MINUTES OF MEETING

OF THE

FEDERAL ADVISORY COUNCIL.

February 16, 1920.

A regular statutory meeting of the Federal Advisory Council was held in the Federal Reserve Board room, in the Metropolitan bank building, Washington, D C, Monday, Feb. 16, 1920, at 10:30 A M.

Mr. James B. Forgan called the meeting to order and Mr. A. L. Mills was chosen temporary chairman.

The secretary reported the following accredited members of the Federal Advisory Council for the year 1920.

	Federal Reserve District No.
Philip Stockton	1
A B Hepburn	2
L L Rue	3
W S Rowe	4
J G Brown	5
Oscar Wells	6
James B. Forgan	7
F O Watts	8
C T Jaffray	9
E F Swinney	10
R L Ball	11
A L Mills	12

The following members were present:

Messrs L L Rue, W. S. Rowe, J G Brown, James B. Forgan, F O Watts, C T Jaffray R L Ball, A L Mills, and Merritt H. Grim, Secretary.

Absent: Messrs. Philip Stockton, A B Hepburn, Oscar Wells and E F Swinney.

Mr. Forgan stated that he had word from Mr Stockton and Mr Wells that owing to train delay they would be late in arriving; that Mr Hepburn was detained in New York on business and that Mr E F Swinney was prevented by illness from attending the meeting.

FEDERAL ADVISORY COUNCIL

Mr. F O Watts moved that Mr. James B. Forgan be elected President of the Federal Advisory Council for the year 1920, and that the Secretary be instructed to cast the unanimous ballot for Mr Forgan. Motion seconded by Mr R L Ball, and unanimously carried. The Secretary having cast the ballot as directed the temporary chairman declared Mr Forgan duly elected President for the ensuing year.

Mr Mills then resigned as temporary chairman and Mr Forgan took the chair. It was moved by Mr Mills that Mr L L Rue be elected Vice-President of the Council for the ensuing year and that the Secretary be instructed to cast the unanimous ballot for Mr Rue. Motion seconded by Mr Brown and unanimously carried. The Secretary having cast the ballot as directed Mr Forgan declared Mr Rue duly elected Vice-President.

Mr Mills moved that Mr Stockton, Mr Hepburn and Mr Watts be elected members of the Executive Committee for the year 1920 and that the Secretary be instructed to cast the unanimous ballot for these gentlemen. Motion duly seconded and unanimously carried. The Secretary cast the ballot as directed and they were declared elected.

The official organization of the Federal Advisory Council for the year 1920 is therefore as follows:

President, James B. Forgan
Vice-President, L L Rue
Executive Committee: Messrs. James B. Forgan, L L Rue Philip Stockton, A B Hepburn, W S Rowe and F O Watts.

The report of the Secretary showing his traveling and incidental expenses for the year 1919 was on motion of Mr Watts approved and ordered filed. (See copy hereto attached and made a part of these minutes.)

Feb. 16, 1920

REPORT OF SECRETARY, FEDERAL ADVISORY COUNCIL, FOR YEAR 1919

Balance on hand Dec. 31, 1918, according to last report $334.88

RECEIPTS:

March 15, 1919, Annual Assessments on 12 Federal Reserve Banks of $150. each, total 1,800.

TOTAL $2,134.88

DISBURSEMENTS:

Expenses attending four meetings of the Federal Advisory Council and two special meetings of the Executive Committee in Washington as follows:

1919	R R Fare	Hotel Meals	Mcls	Total	
Feb 17,	$61.96	$24.75	$2.26	$88.97	
Mar 20	59.88	29.90	10.94	100.72	Exec. Com.
May 19	59.70	33.95	6.09	99.74	
June 19	81.55	17.10	2.82	101.47	Exec. Com.
Sept 15	76.21	65.40	9.72	151.33	
Nov 17	67.26	35.60	4.64	107.50	
Totals -----	$406.56	$206.70	36.47	649.73	

Total traveling expenses as above	649.73	
Stenography, Stationery	24.35	
Printing	111.90	
Telegrams, Postage	34.79	
Salary Secretary 1919	1200.00	
Balance in First National Bank, Chicago, Dec. 31, 1919	114.11	$2,134.38

Respectfully submitted

Merritt H. Grim

Secretary

In order to provide for the secretarial and incidental expenses for the year 1920 Mr Rue moved the adoption of the following

"Resolved that the President be and he is hereby authorized to ask each Federal Reserve Bank to contribute $200. towards the secretarial and incidental expenses of the Federal Advisory Council for the year 1920 and to draw on them for that purpose.

Motion duly carried.

Mr Rue moved that Mr Merritt H Grim be reelected secretary of the Federal Advisory Council for the year 1920 with a salary of $1,200 per annum.

Motion duly carried.

On motion the by-laws for the past year were readopted as the by-laws of the Federal Advisory Council for the ensuing year.(See copy hereto attached and made a part of these minutes.)

Mr Rue moved that the minutes of the meeting of the Federal Advisory Council held on November 17th, copies of which had been sent to members of the Council, be approved. The motion , was carried.

