A meeting of the Board of Governors of the Federal Reserve System was held in Washington on Tuesday, June 4, 1940, at 11:00 a.m.

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

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. Parry, Chief of the Division of Security Loans
Mr. Dreibelbis, Assistant General Counsel
Mr. Vest, Assistant General Counsel
Mr. Williams, Assistant Counsel

ALSO PRESENT: Mr. George L. Harrison, President of the Federal Reserve Bank of New York

Mr. Ransom stated that Mr. Dreibelbis had been serving as the point of contact between the Federal Reserve Bank of New York and the Treasury in connection with telephone discussions of the question whether the New York Bank could open and maintain accounts for British and other foreign Governments as distinguished from accounts for the central banks of those Governments and that he would like to have Mr. Dreibelbis review the latest developments in connection with this matter.

Mr. Dreibelbis said he talked with Mr. Bernstein, Assistant General Counsel for the Treasury Department, on May 31, 1940, at

which time the latter stated that a letter had been prepared at the Treasury to be sent to the Federal Reserve Bank of New York which would state that the Treasury would be pleased if the New York Bank would open an account for the British Government. Mr. Dreibelbis also said that in his telephone conversations with Mr. Logan, General Counsel for the Federal Reserve Bank of New York, the position had been taken by Mr. Logan that there should be a request from the Treasury that the New York Bank open the account, that the authority of the Federal Reserve Bank to take such action under section 14(e) of the Federal Reserve Act was very doubtful, and Mr. Logan felt that a request from the Treasury would be the basis for action by the Bank under other provisions of the law, that Mr. Bernstein agreed to recommend that the letter be changed to include a request that the account be opened, that as a result the letter was amended and submitted to Mr. Logan who revised it to include the statement that the Treasury "requests and authorizes" the Federal Reserve Bank of New York to open the account, and that when this draft of the letter was submitted to Mr. Bernstein he took the position that the words "and authorizes" should be omitted, but that Mr. Logan felt that that should not be done.

At this point Messrs. Goldenweiser, Director, and Gardner, Senior Economist, of the Division of Research and Statistics, joined the meeting.

Mr. Ransom raised the question whether a request from the

Treasury would not imply an authorization from the Treasury to the New York Bank to open the account.

Mr. Harrison reviewed the consideration which had been given to the whole matter by the Federal Reserve Bank of New York and pointed out that the question arose because of the position taken by the Treasury that it would be preferable for the British and other foreign Governments involved to maintain accounts with the Federal Reserve Bank of New York rather than with commercial banks and stated that, in view of that position on the part of the Treasury, it would appear that the Department should be willing to take such steps as may be regarded as necessary to establish a legal basis upon which the accounts could be opened by the Reserve Bank. He made the further statement that he and his directors felt that the specific authorization proposed in the letter was very desirable and that there was a question in his mind whether his directors would be willing to open the account on the basis of the letter in the form proposed by Mr. Bernstein. He added that the Reserve Bank was willing to do anything it could in the emergency but that as long as there was a serious legal doubt as to the Bank's authority in the absence of an authorization from the Treasury and since the Treasury had been insisting on the maintenance of such accounts in the Federal Reserve Bank, the Treasury should either authorize the opening of the accounts or sanction the placing of the accounts in commercial banks.

Mr. Draper suggested that Messrs. Ransom and Harrison discuss

the matter with the Secretary of the Treasury in an effort to find a solution.

This suggestion was considered and it was agreed unanimously that Mr. Harrison should call on Mr. Bell, Under Secretary of the Treasury, and discuss the matter with him and that if it should develop that it was necessary to confer with the Secretary of the Treasury, Messrs. Ransom and Harrison should arrange to see him.

Mr. Gardner stated that recently the Central Bank of Bolivia transferred a shipment of gold from London to the Federal Reserve Bank of New York to be earmarked in the name of the Central Bank, that the Reserve Bank accepted the gold as the property of the Central Bank of Bolivia, and that subsequently, following receipt by the Federal Reserve Bank of instructions from the Central Bank to ship the gold to Bolivia, a cable was received from the Banco Mercantil, La Paz, Bolivia, making claim to 150,000 gold sovereigns included in the earmarked gold and asking that it be sold and credited to its account with the Bank of London and South America in New York. Upon inquiry of the Bolivian Minister, Mr. Gardner said, the Federal Reserve Bank was informally advised that the gold in question did belong to the private bank and on the strength of that statement the Federal Reserve Bank of New York refused to ship the gold to the Central Bank of Bolivia, but following this development advice was received from the Bolivian Minister to the effect that the Central Bank had purchased the gold under a repurchase agreement and that at the moment

