

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, May 20, 1946, at 10:30 a.m.

PRESENT: Mr. Eccles, Chairman  
Mr. Szymczak  
Mr. Draper  
Mr. Evans

Mr. Carpenter, Secretary  
Mr. Hammond, Assistant Secretary  
Mr. Thurston, Assistant to the Chairman  
Mr. Paulger, Director of the Division of Examinations  
Mr. Thomas, Director of the Division of Research and Statistics  
Mr. Vest, General Counsel  
Mr. Parry, Director of the Division of Security Loans  
Mr. Bethea, Director of the Division of Administrative Services  
Mr. Horbett, Assistant Director of the Division of Bank Operations  
Mr. Townsend, Assistant General Counsel  
Mr. Young, Assistant Director of the Division of Research and Statistics

Messrs. Traphagen, McCoy, Wiggins, Brown, Penick, Baird, Bradshaw, Winton, and Odlin, members of the Federal Advisory Council, from the Second, Fourth, Fifth, Seventh, Eighth, Ninth, Tenth, Eleventh, and Twelfth Federal Reserve Districts, respectively,

Messrs. Bucklin, Loeb, and Robinson, alternates for Messrs. Spencer, Williams, and Strickland, from the First, Third, and Sixth Federal Reserve Districts, respectively.

As stated in the minutes of the meeting on May 8, 1946, Mr. Vardaman was absent on official business.

Mr. Brown stated that in response to the request contained

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in the Board's letter of May 7, 1946, the Federal Advisory Council at its separate meeting yesterday gave considerable time to a discussion of a possible formula or set of principles that might be used in the designation of central reserve and reserve cities and that the Council came to the same conclusion as was expressed at the meeting of the executive committee with the Board of Governors in April that, while there might not be much logic in the present designations, the proposal to designate as reserve cities only those cities in which a Federal Reserve Bank or branch was located was even more illogical; and that the test whether a city should be a reserve city was the character of business done by the banks, that is, whether they held a substantial amount of correspondent bank deposits and commercial deposits from outside the trade area in which the banks were located. He added that in the opinion of the Council the proper course for the Board to pursue was to permit the existing situation to continue and to terminate the designation of a reserve city only at the request of the banks in that city. If in a few cases such as Grand Rapids, Michigan, the banks were divided in their opinion as to what should be done, the Board should analyze the character of the deposits of the banks and decide the action that should be taken in the light of that analysis. Mr. Brown went on to say that at

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its separate meeting the Council had attempted to write a formula or set of principles that might be used by the Board but had come to the conclusion that, because of varying conditions in different parts of the United States, it was difficult if not impossible to find a solution that could be applied satisfactorily in all sections of the country, that there were several cities in the United States which were more important as trade centers than some of the cities in which branches of the Federal Reserve Banks were located, and that the proposal to limit reserve city designations to Federal Reserve Bank and branch cities "made no sense at all." He felt that the only explanation that had been given for such a proposal was that several years ago the advantage which a bank had by being able to discount paper and obtain currency and coin more quickly when it was located in a Federal Reserve Bank or branch city than was otherwise the case justified the requirement that such banks maintain higher reserves, but that the airplane service now available and the ability of a bank to borrow on Government securities held in safekeeping at a Federal Reserve Bank had practically eliminated that advantage. He made the further comment that the Board now realized how strongly the banks that would be affected by the Board's proposal felt about the matter, and that, since it was not a question of great importance, the Council could not understand

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why the Board believed it necessary or desirable to disturb the existing situation at this time.

Chairman Eccles responded that the Board did not feel that it was a satisfactory solution to leave to the decision of member banks in a particular city whether that city would or would not be designated as a reserve city, and that as an agency of the Government charged with responsibility in the matter the Board should have some basis upon which reserve city designations would be determined. He also repeated the statement previously made that the argument that banks with large amounts of bank and commercial deposits should be required to carry higher reserves was not sound because the necessary protection for such deposits was furnished by access to the discount or open market facilities of the Federal Reserve Banks and not by higher reserve requirements which only served to immobilize a larger part of the bank's funds.

Mr. Traphagen said that the termination of reserve city designation of cities which had been reserve cities for a number of years would work hardship on the banks in such cities as they would lose accounts which they had acquired because of their reserve city status.

Chairman Eccles questioned whether this would be the case and stated that there were a number of cities in the United States which were not reserve cities in which correspondent bank

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and commercial deposits from outside the cities' trade areas were much larger than in banks in reserve cities, and that the determining factor was not whether the city was a reserve city but the nature of the business done in the area. He made the further observation that in the past member banks had felt that there was a decided advantage in being located in a Federal Reserve Bank or branch city because it gave them the privilege of immediate access to the currency and coin collection, and discount facilities of the Federal Reserve Banks and that the Board felt there was more justification for limiting reserve cities to the cities in which Federal Reserve Banks and branches were located than in any other proposal that had been advanced, particularly since it would reduce the required reserves of banks in cities where the designation was discontinued and would work no hardship on them.

