

VOLUME I

A CONFERENCE OF GOVERNORS OF FEDERAL RESERVE BANKS

Treasury Building,

Washington, D. C.

November 8 - 10, 1926.

Walter S. Cox
Shorthand Reporter
Washington, D.C.

A CONFERENCE OF GOVERNORS OF THE FEDERAL RESERVE BANKS

Washington, D. C.,

Monday, November 8, 1926.

The Conference of Governors of the Federal Reserve Banks convened in the hearing room of the Federal Reserve Board, Treasury Building, Washington, D.C., on Monday, November 8, 1926, at 10 o'clock a.m.

APPEARANCES:

W. W. Paddeok, Deputy Governor, Federal Reserve Bank of Boston.

J. H. Case, Deputy Governor, Federal Reserve Bank of New York.

George W. Norris, Governor of the Federal Reserve Bank of Philadelphia.

E. R. Fancher, Governor of the Federal Reserve Bank of Cleveland.

George J. Seay, Governor of the Federal Reserve Bank of Richmond.

M. B. Wellborn, Governor of the Federal Reserve

Bank of Atlanta.

J. B. McDougal, Governor of the Federal Reserve
Bank of Chicago (Acting Chairman).

D. C. Biggs, Governor of the Federal Reserve Bank
of St. Louis.

R. A. Young, Governor of the Federal Reserve Bank
of Minneapolis.

W. J. Bailey, Governor of the Federal Reserve Bank
of Kansas City.

Lynn P. Talley, Governor of the Federal Reserve
Bank of Dallas.

J. U. Galkins, Governor of the Federal Reserve
Bank of San Francisco.

G. L. Harrison, Deputy Governor of the Federal Re-
serve Bank of New York and Secretary to the Conference of
Governors.

P R O C E E D I N G S .

Governor McDougal. Gentlemen, Mr. Case has just re-
ported an interview with Governor Crissinger, who states
that the Board will be ready to respond to our invitation
to come in at any time it suits us; that they have been very
busy in the last few days with the other Conference, and I

assume from that, Mr. Case, that if we desire we are at liberty to proceed, and shall invite the Board to come in later on?

Deputy Governor Case. Yes, Governor McDougal.

Governor Fancher. I move that Governor McDougal take the chair and preside as Chairman of this Conference.

Governor Young. I will second that.

(The motion was unanimously carried and Governor McDougal took the chair).

The Chairman. We all regret, I am sure, the absence of our Chairman, Governor Strong, particularly as it is caused by illness, and if it is in order I would like to suggest that Governor Fancher and Governor Seay prepare a suitable message to Governor Strong, expressing our regret at his absence and our best wishes for his rapid and complete recovery.

Governor Norris. I will make that as a motion, Mr. Chairman.

Governor Colkins. I will second it.

(The motion was carried and the following telegram was sent to Governor Strong):

"November 8, 1926.

"Benj. Strong,
"270 Park Avenue,
"New York City.

"The Governors have learned of your recent severe illness with acute regret but are rejoiced to know that you are well on the road to recovery. We all miss you greatly and send our love and best wishes.

"McDougal,

"Acting Chairman."

The Chairman. Now, if it meets with the approval of the Conference, we will proceed with our program in the order of its arrangement. One of the important matters that we will have to consider later on will be the report of the Standing Committee on Collections. It has been customary to invite Mr. Strater, Chairman of that committee, to be present, and since there is a report of that character to be submitted, and also material questions on which Mr. Strater will probably be helpful, will arise, I would suggest that Mr. Governor Fancher communicate with Mr. Strater at once and ask him to be here tomorrow morning. If that meets with the approval of the Conference we will ask

Governor Fancher to do that.

Governor Fancher. I will be glad to do so, Mr. Chairman.

The Chairman. This program is divided into three or four sections. Section 1, Topic 1, is

I. CREDIT TRANSACTIONS AND POLICIES.

A. Open Market Operations.

1. Report of Open Market Investment Committee.

Deputy Governor Case. Mr. Chairman, a copy of that report has been distributed by the Secretary. I might say that the various members of the committee met yesterday afternoon and went over this report, and the report represents the views and recommendations of the Open Market Committee. That report is as follows:

Since the Governors' conference last spring there have been two important changes in the special investment account,-- a purchase of securities between March 29 and April 15, which increased the amount from 210 million dollars to 275 million, and a sale of securities between August 7 and September 15, which reduce the account again to 200 million dollars.

Purchases in March and April.

The purchase of 65 million dollars of securities in March and April was made at a time when business psychology

was pessimistic, when commodity prices were falling, and when there had been a considerable liquidation of credit employed in the security markets, and to a lesser degree in commercial loans. The result of the purchases was to reduce approximately to that extent borrowing by member banks at the Federal Reserve Banks, particularly in larger centers, and to operate together with other causes toward slightly easier money conditions.

Sales in August and September.

As the year advanced no business recession such as had been anticipated by many earlier in the year developed. The volume of trade continued at a very high level, building activity and automobile production were well maintained, commercial loans increased, and the volume of credit employed in the security markets again showed an increase. Money rates showed an advancing tendency and the Federal Reserve Bank of New York raised its discount rate from $3\frac{1}{2}$ to 4 per cent on August 12.

The sale of 75 million of securities from the open market investment account between August 7 and September 15 took two forms; first, the sale of 35 million to foreign correspondents to employ balances created by gold imports into

this country. This sale of securities merely offset the effect of the gold imports. In addition 40 million of securities were sold to the Treasury Department for account of the sinking fund and the effect of this sale on the market was distributed throughout the country as the Treasury withdrew funds from depository banks in all districts to pay for the securities.

The sale of securities was naturally accompanied by a slight further increase in borrowing by member banks, by increased offerings of bills to the Reserve Banks, and by slightly firmer money conditions. The relationship between open market purchases and sales during the year to changes in bills discounted and holdings of bankers acceptances, is shown in the attached diagram.

The Present Credit Situation.

The present credit situation does not appear to indicate the desirability of any change in open market policy. Business continues to be active and the volume of trade is at a high level. The business atmosphere, however, is conservative and there is some apprehension as to the future. There were reports recently of some decline in building and production of automobiles. In recent weeks there has been a con-

siderable liquidation of brokers loans and some slight reduction in the total volume of credit outstanding. The October period of largest demand for commercial credit appears to have passed without credit stringency and, aside from a period of slight ease in the second half of October, money conditions have been steady.

Turn of the Year.

In the past two years it has been found desirable to sell securities in January to take up the usual seasonal slack in credit resulting from the return of Christmas currency and the usual seasonal flow of funds to money centers. Last year a purchase of 50 million dollars of securities was made during the period of greatest currency demand in December, and these securities were sold in January and February. These transactions appeared to have a stabilizing influence upon money conditions, although the amount of purchases and sales was not sufficient to prevent a considerable tightening of money rates at the end of the year and a considerable easing in rates at the beginning of the new year. The committee therefore suggests that this year it may be desirable to purchase up to 100 million of securities during the coming six weeks, to be sold again at such

time as credit conditions appear to make that course desirable. If business and credit conditions continue as at present it would seem wise to sell these securities shortly after the turn of the year, but in the event of a decline in business activity, such as some observers think may occur, it then might be desirable to retain a part of these securities in the Federal Reserve portfolio. In any event we should be prepared for either course.

Temporary Sales of Securities.

At the June 15 tax period the usual temporary sales of securities were made from the open market account to stabilize money conditions, with the result that money rates were steady during the period. At the September 15 tax period the New York City banks were so largely in debt at the Reserve Bank that it was felt that temporary sales would not be necessary and this proved to be the case. The temporary supply of funds in the market, due to the redemption of maturing issues, was offset by the liquidation of member bank indebtedness and money rates were steady during the period.

The exhibits "A" and "B" attached show in detail the distribution of government securities and bankers acceptances among the Federal Reserve Banks; there is also attached

(exhibit "C") statement showing actual earnings of all Federal Reserve Banks for the first nine months of the year 1926 and the estimated earnings for the entire year; also (exhibit "D") a comparative statement of earning asset holdings of all Federal Reserve Banks.

Exhibit "A"

STATEMENT SHOWING PARTICIPATION BY FEDERAL RESERVE BANKS IN SYSTEM SPECIAL INVESTMENT ACCOUNT AND CLASSIFICATION OF ISSUES HELD OCTOBER 27, 1926, IN THE ACCOUNT BY MATURITIES.

	<u>Holdings</u>		<u>Holdings by Maturities</u>
Boston	\$ 8,767,000	December 15, 1926	\$ 42,802,500
New York	52,761,500	March 15, 1927	54,919,200
Philadelphia	4,920,000	June 15, 1927	67,457,000
Cleveland	13,202,000	December 15, 1927	34,821,300
Richmond	5,818,500		
Atlanta	0		
Chicago	26,233,000		
St. Louis	13,725,000		
Minneapolis	8,923,500		
Kansas City	17,995,000		
Dallas	18,467,000		
San Francisco	<u>29,187,500</u>		
	\$200,000,000		\$200,000,000

Exhibit "B"

PURCHASES OF BANKERS ACCEPTANCES FROM JANUARY 4 TO OCTOBER 27,
1926 AND AMOUNT EACH BANK HAS RECEIVED IN EXCESS OR SHORT OF
ITS PRORATA SHARE UNDER APPORTIONMENT PLAN PUT INTO EFFECT
JANUARY 4, 1926.

	<u>Bills Acquired</u>	<u>Bills Entitled to Acquire</u>	<u>Bills Over Pro Rata Share</u>	<u>Bills Short Pro Rata Share</u>
Boston	\$ 104,836,000	94,664,000	10,172,000	\$ 0
New York	315,436,000	318,297,000	0	2,861,000
Philadelphia	106,557,000	108,188,000	0	1,631,000
Cleveland	133,772,000	135,231,000	0	1,459,000
Richmond	70,376,000	70,945,000	0	569,000
Atlanta	70,841,000	71,411,000	0	570,000
Chicago	188,637,000	189,326,000	0	689,000
St. Louis	53,746,000	54,562,000	0	816,000
Minneapolis	56,768,000	57,422,000	0	654,000
Kansas City	80,155,000	81,140,000	0	985,000
Dallas	57,311,000	57,422,000	0	111,000
San Francisco	<u>121,885,000</u>	<u>121,712,000</u>	<u>173,000</u>	<u>0</u>
Totals	\$1,360,320,000	\$1,360,320,000	\$10,345,000	\$10,345,000

The averages shown in the above statement are being adjusted in the usual manner.

Exhibit "C"

STATEMENT SHOWING ACTUAL EARNINGS OF ALL FEDERAL RESERVE BANKS
FOR THE FIRST NINE MONTHS OF THE YEAR 1926 AND ESTIMATED
EARNINGS FOR THE ENTIRE YEAR 1926.

	Actual Net Earn- ings in Excess of Expenses and Dividends, but before Charge- offs, 9 Months Ended Sept.30, 1926.	Estimated Net Earnings in Excess of Ex- penses and Dividends, but before Charge- offs Entire Year 1926.	Estimated Charge- offs for Year 1926	Estimated Net Earnings after all Charge-off Available for Surplus and Franchise Tax for Year 1926.
Boston	\$ 533,345	711,132	137,047	574,085
New York	1,183,296	1,577,724	455,000	1,122,724
Philadelphia	528,870	705,156	38,000	667,156
Cleveland	570,000	760,000	372,000	388,000
Richmond	533,000	710,667	105,000	605,667
Atlanta	936,426	1,248,564	340,327	908,237
Chicago	938,099	1,250,800	660,197	590,603
St. Louis	592,684	790,248	233,591	556,657
Minneapolis	275,612	367,488	95,946	271,542
Kansas City	583,715	778,284	166,024	612,260
Dallas	531,019	708,024	41,296	666,728
San Francisco	<u>1,160,000</u>	<u>1,546,667</u>	<u>662,000</u>	<u>884,667</u>
Totals	8,366,066	11,154,754	3,306,428	7,848,326

The Chairman. You will observe in the report that, beginning at the bottom of page 2 and going over to the next page to the completion of the paragraph, you find the recommendations of the Committee, and it is with respect to that paragraph in particular that we want careful consideration and action by this Conference.

Governor Calkins. Has that report been discussed with the Federal Reserve Board?

The Chairman. It has not been. It has been submitted to the Open Market Committee and has their approval. I think it would be interesting, and probably helpful, Mr. Case, if you would make reference, as you did yesterday, to what transactions took place about a year ago at this time in anticipation of the same situation.

Deputy Governor Case. Last year, and perhaps a little later, in December, there was a real demand for credit existing in our district. The committee recommended the purchase of fifty million. We not only made that investment, but we also had another, and rather difficult situation, with which to deal, due to the fact that of recent years there seems to be a tendency to do considerable window dressing throughout the country, and the burden of that

falls on the New York Bank. Last year a certain amount of such window dressing was required by the calling of upwards of a hundred millions of call loans within the last ten days or two weeks of the old year, and the situation was not too well handled by us. We did not recognize and see it soon enough and as a matter of fact those loans pretty nearly went into one bank, which, in turn, borrowed from us one hundred to a hundred and fifteen million dollars against Government securities. We hope this year to handle that situation in much better fashion; but, as this committee report suggests, we think, because of the extra demand for currency which occurs in December, which usually amounts to a couple of hundred million dollars, plus the desire on the part of a good many banks throughout the country to put their affairs in little better shape and show no borrowings, that it would be desirable for the committee to have power to buy up to one hundred million this year, if need be.

The Chairman. What does the Conference wish to do with this report?

Governor Young. I move that the report be approved and that the committee be directed to furnish a copy of it to the Federal Reserve Board with a statement that it has the

unanimous approval of this Conference.

Governor Seay. That seems a very logical resolution, Mr. Chairman. Last year, if I remember correctly, the earning assets of the Federal Reserve Banks increased about \$250,000,000 in the last two months of the year. They did not do so in the year before, 1924. There appears to be some likelihood that it may happen again, and if for no other reason than to be in a position to sell securities after the turn of the year, when money is likely to become more plentiful by reason of the return flow of Federal Reserve notes and the paying off of borrowed money, it would be desirable to buy at least a hundred million. Coupled with the influence, which Mr. Case has just explained to us, I think it highly necessary that the committee should have that power. I would like to ask Mr. Case if, within the last ten days or so, the committee has not sold some seventeen millions of securities, and what the occasion of that was.

Deputy Governor Case. Yes and no, Governor Seay. We sold 25,000,000 last Friday, an unusual and sudden demand on the part of a foreign correspondent; but that was a temporary sale and that has all been replaced, some of it coming in today.

The Chairman. Governor Young's motion has been seconded by Governor Seay. Is there any further discussion?

(The motion, having been duly seconded, was unanimously carried.)

The Chairman. The Topic 2 is "Policy", with respect to open market operations. The source of that topic is not disclosed here. Do you wish to discuss it?

Deputy Governor Case. Is not your plan to go around the table, Mr. Chairman?

The Chairman. I do not know that that will be necessary.

Deputy Governor Case. The topic relates to open market policy. I think it is pretty clearly covered in the report and I do not think it is necessary to have any further discussion of it. I thought you were referring to another topic, Mr. Chairman.

The Chairman. Then without objection that will be passed

The next is 1 B, Discount Rates and Policies. Does anyone wish to discuss this topic?

Governor Fancher. It would be interesting to hear from Mr. Case with regard to the view they hold in New York as to present credit condition and rates, what their viewpoint is there, together with the foreign viewpoint as well; the

present situation and what they think is before us in the next few months.

Deputy Governor Case. The present credit situation, the economic situation, is outlined, as we see it, in New York, in the second paragraph of this report, on page 2: namely, that business continues to be active and the volume of trade at a high level; but on the other hand there is a more conservative tendency in the business atmosphere and a feeling, certainly in some lines, that perhaps business may not be as active, with a little apprehension as to the future. That is shown in the fact of some report of decline in the building activity^{and} in the production of automobiles.

But the credit situation in New York is really at the present time a very comfortable one. The officers and directors of the Federal Reserve Bank for the last three or four weeks have been following the credit situation very, very closely each week. In other words, it has not been dealt with at all in a perfunctory way, but in a very careful and thorough way to see whether, in the judgment of our directors, there should be any change made in the discount rate, in open market operations, or any thing of that sort. As the result of that very careful examination I think it is a fair statement

that our directors feel that while the situation at the moment is a very comfortable one, it should be continued to be followed very closely, particularly as we get toward the end of the year.

Governor Fancher. I notice, Mr. Case, that the bill dealers have reduced their rates slightly on very long time bills.

Deputy Governor Case. Yes.

Governor Fancher. Does that mean, in your judgment, a little softening of rates, or how do you interpret that?

Deputy Governor Case. There has been a slight tendency that way. You will recall during the summer, going back perhaps to August, money rates stiffened quite materially. Commercial paper was pretty firm at 4-3/4 to 5 per cent., and during the last month there has been a softening tendency and money has been much more plentiful and easy in our market. Call money, which has been ruling at 5 to 5 $\frac{1}{2}$, is now obtained very freely at 4 $\frac{1}{2}$. Commercial paper rates have dropped a bit, ruling now from 4 $\frac{1}{2}$ to 4-3/4, and that is also reflected in the bill rates.

Governor Wellborn. You stated a few moments ago that there is some thought that business is slowing down, that

the conservative element thought business would be slower. I would like to ask if you think that is just a state of mind or whether there are actual conditions that point in that direction?

Deputy Governor Case. I think a little bit of both, Governor. Building activities and automobile production have been running at a very high pace and there are indications that there is a slowing down in those two respects. I think it is a fair statement that when you see that curve in two important lines--I think there was between $6\frac{1}{2}$ and 7 billion dollars expended, or will have been expended in building activities this year--I think when that occurs in two important lines there is just a little feeling of apprehension that it might extend to other lines, certainly if they should go much farther and affect the labor situation, either in building or automobile production, and thereby create some unemployment.

Governor Wellborn. I read an article by Mr. Ayers, of Cleveland, who seemed to take the view that business is slowing down; that it is inevitable.

Governor Seay. He took that same view early last spring.

The Chairman. Governor Talley, what is the situation down in your district?

Governor Talley. The city banks represent 75 per cent of our loans and the country banks 25, I was just thinking, as Mr. Case was speaking, that the balance of trade next year won't run anything like as heavily against us as it has in the past year, which means that there will be a great reduction in expenditures in our district next year, and of course that will mean a great falling off in the consumption of goods that are produced in the other districts, particularly in the northern and eastern districts. The present impression of the country banks is that they will have to borrow a good deal of money next year, but they won't after all, and it would seem that that was rather contrary to the present impression in our district, and would make for an easier credit condition rather than a more stringent credit condition; that a market as large as the Eleventh District for consumptive articles would naturally affect the manufacturing districts and cause a slowing down. I think that would probably be true of Governor Wellborn's district to a large extent and to Governor Seay's District also.

The Chairman. How does your Board feel in regard to the 4 per cent rate down there?

Govenor Talley. At our meeting on September 7th I strongly recommended an increase in our rate of one half of one per cent. The majority of the Board did not feel that it was an oportune time to increase rates, although I think several of the majority group did not view the rate structure as I did, they seemed to think that because our loans were not expanding rapidly at that time that there was no indication that the amount of re-discount would become burdensome, and that in view of the fact that the marketing season was just coming on for cotton, their chief product, that we should not raise the rate. Another view was that one-half of one per cent wouldn't have any appreciable effect. My own position was I did not care whether it was raised one tenth of one per cent, one eighth of one per cent, or one-half, just so it was raised, because I wanted the influence of an increase in the rate to fall directly upon the attitude of the reserve city banks.

In October I repeated that recommendation and added to it that we establish a four per cent rate as a commodity rate, particularly on cotton loans, so as to embrace the cotton loans, and an ordinary rediscount rate of four and a half per cent. That did not meet their

view. I can see nothing in the situation that causes me to change my view, but subsequent developments rather confirmed that view. That is illustrated, briefly, by the fact that our loans declined ten million dollars after the peak and then increased four or five million dollars after the low point, and that was exactly the period when the increase to rates should have applied. I want to say that I personally feel that we are operating — not like a ship without a rudder, because we are using the rudder rather freely to steer around some points that look rather shoaly — but I will say that I feel like we are operating sometimes like a ship without a compass and do not know just where we are going right now. We have to intensify our administrative control, and I think that would be especially true along in the early spring months.

Deputy Governor Case. You stated that the Board did not approve of your recommendations. Do you mean your own Board?

Governor Talley. Our own Board, yes.

Deputy Governor Case. It never went to the Federal Reserve Board?

Governor Talley. No, except as a matter of record in the minutes of the meeting.

Governor Fancher. May I ask Mr. Case about the foreign situation?

Deputy Governor Case. Mr. Harrison is our foreign expert in these matters, and if you have no objection I will pass that question on to him.

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

The Chairman. It would be interesting to know from anyone here as to whether they think conditions in their district justify an increase in the rate?

Governor Norris. In view of the interesting statement of Governor Talley, I would like to hear from Governor Biggs as to whether, in view of the low reserve ratio in the St. Louis Bank which has existed for some time they have given any consideration to a change in the rates.

Governor Biggs. It was given consideration last Wednesday by our Board and there seemed to be no question but what we were doing the right thing in not changing it.

The Chairman. What is your reserve ratio, Governor

Biggs?

Governor Biggs. About 53.

The Chairman. Does that reflect a demand from the city or the country?

Governor Biggs. Our reserve percentage has been running around 53, 51, 52 and 53. We have kept it that way all through the season. Two or three times it got below 50.

The Chairman. That does not reflect a demand from your member banks?

Governor Biggs. Not at all.

Governor Norris. I was under the impression that for a number of weeks St. Louis had not participated in the purchase of bills, but had sold them at times.

Governor Biggs. We did sell them to keep from getting too low in our reserve. I think I can explain that pretty well. The Little Rock Branch is borrowing \$3,473,000, Louisville \$7,740,000, Memphis \$7,148,000, and St. Louis \$19,377,000. The change is very little, with the exception of St. Louis. A year ago they were borrowing ten million and now they are borrowing about twice that. Our smaller banks are paying off but our

larger banks are borrowing rather freely. They are having a rather good demand for money.

The Chairman. What are your total loans to member banks now?

Governor Biggs. Forty million.

The Chairman. If there are no further comments we will go to the next topic.

Deputy Governor Case. Mr. Chairman, before passing to the next topic, on the question of discount rates, it might be interesting to have a little discussion as to the policy of the Federal Reserve Banks in dealing with member banks in their demand for credit, as to methods employed, and so on. I would like to say a word or two as to what we have done in New York. While I do not mean to imply that there has been any tightening of credit, I think it is a fair statement to say that we have been giving perhaps a little more intelligent and closer scrutiny to applications for credit. I think it was about a year ago when Professor Sprague, who was here, and who made a report to the Governor's Conference on his survey of conditions throughout the country of Federal Reserve Banks, commented quite freely on the number of banks which were really continuous borrowers. I think he pointed out that

there were some 800-odd member banks that had been continuously in debt for a year or more. Now I recognize very fully and frankly that conditions in our district are very different from those which obtained in many other districts, in districts like that of Governor Bailey, Governor Biggs, Governor Talley, Governor Wellborn, and so on, but we have been scrutinizing our applications more carefully and have set up a procedure for the prevention of misuse of credit. We have been following up those banks that were continuous borrowers. Beginning with the first of the year we had some 22 banks in our district, only 22, that had been continuous borrowers, that had been continuously on our books for a year or more. We reviewed the situation in each particular instance and we found, frankly, that a number of banks were borrowing, not because they needed money, but because they thought it was profitable. There was a spread between our rate and what they could obtain. Now we have been gradually dealing with those banks until today that list of banks that have been continually in our debt for a year or more has been reduced to two banks, and we are working on those. Those are banks that were not in very healthy shape, but we hope and believe

that we will have those banks off our books entirely by the end of the year. We believe that we will not, at the end of the year, have any banks in our district that are borrowing continuously. We submit to our directors weekly full information in addition to the usual list of applications and statements of the borrowing banks in Manhattan, and incidentally, as a matter of information we carry the amount of their Street loans on that paper, so that we can see to it that none of our city banks are steady borrowers, and particular where they have investments that would enable them to adjust their position without recourse to us. Then we review those banks that have been continuously in debt for a year or more. They come up before our discount committee each day, and then they are presented to the executive committee and our board of directors each week. I want to say that I think this method of presentation has not only been helpful and useful to the directors in keeping them informed of the situation, but it has been educational and helpful to those of us who are responsible for the loan operations. We also show the banks that are borrowing in excess of their capital and surplus. Now on our last report we had about seven banks.

Five of them were just current borrowings and, beginning in the month of October, where they had adjusted their reserve position and were temporarily borrowing in excess of their capital. One was in September, a bank borrowing \$127,000 with a capital of \$65,000; another bank that had been on since June, a bank in an agricultural section, borrowing a hundred thousand against a capital of \$60,000. In addition to those lists we have a list of banks that are on our special list, which are not in good condition and which we show up separately. I might say that while that list is perhaps 18 or 20 in number, there are but six of that group that are borrowing from us and as a matter of fact they are only borrowing about a million dollars. I do want to say that as a result of this more intensive study, the presentation to the discount committee and to our officers and directors, our feeling is that what we have done in that regard has been very helpful all along the line.

The Chairman. What has been your experience in regard to this matter, Governor Seay?

Governor Seay. There are some thirty or forty institutions in our district which have been borrowers for

a year or more, some of them for several years. They claim, in some cases, that it is still the result of the credit crisis of 1921. We have had these banks under discussion with our directors, and in September of this year, under authority of our directors they were communicated with to the effect that we should expect them to liquidate their accounts during the current year, in the absence of any emergency. I am quite sure that those banks have been profiteering. They have been advised that it is opposed to the policy of the directors of the Richmond Bank to permit continuous borrowings; that while the Federal Reserve Bank of Richmond was prepared to grant them reasonable seasonal accommodations, and help in emergencies, that it was opposed to the principle of the Federal Reserve System to permit banks to continue to borrow continuously for the purpose of profit. We have practically taken about the same action as that taken by the New York Bank, we have taken it up directly with each individual bank and definitely advised them that we viewed with disfavor continuous borrowing and, as I have stated, we have told them that we expected liquidation from them within a reasonable period.

Governor Wellborn. I wish to say, Mr. Chairman, that

I have been very much interested in the statement of Mr. Case. We have been working along those lines ever since our bank has been established. We had quite difficulty in holding quite a number of banks down to borrowing moderate amounts, and we finally decided that it would be the best policy, and announced to them, that we would lend them no more than their capital and surplus. We do not make that a rigid rule, but we want it understood because we believe that doing it would be a violation of the Federal Reserve Act. Of course in emergencies we go the limit to aid a bank.

The Chairman. How many borrowing banks have you down there?

Governor Wellborn. We have about 220 borrowing banks.

The Chairman. How many of those banks do you suppose are borrowing more than their capital and surplus?

Governor Wellborn. I think there are about fifteen. By the way, only three of those banks are in Florida. About the middle of September or first of October I send a form letter to all of these agricultural banks that are borrowing pretty heavily, that we want all of them to pay up in the Fall and clean up before the first of January.

We keep after them continuously. In a year like this, when they have a slump, they come back with their tales of woe and we tell them that they can substitute commodities for unsecured paper, which seems to be agreeable to them.

