

FIFTH CONFERENCE

OF

GOVERNORS OF FEDERAL RESERVE BANKS

8

MINNEAPOLIS, MINNESOTA

HOTEL RADISSON

Wednesday, October 20, 1915

Thursday, October 21, 1915

Friday, October 22, 1915

Saturday, October 23, 1915

**WALTER S. COX**

SHORTHAND REPORTER

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FRIDAY OCT 22 1915

## THIRD DAY.

Hotel Radisson, Minneapolis, Minn.,

Friday, October 22, 1915.

10 o'clock a. m.

The Conference reassembled at 10 o'clock a. m., pursuant to adjournment.

Attendance the same as on the two preceding days.

There were also in attendance, pursuant to an invitation extended to them by the Conference of Governors, Messrs. Paul Warburg, member of the Federal Reserve Board, and W. P. G. Harding, Member of the Federal Reserve Board.

The Chairman: The meeting will come to order.

I have just suggested to Mr. Warburg and Mr. Harding that, if agreeable to them, we would go right ahead with the unfinished portion of our program, consisting of twelve or thirteen items, which we have not yet discussed, all of which I believe are matters in which they would like to participate in the discussion.

Last night we were in the midst of a discussion of a sub-heading of Topic 11, which is "Amendments to the Federal Reserve Act."

Possibly I should explain to these two gentlemen, who have not attended our meetings before, that by mutual consent the Chairman has been clothed with rather unusual powers by this meeting; that we impose certain restrictions upon the extent of the discussion so as to save time and



repetition of matters already gone over.

I will also state that the Chairman has been authorized not only to participate in the discussion, but to offer resolutions himself.

Item (a), "Immediate transfer of reserves" and Subject 19, "Reserves of Member Banks", including the sub-heads (a), "Treatment of the float", and (b), "Penalties for impairment of balance", were left for final discussion today, although they have been formerly discussed. These subjects were suggested by Governor Seay and under our rule here the one that suggests a topic opens the discussion.

Governor Seay, will you make the first statement?

Governor Seay: In reference to which topic?

The Chairman: Topics 11 (a), and 19 (a) and (b).

11-(a). IMMEDIATE TRANSFER OR RESERVES.

19. RESERVES OF MEMBER BANKS.

(a) Treatment of the Float.

(b) Penalty for Impairment of Balance.

Governor Seay: You are all familiar, I believe, with the opinion which I hold on that subject. I have prepared some tables which would show the facility with which such transfers might be made at this time, and the effect after being made. Inasmuch as perhaps everybody here has seen the argument, if he has not read it, I won't go very elaborately into detail.

I believe the time to do a thing is when you can and not when you cannot. I believe the time is ripe now for putting the act into full operation, and that in all prob-

ability the difficulties will increase as we go along.

There is one point of view which I did not touch upon in the prepared argument, which point has already come up. We are about to face another transfer of reserves and already some of the smaller banks are face to face with the proposition that they will have to drawdown their reserves from their regular correspondents, which will deplete their balances to an extent which will not enable them to get the same accommodations which they have heretofore gotten, particularly in the matter of collections. When we reach the next transfer, in six months, that condition will be emphasized. I therefore believe that the disturbances created by these periodical transfers will perhaps place the country banks between the devil and deep water, and that it will be better to make one bite at the cherry instead of several bites.

The Chairman: AS I understand your view of this matter, you say that you believe the reserves which the Act contemplates should be transferred to reserve banks over a period of years, should be transferred at once, and that be done through an amendment to the Act?

Governor Seay: I believe that should be done, and particularly do I believe it to be advisable since we are brought face to face now with the collection feature of the Federal Reserve System. I believe at the very first meeting it was the opinion of some of us, and certainly my own expressed on the record, that the whole collection matter should have been postponed until we had transferred



all the reserves. I have not changed my opinion after considerable thought on the subject. I think the two are inseparably bound up. I think we cannot perform one unless we perform the other to entire satisfaction. In any event it is going to breed very widespread disturbances, if not dissatisfaction, among the country banks, no matter what collection plan we might put in force; but if we carry out the provisions of the Federal Reserve Act and give them the object lesson by saying that the Federal Reserve System is there to provide a collection plan for them, that they will be thrown upon the Federal Reserve banks in order to provide a system, that they will acquiesce more readily and with less disturbance, There will be no other agency to perform the collection service for them. Their balances will not be much if they are not entirely transferred, and the consideration for which that service has been performed will be removed. Therefore the Federal Reserve Banks will be in a position where, under the law, they must perform it, and they will be in a position where they will see that acquiescence in the law carries them to the Federal Reserve Bank, and one will dovetail into the other, then I believe we can accomplish with much more satisfaction and much less disturbance the settlement of that most vexing of all our problems--- the collection problem.

Then there is another very important point, from an economic viewpoint, as I believe. The Federal Reserve Act was passed for the avowed purpose of decentralizing

reserves. At the present time all of the **excess** reserves are deposited in the central reserve cities, all of them being accumulated there under the burden of an interest charge. We know an effort was made to have those funds earn interest. I think everywhere in the country greater encouragement is given to borrowers; money is being thrust upon them, and I think there are many cases in which second-rate firms are getting the credit upon terms which first rate firms did not formerly enjoy. It certainly would have a material effect upon the reserve situation and the interest rate and the plentitude of money to corral the reserves in the Federal Reserve Banks where they will be under certainly modified control, if not complete control. For these reasons, and others which I might state in extenso, I believe the time is ripe, that it would be prudent and that it is more than advisable to undertake to complete the regeneration of this system and transfer the reserve.

The Chairman: May I ask you one or two questions?

Governor Seay: Certainly.

The Chairman: You realize that if the reserves are immediately transferred in full by all the banks and the present capacity of the bank for making collections is taken away from it, that we would then be forced at once to develop our own collection facilities to the maximum, so as to take care of the collection business that could not be attended to through the old channels.

Governor Seay: I fully realize that.



The Chairman: Our earnings possibly might not justify that expense. I am going to give you two or three of the objections that occur to me as you discuss the matter---

Governor Seay (Interposing): They have occurred to me. Of course when I say "at once" I do not mean in the next month or week, because I do not believe the machinery could be perfected in much less than six months. We have gathered here for the purpose of putting into execution some collection plan and I believe that it is essential that we put into operation some collection plan as quickly as possible.

The Chairman: Another point that you have not touched upon is that the immediate transfer of the reserve would throw upon us the burden of using the method of collection and reserve which we believe is the intention of the Act, and that would at once throw the burden of carrying the float upon the member banks.

Governor Seay: Where I think it should be carried.

The Chairman: That in turn would put the pressure of the new reserve requirement entirely upon the country bank, as was suggested yesterday.

Governor Seay: (Interposing) Where I am firmly convinced it should be. I do not believe it is possible to carry it in any other way. It is a burden too great to be borne by any centralized institution. The labor is tremendous and the burden of the float is too huge. Gradually in this country there has grown up a very per-

nicious practice of allowing the float to be counted in the reserve. The Federal Reserve banks are inheriting the results of that pernicious practice.

These subjects are so correlated that it is difficult to speak of one without speaking of the other. While you refer to Section 19 there comes up the treatment of the float. If action could be taken <sup>that</sup> would demonstrate to the country how vicious the practice has been, and that the burdens of the Federal Reserve Banks are now forced upon them and accentuated because of that practice, I believe it would be an object lesson. For instance, suppose the Comptroller were to rule now that items sent for credit, unless drawn upon reserve city banks, to be collected when reaching the reserve city, should not figure in the reserve of the bank sending them? The little country bank might send items all over the country; and although the reserve city bank might not collect them for a week, if it gives credit to the country bank, it becomes a reserve. That process is a little too familiar to dwell upon. If that practice has not been allowed to grow up, or if the comptroller were to rule now that that float should be borne by the country bank whence it originates, and by whom alone I believe it can be borne--- it is of such magnitude--- they are responsible for it and the responsibility should be placed upon the place of origin--- I believe it would show that the Federal Reserve banks are not to be held responsible for creating practices which have a vicious tendency.



You speak of the tremendous expense involved. We have got to face that of course. There is another point intimately associated with that which we are discussing here, and that is some readjustment of the capital of Federal Reserve Banks.

The Chairman: Do you not think we ought to leave that for the present?

Governor Seay: Yes, I do; but it answers one question you ask, and that is the only reason I mention it.

The Chairman: Governor Seay, the present plan for the gradual transfer of reserves does permit a gradual readjustment of both the float and the collection system. Immediate transfer of reserves would require an immediate adjustment of the method of treatment of the float and the immediate assumption of all of the collection business or a very large part of it by the banks, which argument is designed to emphasize the desirability of transferring reserves at a time when reserves are abundant, but it does present the disadvantage that it requires an immediate adjustment of other important matters which, under the present plan, would take place over a period of two years.

Governor Seay: That also is a question of analysis. If these reserves should be transferred it would still leave in the hands of the reserve cities and central reserve cities an enormous amount of bank balances. It would not be necessary all at once for the Federal Reserve Banks to undertake the whole collection system. There

would be some \$490,000,000 of balances remaining in the hands of reserve cities and central reserve cities which would still justify those banks in continuing the operation of the collection system.

The Chairman: Yes; but if the balances in the reserve and central reserve cities did not count as reserves, that portion of the balances created by the sale of uncollected checks not counted as reserves would put the burden of adjusting the float upon the country banks at once, and personally I do not think the country bank can stand it.

(Further discussion followed upon this subject. Mr. Warburg requested that his remarks directed to this topic should not be entered upon the record.)

The Chairman: Governor Seay, have you prepared a resolution to deal with this matter?

Governor Seay: Not until the matter has been discussed finally. However, I think I have delivered myself.

The Chairman:-- Are you disposed to offer a resolution and submit it to the tender mercies of this crowd?

Governor Seay: Yes; for the purpose of invoking discussion, I offer this resolution: That it is the sense of the Conference that the present time is propitious for a complete transfer of reserves to Federal Reserve Banks, and that it would be in the interest of the development of the Federal Reserve System that such transfers should be made, and that this conference recommends that



an amendment to the act for this purpose be asked for.

The Chairman: Is that motion seconded?

Mr. Wold: I will second it, Mr. Chairman.

The Chairman: Is there any further discussion?

(There was no further discussion, and the motion, being put upon a viva voce vote, was lost.)

Mr. Warburg: I might suggest that there is a way of doing something in that direction. It sounds pretty drastic and I do not suggest that it ought to be done; but the Federal Reserve Board can make every city in the country a central reserve city today. If you did that of course that would stop the accumulation of reserves. That would mean that the country banks would have to have a higher reserve; it would bring them up to 18 per cent. I don't think we ought to do that. Then we could, by a ruling, suspend the reserves and get them down to 12 per cent. But, I am afraid that while we could do it that way, it would create trouble and cause objection.

The Chairman: Your motion, Governor Seay, would not dispose of Topic 19 on the program, that is, the method of dealing with the float and penalty for impairment of balance, the latter subject not having been mentioned yet. Do you care to offer a resolution covering Item 19 (a) in the matter of the float?

Governor Seay: Yes. For the purpose of invoking discussion and testing out the sentiment, I will move that it is the sense of the conference that what is meant by the "float", that is to say, checks forwarded by country

banks to their reserve correspondents, should not be permitted to count in their reserves until collected.

That would have the effect of making all checks drawn on banks outside of reserve cities put into the collection class where they are now put by all the country clearing houses. If a realization of the situation could be brought to the banks of the country by a ruling of that kind, I believe it would be beneficial. It would tend to correct a situation that is vicious and would bring the banks face to face with the actual situation for which they themselves are responsible.

The Chairman: You started to offer that in the form of a resolution, but you ended up with a comment.

Governor Seay: The first part of it was the resolution and the last part was the comment thereon.

The Chairman: Governor Seay's motion, as I understand it, is to express the sense of this meeting by a ruling providing that the present method by which country banks count uncollected checks on the way to their reserve agents as a part of their reserves, should be discontinued. Do I hear a second to that?

Governor Fancher: I second the motion.

Governor Rhoads: Did not Governor Seay go further than that and say that they should not count until they were collected?

The Chairman: Yes.

Mr. McKay: May I ask if they should be permitted to count as a reduction of gross deposits?



Governor Seay: Yes; I think they should be permitted to count as a reduction of gross deposits.

Mr. McKay: What are the abuses of the present system---

Governor Seay: (Interposing) The abuses are what we are trying to settle now through the means of some collection system. They are so many, Mr. Foote thinks I would find difficulty in telling you about them in a few words. It is perfectly clear that your bank, for instance, would not allow one of its non-depositors to check too freely upon uncollected funds. If he were to put into your hands a larger proportion of these balances which consisted of money which you knew you could not collect before he had checked his balance out, it would bring you up against a problem. You would not permit your customer to do that, in all probability, and yet you are placing your reserve agent in just that position.

Mr. Foote: We, of course, have to make our customers give us an account that compensates us for the service. However, we do not do that consistently, because we have some accounts we lose money on. I think that is generally true of most banks. But I think it is jumping right at the middle of the question, to take an arbitrary stand and lay this at the door of the country banks. I think you can just as consistently charge the city banks with being responsible for it. The country bank is simply a relay station for this float just like the city bank. This whole thing goes right back to the question of traders.

That is where the question originates. It is a problem the solution of which lies with the traders, the people who buy and sell, and to pick out the country bank and crucify it is just an arbitrary treatment of the question. I think the city banks could just as consistently be charged with the responsibility.

The Chairman: Mr. Foote, this item "Treatment of the float" should have been put under section 7 of our program. It has more direct relation to collection and clearances than to reserves, although we may have discussed it under the various reserve headings that we were discussing. I can see that we will gradually drift into a discussion of the whole subject of collections in an effort to deal with this one item, "treatment of float", which is a part of that problem. I would like to suggest, if satisfactory to Governor Seay, who has offered this topic for discussion, if he is willing to do so his motion will be tabled and I will change this item from Topic 19, to Topic 7, where it will come up in its proper place in our discussion.

Governor Seay: I would be very glad if you will do that, for the particular reason that the very resolution which I have proposed here comes in the report of the transit committee which will be discussed at that time. I think it could properly be deferred.

The Chairman: Governor Fancher, is that method of dealing with this subject satisfactory to you? You seconded Governor Seay's motion.



Governor Fancher: It is entirely satisfactory to me, Mr. Chairman.

The Chairman: Would not the same course apply to topic 19-(b), Governor Seay?

Mr. Curtis: That has already been passed upon.

Governor Seay: We disposed of that subject, I think.

The Chairman: Yes; that is right. We have acted upon that subject.

The next topic is 11-b:

11 (b) REDUCTION OF COUNTRY BANK RESERVES CARRIED WITH FEDERAL RESERVE BANKS.

The Chairman: I suggested that topic for the program after hearing from Governor Seay that he proposed to endeavor to effect an immediate transfer of reserves, having some compunction about the way this would affect the country banks. Now, as we have disposed of Governor Seay's proposal adversely, I would like to withdraw the topic 11-b, from the program.

Governor Van Zandt: In withdrawing that you would not withdraw the subject which would necessarily be considered under subject 19-a, which you have just transferred to 7?

The Chairman: It would come up incidentally anyway. If you prefer to have it specifically under item 7 I will transfer it.

Governor Van Zandt: I think that will be better, Mr. Chairman; that is, to leave it on the program until No. 7 has been discussed.

The Chairman: Unless objection is made I will transfer item 11-b to topic 7.

You passed a resolution yesterday the substance of which was that this Conference recommend that the Federal Reserve Act be amended so as to provide for the transfer, within a period of two years, of the general fund of the United States Treasury with the fiscal agency functions of the treasury to the Federal Reserve Banks.

We should not pass that topic finally without hearing from Mr. Harding or Mr. Warburg.

Do you care to make a statement on that subject, Mr. Warburg?

Mr. Warburg: I would like to have you give us a statement of the gist of that discussion.

The Chairman: I think the discussion was based upon the feeling that prevailed at this meeting, that the true intention of the Federal Reserve Act was to do away ultimately with the independent treasury; that the Government should get out of the banking business and <sup>should not</sup> maintain balances with fiscal agencies. Further that the true purpose of the Act had not been expressed because discretion in that matter was left to the Secretary of the Treasury, which involves a very great responsibility. It was brought out in the discussion that quite naturally the Secretary of the Treasury would hesitate to take the responsibility of turning over between two and three hundred millions of Government funds to newly organized banks with the management of which he was not even familiar, which had not



established themselves in the public confidence, and so forth; but nevertheless <sup>if</sup> the purpose of the legislation was ultimately to be carried out the Secretary of the Treasury would have to be relieved of the responsibility of making a very momentous decision, and the only way in which he could be relieved would be to amend the act making the operation mandatory in that respect instead of discretionary with an officer of the Government.

The resolution offered suggested no particular method to be followed, nor did it suggest any particular safeguards to be introduced in the amendment to the Act; but it is undoubtedly the sense of this meeting, brought out by the discussion here, that the terms of the Federal Reserve Act which at present left all responsibility with the Secretary of the Treasury, are mistakes; that the act should be changed to make the transfer effective by mandatory direction within say two years or longer, or a shorter period, as might be deemed wise.

Mr. Warburg: While Mr. Harding and I have views upon the subject I am not quite sure whether it would be proper for us to discuss them here.

Mr. Harding: No, I think we should not discuss that matter.

The Chairman: I suppose both of you realize that at these meetings, which we have always regarded as of a most confidential nature and which we regard as very important to this work, we do not hesitate to tackle anything. That condition I think will prevail at these dis-

cussions right along. It does not make any difference whether it happens to be one or another individual. This discussion was not directed at the Secretary of the Treasury at all; we are dealing with a very important principle.

Mr. Harding: The discussion would ultimately come back to the Federal Reserve Board. If we discussed it openly here we might commit ourselves to certain ideas on the matter which might embarrass or bind us to a discussion in the Federal Reserve Board. I prefer to keep an open mind on the proposition, so far as I am concerned.

The Chairman: The resolution ~~made~~ that was passed yesterday was very brief. I am very sure that if you have any suggestion to be made, either on or off the record, to the effect that it is inadvisable to deal with it by this method, the meeting would be very glad to hear your suggestion.

Mr. Curtis: The resolution is as follows:

It is the sense of the Conference that the Federal Reserve Act should be amended to provide for the transfer of the general fund of the United States Treasury and the fiscal agency functions of the Treasury to the Federal Reserve Banks within a period of two years from the passage of the amendment.

