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, September 20, 1949, at 10:40 a.m.

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

Mr. Carpenter, Secretary

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

Mr. Prochnow, Secretary of the Federal Advisory Council

Before this meeting the Board had received from the Council a memorandum of the matters which the Council wished to discuss with the Board. At this meeting President Brown read the Council's statement with respect to each of the topics and the discussion was substantially as follows:

1. H. R. 1689, Executive Salaries.

In connection with H. R. 1689, the Council has unanimously approved the resolution which follows for transmission to Senator Maybank as Chairman of the Senate Committee on Banking and Currency:

RESOLUTION

"The Federal Reserve Ststem is this country's Central Bank. Its decisions are of grave importance for the Nation's well-being. They influence the trend of business and employment.

"The Board of Governors of the Reserve System is the top command of the System. It should be manned by the ablest and best qualified people in the country. When the System was set up, the salaries of the Board were placed at the same level as members of the Cabinet and that relationship has been continued until the present.

"H. R. 1689 would break this sound tradition by treating the Board simply as a minor regulatory agency. This would lower the prestige of the Board and make it much more difficult to persuade able men to be its members. It would impair its influence upon banks and the public and cripple it for its essential service to the Nation.

"We recommend that members of the Board be placed on a higher salary level, preferably $20,000."

During an informal discussion of the resolution, President Brown stated that copies thereof were handed to Senator Maybank yesterday by members of the Council.

2. Discount rates at Federal Reserve Banks and business trends during the remainder of year.

> In view of changed economic conditions and the present level of the Government securities market, what should be the policy of the Federal Reserve System with respect to the rediscount rate?

The Council believes that under current conditions it is desirable to retain the present rediscount rate. Any reduction in the rate now would only tend to ease money rates at a time when rates are historically very low. With deficit financing, and with business showing some improvement, it is not desirable to lend encouragement to a possible inflationary trend. Normally the rediscount rate should be a penalty rate. The present rate is low for a period of relative prosperity. A reduction in the rediscount rate now would also tend to increase the prices of Government securities and would therefore make more difficult the Treasury and Open Market Committee responsibilities in connection with the Government security markets.

What are the views of the Council as to business trends during the remainder of 1949?

The business trend at present is moderately upward from its low of recent months, and it is probable that it will continue upward for the remainder of 1949. Developments which might threaten a continuance of this trend are strikes in such major industries as steel, coal and the railroads and effects of the British devaluation.

Since these two topics were related, they were discussed together.

Amplifying the statement on the first topic, President Brown stated that since July there had been very rapid improvement in business sentiment, that orders had increased to about the level of 1948, that there was demand for a fourth round of wage increases some of which were being granted, and that further Treasury deficits were in prospect. He also said that with greatly improved business sentiment and the possibility of further wage increases it was the view of the Council that no action should be taken which might start another inflationary spiral, that a majority of the Council felt that the recession had not gone far enough, and that the trend had started up again before a number of necessary price adjustments had been made.

Commenting particularly on the second question, President Brown stated that, because of the greatly improved business sentiment in some districts, a number of capital expansion programs were being revived, and that it was felt that barring severe strikes and possible adverse effects of such things as the British devaluation business would be good for the balance of the year and would stay at the present levels or increase somewhat in volume. The Council was not prepared, he said, to say what the situation would be after the turn of the year but indications of a sustained upward trend were not nearly as clear as for the rest of the current year.

Chairman McCabe referred to the last sentence of the Council's comment on business trends for the balance of 1949 and raised the question whether that comment was entirely consistent with the views of the Council on the reduction of the discount rate.

Members of the Council indicated the opinion that a reduction in discount rates would not have any effect on a situation resulting from strikes and devaluation of foreign currencies. President Brown stated that it was not expected that strikes in steel and coal would be of long duration but that if they lasted a month or more the effects would be serious. He also said that it would be impossible to evaluate the effects of devaluation of foreign currencies for a month or two.