the gold was under the control of the Central Bank, and it had authority to ship it to Bolivia. Mr. Gardner added that the Federal Reserve Bank had also been advised by the State Department that, in view of the fact that the situation was causing political repercussions in Bolivia and the further fact that the Bolivian Minister had taken the position that the Central Bank had the right to control the gold, the State Department was anxious to have it shipped as soon as possible. Mr. Gardner made the further statement that he suggested to the State Department that one of its lawyers be familiarized with the circumstances as he felt that before the Federal Reserve Bank of New York would feel free to ship the gold it would require some assurance that it was acting on proper authority.

Mr. Dreibelbis said that, after being advised by Mr. Gardner of the developments this morning, he felt the whole matter was one for consideration by the attorneys for the State Department in an effort to determine what could be done to find a solution to the matter which would protect the position of the Federal Reserve Bank of New York.

At this point Messrs. Harrison, Goldenweiser and Gardner left the meeting.

Mr. Ransom referred to the action taken at the meeting of the Board on April 9, 1940, in approving a draft of report on the Federal Home Loan Bank bill (S. 2098), which was to be sent to the

Chairman of the Senate Banking and Currency Committee when it was ascertained that the committee was going to give consideration to the bill. At Mr. Ransom's request, Mr. Williams stated that the bill passed the House of Representatives in an amended form on May 31, 1940, and was sent to the Senate and referred to the Committee on Banking and Currency. He also stated that this morning he prepared a memorandum outlining the changes in the bill as it passed the House, and after reviewing the changes expressed the opinion that, inasmuch as there was a possibility that the Senate committee might consider the bill at any time, the Board's report on the bill should be sent to the Chairman of the Senate committee as soon as possible.

In the discussion which followed, it was stated that the changes made in the bill as passed by the House eliminated some of the objections made by the Board in the draft of report approved at the meeting on April 9, and the suggestion was offered that the report should be amended to call attention to the fact that the House had eliminated certain provisions of the bill which were objectionable to the Board.

It was agreed unanimously that the report should be changed in accordance with this suggestion and that the revised report should be sent immediately to the Chairman of the Senate Banking and Currency Committee.

The report in its revised form read as follows:

"This is in reply to your letter requesting an opinion as to the merits of S. 2098, a bill 'To amend the Federal Home Loan Bank Act, Home Owners' Loan Act of 1933, Title IV of the National Housing Act, and for other purposes.'

"The Board is concerned by the broad implications of the bill in respect to the probable effect of its enactment upon the banking and credit structure of the country. Certain of its provisions would expand the permissible activities of Federal Savings and Loan Associations and other member institutions of Federal Home Loan Banks far beyond their original character as local mutual thrift and home-financing associations and would allow them to transact a large amount of general banking business. Other provisions would, by affording preferential insurance facilities to the shares of such associations, lend a degree of liquidity to them comparable to that of bank deposits. By thus, on the one hand, expanding the types of business in which such associations could engage so as to include a large amount of general banking business and, on the other, making it possible for them to compete with savings banks and savings departments of commercial banks and other financial institutions on favored terms, the enactment of the bill would tend to establish a separate and complete banking system. The question presented is so important that it would seem that Congress would be justified in studying this particular step carefully in its relation to the whole credit and banking structure, as a part of a comprehensive review of our banking, credit and monetary system such as is contemplated by S. Res. 125.

"It may be helpful to point out in some detail certain sections of the bill which the Board believes raise the foregoing question of the probable effect of the bill's enactment upon the banking and credit structure of the country.

"Sections 1, 2, 8, and 11 of the bill would materially expand the permissible activities of such associations.

"Section 1 would liberalize the class of collateral securities upon which Federal Home Loan Banks are authorized to make advances to their member institutions. At present, mortgages are restricted to 'home mortgages'. This section would completely eliminate any such restriction and would support any past or future enlargement of

"the lending powers of State-chartered member associations, as well as Federal Savings and Loan Associations by authorizing advances upon the security of any first mortgage.