Mr. Brown stated that, although the establishment of a Federal Reserve branch might have been an indication of the importance of the city when the branch was established, conditions had changed to such an extent that there were several cities in the United States that were much more important as trade centers than some Federal Reserve branch cities and that to limit designations to Federal Reserve Bank and branch cities was not a proper recognition of the importance of other cities.

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Mr. Bradshaw expressed the opinion that when a city had been a reserve city for a number of years and the business of its banks had been built on that basis, the discontinuance of the reserve city status, particularly at the present time when it was expected that there would be a substantial shift of deposits because of readjustments following the war, would only serve to accentuate that shift and banks in those cities would suffer as a result.

Chairman Eccles stated that in his opinion the law should be changed at the first opportunity to provide for a uniform reserve requirement for all banks. Mr. Brown agreed that the present law was unsatisfactory but felt that it would be some time before satisfactory legislation could be enacted, and that inasmuch as changes in present reserve city designations was not an important matter action to change the existing situation should not be taken.

During the course of a discussion, members of the Council referred again to their feeling that the discontinuance of reserve city status would place banks affected at a competitive disadvantage which would result in the loss of deposits and, regardless of the fact that higher reserves were not a protection to depositors, the argument that they were would be used to attract deposits from banks in the cities where the reserve city

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city designation was terminated.

Mr. Winton said that the situation would be different if a city like Fort Worth or Tulsa had never been designated as a reserve city, but having had the designation and the banks having built their business on the strength of the designation, there was no question but that they would suffer a loss of deposits if the designation were taken away. He also asked why the Board felt that the matter was important at this time and Chairman Eccles responded that time for action with respect to matters of this kind never seemed to be appropriate. Mr. Winton said he did not want to leave the impression that he felt the time would ever be appropriate to discontinue the designation of Fort Worth as a reserve city but he would like to know why the Board proposed action just at this time. Mr. Szymczak said that the matter had been under consideration for a long time and that it was not a new proposal.

Mr. Winton suggested that, inasmuch as it was agreed that the present designations were illogical but that the problem involved broader questions which should be handled by legislation and since action to change the designations was not important at the present time, the situation might be left without change. There was some further discussion of the matter but no new points were presented.

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Mr. Brown referred to the draft of bank holding company bill which had been sent by the Board to members of the Council under date of May 1, 1946, and stated that the Council was generally in agreement with the proposed bill realizing that some legislative action was necessary to enable the Board to correct the unsatisfactory expansion policies followed by the large bank holding company on the west coast, and that, while the draft had some defects, they could be ironed out in conferences between attorneys for the Board and responsible bank holding companies without altering the fundamental purposes for which the draft was drawn. The Council did not know, he said, what the legislative situation was with respect to the bill or whether the other Federal bank supervisory agencies favored it or whether they still preferred a bill containing a death sentence. He added that most of the members of the Council considered a death sentence bill as unfortunate since a number of bank holding companies could not be liquidated at the present time without adversely affecting large sections of the United States.

During Mr. Brown's statement, Mr. Draper left the meeting.

Chairman Eccles reviewed the reasons for the preparation of the bill in the form now proposed by the Board and the situations which the bill was designed to meet and stated that he did not think that the question of a death sentence was any longer an issue at the Treasury but that as he understood it the Federal De-

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posit Insurance Corporation still favored a death sentence bill.

During the ensuing discussion it was stated that the Independent Bankers Association had formally endorsed the bill in principle and were undertaking to rally the support of independent banks for the legislation.

Chairman Eccles stated that, because of other pressing legislation he did not think there was any likelihood that the bill would be taken up by Congress this year, and it was his view that hearings should not be held until just before the legislation could be considered by Congress for the reason that, if hearings were held and the bill were reported out by the Congressional committees and no action were taken, the situation would be more unsatisfactory than if no hearings were held.

In response to an inquiry from Mr. Bucklin whether the Independent Bankers Association preferred a death sentence, Chairman Eccles said that they realized they could not get a death sentence and preferred the bill proposed by the Board as an alternative, and that a bill which would freeze the existing situation was a possible compromise. He also said that the bill had been discussed with representatives of the Treasury, the Federal Deposit Insurance Corporation and Department of Justice, that the Department of Justice favored the bill, that the staff representatives of the Treasury and the Federal Deposit Insurance

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Corporation were not in favor of giving the Board any additional discretion under the law, but that the Treasury would favor the bill if the administration of the statute were placed in that Department and the Federal Deposit Insurance Corporation would feel the same way if it were given authority to administer the amended law. Chairman Eccles added that after a long period of discussion with representatives of the Treasury and the Federal Deposit Insurance Corporation without agreement on a bill, the Board decided to present the bill to Congress but that before doing so he talked with Secretary of the Treasury Vinson who had no objection to the introduction of the bill but reserved the right to support or oppose it in any hearings that might be held.

