A meeting of the Board of Governors of the Federal Reserve System with the executive committee of the Federal Advisory Council was held in the offices of the Board of Governors in Washington, D. C., on Wednesday, April 24, 1946, at 12:00 o'clock noon.

PRESENT: Mr. Eccles, Chairman
Mr. Ransom, Vice Chairman
Mr. Szymczak
Mr. Draper
Mr. Evans
Mr. Vardaman

Mr. Carpenter, Secretary
Mr. Hammond, Assistant Secretary
Mr. Morrill, Special Adviser
Mr. Thurston, Assistant to the Chairman
Mr. Paulger, Director of the Division of Examinations
Mr. Smead, Director of the Division of Bank Operations
Mr. Parry, Director of the Division of Security Loans
Mr. Vest, General Counsel
Mr. Thomas, Director of the Division of Research and Statistics

Messrs. Brown, Spencer, Traphagen, McCoy, and Wiggins, members of the executive committee of the Federal Advisory Council.

Mr. Prochnow, Acting Secretary of the Federal Advisory Council.

Mr. Brown stated that the members of the executive committee of the Federal Advisory Council had received numerous inquiries about the proposal of the Board to discontinue the designation as reserve cities of cities other than those in which

Federal Reserve Banks and branches were located, and that, while the matter was not regarded as being of major importance, the executive committee would like to know what the Board had in mind in suggesting the change. He also said that it was realized that there was no logical basis for the present designations, but that the members of the Council did not see any merit in the proposal to limit designations to the cities in which Federal Reserve Banks or branches were located. They thought, he said, that such an arrangement would result in hardship and unfairness in a great many cases because, rightly or wrongly, country banks and large commercial depositors were influenced in their decision as to where they would keep their funds by the fact that banks in some cities were required to maintain larger reserves than in others. He made the further comment that the executive committee had discussed the matter this morning and felt that (1) cities in which the banks hold considerable amounts of bank deposits and deposits of business concerns located outside the immediate trade area should carry larger reserves than other banks, (2) the only way the problem could be met was for the Board to consider each city on an individual basis as it would be difficult to find a formula which could be applied satisfactorily throughout the country,

(3) if the banks in a particular city wished to retain the reserve city designation or if they desired to be classified as country banks and there was no reason for continuing the designation those considerations should govern the decision of the Board, and (4) in the few cases, such as Grand Rapids, Michigan, where the views of the banks were divided, the Board should consider the nature of the deposits held by the banks and decide each case on the basis of the facts involved. He went on to say that there were certain cities, such as Des Moines, Iowa, and Indianapolis, Indiana, which held large deposits of country banks and commercial deposits from practically all parts of their respective States and, therefore, should be continued as reserve cities, but that there were no reasons at the present time why other towns, such as Dubuque, Iowa, should retain a reserve city designation. It was his opinion that it would be nonsensical to establish branches of Federal Reserve Banks in such places as Milwaukee and Indianapolis as they were only a short distance from a Federal Reserve Bank or branch and did not want a branch if they could retain their reserve city designation. They felt, however, that they would lose a considerable amount of bank and large commercial deposits if the designations were terminated, and, undoubtedly the Board would receive a number of requests for the establishment of

additional branches.

Chairman Eccles stated that the Board had given consideration to this problem over a long period of time and had carefully considered all of the reasons for and against action including all that had been stated by Mr. Brown at this meeting. He said that the Board had decided to afford the member banks which would be affected by the change an opportunity to fully present their views and the reasons therefor in writing, that after all the comments had been received the Board would reach a decision, but that he did not know what that decision would be. The purpose of the inquiry, he said, was to undertake to obtain the necessary information upon which a solution of the present unsatisfactory situation might be based and, if possible, to find a formula which could be followed in the future rather than to leave the matter to the initiative of the banks in a particular city as had been done at least during recent years.

Mr. Ransom stated that the Board had hoped that the banks would suggest formulas which might be considered by the Board.