"Section 2 would further extend the list of eligible collateral to a materially different class of securities, which would include not only obligations of the Federal Savings and Loan Insurance Corporation and of the Federal Home Loan Banks, but also any other obligations acceptable to the Federal Home Loan Bank Board which a member association might lawfully have available.

"Section 8 of the bill would allow Federal Savings and Loan Associations, under proper authorization from the Federal Home Loan Bank Board, to place 15 per cent of their assets (in addition to 15 per cent now allowed to be invested in first mortgages with no restrictions) in residential mortgages of any sort - not necessarily 'home mortgages' - within a 50 mile radius. This may be a justifiable change, but the restrictions of that section would apply only to Federally-chartered institutions. The lending powers of State-chartered institutions are governed by State law and the amendments proposed in section 1 would therefore encourage the latter to expand their activities to other fields instead of continuing as local mutual thrift and home-financing associations. Therefore, it would be desirable to place in section 1 restrictions upon advances by the Federal Home Loan Banks similar in terms to those which would be placed in section 8 upon the types of mortgages in which Federally-chartered associations are authorized to invest.

"Section 8 also would allow Federal Savings and Loan Associations to invest their assets in any securities that are legal investments for fiduciary and trust funds and are approved by regulations of the Federal Home Loan Bank Board. This might be justified as permitting associations to employ idle funds when satisfactory home mortgage loans are not available; but there appears to be no reason for permitting Federal Home Loan Banks to make advances upon such securities, as is done in section 2, if such securities are to be merely temporary investments and the associations are to continue as home-financing institutions.

"Section 11 of the proposed bill would change the name of the 'Federal Savings and Loan Insurance Corporation' to 'Federal Savings Insurance Corporation' thereby

"giving additional impetus to the transformation of the character of Federal Savings and Loan Associations from a system of local mutual thrift and home-financing associations into a separate banking system.

"Sections 14 and 15 of the bill would afford preferential insurance facilities to the shares of such associations, lending to them a degree of liquidity comparable to that of a bank deposit. The underlying reason for including these particular sections in the bill seems to be based upon an assumed analogy between shares and other liabilities of Federal and other savings and loan associations and savings deposits of savings banks and the savings departments of commercial banks.

"Section 14 would reduce the premium for insurance for Federal and other insured associations from the present rate of 1/8 of one per cent to 1/12 of one per cent.

"Section 15 of the bill, in the event of a default by an insured institution, would permit the payment of insured accounts to each insured member either by making available a transferred insured account in another insured institution or 'in such other manner as the Board of Trustees may prescribe.' It would permit, if the Board of Trustees so decided, the full payment of insured accounts in cash rather than in the manner now provided, to wit: 10 per cent cash, 50 per cent of the remainder within one year and the balance within three years in negotiable noninterest-bearing debentures of the Corporation.

"While it is true that 1/12 of one per cent is the current rate of the Federal Deposit Insurance Corporation, the risks of the two types of insurance and the rates which should accordingly be charged for such insurance are not comparable. Such associations for the most part, are mutual in character. Their assets are normally on a long-term basis. Their liabilities are evidenced largely by obligations purchased by individuals seeking to acquire and hold an investment rather than to make a deposit.

"The Federal Deposit Insurance Corporation insures only the deposits of banks, and the net worth of banks, represented by the shareholders' interest in the banks' capital and surplus funds, protects depositors and the Corporation. Generally speaking, there is no comparable cushion in the case of the Federal Savings and Loan Insurance Corporation, whose member institutions are largely mutual in character and which insures withdrawable or repurchasable shares, investment certificates, or deposits.

"Ordinarily, therefore, a smaller percentage of losses on the part of one of its insured institutions will expose the Federal Savings and Loan Insurance Corporation to loss than will follow in the case of the Federal Deposit Insurance Corporation. Furthermore, the uninsured portion of deposits in insured banks, upon which banks pay premiums, is much greater than the uninsured liability in building and loan associations, which means that if the premium collected by the Federal Deposit Insurance Corporation were calculated with respect to the deposits insured rather than all deposits the rate of the Federal Deposit Insurance Corporation would actually be higher than 1/12 of 1 per cent.

