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 on Tuesday, May 17, 1955, at 10:30 a.m.

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

Mr. Carpenter, Secretary
Mr. Sherman, Assistant Secretary

Messrs. Ireland, Alexander, Mitchell, Denton, Fleming, Davis, Brown, Campbell, Ringland, Chandler, Matkin, and Wallace, members of the Federal Advisory Council from the First, Second, Third, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, Tenth, Eleventh, and Twelfth Federal Reserve Districts, respectively

Mr. Prochnow, Secretary of the Federal Advisory Council

Before the meeting the Council submitted to the Board of Governors a memorandum setting forth the Council's views on the subjects to be discussed with the Board at this joint meeting. The statement of the topic, the Council's views, and the discussion with respect to each of the subjects were as follows:

1. Consideration of the salaries of the Chairman and the members of the Board of Governors of the Federal Reserve System.

The members of the Council have on various occasions expressed themselves in favor of increasing the salaries of the Chairman and the members of the Board of Governors of the Federal Reserve System.

The Council again strongly urges that favorable consideration be given to this matter and has unanimously approved the following resolution:

> With the establishment of the Federal Reserve System in 1913 the Congress specified salaries for members of the Board which were equivalent to those of Cabinet members and in excess of those of members of the Congress. For a number of years that relationship prevailed. At the present time the salaries of members of the Board are materially below those of Cabinet officers and also below those of members of the Congress as well as of other government officials of less or no greater responsibility.
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> The Board of Governors has responsibilities of far-reaching importance to the nation's economy. The salaries of the members of the Board should more adequately reflect these responsibilities and should be made more attractive to persons with the highest qualifications.
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> An increase in the salaries of the members of the Board would also justify a much-needed revision upward in the salaries of the members of the staff in order to retain and attract persons of high competence.
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> The Council believes that legislation should be passed providing that the salary of the Chairman of the Board, who is its active executive officer, should be $22,500 annually, and that salaries of the members of the Board should be at least $20,000 annually.

President Brown stated that the question of Board members' salaries also had been discussed in the executive council of the American Bankers Association which also felt they should be increased. He felt there was some chance that the necessary legislation would be approved, in view of the recent action of the Congress in increasing salaries and other

forms of compensation for its members, and the Federal Advisory Council wished to take the action of indicating that it favored increases in Board members' salaries along the lines of the foregoing statement in order to be in a position to support legislation if it were introduced at this session of the Congress.

Mr. Fleming stated that he felt the chances of getting such legislation were good but that the question was one of timing, and he did not believe it would be desirable to introduce any bill calling for an increase in salaries of members of the Board until legislation relating to an increase in postal workers' salaries was out of the way.

Chairman Martin stated that the Board appreciated the willingness of the Federal Advisory Council to support such legislation if it were introduced.

2. H. R. 2643, introduced by Representative Patman on January 20, 1955, "To direct the Comptroller General to audit the Board of Governors of the Federal Reserve System, the Federal Open Market Committee, and the Federal Reserve banks."

The attention of the Council has been called to H. R. 2643, a bill "to direct the Comptroller General to audit the Board of Governors of the Federal Reserve System, the Federal Open Market Committee, and the Federal Reserve banks." The members of the Council are unanimously of the opinion that the auditing procedures suggested in H. R. 2643 are unnecessary, unwise, and contrary to the fundamental concept of the independence of the Federal Reserve System. The Council believes that the examination and auditing procedures of the Federal Reserve System should be set by the Federal Reserve Board. The Council has therefore authorized its officers to testify in opposition to the bill if it should come up for hearings in the Congress.

President Brown stated that the subject of auditing the Federal Reserve System had been discussed by the Council with a view to having an agreed position which would be taken by representatives of the Council on H. R. 2643 or a similar bill if it appeared that such legislation might receive active consideration.

Chairman Martin stated that H. R. 2643 had been referred to the Government Operations Committee of the House of Representatives which in turn had referred it to a subcommittee of which Mr. Mollohan of West Virginia was chairman, but that he understood no date had been set for hearings on the bill. He added the comment that the position adopted by the Council in opposition to this legislation would be very helpful.

3. The Board would like to have the comments of the members of the Council on the business and economic outlook throughout the spring and summer of the current year, and it would appreciate having the Council's views as to the probable demand for bank loans in that period compared with demand during the corresponding period of 1954.

