

MINUTES OF MEETING
OF THE
Federal Advisory Council

November 17, 1919

November 17, 1919.
Continued.

A statutory meeting of the Federal Advisory Council was held in the Federal Reserve Board room, Metropolitan Bank Building, Washington, D C, Monday, November 17th, 1919, at 10:30 A.M.

Present: Messrs. James B. Forgan, President, L. L. Rue, Vice-President, D. G. Wing, A. B. Hepburn, J.G. Brown, C. A. Lyerly, W. S. Rowe, C. T. Jaffray, F. O. Watts, E. P. Wilmot, and Merritt H. Grim, Secretary.

Absent: Messrs. E. F. Swinney, and A. L. Mills.

Mr. James B. Forgan, President, called the meeting to order.

On motion the minutes of meetings of the Federal Advisory Council held on September 15th and 16th, 1919, and of the Executive Committee on September 15th, copies of which had been sent to members of the Council, were approved.

Mr. Forgan announced that Governor Harding and other members of the Board would come in about eleven o'clock for a preliminary conference.

The matter (postponed FROM LAST MEETING) of suggested changes in the basis for computing the reserves of member banks was discussed. In this connection the chair read a communication from Mr. E F Swinney, giving his views on this subject. Mr. Hepburn read a report on this question prepared by a special committee of the New York Clearing House Association.

FEDERAL RESERVE BOARD

Page 2.

WASHINGTON

MINUTES OF MEETING October 24, 1919.

OF THE

FEDERAL ADVISORY COUNCIL.

CONFIDENTIAL

November 17, 1919.
Continued.

Dear Mr. Rue moved that Mr. Hepburn be requested to give the Council a copy of the report and that it be transmitted to that the Federal Advisory Council will meet in Washington on the Federal Reserve Board along with its recommendation to the members of the Board.

effect that the Council agrees with the Committee's report that

You ask for a list of topics which the Board would the present time is not opportune for the inaugurating of a re- vision of reserves in any manner that would add another item of unrest to the present disturbed situation throughout the country and that it would be much better to await a period when bankers, bank clerks and the public are in a more tranquil state of mind.

Motion seconded by Mr. Lysterly and carried, necessary to add to the productive capacity of the country, but it cannot

Note: The report of the Special Committee of the New York the resources of the Federal reserve banks are unlimited Clearing House above referred to is included in the formal re- commendations of the Council hereto attached.

The Chair laid before the meeting the following letter

from Governor Harding of the Federal Reserve^{Board}, dated October 24th, copies of which had been previously sent to members of the Council.

of the country, without an advance of discount rates generally. This, of course, would involve more or less discussion. In view of the present conditions throughout this country and throughout the world, would it be practicable to bring about the desired contraction by advancing discount rates without an intensive study of the credit situation at leading centers, or does the Council feel that moral suasion plus a moderate advance in discount rates would be more effective?

FEDERAL RESERVE BOARD

WASHINGTON

OFFICE OF THE GOVERNOR

October 24, 1919.

CONFIDENTIAL

Dear Mr. Forgan:-

I acknowledge receipt of your letter advising that the Federal Advisory Council will meet in Washington on Monday morning, November 17th, and have advised all members of the Board.

You ask for a list of topics which the Board would like to discuss with the Council. The question which overshadows all others in importance just now is the control of the credit situation. The Board views with alarm the speculative tendencies which are so strongly in evidence in various parts of the country and is desirous of doing all it can in the proper way not only to promote a saner and more conservative spirit, but to call a halt on the credit expansion which is taking place daily. It has no desire, of course, to curb credits which are needed for legitimate business and which may be necessary to add to the productive capacity of the country, but it cannot escape the conclusion that the popular impression that the resources of the Federal reserve banks are unlimited and that no check is to be imposed upon discount operations is dangerous. At the same time the necessities of the Treasury must be given consideration, and it is important that nothing be done to add to the difficulties of the Treasury financing.

The Board would like the opinion of the Council as to whether excessive credits can be controlled by the Federal reserve banks, supported by the larger member banks of the country, without an advance of discount rates generally. This, of course, would involve more or less discussion. In view of the present conditions throughout this country and throughout the the world, would it be practicable to bring about the desired contraction by advancing discount rates without an intensive study of the credit situation at leading centers, or does the Council feel that moral suasion plus a moderate advance in discount rates would be more effective?

It is requested that in communicating with the members of the Council you urge the importance of keeping this matter confidential, for any premature discussion in the press would be harmful. The members of the Council may have other matters which they would like to discuss with the Board, but in view of the paramount importance of the matters above referred to, the Board has no other suggestions to make at this time.

Very truly yours,

W. P. G. Harding,

Mr. James B. Forgan, President,
Federal Advisory Council,
Chicago, Ill.

Governor.

Dictated but not read.

FEDERAL ADVISORY COUNCIL

MINUTES OF MEETING.

November 17, 1919.

The following members of the Federal Reserve Board then arrived: Governor, W. P. G. Harding, Albert Strauss, J. S. Williams, C. S. Hamlin, A. C. Miller, H. A. Moehlenpah and R. G. Emerson Assistant Secretary.

