

A meeting of the Board of Governors of the Federal Reserve System was held in Washington on Friday, September 18, 1942, at 10:45 a.m.

PRESENT: Mr. Ransom, Vice Chairman
 Mr. Szymczak
 Mr. McKee
 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. Paulger, Chief of the Division of Examinations
 Mr. Dreibelbis, General Attorney
 Mr. Leonard, Director of the Division of Personnel Administration
 Mr. Vest, Assistant General Attorney
 Mr. Wyatt, General Counsel

There were presented telegrams to Mr. Paddock, President of the Federal Reserve Bank of Boston, Messrs. Treiber and McCreedy, Secretaries of the Federal Reserve Banks of New York and Philadelphia, respectively, Mr. McLarin, President of the Federal Reserve Bank of Atlanta, and Messrs. Dillard and Hale, Secretaries of the Federal Reserve Banks of Chicago and San Francisco, respectively, stating that the Board approves the establishment without change by the Federal Reserve Bank of San Francisco on September 15, by the Federal Reserve Bank of Atlanta on September 16, by the Federal Reserve Banks of New York, Philadelphia, Chicago, and San Francisco on September 17, 1942, and by the Federal Reserve Bank of Boston today, of the rates of discount and purchase in their existing schedules.

Approved unanimously.

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Reference was made to a letter received under date of September 16, 1942, from Mr. Lichtenstein, Secretary of the Federal Advisory Council, reading as follows:

"Acting under instructions of the Federal Advisory Council, I beg to transmit to you herewith a copy of a resolution adopted at the recent meeting of the Council on September 14.

"This resolution was presented to the Board of Governors at the joint meeting with the Council on September 14, but it was understood that the Council would reconsider the subject after a committee of the Council had met with a committee of the Board and Mr. Charles O. Pengra, Counsel, War Department Price Adjustment Board. I am instructed by the Council to inform you that the Council considered the matter at its afternoon session after it had listened to a report of the meeting of its committee with the committee of the Board and Mr. Pengra. It was unanimously voted not to alter the wording of the resolution and to request the Board of Governors to make use of the resolution at such time and in such manner as would seem advisable whenever the question of a change of the present act might be under consideration."

Upon motion by Mr. Szymczak, the letter was referred to the War Loans Committee for recommendation as to the action to be taken by the Board on the Federal Advisory Council's resolution.

Mr. Szymczak stated that during discussions of the indebtedness of Mr. Wagner, who had resigned as Vice President of the Federal Reserve Bank of Cleveland, the suggestion was made that the policy and procedure with respect to reports of indebtedness of officers of the Federal Reserve Banks be reviewed and such steps taken as would be necessary to prevent a recurrence of that kind. With that in mind, Mr. Szymczak said, he had had prepared drafts of two letters to the Chairmen and Presidents of the Federal Reserve Banks (1) stating the policy to be followed in the future with respect to indebtedness of officers and employees holding responsible

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positions in the Federal Reserve Banks and (2) setting forth the procedure to be followed in connection with the handling of reports of indebtedness of such officers and employees.

Following the reading of the drafts, there was a discussion of the reasons for the Board's original letter of April 29, 1933 (X-7425), and for the currently effective instructions which were sent to the Federal Reserve Banks in the Board's letter of June 25, 1937 (S-8). Reference was made during the discussion to the fact that one of the reasons for the System's policy was the desire to avoid any situation that might result in embarrassment to the Federal Reserve Banks or in questions being raised as to the independence of the judgement of officers and employees of the Federal Reserve Banks or as to their disinterestedness in the discharge of their official responsibilities, and it was pointed out that there was a much greater need for such a policy at the present time because of the greatly expanded contacts of the officers and employees of the Federal Reserve Banks as the result of the increased responsibilities placed on the Banks in such fields as the regulation of security loans, the regulation of consumer credit, loans under section 13b of the Federal Reserve Act, and the issuance of guarantees of loans under Executive Order 9112.

