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 Tuesday, May 17, 1949, at 10:30 a.m.

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

Mr. Carpenter, Secretary

Messrs. Spencer, Burgess, Congdon, Fleming, J. T. Brown, E. E. Brown, Hemingway, Atwood, Kemper Woods, and Odlin, members of the Federal Advisory Council from the First, Second, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, Tenth, Eleventh, and Twelfth Federal Reserve Districts, respectively

Mr. Prochnow, Secretary of the Federal Advisory Council

1. Reorganization legislation. President Brown stated that following the last meeting of the Council, in response to the instructions of the Council, he addressed a letter under date of February 18, 1949, to Senator McClellan, Chairman of the Senate Committee on Expenditures, strongly urging that the Board of Governors be exempted from the reorganization bill (H.R. 2361) and that subsequently, during his absence in Brazil, Mr. Fleming conferred with Senator McClellan about the matter and on March 23, 1949, sent a letter to him (President Brown) summarizing what occurred during that conference. He also said that copies of the two letters would be delivered to the Board for its records.

Following President Brown's statement, there was a brief discussion of the status of the reorganization bills now pending in the Congress. Copies of the two letters referred to by Mr. Brown were handed to the Secretary after this meeting and have been placed in the files of the Board.

2. Council's statement on legislation relating to supplemental reserve requirements and consumer credit control. Reference was then made to the statement by President Brown on behalf of the Federal Advisory Council before the Subcommittee of the Senate Banking and Currency Committee in connection with proposed legislation with respect to supplemental reserve requirements and consumer instalment credit. President Brown stated that at the last meeting of the Council its executive committee was authorized, in the event this legislation was introduced before another meeting of the Council was held, to issue a statement and testify at any hearings on the bill. He also said that the executive committee met on Tuesday and Wednesday of last week and approved the statement which he presented at the hearings before the Subcommittee and that subsequently the members of the Council approved and ratified the statement.

Chairman McCabe stated that he had been accused of bad faith in that he had arranged to have the hearings called and concluded before the scheduled meeting of the Federal Advisory Council could be held and that that was not true. He outlined the circumstances under which the hearing was called and stated that he began more than a month ago to get the bills on the calendar since the existing authority would expire on June 30, 1949, that when the matter was first discussed with the Chairman of the Banking and Currency Committee it was understood that the hearings would be held about the first of May, that Chairman Maybank later changed the date to about the fifteenth of May, and that when the bills were introduced Senator Robertson decided to start the hearings on May 11 and to hold the testimony for three days only because of the limitation on the time during which the matter could be considered. Chairman McCabe added that this had all occurred without regard to the scheduled meeting of the Council because he did not have the time of that meeting in mind and that, in any event, he knew the views of the Council on the legislation and stated at the hearings what he thought those views would be.

President Brown said that no member of the Council had accused Chairman McCabe of bad faith in the matter, and Mr. Fleming stated that Senator Robertson had made it very clear in the hearings that he had set the hearings and took full responsibility for their timing. Mr. Fleming also said that the American Bankers Association had been notified of the hearings but that the Council had not been.

Chairman McCabe responded that the notices had been sent out by the office of the Senate Banking and Currency Committee and he had assumed that a notice had gone to the Federal Advisory Council as well as to other interested parties.

President Brown stated that Mr. Potts, the member of the Council from the Third Federal Reserve District, had attended the separate meetings of the Council on May 15 and 16 but had found it necessary to return to Philadelphia yesterday for a meeting of the board of directors of his bank.

In accordance with the procedure established on December 3, 1946, the Federal Advisory Council submitted to the Board of Governors before this meeting a memorandum of the topics to be discussed with the Board. The statement of the Council with respect to each of the topics was read by President Brown and the discussion at this joint meeting was as follows:

3. Holding company legislation.

> Does the Board of Governors propose to secure introduction of bank holding company legislation in this session and attempt to obtain enactment; and if that is not intended in this session, what are the plans for bank holding company legislation?

