A meeting of the Board of Governors of the Federal Reserve System with the Presidents of the Federal Reserve Banks was held in the offices of the Board of Governors in Washington on Friday, May 21, 1948, at 11:30 a.m.

PRESENT: Mr. McCabe, Chairman
Mr. Eccles
Mr. Szymczak
Mr. Draper
Mr. Evans
Mr. Vardaman
Mr. Clayton

Mr. Carpenter, Secretary

Messrs. Whittemore, Sproul, Williams, Gidney, Leach, McLarin, Young, Davis, Peyton, Leedy, Gilbert, and Earhart, Presidents of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco, respectively.

Mr. Treiber, Secretary of the Presidents' Conference.

Mr. Charles G. Young, Secretary designate of the Presidents' Conference.

Chairman McCabe stated that Senator Taft, Chairman of the Joint Committee on the Economic Report, had called on the telephone to ask that he (Chairman McCabe) testify before the Committee on Wednesday, May 26, but that he had replied that he would prefer not to testify because he had only recently become Chairman of the Board, the Board had stated its views, and Mr. Sproul had also testified. Chairman McCabe said that he promised to call Senator Taft back the

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next day and that when he called the Senator was absent and he talked to Mr. Hardy, Staff Director of the Committee, who said that the hearings were to be closed on June 1 and that he did not want to terminate them without hearing from Chairman McCabe.

Mr. Hardy also referred, Chairman McCabe said, to the recent story in the Wall Street Journal with respect to the study being made by the System of a plan for uniform reserve requirements for all member banks and stated that inasmuch as he had worked on that problem while he was on the staff of the Federal Reserve Bank of Kansas City he would appreciate it if the Board would give him a memorandum as to the present status of the study. Chairman McCabe said that he informed Mr. Hardy that a statement would be sent and that he had prepared a letter which, with the approval of the Board of Governors, he would send to Senator Taft.

Chairman McCabe read the letter and after some discussion, it was approved unanimously by the members of the Board in the following form:

"In response to the request of Dr. Charles O. Hardy, Staff Director of your Committee, I am pleased to submit a memorandum on our study of reserve requirements, which was the subject of a recent article in the Wall Street Journal.

"Of course the Federal Reserve System is continuously studying the basic concept and the functioning of bank reserves. The enclosed memorandum was prepared by members of the staffs of the Board of Governors and the Federal Reserve banks and indicates some phases of the study. As Dr. Hardy knows "this particular study was initiated several years ago and was later carried forward by the System's technical staff.

"I should like to emphasize that the study is not complete and that no final conclusions have been reached. Other groups in the Federal Reserve System will be drawn into the continuing discussions. The staff committee's memorandum was recently presented to the Conference of Presidents of the Federal Reserve banks, and in due course will be referred to the Conference of Chairmen of the Federal Reserve banks. The advice and assistance of the Federal Advisory Council will be solicited. Commercial bankers and other interested parties will be invited to participate in the study. By these means the strengths and weaknesses of the views tentatively presented in the memorandum will be carefully and thoroughly tested, and thereafter, if deemed advisable, legislation may be recommended.

"It will be most helpful to receive the benefit of the views and comments of your Committee and its staff. Please be assured of our complete cooperation with your Committee in the consideration of this matter."

Before this meeting a memorandum covering matters to be discussed by the Board and the Presidents had been submitted by the Presidents' Conference to the Board of Governors. The statement of the Presidents, the response of the Board of Governors as read by the Secretary of the Board, and the discussion at this meeting, with respect to each of the matters considered were as follows:

1. Custody receipts for collateral securing loans to member banks.

Presidents' statement: The presidents reviewed, and discussed with Governors Clayton and Vardaman and Mr. Smead, the subject heretofore considered of general acceptance by Reserve Banks of custody receipts for collateral securing loans to member banks. This matter was the subject of the Board's letter (S-1000) of November 25, 1947, and its letter of April 5, 1948. The presidents have already replied individually to the Board informing it of their views on this subject as requested in the Board's letter of April 5. The presidents are in accord with the Board's letter S-1000, in which the Board stated that the Reserve Banks might properly accept custody receipts of responsible city correspondent banks, as well as those of the Federal Reserve Bank of New York, for reasonable periods where actual delivery of securities is not convenient for the borrowing bank. Many of the Reserve Banks have been doing this for some time and the presidents concur in the Board's view that this practice may enable the Reserve Banks to be of greater service to their member banks, a matter which should be encouraged. Recognizing that the acceptance of custody receipts may in some instances involve risks and that the primary responsibility for making loans on the basis of such receipts lies with the respective Reserve Banks, it is the consensus of the presidents that it would be unfortunate if the practice were advertised and promoted by a published statement. Therefore they would prefer to forego the publication of a statement such as that set forth in the Board's letter of April 5. It is the feeling of the Conference that the right of a Reserve Bank to reject custody receipts in any particular case should not be impaired by any generalized statement seemingly indicating a willingness of the Reserve Banks to accept such receipts from any correspondent bank.