Following the reading of the Board's letter of June 25, 1937 (S-8), the members of the Board agreed that a letter restating the policy with respect to indebtedness of officers and employees of the Federal Reserve Banks was not necessary. Mr. Szymczak stated that, inasmuch as

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this whole matter involved one aspect of the question of the relationship of the auditors to the boards of directors of the Federal Reserve Banks and the examiners for the Board of Governors and since that subject was on the agenda for the Conference of Chairmen, he would suggest that the question of the procedure to be followed in carrying out the policy with respect to indebtedness of officers and employees be discussed with the executive committee of the Chairmen's Conference which will meet in Washington on September 26, 1942, with the thought that the committee would present the matter at the Chairmen's Conference on October 5, 1942.

This suggestion was approved unanimously, with the understanding that the members of the Board would send to Mr. Szymczak before September 26 any suggestions that they might have to make with respect to the procedure that should be followed, and that Mr. Szymczak would have the statement of procedure revised in the light of these suggestions and would present the revised statement to the executive committee of the Chairmen's Conference at its meeting on September 26.

At this point, Messrs. Paulger and Leonard left the meeting.

Mr. McKee stated that yesterday a telegram was received from President Young of the Federal Reserve Bank of Chicago in which it was stated that under the provisions of the Board's Regulation A, Discounts for and Advances to Member Banks by Federal Reserve Banks, the notes issued by the Bendix Aviation Corporation in connection with the credits to be extended to that Corporation under the provisions of Executive Order 9112 would be ineligible for rediscount by the Federal Reserve Banks for the reason that

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they were not negotiable. The wire also stated that it was felt that it would facilitate placing the loan with numerous banks if the notes were made eligible for rediscount; that an informal ruling by the Board declaring notes to be eligible would be advisable in the interests of the war effort because (1) the notes would probably be guaranteed to the extent of 90 per cent, and (2) the Federal Reserve Bank, acting as agent for the War Department, had complete knowledge of the borrower, its condition, and terms of the loan; and that for these reasons the importance of negotiability was materially reduced.

The question raised by Mr. Young's wire was discussed over the telephone this morning by Mr. Vest with First Vice President Rounds of the Federal Reserve Bank of New York, who addressed a telegram to the Board in which the opinion was expressed that it would be necessary to consider each separate case upon its merits, and that as to the pending Regulation V credit to the General Motors Corporation it would be difficult to consider the notes as now drawn as being eligible. The wire also stated that it was believed that the form of note and credit agreement could be revised in such a manner as to make it possible for the Board to determine that the paper would be eligible, that subject to such revision it was believed highly desirable that the paper be considered eligible, and that the matter was important as a means of assisting the banking system in making available large amounts of credit for purposes of financing the war program.

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Mr. McKee said that it would be helpful in connection with the two credits if a decision could be reached on a solution of the eligibility problem as promptly as possible, and that the matter was important because of the fact that, if the paper was not to be considered as eligible for discount, it could be acquired by the Federal Reserve Banks only as collateral for an advance under section 10(b) of the Federal Reserve Act which, under the provisions of that section, would carry a rate at least $\frac{1}{2}$ of 1 per cent greater than the discount rate for loans and advances under sections 13 and 13a of the Federal Reserve Act. He added that the cost of borrowing money was one of the elements entering into the cost of war contracts, that for that reason the General Motors Corporation had made every effort to reduce to a minimum the interest rate on the credit to be extended to it, and that it was felt the paper would circulate much more freely if it were eligible for discount at a Federal Reserve Bank. He made the further statement that he would like to see the Board take action on the matter in such form as would furnish a solution to any similar cases that might arise in the future.

