

Minutes of actions taken by the Board of Governors of the Federal Reserve System on Wednesday, May 4, 1949.

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

Mr. Carpenter, Secretary
Mr. Sherman, Assistant Secretary
Mr. Morrill, Special Adviser
Mr. Thurston, Assistant to the Board

Minutes of actions taken by the Board of Governors of the Federal Reserve System on May 3, 1949, were approved unanimously.

Minutes of the meeting of the Board of Governors of the Federal Reserve System with the Presidents of the Federal Reserve Banks held on May 3, 1949, were approved unanimously.

Memorandum dated April 29, 1949, from Mr. Young, Associate Director of the Division of Research and Statistics, recommending the approval of a voucher for reimbursement to Richard A. Musgrave, a consultant for that Division, for stenographic expenses amounting to \$28.50 which were incurred by Mr. Musgrave at Ann Arbor, Michigan, while he was working on a special project approved by the Board on October 1, 1948.

Approved unanimously.

Memorandum dated April 29, 1949, from Mr. Leonard, Director of the Division of Bank Operations, recommending an increase in the basic salary of Paul F. Smith, supervisor of the Call Report Section of that Division, from \$4,103.40 to \$4,354.20 per annum,

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effective May 15, 1949.

Approved unanimously.

Letter prepared for Chairman McCabe's signature to the Honorable Burnet R. Maybank, Chairman of the Committee on Banking and Currency, United States Senate, reading as follows:

"Enclosed is a proposed bill 'To amend section 9 of the Federal Reserve Act, as amended, and for other purposes', which the Board recommends be enacted into law.

"The primary purpose of the proposed legislation is to remove unnecessary deterrents to membership by State banks in the Federal Reserve System by eliminating arbitrary statutory requirements with respect to the capital stock required for the admission of State banks to membership and the establishment and operation of domestic branches by State member banks and by vesting discretion in the Board to determine the adequacy of the capital of banks applying for membership or desiring to establish branches. The bill also would require that the Board's consent be obtained by a State member bank before it reduces its capital stock or establishes a branch within the place in which its head office is located.

"Requirements for Admission to Membership. - The existing law provides, generally, that no State bank shall be admitted to membership in the Federal Reserve System unless it possesses a paid-up unimpaired capital stock of \$50,000 in places of not over 6000 population, \$100,000 in places of 6001 to 50,000 population, and \$200,000 in places of over 50,000 population (unless the bank is located in an outlying district where a \$100,000 minimum may apply). Certain exceptions permit the admission of State banks located in places of not over 3000 population with a minimum capital of \$25,000 in most instances.

"These requirements are arbitrary and unrealistic and prevent sound banks, which are otherwise entitled to membership and most of which are insured banks, from becoming members of the Federal Reserve System. The capital needs of a bank are not dependent upon and cannot be determined by the population of the place in which the bank is located. For example, one bank may not have half as great a volume of deposits and of risk assets as another bank in the same town, or a bank

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"located in the larger of two towns may be much smaller than a bank located in the other town. The arbitrary nature of the present requirements is further emphasized by the fact that a very slight difference in populations of the towns in which two banks are located may make it necessary for one bank to have twice as much capital stock as the other in order to be eligible for membership, although the banks are comparable in size and character of assets.

"In order to be eligible for membership, it would be necessary for numerous banks to increase their capital stock to amounts out of all proportion to their needs. In this connection, it should be noted that the existing requirements relate only to capital stock and disregard surplus and other accounts which are part of the capital structure of a bank and provide protection for depositors. Thus, one bank may be eligible for membership because it has the required capital stock but another bank with less but adequate capital stock is not eligible although it has a substantially larger and better balanced capital structure. While a bank should have a reasonable basic capital, this is only one factor and consideration should be given to other capital accounts.

"No precise formula can be devised for determining the adequacy of capital in all cases. In approving a bank for deposit insurance, the Federal Deposit Insurance Corporation is required to consider, among other factors, the adequacy of the bank's capital structure, but the law prescribes no specific requirements. The proposed legislation would vest in the Board similar discretion with respect to the admission of State banks to membership in the Federal Reserve System. In lieu of the existing capital requirements, it would provide that no bank shall be admitted to membership unless it possesses capital and surplus which, in the judgment of the Board, are adequate in relation to the character and condition of the bank's assets and to its deposit liabilities and other corporate responsibilities. A minimum of \$50,000 paid-up capital stock would be prescribed, subject to the exception that a bank organized prior to the date of the enactment of the proposed legislation might be admitted with \$25,000 paid-up capital stock.