In response to an inquiry as to whether any of the deposits held by the banks in Columbus, Ohio, were held because of the reserve city designation, Mr. McCoy stated that the banks had many commercial accounts because of the fact that business normally flowed to Columbus, but that a number of bank accounts probably would never have been established in Columbus if it had not been a reserve city, and that if the reserve city designation were discontinued banks in other cities, such as Cleveland, Chicago, and New York would try to influence the banks maintaining deposits in Columbus to transfer their funds to banks in cities which were recognized by the Board as reserve centers.

Chairman Eccles stated that bank deposits usually would go where they could get the best service and he did not think that the continuation or termination of a reserve city would have much effect on where they were maintained. Referring to Mr. Brown's comment that banks and large depositors are influenced to keep their funds with banks that were required to maintain higher reserves, Chairman Eccles stated that it was a mistaken idea that higher reserves under present conditions meant that depositors could more readily withdraw their funds, that just the opposite was true because the higher reserve requirement immobilized more of the bank funds than would be the case if a lower reserve requirement were in effect, and that to regard required reserves as a protection for depositors under modern banking conditions was completely misleading.

Mr. Brown replied that whether the ideas of depositors with respect to higher reserve requirements were justified or not, it would not be possible to change their habits of thinking as they had existed for a good many years, and that the small banks and others who maintained deposits in reserve cities did feel that there was an element of safety in higher reserve requirements. He also emphasized the feeling of the Council that discontinuance of the reserve city designation of all cities except those in which Federal Reserve banks or branches were located would not be a satisfactory solution of the problem and said that the impression had spread rather widely that the Board had about made up its mind to take that action.

Chairman Eccles stated that the Board had felt that the services rendered by the Federal Reserve Banks to member banks in Federal Reserve bank and branch cities enabled the member banks in those cities to carry small amounts of vault cash, and that this situation constituted a logical basis for limiting the reserve city designation to Federal Reserve bank and branch cities.

In response to an inquiry from Mr. Ransom whether the Council would propose a formula that might be used by the Board, Mr. Brown suggested that whenever country bank deposits plus

20 per cent of the demand deposits held by banks in a city exceeded a certain amount, say $100 million or $150 million dollars, the city be designated automatically as a reserve city. He thought that the two tests for a reserve city were the amount of country bank deposits and the amount of commercial deposits of business concerns operating outside the immediate trade area of the city. He did not see why, if the banks in a reserve city wish to retain that designation, the Board should force such banks to be classified as country banks.

Chairman Eccles commented that it would not be possible to find a solution that would be satisfactory to everyone but that the Board would consider the matter carefully and do its best to come to the most satisfactory decision.

Mr. Vardaman inquired whether the fact that the problem was pending before the Board was injuring in any way the banks that would be affected by the decision and whether there would be any advantage in a statement by the Board that it would take action by a stated date.

Mr. McCoy said that while the proposed termination of reserve city designations was not generally known, it would be hurtful to banks in Columbus if it were generally known. The comments of the other members of the executive committee indicated agreement with Mr. McCoy's views and in the ensuing discussion there was agreement with Mr. Vardaman's suggestion that action should be taken by the Board as promptly as possible.

Mr. McCoy inquired whether the views of the Federal Reserve banks on the matter would have any weight and Chairman Eccles replied in the affirmative stating that the weight of their views would depend on the reasons therefor.

Mr. Brown then referred to the resolution adopted by the Federal Advisory Council following its meeting with the Board on February 18, 1946, and which related to credit policies and the policies of the Government in the management of the public debt. He stated that the Council would like to know, to the extent that the Board was free to give the information, whether there had been any change in the attitude of the Board or the Treasury with respect to the matters referred to in the resolution and, particularly, whether the Treasury was still opposed to the elimination of the preferential discount rate and the buying rate on Treasury bills.

Chairman Eccles stated that the Treasury's position had not changed. He said that the question of the buying rate on bills was a matter that would be considered by the Federal Open Market Committee at its next meeting, but that, inasmuch as all but three or four billion dollars of outstanding bills were now held by the Federal Reserve Banks and the bill was no longer an effective market instrument, the question of the continuance or elimination of the buying rate was not a matter of very great importance. With respect to the preferential discount rate he stated that the Board and the Federal Open Market Committee had been strongly of the opinion that the rate had served the purpose for which it was established and that it should be discontinued, and that it was expected that that opinion eventually would bring results.

