A meeting of the Board of Governors of the Federal Reserve System with the Federal Advisory Council was held in the offices of
the Board of Governors in Washington on Monday, September 20, 1943,
at 10:30 a.m.

PRESENT: Mr. Ransom, Vice Chairman
Mr. McKee
Mr. Draper
Mr. Evans

Mr. Morrill, Secretary
Mr. Bethea, Assistant Secretary
Mr. Carpenter, Assistant Secretary
Mr. Clayton, Assistant to the Chairman
Mr. Smead, Chief of the Division of Bank Operations
Mr. Paulger, Chief of the Division of Examinations
Mr. Parry, Chief of the Division of Security Loans
Mr. Dreibelbis, General Attorney
Mr. Wyatt, General Counsel
Mr. Berntson, Clerk in the Secretary's Office


Mr. Walter Lichtenstein, Secretary of the Federal Advisory Council

Mr. Brown stated that the first topic the Federal Advisory Council wished to discuss with the Board was the problem created by the activities of Federal agricultural credit agencies which had been
established to take care of agriculture's credit needs at a time of emergency when banks were unable to do so, and that it was felt that the continuation of the activities of these agencies was furnishing a source of Federally-subsidized competition which created a serious problem for small country banks which had to rely heavily on agricultural loans. He also said that various resolutions had been introduced in Congress calling for an investigation of these lending agencies, that the American Bankers Association had adopted a resolution on the matter at its recent convention, and that the Advisory Council hoped that the Board would support the investigation of these agencies by Congress since their activities were affecting the solvency of a large number of country banks and causing some of them to withdraw from the Federal Reserve System so that they could charge exchange as a means of replacing the loss of income from loans.

In response to a request from Mr. Brown, Mr. Young stated that the production credit associations, which it was originally understood would be "stand-by" organizations, were very active in the South and aggressive to an extent such as that of hiring clerks of the superior courts to solicit business, which furnished a type of competition that was hard for banks to meet, that, while country banks had at one time charged too much for these loans, they had long since realized this fact and were now willing to meet the competition of any organization doing business on its own capital, and that he felt that the existence
of the production credit associations was a threat to the Federal
Reserve System. He also said that the situation on commodity loans
was almost as bad since most of these were made by the Commodity Credit
Corporation, and that the banks were faced with the alternative of act-
ing as service stations and living on service charges or getting rid
of subsidized competition so that they could get back into the lending
business. In answer to a question, he said that banks were charging
6 per cent on agricultural loans of $500 or less and 5 per cent on
loans in excess of that amount, and he also referred to the study which
had been made by the American Bankers Association by States of the rates
of interest charged by production credit associations on agricultural
loans. Mr. Young went on to say that the joint resolution introduced
in Congress, known as the Butler Resolution calling for a thorough in-
vestigation of the production credit associations, was a step in the
right direction.

Mr. McKee expressed the opinion that the agricultural lending
agencies should be subject to a requirement similar to that prescribed
in section 13b of the Federal Reserve Act that no loan should be made
unless it appeared that the borrower was unable to obtain the necessary
credit on a reasonable basis from the usual sources. Members of the
Council discussed this point and stated reasons why in their opinion
such a provision would not be effective.

Mr. McKee inquired whether the Federal Reserve Banks had taken
any business away from commercial banks by making loans under section
of the Federal Reserve Act, and members of the Council replied in the negative, stating that if the procedure followed by the Federal Reserve Banks were followed in connection with regional agricultural credit loans and commodity credit loans the results would be entirely satisfactory.

In response to an inquiry by Mr. Ransom whether the question was one of proper administration of present law rather than a change in the law, Mr. Brown said that all the Council wanted the Board to do was to see that Congress was given a true picture of the serious effects that the existing situation might have on small banks, and that he felt the System should interest itself in the matter and point out the dangers in the continuation of the present situation.

Mr. Evans reviewed briefly the consideration that had been given by the Board to the matter under discussion, and stated that he had heard the opinion expressed a number of times that, if the capital furnished by the Government were taken back, the production credit associations would be unable to expand their operations. He added that it was understood that farmers generally were willing to pay a higher interest rate to a private bank in recognition of the other services rendered by the bank in the community and that it was important that the banks take a position on the matter that would stand up under criticism.