Mr. Forgan asked Governor Harding to address the meeting.

Governor Harding reviewed financial conditions in the Country and raised the question as to whether the Discount rates of the Federal Reserve Banks should be raised again to check expansion of credits.

He asked the Council to make recommendations on the general subject as to whether it would be advisable to increase discount rates at present and especially if the present differential in favor of member banks' 15 day notes secured by U S Government obligations should be taken off to reduce the amount of government obligations being carried by the Federal Reserve Banks. He asked the Council to make any criticisms of the Board's actions in the past and to indicate the policy that should be pursued in the near future.

After some general discussion the members of the Board withdrew and the Council continued its consideration of the question of discount rates.

At one o'clock the meeting adjourned.

SECRETARY.

MINUTES OF MEETING
OF THE
FEDERAL ADVISORY COUNCIL

November 17, 1919.

A meeting of the Federal Advisory Council was held in the Federal Reserve Board room, Washington, D C, at 3 P M, Monday November 17, 1919.

Present: Messrs. James B. Forgan, President, L. L. Rus, Vice-President, D. G. Wing, W. S. Rowe, J. G. Brown, ^{c a Lyerly} C. T. Jaffray, F.O. Watts, E. P. Wilmot, and Merritt H. Grim, Secretary.

At the invitation of the Council Mr. R. C. Leffingwell, assistant Secretary of the Treasury, Governor Harding and Mr. Albert Strauss, were present.

Mr. Forgan asked Mr. Leffingwell to tell the Council the requirements and plans of the Treasury Department for the immediate future.

Mr. Leffingwell informed the Council that there were \$3,400,000,000 short time Certificates of Indebtedness outstanding, of which 2,400,000,000 mature on or before Feb 2, 1920, and the balance March 15th and Sept 15, 1920. Mr. Leffingwell emphasized the desire of the Treasury officials that the outstanding Liberty Loan bonds should not be allowed to further depreciate and stated that the Government owed it to the people to protect these bonds. He also stated that the Government would have to renew \$1,900,000,000 of the \$2,400,000,000 Certificates of Indebtedness maturing on or before Feb. 2, 1920. For these reasons he thought discount rates should not be increased at present. He however stated that the Treasury would be out of the market by January 15th at least to the extent that it would be indifferent to the rates of discount, unless Congress should pass measures making further appropriations

MINUTES OF MEETINGS

RECOMMENDATIONS OF THE FEDERAL RESERVE BOARD
OF THE
COUNCIL TO THE FEDERAL RESERVE BOARD
FEDERAL ADVISORY COUNCIL.

November 17, 1919.

cont.

for payments to returned soldiers or other purposes. The Council thereafter resumed its work and a recommendation was drafted and approved covering the whole question of discount rates.

The Council then considered the Federal Reserve Board's rulings to the effect that "balances due" from foreign banks cannot be deducted from "balances due to" banks in computing the net amount on which member banks' reserves are based. Legal opinions from four different bank attorneys at variance with the Federal Reserve Board's rulings were read to the meeting by Mr. Forgan. A recommendation was prepared on this subject including the legal opinions referred to.

On motion duly seconded and carried, the President was requested to revise the three recommendations of the Council and to submit them to the Federal Reserve Board tomorrow.

A printed copy of the Council's recommendations as approved is hereto attached and made a part of these minutes.

At 5:15 the Council adjourned.

SECRETARY.

RECOMMENDATIONS OF THE FEDERAL ADVISORY
COUNCIL TO THE FEDERAL RESERVE BOARD

November 17, 1919.

TOPIC NO. 1. Policy in regard to Discount Rates of the Federal Reserve Banks for the remainder of the year 1919.

Recommendation:

It is desirable that the expansion of credit through the discount facilities of the Federal Reserve banks should be held in check. The Council therefore approves the recent advance in rates made by the Federal Reserve Banks. The Federal Reserve Banks should be instructed by the Federal Reserve Board to use all their influence and authority to prevent an excessive use of credits by member banks.

Increases in the discount rates would, in the opinion of the Council, tend to correct the present situation, but as such action might seriously affect present government bond values and the successful refunding of the outstanding certificates of indebtedness and as the Treasury officials are firmly of the opinion that at an early date the needs of the Treasury will cease to be an important factor in the money market the Council recommends that no further change be made in discount rates at present.



TOPIC NO. 2. Suggested changes in the basis for computing the reserves of member banks.

Recommendation:

The Council member for New York has furnished the Council with a copy of a report on this subject made by a Special Committee of the New York Clearing House Association, a copy of which is herewith submitted for the information of the Federal Reserve Board.

The Council agrees with this Committee "that the present time is not opportune for the inaugurating of a revision of reserves in any manner that would add another item of unrest to the present disturbed situation throughout the country and would recommend that it would be much better to await a period when bankers, bank clerks and the public are in a more tranquil state of mind."

November 8th, 1919.

Mr. James Stillman, Chairman,
New York Clearing House Committee,
National City Bank, New York City.