"Individuals invest in the obligations of building and loan associations because they expect a higher rate of return than can be obtained in savings banks and the savings departments of commercial banks. Furthermore, the rates of return permitted to be paid and actually paid by the associations upon their insured obligations are higher than the rates of interest permitted to be paid upon savings deposits. Investors in the associations should not expect to obtain the same degree of liquidity as in the case of a savings deposit because such associations, at the present time, are not expected to be and are not regarded as being, as liquid as banks. If their obligations are to be given the liquidity contemplated by this legislation, the discrepancy in the rate of return between such obligations and savings deposits will constitute another serious competitive disadvantage for national and State banks and will result either in the growth of unsound banking practices or in mortality among the institutions competing with the favored Federal and other savings and loan associations.

"For the foregoing reasons the Board of Governors is of the opinion that the enactment of the bill would not be in the public interest.

"The Board notes that a similar bill, H.R. 6971, which passed the House of Representatives on May 31, 1940 and has been referred to your Committee, was amended by the House of Representatives so as to eliminate sections 1, 2 and 11 and so as to modify section 8. These amendments, if concurred in by the Senate, would eliminate some, but not all, of the objections set forth above. Thus, they

"would not eliminate the Board's objections to a part of section 8 or to sections 14 and 15 or to the broad effect of the bill as a whole on the credit and banking structure of the country."

Mr. Williams also reported on the present status of the Glass bill, S. 3938, which, among other things, would authorize the Reconstruction Finance Corporation to assist in the mobilization of materials, plants, etc., for national defense. There was a discussion of the question of whether any action should be taken by the Board with respect to the bill and it was agreed that no action was called for at the moment.

Mr. Williams left the meeting at this point.

Before this meeting the attention of the members of the Board was drawn to a memorandum prepared by Mr. Parry under date of May 29, 1940, in connection with the suggestion made by the Federal Advisory Council at its last meeting that Regulations T, Extension and Maintenance of Credit by Brokers, Dealers, and Members of National Securities Exchanges, and U, Loans by Banks for the Purpose of Purchasing or Carrying Stocks Registered on a National Securities Exchange, be amended to permit the transfer of undermargined security loans from a broker to a bank and vice versa. There was attached to the memorandum a letter received by the Board from the Chairman of the Securities and Exchange Commission under date of May 27, 1940, in which the statement was made that, in view of the caution with which security

loans are accepted by banks and are reviewed by bank examiners, there was sufficient safeguard so that transfers of undermargined loans from brokers to banks would not involve financial hazards, but that the Commission did not feel the same safeguards were present in the case of transfers from banks to brokers and that, therefore, the Commission was fearful that such transfers might jeopardize the financial condition of some brokers and thus subject customers of such brokers to unwarranted risks. Mr. Parry's memorandum also referred to the reasons stated by the Advisory Council for the proposed amendment to Regulation U and outlined the reasons that might be offered for a similar amendment to Regulation T.

The various reasons which had been advanced for and against the proposed amendments were discussed, and Mr. Draper raised the question whether the present would be an opportune time to make the amendments even if it was agreed by the Board that they were desirable. In that connection, Mr. Parry stated that he did not believe the matter was ready for action by the Board at the present time for the reason that the proposed amendment to Regulation T was not yet in a form entirely acceptable to the representatives of the New York Stock Exchange and the representatives had not completed their discussions with the Securities and Exchange Commission regarding the amendment.

At Mr. Ransom's suggestion, it was agreed unanimously that the matter should be laid on the table to be called up again

at such time as Mr. Draper feels the matter should be given further consideration by the Board.

Mr. Parry withdrew from the meeting at this point.

All of the members of the Board present had had an opportunity to read a memorandum which had been prepared by Mr. Vest under date of May 28, 1940, in response to the request made at the meeting of the Board on May 24 in connection with the suggestion of the Federal Advisory Council that the Board recommend to the proper authorities an amendment to section 3477 of the revised statutes which invalidates transfers and assignments of claims on the United States. The memorandum reviewed the history and objectives of the statute and the possible objections that might be raised to its amendment as proposed by the Council and suggested that, inasmuch as the Treasury Department and the Office of the Comptroller General would have an interest in such a proposal and in all probability would be consulted by Congress in any consideration of legislation of this kind, the Board might wish to ascertain the views of the Treasury or other interested Government agencies on the subject.

It was stated that Mr. McKee had suggested at the meeting with the Federal Advisory Council that this matter be given further consideration by the Council, and it was agreed unanimously that Mr. Vest's memorandum should be referred to Mr. McKee with the suggestion that he take the matter up with the interested departments and agencies of

the Government and ascertain their views as to the desirability of the proposed amendment.