Board's response: The Board understands from Mr. Clayton that he and Mr. Vardaman stated when they met with the Presidents that they thought there would be no objection on the part of the Board to changing the proposed procedure to provide that the Federal Reserve Banks would accept custody receipts issued by a member bank satisfactory to the Federal Reserve Bank. The Board has noted that the Presidents are in accord with the Board's letter of November 25, 1947, in which it was stated that the Reserve Banks may properly accept custody receipts of responsible city correspondent banks for reasonable periods where actual delivery of securities is not convenient for the borrowing bank. It appears therefore that there is substantial agreement on the matter except that the Board believes that the procedure should provide that each Federal Reserve Bank will adopt a method of advising all member banks in its district which will insure the banks knowing that the service is available.

Mr. Davis stated that the Presidents were strongly of the opinion that, as set forth in their statement quoted above, it would be unfortunate if the practice of accepting trust receipts were advertised and promoted by a published statement for the reason that a difficult question of bank relations might arise in any case in which a Federal Reserve Bank found it necessary to decline to accept a receipt from a particular bank. He also said that the only question of difference seemed to be, as stated by the Board, the extent to which the service should be advertised.

There was a discussion of Mr. Szymczak's inquiry as to the value of the service if it was not known to member banks, and Mr. Peyton inquired whether it would meet the views of the Board if advice of the availability of the service were given by the bank relations men in their visits to member banks once or twice a year. Mr. Szymczak stated that it was understood that the Federal Reserve Bank of Philadelphia proposed to advise member banks of the service at the time of regional conferences throughout the district. Mr. Davis said that the adoption of such methods of advice would be in line with the discussions of the Presidents.

Mr. Eccles stated that it was the consensus of the members of the Board that they wanted to be sure that each Federal Reserve Bank would see to it that all members in the various districts would know that the service was available to the extent that the custody receipt was issued by a member bank acceptable to the Federal Reserve Bank.

Mr. Sproul questioned whether the Board had the authority to, or should, tell the Federal Reserve Banks how the availability of the service should be made known and suggested the manner in which the service is brought to the attention of the member banks be left to the Federal Reserve Banks for decision. Mr. Eccles responded that the Board was not trying to tell the Federal Reserve Banks how to advise their member banks but rather that the member banks should be informed.

Mr. McCabe suggested that the last sentence of the Board's statement as set forth above be revised to read as follows:

> "It appears therefore that there is substantial agreement on the matter except that the Board believes the procedure should provide that each Federal Reserve Bank will adopt its own method of advising member banks in its district which will insure the banks knowing that the service is available."

Mr. Davis stated that it was not only a question of a particular bank being in a satisfactory condition and satisfactorily managed, but also whether the practice of accepting custody receipts from correspondent banks no matter where they are located might result in distorting the normal pattern of correspondent bank relationships that has developed out of need for service.

Mr. Clayton suggested that there was still a question whether under the proposed arrangement some Federal Reserve Banks would accept custody receipts from any of their member banks.

Mr. Sproul responded that all of the Presidents had agreed that it would be desirable to encourage the practice and that it should be assumed that all Federal Reserve Banks would follow that policy.

After some further discussion, Mr. McCabe suggested that, as a means of deciding the matter, the Presidents and the Board of Governors agree with the last sentence of the Board's statement amended in the manner he had proposed. This suggestion was agreed to unanimously.

2. Absorption of cafeteria expenses.

Presidents' statement: The Conference approved the recommendation of its Committee on Personnel that it is desirable that the existing authority of the Reserve Banks to absorb up to one-half of the costs of cafeteria operations (Board letter S-912, May 14, 1946) should be continued. The presidents agree that furnishing their employees wholesome meals at low prices has significant value and importance as a part of the personnel policy of the Federal Reserve Banks. The cost per employee for the subsidized food service is so small that it would be considered a trifling salary increase for any individual employee if paid in money. Yet the service is important to employee morale, particularly since in some Reserve Bank cities furnishing employees with free or subsidized meals is a well established practice.

Board's response: This is only one phase of the problem being studied in connection with the budgets of the Federal

Reserve Banks for the provision of personnel function. Because of the continuing inflationary situation, it would be unwise to increase the cost of meals at the present time. Therefore, the problem is one of efficiency of operation which can continue to be studied with other questions arising under the present budget procedure.