Deputy Governor Paddock. In the First District we started after this situation a year and a half ago. At that time we had 26 banks which had been continuous borrowers for over a year. That number has been reduced to about half. We have not gone after it formally, but we have had in mind those banks which were borrowing larger amounts and we have taken it up with them by conversation, when they happened to be in, or when we happened to be visiting a bank, and we have had no difficulty in getting them down when we have talked with them. With us the continuous borrowers are mostly those who use governments as collateral. Of course that makes a difference in our attitude in handling them. We bring those cases up just about the same way that New York does. We have a list which comes up every two weeks for careful consideration. We also have a list of banks in the district which we call our special list, banks which are not in the best condition, but I expect within the

next six months all of those banks will be out of debt and will get a fresh start.

The Chairman. How many member banks have you?

Deputy Governor Paddock. 420.

The Chairman. How many are borrowing?

Deputy Governor Paddock. Less than 200.

Governor Calkins. We have dealt with the matter of continuous borrowing at all times without any set rule, reviewing each case according to conditions and dealing with each case by itself. With very few exceptions the banks that are in the continuous borrowing class with us are banks which have not recovered from the acute slump of 1920 and 1921. Those banks are being encouraged to work themselves out to a point of liquidation as rapidly as possible. The condition of each borrowing bank is before us at all times when we consider applications.

There was one matter, which was indirectly referred to, about which I would like to hear some reports. Governor Talley indicated, and I think Governor Biggs too, that borrowings in their districts are mainly borrowings by city banks. I am wondering whether that is a general condition throughout the country, as I believe it is, that the prin-

cipal borrowings from the Federal Reserve Banks are city borrowings and not country borrowings; that there has been a rapid and almost continuous increase in the last year and a half in the borrowings by country banks and a considerable tendency to increase borrowings by city banks. I wonder whether that is true throughout the country.

Governor Wellborn. That is true in our district.

Governor Seay. It is not true of our district at this time. The burden of the country banks has shifted to some extent to the city banks, but that is not true in our district. It happens periodically, but not continuously through the year. The banks to which I refer are all country banks.

The Chairman. Mr. Case, your loans of course are very largely with city banks. The question is whether or not the demand that you usually have comes from the country or city correspondents.

Deputy Governor Case. I think it is a fair statement to say at the present time that it is pretty well diversified. Our city banks are borrowing at the present time comparatively very small amounts. Last week our total was \$46,000,000. It is a fact that it fluctuates, that normally

our city banks collectively borrow approximately a hundred million dollars but just at present the amount is materially below that.

Governor Biggs. Our city banks are borrowing quite heavily now. Sixty per cent of their borrowings are on Government securities. They bought Government securities very heavily for some reason. I do not know what started it, but one bank went in and bought eighteen million, another bought twenty million. Three or four of the big banks bought them, they do not want to sell them at the present time, they have had their seasonal needs and requirements to take care of and have been borrowing on these Governments. It is only temporary because next week they may all be out. One bank will come in for ten million and be in in three or four days. In following up Mr. Case's statement I want to say that we follow the same plan with our directors. They are informed at every meeting of the number of banks that are borrowing over their capital and surplus. Eight or ten of them have not been able to get out. We have not increased their loans. We finally get them reduced, but we are not pushing them too hard.

Deputy Governor Case. Do you also give the direct-

ors a list of your continuous borrowers?

Governor Biggs. Oh yes. They have that right in front of them. For instance, if there is a bank in Arkansas, and we have several down there, then our Arkansas director is going to ask questions about that. The same is true with regard to Louisville and Memphis. We keep in very close touch with our weak banks. We have as many as two or three of their officers come in to see us and talk the situation over. If things don't look good, they tell us that such and such a condition exists in their particular territory, and sometimes we will send a man out to investigate that and find out what other banks in the territory are doing. In one or two cases we have found that one bank would be overextended and that right in the same county another bank would be running along fine. That is a question of management. In every case you will find it is a question of poor management. We are working at those things continuously and I would say we have about ten of those which are over what we call the danger line in good banking.

Governor Talley. I think the disparity in the amount of borrowings by our Reserve city banks as compared with

our country banks is easily explained in our case. In the active borrowing season we had a good many of the country banks coming in with rather extravagant programs laid out, which programs we declined to become a party to. We rather pegged those loans and in most cases we pegged them rather definitely. Then we would go into what we considered the fundamentals of their situation and would, in most cases, sell them, at least on the principles, and then they would close with the remark that they had to lend money in their community because they had to make a crop in their community. Then they would say that if that was all the money that we were willing to advance that they could get what they needed from their correspondents. We would then say that we were just as much concerned with the amount of their borrowing, regardless of the source from which they obtained the advances. The country banks then went to the city banks and the city banks made advances from entirely different considerations, it seemed, from what we did. We always try to have due regard for the result of excessive borrowing to the borrowing bank and also to the community in which it is located. The reserve city banks, largely through objective influence, seem to make advances on the basis of the charac-

ter of collateral that they receive and the type of bank that they were lending to. Of course we realized, or though we did at the time, that the more credit absorbed outside the easier it would be for us, and that has been confirmed in view of the fact that the reserve city banks now are talking rather glibly about materially reducing their advances as a matter of general policy. Now the unliquidity of the country bank loans in the reserve city banks has caused them to borrow indirectly to carry their cotton exporters. Ordinarily at this time of the year, with liquidation of bank loans they can carry their cotton exporters very conveniently, but now, with the unliquidity of the country bank loans in the city banks, it has made it necessary for the city banks to borrow rather heavily from us, unusually heavily, in order to carry their cotton loans. Of course the cotton exporter has taken on just as much cotton as he can finance. In some cases I have known they are buying cotton at five dollars a bale under the quotation, which gives them an immediate profit of five dollars a bale on their hedges and naturally they are taking on just as much cotton as they can. The mill demand has been very brisk because they realize that they can purchase low priced

cotton and make a profit out of it. I think the reserve city banks will be pretty well cleaned up with us by the middle of February.

The Chairman. How many have you?

Governor Talley. 194 borrowing.

The Chairman. How many banks have you altogether?

Governor Talley. 845.

The Chairman. And only about 200 borrowing?

Governor Talley. 194 borrowing banks, fifteen of them reserve city banks, and 179 country banks.

Governor Fancher. Mr. Chairman, the discussion has taken on two phases. First going back to the matter of extended banks, the list of extended banks is before our discount committee each day. The beginning of this year we had about 35 banks that had been our books more than a year. Quite a number of those banks were borrowing on governments. That number has been considerably reduced. In some sections of our district we had an unusual wheat crop, which enabled the country banks to pay out. We have only a few cases where the banks are pretty badly frozen and we are fully informed as to the reasons for that. The depressed bituminous coal situation has resulted in some of our banks, in

parts of our district, having a very hard time to get along. Their deposits are off, their loans are frozen, but that condition has made a marked change for the better in the last two months or six weeks, the mines have reopened and the price of coal has advanced very markedly. There is a great boom in the bituminous mines. If that should continue through the balance of the year I think that several of our frozen situations would be liquidated.

Then we have another list of banks that are not in a healthy condition, in a satisfactory condition, and that list we have before us. We have 853 member banks. About 300 are borrowing. Our total loans to member banks at the close of last Friday night was \$69,000,000, of which fifteen million were loans to country banks and 54 millions to city banks. Our increased borrowings have largely come from that source. Our loans on the 1st of May were about 69 million dollars. They were liquidated down in July to 30 million. They increased since that date to 70 million, and the increase from July to the present time has largely been the borrowings of the city banks. Our country banks have not increased their borrowings more than two million dollars and the city banks have increased

their borrowings nearly forty million dollars, although our borrowings are not as much in the aggregate as they were a year ago.

Governor Morris. We have a total number of banks in the District of 760, member banks. 320 of those member banks are borrowing. During the last month our total loans have been about 45 million, of which 15 million, or one third, has been to the city banks, and about 30 million, or two-thirds, to the country banks.

Owing to the absence of the reporter the latter part of topic I-B and all of topics I-(c) and I(j) were discussed off the record.

The Chairman. I would like to go back one moment to the subject we discussed a few moments ago. It was interesting to hear from those present as to the conditions in respect to chronic borrowers, and it would be a good thing, I believe, for all if we could come to these conferences prepared to give definite figures in respect to the number of banks in the district, the number of borrowing banks, and the number of those that are continuous offenders in the respect of borrowing.

Deputy Governor Case. It would be interesting if that were made on a comparative basis each year.

The Chairman. Yes, and I would say, that perhaps to bring similar figures for the six months previous, or a year. That is a suggestion. Do you want to act on that? If so, let some one make the motion.

Governor Wellborn. I so move.

Governor Norris. Will you restate the motion?

The Chairman. That the members of this Board come to these conferences prepared to give definite figures in respect to the number of banks in their districts, the number of borrowing banks, and those banks which have been borrowing for a year or more.

Deputy Governor Case. On a comparative basis.

Governor Calkins. As pointed out, the list of those borrowing continuously for a year or more is not complete, as many of the banks get off the list once a year and then get back on again.

The Chairman. The next topic is L-(d). Discussion of the report of the Agents Committee on Member Bank Reserves with a view to considering whether now is the appropriate time to seek legislation concerning those features of the report which the governors have heretofore approved in principle. (See paragraphs 3 to 13, inclusive,

of the Secretary's Minutes of the November 1925 Governors' Conference.)

That is another New York topic.

Governor Calkins. That is rather a long topic and as it is now half past 12, had we not better adjourn?

Governor Morris. We probably would not have time to finish that, but probably we would have time to finish L-(E), and if agreeable I move we pass D for the present and take up E.

The Chairman. L-E is: Discussion of further steps which might be taken by Federal Reserve Banks to prevent member bank failures.

This is from Atlanta.

Governor Wellborn. I have prepared a paper containing of my thoughts on this subject and if there is no objection I will read it.

The Chairman. How long is it?

Governor Wellborn. It will only take a very few minutes to read. It is headed "Should not the Federal Reserve Banks play a greater part in the prevention of member bank failures."

In the caption to the Federal Reserve Act, we read

that this legislation is "An Act to provide for the establishment of Federal Reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes."

I want to call particular attention to the last named of these stated aims, namely, The Establishment of a more effective supervision of banking in the United States, and I want each of you gentlemen to ask himself if we have done our full duty toward realizing that aim. It is needless for me to point out that the Federal Reserve System is at this time, so to speak, on trial before the people of the United States. The matter of charter renewal is now before Congress, incorporated in the McFadden Bill, and you may be certain that the political enemies of the System -- many of whom wield a very powerful influence -- are examining our record with a microscopic eye, and will hold up to the public view any shortcomings or deficiencies they can find. Accordingly, it is up to us to do all within our power to see that the System as a whole and the individual reserve banks meet squarely and competently the enormous public responsibility that has been placed upon us. It is impossible

of course, that so young an organization as the Federal Reserve System, charged with the financial administration of a great nation and subjected almost at birth to the stress of abnormal conditions, should work smoothly in every detail. Defects in the machine are bound to show up, from time to time, and it is our duty to benefit by experience and to correct such faults as the passage of time may develop.

When the System was established, it was in the minds of the public that the Federal Reserve Banks could and would to a greater extent prevent bank failures. The large number of failures that has taken place in the past five years has tended to dissipate this confidence. In conversing casually with those not connected with the banking business, I find that they are surprised at the number of failures among banks which are members of the Federal Reserve System. We have always urged state banks to become members, and we have consistently told them that the time would soon come when the public would learn to discriminate between banks that belonged to the System and those that did not. It is undesirable that the large number of failures in the past five years has robbed this argument of much of its force.

I feel quite sure that every Federal Reserve Bank has taken the proper interest in their members which get into an extended condition, and that the Federal Reserve officers usually go as far as they think they safely can to help the member banks. Perhaps sometimes we might stand back of them to a greater extent but for the fear of risking a loss. All of this, of course, is a matter of judgment in the administration of each Federal Reserve Bank. In his discourse before the Governors' Conference last March, Hon. Newton D. Baker expressed the opinion that it might be better for the reserve banks to take some risk and lose some money rather than that the Federal Reserve should "be in a state of rigidity with regard to banks that are in trouble." I believe that Mr. Baker put the matter very frankly, and that in the main he is right. When we find a member bank in trouble, we are like the doctor to whom a patient comes for aid. We ought to give the closest attention and study to every case, and take the greatest interest in the welfare and financial recovery of that member bank. Of course I do not advocate the rediscounting of worthless paper, or the throwing away of money in a case where there is not a reasonable chance that the institution can be saved. But,

in order to be of real value, there are times when a reserve bank simply has to risk a loss. The regional banks were not created as profit-making institutions; and when, in the calm and deliberate judgment of reserve bank officials, a member's failure would have a serious effect upon its community, when we are convinced that its officers and directors are capable and honest and willing to cooperate with us to save the bank from a situation that arises through adverse conditions, and when there is a reasonable chance that a further advance from the reserve bank will pull the member through, in such circumstances I think we are only fulfilling our duty and justifying our existence when we make the advance that the member bank requires. When our judgment is vindicated by events and the bank is saved, no loss is entailed upon anyone and the community has been preserved from the hardships and suffering that go hand in hand with failure.

It seems to me that the large number of failures among member banks in the past few years has attracted the attention of the public. In the list that follows, I give the total number of such failures in the United States by years from 1921 to date:

<u>Year</u>	<u>Total</u>	<u>National</u>	<u>St. Member</u>
1921	56	40	16
1922	39	29	10
1923	110	77	33
1924	159	123	37
1925	146	118	28
1926 to Oct. 15th	89	74	15
	<hr/>	<hr/>	<hr/>
Total	589	453	136

The largest number of failures of national banks in any five consecutive years prior to 1923 occurred in the 5-year period ending October 31st, 1897, in which there were 187 such failures.

The Chairman. What are your recommendations, Mr. Wellborn, with the view of preventing bank failures?

Governor Wellborn. Well, that is a matter that I simply wanted to call to the attention of the Conference. It is a matter for us to work out ourselves, and I think we should pay a little more attention to it, perhaps. We have done our best but sometimes I have said to the committee while we have done our best we have not done our very best, and perhaps some banks have failed that perhaps we should have

gone a little further to save. It is a matter of judgment and I have no panacea to offer, but I think it is remarkable that so many banks have failed, and it has the effect of preventing good State banks joining. If National banks fail they can well take the position that they have no particular reason for joining, there is no very good talking point towards inducing them to join.

The Chairman. Are there any other suggestions from any source?

Governor Norris. I have one. I am in agreement with everything that has been said in Governor Wellborn's statement, but I think the emphasis should be put upon the importance of preventing a member bank from getting into a desperate situation rather than helping it out after it has got there.

Governor Wellborn. I agree with you on that, and I think that is one thing we should give careful attention to. We should probably do as Mr. Baker pointed out in his discourse last spring; instead of sending the examiners to a bank when we see the first indication of trouble I think we ought to send some executive officer from our bank and take that bank at the very beginning, and take a deputy

governor or cashier of the bank, one that sits around the executive committee and knows the policy of our bank, and see if the cause of the trouble is excessive borrowing or mismanagement. That is one of my ideas of correcting the situation. Of course after a bank gets in trouble it is very difficult to correct anything; but I think at the very inception of it, when we see that a bank is liable to get into trouble, we ought to take active measures by our executive officers, and otherwise I want to see us do all we can to prevent bank failures.

Governor Norris. We have a record in the third district that I imagine is not touched in any other district, except possibly the first and second. In the twelve years since the institution of the Federal Reserve System we have only had two member banks closed, and one of them reopened. So there has only been one bank failure in the district in twelve years. Now, a very small part of that is to our credit. Over 99 per cent of it is due to the intelligence and care with which the banks of the district are operated. But we watch them very closely all the time, and whenever we see any evidence of the existence of practices or the holding of an office by a man who does not seem to be quali-

fied, we take it up with the bank ourselves and in the case of a National bank we get the Chief Examiner to put them on the list for special examination and make an immediate examination, we tell him what our doubts are and get him to have his examiner emphasize those points with the bank. If it is a State bank we do the same thing with the state banking department, and we try to catch all those things at the very beginning, the moment we see evidence of anything that may in the future get the bank into trouble I think that has been of some little help in bringing about the record we have in the District.

Governor Wellborn. You have a magnificent record.

Governor Seay. I imagine if a list were made of those banks which have been prevented from closing by the Federal Reserve Bank, by advice or other assistance which they had no right to expect, it would make a very respectable list in comparison with the numbers on the list of failed banks. It is our experience at the banks which failed, failed not only from bad management but from mismanagement, and in some cases it has been a question with us whether it would not have been a good thing for the science of banking if more of them had not been allowed to fail. When I say

prevented from closing I mean temporarily prevented from closing. It is a question of change of management in many cases, a bank may have to close if there is no change of management.

The Chairman. The most important factor in contributing to the failure of something like 3,000 banks in this country since 1924 has been inefficient management. It seems to me that there are two things that might work towards the accomplishment of what Mr. Wellborn desires. One, greater caution in the matter of granting bank charters, or care in granting them, and the other is a close relationship and complete cooperation with the State and National bank examining authorities. Those two things I think are worth while considering.

Governor Seay. Mr. Chairman, there is one thing I would like to call attention to and that is that Federal Reserve banks have no power over the management of the banks except a moral power, the influence they may exert, and very often it is a great responsibility in keeping up mismanaged banks, banks that have gotten themselves into a desperate condition from mismanagement.

Governor Calkins. And they have no control over the

granting of charters either to National or State banks.

The Chairman. We have a situation in the State of Iowa where a few years ago they had not less than 1900 banks. They have had a great many bank suspensions but Iowa, on the whole, is in good condition and the banks, generally speaking, have been in good condition; the banks that have suspended and the large number of banks in that territory now that are in unsatisfactory or desparate condition find themselves there because of inefficient management. That is the greatest factor that contributes to their condition at the present time, and I think the State authorities and National authorities should exercise more care in the granting of charters, and that could be stopped at the beginning.

Governor Young. Has not that been handled pretty well in the last few years?

The Chairman. It has been handled pretty well in our district.

Governor Bailey. The economic conditions following the War are responsible for the whole thing. They were almost negligible after we got over the flurry of 1907 up to the beginning of the War or after the War. I was going to say

that I know of men in my district who had a wonderful record -- and the same is true of Iowa --but the inflation just swept them off their feet; and of course everybody got pinched some; but I think it is more the aftermath of the War than the shrinking of values. Men who thought they had an intrinsic value of \$15 a hundred in steers had to sell for six or seven dollars a hundred.

Governor Seay. Inexperience and incapacity are what call commercial failures, and bank failures also result from inexperience and incapacity. The public has got to learn, even by a severe lesson, that competence and proper management is the only safeguard to a successful banking business, and that the banking business, like most everything else, is a question of the survival of the fittest.

The Chairman. Does this discussion satisfy you, Mr. Wellborn?

Governor Wellborn. Yes, it has been very good.

Governor Young. I move that we take a recess until 2 o'clock.

(The motion prevailed, and at 12:50 p.m., a recess was taken until 2 o'clock p.m.)

AFTER RECESS.

The Conference reassembled at 2 o'clock p.m., at the expiration of the recess.

The Chairman. Gentlemen, are you ready to proceed?

1. CREDIT TRANSACTIONS AND POLICIES.

- D. Discussion of the report of the Agents Committee on Member Bank Reserves with a view to considering whether now is the appropriate time to seek legislation concerning those features of the report which the Governors have heretofore approved in principle. (See paragraphs 3 to 13, inclusive, of the Secretary's minutes of the November, 1925, Governors' Conference.)

The Chairman. The next topic I believe on the program is I-D: "Discussion of the report of the Agents Committee on Member Bank Reserves with a view to considering whether now is the appropriate time to seek legislation concerning those features of the report which the Governors have heretofore approved in principle." That is put on by New York.

Deputy Governor Case. The idea of this topic is to consider whether we should seek now legislative enactment dealing with those recommendations which were approved in principle at the last Conference. The Agents' Committee made a very careful study of this question of reserves/

a number of years. Their report was submitted nearly a year ago to the Joint Conference, and this was put on merely to see whether the Conference was not ready to act upon it.

The Chairman. It might be well to point out the specific recommendations. I suppose you have them; if you have not, I can give them to you.

Deputy Governor Case. Well, go ahead.

The Chairman. The report recommends that the requirements of the Federal Reserve Act relative to member bank reserves shall be changed as follows:

1. Deduction of Checks in Process of Collection.

Permit the deduction from demand deposits of (a) exchanges for clearing house, (b) checks on other banks in the same place and (c) checks in process of collection (whether with Federal Reserve Banks or correspondent banks) according to Federal Reserve schedule of time required for collection of checks.

2. Net difference of amounts due to and from other banks.

Retain the present provision of the law that "the net difference of amounts due to and from other banks" shall be taken as the basis of ascertaining the net amount of bal-

ances due to banks.

3. Increase in Reserves against Bank Balances.

Provide that the reserve required to be held against net balances due to banks be 10 per cent. for all member banks except those in New York City and Chicago. This involves an increase from the present requirement of 7 per cent for country banks.

4. Reserves against Government Deposits.

Provide that reserve shall be carried against Government deposits at the same rate as against demand deposits.

There may be some other recommendations in that report, but if there are I do not know what they are.

Deputy Governor Case. But you have the recommendation here.

The Chairman. At the last meeting this report on the agents was considered and acted upon, but, as I remember it, Mr. Case, it was thought that the time was not opportune to ask for legislation where such legislation would be unnecessary. Isn't that it?

Deputy Governor Case. Yes, as to certain items. As to others, we concurred in the recommendation of the committee. I am not at all sure whether that recommendation included the

idea of getting a new report.

Governor Seay. Mr. Chairman, I have a letter which I should like to read, which bears on this subject. You will recall that there is what has been claimed an advisory committee on legislation, the exact standing of which I have been unable to determine to my own satisfaction, although I am its chairman. That committee was working in connection with Professor Sprague under the Federal Reserve Board itself. I would like to read, therefore, a short letter from Professor Sprague bearing on this subject. I wrote him and asked him if he had any report to make to this committee, and he replies that:

"I have no definite proposals to bring to the attention of the Advisory Committee on Legislation at the present time. The present Congress will have no time for any banking legislation other than the McFadden, and the slight interest of the Board in the proposals made last year does not encourage the formulation of further suggestions.

"While in Maine this summer, I made some study of the simple savings assets segregation system in that State. It seems to be regarded with satisfaction by bankers, and to give a reasonable measure of security to the depositor. I

am more than ever convinced that the Maine law might well be taken as a model for national legislation, but the time does not seem ripe for making any move in the matter."

Then again a letter in reply to one from me to the Secretary of the Board:

"I acknowledge receipt of your letter of the 5th instant, in which you ask whether Professor Sprague has made any formal reports on the matters which were referred to him for study which come within the activities of the Advisory Committee on Legislation.

"Since the submission of his reports which formed the basis of the Board's letter to the Banking and Currency Committee, with respect to the McFadden Bill, the contents of which you are familiar with, no formal reports have been made by Professor Sprague.

"During the spring, we referred to him and to one or two officers of the Board a matter concerning the Board's organization and subsequent to the rendition of that report the services of Professor Sprague were discontinued, as there were no other matters before the Board requiring his expert advice."

That I refer to particularly was Professor Sprague's

opinion that the present Congress will have no time for further legislation other than the McFadden bill.

Governor Case. The McFadden bill is the most important outstanding piece of legislation to be considered by Congress. It seems to me it would be a mistake to inject any new element into this short session. We ought to defer action, so far as Congress is concerned, until after this McFadden bill is gotten out of the way.

Governor Seay. Personally I thought the same way about the matter, and therefore thought that this subject might be held in abeyance, probably.

Governor Norris. Is it agreeable to you if we pass it, Mr. Case?

Deputy Governor Case. Yes. Mr. Harrison I know has an interest in this topic and he has carried on some conversations and correspondence with Mr. Curtiss. It might be interesting to get his view about that, Mr. Chairman

Mr. Harrison. Mr. Curtiss wrote me some time ago when he was preparing or aiding in the preparation of the program for the Agents' Conference, and asked whether we desired to put the topic on our program. It was his feeling that as long as the Federal Reserve Agents and the Governors'

Conference had last fall each made separate recommendations to the Federal Reserve Board, and as long as the Federal Reserve Board had not acted on either set of recommendations, it might be advisable to bring the matter up again, first, to determine whether now is an appropriate time to ask for legislation about these matters on which there is agreement, and, second, whether or not now is the right time to ask for legislation, we might not reach some common point of view about the question of reserves, so that we could present a system front when the appropriate time does arrive.

Now, there are before us specific recommendations that were taken up a year ago. The Agents' Conference approved all four recommendations of the committee. The Governors' Conference differed in principle as well as on the question of legislation, on what the Agents considered to be the most important topic. That was the first one to which Governor McDougal referred. In order to recapitulate, I might read that particular recommendation again:

"Permit the deduction from demand deposits of (a) exchanges for clearing house, (b) checks on other banks

in the same place and (c) checks in process of collection (whether with Federal Reserve Banks or correspondent banks) according to Federal Reserve schedule of time required for collection of checks."

The Governors' action on that topic was that, in the opinion of the Conference, the recommendation of the committee is inconsistent with the fundamental principle that a check in the process of collection is not a balance due from a bank, and that therefore the recommendation should not be approved.

The Agents' Conference on the other hand approved that recommendation of the committee, and I think unanimously, and recommended to the Federal Reserve Board that they adopt it by ruling, if possible.

Mr. Curtiss feels that it can be done by ruling, and that we have never been advised by the Board's counsel that that is impossible. While I am not certain as to that, it is my impression that Mr. Wyatt has ruled that we cannot do it by a ruling, and that it does require legislation; but the Governors, you will remember, discussed whether this principle to which they referred in acting on this recommendation, is not equally applicable to the

present provision of the law which authorizes that same deduction in the case of those banks which have got balances due to other banks. . . It is my memory of the discussion that when that question was pointed out to the Conference, it was stated that there was no use in making a bad principle any worse by extending it. That is the way the matter was handled by the Governors' Conference.

But here is the point. It is one of the most contentious matters on the question of reserves now before the System, and you have two different bodies of the System making diametrically opposite recommendations. If the appropriate time for legislation arises, what is going to be the position of the System in the matter? I have a feeling that the Agents perhaps will reaffirm their earlier decision. It might be that the Governors would want to take up the question again and reaffirm their judgment on the matter.

The only other questions which came before the Conference were those Governor McDougal refers to, and in each other case the Governors agreed with the recommendation of the Agents' committee in principle, but suggested deferring any action because they thought it was an inappropriate time to ask for legislation.

It is our feeling in New York that the McFadden bill is in such a precarious situation at the moment that any further request for legislation relating to the Federal Reserve System might only muddy the waters and seriously endanger the enactment of the McFadden bill, without accomplishing anything on the other matters.

Governor Seay. Mr. Chairman, I offer the motion that it is the consensus of opinion of this Conference that now is not an appropriate time to seek legislation concerning the report of the Agents' committee on member bank reserves.

Before putting that, I would like to say that all of you I am sure are aware that the Chamber of Commerce of the United States has appointed a series of committees, consisting of bankers all over the country, to consider different phases of the Federal Reserve Act. I know that I have been held up by members of two of these committees to answer questions which practically would involve writing a thesis on the Federal Reserve System. So they are studying those matters and bringing to bear the wisdom of the bankers over the country. But I share the opinion that has been expressed here that it is not an appropriate time to seek legislation, and that it is the consensus of this meeting

that we give it to the Board.

The Chairman. Do you offer that as a motion?

Governor Seay. I offer that as a motion; yes, sir.

Deputy Governor Case. I second it.

Governor Norris. I think we are all in agreement with that motion, but I think we ought to consider whether it might not be in line to amend it in line with Mr. Harrison's suggestion, that, granting now is not the appropriate time, it might not be well to have something in the nature of a conference committee between the Governors and the Agents and see whether they could come to an agreement on those points to which we are at present opposed, so that when the time does become appropriate, which might be next March, which will be before the next Conference, we would then be in a position to at least think what the legislation was that we desired.