Mr. Warburg: Has it not been the habit of this meeting to give our certain resolutions at the conclusion of the meeting?

The Chairman: We give out just what we want to give out. This matter would be given no publicity whatever.



It would be reported to the Federal Reserve board in a brief summary of our proceedings, as has always been done, Mr. Warburg.

Governor Seay: We could eliminate it from the record, as we do many things that pass.

The Chairman: We certainly would be wasting our time in discussing a very important matter if we should take action of that sort and then not do anything further about it.

Governor Seay: I mean we could listen to the discussion of Mr. Warburg and Mr. Harding and then do that.

Mr. Warburg: I did not ask for that reason.

The Chairman: You realize that at our former meetings this matter has been on the program for discussion, not with a view to an amendment to the Act, but to arrive at an understanding with the Federal Reserve Board and with the Treasury Department as to a method by which this could be carried out. The Secretary of the Treasury exercises his discretion in the case and we have made no progress toward an arrangement of the matter, although we have had one or two meetings in Washington with an Assistant Secretary of the Treasury and a member of the Reserve Board.

As the matter now stands, the Secretary of the Treasury has got the right, with or without the consent or knowledge, even, of the Federal Reserve Banks, to walk into the bank some day and make a large deposit. It seems an extraordinary relationship for these banks to establish

with the Treasury Department that would enable their business, or the business of the Federal Reserve bank, if you please, to be thrown out of joint, so to speak, by the sudden and unexpected action of one officer of the Government.

Governor Seay: He would have equal power to withdraw it, having made it.

The Chairman: Yes.

Mr. Warburg: I have here a letter which I want to submit to the Conference on this subject. I think it might possibly enable you to achieve something. The letter is addressed to Governor Hamlin by Assistant Secretary Malburn.

(The letter referred to was read to the Conference by the Chairman. Request was made of Mr. Warburg to allow the letter to be placed in the record, and he informed the stenographer that he did not desire to have it in the record. A discussion followed which the stenographer was likewise directed to leave out of the record.)

The Chairman: What is your pleasure with regard to the resolution which we have passed and for the present made a part of our record, in view of the discussion which has taken place?

Governor Kains: I move that the resolution stand as it is.

Governor Seay: I second the motion. I think it would serve a purpose to present our views for the consideration of the Board at the time they are expressing their



own views.

Governor Aiken: If I remember correctly none of the resolutions that we have passed in these meetings have become public or have been given to the press.

The Chairman: Oh, no.

Is there any further discussion of Governor Kains' motion? However, I would like to call attention to the fact that Mr. Curtis has just stated that it really is not necessary to pass another motion unless it is the intention of this meeting to change its former action; that we do not need to vote. I ask for a motion in case it is your intention to change the action that was taken yesterday.

Governor Kains: I will withdraw the motion.

The Chairman: No motion is offered, and there is no change in the resolution.

We will then pass to Topic 11-(d).

11-(d). ELIMINATION OF DESIGNATION OF CAPITAL  
FOR FOREIGN BRANCHES OF NATIONAL BANKS.

Before taking that up I would like to report to Mr. Warburg and Mr. Harding that at yesterday's meeting a resolution was unanimously passed recommending that the National Bank Act be amended, and in case the Federal Reserve Bank Act is amended to provide for the establishment of domestic branches by national banks, that that be affirmed in the Amendment to the National Bank Act suggested, so that the banks establishing branches either in this country or abroad should not be required to segregate any portion of

their capital to represent the business of any particular branch.

It was quite fully discussed at this meeting, and we were all clearly of the opinion, I think, that that was a sort of bookkeeping fiction which was quite unnecessary except in the case of foreign branches, where they were required to segregate a certain portion of their assets to protect their creditors in those foreign countries. The question was also discussed as to whether the imposition of taxes upon the assets of branches would not automatically require the segregation of a certain amount of capital; but the amendment to the National Bank Act which we recommended would simply authorize banks with a capital of a million dollars or over to establish branches within the limits of the municipality in which they had their offices, so that would eliminate any question of taxes upon the segregated capital, and we accordingly have made that unqualified recommendation.

Bearing on that subject, under the head of topics (d) and (e), it was suggested here that the Federal Advisory Council in making their recommendation, had confined their recommendation to the extension of the powers of national banks having a capital of a million dollars or over and located in reserve or central reserve cities, and that appeared to us to be a very arbitrary method of dealing with the subject of branches. There are many cities in the United States that are not reserve cities that have ten times the population and bank resources of



some of the reserve cities, and to exclude the banks in those cities from the benefits of such an amendment to the National Bank Act, or to require them, in order to avail themselves of the privilege, to change their status and become reserve cities, seems to us a round about way of dealing with a subject that should be dealt with directly. We felt that banks of a certain size should be permitted to establish branches. Of course that could be reached in a good many ways. It could be confined to banks located in cities of a certain population. We were not inclined to endorse the recommendation made by the Federal Advisory Council that it be confined to reserve and central reserve cities. We were of the opinion that that should not be done, that that was not a fair basis. Possibly I had better report completely on these matters that we discussed yesterday under Topic 11.

It was recommended that the Federal Reserve Act be amended so that the Reserve Banks might issue notes directly against a deposit of gold. It was also recommended that either a formal or informal opinion be obtained from the Federal Reserve Board making it clear whether there was or was not under the statute any question as to the ability of the Federal Reserve Banks to recover the gold pledged as security for Federal Reserve notes by the present process, such recovery to be effected by a reversal of the present process of putting it in.

Mr. Warburg: We have given an opinion about that, that it can be done.

The Chairman: Mr. Warburg advises me that an opinion to that effect has already been rendered. We will have that entered upon the record and that will eliminate the necessity of reporting that action to the Board.

We have also passed a resolution recommending that National banks be given the right to accept drafts arising out of domestic transactions, with suitable safeguards, and we also have passed a resolution declaring it to be the sense of this meeting that the powers of member banks to make loans upon real estate should not be extended beyond those now contained in the Federal Reserve Act.

In connection with that discussion it was brought up here that the officers of the Reserve Banks has been asked to express their views to the Joint Committee of Congress that is dealing with rural credits legislation, as to the provisions of the Hollis Bill. Two resolutions were passed on that subject condemning the suggestion that the Federal Reserve Banks be permitted to make loans upon the bonds of those rural credit banks, and also condemning the suggestion that the national banks might be permitted to accept drafts which would in fact be financed by bills secured by those bonds.

Our resolution suggested that if the powers of the national banks to accept drafts be extended so as to include any form of finance bill, they certainly should not be so restricted as to confine that class of acceptances to those which would be secured by these particular bonds. We recommended <sup>that</sup> the extension of the powers of National banks



to accept drafts if made to include finance bills, should confine those bills to those which arose out of commercial transactions or the proceeds of which had been used for industrial, commercial, agricultural or exchange purposes.

I think, after quite a full discussion, the feeling here was that a draft drawn for the purpose of making exchange, as distinguished from a draft drawn for the purpose of carrying stocks, was quite a legitimate draft; that it had a very proper place in the banking system and should not be excluded from the province of the national banks or possibly the reserve banks as to the discounting of them.

I do not know that I need to go into a further discussion of that. It will be brought out in the report, Mr. Warburg, and you will undoubtedly comment on it. It will be rolled along and possibly taken up at our December meeting.

It was also recommended yesterday that the Federal Reserve Act be amended so as to provide that mutual savings banks which had no capital stock, be permitted to establish a relationship to the Federal Reserve System under which they would keep a required deposit, based upon the amount of their deposit liabilities, with the Federal Reserve Bank of the District in which located, and that they be entitled to discount eligible paper where they held such paper, or be entitled to borrow money from the reserve banks upon a security of Government bonds or state or municipal

bonds. I think we all felt that an amendment of that character would require a great deal of study and preparation so that the reserve banks of the system as a whole could be suitably safeguarded; but a number of those present made statements indicating that the <sup>savings</sup> banks in various parts of the country are now very anxious to establish relations with the federal reserve banks and are struggling with the difficulty of having no paper which is eligible for discount which would justify their becoming members, if they were permitted to do so.

Governor Van Zandt: I do not think we took any definite action on that point, other than to refer it to the Executive Committee.

The Chairman: That is right, it was referred to the Executive Committee. But I think I am right in stating that as the sense of the meeting.

Governor Van Zandt: That was the sense of the meeting.

Mr. Curtis: With the suggestion that the Executive Committee should, if possible, prepare the amendment.

The Chairman: That, gentlemen, concludes all of the action taken under Topic 11 of our program.

Of the four or five items left under that topic we might discuss now Item (f) we have not dealt with, and, I am ashamed to say, it was suggested by me.

11-(f). CONSOLIDATION OF COMPTROLLERS' FUNCTIONS.

This matter has been discussed at almost every meeting



of the Governors and was discussed in connection with the unfinished business of the last meeting yesterday. At yesterday's meeting we passed a resolution renewing the recommendation that was sent to the Federal Reserve Board, following our meeting in Chicago, that the Federal Reserve Banks should be given all the information that the Comptroller's examiners obtained in the examination of the banks.

Mr. Curtis: That was not sent to the Board. It was submitted to the Board orally by Mr. Miller.

The Chairman: The situation as it exists at present in New York has undoubtedly resulted in a certain division of authority and responsibility that would be unsatisfactory in a commercial bank. All that we want to accomplish in New York is to insure the ability of the officers and directors of the bank to conduct it along well recognized banking principles by having the most complete information about credits that they can obtain and which they have a right to. At present we are in a position where we cannot get information that we ought to have to enable us to deal with members who have the right to come in and get discounts from us. This grows out of what appears to some of us to be an inherent defect in the Federal Reserve Act in the division of responsibility between the Comptroller's office and the Federal Reserve Board, and the division of responsibility, in the case of our bank particularly, between the Federal Reserve Agent and the chief examiner of the district, who is the Federal

Reserve Agent's deputy.

The question is whether this meeting cares to make any recommendation as to a method of dealing with this subject of division of responsibility, which really extends throughout the entire system.

Governor Rhoads: Mr. Chairman, it was my hope that you would offer a resolution.

The Chairman: We generally have a little preliminary discussion before a resolution is brought out. I will apply the same rule to this that I have applied to other topics; that is, when the time comes to offer a resolution, I will call for one, if there seems to be any hope of passing it.

Governor Seay: I think possibly the discussion went even further than you have indicated. Was it not in your mind, when you spoke of consolidation of the Comptroller's functions, that each of those functions should now be consolidated and conferred upon the Federal Reserve Board?

The Chairman: What I had specifically in mind, Governor Seay, was this: That the Comptroller has the right to examine the member banks through his examiners under the national bank Act, and exercises a very considerable control over their affairs. The Federal Reserve Banks likewise have the right to examine member banks, but they have very little control over the affairs of member banks other than that arising out of the discount relations and the control of their reserve account. The Federal Reserve Board has the right to examine member banks and



Federal Reserve Banks, and to require reports, and it exercises a very considerable control over the member banks. We have a most extraordinary situation, where the Comptroller is, by law--- and what is often more important, by long habit and precedent, the controlling factor in the direction of many of the affairs of national banks. The Federal Reserve Board is now created and likewise has these broad powers. We are expected to, and required by law, to report to the Federal Reserve Board on the condition of any member bank in our district when they ask us to do so.

I have never heard of a business organization that could be made a success as an organization and effective and economical, with such a division of authority as that. I would like to see the situation remedied. Just how it is to be brought about I do not know. I think it is most unsatisfactory. It has been so in our case, at least.

Governor Seay: Is it not correct to say then, that a summary of the expression of opinion was that complete control and supervision of member banks should be lodged in the Federal Reserve Board.

The Chairman: Yes. This Act provides in its short title that one of the objects of the legislation is to provide better supervision of banks in the United States, but instead of that we are liable to get worse supervision, because we have three supervisors.

Should not the Act be qualified so as to find out where the authority does rest? It is not simply the

authority of the Comptroller, because the word "comptroller" covers a very small part of the subject. It extends through the entire subject of examinations. We want to know whether we are to deal with the Federal Reserve Board or the Comptroller or with both, or with the Deputy Federal Reserve Agent or the chief examiner.

Governor McDougal: I have noticed that since the regulation bearing upon the admission of state banks has been issued, containing a condition under which the federal reserve banks may withdraw, which was apparently the objection generally raised at the outset, that the question now most generally talked about is the very one that you are discussing here--- the fact that the state banks would be under the supervision of two many supervisors. I have been told that that has been instrumental in prejudicing them against coming into the system; that if the right of supervision were confined to one or the other authority, that it would be much more satisfactory to them.

The Chairman: Well, Governor McDougal, as a by-product, so to speak, of this division of authority between the Federal Reserve Board and the Comptroller, we now have the extraordinary condition that a brand new system of examination is created where we have the Federal Reserve Banks conducting examinations of state banks that are members in cooperation with the State examiners, and the Comptroller has nothing whatever to do with those examinations. An effort to meet a situation where the responsi-



bility was divided and presumably unsatisfactory to such institutions has resulted in a still further complication of the matter of examination and supervision.

How do you feel about that subject, Governor Kains?

Governor Kains: I think the Comptroller ought to be a sort of chief examiner under the Federal Reserve Board. I think there ought to be only one system of examination.

The Chairman: How do you feel Governor Van Zandt?

Governor Van Zandt: I think there should be less conflict of authority in the examination; that it should be consolidated in some manner. I think the proper place for it is under the supervision of the Federal Reserve Board, although they may designate the Comptroller of the Currency or any other official to have charge of the bureau of examinations.

The Chairman: What is your opinion, Governor Sawyer?

Governor Sawyer: I fully agree with the idea that the power of supervision should be supervised by the Federal Reserve Board and should not be so divided. I think that condition has a tendency not only to complicate matters but to make supervision much less effective than it would be if it was centralized.

The Chairman: How do you feel about it, Mr. Hoxton?

Mr. Hoxton: I think the examination and control should be centered in the Federal Reserve Board.

The Chairman: And what do you think Governor Rhoads?

Governor Rhoads: I think it should be centered in

the Federal Reserve Board and that the details of it should be exercised through the Federal Reserve banks in the district so that the information would be in those banks.

The Chairman: What do you think about it, Governor Aiken?

Governor Aiken: I think they should transfer the control of the banks to the Federal Reserve Board.

The Chairman: What do you think, Mr. Foote?

Mr. Foote: I am of the same opinion.

The Chairman: And what is your opinion, Governor Wold?

Governor Wold: I am thoroughly convinced that the success of the Federal Reserve System depends upon all the Comptroller's supervision being put into the Federal Reserve Board and being exercised through the Department to the Federal Reserve Banks so that we will be in a position to get all the information pertaining to examinations and so forth.

The Chairman: What is your opinion, Governor Fancher?

Governor Fancher: I am strongly of that opinion, Mr. Chairman, and the point which Governor McDougal brings out as to the consideration some of the state banks are giving to the question of joining the system <sup>is a good one.</sup> That is one of the features that they are giving a good deal of thought to. I might add that I was in conference with the Board of one of our state banks some two weeks ago. That bank was contemplating joining the system, and the question of supervision was brought out by several of the



members of the Board; the matter of where the supervision was going to rest and what the power of the Comptroller of the Currency would exercise over the examination of the banks in the matter of reports was an important question in their minds, something that they wanted clearly determined.

(A statement by Governor Strong with reference to the above matter was directed not to be recorded.)

Governor McDougal: I move that the procedure be followed as you have outlined it.

Governor Van Zandt: I second the motion.

The Chairman: That resolution, as I understand it, provides that the Chairman, as is our custom, will ask the Secretary to prepare a resolution for submission to this meeting, which would outline the sense of the meeting as brought out by the discussion. Have I correctly stated that, Governor McDougal?

Governor McDougal: Yes, sir.

The Chairman: Is that motion seconded?

Governor Van Zandt: I second it.

The Chairman: Is there any further discussion?

(There was no further discussion and the motion was carried.)

The Chairman: I am going to skip Item (i), for a moment, at least, and ask for a discussion of item (j):

11 (j). READJUSTMENT OF CAPITAL OF RESERVE BANKS.

That item was suggested by Governor Seay. Will you open the discussion, Governor Seay?

Governor Seay: Mr. Chairman, one of the criticisms that has been developed against the Federal Reserve Banks is that they are expensive organizations unable to earn in-

terest on their capital. I do not believe that we should be under the necessity of earning interest upon a capital which we do not use and perhaps never will use. The Federal Reserve Bank of New York, for instance, has a paid in capital of over \$10,000,000, I understand.

The Chairman: About \$11,000,000.

Governor Seay: You would have to earn \$700,000 over and above expenses to pay a dividend.

I do not believe it is a wholesome influence at all. The feeling that Federal Reserve banks must use their resources so as to earn interest upon a large capital is wrong. I do not believe the necessity exists for putting in so much capital in order to secure the degree of safety which is necessary.

I believe it would be to the interest of the system to remove that necessity that we now feel under, and that we have been told we are under and will be under as long as we possess the capital of the member banks. As long as we hold in our possession the funds of member banks we will be expected to return a dividend upon them. I would rather see the amount of the call capital reduced, and in order to get at the heart of things I will offer a resolution as follows:

That it is the sense of the Conference that while the subscribed capital shall remain as now provided for in the Federal Reserve Act, that the paid-in capital shall be one sixth instead of one-half. I believe it will be necessary to call some capital. I have heard the opinion expressed



that there is no necessity for calling in capital, but if the Federal Reserve Banks operate merely upon the reserves I believe there is a positive necessity for calling some of the capital. It could perhaps be an elastic proposition which would enable the Federal Reserve Board to say in any district what proportion of the subscribed capital should be paid in to the banks; but to cover the whole thing, I offer a resolution that the paid-in capital of the Federal Reserve Banks, instead of being 50 per cent as now provided for, shall be made, by amendment, one-sixth of the total capital.

Governor McDougal: I will second that motion.

The Chairman: (Governor Aiken presiding for the moment.) After having heard the motion by Governor Seay, and the second by Governor McDougal, I am somewhat embarrassed by the absence of the leader of this meeting. I think it would be interesting to have an expression of opinion from the officers of the different banks with regard to this matter. We would also like to have Mr. Harding and Mr. Warburg express an opinion about it.

Mr. Warburg: I think that matter was discussed with the Advisory Council the last time they were in Washington. Mr. Seay was present at that discussion. I think every one was generally in sympathy with the thought that there was some difficulty in making the dividends and that it was an embarrassing matter and that a reduction would be advisable. Nothing formal has been done on it, but informally I think most of us have expressed ourselves as in favor of

it.

