Minutes of actions taken by the Board of Governors of the Federal Reserve System on Friday, February 13, 1948. The Board met in the Board Room at 10:30 a.m.

PRESENT: Mr. Eccles, Chairman pro tem
Mr. Draper
Mr. Evans
Mr. Vardaman
Mr. Clayton

Mr. Carpenter, Secretary
Mr. Sherman, Assistant Secretary
Mr. Morrill, Special Adviser
Mr. Thurston, Assistant to the Board
Mr. Smead, Director of the Division of Bank Operations
Mr. Vest, General Counsel
Mr. Townsend, Associate General Counsel

There was presented a telegram to Mr. Leach, President of the Federal Reserve Bank of Richmond, reading as follows:

"Retel February 11 Board approves effective February 14, 1948, minimum buying rate of 1-1/4 per cent on bankers' acceptances. Otherwise Board approves establishment by your Bank, without change, of rates of discount and purchase in Bank's existing schedule, advice of which was contained in your telegram dated February 11."

Approved unanimously.

There was presented a telegram to Mr. Gilbert, President of the Federal Reserve Bank of Dallas, reading as follows:

"Retel February 13, Board approves effective February 14, 1948, minimum buying rate of 1-1/4 per cent on bankers' acceptances and rate of 2-1/2 per cent on advances to individuals, partnerships, and corporations other than member banks under last paragraph of Section 13. Otherwise Board approves "establishment by your Bank, without change, of rates of discount and purchase in Bank's existing schedule, advice of which was contained in your telegram dated February 13."

Approved unanimously.

There were presented telegrams to the Federal Reserve Banks of Boston, Cleveland, St. Louis, Minneapolis, Kansas City, and San Francisco stating that the Board approves the establishment without change by the Federal Reserve Banks of Kansas City and San Francisco on February 10, by the Federal Reserve Banks of Cleveland and Minneapolis on February 11, by the Federal Reserve Banks of St. Louis, Kansas City, and San Francisco on February 12, 1948, and by the Federal Reserve Banks of Boston and Minneapolis today of the rates of discount and purchase in their existing schedules.

Approved unanimously.

Mr. Carpenter stated that the Bureau of the Budget had informed him by telephone that it was sending over a draft of a bill prepared by the Housing and Home Finance Agency which would provide for setting up a corporation for the purpose of establishing a secondary market for housing mortgages insured or guaranteed by Government agencies, and that the Bureau had requested an informal statement of the Board's reaction to such a proposal. Mr. Carpenter also stated that the Bureau had informed him that, while it was opposed to such a measure in principle, there was a great deal of pressure for legislation of some kind and if a bill to provide housing aid were to be enacted the proposals in this one might be less undesirable than others that might be laid before Congress at this session.

During the meeting, the draft of bill was received and there was a discussion of the proposal in the light of present inflationary conditions, especially with respect to housing, during which the members of the Board who were present expressed the view that Government action to make more credit available for the purchase of houses would be undesirable at this time.

> It was agreed unanimously that the Secretary should telephone the Bureau of the Budget and informally advise that the Board was unanimously opposed to the setting up of any mechanism by the Government under the present inflationary situation for the purpose of creating a secondary mortgage market.

Reference was made to a draft of a letter to the Presidents of all Federal Reserve Banks outlining a proposed revision of the instructions relating to waiving penalties for deficiencies in reserves of member banks and requesting comments and suggestions of the Reserve Banks with respect thereto. The proposed revision would permit a Reserve Bank to waive penalties to the extent that a deficiency is offset by excess reserves during the immediately following reserve computation period. The waiver was not to be regarded by the member bank as a right, but a privilege to be granted infrequently only in case the Federal Reserve Bank was satisfied that the member bank was making reasonable efforts to maintain its reserves.