Governor Seay. I have a feeling, Mr. Chairman, that the matter should be left to the advisory committee. I know how deeply we have gone into this subject. Certain matters in the report of the committee were left to this advisory committee on legislation for further study.

The Chairman. Is there any further comment on this

question?

(The motion was put and unanimously carried.)

I. CREDIT TRANSACTIONS AND POLICIES.

F. Amendment to Regulation A to make eligible for rediscount or purchase by Federal reserve banks a bankers' acceptance drawn by an elevator or warehouse company and secured by terminal warehouse receipts of the elevator or warehouse company that draws the draft.

3

The Chairman. The next is I-F, "Amendment to Regulation A to make eligible for rediscount or purchase by Federal reserve banks a bankers' acceptance drawn by an elevator or warehouse company and secured by terminal warehouse receipts of the elevator or warehouse company that draws the draft.

That is one of the Board's subjects.

Governor Young. I think, Mr. Chairman, that everyone is familiar with that topic. All the information has been forwarded to each Governor, and all have had an opportunity to look it over. I think the whole thing centers down as to whether it is advisable to amend the regulations, or to get the Board to waive that requirement.

In this particular case it is pointed out by some of the Governors that it might be dangerous to amend that

regulation. Mr. Wyatt has told me--he told me this noon--that it would be possible for the Board to waive that requirement. Now, this is a good bill. It is protected as well as any bill could possibly be protected. It has the approval of Mr. Kenzel of New York, Mr. Zurlinden, Mr. McKay, Mr. Warburg and Mr. Kent, and others. I am not going to attempt to mention all of them. I therefore suggest that the Conference request the Federal Reserve Board to waive the requirements of this regulation, insofar as registered warehouse terminal receipts are concerned, whether the title to the grain absolutely leaves the custody of the drawer of the draft. I make that as a motion.

The Chairman. The elevator company is also a merchant of grain, is it not?

Mr. Young. Yes. It may or it may not be.

Governor Seay. Mr. Chairman, I would like to amend that proposal just slightly, to this effect, that the Federal Reserve Board consider whether it may not --and this is a specific case--waive the requirements of the regulation. Our study of the practice, as explained by the Minneapolis bank and by its counsel, rather tends to convince us that the practice as carried on there is a safe one. The banks are

practically willing to operate under it, and the purpose of the Board's regulation is to further the various processes of commerce if the banks in that district are entirely satisfied that it is a safe practice for them, and the Federal Reserve Bank of Minneapolis also regards it as a safe practice, and I for one cannot see that the matters might not be so arranged that the Federal Reserve Bank of Minneapolis should discount this paper.

Governor Bailey. I would like to put Kansas City in the same situation.

Governor Seay. I would not like to go so far as to say that this Conference recommends that the Federal Reserve Board do this thing, but that it suggests to the Federal Reserve Board whether they might not do it.

The Chairman. Well, they are considering it.

Governor Seay. That is as far as I believe that we might with propriety go or we would like to go.

The Chairman. I think what the Board would like, Governor Seay, is an expression of opinion here and a recommendation.

Governor Fancher. Mr. Chairman, I have seen Governor Crissinger and discussed with him these several topics

suggested by the Board on this program, and it is his desire that we proceed and discuss them and make recommendations. He said that perhaps in discussing topic "H" it might be thought advisable to bring Mr. Wyatt in on that. That is, "Notes secured by adjusted service compensation certificates", and after we have discussed the topic and have made our recommendations, that we then have a joint meeting with the Board. I told him, however, that he need not feel that he could not come in and sit in with us if he did not have a formal invitation.

The Chairman. The Conference will proceed accordingly. Mr. Young, will you name some of the elevator companies? I remember one of them, but will you name some of them that might be involved in this question?

Governor Young. The Concrete, the Atlantic, the Pacific.

The Chairman. Are they all of the class known as the regular terminal warehouses?

Governor Young. Yes.

The Chairman. They are not all, though, engaged in merchandising grain, are they?

Governor Young. No, I do not think so. I think some

of them are pure storage warehouses. No, if they draw the draft, they must be. Yes, they are all engaged in merchandising grain.

Governor Seay. Mr. Chairman, in its final analysis, this matter will have to be given an opinion upon. It is one of State law, and it seems to me it ought to be determined by the Board. Our counsel in his opinion states that he concurs with the counsel of the Board, that the Board has the power to amend the regulation and to sanction the use of such receipts, provided that the receipts themselves thus issued are sufficient under the law of the State in which they are issued to convey or secure title to the grain or other commodity which they purport to represent. In most of the States it has been held that a warehouse receipt issued by one engaged in a general warehouse business covering goods which are the property of the warehouseman is not sufficient to convey title to such goods to a creditor of the warehouseman to whom such receipt is given as a pledge.

This is a matter of law, and it seems to me that if the Board desires to solve that the better course would be to invite the counsel of the Federal Reserve Bank to consider

the matter jointly with its own counsel.

Governor Calkins. Has the validity of that receipt been passed upon by a court?

Governor Young. I cannot answer that. I expect so, that those receipts have been passed upon, because they have always passed as so much money up there.

Governor Calkins. It seems to me that is really the vital question.

The Chairman. I do not suppose that there is any terminal where the rules and regulations relating to the operation of public warehouses of this character are in any better shape than they are in Minneapolis and St. Paul. I can see, though, where if the Board rules that receipts of that sort or a draft of that kind would be eligible, that it might possibly involve embarrassment in some other direction where the regulations are not so good.

Governor Seay. Our counsel further says that if the receipt be issued by a warehouseman upon his own goods, it is obvious that it does not transfer the person's possession of such goods actually or symbolically, but merely agrees to hold his own property as a special trust for a particular creditor.

Governor Calkins. It adds nothing to the security already given.

Governor Seay. So therefore I maintain that it is a matter of law and ought to be decided from a legal standpoint. I should like to see it decided in favor of the Minneapolis Bank or in favor of the people out there, I would say, and not merely the Minneapolis Bank, which merely desires to accommodate its people and its customers.

The Chairman. Mr. Young has made a motion, Mr. Seay has suggested an amendment of it. The amendment will not satisfy Mr. Young.

Governor Fancher. What was Mr. Young's motion? Will he state it again, or will the Secretary?

Mr. Harrison. The motion was that the Federal Reserve Board be asked to waive the requirements of Regulation 7 so as to except from those requirements these particular warehouse receipts which Governor Young has referred to. In other words, the regulations now require that receipts must be issued by a warehouse independent of the borrower--in this particular case the warehouse is the borrower--but there are peculiar circumstances and regulations out there which make the control of the delivery of the goods under

the warehouse receipt a matter independent of the borrower, so that they really comply with the spirit of the Board's regulation on that point, and the only question for consideration is whether the Board should say that as long as they do comply with the spirit of the Board's regulation they should not waive that technical requirement that the warehouse must be independent of the borrower.

Governor Fancher. I notice here in a communication from the counsel of the Board under date of August 10th that he suggests an amendment to the regulation along the line recommended by the last Governors' Conference.

Governor Young. I have talked with Mr. Wyatt since then, and he suggests that we proceed this way.

Governor Fancher. I see.

Governor Seay. It appears to us, Mr. Chairman, that the amendment as proposed by Mr. Wyatt does not fully meet the case, that there is still a query there as to whether the amendment would meet the situation in that district, as to whether those receipts as they stand would actually convey title as defined by the Board's regulation.

The Chairman. Well, they would convey title. Here is a case where a public warehouse, organized and operating

under laws which afford every protection, is engaged in two classes of business. In the first place, they are a public warehouse and store grain. In addition to that, they are buying grain themselves and storing it and issuing the receipts to themselves, and those receipts that they hold of course presumably are safeguarded through the State custodian and such other safeguards as they may have, to the same extent that they would be safeguarded if they were held by a third party.

Governor Seay. Counsel has given the opinion that if the receipt be issued by a warehouseman upon his own goods-- which is the case here--it is obvious that he does not transfer the possession of such goods actually or symbolically, but merely agrees to hold his own property as a special trust for a particular creditor.

The Chairman. He does not transfer them out there.

Governor Seay. And therefore it is not security against general creditors.

Governor Wellborn. He has actual physical control of the property, notwithstanding State law.

The Chairman. Only subject to the cancellation and return of the receipts, that is all, and their organization

is not in charge of that elevator.

Governor Norris. Mr. Chairman, it seems to me that the amendment proposed by Mr. Wyatt safeguards the existence and the custody of the grain, but that it does not meet the point raised by Governor Seay, and I would move that the amendment be approved as far as this Conference is concerned provided that the following clause be added to it:

"Provided, That under the law of the State in which such grain elevator or grain warehouse is located such receipts give the holder a good legal title or an effective lien upon the grain."

Governor Seay. You make it as I do, as a matter of law.

Governor Norris. Yes.

Governor Young. I am afraid of that.

Governor Calkins. It is very doubtful, Mr. Chairman, whether the State law does or perhaps could determine that fact.

Governor Seay. In its present shape.

Governor Calkins. In its present form.

Governor Norris. If the State law does not give us either a title to the grain or an effective lien on it, do we want to do the business?

Governor Young. You are beginning to run into some trouble there that may throw out every acceptance you have. A man with a chattel mortgage on some cotton can follow it anywhere, or he can with the grain and I assume he can on cotton.

Governor Seay. If it is recorded.

Governor Calkins. This is not a chattel mortgage.

Governor Young. I know, but it is the same. If I have a chattel mortgage on some grain in Montana I can follow it on to Minneapolis or anywhere else.

Governor Seay. In some States there are some liens superior to a chattel mortgage.

Governor Young. Yes, but I do not think you want to put that in the regulations. There is always a certain reason, but you cannot get a clearer proposition than this, and I am afraid we are getting too technical with it altogether.

Governor Calkins. I am in entire agreement with Governor Young that the proposition as outlined in the Twin Cities is without any considerable or any unreasonable risk attaching to it, but that if the amendment is so amended as to permit the acceptance of the ware-

houseman's receipt who is also the owner of the goods, it would be extended to other lines. We wont know anything about where we stand as to securities.

Governor Young. That is why I ask that you go to this proposed amendment to the regulation, and we suggest to the Board that they waive this requirement insofar as those particular bills are concerned, which Mr. Wyatt says the Board can waive.

Governor Seay. That is, waive the requirement that it be stored in a warehouse, leaving it to the Federal Reserve Bank to determine its own course.

Governor Young. That is it exactly.

Governor Bailey. I want it exactly that way in Kansas City. There is a volume of business that we cannot re-discount, because it is within the prohibition of this regulation. It is protected by the State law, and I think it is physically impossible to get that grain out of that elevator with this warehouse receipt against it until it is paid for.

Governor Calkins. I have no doubt whatever that Governor Seay's counsel has advised him correctly when he says that it does not convey a good title.

5

Deputy Governor Case. I think all of those who have studied these particular bills secured by a warehouse receipt are satisfied that it is a very good obligation, and it seems to me that this whole situation, all the views that have been expressed by Governor Young and Governor Seay and Governor Norris, might be met by some such resolution as this, that it is the sense of this Conference that these particular warehouse receipts are wholly within the spirit of the Board's regulation, and that therefore the Board should rule that acceptances secured by them are eligible, provided, of course, that they comply with the requirements of the law. By that we merely express the sense of the Conference that they are within the spirit of the Board's regulation, and that they should rule, therefore, and in this instance that they are eligible, provided they are not out of line with the requirements of the law.

Governor Calkins. Does not that proviso destroy what goes before it?

Mr. Harrison. If I may say something, Mr. Kenzel, who studied this thing more perhaps than any other person perhaps than Governor Young, had a long discussion with me before I came to Washington, and he said "You have got to

remember there are two things that are involved: first, the law, and then, secondly, the regulations of the Board. On the question of the law we are asking for nothing. The acceptance to be eligible must be secured by a warehouse receipt which can pass a good title. That is a matter of law, and nothing can be done about it. The only other thing is the one of regulation, and the regulation now provides that the particular warehouse receipts must have been issued by a warehouse independent of the borrower, the purpose of that regulation being to insure that the borrower could not snatch the goods."

All that Mr. Young wants and what Mr. Kenzel has recommended is that the Board change or waive that particular requirement to suit a case like this, where even though the warehouse receipts are issued by the borrower himself, nevertheless the control is free or independent of the borrower, and that therefore they comply with the spirit of the Board's regulation, and that regulation should be in some way or another interpreted so as to cover this particular case or any other similar case. The law still stays the same, but--

Governor Calkins. But do they comply with the law?

Mr. Harrison. That is a question for every Federal Reserve Bank to determine in this case as in every other case, that we buy--first, do the investments comply with the law, and, secondly, do they comply with the regulations of the Board? We are assuming that Governor Young is not going to buy any bills that do not comply with the law. The only thing we are talking about is whether we should have an interpretation of the regulation which would enable him to buy these particular acceptances even though they are secured by warehouse receipts which are issued by the borrower himself.

Governor Wellborn. It seems to me, gentlemen, that the borrower would have in this case physical control of the property. Those receipts being out, he can hold up cars from delivery.

Governor Young. No chance.

Governor Wellborn. Why can't he do it if he has control of them?

Governor Young. He hasn't it. The State department has control.

Governor Wellborn. Do they have men there all the time?

Governor Young. All the time. In my original letter

I said there was not a man there at night. There is. There is a watchman there all night.

Governor Wellborn. And he has no control over these men at all?

Governor Young. The man that draws that draft has no more chance of getting that grain than I have of being the Pope of Rome.

Governor Seay. There is no question of the law being deficient. It is not mandatory that these receipts be registered?

Governor Young. No.

The Chairmann And there is no question as to the class of these loans. They have been regarded for many years as a very desirable class of loans.

Governor Seay. So it is clear that the elevator authorities can issue two classes of receipts, one of which I understand the bank would not take and the other they would take.

Governor Young. No.

Governor Wellborn. It looks to me like all of this talk is for nothing.

The Chairman. Mr. Norris, are you ready to recall

your suggested amendment?

Governor Norris. Well, do I understand then that it is not proposed to do this at all by an amendment to the regulation?

The Chairman. No; it is supposed to do it by an amendment.

Governor Young. No.

Governor Norris. One authority says "yes" and the other says "no."

Governor Young. I do not think we need an amendment to the regulation.

Governor Norris. Then how do you propose to do it?

Governor Young. I think Mr. Case stated the proposition accurately.

Mr. Harrison. Mr. Kenzel and Mr. Wyatt have both said that you can accomplish what you want to accomplish by a ruling, either affirmative or negative, in the nature of a waiver, and all you have got to do is ^{to say} that as long as these particular acceptances are secured by warehouse receipts which comply fully with the spirit of the Board's regulations, which require independence, that then this particular provision of the regulation which requires that the receipt be

issued by the warehouse independent of the borrower is not prohibitive of the acceptance of this draft in that particular case.

Governor Norris. Then it will be done by a separate ruling of the Board. It would not be an amendment of the regulation?

Mr. Harrison. I think all that would be necessary would be a letter from the Federal Reserve Board to Mr. Young, and with a copy to each Governor, that these receipts comply with the regulations.

Governor Seay. There would be some obscurity in that, the legal doubt as to whether these warehouse receipts convey or secure title according to the requirement of the law.

Mr. Harrison. But that is a separate and independent question, Governor Seay.

Governor Seay. Yes, I know it is, but I believe there would be some obscurity about the right of the Board to make that specific waiver.

Mr. Harrison. Mr. Kenzel's feeling was that no Governors' Conference or even the Federal Reserve Board itself should be asked to pass upon the interpretation of the State law in Minnesota, that that is a question for the Federal

Reserve Bank of Minneapolis to satisfy itself as to. So also, if Governor Bailey is going to buy any acceptances secured by any warehouse receipts, whether independent of the borrower or not, he has got to determine, and each bank has got to determine, whether in that particular case it conveys title.

Governor Seay. I would like to ask this question, in the opinion of his counsel, do the warehouse receipts convey or secure title?

6

Governor Young. I cannot answer that.

Governor Seay. But, fortified by the practice that prevails there, I think that question can be answered.

Governor Young. Suppose I wire tonight to Mr. Ueland and find out. Perhaps they have had some case in Minnesota which has been adjudicated, but I know this practice has been in operation there for thirty or forty years, and no one has ever lost a five cent piece on these receipts, and they must give you title.

Deputy Governor Case. That is a good suggestion.

Governor Seay. Mr. Case's resolution, which is a most excellent one, I think, has this proviso, that it be issued in conformity to law. Now, my query is, does that

receipt secure and convey title?

Governor Young. He has reference to the Federal Reserve Act.

Governor Seay. So do I. The Act requires that it convey and secure title. Now, the question of law is, does a Minnesota law do that thing as against general creditors?

Governor Young. If you pass this resolution, no harm is done. If those receipts do not convey title, why, we haven't done any harm by this resolution.

Governor Seay. I acknowledge that, but as far as the Board is concerned it is still involved in some obscurity.

Deputy Governor Case. Yes, possibly.

Mr. Harrison. The motion is: that it be the sense of this Conference that these particular warehouse receipts are wholly within the spirit of the Board's regulation as to the independence of the warehouse which issues the receipts, and that therefore the Board should rule that acceptances secured by these warehouse receipts are eligible, provided, of course, that they comply with all the relevant requirements of the law.

Deputy Governor Case. I cannot see any harm.

Governor Seay. Would you be willing to put in there

"Under the practice which prevails that these receipts comply with the spirit of the regulation?"

Governor Young. I am afraid that we are discussing the law rather than the merits of this bill, and I therefore suggest that we withdraw this until tomorrow morning or tomorrow afternoon, and I will wire Mr. Ueland and find out just that part of it, and after I get his opinion I suspect that some other counsel will dispute it, and I do not know whether we will be any further ahead or not, but we may be.

The Chairman. You would not be satisfied with the resolution as offered by Mr. Case?

Governor Young. Yes, I am entirely satisfied with that, but I do not think they want to vote for that.

The Chairman. I think they do.

Governor Young. All right. Then I will withdraw my previous motion and second it.

The Chairman. Do you withdraw yours, Mr. Norris?

Governor Norris. Yes. My amendment was toward a totally different thing. That was offered with the thought that this was to an amendment to the regulation. If it is not to be an amendment to the regulation, but is simply

to be an expression of opinion by the Board in a separate ruling, then I do not think my amendment is appropriate to that at all, and I withdraw it.

The Chairman. Then it comes to the motion of Mr. Case.

Mr. Harrison. It is moved to be the sense of the Conference that these particular warehouse receipts are wholly within the spirit of the Board's regulation covering the independence of the warehouse which issues the receipts, and that therefore the Federal Reserve Board should rule that acceptances secured by these receipts are eligible, provided of course they comply with all the relevant requirements of the Federal Reserve Act.

Governor Norris. I do not see, as a matter of fact, how the Board is going to rule that a receipt issued by the owner fully complies with the rule that it shall be issued by an independent person.

Governor Young. Mr. Wyatt told me not over two hours ago that the Board could waive that requirement.

Governor Norris. That is waiving a requirement.

Governor Young. That is something for an attorney to determine.

Mr. Harrison. I do not see that. This resolution

does not say that. It says that the warehouse receipts are within the spirit of the Board's regulations and that therefore the Board should rule not that they are issued by the warehouse independent borrower, but merely that these acceptances ~~issued~~ by these warehouse receipts are discountable.

Governor Seay. I cannot bring my mind to the conclusion that they are within the spirit.

Governor Bailey. But they are absolutely safe.

Governor Seay. I agree with you on that, but they are not certainly within the spirit of this requirement which reads that they should be issued independent. They are safe under the practice which prevails--I believe that if I believe anything--but I cannot bring myself to say that it complies with the requirement of the Board which shows that it shall be used by a party independent of the customer.

Governor Young. Why did the Board issue that ruling in the first place?

Governor Seay. It does not seem to follow logically.

Governor Young. The Board issued that for the reason that they wanted to get these goods away from the owner.

Governor Seay. All right. I am in favor of this, but

I cannot believe that it complies with the rulings

Governor Norris. They have here another rule that a receipt must be issued by a party independent of the customer, and now they find in a particular section of the United States that a custom has grown up of issuing a receipt by a customer, but that, owing to the restrictions by which it is hedged around, notwithstanding that fact, it is still safe. That is a distinct exception to that previous regulation.

Governor Seay. That is the way I think about it.

Governor Calkins. I believe that the practice is safe, but I also believe that this resolution, reduced to its actual content, says that they are eligible if they are eligible. They certainly cannot be eligible unless they comply with the law, and the Board cannot make them eligible by rulings, and this resolution in its actual content is an attempt to say that they are eligible if they are eligible.

Governor Wellborn. Don't you think this resolution waives that part, as to the independency?

Governor Calkins. It cannot.

The Chairman. That is a very delicate question, and I would like to say this, you would handle this thing and

inject some common sense into it and find some way to rule that these bills involving that class of warehouse receipts are eligible.

Governor Wellborn. I do not like to oppose this, but I am afraid it will get us into trouble in our district on cotton warehouse receipts. We have a big firm in New Orleans that wants us to take receipts of warehouse controlled by them, and we have ruled against it. I am afraid, if they heard of a change of idea by any other district, it will give us a lot of trouble.

The Chairman. I do not know whether we had better put this to a vote or not.

Governor Norris. I make this suggestion. Would it answer Governor Young's purpose if this Conference were to adopt a resolution expressing the belief that these particular warehouse receipts that are in question here are practically safe, and suggesting that they authorize their purchase by such amendment to the regulation or otherwise as they think best?

Governor Seay. Mr. Chairman, I imagine that if we were to receive a reply from Mr. Ueland, the counsel of the Minneapolis bank, such as has been proposed by

Governor Young, to the effect that these receipts did not convey and secure title, we would not vote for this resolution.

The Chairman. They do convey a good title. I can answer that. They have been doing it for twenty years.

Governor Seay. It is the opinion of counsel here by which we are guided.

Governor Bailey. I think there is a lot of difference in the laws controlling wheat and cotton.

Governor Seay. I am not thinking of cotton.

Governor Bailey. We can take the wheat out in Kansas City, we have got a very rigid State law, and the board of trade checks with them every one of those receipts, as Governor Young says, it would be as impossible for him to get them as for him to be the Pope of Rome, and we all know that would be a very hard proposition for him. Now, if it is safe, why not take them? We are taking a lot of them, and they are sent on by commercial banks down East, and I believe it is the finest thing in the world for us to do.

Governor Seay. I am perfectly willing that the Federal Reserve Bank of Minneapolis should be permitted to buy this bill, and I am of the opinion that they are safe, but these

facts do not justify the alteration of the Federal Reserve Board's ruling.

Governor Bailey. It is not a regulation, where State law safeguards them.

Governor Seay. That is, I say, a matter of law.

The Chairman. I stated what I did, Mr. Seay, because I am of the belief that this matter has been settled long ago. It must have been, and if by any chance it should be discovered now that those receipts did not convey and secure title, it would certainly revolutionize our method of doing business.

Governor Calkins. I think, while your argument is interesting, it is not conclusive, because many practices have gone on for many years and then have been shown to be unsafe and illegal.

The Chairman. But this has been shown to be safe.

Governor Calkins. And the others were too.

Governor Fancher. Might it not be brought out, if Governor Young should wire his counsel, that the courts have passed on these warehouse receipts? He may have some decision to which he can cite us which would control in the matter.

Governor Calkins. I would say, if Governor Young's counsel advises that these receipts convey title, I am in favor of the resolution.

Governor Seay. I would, too. Then I believe it would come within the spirit of these resolutions.

I. CREDIT TRANSACTIONS AND POLICIES.

G. Notes of parent corporations representing borrowings to be advanced to subsidiaries.

The Chairman. The next title is 1-G, "Notes of parent corporations representing borrowings to be advanced to subsidiaries." Governor Fancher, we will ask you to lead this discussion.

Governor Fancher. Mr. Chairman, you may recall that this topic came up at the last conference and was not given consideration. This was referred to the Conference by the Board, and it was not received by some of the Governors in time to give the matter consideration. It was suggested by the Board in their letter dated December 30, 1925, X-4484.

You will recall that throughout the discussion this particular note was discussed by the members of the Board with the members of the Open Market Investment Committee, and in that discussion the question of borrowing by the

parent corporation that controlled subsidiaries was under consideration. At that time no fixed percentage as to the capital stock ownership was mentioned. We think, if I recall the words, substantially were controlled was used, and after further consideration by the Board this ruling was put out, whereby they propose the addition of 75 per cent stock ownership, thus limiting the parent corporation to making any additions except to those subsidiaries.

Governor Calkins. As to which it owned more than 50 per cent.

Governor Fancher. Now, that matter has been discussed, and it turns out that the paper of a number of corporations in our State under the ruling becomes ineligible. This matter was referred to the Advisory Council at the last meeting, and in discussing it it was brought out--for instance, in one case the paper of Wilson & Company would be ineligible because it had advanced \$50,000 or \$100,000 to some raiser of turkeys in Texas to get his turkeys in shape for market. They had advanced certain moneys, and at the last part of the season there were some advances made to the customer, and the very fact that those advances were made made the paper of Wilson & Company inel-

igible .

It is found that that prevails in the general practice of other corporations.

This matter was discussed informally with some members of the Board only last week by our member of the Advisory Council, and this suggested substitution for the Board's regulation was suggested. It is found on page 1 of the letter X-4484 :

"That the Federal Reserve Board will not consider, first, financial paper, notes of a parent corporation the proceeds of which have been advanced by and loaned to a subsidiary corporation in which the parent corporation owns at least 51 per cent of the stock,

That would take the place of 1, 2 and 3. That makes no mention about the parent corporation making advances to its own subsidiaries. It puts the parent corporation's subsidiaries in a position of making the paper ineligible.

Governor Calkins. Why not change 51 to 50? It is a perfectly absurd case that you want to deal with right there. I have one before me. I have before me, Mr.

Chairman, a case which is informing, I think. Here is a concern which owns in their entirety eight subsidiaries and 50 per cent of one subsidiary. This concern has a consolidated net working capital of over \$6,000,000, is engaged wholly in merchandising with but small fixed investment, and is in the ^{highest} credit standing. The parent company has made advances to all subsidiaries in varying amounts, that due the 50 per cent owned subsidiary being \$100,000. Five of the wholly owned subsidiaries do not show an excess of quick assets over their current liabilities to the parent concern.

Under the foregoing form of analysis, the paper of this concern would be ineligible on two counts:

First, it had loaned to a subsidiary in which it did not have at least a 75 per cent interest; and

Second, the borrowings of five of its subsidiaries had not been used for an eligible purpose in so much as the borrowings from the parent corporation were in part represented by assets of ~~that~~ ineligible nature.

To say that they shall make no advances whatever to a subsidiary unless they own 75 per cent is to apply a rule that nobody could apply in practice in banking or otherwise.

Governor Fancher. I would say, Mr. Chairman, that this is a matter that has been discussed. I have discussed it at considerable length several times with Mr. Wyatt. I could not convince him in going over the matter with him several months ago that this Board's regulation should be modified. He thought the Board had gone about as far as it could. But I understand that he has a little different view of the situation now, and I have not had an opportunity of discussing this with him. When Mr. Cotton was here in Washington on Thursday Mr. Wyatt was out of the city, and he had hoped to have Mr. Wyatt in at the discussion, and then it was hoped that Mr. Wyatt would come to Cleveland on Saturday, but he was called to Indiana and he did not have opportunity, and I have not had the opportunity since I have been here.