> Bank holding company legislation has been the subject of joint discussions by the Board and the Council on numerous occasions, but no legislation has been enacted. The Council would appreciate knowing what action the Board may be contemplating on such legislation.

President Brown stated that at least one member of the Council was being pressed for current information as to the status of this legislation and that the Council would appreciate any information that the Board could give.

Chairman McCabe reviewed developments in connection with the proposed legislation during the past year and stated that some time ago he had presented copies of a revised draft of the bill, in which a number of substantial changes had been made, to the Secretary of the Treasury, the Comptroller of the Currency, and the Chairman of the Federal Deposit Insurance Corporation but had not yet received their reactions. He also said that the position of the Board, which had been the same from the beginning, was to push the bill along, that he had talked with the Chairman of the Senate Banking and Currency Committee about getting the bill on the calendar, and that yesterday Senator Robertson told him that consideration was being given to the question whether the bill could be taken up by the present session of Congress before it adjourned, and if the Board would send the bill up, Senator Maybank or he would introduce it and his Subcommittee would hold hearings on it which would give the legislation priority in the next session of Congress if it could not be considered during the current session.

Mr. Odlin inquired whether the Board would offer the bill and stated reasons why he thought it desirable that the legislation should be expedited.

Chairman McCabe responded that it was the intention of the Board to offer the legislation, that he proposed to tell the Treasury, the Comptroller of the Currency, and the Chairman of the Federal Deposit Insurance Corporation of his conversation with Senator Robertson and give them an opportunity to comment on the legislation, and that the bill would be submitted to the Bureau of the Budget for comment in accordance with the established procedure after which it would be presented to the Senate Banking and Currency Committee. He made the further statement that he would like to have an expression of the views of the Treasury, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation before the bill was sent to the Congress but that if they did not comment on it promptly, it would be sent to the Budget Bureau where it was not expected there would be any delay in its consideration.

4. Deposit insurance coverage and assessment.

> 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 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.

The Council is familiar with the discussions on this matter which the Federal Deposit Insurance Corporation has had with a committee of the American Bankers Association. Without being committed to any particular formula, the Council favors in general an approach to this subject on the basis of these discussions.

Specifically, the Council believes any legislation should include the following points:

A. No increase should be made in the present insurance coverage of $5,000;

B. The maximum assessment in any one year should not exceed one-twelfth of one per cent;

C. Provision should be made for maintaining the integrity of the fund by establishing a statutory formula for an automatic scale of assessments, based on the previous years' losses and expenses, to range from no assessment, or an assessment of a nominal amount, under present conditions, to a maximum of one-twelfth of one per cent per annum.

In any study for the purpose of determining the adequacy of Federal Deposit Insurance Corporation funds and the rate of assessments, the Council suggests the importance of considering not only the possible losses of the Federal Deposit Insurance Corporation but also the effect on bank earnings, capital and dividends of the steady drain of assessments. These assessments reduce the power of the individual bank to make its own provision for losses.

President Brown stated that the formula that had been discussed by the committee of the American Bankers Association and representatives of the Federal Deposit Insurance Corporation would provide for a flexible assessment rate with a minimum of 1/96 of one percent and a maximum of 1/12 of one percent and that the board of directors of the Federal Deposit Insurance Corporation would determine each year the amount of the assessment that would be needed together with other income to cover the Corporation's current losses and expenses and provide a statutory addition to surplus of $25 million for the year. He said that the Council would be glad to have the conclusions that the Board's study might have led to and that the members of the Council did not favor the so-called "Pittsburgh plan" under which the earnings of the Federal Reserve Banks would be paid to the Federal Deposit Insurance Corporation and assessments would be discontinued for banks that had paid such assessments for 15 years.