Chairman McCabe reviewed for the confidential information of the members of the Council the background of the recent discussions by the Board of Governors of a reduction in the discount rates at the Federal Reserve Banks and of the reasons that had been advanced for taking or for withholding approval of such a reduction at this time.

There was a general and informal discussion of the problem of discount rates in the light of existing conditions including the devaluation of foreign currencies. The members of the Council were unanimous in their view that a reduction in the rate would accomplish no useful purpose, but on the other hand would "break" the two percent rate charged by banks on prime commercial paper and would reduce rates on long-term investments which were already too low to provide an adequate return for savings funds in the hands of insurance companies, savings banks, savings and loan associations, endowments, and other investors. They also were in agreement that a reduction in the discount rates would not be effective in reducing lending rates to small borrowers.

There was also discussion of the history of Federal Reserve Bank rediscount rates during and since the war, the function that the discount rate might be expected to perform in the present situation, and whether there would be justification for reducing the rate by only 1/8 of one percent to bring it in line with the market rate on Treasury certificates or for establishing of a preferential rate on rediscounts secured by Treasury bills and certificates.

President Brown raised the question whether, if the discount rate were reduced, the rate on certificates would go to one percent. Members of the Board stated that the certificate rate would be determined by the open market policies of the System and a reduction in that rate to one percent would not follow from a reduction in the discount rate alone.

The discussion was concluded by a statement in which the members of the Council appeared to concur that there was little immediate relationship between a reduction in the discount rate and the possible effects of the devaluation of foreign currencies but that such a relationship might develop later when the effects of devaluation on the business situation in this country became more apparent.

3. System credit policy.

> Does the Council have any comments to make on the credit policy actions taken by the Federal Reserve System since the last meeting of the Council?

The Council is in agreement with the June statement indicating a departure from the policy of maintaining a fixed pattern of rates. The Council also approves the reductions in reserve requirements that have been made. These actions have been an encouraging influence on business sentiment. Looking backward, the Council believes it would have been helpful if the Federal Reserve System had released securities to the market more promptly in late June and early July and if interest rates had not been permitted to fall so low. The Council also believes the whole bond market would be in sounder condition if the System had released and were currently releasing bonds more freely from its portfolio.

The discussion of this topic brought out the point that the last sentence of the Council's statement referred particularly to ineligible bonds of which the System's holdings were substantial. President Brown stated that ineligible Treasury bonds had gone up as much as two points, that such an abrupt rise had affected the entire high-grade corporate bond market, and that it would be better if sales from the System account could be used to counteract this trend.

This matter was discussed in the light of the June 28, 1949, statement of the Federal Open Market Committee, the policies followed by the Committee since that time, and what the policy with respect to market rates should be under the conditions that had developed.

4. Treasury refunding program.

> Does the Council wish to express any opinion at this time with respect to the future refunding program of the Treasury?

The Council believes that the Treasury's announcement that it proposes to issue notes to refund the bonds coming due in December is a step in the right direction. As the program develops, it should include refunding into both intermediate and longer-term issues. Too large a proportion of the Federal debt is now in short-term securities, especially when considered in connection with the amount of savings bonds outstanding and with the steadily shortening maturities of the present long-term issues.

Question was raised by members of the Board whether the longer term issues referred to in the above statement would include bank eligibles or only restricted issues, and President Brown stated that the Council was thinking only of ineligible bonds. Mr. Burgess felt, however, that some of the issues should be bank eligibles. In response to an inquiry by Mr. Eccles as to whether there would be justification for issuing long-term eligible bonds to banks while the market for Treasury securities was being supported, Mr. Burgess stated that he felt there should be some ten-year bank eligibles and that eventually it would be necessary to move in the direction of an entirely free market.

Mr. Eccles questioned whether there would be justification for refunding in an easy money market at low rates which would cause the issues to decline below par if rates moved substantially higher, and President Brown stated that it would be necessary to announce before the securities were issued that there was no intention to support them. During a discussion of the responsibility of the Treasury with respect to issuing long-term securities at low rates, Mr. Burgess expressed the opinion that the present low rates on Government securities were preventing the Government from refunding with longer term issues.