In discussion informally with several members of the Board on Thursday, they rather thought that perhaps what I had suggested in the discussion last December would answer the question and clear the situation up, if Mr. Wyatt could be convinced that they should not specifically make mention of advances to corporations other than subsidiary.

Governor Calkins. The question should be determined

by them without question as to whether the money has been used or should be used by an investor for a commercial purpose.

Governor Fancher. In this proposition they owned more than 51 per cent. The other is a smaller ownership, and in that particular case it is a matter which can be very readily handled, and with this modified reservation it would fit their particular case; and this was the particular situation which was discussed, and the object of the discussion during the consideration of this regulation of the Board.

Governor Seay. This would not in any way alter your practice requiring statements from related corporations?

Governor Fancher. Not at all.

The Chairman. The new point submitted in connection with the Hanna paper was the way to furnish such company with all funds they need for the production of coal and iron, and that the coal and iron is sold to the Hanna Company by contract before the contract is made, and it could not be held to be a financial transaction.

Governor Fancher. Not at all. The Hanna Company were selling agents under contract with certain furnace concerns to sell its pig iron. On the other hand, it is

under contract with certain ore producing companies to sell its iron ore. What takes place during the winter season is that these ore companies up on the range come along and get ready for shipping early in the spring a stock of ore, which is ready as soon as the navigation season opens, and they ship the ore to the docks and it is loaded into the ship and brought down on the lakes during the season of navigation, and from the proceeds of the ore of this company, acting as a sales agent, the advances are repaid. The operation with the furnace concern--it is appreciated that you cannot close down a furnace when the market becomes a little dull or the price is off, and they go on and operate and oftentimes stack up pig iron in the yard, and advances are made by Hanna & Company to these furnace companies to help them carry this pig iron until favorable market conditions arise, and then they are repaid.

That is a picture of the operations of the Hanna Company and I think that is a legitimate business and their paper is eligible.

The Chairman. The Hanna paper was thrown out because they were loaning money to corporations other than those which they owned and controlled. I think that this new informa-

tion in relation to their operations is not only desirable, but it makes their paper eligible.

Governor Fancher. Take the situation of the much-talked of Wilson paper in Chicago. I spoke of that a little while ago. There comes a time when the man, in order to get his turkeys ready for market, has to have some advances, and under the ruling of the Board the paper of Wilson & Company is ineligible because they made those advances.

Governor Talley. Why is not this a factor-^{age} proposition? It is exactly the same principle, it seems to me. The Act was amended so as to accommodate factor-^{age} paper. That is exactly what happened in connection with the production and storage of cotton. The concerns borrowed money from their local banks, and with the proceeds in their hands they used it to make advances on cotton.

Governor Fancher. I have this thought in mind, that before we take formal action I be given an opportunity to sit in and discuss this matter a little further with Mr. Lyett and just see the frame of mind he is in and whether he believes that this sort of recommendation would fit the case and whether he would favor it, so that if we made a recommendation we could make it with the thought that some-

thing would be adopted by the Board.

The Chairman. It might be well to ask Mr. Wyatt to come in here. We are going to have him on the next topic, anyway.

Governor Fancher. Perhaps, in view of the discussion Thursday with various members of the Board, we would like to have a little light on that. I think, if I had the opportunity, I would do that, if this topic could be passed, unless some member of the Conference has some other suggestion.

Governor Seay. You move to defer consideration of this?

Governor Fancher. Yes, unless some member of the Conference has some better suggestion than this.

Governor Seay. I second that motion.

The Chairman. What is the motion?

Deputy Governor Case. To defer action.

The Chairman. Until when?

Deputy Governor Case. Until he has a chance to discuss it with the Federal Reserve Board.

The Chairman. He is going to discuss this with Mr. Wyatt?

Governor Fancher. If the Conference wishes, I will endeavor to see him and discuss it with him. I had two or three discussions with him at various times, and I will

take another crack at it.

The Chairman. All right. If we take this program in its order, we are ready for Mr. Wyatt.

Governor Fancher. I do not know that he does want to be here, but Governor Crissinger suggested that perhaps it might be well for him to be here when that topic was discussed.

The Chairman. Can we take up anything else now?

Deputy Governor Case. We can take up Item I and skip H.

I. CREDIT TRANSACTIONS AND POLICIES.

I. Ratio of Bank Capital to Deposits.

Review of steps taken by the Federal reserve banks to urge member banks to increase their capital and surplus to at least 10 per cent of their deposit liability as recommended at the November 1925 Governors' Conference.

The Chairman. This topic I reads as follows:

"I. Ratio of Bank Capital to Deposits. Review of steps taken by the Federal reserve banks to urge member banks to increase their capital and surplus to at least 10 per cent of their deposit liability as recommended at the November 1925 Governors' Conference."

At that Conference consideration was given to this subject, and it was voted that it should be the policy of the

Reserve Banks whenever opportunity arises in their dealings with member banks to urge them to increase their capital and surplus, gradually, if necessary, to at least 10 per cent of their deposit liability.

That is where the matter was left, and New York wants to know what we are doing about it. What are you doing about that, Mr. Case?

Deputy Governor Case. We are at work on it, and I have a short memorandum here that I would like to read on the subject. On October 6, 1920, six years ago, we sent to all member banks in the district a circular containing a reprint of the article by Professor Kemmerer of Princeton on "The ratio of bank capital to deposits." More recently this year, in our circular 730, issued July 26, 1926, a chart was given showing the number of banks in the district which have capital stocks in excess of their deposits. This indicated that 84 per cent of the banks in our district have a capital ratio of 10 per cent or more, and the average ratio for all banks in the district is 16 per cent. It is stated also that in the past five years more than 200 banks in the district have increased their capital other than through mergers. A copy of these circulars is in the files.

Governor Norris. As of what date was that 16 per cent, Mr. Case?

Deputy Governor Case. We sent out a circular July 26, and this information was compiled by our Statistical Department just prior to the sending out of this circular.

Governor Norris. And that was your member banks, or all banks?

Deputy Governor Case. All the banks, all the banks in the district.

Mr. Harrison. Member banks.

Deputy Governor Case. It does not say so. The diagram indicates that a large majority, in fact 84 per cent, of the banks of the district have a capital ratio of 10 per cent.

10

The Chairman. That does not include the surplus?

Deputy Governor Case. It includes capital funds-- capital and surplus.

"Our efforts towards having banks bring their capital funds into suitable relation to their deposits have been most effectively exercised, first, in connection with the application of banks for membership in the System, in which case we have uniformly insisted that capital funds be in satisfactory proportion to deposits and not materially below

10 per cent thereof and second, in connection with applications for fiduciary powers, in which case we have insisted that the net capital funds should in all cases be at least equal to 10 per cent of deposits."

The only exception we have made there is where a bank was well managed, had a little bit under the 10 per cent ratio, and we had their agreement to effect an improvement.

Governor Bailey. How long a period did you cover to get at this relation? You know deposits fluctuate a whole lot.

Deputy Governor Case. In case of a bank that is low, and we have in several instances granted fiduciary privilege in cases where we have made a direct approach to member banks, we have met with success in some cases and polite failure in a few others. In granting these accommodations to member banks, we have of course taken into consideration the amount of their capital funds, and it is probable that as time goes on this will also prove an effectual influence to bring about corrections where needed. In one instance we have constantly in our discussion with the member banks brought this to their attention.

Here is the chart, and 84 per cent of the banks that

have 10 per cent or more is represented by this large group, and the other 15 per cent--there are five banks that have 4 per cent capital, seven banks with 5 per cent, ten banks with 6, and so on. So you see that the banks as a whole in our district have a very satisfactory ratio.

This circular which we have sent out has created very favorable comment, because it contains tables of average operating ratios of representative member banks in different groups, so as to enable the bank in any particular group to compare their own figures with the average which we have made up. We really made this table which we sent out a vehicle for conveying our ideas on this capital ratio, and it has proven quite effective.

Governor Fancner. Might I inquire if the State banking department or the superintendent of banks has the policy of suggesting to banks, when they are a little out of proportion, to increase their capital? Is that a policy of that department?

Deputy Governor Case. Yes, it is. As a matter of fact, where the bank is very much out of line, we frequently discuss such a case with him. He says that he recognizes it and says he will be glad to undertake to do what he can to

bring about a correction of the situation.

Governor Fancher. We have been doing what you have been doing in New York where a bank applies for membership. The matter can very appropriately be discussed at that time, and has also applied to the fiduciary the proposition. We have held up applications when it was not in the proper ratio. We have not got the State bank superintendent to become very much interested. He admits that it is good policy, but we have not yet got the department to take much interest. Where they really know that it is a situation that it is simply out of line, the examiner suggests that a capital adjustment be made. Do you know whether there is any policy on the part of the Comptroller's office?

Deputy Governor Case. I cannot speak for the Comptroller, but for the chief examiner of our district, with whom we have a very satisfactory relationship, and he is most sympathetic. There is one rather substantial bank uptown in New York where they had but a 5 per cent ratio, and I had occasion to talk, in fact I talked several times, with the chief examiner, and I talked about a year ago with Colonel McIntosh. I saw him several days ago in the bank and he says there has been no improvement in that

situation, and he said he was going to get after that bank now. That indicates that the Comptroller has a very sympathetic attitude and they are bringing about a better relationship in regard to this capital ratio.

The Chairman. In considering this matter, have you not found it advisable, instead of dealing with capital account, that you deal with surplus and undivided profits?

Deputy Governor Case. No. I think that would be a mistake.

The Chairman. It would strengthen the position of the bank, though, if they would increase the capital from their surplus.

Deputy Governor Case. Yes, but most banks today look upon undivided profits, and the Comptroller rules in regard to making loans, that the capital and surplus is the yardstick. They will tell you to fix your own bank up first if you went to them on that plan. We cannot go on that argument.

The Chairman. If you do not, you would make a mistake. The surplus is subject to withdrawal and it is a much easier proposition than reducing your capital,

Governor Fancher. Have you given any thought to any plan of getting the matter before the Comptroller and before

the various departments?

Deputy Governor Case. No. All we have undertaken to do in the ordinary course of business is to do what we regard as good missionary work, to bring this matter to their attention. A year ago we talked of sending out some circulars, but Governor Strong had some question in his mind about it, as to the desirability of it, and then we thought that we might take it up with particular banks, and he pointed out that that was not nearly as good as a circular.

Governor Fancher. The point I wanted to make was that if the State bank superintendent had some fixed policy it would help us very much. We have taken up particular cases and we have had some success, and in some other cases we have not.

Deputy Governor Paddock. We took it up in two cases of consolidation.

The Chairman. Do you want to go any further on this matter, Mr. Case?

Deputy Governor Case. No.

I. CREDIT TRANSACTIONS AND POLICIES.

- H. Regulations covering rediscount of notes secured by adjusted service certificates under the provisions of Section 502 of the World War Adjusted Compensation Act.

The Chairman. Mr. Wyatt is here, and we are ready to start with topic I-H, "Regulations covering rediscount of notes secured by adjusted service certificates under the provisions of Section 502 of the World War Adjusted Compensation Act." The Board has had that under consideration and they presented this topic for discussion.

Mr. Wyatt. What do you wish me to tell you?

The Chairman. We want you to tell us what is the status of it now. There is a letter here, I think.

11 Mr. Wyatt. No loan can be made on these certificates before January 1, 1927, and the Board is doing nothing until it hears from the Governors' Conference and knows what their desires are. The correspondence which you see here is the last correspondence which the Board has had.

Governor Fancher. The compensation law makes the loans eligible, subject to the rules and regulations prescribed by the Federal Reserve Board?

Mr. Wyatt. Yes, sir.

Governor Fancher. And that is the thing that is to be worked out before January 1?

Mr. Wyatt. Yes, sir. This is the reason why the Board wished to put it up to the Governors' Conference.

General Hines, the Director of the Veterans' Bureau, asked the Board to assist him in two respects: first, with respect to a campaign of publicity to educate the people as to the conditions on which they could make loans on these certificates; and the other was the question whether or not we could make out a uniform form of promissory note, and I think that both of those questions are practical questions rather than legal questions, and the Board felt the same way, and they thought they would put it on the program of the Conference here so as to get any recommendations the Governors might make as to the kind of regulations they would like to see promulgated, and such suggestions as the Conference would like to make for educating the public as to making these loans. The Board feels of course that the Federal Reserve Bank would be in a better position to do that than the Federal Reserve Board. Another question is whether the Board can participate in asking people to borrow.

Governor Fancher. As I understand, under the Act we are expected to rediscount for non-member banks?

Mr. Wyatt. The paper is eligible, although it is offered by a non-member bank.

The Chairman. What is the aggregate amount of these

certificates?

Governor Fancher. January 1, 1927, \$262,000,000, and of course it will increase each year. The loan value during the year 1927 will be about \$262,000,000.

Governor Seay. \$370,000,000 in 1928, \$482,000,000 in 1929, and \$590,000,000 in 1930.

Mr. Wyatt. Of course you realize that the loan value on each certificate is very small. This year it is probably less than a hundred dollars. It will mean a lot of little notes. Personally I do not feel you will get so much of them, because it will be too much trouble for the member banks. You may get some from non-member banks.

Governor Calkins. Could we not be compelled to take them from non-member banks?

Mr. Wyatt. No, sir. They are made simply eligible.

Governor Seay. It would make a very wide distinction if the Board provides, and I hope they will, that they will be eligible only for member banks.

Mr. Wyatt. If the Board does that, they will have to promulgate a regulation right in the face of the law. I have some doubt about the Board's power to make that kind of a regulation. I do not think they could. I have not

gone into it enough to render a final decision, but that is off-hand opinion.

Governor Calkins. It would certainly be inexpedient.

Mr. Wyatt. There is one thing you have almost got to do for your own protection, and that is to require any bank to furnish right along with the note an affidavit to the effect that they have not charged any commission or any interest in excess of that allowed by law, because you have to have that affidavit.

The Chairman. This should be done by all banks on some uniform basis.

Mr. Wyatt. Oh, yes.

The Chairman. But it seems to me that this law which permits non-member banks to inflate the paper of the Federal Reserve Bank is unsound. I do not think that they have any right to come in and ask for the business which originates with our member banks, and these things are going to amount not only to millions, but to billions of dollars, and the average veteran will take what he can get immediately on these certificates, and that will be true every year. I think the Board should not do anything to encourage the re-discount of these instruments with the Federal Reserve Bank,

and if they can do anything to discourage it I hope they will do it. If we are presented with this from a non-member bank we do not have to take it.

Deputy Governor Case. It seems to me that there is a great inconsistency, Mr. Chairman, in taking from a non-member bank these adjusted service certificates and then declining to loan the same non-member bank--very properly as I see it--against Liberty Loan bonds, another form of Government obligation.

The Chairman. The discounting of these certificates by Reserve Banks is in my opinion unsound.

Governor Calkins. The unsoundness is in the law, however.

The Chairman. The intention of the law is that all paper received by the bank should in all cases be self-liquidating, and in the case of bonds there is always a value. These kind of loans against adjusted service certificates can absorb a very large amount of bank credit, and they extend over a period of 18 years, and instead of being self-liquidating they are just the contrary.

Governor Seay. There are a good many practical questions. What is to become of the note in case the veteran does not pay it?

Mr. Wyatt. You take it to the Veterans' Bureau and they pay it.

The Chairman. We do not want to do business with them.

Governor Seay. We do not want to do that. Why not require the member bank to do it?

Mr. Wyatt. That is what you ought to be permitted to do, but I am telling you what the law says. When the note is not paid, you can take it to the Veterans' Bureau and it will be paid.

Governor Norris. The Director may pay in his discretion.

Mr. Wyatt. That is right, it is discretionary.

Governor Seay. He can require, but I do not know what effect the requirement would have, the bank to supply us with funds at maturity to pay the note. We are not required by law to collect them for the non-member bank, but it is rendered eligible.

Governor Young. The Board has the right to limit the amount of agricultural paper, hasn't it?

Mr. Wyatt. Yes.

Governor Young. But they could not limit this?

Mr. Wyatt. I think they can.

Governor Young. These notes are not collateral for Federal Reserve notes.

Governor Seay. It is an instrument of inflation to begin with, of course.

Governor Young. Do you think it policy to turn it down altogether?

Governor Seay. My idea is that both member and non-member banks will endeavor to curry favor, and that they will discount this paper freely, and I believe they will have it to offer to the Federal Reserve Bank. It has been estimated by actuaries I think that about one-half of the loan value of these certificates, which is \$260,000,000, will probably be offered in the first year. There is inflation to the extent of \$130,000,000. The Federal Reserve Banks are going to be asked to pass this paper, and unless they make a retirement the non-member banks will ask for funds.

The Chairman. I just want to point out that it is not compulsory, but it is discretionary with the Veterans' Bureau, whether they pay us or not.

Governor Seay. Unless the regulations provides the manner in which those things will be dealt with, there is

going to be great pressure on the Federal Reserve Banks to take them.

Mr. Wyatt. Of course the non-member bank will be liable on its endorsement.

Governor Seay. Of course, but that does not amount to very much. It puts it on you to take it up by correspondence.

Mr. Wyatt. I do not think there is any difference in opinion as to the undesirability of this, but the thing is you have got it and what are you going to do with it.

Governor Seay. I sincerely trust that the Federal Reserve Bank will discount them only when offered by member banks.

Governor Calkins. You have to get the law changed.

Governor Seay. No, I do not think you do. They are simply made eligible.

Governor Calkins. What do you say, Mr. Wyatt?

Mr. Wyatt. I did not get the question.

Governor Calkins. Have we the option of refusing to rediscount these from non-member banks?

Mr. Wyatt. Yes, I think you have.

Governor Calkins. Where do you get that out of the law?

Governor Seay. We are simply not required to discount

them at all.

Mr. Wyatt. It merely says it shall be eligible for discount. It does not say that you must discount.

Governor Seay. We may permit the member bank to become the agent for a non-member bank for the purpose of discounting this paper, but that would be inconsistent with the attitude of the Board at the present time.

Governor Calkins. That would be inconsistent with the attitude of the Board, but it is not inconsistent with the intention of the people who made the law.

Governor Seay. I know that, but it will receive some shock in other directions, and I think we had better give them that one too.

Governor Calkins. I do not know whether you had better or not.

Deputy Governor Case. These notes are made eligible for member and non-member banks. You could not take them in from member banks and decline to take them from non-member banks.

Governor Calkins. The probable result is that the law would be amended to require us to do it. I think that is the intention of the law.

Mr. Wyatt. I think that is the intention of the law.

Governor Seay. I have been in hopes that it could be met by the Federal Reserve Bank requiring the bank to become the agent for this particular class of paper.

Mr. Wyatt. Would you go so far as to require the non-member bank to offer it through a member bank?

Governor Seay. Yes. There will be no risk run by the member bank in endorsing paper.

Mr. Wyatt. If you do that you refuse to carry out the plain purpose of the law.

Governor Seay. I hope we will come as near to it as possible, because it is a very vicious law, I think, in principle.

Governor Norris. I do not know whether this came from the Federal Reserve Board or the Treasury Department, or where it came from, but it looks like the Federal Reserve Board typewriting:

"Upon the endorsement of any bank and subject to regulations to be prescribed by the Federal Reserve Board, any such note secured by a certificate and held by a bank shall be eligible for discount or rediscount, whether or not the bank offering the note is a member of the Federal Reserve

System and whether or not it requires the note in the first instance from the veteran."

Governor Seay. That is the law.

Mr. Wyatt. Yes. That is the law.

Governor Norris. Yes. Now, manifestly the law intended that we should rediscount for non-member banks in order to give the veteran whom we were seeking to favor the widest possible range in getting his loan.

Governor Seay. I have no doubt of it.

Governor Norris. I was under the impression that if a note was not paid and you would simply present it at the Veterans' Bureau when it was six months' over due, they would pay it, but this provision that the Director may in his discretion pay it, gives us no guarantee of payment at all.

Governor Seay. Inasmuch as the non-member bank keeps no account with the Federal Reserve Bank against which to charge this note upon maturity, reiterating what I have already said, they would have to be presented, whether endorsed or not by a member bank, with authority to charge them to the account of the member bank if not paid.

Governor Calkins. I would like to hope the same thing as that offered by Governor Seay, but I think we

should just as well prepare now as at any other time to do it for non-member banks. We have no option.

Mr. Harrison. Would it be possible to reason the thing out this way, that after all you are getting a note of the veteran, endorsed by the non-member bank, and the fact that the law gives you the opportunity to ask the Veterans' Bureau to pay it in the event it is not paid by the maker, does not mean that you could not send the note back for collection ^{through} the non-member bank to the maker?

Governor Seay. Not at all.

Mr. Harrison. And if the maker of the note refuses to pay, you have the right to proceed against him.

Governor Seay. Yes, but I would provide the method by which this is to be done, and that is that these notes will be forwarded before maturity to the non-member bank for collection, and in the event they are not paid by the veteran then the non-member bank must provide funds on the day of maturity to pay the paper. That is clearly a detail.

Governor Bailey. That would keep the non-member bank from taking them so freely as before.

Governor Fancher. Mr. Chairman, it seems to me here that

in doing what the Board would like to have this Conference do involves a lot of detailed study in preparation of forms and legal points of law and that sort of thing. It seems to me that if Mr. Wyatt could look about at these different banks and select three or four men that he thought could assist him, and let them be a committee to work these things out, it would be a good idea. We cannot sit around this table and determine on the form of a note or an affidavit or this or that. That is impossible, and it is impossible also to work out a concrete plan in this discussion. It is a matter requiring a good deal of study and involving a good deal of time.

The Chairman. Mr. Wyatt has stated that in his opinion it would be necessary to work out a form of affidavit, and in relation to that matter I would like to read from a statement I have. It is very important that the form of affidavit to be made by the officer of the bank should be prescribed and sent out to banks by the directors. These loans will be made and negotiated under statutory provisions. The Act provides that if the statute is not strictly complied with the loan should be void. This application should be full enough to show that every essential provision of the

DP statute is complied with, not only as to the rate of interest charged the veteran, but that the bank making the loan was a bank incorporated under the laws of the United States or of some State or Territory. This form should be submitted in advance to the director and definitely approved by him, so that a bank making the loan would be assured that the loan would be paid at maturity. This just emphasizes your statement that it would be necessary to have a form and a uniform form.

Mr. Wyatt. Mr. Chairman, may I answer Governor Fancher's remark? The Federal Reserve Board of course does not expect a Governors' conference to work out all of these details. As I understand it, all the Board wished was an expression from the Governors' Conference as to what their views are as to the general policy, so that the Board could promulgate its regulations in such a way as to meet the wishes of the Governors. Of course, the Board itself would have to work out the details, but it is possible that there are some practical considerations that are very important, and such questions as Governor Seay has been raising, and if you could get an expression from the Conference on that I think it would have a good deal to do with the kind of regulations the Board pro-

mulgates. Otherwise, the Board has to go ahead in the dark and do the best it can, and it may meet the wishes of this Conference or it may not. It is simply an effort to cooperate with this Conference in the matter of promulgating the proper regulations.

Governor Oalkins. The first thing would be the regulation of the Board and the next thing would be a uniform circular to be sent by the Federal Reserve Bank to member banks, and it seems to me that those things should be worked out with the Counsel of the Federal Reserve Board and the assistance to him of some operating officers of the Federal Reserve Bank.

Governor Seay. First and foremost, Mr. Chairman, I would like to know whether it is going to be the policy of the Federal Reserve Board to require Federal Reserve Banks to discount this paper for non-member banks. That is the primary thing, as it seems to me. You will recall that in the case of the intermediate credit banks the Board provided that no Federal Reserve Bank should purchase any of their stuff when their own reserves were below 50 per cent, and there are a variety of limitations that might be imposed, but that is the primary thing to be determined, if the Federal Reserve

Banks ought, or whether they would require the Federal Reserve Banks to discount this paper for non-member banks.

The Chairman. They certainly would require them to do it, will they?

Governor Seay. I do not know that they will require them to, but I would like an expression of opinion as to whether they will discount them directly from non-member banks or through the member banks as an intermediary.

Mr. Wyatt. The question as to whether they would require it is entirely academic.

Deputy Governor Case. That is, you think the Federal Reserve Bank should do it with the law as it is?

Mr. Wyatt. That is obviously the policy.

Governor Calkins. It is obvious under the terms of the law that the Board will not prohibit us from doing it.

Deputy Governor Case. It seems to me on this matter there is much ado about nothing. Here there are two and one-half billion of these certificates put out in the hands of veterans. On January 1st they have a loan value of \$260,000,000. Assuming that 50 per cent of the veterans — and I would not be surprised if at least that percentage did cash in on them — it would mean somewhere between

\$125,000 and \$150,000 taken from the banks of the entire country. My judgment is that — of course our district may be a little different from some of the others — but my judgment is that little or none of them would find their way into the Federal Reserve Banks; that the banks would carry them themselves. With the law as it is, if a bank up at Painted Post, a member bank, offered one of those for discount and it had the affidavit which is prescribed and which I assume our general counsel of the Board would send us a copy of the form, if it had that on a plain collateral note given to the member bank, I see no reason why the Federal Reserve Bank of New York should not discount it and not make a wry face about it. I do not believe you will get \$5,000,000 of that paper in the entire country, because the tendency of the banks is to give you the bigger notes to carry, and similarly, with the law as it is, if the First State Bank of Painted Post, a non-member bank, were to offer us one of these certificates, personally I should be in favor of advancing the money against it and do just what Governor Seay says, as the loan matures I would send it to them and I would say "This matures on November 15th; please send us a check for it when it matures." And I do not believe in making a

terrible thing about it.

The Chairman. You would exercise discretion?

Deputy Governor Case. I would exercise discretion.

The Chairman. If the non-member bank was in good standing, so far as you were aware, you would take it?

Deputy Governor Case. Yes.

Governor Seay. You could not discriminate?

Deputy Governor Case. I do not think there would be any risks involved, whether the bank was in good shape or not. I do not think you will get very much of it as a practical proposition. The banks would carry that paper themselves and consider it a real nuisance, which it would be, of course.

Governor Seay. Unless, Mr. Case, the Federal Reserve Bank would undertake to collect these notes themselves.

Deputy Governor Case. I do not think they should.

Governor Seay. I agree with you there, and I think that such should be the regulation. How much of this paper will find its way to the Federal Reserve Banks when \$900,000,000 of it is outstanding, is a problem. I do not think any appreciable quantity will come into the city banks, but a lot in the country.

Deputy Governor Case. We will have a lot of experience by that time.

Governor Young. You could put a limit on the amount to be taken at any time.

Governor Calkins., Just so far as the Veterans fail to pay, the amount would be equally distributed.

Governor Seay. It is like the life insurance policies, the loan value would increase from year to year, and the man will try to borrow as much as he can get.

Governor Calkins. He would have to pay the first note before he can borrow in the second year.

Governor Norris. I would like to ask Mr. Wyatt, does he know as a matter of fact what the director's policy would be where the ^{law says} that he may in his discretion pay the bank, whether he would establish it as a rule to make the payment except in some extraordinary or unusual case, or whether he would not.

Mr. Wyatt. I have no way of knowing that.

Governor Bailey. Would the veteran forfeit his right to make the additional loan if he did not pay the first note?

Mr. Wyatt. The Director pays the amount of the note, with interest, and then holds the certificate until one of

two things is done, in which event he gives the certificate back to the veteran. If he does not pay off the loan, the director holds it until maturity, deducts the amount of the loan, plus interest to date, and pays the balance to the veteran, if he is living, or to his beneficiary. I think that will happen in most of the cases.

Deputy Governor Case. Governor Norris, your question is a very practical one from the Federal Reserve Bank's viewpoint, if they follow the ordinary business custom of asking the member bank that is under discount at maturity.