Members of the Council report that business activity in general is at a high level in all twelve districts but with some variations from industry to industry and with some industries lagging behind. Consumer spending and construction are setting new records. In all twelve districts, the over-all economic outlook for the spring and summer months is good, and business sentiment is favorable, as reflected in plans for large expenditures for the expansion of plant and equipment.

Agriculture, with a decline in the prices of farm products and farm income, is an important exception to the broad upward trend in the economy. The outlook for farmers has also been adversely affected over wide areas by drought and freezes.

All members of the Council anticipate that there will be an increasing demand for loans in the months immediately ahead, and that the total volume of loans will be larger than in the corresponding period a year ago.

President Brown stated that in responding to similar questions regarding the economic outlook in the recent past one or more of the members of the Council had usually indicated that business conditions in their districts were not keeping pace with the national picture. At the present time, however, each member of the Council reported that industrial activity in his district was at a high level. President Brown noted that Mr. Denton in particular, but also some other members, called attention to the fact that while the general level of employment, production, and profits in industry is high, some of the smaller units are not sharing in the upturn in proportion to the over-all rise in activity — for example, units employing from 20 to 30 individuals do not seem to be getting proportionately the same level of activity or volume of sales that larger producing or retailing units are getting. Except for farming, President Brown stated, each member of the Council expressed the view that conditions favored a continuation of activity at high levels during the rest of this year. Since the meeting of the Council in February, evidence regarding plant expansion plans in the Chicago District had indicated a substantial increase in programs for capital outlays, he said, and he noted that in some cases such as in the steel industry plans involved construction that would run for periods of as much as two or three years. President Brown recalled that in February the Council felt that the high rate of activity in residential

construction might come to an early end. However, at the present time such activity is continuing to increase and all members of the Council now indicate that there is no sign of such activity dropping soon. Agriculture is the one exception to the general broad upturn in the economy, and there are some serious factors to be considered in that area such as low prices for grain feeds which are affecting farmers in the mid-West, the decline in dairy products prices affecting unfavorably producers in Minnesota, Wisconsin, and New York, and the drought in the Kansas City, Dallas, and San Francisco districts. He also noted that drought conditions in the Southeast had affected agriculture unfavorably during 1954 and this had been followed by a severe freeze early this year which had caused serious losses to fruit and vegetable crops. Over-all, however, the prospect is for a strong continuation of business activity and an over-all increase in production.

As to future demand for credit, all twelve members of the Advisory Council expected that there will be an increased demand for loans this year and that the total will rise during coming months as compared with figures a year ago. This demand has been quite general, President Brown said. There has been some increase in ordinary business loans, which had not been anticipated; consumer credit is rising, not only directly but to an important degree in loans to finance companies to assist them in extending consumer credit. Department stores and mail order houses also are borrowing

for the purpose of carrying the increased volumes of receivables they are getting and are confident they will continue to get. President Brown also noted the continued substantial demand for housing loans, not only for construction purposes but loans for mortgages on larger apartment houses, single residences, shopping centers, and other facilities that go along with the spread to suburban areas. There also has been expansion in industrial construction, and as a result there is a larger base which will require financing of additional construction over a period of years. There has also been some increase in loans on securities in New York.

Chairman Martin inquired as to the unemployment situation, whether it really was as laggard in the face of the upturn as some statistics indicate, and whether members of the Council felt that the Federal Reserve System might be looking for any fields in which it might assist in avoiding the kind of imbalance that occurred in the spring and early summer of 1953.

Mr. Denton said that in the Cleveland District there was little unemployment in the larger centers, but there were definite areas of substantial unemployment -- areas which were not sharing in the prosperity that was indicated by the total figures of production, which were very impressive. Many smaller concerns, he said, particularly foundries and smaller merchants in the outlying sections around larger cities, were not having the benefit of large trade that was appearing at downtown stores. Over-all, however, the situation was not bad, and Mr. Denton felt that where difficulties were being experienced by smaller concerns it was not the kind of

problem that resulted from a lack of credit. In fact, he had made certain through some of his checking that merchants were not failing to order or carry merchandise because of lack of credit; in some cases, merchants had large cash balances but were not buying additional inventories because they were not getting the sales in the relative volumes that were going to larger downtown stores.

