks may make. This is inconsistent with provisions in the Banking Act of 1933 which in dealing with investment securities placed State member banks on the same basis with national banks. One of the important advantages in having State banks members of the Federal Reserve System would be lost if there were no uniformity in such matters."

When I undertook just two or three days ago the duty and the pleasure of coming here I did so frankly, not only to do what appears to be my duty but to have the pleasure of meeting you and hearing you. I have already met and listened to a great many of you - I hope to listen to more of you before I leave this convention this afternoon. I have been frank - I have tried to speak dispassionately and, of course, objectively - as dispassionately and objectively as one can speak when one is an interested part of the System affected by the proposals discussed.

I repeat, therefore, that on the whole, there is nothing extreme in this bill with these amendments. It is a bill that provides for a definite allocation of responsibility and therefore a better administration of the Federal Reserve Act of 1913. It deserves consideration. It is being discussed almost everywhere, and that is as it should be. Discussion makes for sound legislation.