Governor Wold: May I inquire if it is the opinion of the Board that any paid in capital is necessary?

Mr. Warburg: I could not give you the opinion of the Board on that.

Governor Wold: What is your opinion, Mr. Warburg?

Mr. Warburg: Yes, I think it is advisable. It is advisable, I think for several reasons. One is the question of assessment. If you do not earn your dividends you have got to be assessed, which is not pleasant. Then I think the banks ought to be in a position to handle discount operations properly. I think the banks would have a stronger standing sentimentally with member banks and with everybody in the country if they have a certain amount of capital paid in.

It always sounds good to say that you have paid a six per cent dividend. If the capital is small, but you have paid a dividend on it, the whole system looks much stronger.

Governor Wold: Some of our members are of the opinion that the Government will reap the benefit of any earnings. The suggestion is made that the banks might make a permanent deposit, approximating the amount of capital withdrawn, which would put the bank in about the same position---

Mr. Warburg: I do not think that would be advisable. I do not think we want to destroy the independent character of these banks. If you put the Government in there as



really furnishing the capital, you are going one step further in that direction. I think these banks ought to be independent autonomous banks, as far as they can be.

Governor Wold: I suggested the idea, as expressed, for the purpose of drawing you out on it. I am very much in sympathy with the reduction of our charges by reducing the capital---

Governor Seay: (Interposing) Do you mean that there should not be a subscribed capital?

Governor Wold: Subscribed capital, yes; but not paid in.

Governor Seay: Out of what funds would you provide for the purchase of the bank home? You could not use reserves for that purpose?

Mr. Warburg: No.

Governor Seay: Some capital would be absolutely essential.

Mr. Warburg: You need some capital, undoubtedly.

Governor Aiken: As an evidence of responsibility it is desirable that there should be some capital paid in.

Governor Rhoads: I should like to ask Mr. Warburg what his objections are to reducing the paid-in capital?

Mr. Warburg: I can only say that when a situation arises where the Federal Reserve Banks deal with smaller banks that are weaker, if you have a certain amount on hand it is comfortable to have that there in case anything should happen. That feature is to be considered.

Governor Seay: To offset that would be the loss aris-

ing from inability to earn dividends, which might necessitate an assessment on capital and that loss would be greater, as it affects the whole system, than any loss by an individual bank. That point we have considered too.

Mr. Warburg: The thought went through my mind, in that connection--- and I do not know whether it is a good or bad thought--- that now the Federal Reserve member banks may withdraw all their reserves; they may withdraw to that extent. Possibly you might say, when you reduce the capital, that no bank shall have the right to withdraw its balance beyond a certain point, which might be made 50 per cent of the capital. That would give you a minimum to deal with.

The Chairman: The withdrawal of deposits by member banks is largely an involuntary matter. If you put a limit upon the amount that they are permitted to overdraw, it means that you have got to refuse to clear checks, and that would lead to a situation that would be intolerable and would drive the banks out of our clearing system.

Governor Seay: That is true, with the present clearing methods.

Governor Fancher: It appears to me that the reserve banks are holding a little different form of reserves than maintained with the reserve agents in reserve and central reserve cities. The banks cannot check them out of the reserve banks and transfer them to other banks. They are required by law to maintain a reserve with the



reserve bank and these reserves only fluctuate as the deposits of the member banks increase or decrease. In District No. 4, when the reserves are finally transferred, we will have deposits of forty odd million dollars, with our present capital of six million. Whether the paid in capital should be six million, or a third of it, two million, does not have any great bearing upon the situation; but it certainly has bearing upon the earnings we are required to produce.

I am strongly in favor of returning to our member banks two thirds of what they have paid in.

The Chairman: In New York the situation is a little different than any other city because the proportion of deposits is so much greater to capital than in any other district. Quite recently our gross deposits have amounted to \$180,000,000 and we have less than \$11,000,000 paid in. If one third of that were returned it would mean a capital of less than <sup>three</sup> ~~ten~~ million dollars with tremendous deposits for that amount of capital. We have been educated for a good many years to regard the capital of a bank as a margin of insurance on its deposits. I do not know whether the people of the country would be satisfied to have a bank showing \$180,000,000 gross deposits with only two and three-quarter millions capital paid in.

(Further discussion followed which the reporter was directed not to take.)

Mr. Warburg: Governor Seay suggests that this amendment be not obligatory, but optional, so that they may do

it in one district and not in another. Was that your suggestion, Governor Seay?

Governor Seay: Yes sir.

The Chairman: I understand, Governor Seay has made a motion, the terms of which Governor Aiken repeated to me. Was that motion seconded?

Governor McDougal: I seconded the motion.

The Chairman: Is there any further discussion?

Governor Van Zandt: In that connection there is at least one provision in the act, or one clause in Section 13 of the Act, and in some of the regulations which have been already promulgated by the Federal Reserve Board, bearing upon the amount of capital stock of the bank, which would of course need to be amended in that respect, that is, an amendment to that portion of Section 13 which refers to discounting of agricultural paper to an amount to be limited to a certain percentage of capital stock, unless that percentage refers to prescribed capital and not to paid-in capital.

The Chairman: Would you suggest that Governor Seay's motion should be amended and made to include an amendment to Section 13, where reference is made to the proportion of the paid-in capital that may be advanced on agricultural paper?

Governor Van Zandt: I think an addition to that motion could be made including all portions of the Act referring thereto, or something of that kind.

The Chairman: Is that acceptable to you, Governor Seay?



Governor Seay: Entirely acceptable. Of course that was contemplated in the original motion.

The Chairman: Governor McDougal, is that amendment satisfactory to you?

Governor McDougal: Yes sir.

The Chairman: Are you ready for the question on this motion?

(The question was called for the the motion was duly carried.)

11 (i) RESERVE NOTES AS LEGAL RESERVES.

The Chairman: Item (i), Reserve notes as legal reserves. Governor Seay, this is one of your topics; will you open the discussion?

Governor Seay: Mr. Chairman, we are now in the position where a member bank can by rediscount create a credit with a Federal Reserve Bank and count its balance as a portion of its reserve, and can proceed to expand its obligations accordingly. There is nothing to prevent three or four or more of the large banks in New York discounting with you \$100,000,000 of acceptable paper and being credited with that amount of reserve to proceed to expand its loans in the usual way, whereas, if they were to take down Federal Reserve notes and put them in their vaults they would not count and they could not accomplish the purpose.

We are also in the anomalous position where Federal Reserve notes now count as reserves of state banks except in those states where there are specific laws providing for

the character of the reserves. I do not know whether New York State has a law which states what the quality of the reserve shall be. Is there such a law, Mr. Chairman?

The Chairman: Yes. It prohibits the use of Federal Reserve notes as reserves, as part of the reserves in state institutions, although it permits the use of national bank notes. At the time the new banking law was passed in New York State we had not discovered that we could apply a rotary pump to our own issue and get gold in behind our notes, and it was generally felt in New York that there was a possibility of a very considerable inflation of the note issues of the Federal Reserve Banks, without any specific gold reserve behind those notes other than the general forty per cent required of banks, and that with the enormous amount of cash held in the cash reserves of state banks in New York State, it might be the means of very seriously inflating note issues to permit the national banks in New York State, by arrangement with the state banks, to take out reserve notes and at once deposit them in the state banks as reserves and continue the process indefinitely.

At the time this act was passed it was very carefully considered by a commission in New York State, of which Mr. Malburn was chairman, and I discussed it with him a great many times and agreed that time fully that he was in accord with our then understanding of the Federal Reserve Act that Federal Reserve notes should serve as reserve in New York state, and I am honest enough to confess that with a year's experience under this act I would not want it now provided



that they should also be permitted to be used as reserves to the national banks.

Governor Seay: I think all of us shared that opinion at the beginning. I am quite positive it was my opinion. But suppose the state banks of New York were to procure the services of the national banks by getting them to discount and take out Federal reserve notes for the purpose of reserves in the state banks. What would the difference be as regards the effect upon expansion? Your member bank itself might create the reserve with you and might proceed to expand. They have to take down the note if they want to have the credit. The expansion can be either in the state bank or in the member bank. Here is the anomalous condition that can create a deposit by rediscount, whereas <sup>as to</sup> the notes that would be required to maintain a forty per cent reserve as against the deposits in their relation to the notes <sup>I</sup> am decidedly in favor of the note itself being used as reserve instead of the proceeds of the rediscount being used.

That subject also is very closely related with another topic that we have discussed and passed upon, and that is the amendment to the Act charging the direct issue of Federal Reserve notes against gold.

I have felt that the Federal Reserve notes should be issued either against gold or against commercial paper, and that inasmuch as member banks can use their deposits created by rediscounts with the Federal Reserve bank as a basis for expansion, it could not possibly add to the dangers

of expansion by allowing Federal Reserve notes themselves to count as reserves. It would tremendously aid us in our endeavor to corral the gold of this country, which, as Mr. Warburg has just said, although it may exceed the supply of any other nation, is never enough for our purposes, because it is not under concentrated control, and we are positively throwing away the banking resources of this nation in the most profligate manner in which we have conducted heretofore our banking business. If it would facilitate the corralling of the gold of this country by using Federal Reserve notes, I believe it can be done, and I think it would be of very far reaching benefit for everyone.

The Chairman: We went over this pretty thoroughly yesterday in discussing that other amendment that was offered, and from that discussion I gathered that we might have a pretty well crystalized opinion on this subject.

May we not have the views around the table, without further discussion, and then go over the subject again on motion, if you please?

Governor Van Zandt, how do you feel about this?

Governor Van Zandt: Ever since the passage of the Act I have felt, in view of the fact that those notes were redeemable in gold or lawful money, that they should be counted as reserve by a member bank.

The Chairman: Governor Sawyer?

Governor Sawyer: I have felt that they could be, possibly, in a limited way.



The Chairman: Governor Kains?

Governor Kains: I am heartily in favor of having them held as reserves.

The Chairman: Governor Hoxton?

Mr. Hoxton: We think that they should be held as reserves, Mr. Chairman. The state banks, however, in our city, are not allowed to hold them as reserves. There might be some complication, in the fact that the sub-treasury in our city, or the Treasury Department, do not, or perhaps would not, count them as reserves. They send them in for redemption.

The Chairman: Governor McDougal?

Governor McDougal: I believe that the notes should be counted as reserves.

The Chairman: Governor Rhoads?

Governor Rhoads: I think it would be safe to do it, although I would be inclined to limit the percentage to some extent.

Governor Aiken: I am in favor of it.

Mr. Foote: I do not think we ought to discredit the reserve notes in any way. With a large gold reserve behind them, in my opinion it makes ~~them~~ it thoroughly consistent that they be classified as reserves.

Governor Wold: I was originally of the opinion that it would be a mistake to have them count as reserves, but in practical operation it develops that these are gold notes, and inasmuch as gold is permitted to count as reserve in a national bank, I see no reason why a federal

reserve note ought not to count, because it represents actual gold.

Governor Fancher: I maintain a more favorable opinion of the Federal Reserve note than I did at the outset. I was rather opposed to their being held as reserves in any form, but I think that the banks can well carry their notes as reserves. I think, however, there ought to be some percentage fixed.

The Chairman: I think we ought to get you down on the record with a good statement today, Mr. Warburg.

Mr. Warburg: Whatever I say is entirely personal. I cannot, of course, speak for the Board. I have thought that the process would be about as it has been here in this room. I was really feeling as though I were getting presents just now.

The Chairman: "Beware of the Greeks bearing gifts!"

Mr. Warburg: No; we have no Greeks this time.

When Senator Aldrich started in he was like everybody else: he was absolutely opposed to the thought. It took me three years to get him around. Everybody at first said, "No; it is inflation."

I will not tire you by all these arguments, but I have been waiting for this moment patiently. I think it is a really interesting moment. Can you not go to Congress with us and say, "These things have got to be reserve, or the system will never be a success"? If you consider this one point that Mr. Seay just mentioned, the getting in of the gold that is coming from Europe--- hundreds and



thousands of millions, possibly--- it will not go into our banks at a time like this. Why? Because what we can give against it is not reserve money. It ought to be in our hands, and can be the basis of a tremendous development such as we foresee and such as is bound to come. It can come only if we have our gold.

There is no logical thought at all that can be against it, and I hope that the two so-called conservative members who still believe there ought to be a limited percentage will come over after a while and even withdraw that end of it, because I honestly think that if we have no confidence in our notes, who is going to have it. We have a note payable in gold in the United States, and it is a necessary obligation, and inasmuch as it is, how can we say that the United States is good on one piece of paper and bad on another?

\$150,000,000 against \$450,000,000 is less security than our notes, and I think we should preserve the 30 or 40 per cent gold required, which I think is low--- I could talk for an hour, but I will not.

Governor Wold: We could listen for an hour, too.

Mr. <sup>W.</sup>Harding: Apropos of Mr. Warburg's statement, I went on record some time ago as being in favor of having these federal reserve notes as reserve in national banks, and the only regret I have, after hearing what Mr. Warburg has said, is that he does not display personally a greater confidence in Federal Reserve notes himself--- because I

challenged him to fill his pocket book with them, and you can see that it is full of gold certificates and there are no Federal reserve notes there.

The Chairman: We would not have our record complete if we did not have Mr. Harding committed.

Governor Seay, I think if you have a motion with regard to this subject we can probably get a vote on it.

Governor Seay: Mr. Chairman, I feel like you do about these important resolutions: It is right difficult to frame them on the spur of the moment, but with the understanding that it may be reframed, or, rather, changed to express our purpose, I move the simple resolution that it is the sense of the Conference that Federal Reserve notes should be and may safely be counted as legal reserves of member banks.

Governor McDougal: I second the motion.

The Chairman: Is there any further discussion? I think we ought to close the door to further discussion except from the two members that have reservations--- or did have reservations--- in their minds. Are you ready for the question, gentlemen?

(The question was called for the the motion was duly carried.)

Governor Seay; Mr. Chairman, in speaking to that resolution I think I said that I entertained an opinion that Federal Reserve notes should be issued against gold or commercial paper, and in saying that it was difficult to frame a resolution to cover that I intended to have that provided for in the framing of the resolution. I would



like to know if it was so understood by all present. The resolution is to be reframed so as to cover the whole subject comprehensively. I am confident that the law pertaining to the issuing of Federal Reserve notes would have to be amended fundamentally so as to enable the issue directly against gold or against gold or commercial paper.

The Chairman: That closes the discussion of this subject, Governor Seay. That motion will be entrusted to the tender mercies of the Secretary.

I am going to skip (k), which should come up under topic 7. It was placed under the heading of No. 11 as this suggestion coming from Governor Seay and Mr. Rhoads, or coming from Mr. Rhoads, and was intended to refer specifically to possible amendments to the Federal Reserve Act in regard to par collections, and Topic 7 was simply a discussion of collections and clearings under the law as it now stands. If agreeable to the meeting I will move (k) to Subject 7.

11 (n). REMOVAL OF RESTRICTIONS ON QUALIFICATIONS OF DIRECTORS.

The next topic under heading 11, of amendments to Federal Reserve Act is the removal of restrictions on qualifications of directors, which is suggested by Governor Rhoads. Will you open the discussion, Governor Rhoads?

Governor Rhoads: Mr. Chairman, my thought in bringing that up was that the restrictions on Class B and Class C directors make it difficult at times, under the restrictions, to get the right type of men, and my thought was to present the subject to the Federal Reserve Board for con-

sideration, if in their judgment it was desirable to remove any of those restrictions.

The Chairman: At our meeting yesterday we were discussing the possible effect of the Clayton Act upon the qualifications of directors of both federal reserve banks and national banks, and the discussion of the effect of the Clayton Act was deferred until we took up Subject (n), so that we might agree, if we could, on a recommendation covering the whole subject.

Do I understand, Governor Rhoads, that this topic that you have suggested relates specifically to the Clayton Reserve Act, and the qualifications of directors therein defined?

Governor Rhoads: I had merely in mind the qualifications of directors of Federal Reserve Banks as set forth in the Act.

The Chairman: Do you suggest an amendment to the statute in respect of the qualifications?

Governor Rhoads: I prefer to do it in the form of asking the Federal Reserve Board to consider the subject and, in their judgment, if it is desirable, to recommend the removal of certain restrictions in Class B and C directors.

The Chairman: Your recommendation would be a little indefinite, Governor Rhoads, unless you made clear what restrictions now imposed by the Act have been found objectionable in your district?



Governor Rhoads: No director of Class B can be an officer, director or employe of any bank. I would be in favor of striking out the restrictions on officers and directors of any bank.

The Class C director is what I have particularly in mind. I do not see why he should be prohibited from having any banking connections. A man must have some banking experience, and if they are to sever all connections, it seems to me it results in subterfuges.

The Chairman: Then you believe that practically Class B directors should be abolished, as such? Of course, the intention of the Act is to insure that the directorship of the Federal Reserve banks should include men who are strictly merchants or manufacturers or agriculturalists, as distinguished from bankers, and that their participation in the management of the reserve banks should be free from any banking connection that would bias their judgment as representing that class distinguishing it from the banking class.

Governor Seay: He might be actively engaged in commerce or agriculture.

Governor Rhoads: I mean to continue that requirement that they shall still be actively engaged in commercial business.

Governor Seay: There are very few high class, efficient business men who are not directors of some bank.

The Chairman: As to the second Class C directors,

would you like to have the same action taken, so that the third Class C director, who is neither a federal reserve agent or deputy federal reserve agent, might still be an officer or director of a bank?

Governor Rhoads: Yes sir.

The Chairman: Do you offer that as a motion, Governor Rhoads?

Governor Rhoads: Yes sir.

Governor Van Zandt: I second that motion.

The Chairman: Is there any discussion of Governor Rhoads' motion which has now been seconded?

Governor Wold: Inasmuch as these institutions were not established for the primary benefit of the banks, but were established for the benefit of the business interests of this country, the representation on the board is important. As one of the Governors remarked yesterday, the business interests of this country have more confidence in this system than the banks apparently have, and I believe we ought to keep that business representation and have the board not a bankers' board, but a board that would fairly reflect and protect the interests of the banks, the business interests, and the public.

The Chairman: You are speaking against the motion, I understand.

Governor Wold: I am not in favor of it.

The Chairman: At least not in favor of it.

