A meeting of the Board of Governors of the Federal Reserve System with the Federal Advisory Council was held in Washington on Tuesday, February 14, 1939, at 10:30 a.m.

PRESENT: Mr. Eccles, Chairman
Mr. Ransom, Vice Chairman
Mr. Szymczak
Mr. McKee
Mr. Davis
Mr. Draper

Mr. Morrill, Secretary
Mr. Bethea, Assistant Secretary
Mr. Carpenter, Assistant Secretary
Mr. Clayton, Assistant to the Chairman
Mr. Thurston, Special Assistant to the Chairman
Mr. Wyatt, General Counsel
Mr. Paulger, Chief of the Division of Examinations
Mr. Smead, Chief of the Division of Bank Operations
Mr. Goldenweiser, Director of the Division of Research and Statistics
Mr. Parry, Chief of the Division of Security Loans
Mr. Dreibelbis, Assistant General Counsel
Mr. Leonard, Assistant Chief of the Division of Examinations

Messrs. Thomas M. Steele, Leon Fraser, Howard A. Loeb, T. J. Davis, Robert M. Hanes, Edward Ball, Edward E. Brown, Walter W. Smith, John Evans, R. E. Harding and Paul S. Dick, Members of the Federal Advisory Council representing the First, Second, Third, Fourth, Fifth, Sixth, Seventh, Eighth, Tenth, Eleventh and Twelfth Federal Reserve Districts

Mr. Henry S. Kingman, President, Farmers & Mechanics Savings Bank, Minneapolis, Minnesota, representing the Ninth Federal Reserve District

Mr. Walter Lichtenstein, Secretary of the Federal Advisory Council

At the request of President Smith, Mr. Lichtenstein read the following recommendations adopted by the Federal Advisory Council at its separate meeting which convened on February 12, 1939, and concluded just before this meeting. The reading of each recommendation was followed by a discussion:

"TOPIC No. 1. Services to Member Banks.

"RECOMMENDATION: The Federal Advisory Council has given careful consideration to the letter of the Secretary of the Board of Governors of the Federal Reserve System, dated January 3, 1939, dealing with the question of 'How Can the Federal Reserve System Increase the Value or Scope of its Services to Member Banks in Practicable or Desirable Ways'. The Council is ready to express opinions on the questions raised in Mr. Morrill's letter, though in some instances the topic has been covered by the Council's Recommendation of November 29, 1938 and by earlier recommendations.

"Following the order of Mr. Morrill's letter, the Council makes the following observations on the queries, as presented:

"1. <u>Collection System</u>.

"(a) All checks payable in United States should be collectible at par through Federal Reserve System.

"<u>Answer</u>: The Federal Advisory Council believes that all checks should be collected at par. The Federal Reserve System, therefore, should continue its efforts to bring this about and the Council believes the cooperation of the Federal Deposit Insurance Corporation is essential to accomplish the purpose desired.

"(b) Handle and collect non-par items, charging any exchange deductions to sending banks.

"<u>Answer</u>: No.

"(c) Permit members to make exchange charges on cash items as long as nonmembers do so.

"<u>Answer</u>: No.

"(d) Abolish par clearance.

"<u>Answer</u>: No.

"(e) Furnish complete transit service similar to that offered by correspondents.

"Answer: The Council answers yes in so far as par items are concerned and no in respect to non-par items. Member banks should be allowed to deposit with the respective Federal Reserve banks or branches all par checks with merely an adding machine tape showing the amount and total of such checks, provided the Federal Reserve bank of the district is satisfied the sending bank maintains an adequate record of such items.

"(f) Speed up check collection service.

"Answer: In accordance with its Recommendation of November 29, 1938, the Council answers yes.

"(g) Collection of non-cash items should be left to member banks.

"Answer: Yes.

"2. Examinations.

"(a) All examining authorities should be consolidated.

"(b) All examinations should be made by Federal Reserve banks only.

"Answer: The Council replies in the negative to (a) and (b), but it requests the Board of Governors to continue its present efforts to bring about greater uniformity in the examination procedure and in the form of the required reports.

"(c) Centralization of authority in Washington weakens System.