Governor Norris. That is all right where it comes from a member bank. But the veteran/^{who} will borrow the moment it is possible is a person of no responsibility.

Deputy Governor Case. That is true.

Governor Norris. A non-member bank may not be a person of much responsibility.

Deputy Governor Case. Most of them I should think would be good.

Governor Norris. In your district and mine, but in Governor Young's district I take it that he does not feel free to accept their endorsement so readily.

Governor Calkins. You will have to take it for what it

is worth.

Deputy Governor Case. Is there anything needed on this other than to get a regulation?

The Chairman. I think something is needed. It is something that is put on by the Board, and what are we going to say?

Governor Seay. Governor Fancher's suggestion that a committee of the operating men of the bank should confer with Mr. Wyatt, seems to be a good one.

The Chairman. Before we do that, why would not that be a proper subject to refer to our standing committee?

Governor Seay. I think that they are such a convenient committee that we are apt to leave to them a great many things which perhaps a great many operatingmen should do.

Governor Fancher. I should like to ask Mr. Wyatt whether that is agreeable.

Mr. Wyatt. I think that is the best way out of it, so far as the regulations are concerned, if there could be four or five operating men.

The Chairman. I will give you two of them.

Mr. Wyatt. That is enough. To confer with us, I think we could get up a regulation satisfactory to those men.

SS
Sels
Selow

There is another question, though, that I do not think that will answer, and that is whether the Federal Reserve Banks will want to participate in any campaign for publicity, as to how these loans should be made.

Governor Seay. There is no question but that a specific circular should be issued to member and non-member banks, describing the way they should do this thing, and that is what I believe this committee should do, to discuss not only matters which should be incorporated in regulations of the board, but the procedure which the Federal Reserve Banks should adapt in dealing with member and non-member banks alike. We may obtain later in this conference an opinion as to whether they think the Federal Reserve Banks should discount this paper from all banks as a matter of policy. I think I can anticipate their answer, but I would like to have it just the same.

Mr. Wyatt. May I make one suggestion about this committee? In view of the fact that these loans have to be made beginning January 1st, would it be advisable to give these men authority to go ahead and work up some regulations in a circular also, if you desire that, and put it out rather than have to come back to another governor's conference?

Governor Biggs. Suppose you put that out a week or ten days before?

Governor Norris. It ought to go out about the middle of December.

Mr. Wyatt. I think if the circular is made complete and clear enough, it will save you a lot of correspondence.

Governor Paddock. It ought to be explicit.

Governor Fancher. It ought to be uniform for all the banks.

Mr. Wyatt. It seems to me, if such a thing is gotten up, the board should publish say in the December bulletin what has been determined upon, and the same statement could be circulated by all the Federal Reserve Banks. We get a lot of letters now inquiring about these loans.

Governor Fancher. It would be necessary for each Federal Reserve Bank probably to serve notice on all the banks in its district, member and non-member.

Mr. Wyatt. Of course, the other angle to it is that it may encourage the banks to expect to re-discount the paper.

Governor Bailey. Most of them know it now.

Governor Wellborn. They cannot charge over 6 per cent?

Mr. Wyatt. No, sir.

Governor Wellborn. That will not be very attractive to them, anyhow. I think we ought to try as much as possible to help the veterans. We ought to carry it out in good faith.

Governor Seay. I think the banks ought to help them.

Governor Norris. One of the operating men in our bank has gotten up a form to be issued to the banks, a form of note and a form of affidavit. So that, if you want to have him help you in this thing, he will be at your service.

Mr. Wyatt. I would like very much to have that anyway if this committee is appointed. I would like to have him on a committee.

Governor Talley. I have a set of regulations written out here, which if you adopt I guarantee you won't get many of these discounts.

Governor Fancher. How large a committee do you want? We will let you select the men.

Mr. Wyatt. I do not care.

Governor Fancher. Suppose a committee of three from

banks that are nearby or are acceptable.

Mr. Wyatt. Of course any bank that has any strong feelings about it would like to be represented.

Governor Case. There is a motion before the house that you should appoint a committee, in consultation with Mr. Wyatt, of operating officials, to prepare the necessary papers dealing with this subject.

Governor Seay. And I have supplemented it, Mr. Chairman, by suggesting that they should be representatives of different banks and not necessarily officials around the table.

The Chairman. We will make that a committee of three, if there is no objection.

Governor Seay. With due deference to you, I believe that we should have more than three banks represented on that committee.

The Chairman. I think three would be enough. What do you suggest, Mr. Seay?

Mr. Seay. I would say five.

Mr. Talley. I suggest that is to be composed of representatives of banks nearer Washington.

Governor Calkins. I suggest that it be representatives

from banks near to Washington and distant from Washington. I think there should be one from Minneapolis or Dallas, -- not to say San Francisco.

Governor Young. I think a small committee of three is sufficient.

Governor Calkins. Three is a plenty.

Governor Young. The collection committee could handle it very nicely. They always refer it to the banks before making any recommendation. This committee can go ahead and get this up and refer it to the banks and they can do it very nicely.

Governor Calkins. I second the motion for three.

Governor Seay. I acquiesce, Mr. Chairman.

The Chairman. There will be a committee of three.

That is settled.

Governor Norris. . Has Topic 1-H been settled?

The Chairman. That has been settled.

Governor Norris. It has not been voted on.

The Chairman. I thought it had. What is to be acted on ?

Mr. Harrison. Governor Fancher moved that the Chairman appoint a committee of three of the operating

officials of the Federal Reserve Banks, to be selected by him to work with Mr. Wyatt in devising regulations and forms, including a circular letter to be distributed concerning those circulars and forms relative to the discount of notes secured by adjusted service certificates under the provisions of Section 502 of the World War Adjusted Compensation Act.

Governor Wellborn. I second the motion.

(The motion was put and unanimously carried.)

IV. OPERATION AND ADMINISTRATION.

D. Advisability of the Board adopting for all National Banks a minimum capital requirement and imposing other requirements in connection with its granting authority to such banks to exercise trust powers.

The Chairman. The next Board topic which I find is IV-D, "The advisability of the Board adopting for all National Banks a minimum capital requirement and imposing other requirements in connection with its granting authority to such banks to exercise trust powers."

What do we want to do with that subject? I have an expression here from our counsel on that. It may help some, ^{and} it is not very long:

"The power of the Federal Reserve Board to establish a minimum capital is clear, all as pointed out by the general counsel of the Board in his letter above referred to; but the necessity or propriety of establishing such rule is, by no means, clear.

" If the Board, in the exercise of its undoubted power, is convinced that no national bank with a capital, for instance, of less than \$50,000 should be granted trust powers, the pronouncement of such conclusion might lessen the labors of the Board in considering individual cases of national banks having less capital than \$50,000; for, in that event, of course, these banks with smaller capital would not make application, having been advised in advance that no such application would be acted upon favorably.

" On the other hand, it occurs to me that the banks with a smaller capital ought not to be deprived of the right to exercise trust powers without a consideration by the Board of the needs of the community to be served and other facts and circumstances that might have a just bearing on whether or not the permit should be granted.

" In my view of the matter it seems to me that under the law every national bank is entitled to have its application

considered on its merits and be refused or granted a permit after the Board has considered all the things which the statute provides the Board has a right to consider in determining the question.

"Then, too, I am inclined to the view that the establishment of such a rule by the Federal Reserve Board might have the effect, and in fact probably would have the effect, of calling down on the Federal Reserve Board the condemnation of the smaller banks. On that account it seems to me it would be a very short-sighted policy on the part of the Board to establish the hard and fast rules suggested. The Federal Reserve Board and the Federal Reserve System need, and should have, the good will of all the smaller banks. It seems to me the establishment of this rule could answer no really good purpose and might have the effect of destroying some good will which the System should have.

" Yours truly,

(S) Chas L. Powell,

Counsel."

Governor Seay. There is a great deal to be said on the other side, however, I believe. The qualifications of the executives of a very small bank, exercising trust

powers, are extremely limited. They are not as good as those of a prominent individual of a community which would be likely to be called on to act as executor or administrator, and so forth. So that there is something to be said on the other side.

The Chairman. That would not be solved by increasing the minimum capital to \$50,000.

Governor Seay. It would help, in those states which do not place a minimum capital and whose state banks therefore are qualified to act as administrators. There might be some competition between small state banks and small national member banks. So that that is a complex question, if you solve it alone on capital limitation, but nevertheless capital limitation is an important element in it, as I believe. It is certainly true that banks with small capital and resources which cannot possibly pay for competent management, are in a very much better position to exercise fiduciary powers, and I have been afraid that sooner or later the failure of some small bank which has been granted fiduciary powers would bring the Federal Reserve System into disrepute, which is a possibility which we cannot wink at.

Governor Fancher. Our counsel states that the Federal Reserve System is at some disadvantage in some of the states that make no capital requirement. There the national banks would be under some handicap.

Governor Seay. Yes. Whether or not it is better to suggest a handicap is a question to be determined, but of course it would be some handicap from the standpoint of the national bank, when it is compared with the state chartered banks.

Governor Galkins. There is very much to be said in favor of placing a limitation upon capital. There are several reasons why small banks should not exercise such powers, the first one being that they are generally incompetent. The second and perhaps a better reason is, if we attempt to set up a trust department in a small bank, it always results in a loss. Small banks deceive themselves in thinking it is desirable to go on a trust basis. However, I do not believe that there is any equitable ground on which the Federal Reserve bank can establish a minimum capital. The question is first bound up with the provisions of state laws with regard to trust companies, and the second is whether or not it is proper for the Federal Reserve bank to discriminate

among member banks on the basis of capital only. My own opinion is that it would be very inexpedient to place any trust powers upon any bank with a capital of less than \$250,000.

Governor Fancher. So far as the Fourth District is concerned, the states have provided for that. Ohio requires \$125,000, Pennsylvania \$125,000, West Virginia \$100,000, and Kentucky \$50,000. So that capital requirements are very definitely provided for in the state laws.

Governor Wellborn. That would be the best solution of this matter, just to require a deposit of so many bonds from a bank.

Governor Seay. On the other hand, in North Carolina, the capital requirement is as low as \$15,000.

The Chairman. For a trust company?

Governor Seay. Yes, sir, with fiduciary powers under state laws -- \$30,000 in cities and towns having a population between 10,000 and 15,000, and \$15,000 being the lower limit.

The Chairman. I was favorably impressed with Governor Calkins' statement, and I wish you would put that motion anew in a few words. You move what?

Governor Calkins. I move that it is the sense of this meeting that it is inexpedient for the Board to place any capital limitation upon banks applying for permission to exercise such powers.

Governor Wellborn. I second that.

The Chairman. Is there any comment or discussion?

Governor Seay. I would like to go on record as saying that while I would vote for that, I nevertheless believe that from other points of consideration it is desirable to place a limitation of capital upon those banks which should be granted trust powers. That just goes into the record, though. I do not believe that under all the circumstances of the case it is expedient to do it.

Governor Calkins. I do not say it is undesirable. I did say that I thought it was inexpedient. It would seem to me to explain itself. The word "inexpedient" is used for, while it might be desirable, it would be bad policy. I would be glad to have it amended.

Governor Seay. I would amend it to this extent, that even in the opinion of the Conference there are many sound reasons why a limitation upon capital should be placed upon these banks granted fiduciary power, nevertheless, in

view of the wording of the law, it is inexpedient to attempt to govern the grant of trust powers by a limitation of capital.

Governor Wellborn. How will it do to amend this motion just to make a suggestion on our part that they consider some plan of requiring banks to purchase bonds to protect the extending of this power?

The Chairman. No.

Governor Calkins. I accept Governor Seay's amendment, and I would like to amend it further, by saying that owing to the provisions of the law and the further fact that the authority to exercise such powers is governed by different provisions in different states.

Governor Seay. I withdraw my amendment, and he has down what he wanted to do in the original motion, and I very gladly accept the original motion.

The Chairman. Will you state the motion, Mr. Calkins?

Governor Calkins. It is the sense of this meeting that it is inexpedient for this Board to place a capital limitation upon banks applying for authority to exercise trust powers in view of the provisions of the law, and the further fact that the exercise of trust powers by

State Banks is governed by different laws in different states.

Governor Norris. I second that motion.

The Chairman. Governor Seay, do you second it?

Governor Seay. I second it.

(The motion was put and unanimously carried.)

Governor Fancher. In connection with this topic, I think there is some language there "and imposing other requirements" that I would like to make a suggestion about. There has been a situation which we have observed in our district that trust powers are granted banks, and they simply don't qualify for some time. They do not qualify at all, for instance. We have granted such powers to 158 National banks and 46 have not qualified. We consider the applications based on the condition of the bank from which the application came, and if all the conditions were met and it was in satisfactory condition, and we are satisfied with the management and that they understand what they are undertaking, we recommend that the trust powers be granted. Now, that situation might change in a few months. It rather seems to us that the Board, in granting the trust powers, should impose a time limit when they

disqualify. Otherwise they should renew the application and let that application be considered a new.

We considered the application of one of our National banks along in May, 1925, when the condition was very good, as far as we could learn from the customers' report and upon investigation. Shortly after trust powers were granted, it took over a State bank which proved to be not in good shape, and when the bank was next examined it was very severely criticised, many things were subject to criticism, and when we got that report and went into it carefully, we learned that the bank had not up to the time of examination qualified by depositing its security with the state, and our committee recommended to the Board that permission be withdrawn, and the matter has been before the Board, has been the subject of some correspondence, and I do not know that the counsel has rendered a formal opinion as to whether the Board has the right or not, but it seems to be the feeling in the minds of some on the Board that they could withdraw those powers. I can see that had the bank accepted the trust there might be possibly a complicated situation, but the bank never having qualified by complying with the Ohio state laws and de-

posited securities, we certainly, with the condition revealed by the second examination, would under no consideration recommend that the powers be granted.

It seems to us that there ought to be a time limit after the trust powers are granted for the bank to qualify.

Governor Galkins, I judge, by Governor Fancher's statement, that the counsel for the Federal Reserve Board appears to be of the opinion that the Board cannot withdraw permission once it is granted,

Governor Fancher. I do not think that has been so stated, but in discussing the matter with members of the Board that has come out, that there is some question as to the matter.

The Chairman. Do you want that settled here?

Governor Fancher. I think it might be very proper to suggest to the Board that in granting trust powers to National banks there should be some limit to the bank qualifying. I would suggest that some time limit be placed by the Board for banks before trust powers are granted.

The Chairman. If there is no objection, that will be taken as the sense of this conference.

Governor Seay. There are points which it might be expedient to incorporate in regulations and which we might suggest to the Board for consideration in granting authority in specific cases. One of them developed in the previous discussion here. I think one of the things either here at the table or outside stated that it was the custom to consider the ratio of capital funds to deposit. That is a very important matter, and it might be suggested in granting this authority in specific cases that capital funds to deposit should be taken under consideration.

I move that it be suggested to the Board that in practice it would be appropriate for it to take into consideration the relation of capital funds to deposit when a bank applies for authority to exercise trust powers.

The Chairman. Does anyone second that motion?

Governor Calkins. I will second it.

Deputy Governor Case seconded it.

(The motion was put and unanimously carried.)

IV. OPERATION AND ADMINISTRATION.

E-6. Authority of a Federal Reserve Bank to receive deposits or securities for safe keeping from farm loan registrars, Federal Land Banks and intermediate credit banks.

The Chairman. The next subject is for E-6, "Authority of a Federal Reserve Bank to receive deposits or securities for safe keeping from farm loan registrars, Federal Land Banks and intermediate credit banks." There is a Board letter on that. I do not know what action, if any, we can take on this. At the last meeting it was voted to be the sense of the conference that the Federal Reserve Banks have no legal authority to receive deposits or securities for safe keeping from Federal Land Banks and farm loan registrars.

Governor Seay. In the case of our bank, we frequently hold a few securities for farm loan registrars, but as I recall the Farm Loan Commission or Farm Loan Board developed some objection to that plan, and latterly we have been holding these securities ^{for} the chief commissioner of the Farm Loan Board for the registrars, and we find that plan works more satisfactorily than the former plan.

Governor Galkins. Mr. Chairman, I have an opinion by our counsel which is quite along that line. The substance of it is:

"It is my opinion that Federal Reserve Banks possess legal authority to receive for safe keeping funds and secu-

titles from Federal intermediate credit banks, but that they do not possess such legal authority in relation to farm loan registrars and Federal land banks."

Governor Seay. How about the Farm Loan Board?

The Chairman. That is in harmony with the opinion of the Board's counsel.

Governor Calkins. Exactly.

Governor Seay. That we have that authority?

The Chairman. That we have not that authority. The last paragraph in the Board's counsel's letter is "We are without legal authority to receive such deposits."

Governor Seay. That states Federal land banks. Are you of the opinion, Mr. Calkins, that that includes the Farm Loan Board itself?

Governor Calkins. I think so. I will read the whole thing if you would like to hear it.

Governor Seay. If it is very long and you know what it says, I would take your word for it. It is a different matter from the Farm Loan Board and the farm registrar and the farm land banks, even.

Governor Norris. You could not accept them from the Farm Loan Board. They are not the property of the Farm

Loan Board.

Governor Seay. We receive them from the chief commissioner of the Farm Loan Board.

Governor Norris. He can only hold them as the agent for the farm loan bank.

Governor Calkins: This opinion is that we have no authority to accept them from the farm loan registrar.

Governor Norris. If you have no authority to accept them from the farm loan registrar or the Board, you would have no authority to hold them for the commissioner.

Governor Seay. It is a question of who is the principal.

Governor Norris. They are the principal. If you had no authority to accept deposits or securities from another Federal reserve bank, you could not accept it from the Federal Reserve Board, acting for the Federal reserve bank in the matter.

Governor Calkins. The paragraphs that perhaps will be interesting are as follows:

"It is my opinion that Federal reserve banks possess legal authority to receive for safe-keeping funds and securities from Federal intermediate credit banks but that

they do not possess such legal authority in relation to farm loan registrars and Federal lands banks.

" I believe that under the seventh subdivision of section four of the Federal Reserve Act, Federal reserve banks have, in addition to the powers specifically given them, such incidental powers as are necessary to carry on the business of banks within the limitations of the Federal Reserve Act and that if it were not for other facts hereinafter disclosed it might be reasonably said that Federal reserve banks, under the general provision of section four of the Federal Reserve Act, have authority to receive for safekeeping securities from farm loan registrars and Federal land banks. It is a familiar rule of statutory construction, however, that when specific authority for a certain kind of business is given with restrictions definitely prescribed, general authority of the kind specifically limited may not be exercised.

"By section fifteen of the Federal Reserve Act, the Federal banks are required, when requested by the Secretary of the Treasury, to act as fiscal agents of the United States. By the last provision of the same section Federal reserve banks are specifically authorized to act as depositories

for and fiscal agents of any national agricultural corporation or Federal intermediate credit bank. This provision of section fifteen was added by amendment (Act of March 4, 1923). By section fifteen of the War Finance Corporation Act, approved April 5, 1917, as amended August 24, 1921, the Federal reserve banks were specifically authorized to act as depositories for and fiscal agents of the War Finance Corporation. It will thus be seen that whenever Congress has seen fit to authorize Federal reserve banks to act as depositories for or fiscal agents of the Government or quasi governmental corporations, the power has been specifically granted and has not been left to implication.

"The Federal intermediate credit banks are organized under an act which is in fact an amendment to the Federal intermediate credit banks was incorporated in the Federal Intermediate Credit Act as Section 406. The Farm Loan Act, as amended to date, contains no provisions which could be reasonably construed as conferring upon farm loan registrars or Federal land banks the right to deposit their funds with the Federal reserve banks nor any provision empowering Federal reserve banks to receive such funds. Section thirteen of the Federal Farm Loan Act, defining

the powers of Federal Land banks, specifically empowers such banks to deposit their securities and current funds subject to check with any member bank of the Federal Reserve System, and to receive interest on the same as may be agreed. It would require a forced construction of this provision to say that it empowered Federal reserve banks to receive such securities and current funds for safe-keeping.

"Therefore, inasmuch as Congress has in each instance seen fit to specifically legislate when conferring upon Federal reserve banks the power to act as fiscal agents of or depositories for other organizations and has not seen fit to so legislate in the case of farm loan registrars and Federal land banks, I am of the opinion, as hereinbefore stated, that Federal reserve banks are without legal authority to receive deposits of funds or securities from farm loan registrars or from Federal land banks for safe-keeping. This, of course, is not intended to include deposits made by Federal land banks in anticipation of maturing coupons on farm loan bonds which are to be paid by the Federal reserve banks. Such deposits, the Federal Reserve Board has ruled, may be received under the pro-

visions of Section 13 of the Federal Reserve Act relating to collection and exchange accommodations to non-member clearing banks (Federal Reserve Bulletin 1917, p. 818; 1918, p. 435).

"The provisions of Section 405 of the Agricultural Credits Act of 1923, empowering Federal reserve banks to act as depositories for and fiscal agents of Federal intermediate credit banks, of course includes authority to receive from such intermediate credit banks securities and funds for safe-keeping."

The Chairman. That opinion is in accord with our counsel. Are there any other members here whose counsel has passed upon the question involved?

Mr. Talley. Ours is in accord with it.

Governor Norris. Of course, Mr. Vest's opinion called attention to the fact that if the Secretary of the Treasury asked us to do it, we would have to do it.

Governor Seay. On what ground, the fiscal agent of the government?

Governor Norris. As the fiscal agent of the government, yes. He can require the Federal reserve banks to receive such deposits from the Federal land banks and

from farm loan registrars as are required of them under certain sections of the Farm Loan Act. That is a separate thing, that is where the Secretary of the Treasury deposits money.

Governor Calkins. I move that it is the sense of this conference that the Federal reserve banks have no legal authority to receive deposits or securities for safe-keeping from farm loan registrars and Federal land banks.

Governor Norris. And joint stock banks.

Governor Calkins. And joint stock banks.

Governor Bailey. Or the intermediate credit banks.

Governor Calkins. We have specific authority for them.

The Chairman. What do you suggest, Mr. Norris?

Governor Norris. I suggest adding the words "joint stock land banks" to it.

The Chairman. That is not included in the question.

Governor Norris. I know it is not, but we might well include it.

The Chairman. I think we might eliminate it.

Governor Seay. Would you say we have any specific authority to hold securities from member banks?

Governor Calkins. That is another question.

Governor Seay. I would like to ask the proponent of that resolution if he means thereby the Federal reserve banks should not receive deposits of securities from farm loan commissioners?

Governor Calkins. I think we have no legal ^uauthority to hold securities for anybody except the intermediate credit banks.

Governor Seay. I ask also if anybody can give the authority for holding securities for member banks, and if they cannot do so, then doesn't it appear that Federal reserve banks may at their discretion hold securities for whomsoever they may desire?

The Chairman. I think it would be best to let our action apply to the bank or to the institutions that are named in the question, because by doing that we have the counsel of the several banks behind us, but if we incorporate Mr. Norris' suggestion, we would have to modify it perhaps at some time.

Governor Calkins. I offer my resolution as originally offered, without the addition of the joint stock land banks.

Governor Norris. I won't go to the trouble of offer-

ing it as an amendment.

(The motion was put and unanimously carried.)

IV. OPERATION AND ADMINISTRATION.

F. Question of Federal reserve banks representation at bankers' conventions -- to what extent should Federal reserve banks be represented by officers and employees.

The Chairman. The next topic will be IV-F, "Question of Federal reserve banks representation at bankers' conventions -- to what extent should Federal reserve banks be represented by officers and employees."

Governor Calkins. Mr. Chairman, representation of a Federal reserve bank in a State bankers' convention held within its district and at meetings of groups of State bankers' associations within its district is for obvious reasons highly desirable. Attendance of one or several representatives of the Federal reserve bank at the American Bankers' Association held in its district, at which many representatives of its member banks will be present, appears to be also desirable. Generally, representation at conventions of the American Bankers' Association outside its district is unimportant. In any case, where it appears that a bank should be represented at conventions of the

American Bankers' Association outside its own district, the question whether it was expedient to send one officer or more than one officer would be determined by the reason or reasons for being represented.

The Chairman. Is there anything else to be said on this subject?

Governor Seay. I am quite in sympathy with that, Mr. Chairman. I think the Federal reserve banks ought to be the judges of whether or not it is desirable to send one representative or more than one representative, and it may well be left with them. I know that in the case of state meetings it is very often desirable in our opinion to send one or more men who will come in contact with our member banks.

The Chairman. I would like to hear Governor Calkins' motion read again.

Governor Bailey. It was a statement of opinion.

Governor Calkins. I will make it as a motion if somebody wants to oppose it.

Governor Wellbern. Mr. Chairman, I think it would be well to get an expression on this subject.

The Chairman. I have here something which I was very

doubtful as to whether I would present or not.

Governor Seay. We all maintain bank relation departments, and we send our representatives to this and that and the other bank.

The Chairman. Will you put your ideas in the form of a motion, Governor Calkins?

Governor Calkins. I will make it in the form of a motion:

It is the sense of this conference that representation of a Federal reserve bank in a State bankers' convention held within its district and at meetings of groups of State bankers' associations when within its district is for obvious reasons highly desirable. Attendance of one or several representatives of the Federal reserve bank at a convention of the American Bankers' Association held in its district, at which many representatives of his member banks would be present, appears to be also desirable. Generally, representation at conventions of the American Bankers' Association outside its district is unimportant. In any case, where it appears that a bank should be represented at conventions of the American Bankers' Association outside its own district, the question whether it

was expedient to send one officer or more than one officer would be determined by the reason or reasons for being represented.

Governor Bailey. Who is to determine those reasons?

Governor Seay. I think the board of directors should be the judge.

Governor Bailey. Yes.

The Chairman. I think we should move that that should be determined by the board of directors of the reserve bank involved. I think it should be left very plain.

Governor Norris. The question that the Board asked was whether or not it would not be possible to suggest some uniform practice to be followed. I have drafted a resolution here which I think is almost identical with this, except I have shortened it a good deal. May I read it, and possibly you will adopt it?

Governor Calkins. I will second it before you read it.

Governor Norris. Resolved, that the representation of Federal reserve banks at conventions in their own district is of the utmost importance, and that such attendance at conventions outside of their district is sometimes advisable, and that the determination of such questions is

one which must necessarily be left to the officers and directors of each reserve bank and it is impossible to lay down a uniform practice.

(The motion was seconded by several of those present, and the motion was put and carried.)

IV. OPERATION AND ADMINISTRATION.

G. Advisability of seeking an amendment to the law to restore to Federal courts jurisdiction over suits by and against Federal reserve banks.

The Chairman. There is just one other question here suggested by the Board, IV-G:

"Advisability of seeking an amendment to the law to restore to Federal courts jurisdiction over suits by and against Federal reserve banks."

This topic was considered at the last conference of governors, at which time it was voted that the counsel of the Federal reserve banks declare opinions on the subject, and that opinion be forwarded to the Board.

Governor Wellborn. Our counsel has already signed an opinion and sent it to the Board covering that subject.

The Chairman. Our counsel has done likewise and recommended an amendment, that is, the advisability of having an amendment to the law to restore to Federal courts the jurisdiction over suits by and against Federal reserve banks.

Governor Calkins. We approve Mr. Wyatt's suggestion for an amendment.

Mr. Talley. Which one -- the third?

Governor Bailey. That is the one he recommended.

Mr. Talley. He speaks about two others.

The Chairman. Our counsel favored the third suggestion, whatever that was.

Dave
fols

S.

1

Governor Bailey. So did ours. I make the motion that the amendment No. 3, as recommended by the counsel of the Federal Reserve Board, be adopted.