Mr. Ireland said that in New England there were some distressed areas relating to the textile industry but that there was no lack of credit involved.

Mr. Campbell stated that there was unemployment in agricultural areas in the mid-West caused partly by reductions in acreage of cotton and rice under crop control programs. There was nothing which the Board or more credit could do toward solving these situations.

In response to a further question by Chairman Martin it was stated that there was little, if any, distress unemployment. President Brown said that in Illinois there was a good deal of unemployment or partial employment in the coal fields but that this was not a result of credit shortage, that coal was being replaced by oil and natural gas, and that the dieselization of railway locomotives was a further factor reducing demand for coal. The answer to that situation would seem to be that people should shift into other lines of work, and some of this is taking place. President Brown also noted that there was unemployment in some cities where agricultural implements were produced although the implement industry was producing at

a much higher level this year than a year ago. Railroad car building is another industry that is quite depressed because of lack of orders.

Governor Balderston inquired whether there was evidence of imprudence in borrowing, such as for the purpose of carrying inventories.

President Brown responded that he saw no evidence of building inventories. Production of almost everything is such that it is not necessary to accumulate inventories against possible shortages. There was some over-optimism in the building industry, particularly in the case of houses coming within the VA 100 per cent guarantee and the FHA 90 per cent insured loans, but he did not know whether that should be called imprudent borrowing.

Mr. Alexander stated that he was not aware of any excessive inventory accumulations. He believed that the over-all figures showed some increase, but on the whole business inventories were not very large. Banks were being besieged by finance companies for more credit and some were getting more credit, he said, and they in turn were lending to consumers and the terms were getting somewhat easier. There had been a very large growth in consumer credit in the last couple of months, Mr. Alexander said, but he was not sure whether such loans were being overdone. In the mortgage business, loans continued to grow. Mr. Alexander also commented on the position of insurance companies and the procedure whereby mortgage loans are placed through mortgage bankers or brokers, noting that some insurance companies have cut down on their commitments to brokers to buy mortgages from them. Some of the brokers have exhausted their commitments from insurance companies

to buy mortgages, and the brokers are asking banks to help them in carrying mortgages for which they in turn have made commitments. Mr. Alexander thought the banks were watching this carefully. In the New York area, there is also a great deal of defense business. Defense spending seems to have levelled off nationally, and Mr. Alexander thought that the number of persons employed in defense industry in the New York area probably had declined, perhaps partly because of shifts to other areas and partly because of greater productivity. He said that he knew of no unavailability of credit to any productive enterprise, and that he was glad the finance companies were not getting all the credit they asked for.

Governor Robertson inquired whether Mr. Alexander felt concern regarding the stretch-out of terms in the consumer credit field.

Mr. Alexander responded that he was concerned but that persons in the finance business in whom he had confidence did not seem to be so concerned. On the basis of delinquencies and repossessions, they felt they had no significant worries; some were setting up additional reserves to protect from losses in the case of individual dealers, but the people who had had long experience in that type of financing felt that the industry was still being "prudent". Mr. Alexander continued, in response to a further question from Governor Robertson, by stating that the stretching of terms (both lengthening of maturities and lowering of down payments) was taking place for the purpose of selling automobiles. However, he was not sure that this was resulting in "borrowing from the future". Mr. Alexander described

the reasoning which made persons in the business feel that the strong demand for automobiles might continue, adding that for his own part, he was not certain that the demand was not going to keep pace with high production. In response to an inquiry from Governor Vardaman, Mr. Alexander said that he thought commercial banks often were requiring an additional reserve against possible bad debts, that this was good from the standpoint of protecting the loans, and that he felt that finance companies in general were watching carefully to see that equities on the part of purchasers resulted.

President Brown commented on loans to finance companies, stating that he did not feel there was any particular credit risk involved on the part of either the larger or the smaller companies because of the stretching of terms. Some companies went to the market for funds, others obtained them from banks, and bank loans to finance companies could be increased by large amounts if the banks were willing. In his case, however, President Brown stated that he did not feel that further increases in such loans were desirable at this stage.

Mr. Matkin stated that in the Dallas District, there was no unemployment problem so far as he had been able to discover. The greatest problem in that district was the drought. Portions of the Dallas District have been suffering from drought for ten years, and to some extent they were getting used to that situation. However, there had been some relief in parts of the district this year. As to terms on instalment credit,

Mr. Matkin felt that in the Eleventh District finance companies were the leaders in easing terms, and that the banks were losing some of that business because of unwillingness to grant terms as liberal as those of finance companies.