Governor Wold: At this time.

Governor Aiken: I would like to ask for information.



In your judgment is it a legislative possibility, without regard to the merits or demerits of the motion, to have such an amendment made in Congress?

Governor Wold: That is another thing.

The Chairman: I do not know that I have any opinion on that, Governor Aiken. I should think Congress would hesitate a long time to adopt any such amendment. And there is another important thing about suggesting amendments just now, and that is that there are undoubtedly a small number, possibly not over half a dozen amendments to the Federal Reserve Act that are really vital to the ultimate success of the system, and in the early stages of the processes it may be well to concentrate our efforts towards bringing about those amendments that are really vital and let the fine French knitting work come later.

Is there any further discussion on Governor Rhoads' motion?

Governor Van Zandt: I seconded that motion, but with the point of view which you have just brought to my mind I believe I would like to withdraw my second.

The Chairman: It looks very ominous for the motion now.

Governor Van Zandt: We had better ask for a few things and fight hard for those which insure the success of the Federal Reserve System, than to ask for it all.

The Chairman: Governor Rhoads, can you find another seconder.

Governor Van Zandt: However, I have not changed my

view on what ought to be done.

Governor Rhoads: The man who has no connections at all is very apt to be a nonentity and not of any use as a director. That is what I had in mind. I realize that it is not the most important thing to be urged at this moment. It is really important with us in our district.

Governor Seay: I am in quite firm agreement with you on the Class B director. I do agree as to the vital amendments to the Federal Reserve Act. There are some vital amendments that should be concentrated upon. I would like to ask Governor Rhoads if he is willing to let this remain and be carried over for discussion.

Governor Rhoads: I am entirely satisfied.

The Chairman: By mutual consent we will permit this to remain on our program without action at this meeting. It leaves the subject, however, of amendments to the Clayton Act still on the program. I wonder if that cannot be disposed of promptly by asking Governor Seay to suggest the substance of the recommendation which was made by the Federal Advisory Council to see whether that would not embody the views of this meeting and whether it is not of sufficient importance for us to take action on that matter.

Governor Seay: The council considered that question in connection with the question of an amendment to the Act allowing National Banks to establish branches; and as a part of their resolution I read the following:

"Amending the Clayton Act; making officer or director



of a national bank eligible as a director in one state bank or trust company and a private banker eligible as a director in one national bank and a state bank or trust company."

Enabling a man practically to be a director in two banks. Having those affiliations it would enhance his value.

The Chairman: Do you think it would be wise to add to that resolution a recommendation that the act make clear its application or non-application to directors of Federal Reserve Banks?

Governor Seay: I do; yes sir.

The Chairman: Would you accept that as an amendment to your motion?

Governor Seay: I will.

The Chairman: Is that motion seconded?

Governor Fancher: I second the motion.

The Chairman: Is there any discussion? Are you ready to vote on the question without discussion?

(The question was called for and the motion was duly carried.)

11-(p). CLARIFYING SECTIONS 13, 14, 16 and 18.

The Chairman: The next Topic is 11 (p), Clarifying sections 13, 14, 16 and 18.

I will ask Mr. Curtis if he will make a statement on this subject, as he really suggested putting this on the program.

Mr. Curtis: I really was not prepared to. I have

not prepared any detailed suggestions. It has occurred to me that all those sections have various portions that are very blind. We are running along on them now, obtaining constructions from the board on them from time to time when a new point comes up. I believe that it would be worth while to have a committee take up those four sections in particular and make the language clear as to what the intent is, following the rulings of the board on them so far as they have been made, and getting new constructions of the portions that have not been covered.

I think in each one of those sections you will find plenty of food for thought and for clarification. I have not prepared a memorandum myself on that, Mr. Chairman.

The Chairman: It is too general a subject for us to dispose of by discussion, at any rate, at one of these meetings. I would be glad to deal with it by submitting in advance of one of our conferences a set of proposed amendments which would clarify those four sections of the Act and give time for study, and then, at a subsequent meeting we could discuss the proposed changes and endeavor to agree upon what they should consist of. Have any of you a suggestion of a method of dealing with this matter?

Mr. Hoxton: Could not Mr. Curtis draw what is necessary in the way of proposed amendments, and send a copy to each of the Federal Reserve Banks to be ready for the next conference?

The Chairman: I have no doubt that Mr. Curtis could



and would be very glad to do that.

We have had one other matter referred to our executive committee of somewhat similar character, and if we could come to the meeting with a recommendation from the Executive Committee, we would possibly facilitate the disposing of the matter.

Mr. Hoxton: That would be better.

Governor Seay: While I have no desire to add to the burdens of the Executive Committee, I nevertheless move that that matter be referred to that body for consideration and report to this conference.

Mr. Hoxton: I second the motion.

The Chairman: This matter has been considered a great deal at different times, and I think we should have an expression, if possible, from Mr. Harding and Mr. Warburg as to whether an effort to make clear these sections of the Act would be of any service to the Board, or whether they might be undertaking the same things themselves, and we be duplicating their work.

Mr. Warburg: The Board is just now taking up the question of amendments, and I was just wondering what the date of your next conference will be.

The Chairman: No date has been fixed. Generally the last business at these meetings is to fix the time and place of the next meeting. The few words that have passed on the subject would indicate that some time in December is the logical time for the next meeting, and it has frequently been suggested that it would probably be

be desirable to have the next meeting in Washington.

Mr. Warburg: While I am not speaking for the Board, I am quite confident that we would be only too glad to have all the suggestions that the Governors can give us in this respect. They would be very helpful. We are just beginning to develop this thing and to work on these various amendments that we think are necessary. Of course I might add that we probably should confine ourselves to the most necessary things, because Congress does not expect to be a very peaceful one this time, and it is very doubtful whether one can altogether afford to open up the Act for fear of what might happen, if we do, and my own feeling is that it is a question of getting the more vital parts amended rather than "going the limit" as you call it, because the minute we begin to work we do not know where we will end.

My own feeling is that it is more advisable to let the board continue until we have really established what is the most desirable thing to do. I think a certain elasticity is very advisable in the law, because our problems change and our experience changes, and it may be just as well to leave it a little bit vague in language in certain spots. I do not object to it.

The Chairman: Would you consider that it would be of advantage to the Board to have the work of studying out the necessary changes in language, which is about all it would amount to, undertaken by this Committee as to those more



particular sections of the Act?

Mr. Worburgh: Most certainly it would be highly suggestive, and we can only profit by it.

The Chairman: Is there any further debate on Governor Seay's motion, or are you ready to vote upon it at once?

(The question was called for, and the motion was duly carried.)

The Chairman: There was another topic under 2 (a), which was passed over to Section 11, which really contains two questions. The portion relating to amendments to the Clayton Act have been dealt with. One section of the Federal Reserve Act is very blind, namely, that having to do with the profits which directors may realize in dealing with their own banking institutions. Speaking from our experience only in New York we have had a very large number of inquiries. I think that is not an exaggeration, Mr. Curtis?

Mr. Curtis: A considerable number of inquiries.

The Chairman: A considerable number of inquiries have been addressed to us as to all sorts of transactions which the country bank director generally is in the habit of conducting, where his bank is in some way involved, and where it does not seem to be clear, by the Federal Reserve Act, as to whether it is prohibited or not. There are cases where a director in a country bank conducts an insurance business and has been in the habit of insuring the bank building, and those who possibly will take out the

liability policies, and there is quite a variety of doubtful points brought out by this section of the Act. It has been on our program for discussion ever since the second or third meeting.

Do you wish to take this up now or pass it over for a later meeting. It rather falls within that class of amendments of less importance; there is no doubt about that, as compared with some of very much greater importance.

Mr. Curtis: I would suggest, Mr. Chairman, that we just add Section 22 to those four that we have just referred to the Executive Committee, which would cover this situation, and then the Executive Committee could think up an amendment to cover Section 22.

I advised one bank in New York, telling the President that this was just a personal opinion and I would put it up to the Board if he wanted it, and I adopted a somewhat more restricted view of the intent of that language than the counsel for the Board subsequently adopted. This banker was rather annoyed by having received a strict interpretation from me and then, afterwards, finding that he could have gone ahead with his business under the interpretation Mr. Elliott put upon it. I told him that he ought to read Mr. Elliott's opinion and find that he specifically said that he would not be responsible for any subsequent indictments under that section;

The Chairman: Mr. Curtis suggests that we add Section 22 to the other four sections referred to the Executive Committee. Exercising my privilege, I would like to



offer that as a motion.

Governor Wold: I second the motion.

(There was no discussion, the question was called for and the motion was duly carried.)

16. RETIREMENT OF NATIONAL BANK NOTES AND PURCHASES OF GOVERNMENT BONDS.

The Chairman: Paragraph 16 of our program was pretty fully discussed, and then left for consideration at this meeting. The topic is "Retirement of National Bank Notes and Purchases of Government Bonds."

Governor Seay, this topic was suggested by you, and I am going to ask if you will make a statement of the discussion yesterday, which is undoubtedly fresh in your mind;

because this is the last item which we will be able to consider before lunch, and if we can dispose of it it will leave us free to spend all of the afternoon on the subject of collection and clearings and one or two subjects that relate to that matter indirectly.

Governor Seay: My recollection is, Mr. Chairman, that we effectively disposed of that item, but that in connection with it there was some subject with reference to purchase of Government bonds that you desired to bring up. I am not anxious to court trouble or assume responsibilities, but I do feel such an ambition to simplify the currency of this country that I put that on the program for discussion; but with respect to that portion relating to retirement of national bank notes I would like to have that carried over.

The Chairman: You will recall, Governor Seay, that your first suggestion was that notwithstanding the prohibition of the National Bank Act we might feel willing to recommend to the Federal Reserve Board that the process of purchase and conversion of the Government Bonds and National Bank notes be accelerated a little faster than the statute contemplates.

Governor Seay: Such is the case; but on going around the Board it developed that it was the sense of the Governors that there were very much more imminent problems, and that that had better be deferred for consideration. I quite agree with that sentiment. If, however, the whole subject will be transferred to a later date I would like it, because I think it is a subject we will have to consider.

Governor Wold: Was there not one more thought brought out in reference to banks being permitted to take out notes?

Governor Seay: Yes. I expressed the opinion that the present position of the Comptroller in permitting new banks to issue national bank notes was perhaps not in harmony with the best development of the Federal Reserve System. I think it would be wise if new banks were not permitted to add to the burden of national bank notes already out. That was an opinion suggested in discussing the first question.

The Chairman: It was brought out in the discussion



yesterday that there were really three problems of the currency to be dealt with. That is, national bank notes or United States notes and the silver certificate, and that, assuming for the purpose of illustration that the Federal Reserve Banks took over the entire amount of government bonds in a very short period, which now secure national bank notes, and assume all of the notes, the note issue would be very largely a fiduciary issue, and the provision of a reasonable reserve of gold in addition to the government bonds would impose a pretty heavy burden upon the national banks. Furthermore, if the general fund of the government were largely deposited in the Federal Reserve Banks and these Federal Reserve Bank notes were also issued against the deposit of Government bonds, the burden of redemption in gold that would be thrown upon the reserve banks would be a very heavy one.

At the present time the government is charged with the statutory obligation of redeeming their national bank notes out of the general fund, and undoubtedly that obligation would be discharged so far as the government is concerned, as rapidly as the Federal Reserve banks took over the national bank notes, and the Government would be under no obligation by the statute as it stands today to redeem the issuance of bank notes out of the general fund. I do not understand that the provisions of the revised statutes applying to redemption of national bank notes were made to apply to Federal Reserve notes at all.

Mr. Warburg: If the Government redeems national bank

notes out of the general fund, it of course calls upon the national banks to make good. So I do not see any difference between a federal reserve note and a national bank note. The Government does not pay the notes; the banks have to pay the notes, anyhow. The banks in turn fall back upon the Federal Reserve banks for their gold. The federal reserve notes they can rediscount if they have a demand for gold, and it will come back to the Federal Reserve banks anyhow. If that be so, it has always struck me that the Federal Reserve Banks would be immeasurably better off if they would control the note issue for the general protection of the system, if they would get the profits, and I have always thought that the most vicious part of our present Federal Reserve System is that it was permitted to start with all the national bank notes outstanding.

(At this point informal discussion took place which the stenographer was directed not to report; after which the following proceedings were had:)

The Chairman: It really is a question of degree, because I do not think you or anybody would assume that the Federal Reserve banks were in a position to assume \$760,000,000 or \$800,000,000 of national bank notes and to set aside what they should in the way of a gold reserve against their own issues. That would be putting a pretty heavy burden upon them and giving them a considerable earning power.

Mr. Warburg: I am not so sure whether that is so.



It looks very dangerous, but when you consider that those \$800,000,000 are really carried by the country and they do come back, because that is the amount of currency that the people require, taking off possibly some millions more or less that are being artificially put out by some of the banks, on the whole this stuff will stay out all the time where the people who control the additional note issue can reach it. If anybody should be afraid, it is we.

The Chairman: Mr. Warburg, I have always felt that the objection to accelerating this process more than a moderate amount lay in the fact that under the law as it stands at present we are ourselves alone obligated for the redemption of all the notes that we issue of that character out of our reserves, and we ought to set aside a very considerable gold reserve against all the federal reserve notes which were issued.

The law only requires a five per cent redemption fund, but as a matter of good, sound banking practice we ought to have a very much larger reserve than the amount of the five per cent redemption fund. You, I think, will agree to that.

Mr. Warburg: Yes; but we naturally would have.

The Chairman: You would think that by, say, one hundred or even two hundred millions there would be no difficulty in it. If we undertook the program it would contemplate making the entire conversion in three or four or five years, and we might find it a very considerable burden unless the whole scheme of amendments was so carried

out and made effective that we could accumulate gold behind our federal reserve note issue very rapidly. One means that we could employ, which is very attractive to me--- others may not agree with me--- would be to effect conversion of the United States notes. If our government were willing to give the federal reserve banks a government obligation which would be salable as an investment obligation to represent the difference between the amount of gold reserve behind the United States note and the amount that is outstanding as rapidly as we retire them, and issue our own notes in exchange, we would accumulate 44 per cent exchange against those notes and have 56 per cent of the amount converted and would get an interest bearing obligation on the Government. As a matter of fact, the Federal Reserve System today could afford to assume all of the \$346,000,000 of United States notes if the Government would give them the \$153,000,000 of gold plus a Government bond for the difference of about \$190,000,000-odd.

Mr. Warburg: Yes, but they will not do it.

The Chairman: I do not know. This Congress may.

Mr. Warburg: I am following you very carefully on your thought that you feel a five per cent bond is not sufficient protection. If you have two per cent bonds they would not be, still. But do not forget that if you really were in trouble you could convert your two's into three's---

The Chairman: You can ameliorate your position for a year.



Mr. Warburg: A year is a long time for a bank of this kind. My theory is, of course, that we never know what will happen, and these eight hundred millions will be a fixture and will continue to be a fixture, and if you should get worried there is your remedy. It is not ideal, and I would never have put out these eight hundred millions to begin with; it was a mistake to put them out. But inasmuch as they are there the national banks can call on you for 100 per cent of gold as if you had issued them yourselves. You are not a bit more protected.

The Chairman: Of course the national banks today can give to us government bonds that secure these notes in order to get gold for their redemption. There is no doubt about that. They can take their surplus reserves out of us for that purpose. I would not care to see this Act amended so that it would impose upon the reserve system or reserve banks the obligation of taking over the entire national bank note circulation in a short period of years. There ought to be protection against that operating too rapidly.

Mr. Warburg: Oh, I would not suggest any amendment. Please do not misunderstand me there. I am not clear in my mind what to do, but my feeling is that we ought to be bold and simply go ahead and buy more bonds and gradually assume more circulation. I think we are too slow about it. I think we are getting no earning power there and there is no risk in it, because it carries itself in times of active money.

The Chairman: You would have the accumulation of the government bonds by the reserve banks effected under Section 14 of the Act, and ~~no~~ attempt to amend the provision in regard to the twenty-five millions to be purchased each year, but operations under Section 14 of the Act, if continued to the limit of possibility, would qualify the provision for the twenty-five million annual purchase, inasmuch as those purchased by reserve banks during the year in which the twenty-five millions were to be purchased are a credit upon the amount to be allotted to them, and we would not get anywhere. We would not facilitate progress.

Mr. Warburg: Oh, you could do it if you wanted to. You could not be forced to buy more; but if you wanted to buy \$50,000,000 a year you could do it and nobody could stop you.

The Chairman: The Act does not permit the reserve banks to purchase more than twenty-five millions in one year.

Mr. Warburg: No, but in the open market you can. It is one of the most wonderful constructions of law that was ever put out, and I am frank to say that it has not entered my mind yet. But we have got it; there is no doubt about it, and our lawyers are quite clear about it, that the law is so poorly drawn that you can go ahead and buy all you please.

The Chairman: Could not the statute be amended to make clear that the reference to bonds purchased under Section 4, which provides for the purchase of no government



bonds at all, really intended to refer to bonds purchased under Section 14?

Mr. Warburg: Yes; I think that is so.

The Chairman: That is evidently a typographical error that ought to be amended. As the statute now reads it is possible that we could not take out circulation against the bonds given us under Section 14. The portion of the Statute which refers to taking out circulation against bonds purchased in the open market refers to bonds purchased under quite a different section than those purchased in the open market.

Mr. Warburg: I think that ought to be made clear.

Governor Seay: I was not prepared, any more than another, to suggest anything definite, but I was satisfied that it would be a fruitful subject of discussion, and I am satisfied in my own mind that the process of retirement of national bank notes, so as to make the Federal Reserve banks the sole banks of issue, will have to be accelerated. I do not think it is wise that the banks should be allowed to buy circulation against the bonds now. I would like to see the matter carried over for discussion, because it will occupy our minds, and in the meantime something of value may occur to us.

The Chairman: Your suggestion, then, Governor Seay, is that this item be continued on our program and no action be taken specifically upon it?

Governor Seay: Yes sir.

The Chairman: If there is no objection, that will be

done.

Governor Seay: Let me remind you, Governor Strong, in connection with that, that you gave to us a circular which your bank had prepared as to the purchase of Government bonds. Do you desire to bring that up?

The Chairman: This is a good time to refer to one feature of the process that ought to be carefully considered. At least, it seemed to us so in New York.