3. Expenses of attendance at banking schools.

Presidents' statement: The presidents reviewed the Board's letter (S-957) of February 3, 1947, regarding the payment of expenses incident to attendance by officers and employees of Reserve Banks at banking schools. The letter states that "as it is felt that each student should have a personal financial stake in attending one of these schools and that the Federal Reserve Bank should not bear the entire expense, it appears reasonable that the student should be expected to pay his living expenses, and that, therefore, no reimbursement should be made by the Federal Reserve Bank for dormitory and dining hall charges, and incidental expenses." While attendance at such schools is voluntary the very fact that a member of the staff is selected by his Bank creates in his mind a feeling of pride and responsibility. The student works hard; he has a nonfinancial stake in attendance and creditable performance; and quite apart from dormitory and dining hall charges he must make a substantial financial investment because of the incidental expenses which he must incur. It is understood that most commercial banks pay all expenses of their employees attending the schools. The presidents believe that the Reserve Banks should pay dormitory and dining hall charges for members of their staff attending these schools. These charges are substantial from the point of view of the individual although not from that of the Bank; it would be unfortunate if a requirement that the students pay these charges were to deter any employee from attending.

Board's response: The recommendation of the Presidents is acceptable to the Board, and the Board's letter of February 3, 1947, will be revised accordingly.

4. Exceeding maximum of salary ranges under personnel classification plans.

Presidents' statement: At the time of the initial establishment of the new personnel classification plans in the fall of 1947 one of the Reserve Banks incorporated in its plan a provision which would permit the payment to employees of salaries in excess of the maximums specified for the jobs to which they are assigned, in a limited number of cases, for meritorious service. In approving the plan the Board stated that it felt that such proposal should "be considered as an additional provision of the over-all plan of job classification and salary administration and should be studied on a System-wide basis", and accordingly it declined to approve the proposal at that time. The proposal has since been studied by the Subcommittee on Personnel Classification and Job Evaluation and a majority of the Subcommittee believes that when exceptional cases arise calling for payment of a salary higher than the maximum of the grade, each such case should be referred to the Board for approval on the basis of the merits of the individual situation. Recognizing the need for exceeding the maximums in special cases, the presidents believe that the Subcommittee's suggestion is a workable procedure; in the light of experience developed thereby, it may be possible at a later date to produce a satisfactory procedure which will avoid the necessity of considering all cases on an individual basis.

Board's response: The procedure recommended by the Presidents is essentially what is being done at the present time and is acceptable to the Board.

5. Member bank capital requirements.

Presidents' statement: The Conference considered the new draft of a proposed bill to modify member bank capital requirements, submitted to each of the presidents with the Board's letter of April 30, 1948. The presidents favor the new draft except in two respects. A majority of the presidents would prefer a minimum capital requirement of $25,000 for banks organized both prior and subsequent to the effective date of the legislation, unless, in the judgment of the Board, such a change would make it more difficult to obtain enactment of the legislation. The presidents also suggest the deletion of the provision that would require approval of the Board for the establishment of intra-city branches principally because they believe that retention of this provision would greatly diminish the likelihood of enactment of this legislation.

Board's response: The Board appreciates the suggestions of the Presidents and they will be taken into consideration in preparing the draft of bill to be submitted to the Congress.

6. Revision of conditions of membership.

Presidents' statement: The Conference reviewed the Board's letter dated April 28, 1948, to the Chairman of the Conference requesting that the subject of revision of conditions of membership be placed on the agenda, and the memorandum of the Board's Division of Examinations enclosed with the letter. Because of the technical details involved in consideration of the program set forth in the memorandum, the subject was referred to the Committee on Bank Supervision with the direction that the Committee pursue the matter vigorously and discuss it with the Board and its staff as soon as practicable in order to dispose of the matter promptly.

> Secretary's Note: On May 19, 1948, following submission of the Presidents' statement on this topic to the Board, the Committee on Bank Supervision discussed the proposed revision of conditions of membership with the Director of the Board's Division of Examinations and the program as proposed in the Board's memorandum of April 5, 1948 was agreed upon.

Board's response: The Board has been advised that the Presidents' Conference concurs in the program for the revision of conditions of membership as set forth in the memorandum of April 5, copies of which have been furnished the Presidents. Accordingly, the Board will take steps to put the program into effect promptly. The program contemplates that present standard conditions of membership numbered 1 and 2 be retained and that standard condition numbered 3 and the three standard trust conditions will no longer be prescribed. Regulation H will be revised accordingly.

The program also contemplates that a review will be made by the Reserve Banks and the Board of the conditions of membership applicable to the State banks which are now members with a view to the cancellation of the conditions which would not be prescribed were the bank applying for membership now, and those conditions which require action to be taken by a certain time and have been complied with.

Details as to the procedures to be followed in making cancellations effective will be worked out but the Board suggests that the Federal Reserve Banks undertake promptly a review of the conditions of membership applicable to each State member bank and submit their recommendations as to which conditions of membership should be cancelled and which should be retained.