"Answer: The Council presumes that the question refers to the centralization of examination authority in Washington. The Council does not believe that such centralization, as heretofore conducted by the Comptroller's office in respect to national banks, weakens the System. As to State member banks the Council recommends that as much discretion and authority be given the examining departments of the twelve regional banks as is given by the Comptroller's office to its chief district examiners.

"3. Reserve Requirements.

"(a) Cash in vaults should be counted in reserves.

"Answer: The Council believes that this should not be allowed in the case of banks located in communities where there is a Federal Reserve bank or branch. In the case of banks located in communities where there is no Federal Reserve bank or branch, some limited percentage of the required reserves should be allowed to be held in cash.

"(b) Uniform raises in requirements hurt country banks.

"Answer: No; not more than other banks.

"(c) Nonmembers have advantage over members.

"Answer: Yes and no, depending upon the reserve requirements of the State in which the bank is located, but advantages accruing to member banks, especially in times of distress, more than outweigh the slight disadvantages to which member banks, under certain circumstances, may be subjected.

"(d) Low rate of interest should be allowed on reserve deposits.

"Answer: No.

"4. Report Requirements.

"(a) Publication expensive.

"Answer: Not unduly expensive.

"(b) Lack of uniformity.

"Answer: The Council continues to urge uniformity and is glad to note that substantial progress has been made.

"(c) Number of reports required increasing.

"Answer: The steady increase in the number of statistical and special reports called for is placing an onerous burden upon the banks. The Council recommends that the Board of Governors review the existing categories of reports to it and other governmental agencies to ascertain whether some may be eliminated, and suggests that no further reports be requested without careful consideration of the question whether the resulting information will be of enough practical value to justify the work and expense involved. To the extent that reports are considered necessary, they should not be required at more frequent intervals than is indispensable.

"5. Miscellaneous.

"(a) Extend wire transfer system to include Government bonds.

"Answer: No.

"(a) Draft rules and regulations in layman's language and in short paragraphs.

"Answer: This matter is fully covered in the Recommendation of the Council of November 29, 1938.

"(c) Furnish a manual, properly indexed, of all acts, rules and regulations of Federal Reserve Board, Comptroller's Office, Federal Deposit Insurance Corporation, and all other agencies dealing with bank management.

"Answer: Yes, but obviously this requires the cooperation of other agencies.

"(d) Create in the Federal Reserve Banks an advisory investment service for member banks.

"Answer: No.

"(e) A study of trust department earnings would be of great value and would point out to many banks sizeable losses that are occurring in certain branches of that business. Such study might also be extended to commercial departments.

"Answer: The Council believes a compilation of the earnings and costs of trust departments made up from the reports of national bank examiners and those of the examiners of the Federal Reserve banks would be desirable at this time. Such a compilation of the earnings and costs of commercial departments is already available and is considered adequate.

"(f) Since large amounts of Government bonds are held by banks, the Federal Reserve System should provide a satisfactory market both as to amounts and prices, thereby rendering a service to member banks and the Government.

"Answer: No, but this answer does not relate to customary operations of the open market committee.

"(g) Committee of operating officers of member banks should be formed in each district to act as a working committee for the Federal Advisory Council, this committee to bring to the attention of the Council from time to time suggestions for the improvement of the operations of the System.

"Answer: No, but members of the Federal Advisory Council will continue, as in the past, to obtain the opinions of the member banks of their respective districts.

"Selected Comments

"Under this heading there are included a number of topics concerning which the Council has either expressed an opinion above or on some previous occasion. Such a question is that referring to the collection of all checks at par; another that of devising a method whereby member banks in future should not be made to suffer by being compelled to pay exchange on items drawn on nonmember banks; again another is whether all member banks should be given permission to make exchange charges on checks or Federal Deposit Insurance Corporation should require nonmember banks to clear checks at par.

"In respect to five other matters raised, the Council replies as follows:

"1. Discontinue solicitations of membership of country banks with deposits under a reasonably small limit, say $1,000,000, through offering free of charge routine banking services now rendered by present members of the Federal Reserve System, such as free safekeeping of securities, free shipment of outgoing and incoming currency.

"Answer: No.

"2. Federal Reserve banks should be given all possible authority in their relations with their local members with the idea of conserving time and also because of a more intimate knowledge of local conditions prevailing.

"Answer: Yes.

