Minutes of actions taken by the Board of Governors of the Federal Reserve System on Monday, April 11, 1955. The Board met in the Board Room at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Balderston, Vice Chairman
Mr. Szymczak
Mr. Vardaman
Mr. Robertson
Mr. Shepardson

Mr. Carpenter, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Thurston, Assistant to the Board
Mr. Riefler, Assistant to the Chairman
Mr. Thomas, Economic Adviser to the Board
Mr. Vest, General Counsel
Mr. Young, Director, Division of Research and Statistics
Mr. Solomon, Assistant General Counsel
Mr. Koch, Assistant Director, Division of Research and Statistics
Mr. Cherry, Legislative Counsel

There had been sent to the members of the Board prior to this meeting copies of a draft of letter to Mr. Roger W. Jones, Assistant Director, Legislative Reference, Bureau of the Budget, Washington, D. C., reading as follows:

> This is in response to your request of March 31, 1955, for the Board's views with respect to a legislative proposal "To amend the Federal Deposit Insurance Act to provide for the payment of Government's share of costs of civil-service retirement, employee compensation and unemployment compensation benefits . . ." and for other purposes.
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> Since the proposed amendments are concerned primarily with the internal accounting problems of the Federal Deposit Insurance Corporation and the method of financing certain benefits which are available to its employees, the Board has no comments to offer.

The draft of letter was accompanied by a memorandum dated April 8, 1955, from Mr. Young, Assistant Counsel, explaining the proposed amendments to the Federal Deposit Insurance Act, which were suggested by the Federal Deposit Insurance Corporation.

The letter was approved unanimously in the form set forth above.

Consideration then was given to a memorandum dated April 7, 1955, from Messrs. Solomon, Assistant General Counsel, and Young, Director, Division of Research and Statistics, copies of which had been sent to the members of the Board, discussing the effect of a more restrictive substitution and withdrawal rule in Regulations T, Extension and Maintenance of Credit by Brokers, Dealers, and Members of National Securities Exchanges, and U, Loans by Banks for the Purpose of Purchasing or Carrying Stocks Registered on a National Securities Exchange. The memorandum pointed out that under the present rule, in effect since May 1, 1949, a customer whose account is undermargined may switch securities without providing additional margin to bring the account up to 60 per cent, as currently required in a new margin account, or may withdraw 60 per cent of the proceeds from security sales in cash. Under a more restrictive rule, it could be required that the proceeds of sales in an undermargined account be applied to reduce the debit balance, or debt. Such a rule was in effect during the period from July 16, 1945, to April 1, 1948, and from the latter date to May 1, 1949, a modified rule was in effect which permitted substitutions in undermargined accounts on the same day. Assuming that average margins at the beginning of March 1955 were 55 per cent, the memorandum estimated that the potential amount of customers' debit balances that might be affected or "squeezed" by the more restrictive rule would be about $500 million. Attached to the memorandum were draft amendments which would apply a stricter substitution and withdrawal rule, these being in essentially the same form as those adopted in 1945 for the same purpose.

The memorandum also suggested that if the Board wished to adopt the suggestion of the New York Stock Exchange, which was discussed at the meetings of the Board on February 23 and March 7, 1955, that the maximum period for obtaining margin, as provided in Regulation T, be extended from three full business days to four full business days, the adoption of a tighter substitution and withdrawal rule might present an appropriate occasion to make the change.

Mr. Young made a statement in which he said that the suggestion for a change in the substitution and withdrawal rule, which would exert a little further restriction on the use of credit in the stock market, was submitted for the Board's consideration without staff recommendation. He pointed out that adoption of the stricter rule would place the Board in a position where, if a further increase in margin requirements appeared to be called for, the increase would not have to be so drastic as it would to obtain the same results with the present rule.

Chairman Martin inquired whether the suggested change had been discussed with the New York Stock Exchange or with a representative group of brokers, and Mr. Solomon responded that, while the technicalities of the draft amendments had been discussed with the staff of the Federal Reserve Bank of New York, the Board's staff had felt that it would not be appropriate to take up the question of a change in the rule with other parties in the absence of authorization from the Board. In reply to another inquiry by Chairman Martin, Mr. Solomon said that the substitution and withdrawal rule was the subject of considerable discussion with outside parties before the present rule was adopted. At that time, he added, the Board was interested in relaxation of the regulations and the change in the substitution and withdrawal rule was a move in that direction. Mr. Solomon also said that without question a stricter rule would involve some annoyance and inconvenience, both to brokers and to customers.

Chairman Martin then stated that he had been wondering whether it would be desirable for the Board to invite the New York Stock Exchange and the Association of Stock Exchange Firms to have representatives meet with the Board from time to time to discuss the effect of margin requirements and other provisions of the Board's regulations. It was his thought that, as in the case of Regulation W, Consumer Credit, and Regulation X, Real Estate Credit, it was important for the Board to have some contact on a regular basis with those affected by its regulations.