In response to a comment by Chairman McCabe that the Board would be interested in knowing whether the members of the Council would favor a change in the assessment base which would take into account the distinction between risk and nonrisk assets, President Brown said that it was felt that such a formula would not be acceptable regardless of its merits because it would give the greatest relief to the larger banks. He added that with the Federal Deposit

Insurance Corporation funds at the level they will reach by the end of this year, it was the feeling of the Council that the assessment should be reduced by a statutory formula and not be left to the discretion of the Federal Deposit Insurance Corporation. He made the further statement that he understood that Chairman Harl was opposed to the formula which would differentiate between risk and nonrisk assets, but it was believed he favored a formula along the lines outlined above.

There was a discussion of the likelihood of legislation on this subject being introduced during the present session of the Congress during which Chairman McCabe stated that the Board's study of the matter was progressing and that the Board would be prepared to express an opinion after it had had an opportunity to consider the results of the study.

In response to an inquiry from Mr. Fleming as to whether the Board favored a reduction in the assessment, Chairman McCabe stated that the Board had taken the position that the question of an increase in deposit coverage should not be considered without due regard to a reduction or elimination of the assessment and revision of the assessment base. Mr. Fleming commented that consideration on that basis was not necessary for the reason that the policy of the Federal Deposit Insurance Corporation of coming to the assistance of insured banks which were in trouble amounted to a 100 per cent insurance of deposits. He also said that anything that the Board might do to further consideration of the assessment problem would be very helpful.

In a further discussion, Mr. Fleming stated that while he had taken the position in the past that the assessment should not be reduced, he now felt that the reserves of the Corporation were adequate and that the continuation of the present assessment would be an unjustifiably heavy drain which, in the case of his own institution, amounted to about $6 for each share of the bank's stock. The problem was important, he said, because, although the banks had had good earnings in the past, that might not be the case in the future. He made the further statement that if the Board would like to have a copy of the formula that was discussed by the committee of the American Bankers Association with the Federal Deposit Insurance Corporation, he would be glad to leave a copy with the Secretary of the Board, but that, for reasons which he outlined, the memorandum should be held in complete confidence for the information of the Board only. The members of the Board present stated that they would like to have a copy of the formula and would keep it in confidence. Thereupon Mr. Fleming handed a copy to the Secretary of the Board with that understanding.

Mr. Eccles stated that the assessment problem was a matter of considerable interest to the Board as well as the Federal Deposit Insurance Corporation for the reason that by far the greatest part of the annual assessment of more than $100,000,000 was paid by member banks and had a substantial effect on their earnings, and that, therefore, the whole question was related to the problem of rates on Government securities and System open market policy.

5. Legislation to permit conversion of national banks.

> 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 criticising 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.

> The members of the Council are in unanimous agreement that national banks should have a right to convert to state charters as easily as state banks can convert to national charters. The fact that state nonmember banks may have different reserve requirements than national banks should not be considered in connection with legislation authorizing such conversion. The Council, therefore, feels that Congressional action on Bill H. R. 1161 should be considered without reference to reserve requirements.

Chairman McCabe stated that the Board was glad to have the views of the Council and would take them into consideration in any decision that it might make in connection with the legislation. He also said that recently Messrs. Brumbaugh, Bell, Hospelhorn, and Rapport of the National Association of State Bank Supervisors discussed the matter with him and urged that the Board support the legislation.

President Brown stated that the information that had come to him was to the effect that there was no active support of the bill in Congress and that there was no chance of its passing during the present session.

6. Credit Controls.

> 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 fields.

The Council is in agreement with the general direction of the action which the Board has taken in relaxing the provisions of Regulation W, but calls attention to the fact that the Board's action has not yet gone as far in some respects as the Council recommended in February. At that time the Council stated in its written memorandum to the Board,

> "In connection with household furnishings and appliances, the Council favors eliminating these articles from control inasmuch as they are now, with minor exceptions, in ample supply."