"3. Coordinate issuance of regulations for member banks and for nonmember banks to avoid conflict as, for example, interest regulations.

"Answer: Wherever possible there should be coordination especially with the Federal Deposit Insurance Corporation.

"4. Membership in Federal Reserve System is purely an expense as there are no benefits offered by Federal that are not also available at correspondent banks.

"Answer: The Council does not agree with the above statement.

"5. System should be developed and conducted in such manner as to bring all banks into membership and then confine members to acceptance of deposits from sources other than banks.

"Answer: Banks should be encouraged to become members of the System, but the Council is unanimously opposed to the elimination of inter-bank deposits."

Mr. Smith stated that the answers set forth in the above recommendation represented the unanimous agreement of the members of the Council who were present at the separate meeting. At the suggestion of Governor Davis, it was agreed that, inasmuch as a discussion of this recommendation would require considerable time, the other recommendations of the Council should be considered first and that, if necessary, the meeting should be continued this afternoon for a discussion of the answers of the Council as set forth above.

"TOPIC No. 2. Easy Money Policy.

"RECOMMENDATION: The Federal Advisory Council, considering that many of the fundamental effects of the continuing cheap money policy have not been fully appreciated, recommends that the Board of Governors of the Federal Reserve System conduct a study of the long-range consequences of the continuing policy of cheap money upon the accumulation and investment of the savings of the people, and upon the financial structure of the country, with especial reference to its effects upon the maintenance of a sound banking system."

Chairman Eccles stated that the recommendation would be considered by the Board.

"TOPIC No. 3. Interlocking Directorates.

"RECOMMENDATION: Section 8 of the Clayton Anti-Trust Act, as amended by Section 329 of the Banking Act of 1935, permits a director, officer or employee of a member bank of the Federal Reserve System, or a branch thereof, who was lawfully serving as a private banker or as a director, officer, or employee of any other bank, banking association, savings bank, or trust company, or any branch thereof, on August 23, 1935, to continue such service to February 1, 1939.

"The Board of Governors of the Federal Reserve System by regulation has permitted such service as director, officer, or employee of a member bank and in not more than one other banking institution, to continue to August 1, 1939.

"The service of the directors, officers and employees who are now serving under the authority of the aforesaid law and regulations is in many cases extremely valuable to the banking institutions of which they are such directors, officers, or employees, and the discontinuance of such service would not result in a commensurate benefit to the public.

"Therefore, the Federal Advisory Council believes that any director, officer or employee of any member bank of the Federal Reserve System or any branch thereof, who is now lawfully serving at the same time as a private banker, "or as a director, officer, or employee of any other bank, banking association, savings bank, or trust company or any branch thereof should be permitted to continue such service so long as the stockholders of any such banking institution shall desire to retain such persons in such capacities, and so long as such persons shall accept the election or appointment to such positions. This, of course, means that no permits for new interlocking directorates will be issued."

Mr. Smith stated that in submitting this recommendation it was the hope of the Council that the Board would agree to a solution of this problem which would permit the continuation of existing interlocking bank directorates, without authorizing the creation of new relationships, as it was felt by the Council that the discontinuance of existing relationships would work a distinct hardship on member banks without a corresponding benefit to the public. He stated that if the desired objective could be accomplished without legislation, the Council would prefer to have the problem handled in that way. Upon inquiry from Mr. Ransom as to whether the Council had discussed the existing discrimination against member banks resulting from the Clayton Act in its present form, Mr. Smith stated that the Council had not given consideration to that point.

Mr. Hanes said that the legislative committee of the American Bankers Association at the present time was drafting legislation which would remove the discrimination in the present law and permit the continuance of existing interlocking directorates but would prohibit new interlocking relationships involving insured banks. He inquired whether the Board would oppose such a solution of the matter and Chairman Eccles stated that the Board would be glad to give the matter consideration.

"TOPIC No. 4. S. 477 (Corporate Trusteeships).

"RECOMMENDATION: The Federal Advisory Council desires to call the attention of the Board of Governors of the Federal Reserve System to Senate Bill 477 relating to the regulation of trust indentures under which securities are issued.