At the request of Mr. McKee, Mr. Vest explained that there were three points to be considered: (1) The notes involved would have a maturity of 90 days but would be issued under a commitment which, in the case of the General Motors credit, would run for three years, so that there was a question whether the obligation was for 90 days or for a longer period. Whatever might be the situation between the borrower and the lender, the

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Federal Reserve Bank would be under no obligation to accept a renewal of a maturing 90-day note and, therefore, the notes could be regarded as eligible so far as that question was concerned. (2) Under the provisions of the guarantee agreement, which would be incorporated by reference in each note, the maturity of the obligation would be subject to suspension in the event of the cancellation by the Government of war contracts with the borrower. In such a contingency, therefore, the maturity of the note might be longer than 90 days and might become indefinite, and, although technically the maturity might be regarded as longer than 90 days, as a practical matter that would not be the case until the cancellation of contracts occurred, which would not be likely to happen except perhaps in isolated cases until the war was over. In these circumstances, the Board would be justified in taking the position that such a contingency should not be a bar to regarding the paper as being eligible for discount until such time as cancellation of contracts actually occurred. (3) The incorporation by reference in the notes of the provisions of the guarantee agreement relating to the suspension of the maturity renders the notes non-negotiable, and under the Board's Regulation A in its present form negotiability was one of the requirements for eligibility. Although such a requirement was not in the law, it was placed in the Board's Regulation A as a means of protecting the Federal Reserve Banks against certain legal disadvantages of non-negotiable paper. In these circumstances, if the Board should decide to do so, it could take action in the form of (a) advising the Federal Reserve Banks that it would have no objection to

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their discounting the notes issued under the General Motors and Bendix Aviation Corporation credits notwithstanding the fact that the notes were not negotiable, (b) amending Regulation A to eliminate the requirement that paper must be negotiable in order to be eligible, or (c) amending Regulation A so that negotiability would not be required in connection with paper representing loans guaranteed in whole or in part under the provisions of Executive Order 9112.

All of the members of the Board present indicated that if action were taken they would favor action in the latter form.

Mr. Vest stated that another point that should be given consideration by the Board was that the Federal Reserve Banks expressly act as fiscal agents of the United States on behalf of the armed services and the Maritime Commission in issuing guarantees on war loans, and, in the event a Federal Reserve Bank acquired by discount or as collateral for an advance a note representing a guaranteed loan, it would stand in the dual position of agent of the guarantor and as lender with respect to the same paper, that it was possible at least theoretically that at times these interests might be in conflict, and that while the question was not regarded as particularly important it was felt that the Board should consider whether there would be any possibility of the Federal Reserve Banks being criticized for occupying such a dual position.

After some discussion of this point, the meeting recessed and reconvened at 3:00 p.m. with the same attendance as at the close of the

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morning session except that Messrs. Leonard and Paulger and Mr. Myrick, Technical Assistant in the Division of Bank Operations, were in attendance.

There was presented a draft of an amendment to the Board's Regulation A, Discounts for and Advances to Member Banks by Federal Reserve Banks, which would add the following sentence to subsection (h) of section 1 of the regulation:

"The requirement of this section of the Regulation that a note, draft or bill of exchange be negotiable shall not be applicable with respect to any note, draft or bill of exchange evidencing a loan which is in whole or in part the subject of a guarantee or commitment by the War Department, Navy Department, or United States Maritime Commission pursuant to Executive Order No. 9112."

Mr. Ransom inquired whether the Legal Division was prepared to render an opinion that the proposed amendment was within the authority of the Board of Governors. Messrs. Dreibelbis and Vest answered in the affirmative, and in response to Mr. Ransom's request stated that they would submit an opinion to the effect that it was within the Board's authority to take the steps outlined by Mr. Vest as a possible solution of the problem of eligibility of paper evidencing loans guaranteed under Executive Order 9112.

Mr. McKee stated that, if the decision were reached by the Board that the paper in question should be regarded as eligible for discount, he would like to see the Federal Reserve Banks, instead of rediscounting the paper, take it in the form of collateral for advances to member banks

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under the provisions of section 13 of the Federal Reserve Act. Mr. Vest stated that there would be no legal distinction in the authority of the Federal Reserve Banks to take the paper as a rediscount or as collateral for a member bank advance.