Mr. Ireland commented that in New England the reverse was the situation, that the banks seemed to have gone further than the finance companies in extending terms on instalment credit contracts, and that recently the Federal Reserve Bank of Boston had been prompted to send a circular letter to all member banks cautioning them in connection with consumer instalment loans.

Mr. Chandler stated that in the Tenth District there was no unemployment problem. This reflected to some extent a movement of population from farms to cities as well as shifts from smaller to larger farm units which could be operated with fewer numbers of persons. In the cities, there were occasional spots of unemployment but this was of minor consequence, taking the district as a whole. The district had suffered from drought this year except in Nebraska and Mr. Chandler looked for the winter wheat crop to be only about half of normal, noting that ordinarily the Tenth District produced approximately 2/3 of the winter wheat grown in the United States.

Mr. Davis stated that in the Atlanta District there was no unemployment and that figures of employment in cities were at the highest levels on record. The complaints in the rural areas came from the drought last year and the freeze this year which did a tremendous amount of damage.

However, this was not a problem which credit would solve. Credit was available and for the most part farmers had ample resources on which to justify credit if they needed it or felt they could use it.

In response to a question from Governor Vardaman, President Brown stated that sales of farm implements last year were extremely depressed. There had been a substantial rise in output and sales of farm implements this year but they were still below normal.

Mr. Denton described recent comments of one of the larger steel producers in the Cleveland area who indicated that his firm was giving some weight to the probable increased demand for steel from the agricultural implement industry as a factor that might help to alleviate and offset a shrinkage in demand for steel from the automobile industry later on this year.

4. In addition to the views of the Council on the general business situation, the Board would be interested in having the Council's views as to the effects of System credit policies since the last meeting of the Council and whether these policies should be changed in any way in the light of the business and economic situation during the near term.

The effects of System credit policies since the last meeting of the Council have been good. The Council believes that a policy of mild credit restriction should be continued for the near term if business continues to be buoyant.

Government financing for new money in substantial volume is inevitable in the last half of the calendar year. If, as seems probable, the banks must provide a considerable part of the new money required, and if business continues at a high level with

an increasing demand for bank loans, the System must be prepared through open market operations or a reduction in reserve requirements, or both, to put more reserves into the banks. In view of the increasing activity of business and of the probability of an increase in loans in the months immediately ahead, it may become necessary to consider raising the rediscount rate. The use of the discount window by member banks should not be restricted or discouraged, as credit for good borrowers should continue to be available at reasonable rates.

President Brown commented on the prospective needs of the Treasury for funds during the remainder of 1955, stating that it looked as though the Treasury would need to obtain from $9-1/2 to $10 billion in the last six months of the year and that probably $4 or $5 billion would be sought during July or early August. That demand would come at a time when demand for bank loans would increase markedly. If it was necessary to finance the Government deficit and take care of additional private demand for credit at the same time, it seemed self-evident, President Brown said, that additional reserves must be provided either through open market operations or a reduction in reserve requirements. President Brown said that no member of the Council would favor an increase in the discount rate at the present time. However, if business continued buoyant and particularly if it should be effervescent, it might be desirable to check the growth through an increase in the rediscount rate. All members of the Council felt very strongly that the use of the discount window should not be discouraged as it was in early 1953, at which time there was a feeling that banks could not get money to satisfy legitimate demands. That feeling had caused great apprehension, President Brown said, and in his opinion had caused injury to the

economy at the time. The present attitude seemed to be that there was no objection to use of the discount window although that did not mean that a bank should stay continuously in debt. Use of the discount window by banks would seem to be desirable; that was a method which would provide the System with orderly information as to the demand for credit, and if it appeared that too much use was being made of the facility the answer would be an increase in the discount rate.