Mr. Odlin expressed the opinion that many independent bankers on the west coast would favor a death sentence or freezing bill, but that he did not think that attitude was general, and that the bill proposed by the Board would be generally satisfactory in that district.

After a discussion of certain provisions of the bill Chairman Eccles stated that the Board would be glad to have its attorneys discuss with attorneys for banks or bank holding companies any changes in the bill which it was felt would be desirable to eliminate objectionable features.

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Turning to Government financing policy and System credit policies, Mr. Brown said that the Council felt that the Board had done an excellent job in getting the Treasury to use its excess balances to retire maturing issues of Government securities. He said that this step, together with the elimination of the preferential discount rate, was very helpful and that it would be desirable to go further in the same direction. He made the additional statement that there had been considerable confusion in connection with the Treasury's announcement that it had authorized commercial banks to hold, for trading purposes, restricted issues in an amount not to exceed 1 per cent of demand deposits or \$500,000 whichever was less. He said that a large number of banks in the Chicago district were seeking to purchase the highest rate restricted issues that they could get up to the limit of the authorization and that the Treasury had sent out a second wire to the effect that the authority granted was only for the purpose of facilitating trading for customers' account and not for the purpose of enabling the banks to acquire additional long-term securities for their own account. He went on to say that it was apparent that the authority would be subject to a considerable amount of abuse.

Chairman Eccles stated that the matter had been discussed at considerable length with the Treasury, that the sug-

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gestion had been made by Messrs. Sproul and Rouse of the Federal Reserve Bank of New York who had felt for some time that the authority should be granted in order that banks would be in a position promptly to execute small orders for their customers which they could not do under the arrangement previously in effect, and that if experience showed that the banks were abusing the privilege the Treasury would have to consider the desirability of discontinuing it.

Mr. Brown suggested that as a means of counteracting any tendency toward abuse it might be made clear that such securities could not be used as collateral for borrowing by Federal Reserve Banks and would not be accepted for safekeeping by the Federal Reserve Banks. Chairman Eccles stated that the refusal to accept such securities for safekeeping might be helpful but that generally the banks would not be interested in using them as collateral for borrowing.

Mr. Brown said that the effect of the Treasury announcement was to increase market prices on the restricted issues and that it had been suggested that the Treasury was uneasy because of the decline that had taken place in the prices on long-term issues and had made the announcement to stop the decline. Chairman Eccles replied that that was not the case, that the Treasury had been considering the matter for several months, and that it just

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happened to be announced in a period when there had been a decline in market prices.

Mr. Brown then inquired whether any action had been taken or was contemplated with respect to speculative loans by banks on Government securities. Chairman Eccles stated that a draft of letter to the Federal Reserve Banks on the subject had been prepared but that it had not been sent. He also outlined his views as to what such a letter should contain and the considerations involved in timing the sending of the letter.

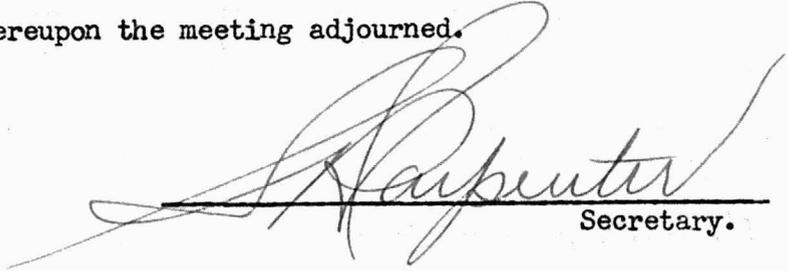
Mr. Brown also asked whether there had been any further developments in connection with the reorganization of the Federal bank supervisory agencies under the Reorganization Act and Chairman Eccles responded in the negative stating that he did not think anything would be done this year in that field.

Mr. Brown then stated that Wednesday, June 26, at 12 o'clock noon had been suggested as the date for the next meeting of the executive committee of the Council with the Board of Governors and he inquired whether that would be a satisfactory time. The members of the Board who were present indicated that, although some members of the Board would be away from Washington on that date, it would be as satisfactory as any other that might be chosen as it was not likely that all of the members would be available at any one time during the summer months.

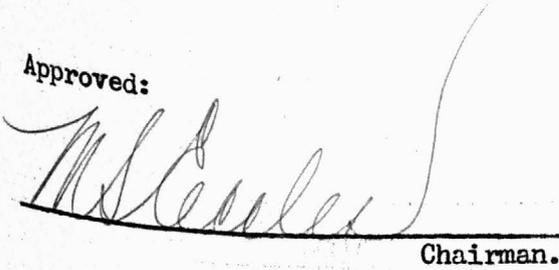
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Thereupon the meeting adjourned.

  
Secretary.

Approved:

  
Chairman.