

MINUTES OF THE
EXECUTIVE COMMITTEE OF
THE FEDERAL ADVISORY COUNCIL.

May 15, 1916

A meeting of the Executive Committee of the Federal Advisory Council, called by the President, was held in the Federal Reserve Board room in the Treasury department, Washington, D.C., Monday, May 15th, 1916, at 11 A. M.

Present Messrs. James B. Forgan, presiding, L.L.Rue, D.C. Wing, J.P.Morgan, W.S.Rowe, and Merritt H. Grim, Secretary.

Minutes of meetings of the Executive Committee held on February 14th and 15th, 1916, copies of which had been sent to members were approved.

The Chairman stated that he had written Governor Hamlin of the Federal Reserve Board on April 14, 1916, asking him to submit any questions the Board wanted the Council to consider at its meeting of 16th inst., that Governor Hamlin had replied he would call his letter to the attention of the Board, and that subsequently he had received the following letter from Vice-Governor Delano, dated April 22, 1916, suggesting subjects for consideration:

"My dear Mr. Forgan:

I have been endeavoring to think up subjects for the next meeting of the Advisory Council, but thus far have not thought of any particularly good ones.

However, I might mention again that we always desire to hear from the Advisory Council its suggestions as to discount policy.

Another subject which occurs to me as worth considering and entirely in line with the objects sought to be attained in the appointment of an Advisory Council might be phrased in this way:

"Presumably members of the Advisory Council hear many criticisms of the Federal Reserve Act and of the Federal Reserve Board. To what extent have these criticisms been substantive, constructive, or suggestive, and to what extent does the Advisory Council endorse and approve them?"

Another subject which I think might be of interest is that which is referred to in a speech by Mr. Lynch, of San Francisco, delivered at Pasadena on the 3rd Day of March, of which I send you herewith fourteen copies, on the subject of pyramiding deposits by reason of inter-bank deposits.

Should the Federal Reserve Board seek to stop this? To what extent should reserves carried against bank deposits be greater than reserves carried against individual deposits? Federal Reserve Banks are required to carry 35% reserve against bank deposits, whereas, the large commercial banks are required to carry only 15% to 18%.

Still another subject: What is the opinion of the Council as to the exceedingly low rates that prevail in the matter of bankers' acceptances?

As any other subjects occur to me I shall be glad to communicate with you.

Yours very truly,
(Signed) F A Delano,

Vice Governor.

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The chairman stated that the question in regard to the Federal reserve bank's discount policy in its relation to existing business conditions in the various districts should be answered individually by each member of the Council for his own district at the joint session with the Federal Reserve Board. This was agreed to.

The Executive Committee then proceeded to formulate tentative answers to the questions suggested in Mr. Delano's letter to be recommended to the Federal Advisory Council at its meeting on the 16th.

The Executive Committee at the suggestion of Mr. Forgan also adopted a recommendation to the Council in connection with the Interstate Commerce Commission's tentative draft of rules governing competitive bidding required under Section 10 of the so-called Clayton Anti-Trust Act, approved Oct. 15, 1914, which section goes into effect on Oct. 15, 1916, to accompany the Council's answers to the questions submitted by the Federal Reserve Board.

The chairman laid before the Executive Committee the following question just received from the Federal Reserve Board:

"Question:

The investments of the Federal reserve banks have reached now the amount of \$164,500,000; the percentage of cash against deposits and note liability is now about 69.8%.

"A further instalment of about \$50,000,000 is due on May 16th and will somewhat increase this percentage.

"It would be interesting for the Federal Reserve Board to have the Advisory Council give its opinion as to the advisability of the Federal Reserve Board's now adopting a definite policy as to a minimum percentage of cash reserve to be maintained by Federal reserve banks -- a percentage which of course would have to be adjusted from time to time according to conditions. If the Advisory Council should favor the adoption of such a policy, what would be its idea as to the proper percentage to be applied under present conditions? Should there be a different percentage in the various districts? Should Federal reserve banks amongst each other adjust deficiencies against these reserves by rediscount operations, or should the average percentage of all banks combined be considered the basis and rediscount transactions become necessary only when Federal reserve banks reach the limit provided by the law of 40% or 35% respectively?"

The Executive Committee then adjourned for luncheon to meet at 3 P M.

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OF THE FEDERAL ADVISORY COUNCIL

May 15, 1916.

The Executive Committee met at 3 P. M., all members being present.