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"The proposed legislation also would provide that the capital stock of a State member bank shall not be reduced without the consent of the Board. National banks and insured nonmember banks are required by law to obtain the consent of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, respectively, before reducing their capital stock, and most State member banks are subject to a condition of membership prescribed by the Board for many years which prohibits capital stock reductions without the Board's consent. It appears desirable to cover this matter by law in the case of State member banks in order that all such banks will be subject to this requirement.

"Requirements for Branches. - Under existing law, State member banks of the Federal Reserve System which desire to establish domestic branches beyond the limits of the places in which their head offices are located are required to have capital stock of at least \$500,000 (except that a lesser minimum is applicable in a few States of smaller population). In addition, such a bank must have capital not less than the aggregate capital required for the establishment of national banks in the various places where the bank and its branches are located. The same requirements are applicable in the case of the admission to membership of a State bank which is operating out-of-town branches, if such branches have been established subsequent to February 25, 1927.

"These requirements have little relationship to the capital needed by the banks and are much more stringent than the requirements under many State laws for the establishment of branches by State banks. This results in unfair discrimination against State member banks and, in effect and without justification, closes the door to membership for banks which otherwise might be members of the Federal Reserve System. In some instances, State banks have withdrawn from membership because they wished to establish out-of-town branches and the increases in capital stock necessary to meet the statutory requirements could not be justified. Other State banks with branches lawfully established and in lawful operation have been prevented from joining the Federal Reserve System because they could not do so without giving up their branches or increasing their capital stock to amounts in excess of their capital needs.

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"The proposed legislation would provide that no State member bank shall hereafter establish and operate any new branch in any State or Territory of the United States without the prior consent of the Board but would prescribe no specific capital requirements. It would provide, however, that the Board's consent should be given only after consideration of the adequacy of the bank's capital structure and the other factors which the Federal Deposit Insurance Corporation is now required to consider before permitting the establishment of branches by nonmember insured banks. Thus, there would be adequate control over the establishment of branches by State member banks but the existing arbitrary and discriminatory statutory requirements would be eliminated.

"Apart from capital requirements, the proposed legislation would remove an inconsistency in the law relating to the establishment of branches by banks within the limits of the places in which their head offices are located. Under existing law, the approval of the Comptroller of the Currency and of the Federal Deposit Insurance Corporation is required for the establishment of domestic branches by national banks and nonmember insured banks, respectively, whether such branches are located within or beyond the limits of the places in which the head offices are located, but the law requires the approval of the Board only for the establishment of out-of-town branches by State member banks. It is felt that the approval of the Board should likewise be required for the establishment of intracity branches by State member banks and the proposed legislation so provides.

"The Board's consent would not be required for the establishment of branches by State member banks in the District of Columbia. This exception is made in view of the fact that the consent of the Comptroller of the Currency for branches in the District of Columbia is now required by law.

"The establishment and operation of foreign branches by State member banks would continue to be subject to the same requirements as are applicable to the establishment of such branches by national banks under section 25 of the Federal Reserve Act. State member banks of course could continue to operate foreign branches previously authorized by the Board without again obtaining the Board's approval.

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"The Board believes that it is highly important that all unnecessary deterrents to membership by State banks in the Federal Reserve System be removed. The modification of the capital requirements for the admission of State banks to membership in the Federal Reserve System and the establishment and operation of branches by State member banks is a major step in this direction and the Board hopes, therefore, that your Committee will give favorable consideration to this proposal.

"We are advised that the Bureau of the Budget has no objection to the submission of this proposed legislation."

Approved unanimously, together with a similar letter to the Honorable Brent Spence, Chairman of the Committee on Banking and Currency, House of Representatives, and a letter to the Presidents of all Federal Reserve Banks transmitting copies of the proposed bill together with copies of the letter to Senator Maybank.

Letter to Mr. Wiltse, Vice President of the Federal Reserve Bank of New York, reading as follows:

"The Board has given consideration to the application for fiduciary powers of The Franklin Square National Bank, Franklin Square, New York, which was forwarded with Mr. Sheehan's letter of April 8, 1949.