The Chairman. What is that?

Governor Calkins. No. 3 is "an amendment might be sought to the above quoted provision of the Act of February 13, 1925 changing the proviso to read somewhat as follows:

"Provided that this ^{section} shall not apply to any suit, action or proceedings brought by or against a Federal Land Bank, joint stock land bank, Federal Reserve bank or any incorporation incorporated by or under an act of Congress wherein the Government of the United States is the owner of more than one_half of its capital stock."

Governor Bailey. It puts it back where we were before.

The Chairman. That motion is made and seconded. Are you ready for the question?

Deputy Governor Case. In addition to the approval of this amendment No. 3, our counsel makes a suggestion that we think well of, and that is that legislation be enacted exempting Federal Reserve Banks from the process of attachment or garnishment before final judgment in ~~any case~~ precisely as national banks are now exempted under the provi-

3

sions of the Revised Statutes of the United States.

Governor Norris. Our counsel makes the same suggestion.

Governor Bailey. So does ours.

Governor Norris. But that would be an amendment to the Federal Reserve Act.

The Chairman. What is the question?

Deputy Governor Case. Our counsel in approving this amendment No. 3 says:

"I think it is desirable also that legislation be enacted exempting Federal Reserve Banks from the process of attachment or garnishment before final judgment in any case, as national banks are now exempted under the provisions of the Revised Statutes of the United States."

That is rather an important principle to be established. I recommend that that be a part of our action on this subject.

Governor Norris. I second the motion.

(The motion was put and unanimously carried.)

(Whereupon, at 5:30 p.m. an adjournment was taken until tomorrow, Tuesday, November 9, 1926, at 10 o'clock a.m.)

A CONFERENCE OF GOVERNORS OF THE FEDERAL RESERVE BANKS.

Washington, D. C.,

Tuesday, November 9, 1926.

The Conference reassembled, pursuant to adjournment, in the hearing room of the Federal Reserve Board, Treasury Building, Washington, D. C., on Tuesday, November 9, 1926, at 10 o'clock a.m.

Appearances:

(As indicated on the first day's record, with the addition of Mr. H. F. Strater, Cashier of the Cleveland Bank, Chairman of the standing committee on corrections.)

PROCEEDINGS.

The Chairman. Governor Fancher, are you ready to go on with Topic 1-(g)?

Governor Fancher. Not for the record.

The Chairman. That topic is:

"1. Credit transactions and policies.

"G. Notes of parent corporations representing borrowings to be advanced to subsidiaries."

4

Governor Talley. I would like to ask Mr. Fancher if he thinks that this regulation would permit the eligibility of notes of cottonseed oil mills when a part of the proceeds are advanced to gins which are owned by the oil mills, for the purpose of buying cottonseed. I would like to ask if in your judgment this regulation would prevent the eligibility of notes of the landlord where they used the proceeds to plant cotton?

Governor Fancher. That does not apply to the matter at all.

Governor Seay. We are not corporations.

Governor Talley. I know we are not corporations, but that is getting back to the question of Mr. Calkins of what determines eligibility for the use of the proceeds.

Governor Calkins. Exactly.

The Chairman. This discussion applies to parent companies that are operating subsidiaries entirely.

Governor Talley. Oil mills operate gins as subsidiaries. The question of eligibility comes in just the same. The principle is the same.

Governor Seay. Say what you will, there is a substantial difference between an absolutely independent company and a controlled company. While the paper of the absolutely

independent company is eligible under the conditions set forth down here, excluding the 51 per cent, nevertheless when you come to the inter-related companies I cannot help feeling that it is an important safeguard to insure control over the parent companies.

Governor Calkins. Inasmuch as this discussion seems to be a controversy, I would like to read this memorandum:

"The relative X letters Nos. 4692, 4484, 4560, 4560A, 4560B and 4602, while ostensibly presenting a question of conflict with the Board's regulations and rulings relative to finance paper, to me center primarily upon the method of analysis.

"The correspondence would indicate that Hanna and Company had a net working capital of approximately \$10,400,000, of which \$2,150,000 was represented by advances to corporations in which they had no stock interest and corporations in which they had less than a 75 per cent interest. If the total advances of \$2,150,000 were deducted from this net working capital, it might properly be contended that none of the proceeds of Hanna and Company's borrowings were used for the purpose of making advances to corporations in which they had no interest, or in which they had an interest of

less than 75 per cent, but that such advances were made out of their own free working capital.

"However, the method of analysis employed apparently assumes that any borrowings become a part of the general working capital; and, if any part of the working capital be used for an ineligible purpose, the whole of the parent corporation's borrowings become ineligible."

Which is absurd.

"Should this method be generally applied, it would not only result in the rejection of a very large proportion of paper issued by corporations with subsidiaries, but would affect practically all paper offered. The mere fact that a parent corporation had made an advance of a wholly inconsequential amount to a subsidiary in which it had less than a 75 per cent stock interest, or to a subsidiary which did not show an excess of quick assets over current liabilities, would render the paper of the parent corporation ineligible. The same method would make a farmer's note ineligible if the statement showed any increase in fixed assets while borrowing, notwithstanding any excess of quick assets over current liabilities.

"It will be interesting, as an example, to note what

would be its effect upon the paper of the Commercial Company, which owns in their entirety eight subsidiaries and 50 per cent of one subsidiary, has a consolidated net working capital of over \$6,000,000, is engaged wholly in merchandising with but small fixed investments and is in the highest credit standing. The parent company has made advances to all subsidiaries in varying amounts, that due the 50 per cent owned subsidiary being \$100,000. Five of the wholly owned subsidiaries do not show an excess of quick assets over their current liabilities to the parent concern. Under the foregoing form of analysis, the paper of the Commercial Company would be ineligible on two counts;

"(1) That it had loaned to a subsidiary in which it did not have at least a 75 per cent interest; and

"(2) the borrowings of five of its subsidiaries had not been used for an eligible purpose insomuch as the borrowings from the parent corporation were in part represented by assets of an ineligible nature.

"Our method of analysis, and one which we think is correct, presupposes the advance to the 50 per cent owned subsidiary and that part of the advance to the five owned subsidi-

8

ries represented by ineligible assets to have been made out of the free working capital of \$6,000, leaving any borrowings amply covered by assets of an eligible character. We believe the method which we have employed to be in harmony with the regulations of the Board, which state in Regulation IV (b) 2 -

"Compliance of a note with II (c) may be evidenced by a statement x x x x showing a reasonable excess of quick assets over current liabilities."

Any regulation or ruling of the Board subjecting paper to the analytical method employed in the Hanna case would inevitably result in excluding most of the paper offered for re-discount, but we do not so interpret the regulations or rulings.

"The subject may, however, be intended to generally review the exception to finance paper, represented parent corporations' paper, rather than analytical methods suggested by the foregoing. If so, it would seem that the following facts and principles are germane to the discussion. In the industrial and commercial development of this country the corporate form of management has expanded to the point where many of our most important industrial units are

managed and controlled by many corporations welded together through the medium of a parent corporation but representing a complete and cohesive business unit. The subsidiary units, while separate legal entities, are engaged much as departments would be in fulfilling their particular function in the consolidated unit. Presumably this form of industrial management has grown on account of its greater efficiency, economy and stability as it has the sanction of law and of financial and industrial leadership. If engaged in those activities which give rise to credit, eligible in substance, it would seem the proper use of administrative and interpretive discretion to minimize the technical barriers growing out of the legal separation of corporate subsidiaries. The paper growing out of the financing of these units is distinct from 'finance paper' such as generally understood, and to my mind should be granted exceptions which could well be withheld from finance corporations engaged primarily in commercial banking not subject to the restrictions of banks of deposit. Other considerations would enter if the discussion were to cover the elimination of all provisions barring finance paper, but it is assumed that this discussion does not contemplate entering that field.

"The present regulations and rulings under the method of analysis we have employed to determine questions of fact relating to eligibility have not resulted in any serious restriction to the entrance of paper of the kind under discussion in this district. It seems difficult, however, to discern the reasons for the limitation of a 75 per cent stock ownership, and it is believed that this might well be modified to "controlling interest"; otherwise we have found little practical reason for requesting any radical modification of existing regulations."

In other words, the principle involved is the use or the purpose for which the money is to be borrowed or has been borrowed.

The Chairman I agree with that last statement entirely.

Governor Fancher. But we have facing us here a regulation which the Board has put out covering the question of full subsidiaries and which we are attempting here to have modified, and now what is the best way to meet the situation? What this regulation in effect does is this, that you take a corporation without subsidiaries, there has never been any condition imposed as to the use of the funds. We look

to the statement and its condition and all the circumstances surrounding it and assume -- possibly not always right in the assumption, but assume -- it was for a purpose that would make the paper eligible. Here you imposed a restriction that you cannot do certain things which perhaps corporations without subsidiaries are doing, but with a liquid basis that the paper is accepted.

Governor Calkins. The acceptability or the eligibility of paper should be determined by two factors: First, the purpose for which the money is loaned; second, the consolidated statement showing the condition of the company as to equipment; and those are the only two vital questions involved.

Governor Seay. May I ask Governor Calkins how it would suit him to offer the first two lines somewhat to this effect, "Where a parent corporation owns or controls stock of each of a number of subsidiary corporations"?

Governor Calkins. I think that would be an improvement.

Governor Seay. Leaving out your 51 per cent.

Governor Calkins., But you are dealing with something that is not a principle at all.

Governor Seay. If we follow that up, it rather strengthens the situation. A noted of such parent corporation, the notes of which have been advanced, and so forth, and ther

it goes on to say, "Where the controlled corporation borrows only from the parent corporation." When you tie those two things together I think it strengthens the situation.

Governor Talley. Why not say "Owned and controlled" and then the proceeds of which have been loaned to the subsidiary corporation for an eligible purpose.

Governor Seay. That is satisfactory, I think. Isn't it, Governor Fancher?

Governor Fancher. Yes, sir.

Governor Calkins. I think that is an improvement — that suggestion — but it does not fit the principle, which is the only thing that is really of any consequence.

Governor Norris. The way it seems to me is that that is adopting a very indefinite sort of a standard. You say "Owns or controls."

Governor Calkins. As a matter of fact, the acceptability of paper of the character we are discussing should be determined in each individual case by the facts in that case and not controlled by an arbitrary ruling which has nothing to do with the principle.

Governor Norris. When the parent corporation owns at least 51 per cent, it is obvious that it does control.

13

Governor Seay. Yes.

Governor Norris. If the suggestion is to leave that control actual^{ly} and unquestionably, then it might just as well be 51 per cent. If it means less than that, then how are you going to do it? In our opinion, if the stock of a corporation is at all scattered, 40 or even 35 per cent ownership of the stock is practical control. Now, do you mean practical control, or do you mean absolute control, and if you mean practical control where are you going to draw the line?

Governor Seay. If you are tying it up with No. 3, it makes practical control, "the subsidiaries borrow no money except from the parent corporation."

Governor Wellborn. You could leave out "control", because if you own you control.

Governor Norris. Actual control is 51 per cent, or dear knows what.

Governor Wellborn. It may be a lot less than 51.

Governor Calkins. As a matter of fact, each case has to be analyzed and considered by itself. The determination of acceptability of paper cannot be determined by an arbitral rule, without an invasion of our rule of not making advances

except for specific purposes -- those purposes specified in the law. That is the determining question, and not any specific percentage of stock ownership.

Governor Norris. And in another case, a parent corporation might own only perhaps 20 per cent, and they might say "Our directors individually own 30 per cent, so that we have practical control."

Governor Calkins. I think that, coupled with three, the suggestion Governor Seay makes is an improvement.

The Chairman. What Governor Calkins would like to find out is the significance of the 51 per cent or 75 per cent. Is that it?

Governor Calkins. There is no difference in principle between 51 and 75 per cent, only an attempt to determine by an arbitrary ruling in regard to the percentage of ownership the purpose for which the money is advanced. It cannot be done. My position is, as I have stated before, that there are two questions involved: First, the use of the money, the purpose for which the money is advanced. That is in the law. Second, the condition of the borrowing company, as shown by its consolidated statement, which in the case of Hanna and Company, would show a net free capital of \$8,250,00

after eliminating the advances of \$4,150,000 to corporations in which it does not own 75 per cent. That statement would make them perfectly acceptable, the question of eligibility being determined by the use of the money, and I think it is unnecessary to injure any other provision.

Governor Seay. Mr. Chairman, there certainly is no difference where the paper of a parent corporation whose statement shows the paper to be eligible, is given to an outside personal corporation for an eligible purpose, or given to another corporation in which if they have an interest for an eligible purpose. There is no difference. The only question is whether it is necessary to throw an unusual safeguard around the paper of the parent corporation when it is related to a number of subsidiaries. I do not know whether it is or not. If you will provide, as this resolution attempts to provide, that it must be issued for eligible purposes all around, that would be a different matter.

Governor Calkins. In the case I referred to, the advances made by the parent corporation to its subsidiaries, including the one in which it owned only 50 per cent, are practical advances of stock in trade to be resold, that might just as well be called that as advances in money. The parent cor-

poration provides its subsidiaries with the stock which they sell -- stock in trade, I mean; I do not mean the stock in any other sense. It happens that it advanced \$100,000 to one in which it owned only 50 per cent. The ratio of quick assets to current liabilities is 218. Its credit is absolutely first class, and there is not a better corporation of its kind anywhere in the country, and to exclude the paper of that corporation because it had made an advance to a subsidiary in which it owns 50 per cent for a strictly eligible purpose, is the height of absurdity.

Governor Seay. The danger, of course, lies in the violation of that fundamental principle, which requires funds to be used in the first instance.

The Chairman. I do not get anything from this discussion that is better adapted to the situation than Mr. Fancher's own recommendation. Read that recommendation.

Governor Fancher. It is before each of the Governors.

The Chairman. What does this do?

Governor Calkins. Nothing.

The Chairman. It does a great deal. It corrects the situation which has caused the difficulty. In the case of Hanna, the reason why the Hanna people were declared to be

ineligible was because that eligibility was desired because they were making advances to companies other than the companies that they owned. Those advances were apparently being made for legitimate purposes, to provide companies with the means of producing goods which were to be returned to Hanna, and that transaction is very different from what it would have been if Hanna had been loaning the money and taking the companies' notes. This suggestion of Mr. Fancher that he has framed is silent on that subject and we can take care of that very well. It seems to me that the suggestion that has been made here will be sufficient to give us latitude enough to operate, and operate on a uniform basis. I do not know what the significance is of stock control myself, and I do not think anyone here has been able to tell us.

Governor Calkins. Mr. Chairman, you don't mean to suggest that we should recommend a change in the regulations to suit the case of one concern?

The Chairman. Not at all, but that would be adapted to many concerns. There are many corporations and many companies that are not operating subsidiaries that are doing the same thing that Hanna is doing, according to this, and it is not noticed.

Governor Calkins. Well, I restate my objection.

The Chairman. Mr. Fancher, do you want to present yours?

Governor Fancher. Mr. Chairman, I would present this as a substitution for the regulations which the Board promulgated in their letter X-4484 under date of December 30, 1925.

Governor Young. Is that a motion?

Governor Fancher. I make it as a motion.

Governor Young. I second it.

Governor Calkins. If the motion is changed as suggested by Governor Seay, I will withdraw my objection and perhaps vote for it, but I shall certainly oppose it as it is.

The Chairman. Will you state your position again, Governor Seay?

Governor Seay. My suggestion was that the first paragraph be made to read about as follows:

"Where a parent corporation owns or controls the stock of each of a number of subsidiary corporations,"

Leaving out the 51 per cent, and my contention was that the idea conveyed by "owns or controls", connected with proviso 3 of the same resolution, would certainly es-

19

establish effective control, no matter what the ownership of the stock was.

The Chairman. Would you be willing to state "Owned or controlled through stock ownership?"

Governor Seay. Yes, sir, certainly.

The Chairman. How would that do you, Mr. Fancher?

Governor Fancher. I of course appreciate that that is a matter for the Board. They have a regulation here.

The Chairman. It is a recommendation.

Governor Fancher. It is a recommendation to the Board, yes.

The Chairman. That in effect is what you recommend, too?

Governor Fancher. Here in this recommendation we specifically say that the percentage shall be a stock ownership.

The Chairman. This would answer the same purpose.

Governor Fancher. In other words, this defines the percentage of stock ownership which is recognized as a control.

Governor Norris. I can vote for the resolution in its present form. If it is amended in that way, I would feel obliged to vote against it, because the proposed amendment is the substitution of an uncertain and indeterminable thing for an absolute foothold.

The Chairman. The question is on this recommendation, of Governor Fancher, which has received a second. Is there any further discussion?

Governor Calkins. I move an amendment to it --

Governor Norris (Interposing:) The question is on the amendment.

Governor Calkins. I move it as an amendment.

Governor Seay. Of course, the Board may take the view, "What do you mean by it?"

Governor Talley. It makes it a question for determination and leaves it to the Federal Reserve Bank to determine it.

Governor Norris. And it can have no possible means for determining it.

Governor Talley. It does not mean anything.

Governor Seay. That is true.

Governor Calkins. You cannot make a thumb rule to accept or reject every piece of paper.

Governor Talley. I would like to say, briefly, that the circumstances surrounding the paper used in the illustration makes the paper eligible. I think the trouble is with the regulation, both the original regulation and the other

one, and even the last one suggested is still too definitive.

The Chairman. Well, the question is on the proposed amendment. Are you ready for the question?

(Cries of "Question, Question.")

The Chairman. There are some ayes and some noes.

(Cries of "Division, division.")

The Chairman. The ayes will please raise their hands.

(Five of those present voted in the affirmative.)

The Chairman. The noes will please raise their hands.

(Six voted in the negative.)

The Chairman. That will leave the question now on Governor Fancher's motion. Are you ready for the question?

Governor Morris. The amendment has been lost, has it?

The Chairman. The amendment has been lost. Are you ready for the question?

(Cries of "Question, question.")

The Chairman. Those in favor of the recommendation as prepared by Governor Fancher will signify it by raising their right hands.

(Eight voted in favor of the recommendation.)

Governor Fancher. Mr. Chairman, here is a note handed me by Mr. Wyatt, saying he would like to be present during

22

this discussion. Had we better call him in and tell him what has taken place here?

Governor Calkins. Mr. Chairman, the opposition would like to be recorded as having voted on this matter.

The Chairman. Those opposed will say "No."

(The Governors from Dallas, San Francisco and Boston voted "No.")

(At this point Mr. Wyatt came into the hearing room.)

The Chairman. We have just considered very carefully a suggestion which came from you and it has been voted to take that for recommendation to the Board.

Mr. Wyatt. I simply wanted to be in here during the discussion in order to get the point of view of any experience the Governors might have had, which would indicate the direction in which this thing is going to lead us.

As I told Governor Fancher when I discussed that tentative arrangement with him, I could not permit myself to do it in any way, but it seems to me that if he wants to make that ruling you have got to be prepared to rule that in any case where a borrower borrows funds to go into a general pot and out of that pot he makes some advances to other people, that nevertheless this paper is paper of a

business which is primarily industrial, commercial or agricultural. If you do that you have abandoned the interpretation of the Federal Reserve Act that in order for paper to be eligible the proceeds must be used in the first instance for an agricultural, commercial or industrial purpose.

Mr. Harrison. Has not the Board's original ruling done that very thing?

Mr. Wyatt. No, for this reason: The original ruling says that where you have got a group of subsidiaries and control all of them, the parent corporation makes the advance only to the subsidiaries, and the subsidiaries borrow no money from the parent corporation, then you disregard the corporate entity and consider the parent corporation and the subsidiaries as a single borrower — consider the group as a single borrower. You get away from the group here. You have not got any single borrower, because you have got this corporation making some advances to other parties who are not subsidiaries and not controlled, and if you once do that I think you have abandoned the fundamental principle on which your rule against finance paper is based. It is a question of how far you are going. I think it is possible to abandon that rule, but I do not think you should do it without knowin

how far you are going.

Governor Seay. Do you hold that opinion notwithstanding the three provisos herein incorporated?

Mr. Wyatt. Yes, because this is a case where your parent corporation is making advances, and that is one condition for eliminating the first condition in the old ruling.

Governor Fancher. In no previous ruling has the first condition imposed herebeen applied to any other corporation; in other words, that has been determined in determining the eligibility. You have determined that by the company's statement, by the nature of the corporation's business, and many things that surround that corporation. Now, you, by interjecting condition 1 there, you have the corporation with a group of subsidiaries which you attempt to recognize as a corporate entity under certain conditions, in a different position than you did the corporation without subsidiaries.

Mr. Wyatt. The Federal Reserve Board has never said in any ruling that if the corporation's statement is satisfactory and its business is principally commercial, all of its paper is eligible, even though part of it is used for finance purposes. The Board has never said that, and I think if the present existing rulings were carried to their

logical conclusion you would have to reject the paper of any borrower if he makes any advances to anybody else; but I think that is carrying it to a very extreme conclusion, and I think probably an undesirable conclusion. But this ruling forces us to come to the parting of the ways. You have got to do one or the other here. As I see it, if you are going to rule on it, you have either got to say that where a borrower makes certain loans to other parties all of his paper is ineligible, or you have got to say where a borrower makes certain loans to other parties his paper is not ineligible for that reason. You have got to carry the rule all the way, or you have got to break down the fundamental basis for your rule.

Governor Calkins. Is it breaking down the provision of law to say that if a parent corporation or a corporation is making inconsequential advances to John Smith, its whole paper is ineligible? Is that an invasion of the provision of the law?

Mr. Wyatt. I do not think it necessarily is, Governor Calkins, if you take the notes of the borrower to whom he makes advances and discount them at the bank, but here is the problem, as I see it: If a borrower borrows money, it

all goes into a general fund, a number of checking accounts, and out of those he draws money for all his purposes. If one of those purposes is to make advances to other people, it is impossible to say what portion of his borrowings is borrowings -- it is impossible to say what proceeds of this note is for commercial purposes and what portion is for finance purposes. The fact that he makes some loans to other people would seem to taint his entire borrowings with suspicion, at least. It is a question of where you will draw the line.

Governor Calkins. Referring to the case I see before me of a parent corporation, it owned outright eight subsidiaries and owned 50 per cent of one subsidiary. The business of the entire corporation is commercial; there is no question about that. The advances that it makes to subsidiaries might just as well be considered as advances of stock -- stock in trade in all cases -- as advances in money. They are simply stated in terms of money. Under the present ruling of the Board, as strictly interpreted, the fact that this corporation, the consolidated statement of which showed a ratio of 218, the fact that the company has loaned \$180,000 out of \$5,000,000 advanced to subsidiaries, to one in which

27

it owned 50 per cent only, would make all this paper ineligible

Mr. Wyatt. The Board has never said that, and I had hoped that the Board never would have that question put up to it. I am simply taking the extreme view to show in which direction it may lead. I think it would be very undesirable to have a rule if all of the money is used for making advances to other persons it would taint the whole borrowing, but on the other hand if you make this ruling, if you rule that the mere fact that part of the borrowings are used for making loans to other parties, then I cannot see where you are going to stop.

The Chairman. Do you think it is right, Mr. Wyatt, for the Board to make a ruling and stand by a ruling where, if a company like the Hanna Company, has advanced funds to an outside corporation for the purpose of producing coal or iron, which coal or iron has been bought under a contract by the Hanna Company -- do you think that is a justifiable ruling? I do not.

Mr. Wyatt. I would like to answer that question.

The Chairman. It is not an advance made on a note which is to be made in money, but it is an advance for the production of goods. If you are going to do that, and if it is car

ried to the extreme, of course it would apply to the other independent corporations or companies, which of course would be more or less absurd, and it would then create ineligibility for a great deal of the most desirable paper we have.

Mr. Wyatt. There are two answers to that. One is that exactly the same argument was made on behalf of the cotton factor, and the Federal Reserve Board, with the support of the Federal Reserve Banks, held out very strongly against the cotton factor's paper to the bitter end in the face of all sorts of opposition, with the result that finally Senator Heflin succeeded in tacking on a report to the agricultural credits bill to make that paper eligible for the use of agricultural products in their raw state. Technically that amendment might be construed as impliedly admitting the soundness of the Board's rule against finance paper, and impliedly saying that paper the proceeds of which have been used to advance to other parties shall not be eligible unless the advance is for the use of agricultural products in their raw state.

The other answer to your criticism is that all of this paper, just like the cotton factor's paper, could have been eligible if they would do their business in a slightly

different way. Hanna Company could take the note of its subsidiary, like it did for years, and put its own endorsement on it and discount it at the bank. If they did the business in that way it would mean no hardship on the subsidiary or the Hanna Company, either one. All of this question comes up as the result of the fact that the Hanna Company changed its way of doing business.

Governor Fancher. That may be true so far as the Hanna Company is concerned, but you have any number of concerns that operate a little differently where the advances are made, simply small advances. The situation in Chicago I think Mr. Whitmore brought out. He discussed that, did he not?

The Chairman. Chicago?

Governor Fancher. The Wilson Company situation?

The Chairman. He discussed particularly this Hanna paper, which he said happened to be very desirable as a financial risk from every standpoint, and stated that the obstruction in the way of eligibility was due apparently to the fact that Hanna & Company were making advances for the purposes that I have tried to outline here, to companies in order that they might be able to produce merchandise which

the Hanna Company had bought or would buy or had contracted to buy, and that that he considered was a perfectly legitimate and proper transaction and one that was indulged in by corporations, whether they had subsidiaries or not, and that if that destroyed the eligibility as a matter of fact you had better be careful or you would not be able to take very much good paper of corporations. He thought we ought to distinguish between advances made of that sort in order to assist in the production of goods, and advances that were made purely for finance in the matter of loaning the money and taking the notes. I would be perfectly willing to see this suggestion carried out and placed on the banks this responsibility, and that is where it belongs, of determining whether or not the borrower in question is conducting itself in accordance with the spirit of the law, and it will have to rest there finally anyhow. We cannot sit here and draw up any rigid, inflexible rules.

Governor Calkins. That is just what you have done.

The Chairmen. I do not think we have. I think we are making this much more elastic than it was before. I am sure of that.

Governor Fancher. I was going to ask whether in this

first condition here, "The parent corporation and all its subsidiaries are engaged in a distinctly commercial or industrial business" just what was in the minds of the Board in putting that condition in in this case? Are you trying to again fortify your position as to finance paper?

Mr. Wyatt. No.

Governor Fancher. Was that what you had in mind at that time in passing that condition?

Mr. Wyatt. No. This whole ruling was prepared with the idea of an attempt to find a way to make an exception of finance paper, but at the same time to guard against any abuse growing out of this ruling. Of course, the basis for the exception was found in the fact, to use the words of Governor Harding, that the corporation and its subsidiaries were really one big concern, and when they made these advances to a subsidiary they were just taking the money out of one pocket and putting it into the other, and we found a basis for the exception in the fact that we might do something that the Board had never done before and which was a very doubtful proposition, and that is to disregard the corporate entity and view the group of corporations as a single borrower. In order to do that we seized upon the hypothetical

state of facts which was put up to the Board and on which the Board was making the ruling, that the parent corporation was making advances to subsidiaries and we understood it only to subsidiaries, and the subsidiaries borrowed no money except from the parent corporation. The ruling stated the facts as the Board understood them. It later developed that the facts were not as the Board understood them. But the whole ruling was based on that principle, that it was one group and borrowed from all within the group, and that is why condition No. 1 is stated.

Governor Fancher. As the Chairman states, in the matter of advances of individual corporations without subsidiaries, that has been a matter of determination within the banks. There has been nothing in any of the Board's rules that has put any restrictions, that has been left with the banks themselves, in the matter of the statement which is furnished by the corporation and of its liquidity, is determined on the eligibility and upon the desirability of the paper.