Consideration of the last question submitted by the Federal Reserve Board was resumed and after a full discussion of it, on motion of Mr. D. G. Wing, seconded by Mr. W. S. Rowe, Mr. J. B. Forgan was requested to prepare an answer embodying the views as expressed by the members of the Committee.

The Committee then adjourned until 9:45 A. M. Tuesday, May 16, 1916.

MINUTES OF THE EXECUTIVE COMMITTEE

May 15, 1916.

The Executive Committee met at 9:45 Tuesday, May 16th, all members being present.

Mr. Forgan read his proposed answer to the last question submitted by the Federal Reserve Board and on motion it was unanimously adopted as the Executive Committee's tentative answer to the question to be recommended to the Federal Advisory Council.

The time having arrived for the convening of the Federal Advisory Council the Executive Committee adjourned.

MINUTES OF THE
FEDERAL ADVISORY COUNCIL

May 16, 1916.

A statutory meeting of the Federal Advisory Council was held in the Federal Reserve Board room in the Treasury department, Washington, D. C., Tuesday, May 16th, at 10 A. M.

Present: Messrs. James B. Forgan, presiding, L. L. Rue, J. P. Morgan, W. S. Rowe, J. W. Berwood, Charles A. Lysterly, F. O. Watts, C. T. Jaffray, T. J. Record, Herbert Fleishhacker, D. G. Wing, and Merritt H Grim, Secretary.

Absent: Mr. E. F. Swinney.

The credentials of Mr. F. O. Watts, of St. Louis, dated April 13, 1916, to represent Federal Reserve District No. 8, on the Federal Advisory Council, were read and placed on file.

The minutes of the Federal Advisory Council of February 15th and of the Executive Committee of February 14th and 15th, 1916, copies of which had been sent to the members, were approved.

The President stated that he had written Governor Hamlin of the Federal Reserve Board on April 14, 1916 asking him to submit any questions the Board wanted the Council to consider at this meeting; that Governor Hamlin had replied he would call his letter to the attention of the Board, and that later he had received a letter from Vice Governor Delano, dated April 22nd, suggesting several subjects for consideration, a copy of which had been sent to each member of the Council. (A copy of Mr. Delano's letter will be found in the minutes of the Executive Committee of May 15th.)

Mr. Forgan suggested that each member should informally report to the Federal Reserve Board on business conditions in their relation to the discount policy of the Federal reserve bank in his own district, at the joint session which had been arranged for 12 M if the Council should be ready at that hour. This was agreed to.

The questions submitted by the Federal Reserve Board were then considered along with the tentative answers prepared by the Executive Committee. The following statements were then formulated and unanimously adopted as the Federal Advisory Council's answers and ordered submitted to the Federal Reserve Board:

Question:

Presumably members of the Advisory Council hear many criticisms of the Federal Reserve Act and of the Federal Reserve Board. To what extent have these criticisms been substantive, constructive or suggestive, and to what extent does the Advisory Council endorse and approve them.

Answer:

The Council has heard no vital criticisms of the Federal Reserve Act beyond such as have been referred to by the Federal Reserve Board in its annual report to Congress and no criticisms of the Board which seem worthy of discussion.

Question:

Should the Federal Reserve Board seek to stop the pyramiding of deposits by reason of inter bank deposits? To what extent should reserves carried against bank deposits be greater than reserves carried against individual deposits?

Answer:

Under our system of banking it is practically impossible to prevent the pyramiding of bank deposits. Each individual bank for its exchange purposes finds it necessary to keep funds at its credit in the principal centers with which its locality has direct business dealings. Quite naturally when it lacks a sufficient local demand to employ its funds it accumulates them with its correspondents at these centers. Generally speaking these centers are the so-called reserve cities. The banks in these cities need funds for the same purpose in the larger centers now known as central reserve cities, two of which - Chicago and St. Louis-- must of necessity maintain large balances in New York. In this way when money becomes redundant, idle funds are passed along from the numerous country banks to the less numerous reserve city banks and from them to the central reserve city banks finally reaching the banks of New York, which thus become the reservoirs for the bulk of the idle funds of the entire banking system. For sometime money has been quite redundant over a large part of the country and this pyramiding process has become intense, causing inflation of bank deposits at the centers with a corresponding expansion of loans and a demoralization of interest rates.