Dear Mr. Stillman:—

Acting under instructions of last year's Clearing House Committee, the undersigned have considered the advisability of changes in the present system of figuring reserves of the Bank Members of the Federal Reserve System. The present method is based upon the classification of the National Bank system as applied to Central Reserve Cities, Reserve Cities and Country Banks—and, we agree that this method could well be superseded by a new classification based on two divisions—the first, to apply only to

Member Banks in cities wherein there is located either a Federal Reserve Bank, or a branch of a Federal Reserve Bank, and, the second to the rest of the country.

As to the further question of the percentage of reserves, should the classification be changed, as above—we feel that it would be unwise to reduce the total amount of reserves of all Banks with the Federal Reserve Banks, but in order to permit of an intensive study of percentage changes—Mr. Hepburn has suggested that there be prepared a tabulation which would show for all Cities of the United States, of 15,000 population, and over, the following figures:

- (1) Capital, Surplus and Undivided Profits
- (2) Deposits
- (3) Average Daily Exchanges

the figures to be brought into two totals—first, applying to Banks wherein there is located a Federal Reserve Bank, or a Branch of a Federal Reserve Bank, and, second, totals for the rest of the country.

These figures, if desired by the Clearing House Committee, we believe, could perhaps be best secured by the Clearing House Examiner, and could supplement certain figures prepared for the Advisory Committee to the Federal Reserve Board, copy attached herewith, which shows amounts of reserves which National Banks are required to carry with Federal Reserve Banks under the present method, and reserves which they would be required to carry under certain proposed amendments.

We feel very strongly, however, that the present time is not opportune for the inaugurating of a revision of reserves in any manner that would add another item of unrest to the present disturbed situation throughout the country, and, would recommend that it would be much better to await a period when Bankers, Bank Clerks, and the Public are in a more tranquil state of mind.

Since the inauguration of the Federal Reserve System, we have gone along very well under the present method—which it seems could well continue for a while longer without change.

The more immediate situation, it seems to us, however, is the desirability for the accumulation of a higher percentage of reserves for the Federal Reserve Banks.

Yours sincerely,
LEWIS E. PIERSON,
CHARLES H. SABIN,
WALTER E. FREW.



TOPIC NO. 3. Federal Reserve Board's rulings, as they appear in the Federal Reserve Bulletin of October 1, 1919, in regard to the computation of reserves with reference to—

1. In figuring reciprocal balances should the dollar balances due to foreign banks be offset by foreign currency balances due from same banks?
2. For the purpose of figuring reserve requirements, should foreign currency balances due from foreign banks be used as a deduction from "due to" bank balances the same as due from banks in this country?"

Recommendation:

The banks principally affected by these rulings are those located in the central reserve cities and the reserve cities, especially the former. Banks in these cities are now required to carry reserves of 13% and 10% respectively against their demand deposits, while banks in other localities are only required to carry 7% against such deposits. The effect of the rulings is therefore to still further penalize the banks located in central reserve cities and reserve cities in regard to the amount of reserves they are required to carry. Funds on deposit with a foreign correspondent may be converted into reserve funds through sales of checks or of cable transfers just as quickly as the funds on deposit with a domestic bank may be realized upon through drafts or telegraphic transfers. Foreign banks should be encouraged to keep

balances with their correspondent banks in this country and if banks doing a foreign exchange business are not allowed to deduct balances due them by foreign banks from the amount of their balances "due to banks," the volume of their foreign exchange business might have to be undesirably and unnecessarily curtailed.

We hand you herewith legal opinions of the following bank attorneys:

Messrs. Shearman & Sterling, and
Messrs. White and Case, of New York, and
Messrs. Mayer, Meyer, Austrian & Platt, and
Mr. Edward Eagle Brown, of Chicago.

These opinions being at variance with your rulings we would respectfully recommend that you give the subject your further consideration.

The following members of the Federal Advisory Council were present at this meeting: Messrs. James B. Forgan, President; L. L. Rue, Vice-President; D. G. Wing, A. B. Hepburn, W. S. Rowe, J. G. Brown, Charles A. Lyerly, F. O. Watts, C. T. Jaffray, E. P. Wilmot, and Merritt H. Grim, Secretary.

Copy

SHEARMAN & STERLING
ATTORNEYS AND COUNSELORS AT LAW
NATIONAL CITY BANK BUILDING
55 WALL STREET

NEW YORK, November 15, 1919

The National City Bank of New York,
55 Wall Street,
New York City.

Dear Sirs:-

We have read the ruling of the Federal Reserve Board to the effect that, for the purpose of figuring reserve requirements, foreign currency balances due from foreign banks are not to be used as a deduction from "due to" bank balances, the same as in the case of domestic banks. The conclusion of the Board is based on an analysis of the statute, in order to determine the meaning of the following provision:

"In estimating the balances required by this act the net difference of amounts due to and from other banks shall be taken as the basis for ascertaining the deposits against which required balances with Federal Reserve banks shall be determined."

In our opinion, the analysis of the statute made by the ruling of the Federal Reserve Board is not in all respects accurate. The ruling quotes from Section 1 of the Act as follows:

"Wherever the word 'bank' is used in this Act the word shall be held to include State bank, Banking Association and trust company, except where national banks or Federal Reserve banks are specifically referred to."