"It does not appear from the information submitted that the proposed trust officer and the management of the bank have a background of training and experience such as is needed properly to qualify them to conduct a general trust business. In addition, the available information indicates that there is no need for additional trust facilities in the community served by the bank and that it is doubtful whether the bank could be expected to obtain a volume of trust business sufficient to support a well-managed and well-equipped trust department.

"In view of the foregoing, the Board has disapproved the bank's application for permission to

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"exercise fiduciary powers. Please advise the bank accordingly."

Approved unanimously.

Letter to Mr. G. A. Leukhart, General Manager, National Used Car Market Report, Inc., 900 South Wabash Avenue, Chicago 5, Illinois, reading as follows:

"This will acknowledge your letter of May 2 with regard to the Automobile Appraisal Guides published by your company.

"It is observed that you plan to supply your subscribers with revised appraisals every six weeks. This is to be accomplished by supplementing your regular quarterly editions with auxiliary editions listing revised appraisals, the first of which is scheduled for release on May 15.

"As you know, the Board is interested that the estimated retail values stated in designated guides be adapted as closely as possible to actual retail prices. On this score, it would appear that the proposed more frequent valuation editions would be helpful in permitting more accurate price estimates.

"The Board is also concerned that the designated guide books be appropriate to the purposes of Regulation W in other respects; for example, that they be set up in a form that will readily permit automobile dealers and others extending instalment credit on used automobiles to comply with the appraisal guide provisions of Part 4 of the Supplement to the regulation. We, of course, are not in a position to make any recommendations or suggestions with respect to the form of your proposed auxiliary editions until we have had an opportunity to examine them and to observe their suitability for the purposes of the regulation."

Approved unanimously.

Letter to the Honorable Burnet R. Maybank, Chairman of the Committee on Banking and Currency, United States Senate,

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reading as follows:

"This refers to your letter of April 25, 1949, to Chairman McCabe, requesting advice as to the Board's views concerning S. 13 and S. 286, bills relating to transactions in gold.

"The purpose of both bills is to permit newly mined or imported gold to be privately held and traded on the open market in the United States and to be exported from the United States, free from any Governmental restrictions.

"It would appear that a major objective of the proposed legislation is to help the gold mining industry in the United States, which has been subject to rising costs while the price of its product has been fixed. The mining industry would benefit, of course, only in case the free market price of gold should rise above the present official price. It may be well to mention at the outset, therefore, that it is not certain that the market demand for gold would be adequate to raise the price, at least for an extended period, or perhaps even to maintain the existing price except as a result of official purchases. Moreover, assuming that the mining industry would be benefited, it would seem questionable policy, considering the welfare of the general economy, to encourage a shift of productive resources of this and other countries into gold production to provide gold for hoarding.

"There are, however, much more fundamental objections to this proposal. By removing controls over gold ownership and gold trading, the proposed legislation would deprive the Government of a key instrument in the maintenance of international monetary stability, namely, its ability to control gold settlements between this country and foreign countries and thereby to eliminate capricious and speculative gold movements. Also, if the legislation actually resulted in a premium market for gold in this country, the resulting uncertainty as to the gold value of the dollar would seriously impair the usefulness of the International Monetary Fund as a mechanism to develop exchange stability, and the effects of the legislation would be inconsistent with the efforts of this country to promote exchange stability by participation

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"in the Fund. By leading to greater international monetary instability, the proposed action might have serious adverse effects upon international trade.

"Moreover, free trade in gold under present circumstances would impair the ability of foreign monetary authorities to maintain confidence in, and stabilize the value of, their national currencies, and thus might retard economic recovery in countries where this is a matter of vital concern to the United States. Demand for gold may be expected from countries where political uncertainties prevail and where the value of local currencies is in question. The use of dollar exchange in foreign countries to purchase gold would reduce the ability of those countries to purchase needed goods from us, and would thus tend to increase the demands for foreign aid under the Economic Cooperation program. While countries which sell gold to the United States would be benefited if the market price for gold in this country rose above the present official price, the benefit would bear no relation to the need and, in general, the countries which would benefit the most are not those most in need of financial assistance by the United States.