In view of the current economic trend, the Council feels even more strongly than it did in February regarding the elimination of articles from control, and it now recommends that all controls under Regulation W be dropped. As stated to the Senate Committee on Banking and Currency, the Council favors the termination of the Board's power over consumer credit.

The Council agrees with and approves the various steps the Board has taken in reducing margin requirements.

The Council believes that under present conditions bank reserves now required are unnecessarily high, and it recommends that the Board make further substantial reductions in required reserves. Decreases in bank reserve requirements increase bank lending power and encourage banks to proceed with more confidence in their lending and investing policies. They also enable banks to maintain their earnings, strengthen their ability to absorb losses, and strengthen their capital funds. The Council has noted with approval the action of the Open Market Committee in supplying securities to the market, and thus maintaining orderly conditions, when reserve requirements were recently reduced.

The Council continues to feel that changes in reserve requirements are not a suitable method of current credit control, but should be used only rarely for adjustment to basic changes in the monetary situation. Changes in reserve requirements make difficult the planning of banking operations.

There now seem to us to have been basic changes in the situation justifying lower required reserves than the twenty-six, twenty and fourteen per cent maximums of the Banking Act of 1935. It would seem wise to lower requirements to a level which can be maintained over a considerable period.

Chairman McCabe reviewed the attitude of the automobile manufacturers, finance companies, and others with respect to the continuation of Regulation W, Consumer Instalment Credit, and stated that there was a wide difference of opinion on the subject.

Mr. Vardaman observed that the registrants who favored continuation of the Regulation did so primarily for the reason that they would like to have it retained as a means of regulating trade practices rather than as a selective credit control. He said that the Act, authorizing the procedure under Regulation W, stated, in effect, that it was for the purpose of restraining inflation, and that no mention was made of regulating trade practices; and that if the Board kept the regulation in effect solely as a trade practice control, the Board would then be usurping the legislative prerogative of the Congress; and for that reason alone, if for no other, he was opposed to the continuation of the regulation after its need as a credit control had expired. This point was discussed together with a comment by Mr. Odlin that the maximum terms prescribed by the Regulation tended to become minimums and to force more liberal credit terms than would otherwise be the case.

Chairman McCabe asked for the views of the Council as to the effects of future reductions in reserve requirements on interest rates and on the Government securities market.

Mr. Burgess expressed the thought that the effect would depend upon Treasury policy with respect to Treasury financing and that banks with excess reserves would be inclined to purchase intermediate term issues which were in short supply in the market. He stated that there were three things that should be done in connection with a reduction in reserve requirements: (1) The System open market account should supply securities to absorb released reserve funds as was very effectively and smoothly done in connection with the recent reduction, (2) Increase the supply of issues in the areas in which the Federal Reserve Banks do not have large holdings (this, he said, was the recommendation of the American Bankers Association Committee on Government Financing in connection with the June refunding), and (3) In connection with the savings bond drive, make F and G bonds available for investment by banks as was done last year.

There was a discussion of the possible effects on interest rates of further reductions in reserve requirements in the event the last two steps suggested by Mr. Burgess were not taken, and Chairman McCabe inquired whether the members of the Council had noticed any change in interest rates since the recent reduction in reserve requirements. The responding comments were to the effect that there had been some softening in rates.

Mr. Eccles discussed the reasons that might be advanced for further reductions in reserve requirements and the likelihood of banks receiving additional reserve funds from the repayment of bank loans, the purchase of investment obligations by other lenders, newly mined gold, and a return flow of currency. He stated that if funds released by a reduction in reserve requirements were put into short-term securities, there might be no problem but that many banks would go into longer term issues in order to maintain earnings which would result in declining yields on these issues and in an extremely serious problem for the banks.

President Brown concurred that bank earnings would decline and that since the recent reduction in reserves, banks were showing a greater willingness to make long-term loans than they were six months ago which he said might be a good thing as a means of slowing down the rate of decline.