Mr. Smead stated that a number of country member banks had expressed the feeling, over a period of a year or more, that because of the spread of the five-day week they had had difficulties in maintaining required reserves owing to unexpected changes in reserves or deposits on the last business day of the reserve computation period which frequently ended on a Friday, Saturday, or Sunday, that proposals for dealing with this problem had been transmitted to the Reserve Bank Presidents for comment with a letter from the Board on April 28, 1947, that the Reserve Banks had raised questions with respect to the desirability of those proposals, and that the letter which it was now proposed to send was for the purpose of transmitting the new suggestion to the banks for their consideration. Mr. Smead also stated that one of the member banks, the Wachovia Bank and Trust Company of Winston-Salem, North Carolina, felt that the present reserve requirements were inequitable, since it was classed as a reserve city bank and was required to compute its reserve requirements on a weekly basis even though only one of its offices was located in a reserve city whereas other banks, not located in a reserve city, were required to compute their reserves only semimonthly, that this bank was sometimes deficient in its reserves because of failure to receive anticipated credit on Friday for cash letters sent direct to other Federal Reserve Banks and which were delayed in the mails, that it had proposed possible changes in procedure in order to overcome this situation, and that the proposed revision would meet in part at least the request of the Wachovia bank.

In this connection, Mr. Smead also referred to a draft of reply to a letter from Mr. Young, President of the Federal Reserve Bank of Chicago, dated January 22, 1948, which transmitted a proposal made by some of the Chicago banks, that banks in reserve and central reserve cities be given the option of selecting a different reserve computation period every week so as to make it easier for banks to adjust their reserve positions and avoid large shifts of funds. Mr. Smead said that some of the New York banks had discussed informally with the Federal Reserve Bank of New York a variation of this proposal, that he did not feel either of these proposals should be adopted at this time, and that the draft of reply to Mr. Young's letter commented upon these proposals and suggested that Mr. Young might wish to discuss them when the Conference of Presidents meets in Washington later this month.

Chairman Eccles stated that he would be opposed to a modification in the Board's general regulations for the purpose of taking care of isolated instances of hardship or inequity, that if the Wachovia Bank and Trust Company or any other member bank was suffering from an inequity the matter should be studied with a view to eliminating the inequity, in some other way, and that this was not an appropriate time to make a change which would have the effect of easing reserve requirements generally when additional authority over reserves was needed and being requested as a means of combating the inflationary expansion of bank credit.

In the discussion that followed the members of the Board present indicated that they would not favor a modification at this time of the kind proposed in instructions relating to penalties for deficient reserves, and it was suggested that the draft of letter to Mr. Young be revised to state that, for the reasons discussed, the Board did not now favor the change outlined in his letter of January 22, 1948.

Upon motion by Mr. Clayton, it was agreed unanimously that no change in existing instructions with respect to waiving penalties for deficiencies in reserve requirements should be made at this time. In taking this action it was understood that the staff would look into the question of inequities that might result from present instructions with respect to computation of reserve requirements by member banks and submit to the Board for its consideration a proposal which would eliminate such inequities as may be found to exist. It was also understood that the draft of letter to Mr. Young, in response to his letter of January 22, would be revised and resubmitted to the Board for approval.

In response to an inquiry from Mr. Vardaman, Chairman Eccles stated that the commitment that the Federal Reserve Banks would loan on Government securities at par made at the outbreak of war in September 1939 and again at the outbreak of war in the Pacific in December 1941 had never been rescinded and that the policy should be considered as still in effect. With respect to the 1938 agreement among the Federal supervisory agencies on examination procedure, Chairman Eccles stated that the Board's examiners had listed securities in the manner provided in that agreement and only in that manner, but that the Comptroller of the Currency and the Federal Deposit Insurance Corporation had continued to show the market value of securities as well as the amortized value provided for in the agreement. He said that he had recently discussed this matter with Under Secretary of the Treasury Wiggins, that he had told Mr. Wiggins that the Comptroller of the Currency and the Federal Deposit Insurance Corporation were not following the agreement with the result that the advantages of the agreement were being lost, that if the supervisory authorities had agreed that market fluctuations in prices of Government and other high grade securities would be disregarded in determining the condition of a bank at the time of examination, it was not apparent what useful purpose was served by listing market prices in the examination reports, and that such listings were unnecessarily causing concern on the part of bank managements as to what the attitude of the examiners would be at the next examination on the question of showing or charging off depreciation in securities.