If a notice is sent to 7600 national banks a very short time before this provision becomes operative, it may lead all the national banks of the country to undertake to do the same thing at the same time with reference to their Government bonds, and that would be an undesirable thing. We prepared that draft, and I believe a copy was sent to Washington in the hope that the Board in Washington would decide to send out whatever circular they saw fit, or arrange that the banks send out whatever circular was necessary on this subject as far as possible in advance of the date when this provision of the Act would begin to operate.

Mr. Warburg: I did not understand that you wanted us to do that. I thought you wanted it understood that you were going to agree among yourselves as to what kind of a circular you would send out.

The Chairman: This was submitted in order that it might be read by those present to see whether it covered the matter and to see whether it was not a suitable form for us to send out.



Mr. Harburg: You could do it any way you prefer, I think. If you desire the board to prepare that, I think it can be easily done. I would suggest that you write the Board to that effect.

(Whereupon, on motion duly made and seconded, the Conference, at 1:10 o'clock p. m., took a recess until 2:30 o'clock p. m.)

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## A F T E R   R E C E S S

The Conference reassembled, pursuant to recess, at 2:45 o'clock p. m.

The Chairman: The meeting will come to order.

There are still a few matters that ought not to take but a minute or two to dispose of, that should be disposed of before we take up collections.

In regard to the tentative draft of the circular prepared by Mr. Curtis on the subject of tender and purchase of government bonds. Mr. Curtis has received a letter in response to an inquiry sent to Washington on this subject and I will ask him to read the letter or state a summary of it.

Mr. Curtis: The letter is dated October 19, 1915, and is addressed to Mr. J. F. Curtis, Secretary to the Conference of Governors.

The first part of the letter simply acknowledges receipt of a letter from Governor Strong, as follows:

"The Federal Reserve Board some time ago received a letter from Governor Strong submitting certain questions with reference to the policy to be pursued in regard to the allotment of bonds to Federal Reserve Banks. The board has considered the matter and for your information and that of the Conference of Governors, I am writing to inform you of the position taken.

"The principal points raised are as follows:

"1. In the allotment of bonds at the end of each



quarter, with the limitation of \$25,000,000 be divided by four and the amount of bonds purchased by the reserve banks in that quarter be deducted from the quarterly amount."

That is the question. The answer is:

"As to this, the Board has passed the following resolution: Resolved, that until further notice, in requiring Federal Reserve banks to purchase United States Bonds offered for sale to member banks under the provisions of Section 18, the Federal Reserve Board will not allot to any one Federal Reserve Bank in any one quarter more than one-fourth of the pro rata share of the bonds to be purchased during the calendar year under the provisions of this section.

"2. In case the applications received exceed the amount to be allotted, will the allotments be based upon the order of receipt of the applications, or upon the pro rata share of each applying bank?"

That is the question, and the answer is:

"It would seem that if the applications filed with the Treasurer exceed the amount to be allotted in any one quarter, the allotments should be based not upon the order of receipt of such applications, but rather upon the pro rata share of each applying bank. The Act evidently contemplated that any bank which has its application on file ten days prior to the end of the quarterly period will be on an equal footing with any other bank which has filed

a similar application, and the order in which such applications are received would seem to be immaterial as long as they are filed before that ten day period.

"3. Will any mention be made of bonds securing circulation other than the two per cents?"

"Bonds made eligible for sale by member banks under Section 18 are not limited to two per cent bonds, but rather to any United States bonds which are securing circulation. That excludes the three per cent Panama bonds, series 1911, the 1908-1918 three per cent bonds, and also the four per cent bonds, loan of 1925, are eligible if they, as a matter of fact, are securing circulation.

"4. To what date will the accrued interest on the bonds that are sold be figured?"

"There is nothing definite in the Act to indicate what date shall be fixed to determine the amount of accrued interest on bonds sold under section 18, but all provisions of that section, as read together, would seem to justify the conclusion that the accrued interest should be figured as of the date on which the lawful money to cover the purchase price of such bonds is deposited with the Treasurer of the United States.

"5. If an application to sell bonds is not granted in full at one quarter day, will it be considered as continuing in effect for the balance of the next quarter day, and so on, until the sale is completed?"

"The Board believes that banks whose applications have not been granted in full at one quarter day should re-



apply.

"Mr. Strong raises again the question whether or not the limitation of \$25,000,000 contained in the proviso of Section 18 prohibits the purchase by Federal Reserve Banks of bonds in the open market."

That was not exactly the question raised by Mr. Strong, but it very nearly states it.

"The board has already ruled on two or three occasions that that proviso is not intended to and does not apply to or restrict the purchase of Government bonds under the provisions of Section 14 of the Act."

I think Mr. Strong's question was whether or not the proviso would limit a bank to purchasing any more than its pro rata share of \$25,000,000 in the open market in any one year, as the language is susceptible of two interpretations.

The Chairman: I understand, both from the Statement made by Mr. Warburg before luncheon and from this letter, that Section 18 of the Federal Reserve Act has been construed by the Federal Reserve Board as not imposing this limitation upon the Federal Reserve Banks as to the amount of their purchases, notwithstanding the language which appears in the Act.

The second paragraph of the Act says that the Treasurer shall, at the end of each quarterly period, furnish the Federal Reserve Board with a list of applications, and the Federal Reserve Board may, in its discretion, require the Federal Reserve Banks to purchase such bonds from the

banks whose applications have been filed with the Treasurer at least ten days before the end of any quarterly period, and which the Federal Reserve Board may direct the purchase to be made, and I will now read the language of the statute:

"Provided, That Federal Reserve Banks shall not be permitted to purchase an amount to exceed \$25,000,000 of such bonds in any one year, which amount shall include bonds acquired under Section 4 of this act by the Federal Reserve Banks."

Section 4 makes no provision for the purchase of bonds at all. Section 14 does. This, I suppose, was intended to refer to bonds acquired under Section 14. I do not understand how the Federal Reserve Banks can acquire more than their pro rata of \$25,000,000 in one year, whether acquired under Section 18 or 14 .

Mr. Curtis: It seems to me that while the statute says one thing it really intends to say the other. I should agree with the construction placed on it by the Federal Reserve Board, that it ought not to carry the limitations over to the bonds purchased under Section 14. It says it does, but I do not think it meant that.

(Further discussion followed which the stenographer was directed not to report.)

Governor McDougal: I understand that any allotment that may be made next year under the provisions of Section 18 will not in any way affect what I have already purchased,



nor will what I have already purchased affect our allotment next year.

The Chairman: Is it proper for me to refer to the gentleman who surreptitiously made an offer to you to sell your bonds to another reserve bank in consideration of your buying their bonds after the first of January?

Mr. Curtis: As I understand the ruling of the Board it is to this effect: That the allotment cannot exceed the amount of the pro rata share that any Federal Reserve Bank is allotted, but in estimating that pro rata share they will take into consideration the bonds that that bank has purchased in the open market during that calendar year; but the prohibition does not prevent any bank from purchasing in the open market more than its pro rata share in a calendar year, in which case it would be free from having any allotment forced upon it during that year?

Mr. Warburg: That is it exactly.

The Chairman: The real question before the meeting is whether any motion is desired to secure, through the aid of this tentative suggestion, a fairly uniform circular for the reserve banks to send to their member banks in regard to the purchase of Government bonds, which will commence after the first of January?

Governor Van Zandt: Under the rulings that have been made, if all of the Federal Reserve Banks should acquire, prior to the allotment by the Federal Reserve Board, enough balance to offset their pro rata share of the \$25,000,000, would that not mean that none of the

national banks would have opportunity to dispose of any part of the \$25,000<sup>000</sup> that they should offer for sale?

The Chairman: I understand--- although Mr. Curtis is the expert on this subject--- that if they acquire an amount equal to their pro rata proportion of the \$25,000,000 allotment, after the period begins, which in this instance would be after January 1st, that they would then have acquired all of the bonds they could be required to take under the allotment, and that they would not have to take any?

Governor Van Zandt: If that were the case with all the banks there would be no national bank circulation transfer.

The Chairman: That would be the unfortunate consequence.

The whole proposition is this: If we wait until after the first of January to buy the bonds at cheaper than par in order to anticipate the allotments under the \$25,000,000 offer, I suppose we will be very successful in making Government 2's sell at par. If you buy them prior to January 1st you do not reduce your allotment. It was some such brilliant thought that occurred to Governor Wold when he made his proposition to Governor McDougal.

Governor McDougal: I might say that Mr. Fancher's operations, together with those of the Chicago Bank, have demonstrated very clearly that there would be no trouble in sending bonds up to par, with special reference to the 2's, and in sending the 3's way up beyond what they



are. There are very few of them being offered.

The Chairman: I might remind you that the same question will arise in regard to the purchase of Government bonds after January 1st by Federal Reserve banks that arose when we discussed this at the last meeting, which resulted in our being charged with a conspiracy to depress the price of Government bonds, when we attempted to effect an arrangement by which a committee of the Reserve Banks would undertake to purchase the bonds for account of all of the Reserve Banks. I think still that that is the proper way to handle the transaction and I do not consider that there is any conspiracy in it at all.

However, we will have a meeting before this contingency arises, a meeting probably to be held during the month of December, and there is hardly any use to discuss that matter now.

Would it be satisfactory to the meeting to have this proposed circular submitted to the Federal Reserve Board as coming from this conference, with a request that suggestions be sent to the various reserve banks of any changes that the Board thinks should be made in it? It is highly desirable that this circular should be uniform, if possible.

Mr. Curtis: I think a copy of it was sent to the Board.

Mr. Warburg: Yes.

The Chairman: But it was sent more as a personal matter from our bank rather than as representing all the banks.

Governor Fancher: I would offer a resolution embodying your statement, that a draft of the circular beforwarded to the Board.

The Chairman: Is that motion seconded?

Governor Wold: I will second the motion.

The Chairman: The motion offered by Governor Fancher is that this form of circular will be submitted to the Federal Reserve Board for their comment and criticism and such changes as they desire to make will be reported back to the twelve reserve banks, the purpose being to have the circular uniform in character and terms.

Are you ready to vote on that motion, gentlemen, or, is there any further discussion of it?

Governor Van Zandt: Would we not have to have very prompt action on that?

The Chairman: Oh, yes; it ought to be dealt with in the next two weeks.

Governor Seay: I had in mind asking a leading question: Whether, in case the Federal Reserve Board exercises its discretion and requires the banks to purchase these bonds, whether they have determined that they should be purchased at par, or whether they are going to determine that because a few bonds are sold at 97-1/2 or 98, that that is the market price. I would like to know if it is the purpose to have these purchases by the Federal Reserve banks made at par?

The Chairman: The statute requires that.

Governor Seay: The statute says the banks shall of-



fer them for purchase at par. But suppose they cannot get par? Is the Federal Reserve Board going to require us to purchase those bonds at par?

Mr. Warburg: It stands to reason that if you can buy them below par that you will order your quota before the moment comes.

Governor Seay: I wanted to know if there was any settled opinion on the matter, irrespective of what the market price of the bonds might be.

Mr. Warburg: I think most certainly they would have to take them at par.

Mr. Curtis: As the only obligation was to sell at par, you could not accept an offer before it had been made---

Governor Seay: (Interposing) But suppose the banks find the market to be 98.

Mr. Warburg: The banks, of course, will have taken them before that.

Governor Seay: That is true. I see how it will work out.

(Further informal discussion followed.)

The Chairman: Are you ready for the question on Governor Fancher's motion, gentlemen?

(The question was called and the motion was duly carried.)

ADVISABILITY OF PURCHASING ACCEPTANCES OF  
STATE BANKS AND TRUST COMPANIES, BASED UPON  
DOMESTIC TRANSACTIONS.

The Chairman: Mr. Harding has handed me some corres-

pondence relating to the possible enlargement of the investment facilities of the reserve banks by their being permitted to purchase acceptances of state banks and trust companies which are based upon domestic transactions. We discussed that subject at length yesterday, believing that the ruling of the Board and the opinion of counsel for the Board, which holds that the Reserve Banks may exercise the functions in the absence of the making of a regulation by the Board, would open the door to such transactions. You will recall that the discussion yesterday hinged first upon the policy as to whether we cared to buy bills of that character, and secondly, if we did, whether it would interfere in any way with the present

arrangement with regard to the purchase of bankers' acceptances, covered by the regulation of the Board. We did not attempt to make any definite declaration of policy in regard to that class of investments yesterday because I think it was understood that the directors of the various banks would want to discuss that matter; but I learned today from Mr. Warburg that the Federal Reserve Board does not understand that this would permit the purchase of domestic acceptances made by State banks and trust companies, those really having been covered in a sense by the existing regulations of the Board, in that it did not permit the purchase of that class of bills.

Mr. Warburg: Domestic bills?

The Chairman: Domestic bills; yes. That view of the law is a little inconsistent with the opinion of counsel, it seems to me. It occurred to me that the exer-



...cise of functions specifically granted to the reserve banks cannot be suspended because of the failure of the Board to make regulations.

However, this question has already been brought before the Federal Reserve Board for consideration, and I have just read a letter from Governor Hamlin indicating that he feels that the powers of the Reserve Banks in that respect should be exercised now, if they care to do so; that they should not be restricted in their investments in the open market only to bills growing out of foreign transactions.

The question before this meeting is, therefore, to convey to the Federal Reserve Board, if it is the desire of you gentlemen to do so, some expression of view as to whether the Reserve Banks should be permitted, either by the absence of regulation or the making of a regulation, to make that class of investments?

Mr. Barburg: I might say a word or two about the law covering the open market transactions. The point of view is this: The Act says that the open market transactions are open to the banks unless they are covered by regulation. We have issued regulations for bank acceptances, warrants, Government bonds, and we have not covered bills of exchange and foreign trade acceptances by regulation. Until they are covered the banks are free to deal with them. That was the idea of the law. Then came the question of domestic acceptances of State banks. We were in some doubt whether we should open that up and amend our acceptance regulations permitting those to become

eligible. The question is would it be quite fair to the member banks, who cannot accept those transactions, to give that advantage to the state banks who have not entered the system.

The Chairman: Will you open the discussion of this matter, Governor Kains?

Governor Kains: In view of what Mr. Harburg has said I am in doubt. I believe we should remember that the national banks are the favored children. I do not think we would want to do anything against the interests of the national banks, although otherwise I am in favor of the privilege of buying acceptances growing out of domestic operations.

The Chairman: Would you favor federal reserve banks purchasing these domestic state bank acceptances prior to the enlargement of the powers of the National banks?

Governor Kains: No, I would not.

Mr. Harding: I think there is one practical question that comes in right there. We are going to recommend to Congress that they give the power, under certain restrictions, to national banks to make these acceptances. That is in accordance with your views, as I understand it. Would our chances of getting that amendment through be increased or lessened by giving this authority to the State banks in advance? Would it be an argument of value to go to Congress and say that the State banks can accept and the Federal Reserve Banks can buy their acceptances, and yet they cannot buy domestic acceptances from the National



banks or from their own members, and for that reason you should go ahead and give the national banks what the state banks have. The question is would that be an argument for it or against it to the minds of Congress.

The Chairman: Does not that question really hinge upon the opinion of counsel for the Board as to how the powers of the banks may be exercised? Certainly it would assist a great deal if the statement was made to Congress that the Federal Reserve Board has no power to restrict the Federal Reserve Banks from exercising powers that Congress expressly intended them to exercise.

Mr. Harding: You might say that those Federal Reserve Banks are badly in need of increasing revenues, and that that is a good opportunity to increase them through the buying of state bank acceptances, but that the Federal Reserve Board did not feel that it was right to give the power to the state banks when they could not give it to the national banks, and if you will enable us to give it to the National banks we will also give it to the state banks.

(At this point Mr. Warburg made a statement to the Conference and directed the stenographer not to put it in the record.)

The Chairman: What are your views, Governor McDougal, about permitting Federal Reserve Banks to buy these domestic acceptances of state banks?

Governor McDougal: We are not interested in having that permission at all. We would rather not have it.

The Chairman: How do you feel about it, Governor Aiken?

Governor Aiken: Mr. Kains expressed my feelings in the matter very clearly. I would rather not have the banks buy them until the national banks can accept.

The Chairman: Governor Wold?

Governor Wold: I am inclined to think our people would not be in favor of going into the open market on state bank acceptances until such time as national banks may be granted the same privilege.

The Chairman: Governor Sawyer?

Governor Sawyer: I would like to ask in what state the state banks can accept?

The Chairman: Quite a number, I judge, because they are accepted in Massachusetts, New York, where they have specific power, Illinois, and I think in Pennsylvania.

Governor Rhoads: The state institutions have no power to accept.

The Chairman: How about Illinois?

Governor McDougal: I am not sure. I think they have the power, but they are not exercising it.

The Chairman: There are a number of states that can.

Mr. Harding: Nearly all the states can do the same thing.

Governor Sawyer: I do not believe our institutions would like it at this time. I do not believe we ought to be granted the power of buying them until the national banks have the same right.



The Chairman: Mr. Hoxton?

Mr. Hoxton: We never have discussed the matter in our board that I know of, but I do not think we should go into state bank acceptances until our own members have an equal right. In Missouri the new law permits state banks to make acceptances, but the National banks have no such right.

The Chairman: Governor Seay?

Governor Seay: I think it would be wise to wait before exercising that privilege.

The Chairman: Governor Van Zandt, what is your view?

Governor Van Zandt: I am such a strong believer in the national bank act that I do not believe anything should be done favoring the state banks or that the state banks should be given preference over national banks. Until national banks can accept I do not believe we should even be granted the power of purchasing state bank acceptances.

The Chairman: Mr. Foote, what is your opinion?

Mr. Foote: I agree with Governor Van Zandt on that proposition.

The Chairman: Governor Rhoads, what is your view?

Governor Rhoads: I think we had better wait until the national banks have the privilege.

The Chairman: Governor Fancher will you state your opinion?

Governor Fancher: The matter has not been considered by our board, but in expressing my personal opinion I should think it would be unwise to give the state banks

the preference and permit Federal Reserve Banks to buy their acceptances before the privilege is given to the national banks.

The Chairman: Does somebody want to offer a resolution that will make a record of the opinion that has been expressed here, and which is apparently unanimous?

Governor Van Zandt: I offer such a resolution, to be drawn by the Secretary?

The Chairman: Is that motion seconded?

Mr. Fancher: I second the motion.

The Chairman: Is there any further discussion?

(There was no further discussion and the motion was duly carried.)

#### TELEGRAPHIC TRANSFERS.

The Chairman: I have a matter of personal privilege to bring up at this meeting.