Mr. Vardaman inquired what the effects would be of the policy, which he understood that the Comptroller of the Currency and the Federal Deposit Insurance Corporation were following in connection with bank examinations, of requiring a capital ratio of six to one in relation to risk assets.

Mr. Congdon said that he had discussed this matter yesterday with Mr. Robertson, Deputy Comptroller of the Currency, who stated that the office had no such policy and that a letter probably would be issued to clarify the situation.

Mr. Woods indicated that examinations of two small banks in which he was interested indicated that some such policy was being followed. Some of the other members of the Council indicated that they had not heard anything about the matter.

Mr. Eccles discussed how the special reserve plan, which was suggested by the Board in 1947, would affect the present situation and particularly the short-term rates on Government securities. He expressed the opinion that the problem should be approached on a broader basis than merely as a reduction in reserve requirements.

Mr. Burgess expressed the thought that it might be wise at some point to make some issues of restricted Government securities available for bank investment. This comment was followed by a general discussion of the changed economic situation and the changes that might be made in Treasury financing policies and the open market policies of the System. There was also discussion of the possible effects of greater flexibility in the short-term rates. Members of the Council indicated that they felt the Treasury had made a mistake in not issuing an intermediate security in connection with the June refunding, and they expressed the hope that action would be taken later to supply that area of the market.

7. <u>Treasury financing</u>.

> Consideration of the refunding of maturing Government obligations, having in mind the need of the banking system for obligations of medium term and the allied question of removal of restrictions against purchase by banks which now apply to certain of the outstanding Government obligations.

In connection with the refunding of maturing Government obligations, the Council recommends the following action:

A. The issuance of notes or bonds of intermediate maturities to meet a shortage of such securities in the market;

B. The shifting of a portion of the Federal debt to longer maturities. Even a '67/'72 maturity is not now long-term. The policy of increasing the amount of the debt payable on demand or in short-term maturities may create a serious problem at a later date.

The Council is not prepared to recommend at this time the removal of restrictions applying to those Government securities which are now ineligible for purchase by commercial banks.

Chairman McCabe stated that a meeting of the executive committee of the Federal Open Market Committee was scheduled for June 3, 1949, at which the views of the Council members on this point could be considered.

There was a discussion of what the Council meant by the statement that a 67/72 maturity is not now a long-term and whether the statement was correct that increasing the amount of the debt payable on demand or in short-term maturities might create a serious problem for the future. Mr. Eccles questioned whether a 67/72 issue was not still long-term in so far as investment by banks was concerned. He inquired whether the statement was intended to apply to bank eligible issues and stated reasons why long-term eligible issues should not be put out at this time.

Mr. Atwood stated that the question of eligibility had not been discussed by the Council in this connection, and further comments indicated that there was no agreement between the members of the Council on this point.

Mr. Eccles also stated that increasing the volume of short-term debt would not present any problems from the standpoint of raising the funds necessary to finance the Government but that inasmuch as short-term issues probably would be taken mostly by the banks, that form of financing might have inflationary tendencies.

8. Business and credit conditions.

> 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.

Each member of the Council will be pleased to make a brief oral statement regarding the current and prospective business and credit conditions in his Federal Reserve District.

Each member of the Council made a brief statement of current business conditions in his district which indicated that although the situation was "spotty" in some areas, business activity throughout the country continued to decline in almost all lines, that business profits were being affected adversely, that crops would be large and would create price and storage problems, but that there were some bright spots in the picture, and while it was expected that a gradual decline would continue, it was thought, at least in some districts, that it would find a floor before going too far.

9. Date for the next meeting of the Council. President Brown stated that the next meeting of the Council ordinarily would be held on September 18-20, 1949, and that unless the Board had some objection, it would be set for those dates. The members of the Board indicated that a meeting at that time would be agreeable to them.

Thereupon the meeting adjourned.

S R Carpenter
Secretary.

Approved:

Thomas B. McCabe
Chairman.