

A meeting of the Board of Governors of the Federal Reserve System with members of the executive committee of the Federal Advisory Council was held in Washington on Tuesday, December 7, 1943, at 12:00 noon.

PRESENT: Mr. Eccles, Chairman
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. Goldenweiser, Director of the Division of Research and Statistics
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. Leonard, Director of the Division of Personnel Administration
Mr. Vest, Assistant General Attorney
Mr. Wyatt, General Counsel
Mr. Piser, Chief of the Government Securities Section, Division of Research and Statistics
Mr. Berntson, Clerk in the Secretary's Office

Messrs. Brown, Harrison, Spencer, Kurtz, and Fleming, members of the executive committee of the Federal Advisory Council

Mr. Lichtenstein, Secretary of the Federal Advisory Council

Mr. Brown stated that the executive committee of the Federal Advisory Council would first like to discuss with the Board the formula to be used during the fourth war loan drive with respect to investments

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in restricted bond issues by commercial banks which carried savings deposits. He explained that the formula which had been presented to the Treasury as a recommendation of the special committee of the American Bankers Association, of which Messrs. Spencer and Fleming and himself were members, had been submitted by President Wiggins of the Association without discussing it with the members of the special committee. The recommendation as submitted by Mr. Wiggins was that commercial banks should be permitted to invest \$100,000 or 10 per cent of their savings deposits, whichever was the greater, in the types of securities to be made available to mutual savings banks and insurance companies, and that this policy should be followed in future war loan drives with the understanding that the amount of a bank's total investment in these securities would be the subject of later discussion. Mr. Brown also said that the members of the executive committee of the Advisory Council had expressed themselves as being of the opinion that there should be a rather severe limitation on the amount of these issues which could be purchased and that 10 per cent of total savings deposits was too high. He favored 5 per cent for any one issue in the next drive, with a limit on total purchases of restricted issues. He felt that an over-all limitation should be announced before the next drive, and that a \$100,000 limitation should not represent an investment of more than 25 per cent of total savings.

At this point Mr. Goldenweiser withdrew from the meeting.

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Mr. McKee stated that the matter of a desirable formula had been discussed by the Board and that he was in favor of granting the small commercial country banks in which savings deposits predominated the same privileges with respect to investment in Government securities as mutual savings banks as they were doing the same job for their communities and were in competition with savings and loan associations. He was not in favor of allowing the same privilege to the large banks.

Chairman Eccles stated that he had just talked over the telephone with Under Secretary of the Treasury Bell with respect to this matter, that the Treasury was rather sorry it had made the announcement with respect to the formula, that it had considered allowing commercial banks to take up to \$100,000 of Series F and G war savings bonds without regard to the amount of the banks' savings deposits, and that Mr. Bell had about concluded to permit banks to take the 2-1/4 or 2-1/2 per cent bonds in the next drive in an amount not to exceed 10 per cent of their total savings deposits or \$100,000, whichever was the lesser, which might meet the problem for the time being and afford the Treasury an opportunity to study it further after the drive. Chairman Eccles went on to say that he told Mr. Bell that that would not meet the situation in which commercial banks, because of the lack of satisfactory investments for savings funds, were discouraging savings deposits and were losing these deposits to building and loan associations, that the

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Treasury should either recognize no difference between commercial and savings deposits or recognize the difference and permit commercial banks to invest in the same types of securities as mutual savings banks and building and loan associations are permitted to invest, with a limitation of 10 per cent of savings deposits and not to exceed \$500,000 in one drive.

Mr. Brown pointed out that there were three distinct problems presented by (1) the very small country bank which was having difficulty to exist, (2) the small city bank with deposits of from 3 to 50 million dollars, half of which were in savings deposits, and (3) the large commercial bank. He felt that a \$100,000 limitation would not help the intermediate group which, if the present trend continued, would be driven out of the savings field altogether, which might be very harmful to the banks in the future should savings deposits again become profitable.

Mr. Fleming suggested that, if a time could be arranged, the executive committee should meet with Mr. Bell this afternoon. He also inquired of Chairman Eccles whether he felt an over-all limitation of 25 per cent would meet the problem.

Chairman Eccles stated that if the Treasury would agree to a limit in any drive of 10 per cent of savings deposits or \$500,000, whichever was the lesser, the total investment might be limited to 30 per cent of savings deposits and \$1,500,000. In response to a

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comment by Mr. Brown that he would favor a limitation of 5 per cent for each issue in the next drive with an over-all limitation of 25 per cent, Chairman Eccles said he did not think any formula would be satisfactory to the Treasury that did not include a dollar limitation. In a further discussion he indicated that he would have no material objection to permitting an investment of up to \$100,000 (not to exceed total savings) or 5 per cent of savings deposits, whichever was the greater, with an over-all limit of 25 per cent and a dollar limitation.

Mr. McKee expressed the opinion that the Treasury would not look with favor on anything that would permit total investment by commercial banks in the next drive of over one billion dollars in restricted issues.

At this point Messrs. Paulger, Parry, and Leonard withdrew from the meeting.