At a meeting some months ago we arranged, based upon the report of the Executive Committee, as I recall it, a scheme for charging for telegraphic transfers, and some of the banks, I understand, have been making use of that. We have not had occasion to use it until quite recently. The question now comes up: what is a telegraphic transfer, when the Gold Settlement Fund effects the settlement only once a week, instead of daily? In other words, is a deposit made with us in New York, to the credit of a bank in some other section of the country, that is, a reserve bank, to be advised by telegram, a transfer of the character that justifies making the charge?



The question arose in connection with a transaction at Atlanta.

The transaction was about as follows: A state bank in New York, the Bank of America, deposited with us \$100,000, advising that they did so for the account of a savings bank and trust company in the Atlanta district, the money to be credited by us to the Federal Reserve Bank of Atlanta and the credit advised by telegraph.

Mr. Hendricks: That is not quite a correct statement. The transaction was this. They deposited \$100,000 in gold for the Federal Reserve Bank of Atlanta by order of the Savings Bank and Trust Company, to be advised by telegraph.

The Chairman: We construed that as being a telegraphic transfer and charged two days interest at two per cent. Atlanta objected to that on the ground that it was simply a deposit in New York to their credit. I have a letter which I received from Governor McCord, having asked him to make an explanation of the transaction, telling him I would submit it at the meeting here for discussion and see whether we could agree upon some method of dealing with transactions of that character which might or might not fall within the class of telegraphic transfers. The letter is as follows:

"I wired you yesterday stating that we were purchasing New York exchange from the Central Bank & Trust Corporation of Atlanta, and were having them to have their correspondent

the Bank of America, New York, make the deposit of gold or gold certificates with your bank as per our request, and I stated also that the Bank of America had offered a deposit of \$100,000 in gold and you had declined to take it except on payment of two days' interest. I wired to know if you insisted on this position as these transactions were for our benefit, and I have your reply saying that you will accept deposits of gold for our credit without charge subject to determination of the matter at the meeting of the Governors.

"However, inasmuch as it is impossible for me to leave here to attend that meeting, I now write to acquaint you and the other Governors of the facts. We have been purchasing gold in the form of exchange by having the gold deposited with you in order to convert it into the gold pool, and we have been paying out our Federal Reserve notes against these purchases on the day that you wired us that the money had been placed to our credit. This was done in order to facilitate the moving of the cotton crop in this section and this matter was discussed at the meeting of Governors in Chicago, and I understood from you at that time that you would accept these deposits for our account. If we were to demand payment of the interest from the Central Bank & Trust Corporation, they would have the currency shipped in from other cities in payment of New York and we would have to bear the burden of receiving these bills on deposit against New York credits. Believing that the matter would be entirely satisfactory to you, we have



made the purchases as above stated and with this explanation of the exact facts, I submit the matter to your consideration for your approval. If this is not ~~sufficiently~~ satisfactory we will, of course, have to discontinue it. I might add also that we have made similar arrangements with several other banks .

Yours very truly,

(Signed) Jos. A. McCord,

Governor."

The purpose of this transaction, as we view it in New York, is to enable the Federal Reserve Bank of Atlanta to convert New York Exchange into gold and use that gold and take out Federal Reserve notes and deliver them to their members or to state banks down there.

I do not want to open up for discussion now, under this particular matter, the whole subject of the operation of the Gold Fund, exchange, collections and so on, but it seems to me that this is a transaction which involves a telegraphic transfer of money which otherwise would have to shipped in currency. There would be the expense of shipment, to cover the constructive cost of which we have agreed to make a charge.

Mr. Harding: I think it might interest you to know that the Federal Reserve Bank of Atlanta made a telegraphic transfer to New York of \$20,000 for one of their member banks, on which they paid two days interest, not at two per cent, but at three per cent.

The Chairman: The basis of the charge on transactions

of this character, notwithstanding the fact that they are settled through the gold fund, is that constructively there is a movement of currency involved in such a transaction, and that we have got to assume that by some method of charging the reserve banks will get some income from the shifts of currency, which, while only constructive, are the cause of expense to the member banks. I will be very glad if we could agree upon a policy amongst ourselves to govern us in this matter. I have no doubt that Governor McCord would accept that agreement, as he has all other agreements and undertakings that we have made at these meetings.

Governor Kains: Why do you think a charge should be made in that transaction? Is it on account of your inability to get the money before the Gold Settlement of that week comes around?

The Chairman: No, but theoretically, if we cannot make any charge at all for these transfers, we will transfer all the currency in the United States and there will be no shipments except through our facilities in New York.

Governor Kains: It is to safeguard yourselves?

The Chairman: Yes, to safeguard ourselves. I think Mr. Harding has had wide experience in that matter and he will confirm my statement, that it is absolutely necessary for the banks to protect themselves by imposing charges of that kind.

Governor Fancher: It seems to me the principle involved is the same, if it is a transfer between two Federal



Reserve Banks or between a member bank and a Federal Reserve Bank.

The Chairman: It is subject to another view of the Gold Fund, which I have always held, and that is that the accounts that are supposed to be maintained between the reserve banks, and are specifically authorized by the statute, are accounts for exchange purposes, and the statute probably never contemplated that the establishment of a clearing house arrangement such as suggested by the language of the Act should result in a daily settlement of an account maintained for exchange purposes. The settlements to be effected by the clearing house or Gold Fund arrangement are settlements of balances which call for settlement, and not balances created for exchange purposes. If the Federal Reserve Bank of Atlanta needs New York exchange and arranges for a transfer to us for its credit by the Bank of America of New York exchange, and intends to check against that, we would carry it in account for credit of Atlanta until it is checked against. Naturally that transaction is not subject to any charge. If that principle is applied to the operation of the Gold Fund, what would it amount to? This is what I think it would result in: That the exchange transactions would be carried on normally as banks conduct exchange transactions between themselves, in an account created for that purpose. The shifts of currency--- that is, the reserve money as distinguished from Federal Reserve notes--- necessitated ultimately by this principle of exchange accounts and by the building up of

reserves in one part of the country as against another part of the country, would be effected through the gold fund and the operations of the gold fund would of course be very much less active.

Governor Seay: Suppose you were advised of the deposit of the Atlanta bank by mail? Do you consider the principle of the transaction to have been changed at all?

The Chairman: Not a bit, excepting that the Atlanta bank wants to move so much reserve money from New York to Atlanta, or to any point in its district, through the operation of the gold fund. Constructively there is an expense attached to that, and that expense should be borne by somebody. In this instance those who get the benefit of it should pay the charge.

Governor Seay: But if you got that advice by mail do you still think a charge should be made? You still would have had the transfer to make?

Mr. McKay: That is not a real telegraphic transfer.

The Chairman: It would have been if we had daily settlements of the gold fund.

(Further informal discussion followed.)

Governor Wold: Is not that a practical demonstration of the advantages to be derived from exchange accounts? It would obviate a good deal of trouble and annoyance by having these exchange accounts settled through the gold fund. In the operations of the Ninth District Bank we are accumulating money in the gold fund that will shortly come out. It will come out through New York exchange. We will



be sellers of New York Exchange as soon as the crop has been moved. Why should not those credits which we have accumulated in the gold fund have been accumulated with you and protected you and made it unnecessary for you to have taken up all these silver certificates and put up gold? Why could they not have counted with you until such time as we sold exchange against them?

The Chairman: Suppose New York exchange was accumulating with you and you were obliged to take it from your members in large volume, even though at some discount. If you found that the accumulation in our hands was too great and you needed reserves in the Gold Fund or in your own vaults you would order through the Gold Fund a transfer and that transfer would be for your benefit, and if there was any cost attached to that transfer you would have to pay it.

Governor Van Zandt: Suppose the Bank of Atlanta had sent you the check of this Savannah bank on the Bank of American for Credit? Would there have been a charge?

The Chairman: There would have been a charge, but I maintain it should be credited for settlement in the Gold Settlement Fund, except in case the Atlanta Bank could not use New York exchange and was willing to pay the cost of transfer of the money from New York to Atlanta. The constructive charge I think is much less than the actual cost of shipping and insuring the money or currency.

As pointed out in this meeting we have up to date paid in \$28,000,000 in gold to the subtreasury for transfer

through the Gold fund to the various reserve banks, and if occasion should ever arise where the Government found it necessary to charge for the actual physical transfer of the gold coin which is held by the Treasury behind the gold certificates, the question would then arise, only in a different form, of who shall pay the cost of shipping the \$28,000,000 of gold from New York to these various points throughout the country. These are transactions in which we have no interest, and from which we do not get one penny's benefit; and we would naturally maintain, when that occasion arose, that every dollar of that expense should be borne by the other reserve banks, the banks that had accumulated this New York exchange, and consequently called for a settlement. We do not get exchange on other parts of the country, and have no occasion to order these transfers to New York.

Governor Seay: Suppose you start the inter-district clearing? Suppose we say to our Baltimore Bank, for instance: "Instead of sending us items on your bank in New York that they transfer to you for our credit items on your member bank and advise us, you advise us by mail and settle for that through the Gold Fund---

The Chairman: But I would like to go back a step in this discussion, this being really item 8 on your program, "Gold Settlement Fund "Daily Settlements", and call your attention to the fact that at the first meeting that we held on October 20th, in Washington, last year, it was arranged,



over our protest in New York, that Federal Reserve banks should receive for immediate credit at par checks drawn on any other federal reserve bank, and the result of that was to put the other Federal Reserve Banks in debt to New York for a very large amount of money. They owed us at one time \$28,000,000, and the question at once arose: Who is going to stand the cost of settlement. We did not want to do it. We did not desire exchange from Dallas, Atlanta and other parts of the country, and it was decided then to discontinue that process and put time on those checks, so that these expensive exchange accounts would be controlled.

Now the same question arises in a different form. We propose to open up an inter-district collection system which will result in very large balances being created, and I find that you are all quite willing to take exchange on New York for immediate credit at par, particularly when it is at a discount, and we are going to be in the unfortunate position, if that develops without limit, of possibly some day standing the cost of shifting this gold around, although we have no interest in doing so.

Mr. McKay: In the transit report that question happens to be covered by a resolution, which I think is exactly what you want.

The Chairman: Let us have it.

Mr. McKay: In submitting our plan of inter-district collection we recommend that any expense covering deficiencies in the Gold Settlement fund, incurred by Federal Reserve Banks, shall be apportioned in an equitable manner to

be determined later."

I think the subject is covered by this resolution. If there is any expense to the New York bank in transferring gold to Washington to make up a deficiency in the settlement fund there, this resolution covers it.

The Chairman: We have had that phraseology in every report and recommendation we have made except the first one. At the meeting on December 10 in Washington, where that question of charges arose, New York very foolishly offered to bear one half of the expense in order to get an adjustment of some kind and get some experience out of it. It was an expense that we were not incurring in any way.

Governor Kains: It did not amount to anything.

The Chairman: No, it did not amount to anything because when these very large balances accumulated in the other reserve banks they were not at all keen to settle. They just let them run.

Governor Kains: We were never asked about them.

The Chairman: We specifically stated that we never would ask.

Governor Kains: But you took them at par without our being consulted in the matter and you should not have done that.

The Chairman: We did not know. We were under the impression we were required to do so by the mandate of this meeting in Washington, and I remember that some of those in attendance had a feeling that we were trying to smother this thing in some way in New York.



Governor Seay: There has always been an understanding between us that if ultimately there should be any expense due to sub-treasury operations that that expense should be borne by the bank which gave occasion for it. It seems to me the question raised is of that character. Theoretically you are making a transfer, but I understand, as I have always said, that ultimately if, in making a final settlement, it involved the actual transfer of funds, that the bank which gives rise to the transaction should bear the cost.

The Chairman: Yes. In this instance if Atlanta and all the other reserve banks are willing to enter into an undertaking that these settlements we are making weekly, which involve the transfer of enormous amounts of gold, are to be made at their expense if any expense arises therefrom, why we do not care, as long as it does not deplete our gold. But the plan that we agreed upon, Governor Seay, was that the transfers by telegraph, which this really is, should be charged for.

Governor Seay: It is a unique transaction. I must confess if the transaction had been offered to us we would have received it. That is the way it occurs to me.

The Chairman: Suppose a member bank came to you and said, "We are depositing with you \$100,000 for credit of the Federal Reserve Bank of New York, by order of the Bank of America for telegraph advice to them." Would not that appear on its face to be a telegraphic transfer? You can hardly read it any other way.

Governor Seay: I do not think it would be a transfer of the nature which we contemplated when we proposed a protective charge upon telegraphic transfers. It was for the protection of a reserve bank against its member banks.

The Chairman: This, as it happens, was a transaction between banks that were not even member banks.

Governor Seay: But boiled down finally it was a transaction between Federal Reserve Banks.

The Chairman: I do not take that view of it.

Governor Fancher: But it was for the benefit of a non-member bank.

Governor Seay: The banks responsible were the reserve bank of Atlanta and the reserve bank of New York.

Mr. McKay: The reserve bank for which the transfer was made expected to collect charges from its customers, whether it be a member bank or a non-member bank, and in that charge is usually covered any cost that the Reserve Bank might have to pay afterwards, should the New York bank have to ship to the Gold Settlement Fund and incur a cost by doing so.

(Discussion followed which the stenographer was directed not to take.)

The Chairman: This would be an academic discussion if it were not for one thing, and that is that when the gold fund was established the Treasury Department apparently reserved the right to charge the cost for shifting the gold and the Federal Reserve Board reserved the right to assess the banks in proportion as they had benefited.



The analysis of this gold settlement fund in our bank and of all transactions going through the fund since May 19 will indicate what an immense volume of transactions have developed and the possibilities of that charge.

We have received <sup>in settlement of</sup> due from ~~accounts~~ accounts \$127,785,000.

We have paid out in settlement of due to accounts \$158,129,000.

We have no assurance whatever that the Treasury will not make a constructive charge for the cost of operating this thing, and issuing the gold order certificates, and for some portion of the cost of the shifting of gold coins that takes place all the time between sub-treasuries.

I do not like the idea of going it blind on the general assumption that we can arrive at a fair determination of who will bear these charges, in view of the large volume of business that is being created. As a matter of fact the New York bank is not benefited to the extent of a dollar by the operation of this fund. So far as we are concerned we do not need to have it operated.

New York being an exchange center these gentlemen are able, through the Gold Fund, to create and draw against New York exchange at will. As an evidence of how the Gold Fund influences these transactions, I will say that shortly before it was established the other reserve banks owed us \$28,000,000 net. They all awoke to the fact, as we knew they would, that if they permitted these balances to remain until the gold fund was settled, it would mean that we would ship \$28,000,000 of gold to our credit

to Washington. They at once scurried around to get New York exchange and when the fund was settled we found ourselves net in debt to the other reserve banks.

If it was possible to adjust the exchange accounts at that time by that method, why isn't it possible to operate the exchange accounts permanently by that method and avoid the immense constructive shipment of gold every week?

Mr. McKay: New York is in a position where it can buy Chicago exchange. I think if they did that they could turn the tide the other way very quickly, because New York commercial houses are now collecting Chicago exchange at a pretty heavy discount. It costs them 25 to 50 cents per thousand to get remittances from the Chicago banks, and in addition to that they are out four days' time. The Federal Reserve Bank of New York could take items for immediate credit at a discount of ten or fifteen cents per thousand, and I think they would get a large volume on Chicago particularly, and I believe it would be a very profitable operation for them.

The Chairman: We are doing that now. We are taking checkson the other Federal Reserve banks with a deduction of time allowance, which amounts, in the case of Chicago, to ten cents a thousand. Of course the volume does not provide an offset. When we first started this transaction we took checks on the other Federal Reserve Banks for immediate credit at par and we got too much of an offset for you gentlemen, who called us off.



Mr. McKay: Those are the transfers of funds, Governor Strong---

Governor Seay: (Interposing) As I view it, the Gold Fund is an experiment in the settlement of exchanges with a view to eliminating the cost of transfer. If you take a period sufficient only to cover the ebb and flow of exchange we hope and believe there will not result any actual physical transfer of money. If it should result, and we cannot tell except by experience, then it would be perfectly proper for the Federal Reserve Board to levy the cost of this settlement against the banks benefiting by it. I think you are right theoretically, but this is an experiment. If we are to make a charge for a specific transaction I think it would tend to vitiate the experiment. I do not want any service performed without an adequate compensation to the bank that performs it. That is the way I look at it now. If we make specific charges for individual transactions there is practically no use in trying the experiment.

The Chairman: When you buy exchange at a discount you are making a charge.

Mr. McKay: I think New York can buy exchange at a discount on Chicago---

The Chairman: What we do is to take checks on the Federal Reserve Bank of Chicago at a discount of ten cents per thousand, which gives deferred credit. What you do is to take New York exchange for immediate credit at par.

Mr. McKay: We take it at par sometimes; sometimes we take it at a discount and sometimes at a premium; and we sell it in that way.

The Chairman: I really did not want to raise the question in connection with the transaction with Atlanta on the basis that we should get a compensation for any service, because we really did not perform any service. I did want to bring out before this meeting that we are operating in a very large way through this Gold Fund and possibly, as was stated at the Executive meeting in New York, are creating some liability of unknown amount to the Treasury Department. It seems to me that it must be fairly apportioned, and I would not want to see any misunderstanding as to our position which we might some day have to take. These heavy demands that we are making through the Gold Settlement Fund, and, if you please, the receipts that go into the fund for our credit, are not for our benefit at all. They are to enable the other banks to create exchange at New York or to sell exchange on New York which they receive from their members through one transaction or another. It might appear, inasmuch as the transaction would go through both ways, that as to those that we sent we were benefiting. We are not. We have no interest in those transactions.

However, if inquiry should be made of the Treasury Department as to whether, in view of the transactions carried on, they felt there was any basis for charge, and we found there was no basis for a charge, why, there would be



no point to this discussion. I was going to suggest in this connection that a resolution be passed requesting the Federal Reserve Board to ascertain from the Treasury Department whether they could not periodically give us a discharge of liability for the cost of operating the fund. It has been in operation now since the 19th of last May. At the end of six months it seems as though we ought to be able to get a statement from the Treasury Department to the effect that we are not liable for any expense, or if we are, how much it amounts to; and when that report comes in this matter might be reported to the Executive Committee and they could begin to work out a basis. I do not like to go it blind in a transaction that involves such very large sums of money, and I do not think Governor McDougal likes to do so either.