Chairman Martin said that the System faced a very difficult period, one which all persons who were connected with the System should study carefully. The problem the Treasury faced in its last financing also had been a difficult one, coming at a time of rising interest rates. He added that we are now in a period when the Treasury is going to need more money and that President Brown had outlined very clearly the problem to be faced during the next few months. He went on to say that some of the members of the Board were apprehensive about using a reduction in reserve requirements at a time when business continued buoyant because of the difficulty of explaining such action. While the present situation would create some problems for credit policy, and would require a good deal of thought, Chairman Martin doubted that it was any more difficult than in other periods that the System had faced. Chairman Martin expressed the view that the forces of supply and demand operate toward higher rates because a rise in interest rates was a normal factor in improving business. He reiterated the view that the members of the Board, the members of the Council, and the members

of the Government Borrowing Committee which met with the Treasury in connection with financing, should study the problems of the difficult July period and the rest of this year very carefully.

Mr. Fleming said that he thought the situation was not acute as far as the June, July, August period was concerned, but that Treasury financing would be a delicate operation. Insurance companies were finding it necessary to ask their agents to arrange with banking institutions to carry their commitments on mortgage loans. There is no long-term money available from insurance companies at the present time -- even a 3-1/4 per cent long-term issue would not bring out much, in Mr. Fleming's opinion. He hoped that the Treasury would call a meeting of the Government Borrowing Committee soon after June 15 so that plans for the financing could be made well in advance of an announcement of the offering.

President Brown said that the Council did not know what the future of interest rates would be but that, as he had mentioned earlier, none of the members favored an increased discount rate at the present time. However, all talk of any drop in the prime rate had disappeared. The Treasury naturally did not like higher interest rates, he said, but if business is buoyant and boiling perhaps higher interest rates represented the only way to hold the economy in healthy restraint.

Mr. Fleming said that an indication of the necessity for careful planning of the next Treasury offering was given by the attrition of 33-1/3 per cent on the recent exchange offering of 2 per cent, 15-month

Treasury notes. This was similar to the experience in June 1953 when interest rates had risen sharply.

Mr. Alexander said that if the Council's guess as to demand for credit was right, and recognizing that the Treasury had to have money in order to pay its bills, that industry had to have credit with which to carry on its activities, and that consumers required funds for financing the sustained higher level of demand, then it would seem clear that the different borrowers would just have to pay more for some of the money they get. Mr. Alexander also commented on the practical aspect from the standpoint of a bank which received a Treasury announcement such as that for the recent financing, where a bank had to decide within a space of a weekend what its subscription would be. If banks had no excess reserves, as was the case with many of them at the present time, and recognizing that the "color" of banks' portfolios had changed considerably in the last six months, the practical problem was how the bank would put up the reserves to pay for a subscription to a Treasury offering. Mr. Alexander described the shift in bank investment portfolios in recent months from a point where the individual bank's account showed a profit to one where it was either in the red or showed less profit, reflecting the rise in interest rates. He also referred to the prospective increase in demand for bank loans from commercial customers who expected to be taken care of by their banks as a means of continuing production and enterprise. Mr. Alexander recognized that at the same time the Treasury had to have funds and his only answer was that the

Treasury would have to make its offering more attractive; since it appeared that a considerable part of any Treasury financing would have to be supplied by banks, the tendency would be for further increase in interest rates generally. This he did not feel was anything very bad, adding that if the economy was working, it was not depressive to have somewhat higher rates. Whether the necessary reserve funds would be supplied to the banks through open market operations or whether there could be a nice meshing of a reduction in reserve requirements such as had taken place in 1953 and 1954, Mr. Alexander could not say, except that he thought the Federal Reserve had meshed the reductions in reserve requirements with Treasury needs in both 1953 and 1954 very carefully and precisely. Obviously, however, such action would be a design to fit the needs of the Treasury. The System could not get away from the actuality that needs of the Treasury and credit policy had to be synchronized. While this would be a delicate period, Mr. Alexander thought that it would mean only a somewhat higher cost to the Treasury and to other borrowers. If the additional reserves (whether provided through open market operations or otherwise) were tailored to fit the Treasury needs and no more, Mr. Alexander felt the operation could be handled very successfully. He felt that a large part of the offering would have to be of very short maturity. Summing up, he felt that this was a good clear-cut orthodox problem for the Federal Reserve, and that it would be most interesting to see how the Federal Reserve would handle it.