"If the price of gold did not go to a premium, but stayed firmly at the official level, some of the foregoing dangers would be reduced, but the existence of a free gold market would cause serious impairment of the functioning of the Government agencies responsible for monetary and credit policies. At present, the centralization of gold in official hands in the United States permits these agencies to operate in accordance with the basic needs of the country, without the disturbing effects of the speculative movements of gold into and out of monetary reserves which would result from a free gold market. Demand for gold for hoarding is not a reasonable or satisfactory guide to general monetary policies. In periods of depression, as was the case for example in 1933, there may be a strong public demand for gold, the withdrawal of which from monetary reserves might call for restrictive monetary policies, although policies of monetary ease are required to combat deflationary pressures. On the other hand, in a period when prices of commodities and other earning assets are tending generally to rise, there may be a shift toward such assets; demand for

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"gold would tend to be small and a free gold market would not act to dampen this kind of price rise.

"In a period of more serious inflation, such as may develop during or after a war, there may be a strong demand for gold as some people lose confidence in the maintenance of official parities of currencies relative to gold or other currencies. Should a change then occur in such parities, a free market for gold would have benefited those who had deserted their country's currency and obtained gold, but meanwhile, the free availability of this gold would hinder the financing of the war or reconstruction on as sound a basis as possible.

"It may be concluded, therefore, that free circulation of gold is more likely to be a hindrance to the adoption of proper monetary policies than an aid in maintaining stable and prosperous economic conditions.

"In view of the foregoing, the Board recommends that favorable consideration not be given to S. 13 and S. 286."

Approved unanimously.

Letter to Mr. Prochnow, Secretary of the Federal Advisory Council, 38 South Dearborn Street, Chicago 90, Illinois, reading as follows:

"Referring to my letter of April 19, 1949, the Board would like to suggest the addition of the following topics to the agenda for the meeting of the Federal Advisory Council to be held on May 15-17, 1949:

"1. Recently there has been renewed discussion of the suggestion that the Federal Deposit Insurance Corporation assessment be reduced and insurance coverage on deposits increased. In a recent reply to a request from the Senate Banking and Currency Committee for a report on a bill to increase the insurance coverage from \$5,000 to \$15,000, the Board stated that this change should not be considered without due regard to the reduction or elimination of assessments and a revision of the basis for such assessments, and that the Board had instituted a careful study with a view to placing itself in a position to respond to

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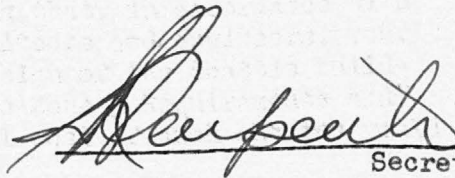
"further inquiries that the Committee might wish to make. The Board would appreciate having the views of the Council on the matters that should be taken into account in making such a study and the conclusions that might be reached.

"2. In a recent letter to the Chairman of the Banking and Currency Committee of the House, the Board took the position that action on Bill H.R. 1161, a bill to provide for the conversion or absorption of national banks into State banks, should be deferred until consideration had been given to the problem of reserve requirements. Subsequently, Mr. Brooks, past President of the State Bank Division of the American Bankers Association, wired the Board criticizing that position. Copies of his wire and the Board's reply are attached. The Board would like to have the comments of the Council on the Board's position.

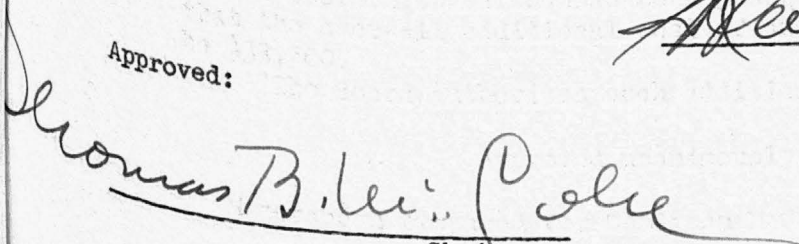
"3. It would be helpful to the Board if each member of the Council would be prepared at the joint meeting to give a brief summary of the current and prospective business and credit conditions in his Federal Reserve District.

"4. Since the Council met on February 13-15, 1949, the Board has relaxed the provisions of Regulation W on two occasions and has reduced margin requirements from 75 per cent to 50 per cent. The Board would welcome the comments of the members of the Council on these actions and their views as to what, if any, further steps the Board or the Federal Open Market Committee might take at this time to meet their responsibilities in the monetary and credit field."

Approved unanimously.


Secretary.

Approved:


Chairman.