The President having arranged for an informal visit on the part of the Council to the new Secretary of the Treasury, Hon. Daniel F. Houston, the meeting adjourned for that purpose.

S E C R E T A R Y.

BY-LAWS OF THE FEDERAL ADVISORY COUNCIL

ARTICLE I. OFFICERS

Officers of this Council shall be a President, Vice-President and Secretary.

ARTICLE II. PRESIDENT AND VICE-PRESIDENT

The duties of the President shall be such as usually pertain to the office; and in his absence the Vice-President shall serve.

ARTICLE III. SECRETARY

The Secretary shall be a salaried officer of the Council and his duties and compensation shall be fixed by the Executive Committee.

ARTICLE IV. EXECUTIVE COMMITTEE

There shall be an Executive Committee of six (6) members of the Council, of which the President and Vice-President of the Council shall be ex-officio members.

ARTICLE V. DUTIES OF EXECUTIVE COMMITTEE

It shall be the duty of the Executive Committee to keep in close touch with the Federal Reserve Board and with their regulations and promulgations, and communicate the same to the members of the Council, and to suggest to the Council from time to time special matters for consideration.

The Executive Committee shall have power to fix the time and place of holding their regular and special meetings and methods of giving notice thereof.

Minutes of all meetings of the Executive Committee shall be kept and such minutes or digest thereof shall be immediately forwarded to each member of the Council.

A majority of the Executive Committee shall constitute a quorum and action of the Committee shall be by a majority of those present at any meeting.

ARTICLE VI. MEETINGS

Regular meetings of the Federal Advisory Council shall be held in the City of Washington on the third Monday of the months of February, May, September and November of each year.

Special meetings may be called at any time and place by the President or the Executive Committee, and shall be called by the President upon written request of any three members of the Council.

ARTICLE VII. AMENDMENTS

These By-laws may be changed or amended at any regular meeting by a vote of a majority of the members of the Federal Advisory Council.

FEDERAL RESERVE BOARD

WASHINGTON

OFFICE OF THE GOVERNOR

January 22, 1920.

My dear Mr. Forgan:-

I acknowledge receipt of your letter of the 16th instant advising that the next meeting of the Federal Advisory Council will be held on Monday, February 16th, at 10:30 A.M.

The Board would suggest that there be a discussion of the new policy of establishing a special rate for bankers' acceptances discounted by a member bank. Heretofore the burden of supporting the acceptance market has fallen upon the Federal reserve banks directly, and it is the Board's view that a special rate established will result in broadening the market as well as in giving the member banks a most desirable form of investment.

The Board would also like to have the Council's views as to the policy which should be pursued by Federal reserve banks which have these special discount rates in their open market purchases of acceptances.

It is suggested that it would be well for the members of the Council to inform themselves as to interest rates, not only on bank balances but upon deposits generally, paid by commercial banks in their respective districts in order that there may be a discussion as to what steps, if any, should be taken to discourage the practice of paying excessive rates on deposits.

With reference to the recommendations made by the Council at its last meeting on November 17th, I have to say that the Board is in full accord with the recommendation that expansion of credit through the discount facilities of the Federal reserve banks should be held in check. Although the Federal reserve banks have been repeatedly urged to do all in their power to restrain the tendency towards excessive rediscounting, admonitions have proved ineffective in several of the districts. Since December 26th about two hundred million dollars of Federal reserve notes have been retired, but the net reduction in invested assets of all Federal reserve banks has been only about sixty million dollars and there has been a net increase in the commercial discounts held by the system as a whole of sixty-four million dollars. It is probable that any substantial reduction in loans that may be made in the near future must be accomplished by the 15th of March, and the Board has consequently approved substantial increases in rates for the three eastern banks and has notified all other Federal reserve banks that it is prepared to act at once on their recommendations for a revision of rate schedules.

The Board concurs with the Council that the opportune moment has not yet arrived for bringing up the question of a revision of reserves. The argument made by the Council on November 17th with regard to this matter applies with even greater force today.

With respect to the question of whether bank balances due to foreign banks should be offset by foreign currency balances due from the same banks in figuring the reciprocal balance and as to whether foreign currency balances due from foreign banks may be deducted from amounts due to banks, the Board has not modified its previous ruling, published in the Bulletin for October 1919. The Board's General Counsel has examined the legal opinions submitted by the Council and feels that, independently of the question of whether or not a foreign bank is a bank within the meaning of the next to the last paragraph of Section 19, which permits deductions of balances due from banks from those due to banks, it was never intended by Congress to permit of the deduction of a balance in a foreign country from a deposit liability payable in dollars in the United States. Counsel will submit a further opinion on this subject for the consideration of the Council at its next meeting.

Very truly yours,

(Signed) W.P.G. Harding,

Governor.

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

MINUTES OF JOINT MEETING
OF THE
FEDERAL ADVISORY COUNCIL, AND
THE FEDERAL RESERVE BOARD.

February 16, 1920

At 11:30 the Federal Advisory Council met in joint session with the Federal Reserve Board in the office of Governor Harding in the Treasury Department.