Mr. Mitchell thought it would be difficult to sell securities with a maturity longer than one year. In connection with this comment, there was a discussion of the advice given to the Treasury concerning the recent financing after which Mr. Denton said that he was impressed by the fact that banks in the Cleveland District were in no position to participate in any long-term financing that might be offered by the Treasury. Many mortgage bankers in Ohio and Western Pennsylvania, he said, were coming to commercial banks to get help in carrying mortgage loans against commitments that had been made by the mortgage brokers, but which were not being taken up by insurance companies.

President Brown said that he knew of no bank in the Chicago area whose Government portfolio was equal to its amortized cost. Most of the banks had shown very severe declines in the last year. With the losses that now showed on their books in their bond accounts, they simply would not buy any quantity of intermediate-term bonds. It was President Brown's opinion that if the money were to be obtained by the Treasury to meet its needs later this year, it would have to be in very short-term securities.

Chairman Martin stated that he would appreciate receiving any comments which the members of the Council might wish to make in connection with this problem in the next few weeks, and he asked that any of the members feel free to call him or other members of the Board on the telephone if suggestions occurred to them as they studied the problem further. Chairman Martin also stated that there was a very real public relations problem

involved in the Treasury financing, that the informed public was one thing and that the general public was another. He did not think this problem should be minimized, adding that psychology played a tremendous part in the success of a Treasury offering.

President Brown then inquired whether the Treasury had indicated its plans for requesting an increase in the public debt limit, and Mr. Fleming stated that he understood the Treasury wished to have an opportunity to sum up its figures on receipts and disbursements for the entire fiscal year which would mean delaying the presentation of a request to Congress until some time after mid-June. President Brown commented that this timing would make the financing difficult.

5. The Board would appreciate receiving the Council's views as to whether a change in the substitution rule under Regulations T and U, to require that proceeds of sales in under-margined accounts be applied to reduce the debit balance, would be desirable or undesirable.

The Council is unanimously of the opinion that it would be undesirable at present to change the substitution rule under Regulations T and U.

President Brown said that the Council was unanimous in feeling that no change should be made at this time in the substitution rule. The Council did not feel that the practical effect of a change would be very great in the case of loans on securities at banks. After commenting on his understanding of why Regulation U relating to banks was similar to Regulation T relating to brokers and dealers in securities, President Brown said that

while the Council felt certain that the volume of credit extended by banks for purchasing or carrying securities would not be reduced substantially by a change in the substitution rule, the Council was not in a position to express an intelligent opinion as to how a change would affect brokers and dealers in securities. However, the Council noted that the existing rule had been in effect for over six years, that it was understood by brokers and their customers alike, and that it was not desirable to make a change in the substitution rule, particularly since it probably would not have a very great effect in reducing the amount of credit being used to carry securities. President Brown went on to say that members of the Council had noted the rise in stock market prices over the past year, that they realized many individuals were borrowing on life insurance or otherwise taking money out of savings in order to carry securities, and that the Council felt the recent action of the Board in increasing margin requirements to 70 per cent was desirable. It was his view that the more recent break in securities prices also was a healthy thing.

Governor Szymczak stated that the more holders of securities could deal in undermargined accounts the more transactions would take place and move up prices of securities. He recalled that a very tight substitution rule had been in effect from 1945 to 1948 and commented that the higher the level of margin requirements, the more difficult it was to tighten up credit in the securities market under the existing substitution rule.

President Brown stated again that all members of the Federal Advisory Council felt that the recent increase in margin requirements was desirable and that they also favored the recent increase in discount rates at the Federal Reserve Banks.

6. The present policy of the Board is to make a determination with respect to whether there is a payment of interest on demand deposits under Regulation Q only after development of all pertinent facts through an examination. The Board would appreciate having the Council's views as to whether various practices being followed by banks result in a substantial noncompliance with the intent of the law or the regulation, and what, if any, changes in Board policy or in the law might be desirable?

The Council believes that member banks generally seek to and do obey the intention of Regulation Q. As the Board memorandum states, "there appears to be no completely satisfactory way of handling questions as to what constitutes an indirect payment of interest" against the intent of the law.

Of the possible alternatives which the Board has presented in its memorandum, the Council favors Paragraph (2), page 5 of the memorandum, with an amendment in the language to read as follows:

> The Board should adopt a policy to the effect that the legal prohibition against indirect payments of interest is "self-policing"; that each member bank, therefore, has the responsibility of determining whether its practices conform to the law; but that the Board, through bank examinations, will be alert to obvious violations and in such cases take steps to enforce the law.