Governor McDougal: No, I do not.

Governor Kains: We are in the same position and we would like to know about it.

Governor McDougal: Is not this accumulation of gold in New York a good thing, and will not the gold remain there. We will never have to take it away.

The Chairman: Which gold do you refer to?

Governor McDougal: I refer to the statement that you made that you had paid in twenty millions of gold, and it had to be transferred. The gold flows naturally eastward and it would seem to me that there would not be any expense of moving it.

The Chairman: The sub-treasury at New York is always

glad to have deposits of gold, because that is where the sub-treasury system loses the gold.

The Chairman: The time is coming when you will need large amounts of New York exchange. The gold will be paid into the subtreasuries in other parts of the country and checked against, and the New York subtreasury will have to pay it out constructively---

Governor Wold: (Interposing) If we accumulate ten million dollars of gold in the fund through purchases of New York exchange that would remain there until the pendulum swings in the other direction, so far as exchange is concerned, then we would sell the New York exchange for drafts upon you, you get the gold out of the fund, and there is no shipment involved at all.

The Chairman: We might gradually accumulate such a large proportion of reserves in the Gold fund by reason of extensive checking against New York for New York Exchange that we would have to say to the Federal Reserve Board "Transfer \$50,000,000 to our credit in the gold fund through the subtreasury at New York.", and we would then go to the subtreasury and ask for an issue of fifty millions of certificates at New York. That would be equivalent to a shipment to New York---

Mr. Warburg: I think there should be a very extended period of operation before we draw any conclusions in this matter.

(Further discussion followed on this subject, in which Mr. Warburg participated, with the request that his remarks be



left out of the record.)

The Chairman: I am going to offer a resolution, as follows:

That the subject of determining who shall be liable for charges or expenses incurred in connection with the operation of the Gold Fund be referred to the Executive Committee for investigation and that the Federal Reserve Board be requested to ascertain informally, if they are able to do so, what if any liability has been created by reason of the operation of the gold fund to date.

(The motion was duly seconded and carried.)

The Chairman: We have two items on the program. One is collections and the other daily settlements through the gold fund.

Mr. Warburg and Mr. Harding have some matters they would like to discuss before we take up the rest of our program.

#### ESTABLISHMENT OF SOUTH AMERICAN AGENCIES.

W-14 Mr. Warburg: There is one thought on the question of establishing agencies in South America that I would like to give you. It has been suggested that possibly before the law is amended so that the member banks can unite in establishing foreign banks we send outside agents to act for the banks down there and place credits for the United States.

The Chairman: Do you refer to reserve banks?

Mr. Warburg: Reserve banks. You remember that the Board issued about a week ago a statement concerning foreign agencies to be established by reserve banks. It

said that reserve banks as such would leave it to the member banks, and I thought it had been discussed, but I understand it has not.

There is one point that possibly Federal Reserve Banks should accomplish in foreign countries, and that is if member banks should agree the Federal Reserve Banks can take it up with the member banks and send out for the time being individual agents. Some of you might be interested. You could act for ten member banks in placing credits and building up business for the member banks. I think, generally speaking, it might be a good thing, because the country wants the Federal Reserve Banks to do everything that they can do, and there is not anything that we could not do except possibly with regard to the item of expense. That is the only thing that I can see against it.

There is another thing that needs to be considered. The mere fact that the Federal Reserve Banks are going into those fields might have an adverse effect on member banks. It might interfere with their business, they say.

We said in our report, before we made our final report we would like to get an expression of the views of the Governors on that point, and we are going to ask the Federal Reserve Agents to give us their views. Then we are going to make our final report, and if it can be done we would like a few expressions on that point.

The Chairman: This is the first discussion we have had of the matter, Mr. Warburg.

Governor Kains, what is your view of this suggestion?



Governor Kains: My view has been against Federal Reserve Banks having foreign agencies; and with regard to the member banks I am neutral. If they want to do it, why, I think they should be offered every opportunity.

The Chairman: Mr. Warburg's suggestion was that an arrangement might be effected by a reserve bank or a number of reserve banks in cooperation.

Governor Kains: You mean member banks?

The Chairman: No; reserve banks; so that in case the member banks of their district contemplated establishing agencies in, say, South America, when the Act is amended so that they can establish joint agencies, possibly joining with the member banks in appointing a representative to go down and investigate the subject thoroughly in the interest of both the member banks and the Federal Reserve banks; possibly doing some preliminary work towards the appointment of an agent there, which would not, however, contemplate appointing a branch.

Mr. Warburg: That is right.

Governor Kains: I do not think that there would be any objection to that.

The Chairman: Would it be of any service in connection with the discussion if we take a vote first upon the question of the advisability of the reserve banks establishing foreign agencies?

Mr. Warburg: Very well.

The Chairman: The record of this matter, as I recall it, is about as follows:

Following the Pan-American Congress in Washington Secretary McAdoo made a brief statement in which he recommended that the reserve banks be authorized by an amendment to the law, if they did not already have the power, to establish branches in South America, and that the Federal Reserve Board take steps to bring that about. His report was referred to the Federal Reserve Board, and they expressed an adverse opinion on the policy of establishing branches of Federal Reserve Banks in South America; but in one paragraph I think it was suggested that the matter would be discussed at this meeting and an expression of opinion obtained. So it would be quite proper for us now to give an expression of opinion as to whether federal reserve banks should go into the business of commercial banking in South American markets.

Governor Kains: I am adverse to that.

The Chairman: Is it necessary to go around the table to get an expression of views? If someone would make a motion, those that have positive views can then discuss that motion.

Governor Kains: I move that it is the sense of this meeting that we are adverse to the idea of Federal Reserve Banks establishing foreign branches in South America .

Governor Wold: I second the motion.

Governor Seay: It might facilitate matters if I should read to the Conference the action taken by the Federal Advisory Council. They passed a resolution to the following effect:



"In our opinion it is not advisable at this time for the Federal Reserve Banks to establish joint agencies in foreign countries, as their resources should be kept for the protection of the member banks and not become involved in financial or trade transactions in foreign markets.

The financing of foreign trade transactions belongs legitimately to the member banks, state banks and private banks, and should not be a function of the Federal Reserve Banks."

Mr. Warburg: I do not think that that is quite what you want to say. We divided this into foreign branches, foreign countries, and South American countries. In foreign countries, England, France and Germany, they have joint agencies which sooner or later will be useful. That means nothing but correspondents with foreign countries, which you might have jointly.

There was another question, and that was the question of individual foreign agents, where we might sometimes cooperate with the member banks in a district in a very loose and experimental way. I think this goes too far in covering all foreign countries. We are willing to include Germany, France and England.

Governor Seay: I did not offer this. I understood there was a definite motion before the Conference, and I merely read this in connection with that.

Mr. Harding: The distinction is that the Board does not want to authorize the Federal Reserve Banks to engage in loan transactions or, to any great extent, in the purchase of bills of exchange in those countries. In normal times,

times of world wide peace, these foreign agencies will probably be beneficial provided we are dealing with thoroughly established gold standard countries.

The Chairman: There is another point where it seems to me we have to distinguish between what Secretary McAdoo apparently desired to accomplish and what the Act provides. I understood his recommendation contemplated that the Federal Reserve banks would actually open branches.

Mr. Harding: He referred to the whole power of the Federal Reserve System.

The Chairman: To create banking agencies or branches in the South American countries and promote banking transactions between the two countries. I do not believe that the Federal Reserve Banks can possibly do that without a wholesale amendment to the law. In the first place, if we should open an actual branch office in a South American capital and undertake to open credits down there, it would be necessary for us to transact that business for the benefit of the American exporter or importer, and we could not very well conduct the business directly unless we had relations with the American importer or exporter, and I do not believe it is possible to develop a business of that character under the present scheme of the Federal Reserve Act.

On the other hand the establishment ultimately of an agency or a joint agency down there might be promoted by the cooperation of the Federal Reserve Bank in some way without interfering or competing with the member banks in



so doing.

Mr. Warburg: Our point of view was that in South America where they have business resources, money shall not be employed. That was our answer to that. It was for the protection of the Federal Reserve Banks, because we want to hold foreign resources, which are liquid assets for the benefit of the Federal Reserve banks. Then it was all right to keep joint agencies in European countries where such a fair market exists. The other thing was simply a matter of cooperating, and it was in a very, very small way.

Governor Rhoads: Would it be sufficient to answer the inquiry of the Federal Reserve board by passing a resolution concurring in the statement they put out.

The Chairman: Do you offer that as an amendment, Governor Rhoads, to Governor Kains' motion?

Governor Rhoads: Yes sir.

Governor Kains: I accept the amendment.

Governor Fancher: I second it.

The Chairman: Governor Kains accepts this amendment, Governor Rhoads, the your resolution is to endorse the statement made by the Federal Reserve Board on the subject of the establishment of branches or agencies in foreign countries. That motion is seconded. Is there further discussion?

(The question was called for and was duly carried.)

Governor Aiken: Having had no experience in this foreign business, I am doubtful as to what the Secretary

proposed in his foreign branches, but it seems to me that if there were opened branches it would involve the transformation of the whole reserve business into a commercial banking system.

The Chairman: It would tend strongly in that direction.

The next question is as to what shall be done by the Federal Reserve banks to promote the interests of the member banks in establishing agencies and branches there.

Mr. Barburg: I think it would be quite sufficient if you would say that you would take that thought home and discuss it with such member banks as have evinced interest in the matter, because I do not think the whole thing is very complete, and we want to try to develop something if we can.

Mr. Harding: What we propose is this: There is only one bank in connection with these foreign branches. A great many other banks do not feel disposed to incur the expense and risk. At the same time they realize that if they do not go into something of this sort they are likely to lose some local business, and we are going to recommend to Congress to amend the law so as to authorize a group of member banks to join together in subscribing for stock in any foreign bank that they might wish to enter, and in making it open to everybody.

The Chairman: Possibly we can frame a resolution which will permit of a discussion of this matter, and a final expression thereon.



I therefore ~~move that it~~ be the sense of this meeting that we ascertain from the member banks of our respective districts to what extent they may desire to establish connections, branches, or joint branches in South America, and to that extent it would be possible for the Federal Reserve banks to promote their interests in doing so by sending a representative down there or by other means to be suggested.

Governor Fancher: I second the motion.

(The question was called for and the motion was duly carried.)

The Chairman: I would like to read the paragraph as it now stands in regard to collections and clearances. We have transferred a number of sub-headings to this section on the program. We have to deal with the treatment of the float, amending the provisions of the Federal Reserve Act relating to the par collection of checks, report of the Transit Conference, the subject of intra-district clearings, the matter of items bearing endorsements of non-member banks, inter-district clearings, including items drawn on banks which are not members of the Federal Reserve system, Mr. Talley's plan of possible necessity of changing the required reserves of country banks, growing out <sup>of</sup> the development of the clearing system, and, again, from another section, the collection of items drawn on banks which are not members of the Federal Reserve System. That is covered under 7-(c).

Governor Wold: I fear that Mr. Warburg drew the wrong

inference from my remark. The reason I thought it would not be necessary to discuss it was because it was so fully in accordance with the views of the Board on that subject that I did not think it was necessary for us to thresh it all out again, and we could vote on it immediately.

Mr. Warburg: But I think you are all cleared up for this collection discussion and it would be better to dispose of it first.

The Chairman: We should like first, I think, to hear from Mr. McKay in regard to the conference of the transit men and their recommendations. I am not sure what form your report takes. Our time is a little short, and if it is possible to summarize it into the recommendations, that had better be done.

Mr. McKay: It is all included in this report of which everyone has had a copy, but if not, there are copies here to be distributed.

REPORT OF TRANSIT MANAGERS' CONFERENCE.

The Chairman: Mr. McKay, would Resolution No. 12, embodied in this report, substantially summarize the recommendations of the conference.

Mr. McKay: Yes. Resolution No. 12 does that, and the preceding resolutions simply are there to show what led up to this No. 12.

Governor Van Zandt: Mr. Chairman, do you not think it would be advisable to take this report of the Transit Committee section by section?

The Chairman: Yes; but the first part of it, as I recall from reading it, Governor Van Zandt, was simply the



specific votes which resulted in the assembling of all of these recommendations into resolution No. 12, so that we would be considering the same matter twice, and by acting on the first eleven votes we take up a summary of all of them in the recommendation No. 13.

Mr. McKay, have you a statement to make in regard to this report ?

Mr. McKay: No, I have not. The report itself is the meat of the whole meeting, the result of the meeting, and we boiled it down, and I thought if there were any questions that would come up afterwards I would answer those specific questions if I could.

The Chairman: How would you deal with items drawn on member banks which are now members of the clearing system and for which immediate debit and credit is made, notwithstanding that they may be some distance from the Federal Reserve Banks; more than one day's transit time?

Mr. McKay: This plan of inter-district clearing is not designed to interfere with any local plan that may be introduced. It does not prevent the Kansas City bank from continuing to go on with immediate debit and credit if it so desires, nor does it interfere with the San Francisco Bank's going on with the deferred debit and credit system which it has in operation.

The Chairman: Suppose we send you an item drawn on a bank in Peoria, which is a member of the clearing system, and in the same letter a check on another bank in Peoria, which is not a member of the clearing system. One

item you would charge immediately to the Peoria Bank that was a member of the clearing system---

Mr. McKay: We would probably immediately go into the deferred debit and credit for the members that are now in our collection system.

The Chairman: You would abandon the present system?

Mr. McKay: Oh, yes; but I mean those banks that have an immediate debit and credit system can keep it up if they so desire. It does not prevent them from doing so.

The Chairman: Then, in our district, if we decided to continue the immediate debit and credit for 125 or 130 banks, we would have two methods of treating items which you would send us. Those on banks which were not in the system would be credited for a greater deferred time on the books than those which were in the system?

Mr. McKay: No; it would mean that each district would have the same system within its own district. If we sent you items on banks that are not now in the collection system, you would treat them just the same as you do now.

The Chairman: That are not in the system?

Mr. McKay: That are not in the system.

The Chairman: Then it would become mandatory as to banks that had not joined the system?

Mr. McKay: That is practically what it means.

The Chairman: You are dealing with those beyond Kansas City on a battle axe basis. I do not know whether



we could do that.

Mr. McKay: While the deferred debit and credit system may be mandatory in that way, I do not think it will offer the same objections as the immediate debit, because there are large overdrafts occasioned, and the fact that they have to carry excess reserves on their own books makes so many objections.

The Chairman: Practically, Mr. McKay, this report means either a mandatory immediate debit and credit system or abandoning the immediate debit and credit system entirely?

Mr. McKay: Yes; but the idea is that the deferred debit and credit system is a proper one. But we do not want to interfere with Kansas City, and The Kansas City representation would not have voted for this if it meant that they had to change their method to deferred debit and credit.

The Chairman: Did Kansas City realize that this would bring all of the items into the Federal Reserve banks and the other districts where they probably might all eleven abandon their present plan of collection, <sup>and</sup> they would get practically no items or very few? In other words, Kansas City, clearing by the immediate debit and credit plan, would offer attractions to banks all over the country for using the Federal Reserve System, which no other bank would offer, and it would precipitate all items of the Kansas City District through the Federal Reserve Banks.

Mr. McKay: Kansas City would not put in an immediate debit and credit system for items drawn on points outside

of its own district?

The Chairman: No; we are talking about items drawn on points within its district. Take New York for instance. The New York banks, of course, have a large amount of checks to clear drawn on the Kansas City district banks. By the present process those banks in New York who have to cash those checks for their correspondents in order to get the proceeds by the shortest possible method and the cheapest, would go by this plan, because the credit would be given in two days instead of four or five, allowing time for their local deferred debit and credit, and Kansas City would naturally be at a disadvantage---

Governor Sawyer: Unless we should defer on outside endorsers.

The Chairman: Then you would have two sets of books to keep for every member bank, which is a very expensive proposition.

Mr. McKay: I think it means that Kansas City will probably be obliged to go on the deferred debit and credit system for the whole district.

The Chairman: Inter and intra-district, both?

Mr. Hendricks: The inter district would be controlled by the other banks.

The Chairman: Ostensibly, then, Mr. McKay, this contemplates the possibility in theory that a Federal Reserve bank may continue its intra district immediate debit and credit plan, which would not apply to the inter-district business, and consequently those banks which had the im-



mediate debit and credit plan in operation as to only a few of its members, if they wanted to continue, would never have to carry two sets of books; and as to those items drawn on members which cleared they would have a suspense account for items which were not to be credited until after the lapse of the deferred time?

Mr. McKay: The Kansas City District would have to do that, because they would not be willing to give us immediate debit and credit,

The Chairman: That would be a means of protecting themselves against the float. If they did that for every member bank, inasmuch as their system is mandatory, they would have to establish two sets of collection records, one to cover immediately cleared items, and another to cover the schedule of debit and credit---

Mr. McKay: The Kansas City representative informed us that they were doing it now to some extent--- taking items from the Kansas City banks on a deferred credit basis of two or three days. They gave those banks a due-bill for the items. So they are operating to a certain extent now under the deferred debit and credit.

The Chairman: Governor Van Zandt, I did not mean to interrupt your suggestion that this recommendation be taken up by paragraphs. After reading it it occurred to me that its basic principle that we have just been discussing was the principle on which the whole thing hinged, and if we could agree, or agree to disagree on that, we would be able then better to discuss it by paragraphs.

Governor Van Zandt: It looks to me ~~that~~ if we took up some of those questions that were adopted ahead of these, it might preclude our acting on No. 12.

The Chairman: This matter is open for discussion by any method which you propose to deal with it, and the Chairman will adopt any course of procedure that you suggest and agree upon.

Mr. McKay: I think it is a very good suggestion that these votes be taken in the order in which they appear here, because they lead right up to the main topic.

The Chairman: What is your pleasure, gentlemen? I want to get the method of procedure pretty well understood here.

Governor McDougal: I move that this report be taken up, beginning with vote No. 1, and considering it as we go along.

Governor Rhoads: I second the motion.

(The motion was duly carried.)

The Chairman: Vote No. 1. "That we heartily favor every extension of the operation of a check collection system consistent with sound principles and permissible under the Federal Reserve Act."

Governor Kains: I move we concur in Vote No. 1.

Governor Wold: I second the motion.

(There was no discussion, and the motion was duly carried.)

The Chairman: Vote No. 2. "The deliberations of this body are based on the assumption that every member ~~ban~~.



is required by law to cover at par all checks and drafts drawn upon it received from the Federal Reserve Bank of which said bank is a member.