Under the national banking system prior to the passage of the Federal Reserve Act the double or triple reckoning of bank deposits as legal reserves formed the greatest evil of the pyramiding process. By providing that no bank deposits other than those with the Federal reserve banks shall be available as legal reserves and by providing the member banks with the facilities offered by the Federal Reserve banks

for rediscounting and supplying circulation the Federal Reserve system has greatly reduced the danger of this unavoidable pyramiding process and will tend to reduce it in volume.

The banks in the present reserve and central reserve cities will undoubtedly continue to carry bank deposits after they cease to act as legal reserve agents and for this reason doubtless they are required by the Federal Reserve Act to maintain larger legal reserves than the country banks. The expectation that they will thus continue to receive bank deposits affords the only reason for this requirement and we believe that the 15% and 18% legal reserve now respectively required of them will be found adequate under the new system.

Inasmuch however as under the Federal reserve system the banks in these so-called reserve cities are to lose their privilege of acting as legal reserve agents for the country banks and as the banks in many cities which have not been designated as reserve cities accept bank deposits and offer special inducements to attract them, it would seem equitable, conservative and proper that all banks receiving bank deposits should be required to maintain a minimum legal reserve against them of 15%.

Question:

What is the opinion of the Council as to the exceedingly low rates that prevail in the matter of bankers' acceptances?

Answer:

The market rates for bankers' acceptances have been regulated largely by the rates current in New York on call loans and bank deposits. Prime bankers' acceptances have already come to be regarded as a new form of secondary reserve of unusual efficacy, being readily convertible into legal reserve by disposing of them to the Federal reserve banks. Banks having surplus balances in New York or idle funds beyond the limited amount on which their New York correspondents will pay them 2% interest have been willing to take prime bankers' acceptances maturing within ninety days at rates only fractionally above the 2% paid on their bank balances. This is the competition met by the Federal reserve banks in purchasing them on the open market, and explains their making a minimum rate for them of 2%, which practically established that as the market rate for all acceptances coming within their legal requirements. When conditions change and money becomes less redundant this competition will be greatly reduced if not practically eliminated and the Federal reserve banks should then raise their minimum rate for them. Under normal conditions for the protection of "dollar exchange" the discount rates prevailing in the leading foreign money centers for similar acceptances payable in sterling or other foreign currencies will have to be considered in fixing the Federal reserve banks' discount rates on prime bankers' acceptances. The rate will be regulated by the law of supply and demand.

Question:

The investments of the Federal Reserve banks have reached now the amount of \$164,500,000; the percentage of cash against deposits and note liability is now about 69.8%.

A further instalment of about \$60,000,000 is due on May 16th and will somewhat increase this percentage.

It would be interesting for the Federal Reserve Board to have the Advisory Council give its opinion as to the advisability of the Federal Reserve Board's now adopting a definite policy as to a minimum percentage of cash reserve to be maintained by Federal Reserve banks -- a percentage which of course would have to be adjusted from time to time according to conditions. If the Advisory Council should favor the adoption of such a policy, what would be its idea as to the proper percentage to be applied under present conditions? Should there be a different percentage in the various districts? Should Federal reserve banks amongst each other adjust deficiencies against these reserves by rediscount operations, or should the average percentage of all banks combined be considered the basis and rediscount transactions become necessary only when Federal reserve banks reach the limit provided by the law of 40% or 35% respectively?

Answer:

In view of the present unsettled conditions of international monetary affairs produced by the European war and the plethora of money and expansion of credit prevailing in this country due very largely to the same cause, we are of the opinion that the Federal reserve banks should conserve their cash resources and run strong in their cash reserves. We are not however prepared to name a definite minimum percentage of cash reserves that could be made applicable to them all. Discretion should be exercised in the case of each. A bank with its portfolio well filled with prime bankers' acceptances, which can be relied upon to liquidate themselves as they mature, especially when they are made available as a basis for the issue of Federal reserve notes, might legitimately encroach upon its cash reserves to a greater extent than a banks having its portfolio filled with the ordinary run of rediscounted paper. Under present conditions the cash reserves of the Federal reserve banks can most readily be regulated and controlled through their open market transactions. Should any of them through their transactions in the open market reduce their cash reserves to a point which in the judgment of the Federal Reserve Board approaches too close to the minimum legal limit, they should be required to raise their rates on such transactions, abandon them entirely or arrange with the other Federal reserve banks not similarly situated to relieve them of some of their bankers' acceptances, municipal warrants or other open market purchases.