Mr. Clayton inquired whether the second sentence of the Council's statement was not intended to read: "As the program develops and as money market conditions become more nearly normal, the program should include refunding into intermediate and longer term bonds." Members of the Council agreed that the sentence as stated by Mr. Clayton expressed the Council's intention.

Chairman McCabe stated that he did not think there was disagreement between the Council and the Board on the statement in the revised sentence.

5. Legislation.

What are the views of the Council with respect to the following legislative proposals:

a. A basic revision in the law relating to reserve requirements which would base requirements on types of deposits rather than location of the bank, and would be applicable to nonmember as well as member banks.

The Council is unanimously of the opinion that neither the Board of Governors nor any Federal agency should have authority to fix the reserve requirements of nonmember banks.

As to the reserves of member banks, while the Council recognizes that there is some lack of logic in the present basis for determining reserves, the banking system has over the years grown up with this arrangement and has operated effectively under it. Before the Council expresses its opinion on a change to some other basis, the Council desires more opportunity to study specific proposals and their effects on individual banks and on the banking system.

President Brown stated that the Council had had the benefit of the statements of Mr. Bopp, Vice President of the Federal Reserve Bank of Philadelphia, before the National Association of State Bank Supervisors last year and of Mr. Szymczak before the Wisconsin School of Banking, that the statements intentionally were not explicit on the percentages that would be prescribed under the plan, and that the plan included the application of the uniform reserve requirements to nonmember banks. As stated previously, he said, the Council feels strongly that no one in the Federal Government should have authority to prescribe reserve requirements for nonmember banks for the reason that if that were done there would, in effect, be only one banking system in place of the present dual system.

Chairman McCabe referred to the wide variation in reserve re-requirements of banks under State laws as compared with the requirements imposed on member banks and asked from where the leadership was to come to bring about a correction of that situation. He also said that while he believed in the dual banking system, that system should be a sound one and the present reserve requirements of State banks could not be regarded as sound. He also asked if the correspondent banks did not take leadership in bringing about the necessary correction who could be looked to to dramatize the need for correction.

Mr. Congdon suggested the State bank supervisors as the logical group to take the matter up on the basis of improving the State banking system and removing a threat to that system if the necessary corrective action were not taken.

Chairman McCabe questioned whether the State bank supervisors would be willing to undertake it.

Mr. Szymczak referred to the special report of the Board, the Federal Advisory Council, and the Presidents of the Federal

Reserve Banks to Congress in 1940 which included a recommendation that increased reserve requirements be applied to nonmember banks.

President Brown stated that that recommendation was made on the basis of the likelihood of the United States being drawn into the war, the very large excess reserves existing at the time, and the possibility that the reserves would be used in such a way as to weaken the ability of the United States in the event it should get into the war. He did not think that the conditions existing at the present time would justify such a recommendation.

Mr. Eccles pointed out that the adoption of the recommendation would have had the same effect then as now so far as the dual banking system was concerned and that the question of the uniformity of reserves had nothing to do with the dual banking system as the same question was involved in the decision to provide Federal deposit insurance. It was not the intention, he said, that the Federal Reserve Act eliminate the dual banking system, that it was intended that it do away with the correspondent banking system, and that that was the issue involved in the question of uniformity of reserve requirement rather than the dual banking system.

Mr. Vardaman stated that he had reluctantly come to the conclusion that there should be some uniform statute, similar to the uniform negotiable instruments law, which would cover reserve requirements of State member banks and that in his opinion the American Bankers Association was the organization that should undertake to bring that about.

Mr. J. T. Brown suggested that the difficulty lay in the fact that the States were not interested in reserve requirements as an instrument of credit control but rather from the standpoint of the original purpose of bank reserves to insure the safety and liquidity of bank deposits. He felt that if the law could be changed so as to avoid using the Federal Reserve Banks as the sole depository for required reserves and permit State banks to carry their reserves with their correspondent banks a satisfactory solution would be found. He felt that such a plan would be acceptable particularly in States where it would effect a reduction in reserves required under State law.