The Council believes that it is unwise to publish the Board's findings in individual cases, or to publish in detail practices the Board considers contrary to the intent of the law. Factual situations are almost never completely identical. Such publication would cause confusion in the minds of bankers and increase the difficulties of administration.

The Council does not believe any change in the law affecting member banks is desirable.

President Brown made a statement to the effect that the basic problem in this matter was the law, that basically a bank pays interest when it performs a service for a depositor, and that the banking system was built on the theory that the cost of services rendered for a depositor would be offset by the earnings on the customer's deposit. He brought out the difficulties of making clear-cut distinctions as to whether services rendered were or were not contrary to the spirit of the existing law and regulation. He stated that Congress had never intended to prohibit the performance of usual banking services as distinguished from paying interest. Also, as a matter of practical bank operations the variation in rates charged different customers was a reflection of the value placed upon their accounts by the bank and this was a factor which was frequently taken into consideration in granting a loan and setting the rate of interest on that loan, including requirements as to the balance the borrower would have to maintain. President Brown stated that the difference in practices between member and nonmember banks with respect to the absorption of exchange charges was unfortunate and that the Council was disappointed to learn that the Board of Directors of the Federal Deposit Insurance Corporation was not now disposed to modify the position that that corporation had long taken as to what constituted a payment of interest. He also made the statement that in his opinion the problem of absorption of exchange constituted most of the difficulty of administering Regulation Q. However, the Council felt that endless confusion would be caused by any statements

which might be issued by the Board attempting to publish in detail practices which the Board considered contrary to the intent of the law.

Mr. Ringland inquired whether in the opinion of the members of the Board the present law was being violated seriously or frequently, indicating that it was his understanding that most of the complaints regarding violations of the Board's present regulation related to absorption of exchange.

Governor Robertson stated that he agreed with the general statement made by President Brown as to the nature of the problem and that the absorption of exchange was one of the big problems. He saw no solution to that problem and felt that member banks were penalized at the present time by the differences in rules on absorption of exchange by the Board of Governors on the one hand and the Federal Deposit Insurance Corporation on the other hand. Speaking more broadly, Governor Robertson felt the existing statute was unenforceable. It was impossible to determine what constituted a payment of interest "directly or indirectly" or to state in advance what practices would be objectionable and what would not. He had no recommendation as to how the problem could be solved. The Board is not now in a position to say in advance what will constitute a payment of interest, and it could only state that it would take a look at all the facts and circumstances at the time of an examination of the bank. Governor Robertson reiterated that he had no reason to differ with the conclusion reached by the Council and set forth in their memorandum and in President Brown's statement.

Mr. Ringland said he was also particularly concerned about the problem because in the Minnesota District a large proportion of banks did not pay checks at par.

Mr. Davis stated that he felt most banks attempted to observe the spirit of the Board's regulation. In any event, he felt the problem was a self-limiting one and he was convinced that if the Federal Reserve and national bank examiners were to bring to the attention of the directors and management of member banks any violations of what they felt to be the terms or spirit of Regulation Q, emphatically indicating disapproval of these practices, such procedure would go a long way toward stopping the undesirable practices. In any event, he felt that only a minor percentage of bankers were foolish enough to lend money at "no interest" rates or at rates so low as to amount to no-interest in order to get balances. There was a point of saturation for such practices, and Mr. Davis was inclined to think that it was near at hand and that competitive practices which brought attention to the problem at this stage would run their course. He stated that in the case of his bank, balances had been lost because it would not engage in some of the practices amounting to an indirect payment of interest but that the bank had found it could survive. He did not think that the subject need give the Board or the banking system too much concern because in his view it was a self-limiting practice.

Chairman Martin repeated his earlier invitation for members of the Council to call him or other Board members on the telephone in order to

pass along any ideas they might have on the current problems of Treasury financing and credit policy.

President Brown stated that the next meeting of the Council would normally fall on Sunday, September 18, and that the joint meeting with the Board would be on Tuesday, September 20, if that was agreeable to the Board.

Chairman Martin responded that while he expected to be out of the country at that time he knew of no reason why the meeting should not be held on the regularly scheduled date and that either he or Vice Chairman Balderston, as well as other members of the Board, would be present.

Thereupon the meeting adjourned.

Secretary