The ruling then attempts to show, from the Act itself that this definition was intended to exclude foreign banks, and that, therefore, foreign banks are not embraced in the words "other banks", in the provision of the Act which we first quoted above. In support of this argument, the Federal Reserve Board says:

"Wherever the Act relates to transactions with persons, firms or corporations in foreign countries, it uses the word 'foreign' to qualify such persons, firms or corporations."

This statement is obviously inaccurate. For example, Section 10 (4) reads as follows:

"No member of the Federal Reserve Board shall be an officer or director of any bank, banking institution, trust company, or Federal Reserve Bank, nor hold stock in any bank, banking institution, or trust company."

If the statement were accurate, it would not be unlawful, under this provision of the statute, for members of the Federal Reserve Board to be officers, directors and stockholders of foreign banks, a result entirely contrary to the spirit of the Act.

The other argument of the Board is that, from a practical standpoint, balances due from other banks in the United States are more available than those due from banks in foreign countries. In general, this might be so. It would not be so in all cases; but in any event, it aids but little in construing the statute.

By applying the same rules of statutory construction used by the Federal Reserve Board, the opposite result can be reached.

Section 19 of the Federal Reserve Act originally contained the following:

"Except as thus provided, no member bank shall keep on deposit with any non-member bank, a sum in excess of ten per centum of its own paid-up capital and surplus."

By the Act of June 21, 1917, this Section was amended and the passage above quoted now reads as follows:

"No member bank shall keep on deposit with any State bank or trust company which is not a member bank, a sum in excess of ten per centum of its own paid up capital and surplus."

The obvious effect of the amendment was to permit deposits in excess of 10% to be made in non-member banks other than state banks or trust companies. This would necessarily include foreign banks.

The term "non-member bank" used in Section 19 above quoted was evidently intended to include foreign banks, and in order to exclude foreign banks from the prohibition, the amendment was made. The term "non-member bank" might have been construed to apply only to eligible banks, but it was not so construed, and as it is a narrower term than the term "other banks" used in the portion of Section 19 first above quoted, it would seem to follow that the term "other banks" should not be limited to domestic banks.

As stated in the ruling of the Federal Reserve Board under discussion, it was the practice long before the passage of the Federal Reserve Act to permit the deduction of balances due from other banks, without making any distinction between foreign and domestic banks. In construing a provision of the Federal Reserve Act relating to a long established business usage, involving large sums of money, unless a contrary intention by Congress is clearly indicated, it should be considered as incorporating, and not as abolishing, that usage.

While the question is by no means free from doubt, we are inclined to the opinion that the courts would not sustain the ruling of the Federal Reserve Board.

Yours very truly,

(Signed) Shearman & Sterling

C B
The question is whether the word "bank" as used in such action includes a regularly incorporated foreign bank or is limited to banks organized under the laws of the United States or of any State thereof.

The argument that it includes a regularly incorporated foreign bank is fully set forth in a letter, dated November 3, 1917, to Mr. James S. Morgan, of Chicago, by the attorney, Mr. Edward Beale Cross, a copy of which letter we enclose herewith. We have pointed out in this letter that under the Federal Reserve Act the prohibition against banks from maintaining deposits in excess of 10% of their capital and surplus with any member bank is limited to the language "any member bank in any State bank or trust company which is not a member bank". The effect of the amendment is to permit the carrying of more than 10% of the amount of capital and surplus in a foreign bank and, in fact, a clear intention that language intended the word "bank" as used in Article 17 to include foreign banks.

Copy
WHITE & CASE

14 Wall St.

New York, November 14, 1919.

Federal Reserve Board ruling
re. Computation of Reserves.

Seward Prosser, Esq.,
President, Bankers Trust Company,
16 Wall Street, New York City

Dear Sir:-

Referring to Mr. Hepburn's letter of November 7, 1919, to you in regard to the ruling of the Federal Reserve Board made in October of this year, prohibiting the deduction of balances due from foreign banks as bank balances in computing lawful reserves, the legality of the ruling depends upon the construction of the word "bank" in Section ¹⁹ of the Federal Reserve Act. The question is whether the word "bank" as used in such action includes a regularly incorporated foreign bank or is limited to banks organized under the laws of the United States or of any State thereof.

The argument that it includes a regularly incorporated foreign bank is ably set forth in a letter, dated November 5, 1919, to Mr. James B. Forgan, of Chicago, from his attorney, Mr. Edward Eagle Brown, a copy of which letter we enclose herewith. Mr. Brown points out in his letter that prior to 1917 Section 19 of the Federal Reserve Act prohibited member banks from maintaining deposits in excess of 10% of their capital and surplus with non-member banks. By amendment in 1917 the language was changed to provide that deposits in excess of such amounts shall not be carried by member banks in "any state bank or trust company which is not a member bank". The clear purport of the amendment is to permit the carrying of more than 10% of the amount of capital and surplus in a foreign bank and is, we think, a clear indication that Congress intended the word "bank" as used in Section 19 to include foreign banks.