Several of the members of the Board and Council questioned whether Mr. Brown's suggestion would be effective or acceptable, and President Brown stated that the question involved also the authority of the Board of Governors to change reserve requirements and that as long as the Board had that authority there would be objection to applying it to nonmember banks.

b. The authority of the Federal Reserve Banks with respect to industrial loans.

On March 11, 1947, the majority (with a minority dissenting) of the Council supported S. 408 with certain amendments but with the following qualification:

"The Council's support, with these amendments, of Bill 408 is given in the belief that some safety valve is desirable for emergency credit situations, and with the recommendation that the lending and guarantee powers of certain other government agencies, including the R.F.C., should be greatly curtailed, and in many instances should be terminated."

At the time of the above statement by the Council, Congress was considering a restriction of the lending and guarantee powers of the RFC to emergency situations. Subsequent legislation has continued the RFC with broad powers, and there is no present prospect of reducing these powers. The Council is opposed to two government agencies having lending or guarantee powers in the same field and therefore would not favor giving additional guaranteeing powers to the Federal Reserve Banks in the industrial field.

There was no discussion of this topic.

c. H. R. 5749, introduced in the House of Representatives by Chairman Spence on July 25, 1949, "To amend Section 9 of the Federal Reserve Act, as amended, and for other purposes." This bill, proposed by the Board, relates to capital requirements for membership and the establishment of branches by member banks.

The Council favors H. R. 5749.

President Brown stated that it was the view of the Council that the establishment of additional branches by State member banks should be within the authority of the Board of Governors.

6. <u>Plan for issuance and collection of postal money orders</u>.

The Board would like to have the views of the members of the Council on the proposal contained in the enclosed letter dated August 10, 1949, addressed to Mr. Leonard, Director of the Board's Division of Bank Operations, by Mr. Joseph J. Lawler, Third Assistant Postmaster

> General, outlining a plan which the Post Office Department has under consideration with respect to issuance and collection of Postal money orders. There is also enclosed a copy of a memorandum prepared by Mr. Leonard under date of August 11, 1949, regarding a meeting of representatives of the Post Office Department with members of the Board's staff at which the proposal was discussed.

> The Council favors the proposal relating to the issuance and collection of Postal money orders provided the Federal Reserve Banks are fully reimbursed for their total expense in handling these items including a reasonable amount for overhead.

President Brown stated that the Council realized fully that the plan if adopted would make postal money orders virtually the equivalent of cashier's checks and would deprive a number of small banks of revenue derived from such checks. The Council felt, he said, that the loss would not be serious and that, on the other hand, the banks would be spared the expense and difficulty of collecting money orders under the existing cumbersome procedure. He added that banks in small communities all over the United States were plagued by the fact that money orders received from their customers were very difficult to cash in the local post office and that while it was recognized that the plan would introduce a certain amount of competition between the post office and the commercial bank, it would increase the attractiveness of postal money orders and reduce the difficulties of banks and on balance would be desirable. The Council had suggested full reimbursement of the Federal Reserve Banks, he said, because it was felt that the Federal Reserve Banks should not be in the position of subsidizing the post office.

Mr. Vardaman said that President Brown's statement answered a number of questions which he had had about the proposal, but that he questioned whether the post office should be permitted to undertake what was essentially a commercial banking function. He preferred to see the postal savings system discontinued rather than to adopt the proposal under discussion and felt that if the plan were adopted it would result in the loss of income to small banks.

Mr. J. T. Brown stated that he had had considerable experience with the issuance of cashier's checks and the handling of postal money orders, that the present procedure with respect to these orders created many difficulties for banks, that it was clear that it would not be possible to abolish the use of money orders, and that, therefore, the proposed plan was a very satisfactory solution of the problem.

7. <u>Exemption of trust companies from bank holding company legislation.</u>

> Should the holding company bill not include an exemption for wholly-owned trust companies?