He suggested that, if the Board favored the idea, it might authorize him to get in touch with the two organizations which he had mentioned and try to work out the necessary arrangements. In further comments, Chairman Martin said his principal concern was that the Board should be informed as well as possible concerning the operating methods of brokers and dealers and the impact of its regulations on their operations.

The other members of the Board were unanimously of the view that it would be advisable to arrange meetings of the kind referred to by Chairman Martin. Questions raised were as to the frequency of such meetings and as to the possibility of obtaining the views of parties who would not be represented by the groups mentioned. With reference to the first of these questions, it was the consensus that the meetings ordinarily should be held twice each year, in the spring and in the fall, so that a request for a meeting would not be interpreted as indicating that some action on the part of the Board was under consideration and so that the meetings would not be too frequent to result in productive discussion. With regard to the second question, it was recognized that it would be very difficult to select any representative group from among elements that would not be covered through the two organizations mentioned. As a means of obtaining the views of bankers regarding Regulation U, the suggestion was made that the meetings with the Federal Advisory Council would provide an appropriate forum and that in proposing topics for discussion by the Council, the Board might suggest from time to time that it would like to have the Council's views with respect to margin requirements and related matters.

> At the conclusion of further discussion, Chairman Martin was authorized to contact appropriate persons connected with the New York Stock Exchange and the Association of Stock Exchange Firms with a view to exploring the possibility of arranging to have representatives of the Exchange and the Association meet with the Board in the near future for a discussion of the kind referred to at this meeting.

The discussion then turned to the question whether conditions in the stock market and in the economy were such as to warrant action by the Board at this time to tighten the substitution and withdrawal rule. Mr. Young cited statistics which indicated that customers' debit balances and brokers' loans had continued to increase substantially during the month of March, but that the rate at which credit was going into the market seemed to have slowed down slightly since the margin requirements were increased from 50 per cent to 60 per cent earlier this year. In other words, the increases in customers' debit balances and in brokers' loans, as well as in stock prices, were at a lower rate than in the last quarter of 1954 although at a greater rate than in preceding quarters.

Chairman Martin said that personally, with the margin requirements at 60 per cent, he would rather have a further increase in the requirements, if necessary, then to put into effect a tighter substitution and withdrawal rule, because of the operating difficulties that would be imposed on the affected firms and the elements of policing that would be involved. He felt that many firms would work hard to conform to the rule while others might tend to ignore it. Since the stricter rule had not been in effect for several years, he pointed out that a considerable amount of reorientation would be necessary.

Governor Szymczak said that in his opinion the tightening of the rule at this time would be helpful, with the economy at a high level and the possibility of a surge to a still higher level. Then, if necessary, margin requirements could be increased, and the increase would be more effective because the substitution and withdrawal rule had been tightened. He recognized, however, that the tightening of the rule would create difficulties for brokers and dealers and that the rule might be difficult to police.

Governor Robertson said he regretted that the rule was relaxed in 1949 since it seemed to him an appropriate way of making a selective credit control effective. However, since it had been changed, and in view of his belief that reliance should not be placed on selective controls ordinarily, he was inclined to doubt whether the rule should be tightened at this time. If necessary, in the light of developments in the economy, he felt that the Board should tighten its general credit controls to increase the cost of money and restrict its availability. It was his view that margin requirements should be kept on "almost an even keel", that their main purpose was to prevent unloading of securities, and that restrictiveness through general controls was the preferable method to employ when it became necessary to keep the economy from "running away".

Governor Vardaman expressed the view that if the substitution and withdrawal rule were to be tightened, that should have been done before the margin requirements were increased from 50 to 60 per cent. Although he felt that the rule should be changed before margin requirements were increased further, he thought it would be better not to tighten the rule until a time when margin requirements were at a lower level than at present in order to avoid, as much as possible, mechanical disruptions in the trade.

Mr. Solomon stated that, while changes in margin requirements are put into effect immediately, a change in the substitution and withdrawal rule probably should be preceded by some advance notice, perhaps ten days or two weeks, to allow affected parties to become acquainted with the new rule. On the other hand, he did not feel that it would be necessary to publish advance notice in the Federal Register and wait for the period prescribed by the Administrative Procedure Act. There was some discussion of this point but no conclusions were reached.

Chairman Martin then suggested that if the members of the Board so desired, there be further discussion of the substitution and withdrawal rule at another meeting of the Board.

Minutes of actions taken by the Board of Governors of the Federal Reserve System on April 8, 1955, were approved unanimously.

The meeting then adjourned.

Secretary's Note: The Office of the Comptroller of the Currency having advised by letter dated April 11, 1955, that on April 13, 1955, a call would be made on all national banks for reports of condition as of the close of business April 11, the usual telegram was sent today to the Presidents of all Federal Reserve Banks requesting that a similar call be made for reports of condition of State member banks.

S R Carpenter
Secretary