Mr. Wyatt. Fortunately that question has never come up before the Board, and I had hoped it never would come up. It would leave the bank some little latitude in determining

the facts for themselves.

Governor Fancher. This would get back — assuming that this recommendation which we have passed here would then permit consideration of the corporation and subsidiaries, the same latitude; in other words, it would get back to the banks themselves to determine the eligibility. Of course unfortunately this condition I here has never been put out in a ruling. That is the unfortunate thing, I think, in considering this whole thing.

Mr. Wyatt. I think it may be unfortunate too, but I do not see on what other basis the Board could have made that ruling, certainly on the facts as presented to the Board at the time.

Governor Fancher. Of course, in discussing it with the Board, that question of outside advances was never touched on at all. Of course the only question was the corporation and its subsidiaries.

Mr. Wyatt. The point was put up to the Board in this way. The paper of this corporation has been declared ineligible because it makes some advances to its own subsidiaries.

Governor Fancher. On the previous Board's ruling?

Mr. Wyatt. Yes. That was the clear understanding. I was

there during the whole discussion, and it was certainly my clear understanding, and I think it was the understanding of the Board, that no loans were made except to subsidiaries.

Now, with reference to this ruling, which I understand the Conference has adopted as its recommendation, I drafted that as a basis for discussion, as I told Governor Fancher. I was not prepared to advocate it. When I drew that I had this in mind. Assuming that the Governors' Conference was prepared to recommend that the old rule against finance paper, the rule that the proceeds of the paper must be used in the first instance for an eligible purpose and must not be passed to somebody else, assuming that you are willing to abolish that ruling or materially modify that ruling, what can we do to let in the paper of corporations like the Hanna Company and any other company, the borrower, corporate or individual, who is doing principally commercial or industrial business, and at the same time rule out the paper of the finance companies who are engaged principally in the finance business? These conditions 1 and 2 are put in there for that purpose.

Governor Seay. Don't you believe this does it?

Mr. Wyatt. If the Federal Reserve Board is willing to

abandon its rule against finance paper, I do believe that this does it, and I do not believe that you can adopt this rule without at least putting yourself in a position where you are going to be forced to abandon your ruling against finance paper.

Governor Seay. I cannot take that view entirely, Mr. Counsel, if you consider the specific provisions of the several paragraphs which follow the first. There are some distances which cannot be negotiated in one leap. I believe this is going in the right direction, and I think if any paper offered to the Federal Reserve Bank complies with all of the provisions here laid down, it can hardly fail to be commercial paper and acceptable paper.

Mr. Wyatt. I do not think so, either, but technically it is paper the proceeds of which have been used to make advances to someone else.

Governor Seay. Under circumstances which are very clearly and fully described.

Mr. Wyatt. Yes. Now, the ^{cotton} factor came up here and he says "I am engaged in a commercial business; I have got a lot of customers who are engaged in the agricultural business. As incidental to my commercial business as a cotton factor I

want to make some advances to my customers who are farmers, and they are going to use the proceeds for an agricultural purpose. My business is commercial and the customers' business is agricultural. Both give rise to eligible paper. Why can't I do this?" The Board said "You cannot."

Mr. Harrison. Perhaps the same argument was made in the first year of the system, when the Board had to decide this one question: What is the purport of the phrase "The proceeds have been used or are to be used"? There was a bank in Florida which borrowed money from another bank. The borrowing bank used all of these funds to advance to farmers. They had no other customers at all, and the lending bank wanted to take that note and rediscount it with the Federal Reserve Bank of Atlanta, on the theory that the proceeds were to be used in the second instance in that case for ^{an} agricultural purpose, and the Board at the outset had to establish the principle then that the proceeds must be used in the first instance and at no other time for the commercial purpose. Otherwise it would have been possible, conceivably, to have ruled that any paper the proceeds of which are never used for a commercial purpose, as established by affidavit or otherwise, would be eligible within the terms

of the Act,

I am very much interested in what Mr. Wyatt has said, because of my past experience with the Board, and I am really alarmed at the development that has taken place in the last few years in admitting into the System finance paper generally. The cotton factor ruling which was made at the time when I was with the Board, I think was wholly correct under the law, but it has been modified by an amendment to the Act. I think that the present ruling, of which this present resolution is to be a modification, while it is justified by the Board on the theory that Mr. Wyatt has advanced, to disregard the corporate fiction, is in fact nothing but finance paper, be-

cause under no theory of law that I know can you disregard the corporate fiction where the parent owns less than 50 per cent. The only theory I ever heard of was where you had one individual incorporating himself and owning the whole stock, or certainly in the case where a group of men owned all of the stock or one corporation owned all the stock of another corporation.

The big question, as I see it now, is not whether you are going to modify the present regulation of the Board (X-4484), but rather whether you want to develop the situation along the line of generally taking finance paper or whether you

are going to stop it.

There is a real consideration, I think, in the fact that the amount of paper in the country that is eligible is gradually decreasing, and it may become necessary, as time goes on, frankly to admit that you want finance paper. If that time comes, it might be necessary to ask an amendment of the law, or it might be necessary, as Mr. Williams once suggested, to admit the discount of stocks and bonds or anything else, leaving the control with the Federal Reserve Bank; but as long as the law is what it is, and as long as you have the old rulings of the Board which are based on the principle that they must be used for a commercial purpose, it seems to me that whatever clauses you leave in or leave out you are breaking away from the principle which has been our safeguard from the very beginning.

Governor Seay. Would you call paper issued under the provisos herein set down finance paper in the general acceptance of the term?

Mr. Harrison. I think it is, without any question. I am talking from a legal standpoint, because one corporation does borrow money which they have used to lend to another corporation, and the fact that they own 50 per cent of the

stock in the borrowing corporation makes no difference as a matter of law in the nature of the transaction.

Governor Seay. For general purposes, loaned to another corporation for general purposes, but this is not for general purposes.

Mr. Harrison. Let us assume that the purpose of the loan is to provide funds which are to be used by the borrower for commercial purposes. That is precisely what the cotton factor used it for. What are you going to do about mutual loan associations or cooperative loan associations?

Governor Seay. Or grain corporations.

Mr. Harrison. Or grain corporations.

Governor Seay. That is the truth.

Mr. Harrison. Who are borrowing for only one purpose, to make a commercial use of the proceeds.

Governor Calkins. Mr. Chairman, Mr. Wyatt and Mr. Harrison have certainly thrown a very desirable light on the discussion which we have endeavored to have, and they have shown, as perhaps some of us said before, that we are getting into very deep water, somewhat deeper water than we are accustomed to getting into. The fact is, of course, that there is not one large commercial corporation in the

United States operating which does not make advances in some form or on some occasion to the subsidiaries or otherwise, and that a strict interpretation of the Board's regulation will make ineligible the best paper which is afloat in the markets of this country. My opinion, which was stated before very badly, but to restate it for the purpose of the question, is that any attempt on the part of the Federal Reserve Board or this Conference of Governors to define down to the last notch, by defining by a difference of one per cent what is and what is not a subsidiary corporation, is dangerous, that the only sound and practical course to be followed, either by the banks in passing upon paper or the Board in formulating regulations, is the application of some degree of analysis to the immediate transaction involved.

Governor Seay. Is not that equally dangerous?

Governor Calkins. I do not think so. The determination of the eligibility may be in accordance with the provisions of the law and the regulations of the Federal Reserve Board, which must be applied by individual judgment in every case. In the last analysis it is not possible to determine eligibility without the application of judgment

41

in the individual case. There is no one who can set up a set of rules which can cover all the corporations in the United States for commercial, agricultural and industrial purposes, and make it possible to determine by that rule and without examination of the actual circumstances whether it is eligible or not.

Governor Seay. Do you hold that the ownership of 51 per cent of the stock determines the eligibility here?

Governor Calkins. I do not.

Governor Seay. I would not think so, either, and it seems to me that under this amendment, as proposed, the bank would have to exercise all of that discretion which you say finally they should exercise.

Governor Calkins. I do not say that they should. I say that they must, because there is no possible way out of it.

Mr. Harrison. Can't you do what you want to do without this rule?

Governor Calkins. Yes.

Mr. Harrison. Or without the Federal Reserve Board's original rule? X4484?

Governor Calkins., I prefer it very much.

Mr. Harrison. And look to the general statement of

the corporation and see whether they show the reasonable ratio of assets to current liabilities, and ignore these insignificant transactions which go on within the corporation?

Governor Calkins. That is the argument I have made, but of course you put it in briefer and better form, as usual. There is no rule, either in the law or in the regulations, or no rule that we can set up, by which we can determine, without excluding almost all the paper that is offered, the eligibility of paper, except and unless in each individual case as it is presented and the application of judgment or whatever you want to call it, to that case. You cannot make a set rule. I object to the present 75 per cent regulation, because it attempts to set up a rigid rule by which eligibility may be determined. I object to the 51 per cent regulation on the same ground, and I think it is highly desirable that some other formula be used which will permit what we all know, and that is that eligibility can only be determined by the application of judgment in the individual case concerned.

Mr. Harrison. Governor Fancher, suppose we had neither rule, X-4484 or the present modifications, and the Hanna

Company paper were presented to you on the basis of their statement, under the old procedure followed by the Reserve Bank, would there be any chance of you considering it eligible within your judgment?

Governor Fancher. The trouble has been in the fact of the Board applying different regulations to the different banks.

Mr. Harrison. That is what I am getting at. Is not that really the fact, that you have had a different interpretation of the regulations by the different Federal Reserve Banks?

Governor Fancher. Yes, sir.

Mr. Harrison. And the Board attempted to cover that by a modification of the regulation, which has made still further differences in practice in the different banks?

Governor Calkins. And if they attempt again to set up an arbitrary rule, it will make still further differences.

Governor Talley. Is this recommendation stands, or as voted by this Conference, and if the Board adopts the regulation, then we shall ask the Board to rule if notes of landlords, where the proceeds are used to lend money

to tenants for agricultural purposes, are not also eligible.

Mr. Harrison. To crystalize it, -- I am sorry to inject myself into this question, and I did it only on account of my interest in the past in connection with the Board's rules--but I would like to ask Mr. Wyatt what he thinks the Board might have to say in the future, if this present regulation were adopted by the Board as a principle, regarding the application of a bank, ^{to} as the eligibility of paper of a mutual loan association of some sort, where all of the members of the association, we will say 99 per cent of them, are borrowing for some commercial purposes, and only that. Would there be any real difference?

Mr. Wyatt. No, not legal difference.

Mr. Harrison. That is what I mean.

Mr. Wyatt. As I see it, if you adopt this ruling, you admit that it is not necessary for the proceeds of the paper to be used in the first instance for an agricultural purpose. That knocks out in toto the technical legal construction on which your ruling against finance paper is based, and you haven't got any legal principle on which you can eliminate any other finance paper at all, if the proceeds are used ultimately in the second, third, fourth

er fifth instance, for an agricultural or commercial purpose.

Governor Fancher. That is exactly the situation that Hanna & Company are under.

Mr. Wyatt. If we can strike out the ruling that has been made on the Hanna Company and go back to the position you had before, you could do exactly what Governor Calkins wishes to do and what Mr. Harrison has suggested, and I think you would still be adequately protected by your rule against finance paper.

The Chairman. What do you think the result would be, Mr. Fancher, if the Board revoked their ruling in regard to the Hanna paper?

Governor Fancher. You are right back, Mr. Chairman, to the fundamental law as to the eligibility of paper, that the proceeds in the first instance must be used, and so forth. Are you going to jump over that?

Mr. Wyatt. I am in an embarrassing position to answer that question, but I might suggest that you could with reference to the Hanna paper the same thing that has been done for years with reference to the Wilson & Company paper and other paper.

There is another point in connection with this I think there has been a great deal of confusion arising out of this, the discussion of the subject, because of the Board's regulation requiring consolidated financial statements. I have talked to one or two people who thought that that ruling required you to get a consolidated statement which showed an excess of quick assets over current liabilities before you could declare the paper to be eligible. It does not. That ruling only declares eligible for this reason: the Board's regulations say that the proceeds of the paper must not be used for capital loans, and that a statement showing an excess of quick assets over current liabilities is sufficient to show that the proceeds are not used for capital purposes.

(At this point the members of the Federal Reserve Board came into the hearing room for a joint conference with the Governors, the following being present: Governor Crissinger, Vice Governor Platt, Dr. Miller, Mr. Hamlin, Mr. Cunningham and Mr. James, Governor Crissinger assuming the chair as chairman of the joint meeting; whereupon the following occurred):

Governor Crissinger. We are ready to take up these four or five items which the Board has suggested. We

will hear from Mr. McDougal of the Conference.

Governor McDougal. The Conference is right in the midst of its program, but we have considered most of the questions put on the program by the Board, and in addition to that, Governor Crissinger, we have received and approved the customary report presented by the Open Market Investment Committee, which I think it would be well for the Board to review. There is a recommendation or two contained in it which I suppose the Board can act upon, either now or at leisure. Mr. Case, will you discuss that report? Have you copies of that for the members of the Board?

Deputy Governor Case. Yes, there are copies. Very briefly, Mr. Chairman, this report undertakes to review what has taken place during the current year. The Board will recall that during the last part of December we bought \$50,000,000 in short-term Governments, which we re-sold to the market in January, and in the New York market we had a period of considerable ease the early part of the year, when our rate was reduced from 4 to $3\frac{1}{2}$ per cent. We ran along until March, when there was considerable pessimism developed as to the current outlook for busi-

ness, and at that time we purchased an additional \$65,000,000 of Government securities, bringing the portfolio up to \$275,000,000 to us. Happily, that feeling that we might have a period of recession of business or a little depression, did not develop. In fact, it might fairly be considered that the reverse was true.

Along in July and August, during the summer, we had a very active situation in the stock market, with a substantial increase of prices, and our rate in New York was at that time marked up from $3\frac{1}{2}$ to 4 per cent, and at a meeting of the Open Market Committee, at which the Board was present, we agreed to reduce the holdings down to \$200,000,000 of the open market funds. That was done between August and September, and the open market holdings stand about \$200,000,000.

There is a feeling that we are getting a little experience as we go along to the end of the year, and that we should be prepared this year to deal with the end of the year situation perhaps a little more effectively than was done last year.

As the Conference will recall, there is usually a demand for currency for the Christmas holidays that re-

quires from \$200,000,000 to \$250,000,000 of additional credit, and also there has developed in recent years a considerable window-dressing, by which the banks and large corporations also undertake to better their position by heavy calling of loans. This year we have every reason to think that the same procedure has occurred last year will take place, and that we should be prepared to deal with that.

So that, in reviewing the past situation at the present moment, the committee and the Conference was unanimous that there was nothing in the situation that called for any change in rate or any further action at this time by the Open Market Committee, either in buying or selling, but there is a suggestion contained in the report, approved by this Conference, that during the next six weeks it might be desirable to buy up about a hundred million dollars in the way of additional short-term Governments, on the theory that all or a substantial part might be sold to the market in January, unless we had a change in the business situation, an outlook of pessimism and depression, in which event, if the committee and the Board concurred, it might be desirable to hold all or part of the additional

amount to be purchased.

Briefly, I think that is a summation of the report.

Governor Crissinger. Well, the Board will have a meeting after this Conference and take up the ^{Open} Market Committee's report.

Governor McDougal. Taking up the topics that were suggested by the Board, in the order in which they appear on the program, Topic 1-F, to amend regulation / to make eligible for rediscount or purchase by Federal Reserve Banks a bankers' acceptance drawn by an elevator or warehouse company and secured by terminal warehouse receipts of the elevator or warehouse company that draws the draft, we are not ready to report yet on that. We are waiting on some advice that Governor Young expects to get from his counsel.

The next topic is 1-G, notes of parent corporations representing borrowings to be advanced to subsidiaries. We are wrestling with that and not ready to report. The Conference has adopted a suggestion in respect to this topic, but subsequently we received some advice from Mr. Wyatt, and I think it was concurred in by Mr. Harrison, which would indicate to me that perhaps we had better reconsider that, and we will report later.

Then coming to Topic I-H, regulations covering re-discount of notes secured by adjusted service certificates under the provisions of Section 502 of the World War Adjusted Compensation Act, the Conference voted that while it was the sense of the Conference that it is regrettable that the Federal Reserve Banks should have been given authority to discount adjusted service certificates, nevertheless as a practical matter it is realized that Federal Reserve Banks will be expected to discount such certificates when offered by member or non-member banks under suitable regulations and safeguards. It was accordingly voted that the Chairman of the Conference should appoint a committee of three operating men from the Federal Reserve Banks to confer and cooperate with Mr. Wyatt, if desired, in the preparation of regulations and forms, including a draft of circular letter to be issued by each Federal Reserve Bank before January 1, 1927, concerning the discount of these certificates.

Do you want to discuss this?

Governor Crissinger. Does any member want to discuss this?

Governor McDougal. It would be a discount of paper

that does not have element of convertability that it should have. It would be a discount of paper from non-member banks which I think you gentlemen believe should not be the case.

Governor Platt. Has anybody an opinion as to what the volume of these loans is likely to be? I saw a statement the other day that it might run to \$200,000,000.

Governor Hamlin. It is very small.

Governor McDougal. The face value ultimately will be something over \$2,000,000,000.

Governor Crissinger. How much do you figure we will be called upon to discount?

Mr. Smead. I would say about \$215,000,000 can be rediscounted, and later on it goes up to \$260,000,000, and later on it runs up a great deal more. I think ultimately it will run up--

Governor McDougal (interposing). To something over \$2,000,000,000.

Governor Seay. By 1930 it is up to \$570,000,000. That is the loan value. The first of January, 1927, it is \$260,000,000 loan value.

Governor Platt. That would not hurt us very seriously.

Governor McDougal. No one can tell the extent to which the banks will be asked to take this paper.

Governor Crissinger. Is it mandatory on the banks to discount them?

Governor McDougal. They are made eligible. It is not mandatory.

Governor Crissinger. If it is desirable.

Governor Platt. The statement has been made in the newspapers that the Federal Reserve Board desires to make a ruling or pronouncement in regard to this thing. Do you know about that?

Governor Crissinger. It came out of the War Department.

Governor Hamlin. We had some announcement of that.

Governor Crissinger. It came from the Veterans' Bureau.

Governor McDougal. We should hope that the Board should never make a ruling to accept these from any and all sources from which they would come.

Dr. Miller. It occurs to me that if there is ground for anticipation that there will be as much as \$200,000,000 of this paper to be presented to the Federal Reserve Bank

for rediscount at the first of the year, Mr. James is very confident that every dollar of it that is available--

Mr. James (interposing). I mean by that of an offer to the Federal Reserve Bank, but the fellows who have got that much money available would cash in on it just as fast as the money becomes available somewhere.

Dr. Miller. Yes.

Mr. James. Whether it comes into the Reserve Bank or not is another question.

Dr. Miller. I should think that until you get some light on this it might be advisable to do only that which the country can digest.

Mr. James. I would like to ask two questions. The first is whether or not these certificates are of a character that the Federal Reserve System can buy, as they buy open market paper, and whether there is any obligation on the part of the Federal Reserve System to take any of these certificates coming through non-member banks.

Deputy Governor Case. I do not think the law states that they shall be bought by Federal Reserve Banks.

Mr. James. That is my understanding.

Governor Hamlin. Rediscounted?

Deputy Governor Case. Yes.

Mr. James. But it does say in the Act that they are eligible the same as any other thing would be eligible from that standpoint, and therefore the same rules and regulations that apply to eligible paper of any kind can be applied to these, could they not?

Deputy Governor Case. Yes. The only unusual thing in this is that Federal Reserve Banks are required to discount notes secured by these certificates from non-member banks.

Governor Crissinger. It requires them?

Governor Seay. Not requires them.

Deputy Governor Case. They are eligible. As a practical matter, you take in any district, with a member bank and a non-member bank side by side, and let them make advances, and then with the provisions of the law what they are, offer them to the Federal Reserve Bank of that district, I think it would be most inexpedient, with the provisions of the law what they are, to take the paper and discount it for the member bank and decline to do it for the non-member bank.

Governor Crissinger. Would you have to do it for

either of them? It is just permissive, that is all.

Governor McDougal. That is only permissible.

Mr. Wyatt. The language is that it shall be eligible.

I think that is permissible.

Deputy Governor Case. In the discussion yesterday, the view generally that was taken, as expressed by Mr. James, was that a very large amount would find their way into the banks, but because of the fact that they are in small units, probably only a small proportion of what would flow into the banks would go into the Federal Reserve Banks, and those banks usually use the largest piece of paper.

Governor Platt. I think the banks will ask us to discount those notes, because they are eligible.

Deputy Governor Case. Mr. Harrison points out there are some technicalities which have been referred to counsel to be worked out; that is, that they have got to have affidavits of a certain character attached, and so on.

Governor Seay. It was hoped also, Mr. Governor, that by the restrictions surrounding these notes, it might deter a non-member bank and the member bank from sending them in to the Federal Reserve Banks. For instance, the

non-member bank who had no account with the Federal Reserve Bank should be required to take up these notes on the day of maturity in Federal Reserve Bank funds if the veteran does not pay it, and then it was rather thought that it might not be desirable for the Federal Reserve Bank to collect these notes finally from the Veterans' Bureau, but require both member and non-member banks to undertake that. It is stated that the Federal Reserve Banks might be loaded up with a lot of paper of that nature because it is within the discretion of the Veterans' Bureau, or the Commissioner, to pay or not to pay this paper; but if there be certain rigid restrictions which will require the non-member bank to reimburse the Federal Reserve Bank on the note on the date of maturity, and then to collect these papers themselves, that it might be a deterrent.

Personally, I have been in hope that the Federal Reserve Board might rule, as Mr. James said, that the same regulations applicable to paper generally might be made equally applicable to these notes, and they might rule that non-member banks would have to offer the paper through member banks, but Mr. Case, I think, has very aptly

stated the political rumpus which that might create. I think that is undoubtedly true, that it would create a political disturbance, and it might therefore be expedient to discount these papers under the terms of the Act for either member or non-member banks.

Deputy Governor Case. But collect them by sending them direct to the bank.

Governor Seay. Yes, for which discounted, and compel them to collect from the Veterans' Bureau.

Governor Platt. 's I understand this, there is going to be a propaganda started by the American Legion to urge the soldiers not to borrow on these certificates. What effect that will have I do not know. Mr. Wyatt calls attention to one thing, that if they borrow the minimum amount which they can borrow the first year, they will have to pay that off before they can borrow the second year.

Governor Crissinger. Mr. Goldenweiser wants to say something.

Mr. Goldenweiser. I was going to say that the proportion of the increase in Reserve Bank credit is likely to be only one-tenth of the amount that is discounted. The creation of that additional credit is not likely to

create a very large increase in currency demand, and the only way to reach the Reserve Bank, as a matter of increase in volume, is by the extent that it will increase the deposits, and therefore their reserve requirements, and that will probably be one-tenth of the amount. So, if they will discount \$200,000,000, the increase in demand for reserves will be about \$20,000,000.

Governor Seay. That is, however, a pure conjecture.

Mr. Goldenweiser. It is just simply on the theory that that in itself will not increase the demand for currency, and therefore the only requirement is in new deposits. Our currency does not go out unless there is an increase in prices or something of that sort.

Governor Platt. Every man that borrows on one of these certificates will take the money right out of the bank.

Mr. Goldenweiser. But he will spend it, and it will come back.

Dr. Miller. The certificates, as I understand, are for small amounts, and presumably they will be cashed by the men who ordinarily have not a bank or a checking account.

Mr. Goldenweiser. Yes.

Dr. Miller. I should suppose that that would take from from the bank actual currency.

Mr. Goldenweiser. If they keep it in their pockets.

Dr. Miller. They take it out to spend.

Mr. Goldenweiser. If they spend it it will come right back to the bank.

Dr. Miller. It will come right back to the bank, yes, sir. Whether it will remain in circulation, then, will depend on whether enough new business is stimulated by purchase by the veterans to demand that.

Mr. James. Would it not be somewhat comparable to the Christmas demand for money?

Mr. Goldenweiser. There may be a very short time increase in demand for currency, but I am sure those men will spend that money right away.

Mr. James. Oh, yes.

Mr. Goldenweiser. They will spend it in the department stores and in various other stores, and they will re-deposit it.

Mr. James. The automobile salesman is right now wishing for the first of January to come around.

Governor Crissinger. As I understand the recommendation of the Governors' Conference, it is going to be that they are eligible for rediscount, and that the banks presenting them for rediscount will have to make collection.

Governor McDougal. The recommendation is for the appointment of a committee in working out with Mr. Wyatt the details, and the Conference recognizes the fact that they are declared eligible on the part of either member or non-member banks, but I of course do not understand that we are required to rediscount them.

Governor Crissinger. Suppose a non-member bank comes along that you know is probably not in good shape, would you take it?

Governor McDougal. No, I would not take it.

Governor Crissinger. Then the question is the determination of the bank itself?

Governor McDougal. I suppose the Board and the bank will make a vigorous effort not to encourage it.

Governor Crissinger. I think the banks will not encourage it themselves, will they?

Governor McDougal. No. The next topic is IV-D, Advisability of the Board adopting for all national banks

a minimum capital requirement and imposing other requirements in connection with its granting authority to such banks to exercise trust powers.

It was voted to be the sense of the Conference that it would be inexpedient for the Federal Reserve Board to place a capital limit on the size of national banks eligible to apply for such powers in view of the provisions of the law; and the further fact that the exercise of trust powers by State banks is governed by different laws in different States.

It was voted to be the sense of the Conference that some limit should be placed upon the time in which national banks must qualify, under the laws of the State in which they are located, to exercise trust powers which have been granted by the Federal Reserve Board.

It was voted to be the sense of the Conference that the Conference should suggest to the Federal Reserve Board the advisability of the Board's taking into consideration the relation between capital and deposits of any national bank applying for the privilege of exercising trust powers.

Governor Crissinger. Is there a discussion on that by any member of the Board?

Governor McDougal. The next topic is IV-E-6, Authority of a Federal Reserve Bank to receive deposits of securities for safe-keeping from Farm Loan Registrars, Federal Land Banks and Intermediate Credit Banks.

It was voted to be the sense of the Conference that the Federal Reserve Bank has no legal authority to receive deposits of securities for safe-keeping from Farm Loan Registrars, Federal Land Banks and intermediate credit banks.

It was voted to be the sense of the Conference that the Federal Reserve Banks have no legal authority to receive deposits of securities for safe-keeping from Federal Land Banks and Farm Loan Registrars.

Dr. Miller. Does that carry with it the idea that it would be inadvisable to do it, to have the authority?

Governor McDougal. Well, I do not think it does, Dr. Miller, but I think it would be inadvisable if we did have the authority. That is merely my own opinion.

Governor Crissinger. Why?

Governor McDougal. For one reason only that I have in mind, that there is a very great responsibility. It sometimes seems a question whether we ought to assume what we are already assuming, with hundreds of millions of

dollars security.

Governor Crissinger. For member banks?

Dr. Miller. And therefore the question seems, as a practical one, whether that responsibility is materially increased by the performance of this additional service, if you should assume it. These are quasi-public agencies, and what you are doing for your member banks that you have no legal authority to do is largely by way of accommodation, isn't it?

Governor McDougal. Yes, purely as a matter of accommodation, but I am not sure about not having legal authority.

Dr. Miller. I say, you have no legal authority for doing what you are doing now. Isn't that right?

Governor McDougal. I am not sure of that.

Governor Seay. Unless it comes under the general authority of the Board of Directors to conduct a general banking business under the Act.

Governor Crissinger. With member banks?