Following the discussion of this matter Mr. Vest left the meeting.

There was then presented a memorandum dated May 31, 1940, from Mr. Cherry, Assistant Counsel, which had been read by all of the members of the Board present and in which it was stated that the Attorney General's Committee on Administrative Procedure would hold public hearings on June 26, 27 and 28, and July 10, 11 and 12 for the purpose of affording all persons and organizations who desire to do so an opportunity to express their opinions of the procedures of the administrative departments of the Government, that, in addition to nationwide publicity in the press, announcement of the hearings is contained on post cards prepared by the Committee stating that those who wish to appear at the hearings should notify the Committee before June 15 of the topics which they wish to discuss and the time needed for presentation of the statements, and that an informal request by a representative of the Committee had been made as to whether the Board wished to mail out any of these cards. The memorandum suggested that the Board might wish to have cards sent to organizations such as the American Bankers Association, Reserve City Bankers Association, Federal Reserve Banks, Members of the Federal Advisory Council, and possibly to State Bank Supervisors or others.

Mr. Ransom stated that he had requested that this matter be discussed at this meeting of the Board for the reason that it had occurred to him that suggestions might be made at the hearings, and that the Committee on Administrative Procedure might make recommendations, with respect to changes in the Federal bank supervisory agencies and he felt the Board should be prepared to meet such a contingency should it arise.

Mr. Wyatt stated that inasmuch as the Committee's studies related only to the administrative procedures of Government agencies as distinguished from the organization of such agencies, he doubted that they would consider the question of changes in the Federal bank supervisory agencies and that in his opinion the only matter that needed to be decided by the Board at this time was to whom it would like to have the postcards of notification sent.

It was agreed unanimously that cards should be sent to the American Bankers Association, the Reserve City Bankers Association, the Independent Bankers Association, the twelve Federal Reserve Banks, the members of the Federal Advisory Council, the State Bank Supervisors, and the Secretaries of the State Bankers Associations.

Mr. Ransom stated that he might talk informally with Dean Acheson, Chairman of the Committee, and state to him that the Board understands that the work of his committee relates only to administrative procedure and that it is not considering recommendations with respect to changes in bank supervisory agencies, but that if such is not

the case the Board may wish to be heard. The other members of the Board present indicated their agreement.

At this point Messrs. Bethea, Carpenter, Thurston, Wyatt, and Dreibelbis left the meeting.

The minutes of the meeting of the Board of Governors of the Federal Reserve System held on June 3, 1940, were approved unanimously.

Reference was made to informal discussions which members of the Board had had with respect to enlarging the Board's building and the erection of an annex on the property owned by the Board on the north side of C Street and consideration was given to the various reasons that had been advanced why the necessary drawings, plans and specifications should be prepared so that, in the event prompt action should be found to be desirable in the direction of providing additional space, action could be taken promptly.

At the conclusion of the discussion, Mr. Morrill was authorized to negotiate the terms of a contract with Paul Philippe Cret, the architect for the Board's building, for the preparation of the necessary drawings, plans and specifications for closing the court yards on Twentieth and Twenty-first Streets and for the erection of an annex building on the north side of C Street.

It was understood that the contract would provide for architects' and engineers' fees for services rendered in connection with the preparation of drawings, plans and specifications, and architectural and engineering services in connection with the construction work (but not including inspection and superintendence) at an aggregate rate which would not exceed 5 3/4 per cent of the total cost of the construction and

completion of the additions and annex as indicated in a memorandum prepared by Mr. Cret under date of June 3, 1940, and if the construction work should not be done and the services of the architect and his engineers should be restricted to the preparation of drawings, plans and specifications only, the architects' and engineers' fees would be fixed at such proportion of the rate of 5 3/4 per cent, on the basis of the estimated cost, as would provide reasonable compensation for the services rendered. In this connection Mr. Morrill was authorized to incur such reasonable expenses as might be necessary to obtain test borings and survey data required by the architect as a basis for the preparation of plans and specifications. It was agreed that it should be understood, however, that there should be no commitment either to begin active construction of the annex or the closing in of the wings of the present building and that the contract with the architect would be submitted to the Board for approval before its execution. It was also understood that Mr. Morrill might consult with Dr. Miller regarding the matter from time to time if agreeable to Dr. Miller.

Thereupon the meeting adjourned.

Chester Morrill
Secretary.

Approved:

Vice Chairman.