If it is the fact, as Mr. Brown states, that prior to the enactment of the Federal Reserve Act, the Comptroller of the Currency treated balances with foreign banks on the same basis as balances with banks in this country, this should be given great weight in interpreting the language of Section 19, as the Federal Reserve Board admits in its ruling that the provision of Section 19 under discussion was intended as a ratification by statute of the prevailing practice of the Comptroller.

The ground upon which the Federal Reserve Board decides that the word "bank" included only banks of this country is that wherever the Act relates to foreign transactions the word "foreign" is specifically used in the Act. This argument is neither conclusive nor convincing, but, on the other hand, the Act in a number of places refers to state banks and trust companies where it is not necessary to do so if the word had the limited meaning ascribed to it by the Federal Reserve Board. Instances in addition to those referred to by Mr. Brown in his letter are the following:

In Section 2, the Act provides that "every national banking association is hereby required and every eligible bank in the United States-----is hereby authorized to signify in writing-----its acceptance of the terms and provisions hereof." Under the Federal Reserve Board's construction, the words "in the United States" are surplusage.

In Section 3, the act provides that "any bank incorporated by special law of any state or of the United States or organized under the general laws of any state or of the United States-----may be converted into a national banking association." If the word "bank" as used in the Act does not include a foreign bank, the mode of expression in Section 3 seems needlessly lengthy.

In Section 9, the Act provides that "any bank incorporated by special law of any state or organized under the general laws of any state" desiring to become a member of the Federal Reserve System may make application to such effect. If the word "bank" does not include a foreign bank, it would have been necessary only to say "any bank" desiring to become a member of the Federal Reserve system, etc.

Under the provisions of Section 16, Federal Reserve notes may be issued against bankers' acceptances, foreign or domestic. This is an indication that foreign banks are to be on the same basis as domestic banks.

The Federal Reserve ruling would furthermore seem necessarily to treat banks in the insular possessions or dependencies of the United States in the same category as foreign banks, because following the line of reasoning adopted by the Federal Reserve Board, wherever the Act relates to transactions with banks in such possessions or dependencies, it qualified the word "bank" by "insular possessions or dependencies".

The probability is that this is a matter which Congress did not have specifically in mind and while the Act is susceptible of construction for or against the Reserve Board's ruling, we think that, as a strict question of construction, the FEDERAL RESERVE BOARD'S ruling is incorrect. It seems probable, however, that the final decision will turn upon the practical considerations involved. The reasonable deduction from the FEDERAL RESERVE BOARD'S argument is that the ruling is prompted by the abnormal exchange conditions now existing. It may be that there are sound banking reasons why the balances of foreign banks (as a whole or the banks of certain countries) should not at one time or another have the same standing as balances of domestic banks, and we think it is upon these banking questions that the main emphasis should be placed. The Federal Reserve Board gives more weight to them in its argument than it does to the strictly legal point involved. The principal argument made was that balances ~~are~~ not due from other banks in the United States are available to meet any unusual or abnormal withdrawal, but that foreign balances are not available for this purpose because they would have to be sold on the market like any other investment.

If there are sound reasons why at times foreign balances should not be permitted to be deducted, while at other times in the interest of good business and foreign trade they should be permitted to be deducted, would not an amendment to Section 19 granting the Federal Reserve Board discretion as to allowing or disallowing the deduction cover the situation satisfactorily?

S. P.

We return herewith Mr. Hepburn's letter of November 7, to you and its enclosure, and also enclose a copy of Mr. Fergan's proposed recommendations to the Federal Advisory Council, which we obtained from Mr. Hepburn.

Yours very truly,

(Signed) White & Case

Enclosures.

Your paper dealing with a recent ruling of the Federal Reserve Board concerning the computation of reserves of member banks as they appear in the October issue of Federal Reserve Bulletin, on page 503, and suggesting our opinion therein, was duly received.

In the ruling in question the Federal Reserve Board reached the conclusion, -

1. "That a member bank should not be required to deduct a share due from a foreign banking corporation from the balance due to such corporation in computing its reserves; and

2. "A further it would not be permitted to deduct balances due from foreign corporations or banks from balances due to other banks."

Section 19 of the Federal Reserve Act, in which reference is made to the Federal Reserve Board in the computation of reserves of member banks, is as follows: "The Federal Reserve Board shall have the effect of action of the Federal Reserve Board shall have the effect of action of the Board in the computation of the reserves of member banks."

It is provided in this section of the Federal Reserve Act that the Board shall have the effect of action of the Board in the computation of the reserves of member banks.

"In computing the balance of a member bank the Board shall not deduct a share due from a foreign banking corporation from the balance due to such corporation in computing its reserves; and a further it would not be permitted to deduct balances due from foreign corporations or banks from balances due to other banks."

As pointed out by the Federal Reserve Board in suggesting the proposed provisions Congress but crystallized into statutory law a

Nov. 12, 1919.

CHICAGO

Mr. George M. Reynolds,
President Continental and Commercial
National Bank of Chicago,
208 S. LaSalle St.,
Chicago, Ill.

Dear Sir:-

Your favor calling attention to a recent ruling of the Federal Reserve Board concerning the computation of reserves of member banks as the same appears in the October issue of Federal Reserve Bulletin, on page 963, and requesting our opinion thereon, has come duly to hand.