Chairman Eccles went on to say that Mr. Wiggins replied he had not known of the practice of the Comptroller of the Currency and the Federal Deposit Insurance Corporation and agreed that it should be discontinued, at least so far as Government securities were concerned.

Mr. Clayton said that members of the staff of the Federal Deposit Insurance Corporation had indicated that they were preparing a letter proposing changes in the 1938 agreement with respect to Group II securities. The members of the Board indicated they would not favor such a move.

Mr. Clayton also said that this morning the Vice Presidents in charge of the examination departments of the Federal Reserve Banks, who were meeting in Washington, discussed a possible revision in the joint statement issued by the Federal supervisory agencies in 1938 with respect to examination procedure and that it was their unanimous view that the statement should be adhered to in every respect in its present form. He made the further statement that the whole question was to be discussed at the next informal meeting to be attended by the Comptroller of the Currency, the Chairman of the Federal Deposit Insurance Corporation, and himself.

Mr. Vardaman raised the question whether the agenda for the meeting with the Federal Advisory Council on February 17 should include a topic relating to the adequacy of bank capital.

> The question was discussed and it was agreed unanimously that the Board was not prepared to submit to the Council any comments on the subject at this time, but that Chairman Eccles should say to the Council at its meeting with the Board next Tuesday that the Board expected to suggest that the question be placed on the agenda for consideration at the May meeting of the Council.

Mr. Vardaman said that he had read the draft of letter that had been prepared, pursuant to the discussion at the meeting on January 16, 1948, in reply to the letter received from Acting Chairman Calkins of the Federal Reserve Bank of New York criticizing the statement of responsibilities of the directors of the Federal Reserve Banks, distributed with the Board's letter of December 22, 1947, and that he felt it would be desirable to send the reply.

Mr. Carpenter reported that a letter had been received this morning from Chairman Brainard of the Federal Reserve Bank of Cleveland which raised several questions concerning the statement.

Chairman Eccles said that the statement of responsibilities had been listed as a topic for discussion by the Presidents at their forthcoming conference, and that he would suggest that a reply to the letter from Mr. Calkins be not sent until after the Presidents Conference and it was determined whether the Presidents agreed on any position or comments with respect to the statement.

Chairman Eccles' suggestion was approved unanimously.

At this point Messrs. Smead, Vest, and Townsend withdrew and the action stated with respect to each of the matters hereinafter set forth was taken by the Board:

Minutes of actions taken by the Board of Governors of the Federal Reserve System on February 12, 1948, were approved unanimously.

Memorandum dated February 10, 1948, from Mr. Smead, Director of the Division of Bank Operations, recommending that the appointment of Miss Carrie Turner, a clerk-typist in that Division, be changed from temporary to permanent, effective February 11, 1948, with no change in her present basic salary of $2,168.28.

Approved unanimously.

Memorandum dated February 11, 1948, from Mr. Smead, Director of the Division of Bank Operations, recommending that Miss Mary

M. Durkan, a clerk-stenographer in the Division of Security Loans, be transferred to the Division of Bank Operations as an analyst and that her basic salary be increased from $2,619.72 to $3,397.20 per annum, both effective February 22, 1948. The memorandum also stated that the transfer was agreeable to Mr. Parry.

Approved unanimously.

Memorandum dated February 10, 1948, from Mr. Smead, Director of the Division of Bank Operations, recommending the appointment of William Joseph Powers as an analyst in that Division, on a temporary basis not to exceed three months, with basic salary at the rate of $2,895.60 per annum, effective as of the date upon which he enters upon the performance of his duties after having passed the usual physical examination. The memorandum also stated that because of the temporary nature of Mr. Powers' employment, it was not contemplated that he would become a member of the Federal Reserve retirement system.