"The Council feels strongly that the imposition of some of the liabilities as provided in the bill would create contingent liabilities for banks of deposit accepting corporate trusteeships which might be dangerous to themselves and the banking system as a whole. Broadly speaking, no corporations other than banks of deposit have either the financial responsibility or the experience which qualify them to act as corporate trustees.

"Furthermore, the Council believes that the bill would materially increase the cost of, and make more difficult long term public financing, particularly to smaller corporations, and would thus tend to hinder expansion of plants and businesses at a time when such expansion is particularly desirable in the interest of business recovery.

"The Council also believes that the restrictions contained in the bill on the right of security holders to waive defaults, and the requirements that the trustee must act in the event of default if it is to avoid liability, would force into receiverships, or the bankruptcy courts, many businesses that otherwise might survive, particularly in times of depression, with resultant loss to their creditors, including banks, and to their stockholders and to their employees and the communities in which they are located.

"The Council requests the Board to submit this expression of its opinion to the Senate Committee on Banking and Currency with the request that it be put in the record of the hearings before its Subcommittee considering the bill.

"The Council understands that the record of the Subcommittee, in the absence of further hearings, will be closed on February 16th, and therefore requests that it be forwarded by that date."

Mr. Ransom reviewed the consideration which had been given to the trust indenture bill for over two years by members of the Board and its staff, stating that they had been in consultation with representatives of the Securities and Exchange Commission and banking groups interested in the legislation. He stated that the Board had made substantial contributions towards improving the bill on its technical side relating to the provisions governing fiduciaries under corporate trust indentures. He added that the bankers had seemed to feel from the beginning that the proposed legislation was unnecessary, although admitting the desirability of improving the discharge of the responsibilities assumed under these indentures, that the feeling seemed to be growing that the legislation was not advisable at this time, and that a number of people had stated that they thought it might have a deflationary effect on the capital market. In answer to a question, he said that the bankers who had been watching the bill seemed to feel that it was doubtful if it would become law, and suggested that the Council consider the question whether, if the above recommendation was transmitted by the Board to the Banking and Currency Committee of the Senate, it would increase or reduce the possibilities of the passage of the legislation. Mr. Ransom inquired whether the Council had given consideration to discussing the bill with the Securities and Exchange Commission and Mr. Brown replied that members of the Federal Advisory Council had discussed it with representatives of the Securities and Exchange Commission and that the members of Council appeared to be in fundamental disagreement with the Commission regarding it.

During the discussion, the question was raised whether some changes should be made in the language of this recommendation before transmission by the Board to the subcommittee of the Senate Committee on Banking and Currency and it was understood that the Council at a separate meeting today, would give further consideration to the questions raised and advise the Board of any revisions in the recommendation.

Chairman Eccles inquired whether any of the members of the Board of Governors had any objection to complying with the request of the Council that the recommendation be transmitted to the subcommittee of the Senate Committee on Banking and Currency and on being advised that there was no objection stated that it would be transmitted by the Board in the form agreed upon by the Council.

"TOPIC No. 5. In Re: Chandler Act.

"RECOMMENDATION: The Federal Advisory Council suggests that the Federal Reserve Board give consideration to amendments to the Federal Bankruptcy Act as amended by the Chandler Act, approved June 22, 1938, and particularly to Section 60 (a) - (b), to alter the provisions of that Section.

"To an increasing extent member banks of the Federal Reserve System are making loans secured by assignments of receivables and other types of collateral. For the most part, such loans are made to relatively small and inadequately capitalized enterprises and without notification to borrowers' debtors, in a spirit of cooperation with the borrowers to preserve their credit standing.

"The Federal Advisory Council is of the opinion that under the provisions of Section 60 (a) - (b) the reliance that banks place upon such collateral, unless title thereto is perfected to comply with the requirements of this

"Section, is illusory and may result in heavy losses. Attention is also called to the timing of perfection of title with relation to the date of the loan, leading to a possible classification of the loan as an antecedent debt.

"In addition to loans secured by accounts receivable, other types of collateral loans may be affected, among which are:

A - Loans secured by assignment of money payable under a contract or rents under a lease.

B - Loans secured by assignments of life insurance policies.

C - Loans secured by assignments of rights and interests in estates and trusts.

D - Loans on the security of instruments which appear to be but are not in fact negotiable instruments.