In the ruling in question the Federal Reserve Board reached the conclusion,-

1: "That a member bank should not be permitted to deduct a balance due from a foreign banking corporation from the balances due to such corporation in computing its reserve; and

2: A fortiori it should not be permitted to deduct balances due from foreign correspondents or banks from balances due to other banks."

Section 19 of the Federal Reserve Act, to which reference is made by the Federal Reserve Board in its ruling, confers no authority upon the Federal Reserve Board to in any manner vary or change the law with reference to reserves. It follows, therefore, that the ruling of the Federal Reserve Board cannot have the effect of law, but is merely to be looked upon as the Board's interpretation of the statute itself.

It is provided in said section of the Federal Reserve Act with reference to reserves as follows:-

"In estimating the balances required by this Act the net difference of amounts due to and from other banks shall be taken as the basis for ascertaining the deposits against which required balances with Federal Reserve Banks shall be determined."

As pointed out by the Federal Reserve Board, in enacting the foregoing provisions Congress but crystalized into statutory law a

practice that had theretofore prevailed in the Comptroller's office. That office had for many years as a rule of practice so treated bank balances in determining reserve requirements; and that practice must have been well known to Congress at the time of the enactment of the above statute. The practice of the Comptroller's office referred to went to the extent of treating foreign bank balances exactly as domestic balances and it seems to us that in adopting the rule of the Comptroller's office Congress must be held to have adopted it in its entirety.

If such had not been the intention that fact could easily have been indicated in the statute itself by appropriate words.

If then these deposits are to be treated as "bank deposits," it would seem to follow that the conclusion reached by the Federal Reserve Board is erroneous. That they are deposits is in effect conceded in the ruling in question. The Board, however, seems to take the position that from a purely technical standpoint these deposits should be treated as individual deposits, to which the same rule does not apply, and never was applied by the Comptroller. The Board reaches this conclusion by referring to the definition of the word "bank" contained in Section 1 of the Federal Reserve Act, where it is said: "Wherever the word 'bank' is used in this Act the word shall be held to include state banks, banking associations and trust companies, except where national banks or Federal Reserve Banks are specifically referred to."

In our opinion the quoted language of Section 1 of the Federal Reserve Act should not be limited to the narrow construction placed thereon by the Board. While the word "bank" is thus conclusively held to include "state banks, banking associations and trust companies," it is nowhere in the Act provided that the word cannot likewise include a foreign banking association, and while it is true that the Act does make a difference between foreign and domestic transactions in the matter of acceptances and the like, it is nowhere provided that there is any distinction between deposits by foreign banking corporations and deposits by domestic banking corporations.

From a practical standpoint we can see no valid reason for the conclusion reached by the Board to the effect that balances due to foreign banks should not be off-set for reserve purposes by balances due from foreign banks. Certainly the suggestion of the Board that such balances cannot readily be realized upon could not be held to be an effective reason requiring reserves to be carried against gross balances due to foreign banks as it is just as difficult from a legal standpoint for the foreign bank to realize on balances due in the United States as it is for banks in the United States to

realize on their balances in foreign countries.

In this same connection it is interesting to note the practice established by the Federal Reserve Board, which seems to be entirely inconsistent with their ruling that the difficulty of realizing on these foreign bank credits should place them in a different category from bank credits in the United States.

We refer to the Federal Reserve Bulletin of September 1919, page 889, from which it appears that the Federal Reserve Board is permitting Federal Reserve Banks to count as part of their gold reserve which they are required to maintain under the Federal Reserve Act, gold held by foreign agencies. If this is legitimate, then it is not apparent why balances of member banks in foreign banking corporations may not be taken into account just as other bank balances in determining reserves of member banks. It seems to us that the ruling of the Federal Reserve Board now under consideration is inconsistent with the ruling of the Board in so permitting gold held abroad for Federal Reserve Banks to be treated as part of their reserve.

If difficulty in realizing on foreign bank credits is to be taken as a reason why those credits shall not be treated like internal bank credits, the same reason would certainly apply to the deposit of gold in a foreign bank. We do not mean to criticize the position of the Board in thus treating gold which is held by a foreign bank for the credit of the Federal Reserve Banks, but we are merely calling it to your attention as an illustration of the inconsistency of the position now taken by the Board in the ruling under consideration.

In conclusion we beg to say that for the reasons above mentioned we are of the opinion that the ruling of the Federal Reserve Board is erroneous and should be abrogated.

Yours truly,

CM

(Copy)

Law Department
Edward Eagle Brown,
Attorney.
John Nash Ott,
Asst. Attorney.

FIRST NATIONAL BANK,

Chicago, November 5, 1919

James B. Forgan, Esq.,
Chairman of the Board,
First National Bank,
Chicago, Ill

Dear Sir:-

The Federal Reserve Board has recently issued a ruling construing the following paragraph of Section 19 of the Federal Reserve Act:

"In estimating the balances required by this Act, the net difference of amounts due to and from other banks shall be taken as the basis for ascertaining the deposits against which required balances with Federal Reserve Banks shall be determined. "

By their ruling the Federal Reserve Board has stated that the word "banks", as used in the paragraph quoted above, excludes foreign banking corporations and that consequently balances due from foreign banks cannot be deducted from balances due to banks in determining the amount of the reserve required to be carried.