In our opinion the average percentage of cash reserves carried by all the banks combined reveals the strength of the system and compulsory rediscounts between the Federal reserve banks should be resorted to only when any of them, through rediscounting for their member banks, approach too close to the limit provided by law of 40% on their circulation and 35% on their deposits.

The following additional statement on motion of Mr. Rue was also ordered submitted to the Federal Reserve Board having been recommended by the Executive Committee:

" In the interests of the banks of the country we would draw your attention to Section 10 of the Clayton Anti-Trust Act, which prohibits any common carrier having any dealings in excess of \$50,000 a year without competitive bids with another company in which a director of the common carrier is interested.

The effect of this statute is that a railroad company, any of whose directors or officers are interested in a bank, cannot deal with that bank in securities without competitive bidding. It might be held that borrowing money and giving notes constitute "dealings in securities" and come within the statute.

This section of the Clayton Act becomes effective October 15, 1916. The Interstate Commerce Commission has just promulgated tentative rules for competitive bidding which require a large amount of newspaper notices, permission to all bidders to see and take copies of the other bids and reports to the Interstate Commerce Commission. The hearing on these rules by the Interstate Commerce Commission, originally set for today, has been postponed to June 19th. The interests of the banks of the country are in the construction placed by these rules on the words "dealings in securities." A great many of the large banks of the country have on their boards of directors one or more persons who are directors of railroads engaged in interstate commerce and many of these banks make short time loans to railroads in order to enable them to pay taxes, bond interest, etc. Sometimes these loans are made on plain, unsecured notes, but more often they are secured by the pledge of bonds, stock of subsidiaries or other securities. It is obviously undesirable that such short time loans, even when secured by the pledge of securities, should require competitive bidding with publication of tenders for bids, etc. Such short time loans from the necessity of the case have to be made quickly and any variation in the rate of interest on them could not produce any appreciable effect on the situation of the railroad. Under the various State statutes requiring issues of securities to be submitted to public utility commissions, etc., there is practically always a provision to except from such submission loans for less than either one or two years. It does not seem to us that Congress intended by the words "dealings in securities" to include short term bank loans either secured or unsecured. We think that the words "dealings in securities" do not cover the case of a pledge of securities as collateral to a bank loan.

We are therefore of opinion that the proposed rules should expressly except bank loans having not more than, say, two years to run, whether or not such loans are secured by the pledge of collateral. The tentative draft of rules promulgated by the Interstate Commerce Commission in paragraph 2 by implication indicates that a bank loan secured by collateral is to be construed as within the terms of the Act and possibly also by implication would include a loan on an unsecured note.

The Federal Reserve Board will do a great service to the banks

of the country if they will make such representations to the Interstate Commerce Commission as will induce them to modify the draft rules so as to indicate clearly that short time bank loans whether or not secured by the pledge of collateral are not construed to be within the terms of the Act and can be made without competitive bidding following advertisement. We would therefore urge that your Board take prompt action in this matter while the Interstate Commerce Commission has it under consideration.

The Council then adjourned pending the arrival of the Federal Reserve Board.

JOINT SESSION
FEDERAL RESERVE BOARD
AND
FEDERAL ADVISORY COUNCIL

May 16, 1916.

The Federal Reserve Board and the Federal Advisory Council met in joint session in the Board room at 12 M, Tuesday, May 16, 1916.

Present: Governor C. S. Hamlin, in the chair, Vice Governor F. A. Delano, Messrs. J. S. Williams, A. C. Millar, W. P. G. Harding, P. M. Warburg, and Sherman P. Allen, Secretary of the Federal Reserve Board, and Messrs. J. B. Forgan, L. L. Rue, D. G. Wing, J. P. Morgan, W. S. Rowe, J. W. Norwood, Charles A. Lyerly, F. O. Watts, C. T. Jaffray, T. J. Record, Herbert Fleishhaker, of the Federal Advisory Council and Merritt H. Grim, Secretary.

Governor Hamlin asked Mr. Forgan to report the findings of the Council on the questions submitted by the Board.

Mr. Forgan then read the statements formulated by the Federal Advisory Council and handed a copy of them to the secretary of the Board.

Governor Hamlin then called upon each member of the Council to report upon the discount policy of the Federal reserve bank of his district in view of general business conditions prevailing therein, after which there was some informal discussion concerning the general business and financial conditions of the country in which the members of the Board and of the Council participated.

The joint session adjourned at 1 P. M.

Secretary.