Mr. Harrison expressed the opinion that if assistance were to be given to the small banks an investment figure of 10 per cent should be established for the fourth war loan drive.

During the above discussion Mr. Fleming withdrew from the meeting to call the Treasury to determine whether the members of the Council on the special committee of the American Bankers Association interested in this matter could meet with Mr. Bell sometime today, and upon his return stated that an appointment had been made to see Mr. Bell at

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3:30 p.m.

Mr. Brown stated that it seemed to him that there was no great difference in the position of the executive committee of the Council and the Board and that the matter would be discussed with the Treasury on that basis.

Mr. Brown then referred to the discussion at the meeting of the Council with the Board on November 15, 1943, with respect to the authority of the regional offices of the Smaller War Plants Corporation to make fully guaranteed loans of up to \$25,000, with an interest rate of 4 per cent and without review from Washington, to concerns engaged in either war or essential civilian work, and to the understanding reached at that meeting that the Council would instruct its executive committee to prepare a statement of the Council's position on the matter for transmission by the Board to such individuals and agencies as it might deem advisable. He stated that the executive committee had adopted the following statement at its separate meeting this morning, and that they would like to have it released to the press:

"The Smaller War Plants Corporation has within the past few weeks announced that it will enter into repurchase agreements up to 100% with banks on loans of \$25,000 or less, to business concerns engaged in the production of war material or essential civilian requirements where the bank agrees to close and service the loans. The interest rate on such loans to be 4%, with one per cent going to the Smaller War Plants Corporation and 3% to the banks. The announcement says that any of the regional offices

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"of the Smaller War Plants Corporation shall have authority to approve these loans without consulting Washington.

"The Federal Advisory Council feels that the announced plan of the Smaller War Plants Corporation is fraught with the possibility of ultimate danger both to solvent and well run small businesses and is a threat to the continued existence of the small banks of the country.

"The one hundred per cent guarantee of a loan by a government agency is equivalent to direct loaning to businesses by the government. Such 100 per cent loans may well be justified in certain cases to companies engaged in war production as a war necessity where credit is not otherwise available. But the Smaller War Plants Corporation plan requires no showing the credit is otherwise unavailable, and it applies to all borrowers engaged in any line of essential civilian production. In no case is any bank or other financial institution required to share any part of the risk but the entire risk is to be borne by the government. The rate, 4%, is the same in all cases, irrespective of the financial responsibility, quality of management or earning record of the borrower.

"The Smaller War Plants Corporation is a new organization and it is yet to be seen what loans it will guarantee. If it is strict in its credit standards it will make few if any loans which the borrower could not obtain elsewhere. If it is lax and easy in its credit standards it will not only cause a loss to the National Treasury, but by enabling inefficient, poorly managed, or badly conceived businesses to operate on government money at a very low rate, create unfair competition for well run and sound small competitive businesses, which may well cause the failure of many businesses in this latter class.

"While an interest rate of 3% is generous for a riskless loan, the overall rate of 4% is impossible of competition by the average small bank. The announced policy of the Smaller War Plants Corporation would tend to cause all small borrowers to borrow under the guarantee of the corporation in order to get a rate as low as that of their competitors. This would mean the socialization of such credit and its extension by public officials, with any loss passed on to the general taxpayer. It would transfer the business of appraising risks in loans, from bankers whose stockholders' and depositors' money is at stake, to the government.

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"The banks have ample funds to meet most legitimate demands from small business. While, as stated above, the rate of 3% for a riskless demand loan is generous and one on which a large bank could not only exist but make excellent profits it is too low a rate to enable the average small bank to pay expenses and continue in operation. If the announced plan of the Smaller War Plants Corporation is expanded and becomes general it will mean the extinction of many small banks throughout the country, with the consequent dislocation of the business of the communities in which such banks are located.

"If the Smaller War Plants Corporation is to operate under the existing law it should require as a condition of a loan evidence that credit is not otherwise available, and should except in extreme cases require that some percentage of the credit risk be borne by the servicing bank."

Mr. Draper questioned whether it would be desirable to release the statement to the press and suggested that it might be transmitted to interested agencies and officials without making it public at this time.

Chairman Eccles suggested that the resolution be sent to Chairman Nelson of the War Production Board since the Smaller War Plants Corporation was under his supervision, and Mr. Ransom suggested that it be transmitted to interested parties and that if no response were received by the date of the next meeting of the executive committee on January 5, 1944, a decision could then be made as to what should be done with the statement.

Thereupon, Mr. Harrison moved that the statement be presented to the Board with a letter signed by Mr. Brown which would request that the statement be transmitted to the Chairman of the War Production Board and

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the directors of the Smaller War Plants Corporation, with the understanding that if no action were taken with respect thereto by these authorities prior to the next meeting of the executive committee on January 5, 1944, a decision would be made at that time what further steps would be taken.

This motion was put by Mr. Brown and carried by the unanimous vote of the members of the executive committee present.

Thereupon the meeting adjourned.

Peter Morrie
Secretary.

Approved:

W. S. ...
Chairman.