This definition by the Federal Reserve Board of the word "banks", as used in the foregoing paragraph, I think is incorrect. Section 1. of the Federal Reserve Act is in part as follows:

"Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the short title of this Act shall be the "Federal Reserve Act. "

"Whenever the word "bank" is used in this Act, the word shall be held to include State bank, banking association and trust company, except where national banks or Federal Reserve banks are specifically referred to. "

Although it is expressly stated by this section that the word "bank" shall be held "to include state bank, banking association and trust company," that definition is not intended to be all embracing. To give the word "include" that meaning would be to hold that the word "bank" was not intended to include national banking associations. Obviously and admittedly the word "bank", as used in the Federal Reserve Act, is intended to include national banking associations, and if Congress had intended that it should not mean foreign incorporated banks, it would have been easy to have so stated. In the absence of a specific statement to the contrary it seems to me evident that it was Congress' intention to have the word "bank" include a regularly incorporated foreign bank. The obvious purpose of the phrase, "shall be held to include state bank, banking association and trust company," was to bring trust companies incorporated under State laws into the definition of the word "bank."

Section 9 of the Federal Reserve Act begins as follows:

"Any bank incorporated by special law of any state, or organized under the general laws of any state or of the United States, desiring to become a member of the Federal Reserve system, may make application to the Federal Reserve Board. "

Obviously, in this section Congress construed the word "bank" as having a broader meaning than "State bank, banking association or trust company," otherwise it would not have been necessary to put in the limiting words "incorporated by special law of any state, or organized under the general laws of state or of the United States,"

A strong argument against the construction that the word "banks" in that part of section 19 under discussion was not intended to cover regularly incorporated foreign banking corporations, is found in the history of that paragraph of section 19, which reads as follows:

"No member bank shall keep on deposit with any state bank or trust company which is not a member bank a sum in excess of ten per centum of its own paid-up capital and surplus. No member shall act as the medium or agent of a nonmember bank in applying for or receiving discounts from a Federal Reserve bank under provisions of this act, except by permission of the Federal Reserve Board."

As this paragraph stood up to the amendment approved June 21, 1917, it read: "Except as thus provided, no member bank shall keep on deposit with any nonmember bank a sum in excess of ten per centum," etc.

If the construction given by the Federal Reserve Board to the word "banks" is correct, the amendment of June 21, 1917, would be entirely meaningless. It had been found desirable to allow member banks to carry more than ten per cent of their capital and surplus on deposit in a foreign bank. The purpose of the amendment was to make it legal for a member banks to carry a deposit in a foreign bank in excess of this ten per cent limitation. Since all national banks are necessarily member banks, "nonmember banks" would, under the construction now given by the Federal Reserve Board, necessarily have meant only state banks or trust companies which were not members of the Federal Reserve system and the limitation would not have applied to foreign banks, and there would have been no necessity for amending the law. Yet it was thought necessary to amend the paragraph by changing its language from "nonmember banks" to "State bank or trust company which is not a member bank," in order to except foreign banks.

As stated by the Federal Reserve Board in the ruling under discussion, it was for many years prior to the passage of the Federal Reserve Act the practice of the Comptroller's office, without any express authority of law, to allow balances due from banks to be deducted from balances due to banks in computing reserves and the insertion of the paragraph in section 19 of the Federal Reserve Act that,

"In estimating the balances required by this Act, the net difference of amounts due to and from other banks shall be taken as the basis for ascertaining the deposits against which required balances with Federal Reserve banks shall be determined, "

was intended as a legalization and adoption by Congress of the practice that had obtained in the Comptroller's office. Therefore, in construing this section the practice of the Comptroller's office should be given great weight. The

Comptroller had never made any distinction between foreign banks and domestic banks and had always considered balances due from foreign banks on the same basis as balances due, from banks within the United States. This fact does not seem to have been considered or taken into account by the Federal Reserve Board in reaching the decision which they have announced.

The Federal Reserve Board justifies its decision in part on the ground that balances due from foreign banks are not as quickly available as balances due from banks in the United States. You are better able to judge on this question than I am, but the experience of this bank in 1893 and on other occasions when it was able to realize on its balances in London but not on its balances in New York, would seem to show that when conditions are at all normal there is not much force in this argument of the Federal Reserve Board.

Yours very truly,

(Signed) Edward Eagle Brown,
Attorney.

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RECOMMENDATIONS OF THE FEDERAL ADVISORY
COUNCIL TO THE FEDERAL RESERVE BOARD

November 17, 1919.

TOPIC NO. 1. Policy in regard to Discount Rates of the Federal Reserve Banks for the remainder of the year 1919.

Recommendation:

It is desirable that the expansion of credit through the discount facilities of the Federal Reserve banks should be held in check. The Council therefore approves the recent advance in rates made by the Federal Reserve Banks. The Federal Reserve Banks should be instructed by the Federal Reserve Board to use all their influence and authority to prevent an excessive use of credits by member banks.