Approved unanimously.

Letter to the Honorable Maple T. Harl, Chairman, Federal Deposit Insurance Corporation, reading as follows:

"Please pardon our delay in acknowledging your letter of January 8, 1948, to Governor Clayton, with which you enclosed a copy of the article entitled 'Bank Capital: The Problem Restated', by Messrs. Tynan Smith and Raymond E. Hengren of your staff.

"The article is a most interesting one and the Board feels that the questions raised by it are of particular importance at this time in view of the inflationary developments in the country's banking system.

"The authors of the article advocate the use by supervisory authorities of a capital to total assets ratio as a screening device for determining which banks may be in need of additional capital. A number of considerations are set forth in support of the proposal. With this proposition, the Board finds itself unhappily in disagreement since it would prefer the ratio of capital to risk assets.

"The Board recognizes fully that if we could assume a period of little change in the structure of bank assets, the use of the capital funds to total assets ratio would be satisfactory and, as pointed out in the article, it has some advantage in its relative simplicity. Unfortunately, however, the history of banking seems to be a succession of ups and downs and of wide fluctuations in the composition of bank assets. At present, banks generally are increasing their risk assets, but the ratio of capital funds to total assets does not reveal this trend. It does not highlight the shift from riskless to risk assets. Bankers are already prone to be complacent toward this shift. Thus the Annual Report of the National City Bank of New York for 1947 stated: 'The growth in these loans, however, has been offset by a continued decline in loans on securities and by a reduction in the bank's security investments, so that our total of loans and investments shows only a modest increase.' Following this argument to its logical conclusion, the conversion of the entire investment account of the country's banking system into risk loans would need cause little concern, as the total of loans and investments would remain the same. By the same token, the capital funds to total assets ratio would likewise remain the same.

"Granting that each of the two suggested ratios has advantages over the other, it seems to the Board that, under present conditions, the arguments are all in favor of using the ratio which will call attention to dangerous trends rather than the one which will make the dangers less apparent. In a period of "inflation, the capital to total asset ratio for the banking system may actually improve as, in fact, it has done for the two-year period ending December 31, 1947. The improvement in the total asset ratio during the period just referred to could have induced a false sense of satisfaction to bank supervisors if they had been using this ratio as the principal yardstick. The Board of Governors, however, stated in its 1946 Annual Report:

> 'In view of the decline in holdings of Government securities and increase in loans since the end of the war, the capital accounts of some individual banks are now disproportionately low relative to their risk assets. It is important, therefore, that bank managements keep continuously under observation the composition of the assets of their institutions and, as the degree of risk in such assets increases, take such steps to strengthen the capital account by the retention of a larger share of earnings or the sale of additional stock or both as their individual situations may require.'

"It is encouraging to note that the Board and the Federal Deposit Insurance Corporation are in substantial agreement as to the need of additional bank capital without expressing a preference for any particular ratio. The Corporation in its Annual Report for the same year stated:

> 'One of the chief reasons for the existence of banks is to supply the credit needed in the economy. To do this, banks must have capital accounts sufficiently large to warrant assumption of the risks involved. Banks have been adding to their capital from retained earnings, but the growth has been much too slow in the light of the credit needs of the present time and the foreseeable needs of the future. New capital stock should be sold to the public to hasten the accumulation of capital commensurate with the added risks which banks are assuming in meeting the loan needs of business and individuals.'

"The matter of the adequacy of bank capital is of particular importance in connection with the current anti-inflationary policies of the Federal banking agencies. It would be highly desirable if these agencies could agree on standards to be used. This would provide consistency in public discussion of the banking problem and in application to specific bank situations. It would seem advisable that the matter be fully discussed at informal meetings of the agencies and perhaps in meetings of the technical staffs in an effort to obtain agreement on the standard to be used."

Approved unanimously.

S R Carpenter
Secretary.

Approved:

M S Eccles
Chairman pro tem.