E - Loans upon borrower's promise to deliver collateral, whether or not the collateral is segregated or escrowed.

F - Loans secured in whole or in part by equities of the borrower in collateral owned by the borrower but pledged to secure other indebtedness.

"The language of Section 60 (a) - (b) is presumably intended to prevent secret liens, but its provisions bear so heavily upon business and banking practice that restrictions in making loans will ensue, thus adversely affecting general business, or if such loans are made without complete compliance with the requirements of this Section, heavy losses may be encountered by banks."

Mr. Smith stated that the above recommendation was being submitted for study by the Board and for such action as it desired to take in the light of the circumstances referred to in the recommendation. It was stated that counsel for the Federal reserve banks were studying the effect of the amendments to the bankruptcy statutes as made by the Chandler Act upon the industrial loan activities of the Federal reserve banks and that following completion of this study the Board would give consideration to the matter in the light of the recommendation of the Council.

During the discussion of the above recommendation Mr. Wingfield, Assistant General Counsel of the Board of Governors, joined the meeting.

There ensued a further discussion of the recommendation made by the Council on topic number 2 as set forth above and Chairman Eccles stated that the Board was continuously engaged in studies of the effects of changes in the volume and cost of money on the country's economic life, and that these studies dealt both with short-term and long-term relationships. In view of this fact he felt that the recommendation was meaningless and also that it was too general in its terms to constitute a real recommendation. In other words, easy money conditions have been brought about by certain specific policies and developments. In his opinion, the only way a recommendation of this character could have a concrete meaning would be by referring specifically to some policy or policies of the Government or the Federal Reserve System, such as, for example, the gold policy, the silver policy, and the fiscal policies of the Government itself, or the policy of the Federal Reserve in regard to reserve requirements or open market operations.

Mr. Steele stated that the recommendation was made in the light of earlier recommendations of the Council to, and discussions with, the Board of Governors on related matters over a period of approximately eight years.

Mr. Loeb stated that the question in the Council's mind was whether the easy money policy was a conscious one or merely the result of what has occurred during the period of depression.

Mr. Fraser stated that he had suggested the resolution, that the question presented by the resolution was what the long range effects of the cheap money situation were going to be, and that the suggestion was made with the thought that the Board would undertake a study to determine whether the long-term results of the policy would be beneficial, and, if not, what steps could be taken to meet the situation.

Chairman Eccles referred to some of the problems inherent in the existing situation such as gold imports and the Government silver program and suggested that the Council might consider making specific recommendations on these important issues.

Mr. Loeb stated that the Council had always looked to the Board for suggestions as to topics on which the Board desired the Council's views and that the Council was not in as advantageous position as the Board of Governors to assess the importance of these various problems. During this discussion Mr. Hanes left the meeting.

The meeting recessed at 1:00 p.m. and reconvened at 2:00 p.m. with the same attendance as at the opening of the morning session except that Messrs. Hanes, Ball, Kingman, Thurston and Paulger were not present.

Mr. Smith stated that in a separate meeting during the lunch period the Federal Advisory Council had given further consideration to the recommendation relating to the trust indenture bill and had decided to request the Board to transmit it to the subcommittee of the Senate Committee on Banking and Currency without change.

There followed a discussion of the answers submitted by the Council at its meeting with the Board this morning under topic number 1.

Mr. Ransom pointed out that the list of topics enclosed with Mr. Morrill's letter of January 3, 1939, referred to above, consisted simply of an abstract from the suggestions offered by member banks as compiled in the report submitted by the Council to the Board of Governors at the meeting on May 17, 1938, and that, therefore, the list of topics had not originated with the Board. He suggested that the comments of the Council on some of the topics were so brief that its position might easily be misunderstood unless the comments were expanded to present more clearly the reasons underlying the position taken, and that the Council might wish to give further consideration to the matter at a later meeting and determine whether it would be desirable to expand the answers to some of the topics for the purpose of stating the reasons in each case for the answer given. Mr. Smith said that the brevity of the comments was influenced by the desire of the Council to make its report short enough so that it would not become unduly burdensome.