Governor Aiken: To bring this before the house I move the approval of vote No. 2.

Governor Fancher: I second the motion.

Governor Rhoads: Speaking to that motion, I would ask a ruling of the Federal Reserve Board on the subject.

The Chairman: The polite language used by the Transit conference sort of veils this question. What vote No. 2 means, to my amateurish mind, on these matters, is that the member banks would have to be required to abandon the charge of exchange. Is that correct?

Mr. McKay: That is correct.

Governor Rhoads: It means remittance at par.

Governor Van Zandt: Remittance at par to the Federal Reserve Banks.

Governor McDougal: If that cannot be definitely understood we cannot proceed very far.

Mr. Foote: I notice, gentlemen, one thing in the votes here. Our cashier who represented our bank at this conference wanted to know one thing, explaining that the Atlanta directors were on record as being opposed to putting into effect any system of clearing on a par basis. Our board is unanimously agreed on that proposition. Mr. Pike, however, was handicapped by instructions from the Board. The Board did not know he was coming up. He made a voluntary explanation---

Mr. Hendricks: He explained that, Mr. Foote. He said he did not agree with them, but he felt he must vote against it, knowing the attitude of the Board.

Mr. Foote: I prepared quite a formidable paper yesterday afternoon while you gentlemen were out playing golf, but I have not had the nerve to read it yet---

The Chairman: I move that Mr. Foote be requested to submit his paper, to be made a part of our record, so we can all read it.

Governor Van Zandt: I second the motion.

(The motion was duly carried.)

(The paper above referred to was not delivered to the stenographer, although request was made for it, until too late to be incorporated in the record.)

The Chairman: That motion is a little out of place, Mr. Foote, but we would like to have the benefit of the paper that you have prepared, if you can have it typewritten and distributed.

Mr. Foote: Thank you very much. The question appealed rather peculiarly to the Sixth District, and the directors, in taking the position that they have on this exchange question, have done so with reference to what they consider the best interests of the district.

The District had charge of 76 banks, 73 in our clearings, and some of them are clearing in a limited fashion. One bank, I recall, permits several banks, its correspondents, to draw on it through the Federal Reserve Bank, and



items are charged immediately at the reserve bank. It does not receive any of its customers' checks.

There are four member banks in New Orleans, three of which were precipitated into this clearing system. There was a member bank in New Orleans having an \$8,000 balance in the reserve bank, getting \$40,000 or \$50,000 of items a day on the other banks in New Orleans, and it forced them in line. Of course the biggest feature of this question is the float. The country bank does not know anything about the float. He is for the most part thinking about the exchange; but after he sees there is some float attached to it, too, if he does not have apoplexy, he will be a good one.

The Chairman: How do you feel about the vote which has been made by all except Mr. Pike, which we thoroughly understand, as it was explained to us? It is in effect that the transit men of these twelve banks, with the exception of Mr. Pike, believe that the law requires a member bank to remit at par for checks sent to it for payment or collection.

Mr. Foote: We are advised by counsel that it does not. That is a legal question, and I am not competent to discuss it. The Mississippi Bankers' Association filed a brief in Washington in which counsel took the position that it is not necessary for the Federal Reserve Board to invoke any such order; it is not mandatory on the Federal Reserve Board to take any such action.

The Chairman: This is really the point, and the only point now under discussion at this stage.

Mr. Footc: Senator Williams explained to me his vote on Section 16. He said that he voted for that section believing that the provision was simply to regulate and not to coerce, except by regulation; that it was his purpose to see that the country banks continued to enjoy reasonable returns with exchange charges, and he did not think those charges ought to be taken from them in view of the very necessary service, as he expressed it, that they rendered the country. He voted with the full understanding that it was simply an authority vested in the Reserve Board for the purpose of regulation only. He went on to say that there had been so many people there in Washington complaining about the heavy charges of country banks. He said he did not sympathize with them, or anything of that kind, but he did sympathize heartily with their being permitted to make reasonable charges, and that it was with a disposition and a desire and a willingness to help regulate and prevent abuses that he voted for that section.

The Chairman: Excuse me just one minute. We are facing this situation, that the board naturally has to be governed by its own views of what the intention of the statute is, and those which it is advised by its counsel are proper to take, and I understand that the Federal Reserve Board has a well settled opinion now as to what this law means in respect of the charge of exchange by a country



bank. Am I correct in that, Mr. Harding?

Mr. Harding: I think you are.

The Chairman: Would it not be proper in connection with the discussion of this vote, Mr. Foote, to get the opinion under which the Board is acting, and which will control our actions until the law may be amended, whether we agree that it is good business or not. We have to accept one fundamental fact, that this law means something, and, arriving by the best possible method at the determination of what it means, the twelve reserve banks have to go ahead and do the business, even though it means some hardship upon the member banks, unless by a test of the meaning of the Act in the courts, or by persuading Congress that they have imposed unnecessary hardships upon the member banks, and that they should amend it, we can escape this difficulty.

We have followed this for nearly a year now, consuming anywhere from twenty-five to fifty per cent of the time of our meetings in endeavoring to get an understanding of what the law means, and to find the means to put the law into effect.

Nobody feels any more strongly than I do that this Act in its various reserve requirements, and in the requirements as to par collections does bear down upon the country banks. We have threshed that out at great length. Unfortunately, it is the law of the land, and we want to get finally and authoritatively a statement of what is meant by the Act.

These gentlemen have stated their understanding of the meaning of the Act, and at this point I would like very much if Mr. Harding and Mr. Harburg could give us the opinion of the board and counsel and their own opinion as to what obligation legally rests upon us to collect checks and upon what method, so far as par is concerned?

Would you accept this interruption, Mr. Foote, before we go further?

Mr. Foote: Certainly, sir.

Mr. Harding: I have not a copy of our counsel's opinion in this matter. He is quite clear, if I recollect correctly, that no bank can be forced to actually pay a check drawn on it payable at its own counter anywhere except at its own counter. There does not seem to be any question about that. So that the charging up to the bank's account of a check by a Federal Reserve Bank does not in any sense constitute payment of that check. They cannot deprive the drawer of his check. He has some rights in the matter, too.

At the same time the counsel is clear that this Act means what it says, that every Federal Reserve Bank shall receive on deposit at par from member banks or from Federal Reserve Banks checks and drafts and so on. I think he held at one stage of the proceedings that that did not necessarily mean immediate credit. I think he recognized the fact that deferred credits might be permitted; whether they were advisable or not he did not undertake to say, but he thought that as long as the word "immediately" was



left out, there was nothing in there that specified immediate credit. So long as you take them at par the fact that credits are deferred for a while does not seem to be material.

There is one saving clause for the member bank:

"Nothing herein contained shall be construed as prohibiting a member bank from charging its actual expense incurred in collecting and remitting funds."

That does not mean constructive, but actual expense in collecting and remitting funds.

In the case of country banks, the business of many of them is very largely made up of the collection business. There are a good many country banks, I presume, that do not have more than one discount on a banking day, and probably a country bank that will make one loan a day---

The Chairman: Pardon me a second. One bank in our district reports \$100, and \$1200 exchange.

Mr. Harding: The average country bank receives deposits of cash, and checks on local business, pays checks over the counter, and they have a lot of drafts for collection sent out by one of the banks to collect those drafts, and they draw checks in payment of remittance for those goods. They get a lot of checks from their city correspondents that they either credit or debit; they draw their checks on the New York or New Orleans correspondent in payment of it, and as far as the actual work of the average country bank is concerned, I should say that fully fifty

per cent of it is taken up in the collection business, the handling of checks that have to be remitted outside of the town in which the bank is located.

Counsel has never given us a very clear opinion as to what this actual expense means, whether anything is allowed for overhead, or whether you are allowed to charge in a certain proportion and what proportion of the overhead charges are proper to put in it. That is something that I think ought to be elaborated on. I have never seen any full information about it, or full opinion as to it. But it is stated:

"Nothing herein contained shall be construed as prohibiting the member bank from charging its actual expense incurred in collecting and remitting funds."

If you send out a lot of checks by a runner down to another bank it seems to me there is an expense incurred in collecting those funds. You have to pay that man's wages; you have got to pay your cashier his salary, and part of his salary goes into the supervision of those transactions.

The Chairman: The difficulty seems to arise here, though, Mr. Harding, that by the present process the country bank collects that charge out of the city bank that sends the checks to it for collection.

Mr. Harding: I understand that.

The Chairman: And by the provisions of the law it is contemplated that the country bank shall collect its compensation or reimbursement for the service it performs from its own customer, and a reversal of the charge means that



the country bank will not be able to collect from its customer, because the customer will promptly draw his account out.

Mr. Harding: It goes on to say here, with respect to charging for collecting and remitting--- by the way, whom are you going to charge, the man for whom you collect or for whom you remit? There is a full stop there.

"The Federal Reserve Board shall, by rule, fix the charges to be collected by the member bank from its patrons whose checks are cleared through the Federal Reserve Bank, and the charge which may be imposed for the service of clearing or collection rendered by the Federal Reserve Bank."

Counsel has never given us any opinion as to what he thought that meant. I have heard that there was a committee that came down in connection with it. Were you along with that committee, Mr. Foote?

Mr. Foote: Yes.

Mr. Harding: I saw some members of the committee when they got back home, and they were feeling very good. They thought they had saved themselves. They said that they had fixed it all right; but they did not seem to realize that they were expected to collect their charge from the man who drew the check. It seems to me that anyone who knows the temperament of the average depositor of a country bank will know that when John Smith draws a check on his bank in Mississippi to send up to Chicago for a hundred dollars or so, that Chicago bank puts a pencil memoran-

dum on it, "Fifteen cents" or "2b cents" extra. He is going to raise a big row about that. He is not going to stand for it. There is no use in discussing it. Suppose I bought some goods in Chicago and I pay the freight on those goods and send them a check. I am not going to pay freight both ways. If the Chicago man will pay the freight on my goods, I will pay the freight on his money. It seems to me that the whole proposition is that a lot of jobbers have been raising a lot of commotion about these charges. If the merchant jobbers would stand up and demand that and refuse to take anything except funds incurred at the place where these goods are shipped from, the system would work out all right; because then with two merchants in a town doing business with different banks, if one merchant did business with a bank whose checks were accepted without question and another did business with a bank whose checks were always returned to him on account of this exchange charge, the second merchant would go to his bank and say, "I want the same facilities; otherwise I will withdraw my account and do business with the bank that gives me these facilities."

Mr. Foote: We always thought that that bunch of fellows went down there and unfixed everything we fixed. We had friends enough and had legal advice enough to have that section fixed, and the words agreed on, that would have the sanction of several members of the committee in the lower house. Mr. Underwood, who at that time was Speaker of the house, concurred. Our Congressman, Mr. Harrison,



handled the proposition. He is a distinguished lawyer of well-known ability. It never was incorporated in the bill, but it was all agreed to.

Senator Williams, who has given this matter a good deal of attention and who I think will cooperate to further any wise legislation by suggestions along these lines, understands the banking business. He told me that he went down to see Mr. Hamlin about this matter. He speaks of Mr. Hamlin as "Charlie." He said, "Charlie told me that this is very indefinite. It is hard to say what it means." He was somewhat at a loss to decide what to do about it, and thought action would have to be taken with reference to what they believed it was the intention of the Senate to have accomplished in that paragraph. Mr. Williams then made an explanation of what the interpretation of it was at the time and what he believed it was and what he believed the Senate thought about it. That was when he made this statement as to what his convictions were, his then convictions.

So it is a two-sided question, gentlemen. I tell you, right now, you are going to see the billows roll from one side of this country to the other about that very proposition, if you do not find some way to get over it without putting the country banks out of business.

The Chairman: We have been rolling along for a year with the billows rolling over us and under us; and, Mr. Foote, as to this statement of the apparent belief of the gentleman who prepared those resolutions, the second thought

it seems to me is an inference drawn from the law rather than a statement of the law itself that is not quite accurate. The law does not say what the country banks shall do except by implication in remitting for checks drawn on it. If I were writing that, with all respect to Mr. McKay and Mr. Hendricks, I would express it something like this:

"The deliberations of this body are based upon the theory that every Federal Reserve Bank is required by law to receive on deposit at par without deduction of exchange"---

And there I think we have to have a qualifying clause something like this:

"but not necessarily in the case of checks on banks in other districts for immediate credit, the checks and drafts drawn upon banks which are members of the federal reserve system."

That is more nearly what the law states. It tells the Federal Reserve Bank, "You cannot make a deduction from the face of the check for exchange."

Mr. Hendricks: Is it not a fair inference, then, if the Federal Reserve Banks are required by law to accept at par that they must accept them at par?

The Chairman: Yes; but the law does not say---

Mr. Harding: The law does not say you must collect them at par. If I were running a member bank I would tell my lawyer to study these two sentences right here---

"Every Federal Reserve Bank shall receive on deposit at par from member banks or from Federal Reserve Banks checks and drafts drawn upon any of its depositors, and



when remitted by a Federal Reserve Bank, checks and drafts drawn by any depositor in any other Federal Reserve Bank or member bank upon funds to the credit of said depositor in said reserve bank or member bank."

And:

"Nothing herein contained shall be construed as prohibiting a member bank from charging its actual expense incurred in collecting and remitting funds, or for exchange sold to its patrons." ---

--- and try to analyze that and see what it covers.

You say that this section is mandatory. If it is mandatory in one line of it it ought to be mandatory all through. It says, "Every federal reserve bank shall receive." That word "shall" is mandatory. Then the last sentence says "The Federal Reserve Board shall by rule fix the charges to be collected by a member bank from its patrons." It does not say the charges that may be collected or are to be collected. In other words, it puts the Federal Reserve Board in the attitude of issuing a regulation to the member banks and saying, "Now, you are going to have some checks drawn on you by your depositors to go to New York or Richmond or Atlanta or Dallas and from such checks that bear an endorsement you shall collect ten or fifteen or twenty cents a hundred. That would be a reductio ad absurdum."

Mr. Foote: I brought a copy of this Mississippi brief. Would you like me to read the comments on this particular section there?

The Chairman: I think we will have to make progress faster than that, Mr. Foote. We will have to adjourn in about ten or fifteen minutes. What we ought to do in order to make progress in this discussion is to agree at the outset that the expression contained in the Second Vote of this committee of this body is or is not correct, and if it is not correct, let us correct it. I do not care whether the vote is stated there in these terms. The effect may be the same, but I do not agree that that correctly states the intention of the law.

Mr. McKay: The point was that the member banks do not expect to charge the Federal Reserve Banks.

The Chairman: No; I think the intention of the law is something like this, that the Federal Reserve Banks must receive these items on deposit and at par. If they receive them on deposit at par, necessarily by implication they cannot stand the expense of the collection charges that may be imposed, and consequently the law provided a method by which the country bank could remit at par for those checks, but could put a reasonable exchange charge upon its own customer as an item of expense.

Governor Wold: I think that is the intention.

The Chairman: And in order that those charges might be uniform and subject to regulation, it clothed the Federal Reserve Board with authority to make a regulation on the subject, stating not what they shall charge, but what the member banks may charge. Many of them may decide to remit at par.



Mr. Foote: That is the view Senator Williams takes.

The Chairman: We are getting pretty close to an agreement, if you gentlemen do not disagree with what has been stated by Mr. Harding as to what the law means. Can we not agree that this second vote does or does not express the intention of the law, for the purpose of our discussion?

Governor Van Zandt: I think that their second vote is sound, in view of the fact that it was based on the theory that that was the intent of the law; that that was what was intended. They do not say that that is what the law states, or says. It is a deduction from the statement of the law.

The Chairman: I agree that this suggests a part of the deduction which I would draw from the law, but not all of it, because this does carry with it the implication that the Federal Reserve Bank may receive on deposit; and, assuming that the present method we are employing is understood to be a legal method, we can charge these checks to the accounts of the member banks as a method of getting par settlements for them. I do not think we have that power.

Mr. McKay: No; it does not mean that at all.

The Chairman: I say that the inference which is stated in this second resolution is not complete enough, because it should specify that par does not mean immediate credit.

Mr. Foote: Deferred credit cannot be classified as par.

The Chairman: Between the two horns of the dilemma we

reach the point where the Federal Reserve Banks buy all the float.

Governor McDougal: It might be well to remind those present of the statement of Mr. Glass as he made it to the committee. He stated that it was unquestionably the intent of the authors of this bill to abolish exchange charges, and, moreover, that it was unquestionably the intent that checks be collected at par. I remember that very well. And he said he would like to have us carry that back with us.

The Chairman: I remember that, too, Governor McDougal, but I do not remember that Mr. Glass undertook to define what par meant.

Governor McDougal: No; I remember that he did not attempt that.

The Chairman: We have a definite and positive ruling from the Board now which is supported by the opinion of the Board's counsel that par, in the language of section 16 of the act does not contemplate that the reserve banks are required to give immediate credit for items deposited with them, no matter where they may be payable, and, on another theory of the law, that if for immediate credit, we would simply be required to buy the float, and we cannot possibly afford to do that.

Mr. Harding: I would like to ask Mr. Curtis a question. Suppose I went to New York and made a transaction, made a deposit with a bank on deferred credit and got credit, say, a week from now, and I had a pass book to show that I



had a thousand dollars in such a bank without any memorandum showing that that was only good for a week from now; suppose I went around and bought something, put up a margin on the stock exchange, and I was not known, and I was asked, "Have you got that money on deposit?" And I say, "Yes." I go around the next day and this is sent through the clearing house and it is thrown bank; it is simply a deferred credit. Would I not be guilty of false representation if there was some slump or the market had gone against me on the proposition?

Mr. Curtis: I think if you knew they had undertaken it for collection and not for immediate credit you would be guilty of misrepresentation.

Mr. Harding: I think so too.

(At this point informal discussion occurred which the stenographer was directed not to report; after which the following proceedings were had.)

The Chairman: Mr. Harding, this meeting is approaching that psychological condition where we generally make progress, and I think we will have to adjourn, undertaking to leave this matter for discussion at a meeting to be called, say, for nine o'clock tomorrow morning.

If there is no dissent from that suggestion we will take a recess until nine o'clock tomorrow morning; and I am going to take the liberty of suggesting that the interests of everyone here really demand that we start promptly at nine o'clock.

(Whereupon, at 5:20 o'clock p. m., the Conference adjourned until tomorrow, Saturday, October 23, 1915, at 9 a.m.)