In response to an inquiry from Mr. Spencer as to how such results could be brought about, Chairman Eccles stated that the Federal Reserve Banks would have to take action to eliminate the rate and that the Board of Governors would then have to take a position either one way or the other.

Mr. Szymczak asked the members of the executive committee for their opinion as to the possible effects of the elimination of the preferential rate on short-term rates. Mr. Spencer thought that it would strengthen them, that it would remove a considerable amount of "sloppy" money from the market as well as a substantial amount of loans that had been made for the purpose of purchasing or holding securities, and that it would be helpful in the overall picture. Mr. Traphagen said it would largely eliminate the lending by banks at rates of less than 1 per cent, particularly the banks that had been borrowers from the Federal Reserve Banks. He did not think it would affect rates above 1 per cent.

Chairman Eccles reviewed the recommendations that had been made by the Federal Open Market Committee to the Treasury with respect to the program for the retirement of maturing Government securities and stated that because of the favorable budget picture it was expected that the program would proceed at a more rapid rate than had been anticipated. He also said that there was every indication that the total war loans accounts would be reduced by redemptions to somewhere between two and four or five billion dollars, so that the question of subjecting war loan deposits to reserve requirements would largely take care of itself and legislation would not be necessary.

Turning to the suggestion in the resolution of the Federal Advisory Council that the Treasury be urged to issue bonds, in addition to E, F, and G Bonds, to satisfy investment demands of large long-term investors, Chairman Eccles stated that the Board would be opposed to such a step at this time as it would only serve to shift securities eligible for purchase by the banks from long-term investors to the banks and that there were substantial amounts of long-term Government securities now outstanding that should find their way into portfolios of insurance companies and other investors. Certainly, he said, the Treasury should not issue such securities when it was not in need of additional funds and, in that connection, he discussed briefly the difficulties that would be faced in pricing a new issue of long-term bonds in the present market.

Mr. Brown inquired whether the Treasury felt any uneasiness because of the recent decline in market prices of Government securities and Chairman Eccles replied that he had seen Secretary of the Treasury Vinson on several occasions recently but that he had said nothing about the matter. He did not think that the Treasury was concerned as it had no financing in prospect.

Mr. Brown asked whether the rule which provides that Government securities would not be allowed to decline in any one day by more than 8/32 should be abolished and Chairman Eccles said that the rule should not be removed as it might necessitate support of the market. Mr. Brown made the further comment that his bank, which was a dealer bank, had been receiving a number of inquiries about the decline in the market which indicated uneasiness on the part of some banks about the situation.

Mr. Brown then stated that it was the feeling of the members of the executive committee that two of the topics on the agenda for this meeting, namely, whether nonmember clearing accounts should be discontinued and whether it was possible for the Reconstruction Finance Corporation, the Federal Reserve Banks and the Board of Governors to make their audits and examinations of Federal Reserve Banks simultaneously, were not of sufficient importance to require discussion at this time.

Chairman Eccles informed the members of the executive committee that the Board was sending a revised draft of the bank holding company bill to the Chairmen of the Banking and Currency Committees of Congress and that copies of the draft would be sent to the members of the Federal Advisory Council in the next day or two.

Mr. Brown asked if the Comptroller of the Currency or the Federal Deposit Insurance Corporation had approved the bill and Chairman Eccles said that they had not, that the Board had not asked for their approval, and that Secretary of the Treasury Vinson had taken the position that he would not oppose the introduction of the bill with the understanding that he would not be committed with respect to it in any way.

Mr. Brown then inquired whether there had been any further developments since the last meeting of the Council on the reorganization of the Federal bank supervisory agencies and whether any proposals had been submitted by the agencies. Chairman Eccles responded that he did not know whether the Treasury or the Federal Deposit Insurance Corporation had submitted anything but that the Board had not.

Thereupon the meeting adjourned.

Secretary.

Approved:

Chairman.