The Council believes that the holding company bill should be amended to exempt wholly-owned trust companies not doing a commercial banking business. Such an exemption would not interfere with the primary purpose of the bill.

In a brief discussion Chairman McCabe stated that while the proposal might open the door for requests for other exemptions, the Board of Governors was willing to accept the suggestion.

8. Authority of Federal Land Banks to Borrow from the Federal Reserve Banks.

> The question of the attitude of the Federal Reserve Board toward H. R. 5512 which would give the Federal Land Banks the power to borrow from the Federal Reserve Banks for one year at the Federal Reserve discount rate.

In the judgment of the members of the Council the provisions of H. R. 5512 would provide for an improper use of central banking facilities and are unsound. The adoption of such legislation would inevitably lead to pressure for similar privileges by other Government lending agencies. The Council would appreciate knowing the position of the Board on this bill.

Chairman McCabe stated that this bill had been recently transferred from the Committee on Agriculture to the Committee on Banking and Currency of the United States Senate and that the position of the Board on the matter was not greatly different from that of the Council.

Mr. Clayton traced the history of the bill and the consideration which the Board had given to it. He stated that the approval of the bill at this particular time would be a signal for requests for similar authority for other agencies of the Government and that for that reason the Board would oppose approval of the bill. If it should appear that it would be approved, he said, the Board would attempt to have it amended so as to require that any advances to Federal Land Banks be on the terms and at rates authorized for advances by the Federal Reserve Banks under section 10b of the Federal Reserve Act or at least on a basis which would require that loans to Federal Land Banks be not made on any more favorable terms than advances could now be made to member banks.

9. Deposit Insurance Coverage

> The Board has sent to the members of the Council a confidential staff study relative to deposit insurance coverage and the rate and base of deposit insurance assessments. The Board would appreciate the current views of the Council concerning any changes that should be made in deposit insurance coverage and the rate and base of deposit insurance assessments.

On May 17, 1949, the Council made the following statement to the Board of Governors regarding the subject of deposit insurance:

"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 percent;

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 percent 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."

The Council appreciates the opportunity it has been given to examine the confidential staff study, which the Council regards as an important contribution to the consideration of this subject. The Council also appreciates the interest the Board is taking in these phases of Federal deposit insurance which are of such vital importance to all banks. In the light of discussions now taking place among various interested groups, the Council does not at this stage of these discussions wish to commit itself to specific proposals. In the meantime the Council will give the matter further study.

President Brown stated that some members of the Council had received the staff memorandum only just before leaving for this meeting, that some did not receive it until they reached Washington, and that therefore they would like very much to have additional time in which to study it. He emphasized the Council's appreciation of the interest the Board had taken in this matter which was one of great importance to member banks. He said that the study contained a great deal of very valuable information but that the matter was being discussed by the Federal Deposit Insurance Corporation and others, and the Council did not feel that it should express its views until it had had an opportunity to study the suggestions contained in the staff memorandum further.

Chairman McCabe stated that copies of the memorandum had been sent to the Federal Deposit Insurance Corporation for comment and that the questionnaire sent out by the subcommittee of the Joint Committee on the Economic Report asked for views on this question. The answers to the questionnaire, he said, were to be filed not later than October 15, and it would be helpful if the comments of the Council could be received in time for consideration in that connection.

During the discussion, Mr. Eccles suggested that the Council appoint a committee to study the matter and submit its views to the Board.

President Brown stated that the Council would meet this afternoon to consider that suggestion.

In response to an inquiry from Mr. Odlin, it was stated that there was no intention to seek legislation on deposit insurance at the current session of the Congress but rather to prepare a program which would be introduced at the beginning of, and acted upon early in, the next session of the Congress.

President Brown stated that in the absence of objection, the next regular meeting of the Council would be held on November 13-15, 1949.

9/20/49

Thereupon the meeting adjourned.

S R Carpenter
Secretary.

Approved:

Thomas B. McCabe
Chairman.