Mr. Clark commented that in one county in Nebraska he had found that loans made by agricultural credit agencies were about three
9/20/43

Mr. Ransom expressed the opinion that the whole structure of agricultural credit needed study to determine how it could be improved and unnecessary competition with banks avoided. He did not think there was reason to expect that Congress would, or for that matter should, close all agencies serving in this field. He said that he was hopeful that Congress would give the matter careful consideration during this session and that the Board would be willing to be as helpful as possible in giving Congress its views. He did not think that removing from the statute books all provisions for agricultural credit would be found to be a solution.

Mr. Brown said the Council would not advocate that but did want to emphasize the fact that the matter was one of grave concern, particularly to the small country bank.

Mr. Evans stated that the Board would like to discuss the matter at a later date when the issues in connection with it had been more clearly defined.

Mr. Brown then stated that the second topic which the Council wished to discuss was the question of termination loans upon the cancellation of Government war contracts, which it assumed the Board was studying even though it was a question with which the armed services and Congress were primarily concerned. He said there had already been a number of large terminations in the Chicago district, that the question would be much more acute in the event of Germany's collapse, and that some provision should be made for a strictly termination loan to
subcontractors as well as prime contractors so that a percentage of the claim could be made available immediately upon cancellation. Mr. Brown went on to say that, from the standpoint of keeping the banks of the country operating, this was perhaps the most important question in connection with the termination of the war, and that while the Council had no final ideas as to how the problem should be met it did realize its seriousness.

Mr. McKee pointed out that advances on Regulation V loans could be made only for war production, that there had been some concern as to the policy to be followed in a period of cancellations, that there was a question on the part of the armed services whether they had authority to guarantee a loan when all war production under the contract had been completed or cancelled, and that the VT loan recognized a changed policy under which a loan could be made and used in part for war production and the balance upon cancellation of the war production contract. He also said that efforts were being made by the services to obtain legislation authorizing them to guarantee termination loans.

Mr. Draper explained that the armed services were thoroughly cognizant of the problem and were building up an organization to handle the situation.

Mr. Brown and others stressed the importance of making adequate provision for automatic advances to contractors upon cancellation
of contracts and said that if this were not done it would have serious repercussions, particularly on the smaller contractors and many subcontractors who did not have sufficient capital to carry them over any period of delay in settlement. He also felt that the Board's suggestions should be submitted before the thinking of the services on the matter became crystallized.

Mr. McKee said that the Board had been working with the problem for six months or more, that it could only make suggestions as to the course to be taken, and that it was desirable that all Federal activities in the field of postwar conversion and readjustment should be coordinated under one head.

Mr. Brown then referred to the ruling appearing in the September 1943 issue of the Federal Reserve Bulletin that on the basis of the facts outlined in the ruling the absorption of exchange charges by the member bank mentioned therein constituted the payment of interest within the meaning of the general law and was therefore a payment of interest on demand deposits in violation of section 19 of the Federal Reserve Act and the provisions of the Board's Regulation Q, and he stated that the Council would like to know what the Board planned to do in the case of other banks found to be violating the regulation.

Mr. Ransom pointed out that, since the member bank in question was a national bank over which the Board did not have primary supervisory authority, it was up to the Comptroller of the Currency to
pursue the matter with that bank.

Mr. Fleming suggested that in order to call the ruling more particularly to their attention it should be distributed as a special circular to all member banks. Mr. Wakefield indicated that this had already been done in the Minneapolis district and that he felt a general distribution of such a circular would have a very beneficial effect.

Mr. Ransom said that when Regulation Q was amended in 1937 it was stated that what constituted a payment of interest in violation of the regulation would be determined as specific cases arose, that this was the first case on which the Board had made a ruling under the regulation, and that no further action was called for by the Board until other cases were presented to it.

Mr. McKee suggested that what would happen was that the examiners, when examining a bank, would ascertain whether the bank was absorbing exchange charges and report any possible violation of Regulation Q, and that the Board would have to determine whether there had in fact been a violation.