7. Special reserve against depreciation in Government securities portfolios.

Presidents' statement: The presidents reviewed (1) the discussion at the meeting of the Conference and the joint meeting of the Board and the presidents in February 1948 regarding the possibility of establishing a special reserve against possible depreciation in the market value of Government securities purchased by the Reserve Banks, or amortizing premiums paid on the purchase of such securities more rapidly than at present; and, (2) the alternative plan for a premium reserve account set forth in the Board's telegram of March 15, 1948. The presidents continue to be of the opinion that the surplus funds of the Reserve Banks are small in relation to their responsibilities and that it would be a desirable policy to increase these funds more rapidly to offset premiums on Government securities purchased. The presidents reiterate the view expressed at the last joint meeting that, in view of the existing policy with respect to reserves for special purposes, it is appropriate and desirable that the Reserve Banks pay something less than 90 per cent of their net earnings to the Treasury in order to build up their surpluses, and desire to discuss with the Board the premium reserve plan proposed in the Board's telegram.

Board's response: The Board would be interested in hearing the views of the Presidents as to how and when they would undertake to change the existing arrangement under which 90 per cent of the net earnings of the Federal Reserve Banks after dividends are paid to the Treasury, the reasons which they would advance for such action, and how they would explain the action to the public.

In the ensuing discussion, there was some question on the part of some of the Presidents and members of the Board as to whether, if the Presidents' proposal were adopted, it would be necessary to issue a press statement regarding a change in the basis of payments to the Treasury. Following a review by Mr. Eccles of the circumstances under which the existing arrangement was adopted, Mr. Sproul stated that at the present time the premiums on securities held in the System account amounted to more than $73 million, that they were being amortized at the rate of approximately $14 million a year, and that he thought the proposal for increasing the rate of amortization would not be effective in meeting the real problem under discussion, namely, exposure of the Federal Reserve Banks in connection with their holdings of approximately $12 billion of Government securities other than Treasury bills. During the discussion it was stated that profits and losses on sales of securities from the System account were taken into account under the present arrangement.

Mr. Eccles stated that, if at some later time the policy of maintaining the rate on long-term securities were abandoned and these securities were permitted to go substantially below par, there would be a very large loss on the System's holdings. He also said that the capital of the Federal Reserve Banks had not changed greatly in recent years and, while their surplus had increased substantially, it was not large enough to absorb the large losses that might result from a change in policy with respect to support of the Government security market or to meet the other responsibilities which the System might have to face. He felt that a more rapid increase in the surplus accounts of the Federal Reserve Banks could be defended and he would prefer to do that rather than to set up a special reserve for premiums on securities held.

Mr. Davis said that the matter might be discussed with the Treasury on the basis suggested by Mr. Eccles. Mr. Leach stated that if there were objection by the Treasury to a change by the Board of Governors in the existing arrangement consideration could be given to writing off the premium entirely or at a more rapid rate than at present.

Mr. Eccles stated that the Board of Governors might say to the Treasury that the premium on the System's holdings amounted to more than $73 million, that since the arrangement was first put into effect the System had purchased some $5 billion of bonds for the purpose of supporting the market, that for various reasons the surplus funds of the Banks were not large enough to insure the Federal Reserve Banks being able to meet the demands that might be made on them in the future, that during the period in which the earnings of the banks were large the System would like to build up their surplus at a more rapid rate, and that the Board proposed to reduce somewhat the portion of net earnings being paid to the Treasury. Then, Mr. Eccles said, unless there were a vigorous protest from the Treasury the change could be made.

There was a further discussion during which several of the group questioned whether a statement would have to be made in connection with such a change, after which, in response to an inquiry by Mr. Eccles, all of the Presidents indicated that they would favor the change.

Thereupon Chairman McCabe stated that the Board would consider the matter further to see what could be worked out.

8. Retirement System investment policy.

Presidents' statement: The policy of the Board of Trustees of the Retirement System of the Federal Reserve Banks in investing a portion of Retirement System funds in securities other than direct or guaranteed obligations of the United States, was questioned in a memorandum from the Board at the December joint meeting. The subject was discussed at the meeting of the Conference in February without a conclusion being reached, whereupon the Chairman of the Board of Trustees was requested to name a special committee to study and report on the issues involved. This was done, and Mr. Whittemore, Chairman of the Special Committee, reported briefly at the meeting of the Board of Trustees of the Retirement System on May 17. The Committee's study has not been completed, but the subject is carried forward on the agenda of this meeting at the request of the Secretary of the Board.

Board's response: The Board is willing to postpone a decision on this matter until not later than the next meeting of the Board and the Presidents.

Thereupon the meeting adjourned.

S. R. Carpenter
Secretary.

Approved:

Thomas B. McCabe
Chairman.