Increases in the discount rates would, in the opinion of the Council, tend to correct the present situation, but as such action might seriously affect present government bond values and the successful refunding of the outstanding certificates of indebtedness and as the Treasury officials are firmly of the opinion that at an early date the needs of the Treasury will cease to be an important factor in the money market the Council recommends that no further change be made in discount rates at present.



TOPIC NO. 2. Suggested changes in the basis for computing the reserves of member banks.

Recommendation:

The Council member for New York has furnished the Council with a copy of a report on this subject made by a Special Committee of the New York Clearing House Association, a copy of which is herewith submitted for the information of the Federal Reserve Board.

The Council agrees with this Committee "that the present time is not opportune for the inaugurating of a revision of reserves in any manner that would add another item of unrest to the present disturbed situation throughout the country and would recommend that it would be much better to await a period when bankers, bank clerks and the public are in a more tranquil state of mind."

November 8th, 1919.

Mr. James Stillman, Chairman,
New York Clearing House Committee,
National City Bank, New York City.

Dear Mr. Stillman:—

Acting under instructions of last year's Clearing House Committee, the undersigned have considered the advisability of changes in the present system of figuring reserves of the Bank Members of the Federal Reserve System. The present method is based upon the classification of the National Bank system as applied to Central Reserve Cities, Reserve Cities and Country Banks—and, we agree that this method could well be superseded by a new classification based on two divisions—the first, to apply only to

Member Banks in cities wherein there is located either a Federal Reserve Bank, or a branch of a Federal Reserve Bank, and, the second to the rest of the country.

As to the further question of the percentage of reserves, should the classification be changed, as above—we feel that it would be unwise to reduce the total amount of reserves of all Banks with the Federal Reserve Banks, but in order to permit of an intensive study of percentage changes—Mr. Hepburn has suggested that there be prepared a tabulation which would show for all Cities of the United States, of 15,000 population, and over, the following figures:

- (1) Capital, Surplus and Undivided Profits
- (2) Deposits
- (3) Average Daily Exchanges

the figures to be brought into two totals—first, applying to Banks wherein there is located a Federal Reserve Bank, or a Branch of a Federal Reserve Bank, and, second, totals for the rest of the country.

These figures, if desired by the Clearing House Committee, we believe, could perhaps be best secured by the Clearing House Examiner, and could supplement certain figures prepared for the Advisory Committee to the Federal Reserve Board, copy attached herewith, which shows amounts of reserves which National Banks are required to carry with Federal Reserve Banks under the present method, and reserves which they would be required to carry under certain proposed amendments.

We feel very strongly, however, that the present time is not opportune for the inaugurating of a revision of reserves in any manner that would add another item of unrest to the present disturbed situation throughout the country, and, would recommend that it would be much better to await a period when Bankers, Bank Clerks, and the Public are in a more tranquil state of mind.

Since the inauguration of the Federal Reserve System, we have gone along very well under the present method—which it seems could well continue for a while longer without change.

The more immediate situation, it seems to us, however, is the desirability for the accumulation of a higher percentage of reserves for the Federal Reserve Banks.

Yours sincerely,
LEWIS E. PIERSON,
CHARLES H. SABIN,
WALTER E. FREW.



TOPIC NO. 3. Federal Reserve Board's rulings, as they appear in the Federal Reserve Bulletin of October 1, 1919, in regard to the computation of reserves with reference to—

1. In figuring reciprocal balances should the dollar balances due to foreign banks be offset by foreign currency balances due from same banks?

2. For the purpose of figuring reserve requirements, should foreign currency balances due from foreign banks be used as a deduction from "due to" bank balances the same as due from banks in this country?"

Recommendation:

The banks principally affected by these rulings are those located in the central reserve cities and the reserve cities, especially the former. Banks in these cities are now required to carry reserves of 13% and 10% respectively against their demand deposits, while banks in other localities are only required to carry 7% against such deposits. The effect of the rulings is therefore to still further penalize the banks located in central reserve cities and reserve cities in regard to the amount of reserves they are required to carry. Funds on deposit with a foreign correspondent may be converted into reserve funds through sales of checks or of cable transfers just as quickly as the funds on deposit with a domestic bank may be realized upon through drafts or telegraphic transfers. Foreign banks should be encouraged to keep

balances with their correspondent banks in this country and if banks doing a foreign exchange business are not allowed to deduct balances due them by foreign banks from the amount of their balances "due to banks," the volume of their foreign exchange business might have to be undesirably and unnecessarily curtailed.

We hand you herewith legal opinions of the following bank attorneys:

Messrs. Shearman & Sterling, and
Messrs. White and Case, of New York, and
Messrs. Mayer, Meyer, Austrian & Platt, and
Mr. Edward Eagle Brown, of Chicago.

These opinions being at variance with your rulings we would respectfully recommend that you give the subject your further consideration.

The following members of the Federal Advisory Council were present at this meeting: Messrs. James B. Forgan, President; L. L. Rue, Vice-President; D. G. Wing, A. B. Hepburn, W. S. Rowe, J. G. Brown, Charles A. Lyerly, F. O. Watts, C. T. Jaffray, E. P. Wilmot, and Merritt H. Grim, Secretary.