Governor Seay. Yes, sir.

Governor Crissinger. But not with other banks?

Governor Seay. There is a disposition to impose upon the Federal Reserve Bank the burden of carrying certain

of the responsibilities which should be imposed upon these separate governmental organizations that are created from time to time.

Dr. Miller. I know, but I am just wondering whether you simply want to take the responsibility that you do not feel obliged to do it, and therefore you do not do it, or whether you take the position that it is inadvisable. My own position is that the banks, with the great funds of money that they have, with the gigantic fortresses with vast vaults, and so forth, that it is not advisable for them to be too bureaucratic in matters of this kind. At any rate, unless your counsel or our counsel should rule definitely that it would be illegal for you to do it, the question should be considered as to whether or not it is an accommodation that you will undertake without undue hazard and without seriously adding to your expense.

Mr. Hamlin. Our counsel has ruled on it, hasn't he?

Mr. Wyatt. We have not, I do not think, ruled on the question of accepting securities from member banks.

Mr. Hamlin. I thought we ruled on that, that that came out of the right to receive deposits.

Mr. Harrison. In 1915.

Mr. Wyatt. Yes, that is a fact. We ruled that you can do it.

Governor Calkins. I think, Mr. Chairman, it should be pointed out that this expression on the part of the Governors' counsel really was a repetition of the opinion of counsel for the Federal Reserve Board, and the counsel for the various banks thought the banks should not have authority to accept securities for safe-keeping for Federal Land Banks, and also that they did have authority to receive securities from intermediate banks, the specific authority being granted in one case and not in the other, which indicated the differentiation.

Deputy Governor Case. It is a fair thing to say to Dr. Miller that we did not in the Conference consider this matter from the viewpoint that he raised.

Governor McDougal. No, we did not. There are some restrictions even respecting member banks with respect to the matter of accepting these securities. We do not accept anything from large city banks.

Dr. Miller. I understand that, but I also understand that there is no legal authority. But I should say,

before disposing of the matter on legal grounds, that the question is to be asked, is there anything that the law contains that would prohibit your doing this? In other words, would it be illegal to do it, or could it be assumed, even in the absence of a specific authorization, one of the things in which your discretion should govern? If so, I should say that it might be worth while to consider it.

Deputy Governor Case. Dr. Miller, assuming that we acted on it, and I am now speaking for myself, on the theory that we could not legally hold them, do you think it would be desirable for the Conference to really take the initiative and suggest that the law be changed to make it permissible?

Dr. Miller. Oh, no, I don't; only in the event that our counsel expresses the opinion that this would not be an unwarrantable assumption of legal authority. I think the Governors' Conference might point out that they could, and if they thought it advisable let the Reserve Board secure the guardianship of these securities.

Governor Seay. It seems to me that the question of our responsibility, if a Federal Reserve Bank undertook of

its own volition to accept the custody of these securities, on account of mob violence or any attempt of that sort, might result in their loss.

Dr. Miller. Exercise the same discretion which you do in the custody of your own securities, and in the event of their loss by riot or anything of that sort--

Governor Seay (interposing). We might not be able to set up that defense in the case of another governmental agency, when we did not have the legal authority to accept them. We might in the case of individuals.

Dr. Miller. I should say all the more. I am not a lawyer, but I think it would be merely a matter of accommodation and they would run the risk themselves, I should say, and that a Reserve Bank would be immune.

Governor Norris. Mr. Chairman, may I add that we discussed this purely and solely as a matter of law. The opinion of the Assistant Counsel given to the Federal Reserve Board reads, one paragraph, in this way:

"There is no express authority given in either the Federal Reserve Act or the Farm Loan Act for Federal Reserve banks to receive deposits of funds or securities from Federal land banks or from Farm Loan Registrars. This

in itself makes the receipt of such deposits beyond the powers of Federal reserve banks. In addition, however, there is a provision of the Farm Loan Act which seems by implication to deny the existence of a right in Federal land banks to make deposits in Federal reserve banks. This is found in Section 13 of the Farm Loan Act and authorizes a Federal land bank 'to deposit its securities, and its current funds subject to check, with any member bank of the Federal Reserve System.' It is reasonable to assume from this provision of law and from the absence of any provision authorizing deposits in Federal reserve banks, that it was not intended that Federal land banks should make deposits in Federal reserve banks."

So that the question came before us not simply as a question of an apparent lack of power to do a thing that perhaps we would be disposed to do, but as a thing that is impliedly prohibited by the law, or at least that the law never intended should be done, and all that we did yesterday was to concur or to accept that opinion of the Board's counsel.

Governor Crissinger. Is there anything further?

Governor McDougal. Mr. Wyatt, you have given some

consideration to the legal status of this matter, haven't you?

Mr. Watt. Yes, to the extent of approving their opinion. I fully concur in the opinion which was rendered. I do not think that the law can be construed as absolutely prohibiting it, but it is like any other ultra vires act, you simply have not the power to do it. If you do undertake to do it, you are exceeding your lawful powers, and there is no distinction in accepting this in this respect and accepting that in any other respect. The fact that you do go beyond your powers would not be any defense to you in a court of law, and your position would be no more good to-day if you had not the lawful power to do it and had taken the responsibility in pursuance of lawful power.

Dr. Miller. Would this be a correct statement, that Federal Reserve Banks are liable as custodians for the several hundred million dollars of securities that they are now carrying for safe keeping for member banks?

Mr. Watt. Well, their liability goes to a reasonable extent. They are bailees without hire, and as such they are liable for any loss resulting from gross

negligence on their part.

Dr. Miller. Yes.

Mr. Wyatt. The situation would be exactly the same if the Federal Reserve Banks exceeded their powers and took these securities.

Governor Seay. Do you think the situation would be the same if we did receive from other governmental bodies those securities?

Mr. Wyatt. I think so. I do not see how the Government would have any better claim than anyone else. The Government, of course, is interested in this, but this is an entirely different question. The Government has the right to question any act of any of its corporations, which are beyond the powers that have been granted to it by the Government. The Federal Reserve Board could tell the Federal Reserve Bank to do that or to do any ultra vires act, and it is conceivable the account of the Federal Reserve Bank might be forfeited.

Governor Crissinger. Do you consider the additional cost to the bank to handle all of this?

Governor McDougal. How many men have you in your safe-keeping department, Mr. Case? I would say not less

than 25.

Deputy Governor Case. I really do not know the number. Do you, Mr. Harrison?

Governor McDougal. I guess probably double that. I do not know.

Mr. Harrison. My feeling is that there are only 12 in the vault and coupon cutting.

Governor McDougal. There is a tremendous amount of labor there in the matter of taking the coupons off and keeping these securities in order.

Mr. Harrison. We have our safe-keeping department now organized on an entirely different basis, which would enable us to eliminate a good many men we had before. When we made the change in our system, that enabled us to cut our force very materially.

Governor Crissinger. Anything further?

Governor McDougal. The next topic is 4-f, the question of Federal Reserve Bank representation at bankers' conventions-- to what extent should Federal Reserve Banks be represented by officers and employees.

It was resolved that attendance at conventions within

the district is of the utmost importance to every Reserve Bank and that attendance at conventions outside of the district is often advisable; that this whole matter must necessarily be left to the judgment of the officers and directors of each Reserve Bank and that it is impossible to establish by rule any uniform practice.

Governor Crissinger. Is there any remark?

Governor McDougal. The next topic is IV-G, the advisability of seeking an amendment to the law to restore to Federal Courts jurisdiction over suits by and against Federal Reserve Banks.

It was voted to be the sense of the Conference that it is advisable to procure an amendment to the law to restore to Federal Courts jurisdiction over suits by and against Federal Reserve Banks in the form suggested in paragraph No. 3 on page 3 of Mr. Wyatt's memorandum X-4551.

It was also voted that it would be desirable to seek the enactment of legislation to exempt Federal Reserve Banks from the process of attachment or garnishment before final judgment in any case, as National banks are now exempted under the terms of the United States Revised Statutes.

That covers, I think, Governor Crissinger, the topics

that the Board has placed on the program. We are in the midst of our program, we are not through with the topics, and it is probable that some of the topics that are being considered or have been are interesting, and some with respect to which you probably would want a report, and we of course will be available to the Board as soon as we are through and will meet your pleasure. I think we can get through here today, can't we?

Deputy Governor Case. It does not look so at the speed we are making.

Governor Norris. We are just half through.

Governor McDougal. Governor Crissinger spoke about a joint meeting. As I understood you, you wanted that to be arranged for tomorrow?

Governor Crissinger. It looks as if that is going to be the only available time we will have for it. We have a hearing on Thursday on the question of Cuban agency, which arises out of the two agencies now existing between Atlanta and Boston, and I presume that is going to take practically all of the day. When this date was set down, I think four of the Reserve Banks were notified--Boston, New York, Philadelphia and Atlanta--that if they wanted

to be heard they could be present. In view of the fact that all of the Governors are here, if they want to come in we will be very glad to have you all come in. We thought that those four banks were all that were interested, but we will be very glad to have you all come in.

This one subject which you have disposed of about the advisability of seeking an amendment restoring Federal jurisdiction in all suits against Reserve Banks, for myself I think it is a debatable one. I think that a man who has an action against the Federal Reserve Banks ought not to be compelled to go away off to some Federal Court, because the suit can finally get into the Supreme Court, and under the National Bank Act they have local jurisdiction--I just suggest that, that it does not look fair to the poor devil who thinks he has a right of action against a Federal Reserve Bank to go way off some place where he can maintain his action. I do not know whether you had considered it along that line or not.

Governor Seay. There is still pending the question as to whether Federal Reserve Banks are domiciled in any State of their district other than that of the State in which they are located. I think that matter is up in

a suit in which the Richmond bank is involved.

Governor Crissinger. I think some of the popularity of the system is dependent on whether you pull people away out of their localities to a Federal court.

Governor Seay. On the other hand, it subjects the Federal Reserve Bank to harrassment.

Governor Crissinger. Yes, perhaps it does. If that is all, the Board will retire and consider your report.

(Thereupon the members of the Federal Reserve Board retired and the Governors continued their Conference as follows):

The Chairman. We had not finished with 1-G.

Governor Calkins. Let us finish with that. I understand that some of those who voted affirmatively are now prepared to suggest that the resolution be rescinded, and that some of those who voted negatively are agreeable to a substitute resolution which might be offered.

The Chairman. I would like to hear the substitute before we rescind the other action.

Governor Calkins. I say, Mr. Chairman, let us rescind the other one, whether we adopt any substitute or not.

Governor Norris. Mr. Chairman, I move that the vote by which the last previous resolution on this subject was adopted be reconsidered.

The Chairman. That motion is seconded?

Deputy Governor Case. I second that.

The Chairman. Are you ready for the question?

(The motion was put and unanimously carried.)

Governor Norris. Now, I think it is open for the offering of a substitute resolution, which I understand has been prepared, and I think it would be advisable for us to consider.

Mr. Harrison. Shall I read it, Mr. Chairman?

The Chairman. Yes.

Governor Seay. Suppose you do, Mr. Secretary.

Mr. Harrison. This is a draft which I understand was prepared by Governor Seay.

Governor Seay. Yes.

Mr. Harrison. Abrogate the present 75 per cent ruling and rule that where the borrower is a parent corporation, or where the parent corporation and its subsidiaries are in practical effect one single organization, and may with propriety be considered as a single

borrower, the paper of such parent corporation may be considered eligible if otherwise complying with the law and regulations of the Federal Reserve Board.

Governor Seay. Mr. Chairman, I will simply state, in explanation, that when we were interrupted in our discussion of that matter, Governor Fancher and I were talking to the counsel for the Board, and that idea occurred to me, and we had some brief discussion with the counsel, and I understood him to say that practically that was considered at some former time by him or by the Board. I do not know what objections there are to it, but it occurred to me that we all want to bring about just about that state of affairs, and the present 75 per cent ruling is in the way, and we recognize the danger of making any specific limitation in the stock ownership of corporations.

It is a fact, as you state, that the volume of eligible paper is perhaps diminishing in this country--eligible under the present rules and regulations--and from time to time it will be advisable and perhaps necessary to make some alterations in the present rulings which will require a greater volume of eligible paper that is good and acceptable from a banking standpoint.

I offer that with some diffidence, not knowing whether I have considered all sides of the question or not.

The Chairman. Mr. Harrison, will you read that motion again, please?

Mr. Harrison. Abrogate the present 75 per cent ruling and rule that where the borrower is a parent corporation or where the parent corporation and its subsidiaries are in practical effect one single organization and may with propriety be considered as a single borrower, the paper of such parent corporation may be considered eligible, if otherwise complying with the law and the regulations of the Federal Reserve Board.

Governor Young. It abrogates that whole regulation, or just that part of it?

The Chairman. That will suit you, wont it, Governor Fancher?

Governor Fancher. The question is whether it abrogates that whole regulation and is a substitution for 1, 2 and 3. We have got two restrictions there. One is 75 per cent of stock ownership and the other is the advances to other corporations rather than subsidiaries.

Deputy Governor Case. This is the 75 per cent only.

Governor Fancher. That is the point exactly.

Governor Seay. I had in mind that it would permit the paper of these parent corporations, whether the proceeds were used for financing the subsidiaries or anybody else, would be eligible under that ruling.

Governor Young. Then you want to abrogate the whole ruling X-4484.

Governor Seay. That was my idea.

Governor Young. Instead of saying 75 per cent, just say that, and that will take care of it.

Governor Fancher. Yes, to abrogate that ruling, substitute that.

Governor Seay. Some such ruling as that, I think, Mr. Chairman, would eliminate the danger of taking the paper of commercial credit organizations. I think that is one of the greatest threats that perhaps menaces the Federal Reserve Bank, the danger of that kind of paper creeping into Federal Reserve Banks, and a resolution of that character would leave such paper ineligible.

Governor Calkins. I am wondering, Mr. Chairman, whether Governor Seay would be willing to accept an opinion on that?

The Chairmen. I think someone is modifying that motion

now, and when it is finished we will have it read again.

Governor Seay. Mr. Chairman, I offer at least for discussion to abrogate the present ruling contained in the Board's letter X-4484.

The Chairman. Is that the Hanna ruling?

Governor Seay. Yes, "and rule," etc.

The Chairman. Will you read it all, please?

Governor Seay. It is moved that the Board be requested to abrogate its present ruling contained in a letter X-4484 and rule that where the borrower is a parent corporation and where the parent corporation and its subsidiaries are in practical effect one single organization, and may with propriety be considered as a single borrower, the paper of such parent corporation may be considered eligible, if otherwise complying with the law and regulations of the Board.

The Chairman. Mr. Wyatt, what have you to say about that?

Mr. Wyatt. That seems to me to be rather vague, and I am afraid it wont accomplish what you want, unless you add something to add. You say there "if otherwise complying with the regulations and the law." It would not com-

ply with existing regulations, to say nothing more, because the proceeds would be used by the parent corporation to advance to one of its subsidiaries. To make this accomplish what I think you want it to accomplish, you have either got to state the facts as they exist in the Hanna case, or you have got to go ahead and say, I think, that the paper would be eligible even though the proceeds are used by the parent corporation to make advances to subsidiaries for eligible purposes. It seems to leave the whole thing up in the air.

The Chairman. And that is what we want to avoid.

Governor Calkins. Is not that covered by the assumption that the parent corporation and its subsidiaries are one corporation, which they are in fact, of course, in practice, absolutely?

Mr. Wyatt. I think I fully understand what you want to do. You want to accomplish two things. One is to get away from this first condition stated, and the other is to get away from the statement of the specific percentage of the stock.

Governor Seay. When the Chairman returns, I would like to suggest that the idea contained in this resolution

or motion be referred to counsel and ask him to dress it up or amend it or add to it in such a way as he thinks will accomplish the idea contained at present in the resolution, and that he present it to us later on in today's session.

Mr. Wyatt. I am willing to try to do that, to express your idea a little more completely.

Governor Seay. In your absence, Mr. Chairman, I suggested something which I will restate, and that is that the resolution as offered be referred to the Board's counsel, and the counsel be requested to elaborate it and amend it in such a way as would carry out the idea at present incorporated in the resolution as offered, and resubmit it to this Conference later on in the day.

Governor Calkins. I am wondering, Mr. Chairman, whether Mr. Wyatt wants that in the record.

Mr. Wyatt. I do not care if it is in the record, if it is distinctly understood that in preparing this I am simply putting something in shape for Governor Seay. I am willing to do anything he wants me to do.

The Chairman. I think we can do that without a formal vote.

Governor Seay. I believe so.

The Chairman. I will be very glad to have you do that.

Governor Bailey. I say, why put that in the record.

Governor Seay. That Mr. Wynn has just said is in the record, and I think that will be sufficient.

Governor Young. Mr. Chairman, I have a communication from Judge Ueland. Can we go back to I-F?

I-F--Continued.

The Chairman. Mr. Young has a message which he wants to read.

Governor Young. I have a wire from Judge Ueland which reads this way:

"Registered terminal warehouse receipt, issued by terminal warehouse in Minneapolis, if endorsed and delivered by depositor, passes secure title to the grain to pledgee, subject to defects in title of depositor. See Minnesota General Statutes, 1923, Sections 519 to 522, inclusive."

Governor Bailey. That means that if the title came to him that his title passed unless he failed to put the grain in the elevator. I have never known that to happen on my line of elevators for forty years. That is a thing

that never happens at all. That is just like being struck by lightning when there is no cloud.

Governor Seay. That means that it is good against general creditors, then?

Governor Young. Oh, yes. I was talking with a man last night and he said that they have actually been upheld by the court. I therefore move that it is the sense of the Conference that these particular warehouse receipts, under the practice which prevails, are within the spirit of the Board's regulations requiring that warehouse receipts shall be issued by a warehouse independent of the borrower, and that therefore the Board should rule that acceptances secured by them are eligible, provided of course that they comply with all of the relevant requirements of the Federal Reserve Act.

Governor Calkins. I second the motion.

The Chairman. Is there any discussion?

(Cries of "question, question.")

(The question was put and unanimously carried.)

Governor Bailey. I would like to have this thing clarified in my mind, that it does not simply apply to Minneapolis, but that it applies to any district?

The Chairman. That applies only to Minneapolis.

Governor Bailey. Then I move that it apply to Kansas City. We have exactly the same condition there.

Governor Seay. It does not say it applies to Minneapolis.

The Chairman. You quoted that as these particular receipts, or words to that effect.

Governor Young. I did not mention Minneapolis. We say "registered terminal warehouse receipts." That is what we are talking about.

Mr. Harrison. Issued under the practice which prevails in Minneapolis.

The Chairman. Do you withdraw your motion?

Governor Bailey. All I wanted to know is that we had the same protection as they have in Minneapolis.

Governor Young. Sure.

II. COLLECTIONS AND CLEARINGS.

- C. Desirability of having Federal Reserve Banks and direct sending member banks (where the volume warrants) list in separate cash letters items which are payable in each State served by Federal Reserve Bank or branch to which same are forwarded.

The Chairman. We will proceed with Topic II-C, desir-

ability of having Federal Reserve Banks and direct sending member banks (where the volume warrants) list in separate cash letters items which are payable in each State served by Federal Reserve Bank or branch to which same are forwarded.

Mr. St. Louis, will you lead this discussion?

Governor Biggs. This topic was suggested with the idea of obtaining an expression, either from the Governors, or preferably in the next report of the standing committee on collections. We have made no attempt to get other Federal Reserve Banks or their direct sending member banks to list in separate cash letters items which are payable in each State, although in quite a few instances it appears desirable. We preferred to get an expression on the subject before taking any action.

I have very little to say about it. It is just the question of whether it is advisable to make that request, or whether we shall proceed as we have.

Governor Young. We approve of it in Minneapolis. We think it is desirable.

Governor Seay. That is at the present time the practice of other Federal Reserve Banks.

The Chairman. I would like to know where it is not the practice. It is the practice with us.

Governor Biggs. We have not taken it up with other banks.

The Chairman. Is there any bank represented here which does not have this practice?

Governor Bailey. We do not sort it that way. We sort alphabetically.

Governor Wellborn. This suggestion might be of assistance to the transit department in eliminating one assortment of checks, where the volume was very large, and if all Federal Reserve Banks and branches and direct sending banks would adopt the same practice. However, we doubt whether the volume of checks coming into this district would be sufficient to render it of material benefit to our bank. So we are not following that practice.

The Chairman. We have followed it for several years. Will those of the banks who are not following it give expression to it? Will you do that, Mr. Talley?

Governor Talley. I do not think it makes any great amount of difference, because it seems that what is desired is to have the sorts made up so the receiving Federal Reserve

Bank will have the item in shape, in the same manner they sort them. We have never seen any occasion to sort by States at all.

Governor Seay. Have they ever requested you to do it?

Governor Talley. No.

Governor Bailey. There is a qualifying word there. It says "where the volume warrants it."

Governor Talley. It simply seems to us that where a bank does make it, it is making an additional sorting that is not necessary.

The Chairman. It seems to be the custom. Is that satisfactory to you, or do you want some action?

Governor Biggs. No; that is acceptable to me.

The Chairman. That, then, disposes of the subject
II-C.

Deputy Governor Case. How is that disposed of?

The Chairman. That is disposed of because Mr. Biggs declares himself satisfied. It is the general practice, but it is not followed by all banks.

III. COIN, CURRENCY AND CIRCULATION.

A. Gold Holdings and Payments.

The Chairman. Here is one topic III-1, calling for "Gold holdings and payments." I do not know where that originates.

Deputy Governor Case. It originates in New York, and in following the usual practice, I think Mr. Harrison, who operates that department, has usually made an oral statement concerning it.

The Chairman. Will you do that?

Mr. Harrison. Yes. Some two or three years ago I was appointed a committee of one for the purpose of taking up with the Treasury the available supply of gold coin and certificates which would permit of each Federal Reserve Bank increasing its supply of hand-to-hand gold currency--that is, gold certificates and gold coin--to an amount equal to 20 per cent of their aggregate liabilities.

A great deal has been accomplished from the time we first started, when the average reserve of this kind of currency was about 12 per cent for the whole system. Some of the Reserve Banks had less than 1 per cent, a great number of them had less than 5 per cent in the form of payable gold. At this time the average for the System is 18 per cent, as contrasted with 12, but it so happens

that a number of the New York banks are still very much below the 20 per cent and below what appears to be even a satisfactory working requirement for even the smaller districts. Kansas City, for instance, has a reserve supply of 3.4 per cent of gold coin and certificates, or of gold reserve that is in the form they can pay out upon demand. Atlanta has 7.4 per cent; San Francisco has 9.4 per cent, as contrasted with 4.7 a year ago. They have about doubled what they had a year ago, but they are still very low. In New York we have 27 per cent, Richmond has 26 per cent, and others range between the low points I have mentioned and the high points which is for New York.

Governor Fancher. What is our position?

Mr. Harrison. Cleveland 13.2.

Deputy Governor Paddock. What is Boston?

Mr. Harrison. Twenty.

Governor Talley. What is Dallas?

Mr. Harrison. 26.8. You are next to the highest.

Governor Fancher. What date is that?

Mr. Harrison. This is as of September 30 of this year.

Governor Fancher. 13.2 you show us?

Mr. Harrison. Yes.

Governor Biggs. What is St. Louis?

Mr. Harrison. 18.8. Chicago is 11.7. Now, I think that the development of our gold business in the past two years has indicated quite clearly that an average of 20 per cent for New York is wholly inadequate, and it is our ambition to increase our supply of gold certificates and gold coin to well above 20 per cent, which we figured was a working basis for all Reserve Banks. We have so many demands that are unexpected and large in volume for gold to be exported that if we tried to work on a 20 per cent reserve supply of gold certificates and coin in the aggregate, it leaves us with such a small supply of coin that we cannot meet the current demands. We are protected in our case by the fact that we have the assay office in New York City, where there is a large supply of coin which would be available to us in time of need, and the same is true of San Francisco and may account for their relatively low percentage. The same is true in Philadelphia, although they have got a pretty good percentage, even so, as contrasted with the whole; but I mention this now in case some of those banks that are still fairly low might care to take steps to build up

their working supply of gold certificates and gold coin.

We have in New York over \$250,000,000 in the gold settlement fund and about \$125,000,000 or \$130,000,000 in the agents' fund. We have figured out that that is entirely too much gold for us to have locked up in the Treasury when we have adequate vaults for our own supply. We have therefore requested the Treasury for \$100,000,000 in gold bars, which after considerable negotiation we are now able to get back from the Treasury without paying the bar charge. They have removed the bar charge since October 1. After we get that \$100,000,000, we hope to get another \$100,000,000.

Governor Fancher. Pursuing that a little further, would it be your thought, Mr. Harrison, taking this situation as applying to our own case, where we are under our percentage and we desire to build it up, we have been pursuing the policy of paying out as much gold as we receive, perhaps a little more, can we reasonably, to follow out our program, curtail our payments and gradually increase our holdings in the form of gold certificates? Is that going to be acceptable entirely to the Treasury, in view of the policy adopted here of banks not paying out gold certificates, which we have tried to perform?

Mr. Harrison. I think that would be wholly agreeable to the Treasury, and would be quite consistent with the policy we have discussed in past meetings, for the reason that at the present time the amount of gold certificates actually in circulation is \$1,100,000,000, which is practically \$100,000,000 more than the figure at which we had hoped to retain the circulation. If some of the Reserve Banks care to contract their gold payments, with the consequent additional expense of paying out their own Federal Reserve notes, I see no reason why they should not do it. That is very much cheaper than building up their gold reserves in the vaults by shipping bars from New York to the respective Federal Reserve Banks.

Governor Talley. We have not paid out any gold for some time, and the result of that has been that following the policy of other Federal Reserve Banks we have accumulated more gold, and in addition to that you will recall you stopped some shipments and that was diverted to us, and that has further increased our gold, and last summer the balance of trade went against us and we took credit in gold, and now the word came through the other day that we would pay out some gold certificates, of course paying out the worn

ones, so that they will come back, and we will ship them here. That will at the same time offset the action of any other Federal Reserve Bank that may want to contract its gold hoarding.

Mr. Harrison. The problem of each bank is an individual problem, because as I say there are some banks that are close to mints or assay offices and there are others who are not. Whether those who have a large supply of bars and a medium supply of coin desire a different ratio, is more or less a local problem, but the main point which I think we should consider and the one which this Conference passed upon some time ago, is that, irrespective of the amount of bars which you hold, you ought to try to maintain a reserve of payable gold, that is, gold coin or certificates, equal to not less than 20 per cent of your liability, and it is that ratio that I have referred to in this memorandum as being pretty low in some cases. The Treasury has done a great job about minting gold in the last three years. I think they have minted between \$150,000,000 and \$200,000,000 of gold coin.

Governor Fancher. Is there a surplus of free minted gold now?

Mr. Harrison. Unfortunately there is not. There is only about \$11,000,000 excess over certificates, and in^a case where the bank, as in our own case, has a large supply of certificates, we can serve the Treasury's purpose by redeeming the certificates and taking coin. That helps to a considerable extent, because that reduces the ratio of these certificates against which they have got to have a supply of one-third in coin. But they have started minting again, I think, in the San Francisco or Denver mint, and it is very likely that ^{they} will be building up in the next few months a large available supply of coin, to be held against certificates, thereby increasing the excess supply of coin.

The Chairman. You are building your supply up by accumulating bars. To what use can you put those?

Mr. Harrison. Well, our thought in building up our supply of bars was not so much to have them in the form that we could pay out, as to reduce the liability of the Treasury to the Reserve System for gold held for account of the System.

Are there any questions about this?

The Chairman. If not, a motion to adjourn will be in

N
10/22