Mr. Brown stated that the Council hoped the Board would follow through on the position taken in the ruling, and Mr. Ransom said that there was little likelihood of the Board not doing so but that what particular course of action the Board should follow when the proper time came could not now be decided.
Mr. Brown expressed the opinion that a line should be drawn where the cost of collecting exchange charges was greater than the amount of exchange absorbed, that probably all banks were absorbing charges to some extent, and that some point should be decided upon at which the absorption of exchange and other expenses was not a payment of interest. There was a general discussion of this point but no conclusions were reached.

Mr. Wakefield suggested that what was and what was not a violation of the law would have to be determined in individual cases in much the same manner as a series of decisions in courts of law on a particular subject determined the law on that subject.

Mr. Ransom pointed out that members of the Council had previously taken the position that if the Board would rule on a case and make its ruling known the banks would fall in line. Mr. Wakefield said he still felt that way, but Mr. Young questioned whether that would be the case.

Several of the members of the Council expressed the opinion that if the examination procedure outlined by Mr. McKee were followed many banks would discontinue their violation of the regulation. Mr. Young did not feel that a single bank would be willing to change its practice with respect to absorbing exchange until it knew that its competitor banks would follow a similar course, and he felt that it would be necessary not only to inform the banks of the Board's ruling
but also to tell them that if they continued to violate the regulation the available sanctions would be used against them.

Mr. Brown then stated that the last subject which the Council wished to discuss with the Board was the plans that had been advanced for postwar monetary stabilization. He said that the 10 members of the Council present at this meeting did not believe that any one of the three plans which had been proposed was feasible or desirable at this time, and that, inasmuch as the Treasury had expressed a desire to receive the comments of interested groups, the Council had asked its executive committee to prepare a memorandum presenting the Council's reasons for not favoring any of the plans. He further stated that, while the Council recognized the desirability of stabilizing the exchanges and abolishing bilateral agreements, it was in agreement that the approach contemplated by the proposed plans was a mistake for the reason that they would result in a concentration of demand on the United States for dollars, and that the desired results could be better achieved if some arrangement were first worked out for the stabilization of the dollar and the English pound with the understanding that as other countries stabilized their own economies they could be included in the arrangement.

There was some discussion of the reasons which led the Council to the conclusions expressed by Mr. Brown.
Mr. Brown then asked whether the Board knew that representatives of the Securities and Exchange Commission had approached various banks throughout the country for permission to examine certain classes of deposit accounts on their books in connection with a study of inflation which the Commission was making at the request of the House Ways and Means Committee. He stated that the banks in Chicago which had been approached had indicated that the request should be made of the Federal Reserve Bank of Chicago and, if the Reserve Bank thought the information should be prepared, the banks would do so and the Reserve Bank could turn the results over to the Securities and Exchange Commission, and that the request had been reported to the Federal Reserve Bank of Chicago.

Mr. Wallace stated that when the request was submitted to his bank he took the position that the desired information was already available in studies made by the System and the Reserve City Bankers Association. However, he indicated that he had finally agreed to prepare the information requested.

Mr. Brown said the matter had been mentioned because of its relation to the examination authority of the Federal bank supervisory agencies.

Mr. Brown then stated that the next meeting of the executive committee of the Council with the Board was scheduled to be held in Washington on October 6, 1943, and Mr. Ransom indicated that this was
Mr. McKee asked the members of the Council if they had given any consideration to future Treasury financing. Mr. Brown replied in the negative, and Mr. Harrison expressed the opinion that certificates should not be included in future drives. Mr. McKee inquired whether the 90-day Treasury bill should be replaced by another security such as a nine-month 3/4 per cent bill, and this matter was discussed briefly.

Mr. Fleming stated that at one of the meetings which he attended with Secretary Morgenthau the latter stated that if the present drive did not bring about an adjustment in going rates to the agreed pattern he would be willing to take appropriate action to maintain the pattern of rates even if it had the effect of increasing the cost of Treasury financing.

Thereupon the meeting adjourned.