In connection with the answers on the Federal reserve check collection system, Mr. Ransom referred to the obstacle to increasing membership in the Federal Reserve System which is presented by the problem of par clearance. He referred also to the problems before the Board in connection with the prohibition against the payment of interest on demand deposits and expressed the opinion that in the event the matter again comes before Congress there would be tremendous pressure for a repeal of this prohibition. During the discussion Mr. Lichtenstein read an excerpt from a letter received from Mr. L. B. Williams, who was a member of the Federal Advisory Council representing the Fourth Federal Reserve District last year, on the subject of par clearance. A copy of this excerpt has been placed in the Board's files.

Mr. Loeb raised the question whether in view of the great amount of work done in the early years of the Federal Reserve System to establish the system of par clearance it would be wise to reopen the matter at the present time.

In connection with the answers on reserve requirements there was a discussion of whether vault cash should be counted as any part of the legal reserve of a member bank and whether the same reserve requirement should be established for all banks outside of New York as the ultimate central reserve city. It was agreed by the members of the Council during the discussion that the answer to 3(a) should be changed to provide that cash in vault should not be counted as reserves in the case of banks located in communities where there is a Federal reserve bank, branch, or agency.

At this point Mr. T. J. Davis left the meeting.

In connection with the answers of the Council on the question of reports required of member banks, Mr. Ransom stated that the suggestion had been made that the Board obtain reports on the extent to which banks are making longer term loans than has been customary in the past and he inquired whether the members of the Council saw any objection to the Board obtaining reports on loans and the recent experience of the banks with respect to demands for credit.

Messrs. Fraser, Evans and Dick withdrew from the meeting at this point.

It appeared to be the consensus of the members of the Council present that there would be no objection to the development of the information referred to in Mr. Ransom's inquiry, but the suggestion was offered that it would be desirable if the study could be made by a disinterested agency so that there would be less occasion for attempts to discredit the report because of bias.

There ensued a discussion of the effects on the capital market of the provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 and of the present difficulties in floating small issues of securities. Consideration was also given to the reasons for the existing low volume of corporate financing and the opinion was expressed among members of the Council that the principal reasons therefor were the feeling that there is little opportunity for profitable investment at the present time and that there is a lack of confidence in the future. There was also a discussion of suggestions that had been made that a new agency be created to make industrial loans and what steps might be taken by existing agencies to meet that need.

In connection with the answer to 5(a) Mr. Ransom stated that the Federal bank supervisory agencies had given some consideration to the matter of statistics relating to the operation of trust departmentsof banks but had found that the practices at the banks were so lacking in uniformity that the information available was practically meaningless.

Mr. Ransom stated that the form of the answer to 5(f) might imply that the Council considered one of the functions of the Federal Open Market Committee to be the provision of a satisfactory market for Government securities. Mr. Smith stated that such was not the intention of the Council to create such an impression and that the answer should be amended. The members of the Council present agreed that the answer should be amended by striking out everything after the word "no".

After a discussion of answer 3 under selected comments, it was agreed that the words "wherever possible" should be stricken out in order to remove any possibility of misunderstanding of the suggestion.

In connection with the answer to the suggestion that the System should be conducted in such a manner as to bring all banks into membership and then confine members to the acceptance of deposits from sources other than banks, Chairman Eccles stated that a suggestion which had been made by him that insured banks be relieved of the insurance assessment on deposits carried by them with Federal reserve banks was not made with the thought of eliminating entirely interbank balances but to discourage unsound pyramiding of reserves and to bring about more stability in reserve deposits at Federal reserve banks and in the balances carried by banks with their correspondents.

Mr. Smith referred to the recommendation made by the Federal Advisory Council at its last meeting with respect to the assignment of claims against the United States and inquired what action had been taken by the Board with respect thereto. The members of the Council were advised that the matter had been looked into by the Board's counsel and the Council's recommendation had been included in the Board's Annual Report for the year 1938 which was submitted to the Speaker of the House of Representatives under date of January 27, 1939, and that the Board felt that in the circumstances no further action should be taken regarding the matter at this time.

Mr. Smith stated that, in order to avoid a conflict with other meetings in May, the Council had decided tentatively to hold its next meeting on June 5-6, 1939, and would like to know whether this change was satisfactory to the Board of Governors. The members of the Board stated that they saw no objection to the proposed change in dates.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved:

M S Eccles
Chairman.