At the conclusion of the discussion, Mr. McKee moved the adoption of the following resolution:

Resolved, That subsection (h) of section 1 of Regulation A, Discounts for and Advances to Member Banks by Federal Reserve Banks, be amended, effective immediately, by adding at the end thereof the following sentence:

"The requirement of this section of the Regulation that a note, draft or bill of exchange be negotiable shall not be applicable with respect to any note, draft or bill of exchange evidencing a loan which is in whole or in part the subject of a guarantee or commitment by the War Department, Navy Department, or United States Maritime Commission pursuant to Executive Order No. 9112."

Mr. McKee's motion was put by the chair and carried, Mr. Ransom not voting.

Mr. McKee then moved that the Board advise the Federal Reserve Banks that (1) the issuance of 90-day notes under a credit agreement made under Executive Order 9112 and running for a longer period, and (2) the incorporation by reference of the standard form of agreement in notes evidencing loans guaranteed under that order, under which agreement in the event of cancellation by the Government of war contracts held by the borrower a suspension of the maturity of the notes might be involved, would not affect the maturity of the notes so as to render them ineligible for discount prior to such suspension.

This motion was put by the chair and carried, Mr. Ransom not voting.

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Further reference was made to the dual position in which the Federal Reserve Banks might be placed as agent for the guarantor and as lender in connection with guaranteed loans.

Mr. McKee moved that advice of the Board's action with respect to eligibility of notes representing guaranteed loans be transmitted to the armed services and to the Maritime Commission, calling their attention to the dual position in which the Federal Reserve Banks would be placed in the event they acquired such notes.

This motion was put by the chair and carried unanimously.

At this point, Mr. Vest withdrew from the meeting.

Mr. Szymczak then presented a memorandum addressed to the Board by Mr. Paulger under date of September 18, 1942, with respect to the relationship of the auditors at the Federal Reserve Banks to the boards of directors of the Banks and to the examiners for the Board of Governors.

Mr. Szymczak suggested that the Board agree on the numbered sentences contained in the first paragraph of the memorandum, or some revision thereof, as a basis for discussion with the Chairmen of the Federal Reserve Banks at their conference on October 5, 1942. The portion of the memorandum referred to by Mr. Szymczak was read by Mr. Paulger, and the ensuing discussion related largely to the question of the relationship of the auditor to the Board's examining staff and to the question whether the examiners should be free to discuss important matters with the auditor in the absence of the Chairman, Deputy Chairman, or auditing committee. There was also a discussion of the question who should call conferences of auditors.

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At the conclusion of the discussion, upon motion by Mr. Szymczak, the following statement was approved by unanimous vote, with the understanding that Mr. Szymczak would discuss it with the executive committee of the Chairmen's Conference at the meeting of the committee on September 26, 1942:

"In order to bring about a more effective functioning of the audit departments of the Federal Reserve Banks and a clearer understanding of the Auditor's duties and responsibilities and his relations to the board of directors of the bank and the Board's examiners, the following principles should be recognized and maintained:

- "1. Emphasis must be placed upon the special nature of the Auditor's position in the bank which differs generally in lines of authority and responsibility from that of operating officers. The Auditor is responsible directly to the board of directors of the Reserve Bank through its Chairman or an audit committee. Therefore, it is imperative that the board of directors maintain a procedure whereunder the Auditor may have a regular and systematic manner of reporting to the board not only at meetings but in the intervals between meetings, and that he have adequate opportunity to discuss matters with the Chairman or the audit committee.
- "2. The Chairman and the audit committee particularly should be interested in the activities of the Auditor and it is essential that this interest be made clearly evident to the Auditor.
- "3. In performing his duties, the Auditor must not be dependent upon any executive or operating officer for the security of his position.
- "4. The minutes of the board of directors or the appropriate committee thereof should indicate action taken with respect to all reports, formal or informal, submitted by the Auditor.
- "5. To facilitate the work of the Auditor in ascertaining whether the bank's operations are being conducted in accordance with the policies adopted by the board of directors, the minutes of the board of directors and any committee thereof should be available to the Auditor.
- "6. The board of directors and the Board of Governors have a common interest in seeing that the operating practices of the Federal Reserve Bank are sound and are in conformity with the law and with the Board's regulations.

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"The Auditor and the Board's examiners occupy essentially the same position in relation to their respective principals. Therefore, it is important that close relations between the Auditor and the Board's examiners be maintained and that the Auditor feel free to discuss matters frankly with the examiners.

"7. The files of the Auditor must contain adequate evidence of all investigations made and of all reports made to the board of directors or a committee thereof, and all such information must be available and furnished to the Board's examining staff.

"8. As needs may arise from time to time Conferences of Auditors shall be called by the Chairmen's Conference, or the Chairman thereof, or the Board of Governors after consultation with each other. In the event that the Auditors deem it necessary or desirable to hold a conference they should take up the matter with the Chairmen's Conference and the Board of Governors. Adequate notice of any conference of Auditors shall be given to all interested parties in order that each may submit suggestions and arrange to have representatives present."

At the request of Mr. Szymczak, Mr. Leonard read an outline which he had prepared for discussion of the program of the Division of Personnel Administration with respect to Federal Reserve Bank matters. Mr. Szymczak stated that the memorandum had been discussed with Mr. Ruml, Chairman of the Chairmen's Conference, on September 12 and had been revised in accordance with suggestions made at that time, and that if agreeable to the Board he would like to discuss it with the executive committee of the Chairmen's Conference at its meeting on September 26 and to present it at the forthcoming Chairmen's Conference. All of the members present indicated that they were in agreement with such a procedure.

Mr. Szymczak reviewed for the information of the members of the Board the conversations which he had had recently with the Presidents of

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the Federal Reserve Banks of Cleveland, Richmond, Atlanta, Chicago, St. Louis, and Dallas with respect to the steps that might be taken to increase the functions and services of the branches of the respective Federal Reserve Banks. He stated that, if agreeable to the Board, he would like to review the matter at the forthcoming Chairmen's Conference with a view to obtaining approval by the Chairmen of the program of expansion of activities of the branches along the lines suggested in the conversations with the Presidents.

Upon motion by Mr. Draper, Mr. Szymczak's proposal was approved unanimously.

Mr. Szymczak then stated that it was proposed by Mr. Ruml, Chairman of the Chairmen's Conference, to have a stenographic record made of the Chairmen's Conference on October 5 and that the members of the Board of Governors had decided informally to give a dinner for the Chairmen of the Federal Reserve Banks and the members, advisers, and certain members of the staff of the National Resources Planning Board on the evening of October 5, and that he would recommend that the Board authorize the payment of the cost of the stenographic report and of the dinner.

Approved unanimously.

Mr. Ransom stated that, following the discussion at the meeting of the Board with the Federal Advisory Council on September 14 of how the suggestion originated that small banks open war loan accounts, he had learned from Mr. McLarin, President of the Federal Reserve Bank of Atlanta, that the suggestion had been made in a telegram addressed by the Treasury

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to the Federal Reserve Banks in which it was requested that the Federal Reserve Banks and the Victory Fund Committees encourage banks which had war loan accounts to increase the size of such accounts and banks which did not have such accounts to open them. There was agreement that in these circumstances nothing further needed to be done by the Board in the matter.

At this point Messrs. Thurston, Paulger, Dreibelbis, Leonard, Wyatt, and Myrick left the meeting, and the action stated with respect to the matter hereinafter referred to was then taken by the Board:

The minutes of the meeting of the Board of Governors of the Federal Reserve System held on September 17, 1942, were approved unanimously.

Thereupon the meeting adjourned.

Chester Mowles
Secretary.

Approved:

Donald R. Anderson
Vice Chairman.