Present: Members of the Federal Advisory Council: Messrs. L L Rue, W S Rowe, J G Brown, James B Forgan, F O Watts, C T Jaffray, R L Ball, A L Mills, and Merritt H. Grim, Secretary.

Members of the Federal Reserve Board: Governor W P G Harding, J S Williams, Oscar Strauss, C S Hamlin and A C Miller.

Governor Harding called the meeting order and talked on the topics submitted to the Council in his letter of January 22, 1920, also on general conditions affecting the Federal Reserve System. He suggested the following additional topics for the Council's consideration.

Effectiveness of the Federal Reserve Banks' 6% rediscount rate.

Differential rates for loans secured by Government bonds.

An amendment to the Federal Reserve Act recommended by the Federal Reserve Board giving it an additional power by adding to subdivision (d), Section 14, a proviso that each Federal Reserve Bank, may, with the approval of the Federal Reserve Board, determine by uniform rule, applicable to all its member banks alike, the normal maximum rediscount line of each member bank and that it may submit for the review and determination of the Federal Reserve Board graduated rates on an ascending scale to apply equally and ratably to all its member banks rediscounting amounts in excess of the normal line so determined. In this way in the opinion of the Board it would be possible to reduce excessive borrowings of member banks and to induce them to hold their own large borrowers in check without raising basic rates.

Rates of interest at which future government certificates of indebtedness should be issued.

Governor Harding asked the Council to make recommendations on any other subjects desired. There was some general discussion., during which Mr. Philip Stockton arrived.

The joint session then adjourned and the members of the Council returned to the Federal Reserve Board room.

MINUTES OF MEETING
OF
THE FEDERAL ADVISORY COUNCIL.

Feb. 16, 1920 (Second Session)

The Federal Advisory Council resumed its session in the Federal Reserve Board room at 12:15 M.

Present: Messrs. James B. Forgan, President, in the chair, L L Rue, Vice-President, Philip Stockton, W S Rowe, J G Brown, F O Watts, C T Jaffray, R L Ball, A L Mills, and Merritt H. Grim, Secretary.

Absent: Messrs. A B Hepburn, Oscar Wells, E F Swinney.

The chair laid before the meeting Governor Harding's letter of January 22, 1920, as hereto attached and made a part of these minutes.

The topics therein suggested were carefully considered. In regard to Topic No. 1, "Bankers Acceptances," after an informal discussion the Executive Committee was requested to draft a formal recommendation on the subject embodying the views thus expressed.

With regard to Topic No. 2, "Rates of interest on deposits paid by member banks," after discussion the following Recommendation was unanimously agreed to:

"The Council has had under consideration the rates of interest paid on several classes of deposits by the banks located in the large cities of each Federal Reserve District as shown in a statement prepared by the Federal Reserve agents and submitted to a conference of bankers representing the twelve districts recently held in Chicago. As the banks in the three central reserve cities and those in all other cities, where the rate of interest paid on bank deposits has been regulated by the current rate of discount at the Federal Reserve banks on ninety day commercial paper, have already taken action limiting the maximum rate of interest to be paid on net and available daily balances of banks and trust companies to 2¼% and as such action enables the Federal Reserve banks to increase their discount rate without reference to existing clearing house rules regulating the payment of interest, we are of the opinion that no further steps are necessary or advisable looking to the regulation of the rates of interest to be paid on deposits."

The Council adjourned for lunch to meet at 3:30 P M.

SECRETARY.

FEDERAL ADVISORY COUNCIL.

At 3:30 P M the Federal Advisory Council resumedits session.

Present: Messrs. James B. Forgan, President, in the chair, L L Rue, Vice-President, Philip Stockton, W S Rowe, J G Brown, Oscar Wells, F O Watts, C T Jaffray, R L Ball, A L Mills, and Merritt H Grim, Secretary.

Absent: Messrs. A B Hepburn and E F Swinney.

The President laid before the Council for its consideration Senate Bill 3773 providing for the payment of interest on reserve deposits in Federal Reserve banks. Mr Forgan read to the meeting a statement giving his views and arguments against the principle involved in the proposed bill. After careful consideration Mr Rue moved that the Executive Committee be requested to frame a recommendation based on Mr. Forgan's statement.

The additional topics suggested by Governor harding at the morning joint session were then taken up. They were all discussed thoroughly and in an informal manner, and the Executive Committee was requested to formulate recommendations thereon.

Mr F. O. Watts asked to be excused as he had to leave for home on an early train. He was excused.

At 5:45 P M the Council adjourned until 11 A M Tuesday, February 17th.

SECRETARY.

MINUTES OF

EXECUTIVE COMMITTEE

OF

THE FEDERAL ADVISORY COUNCIL

Feb. 16, 1920

Following adjournment of meeting of Federal Advisory Council the Executive Committee met to consider the topics that had been referred to it.

Present: Messrs. J B Forgan, L L Rue, Philip Stockton and W S Rowe, also Merritt H. Grim, Secretary.

Absent: A B Hepburn and F O Watts.

The Executive Committee prepared tentative recommendations on the topics submitted, and the secretary was instructed to typewrite copies of same.

The Committee meeting adjourned at 7:15 P M until 10 A M February 17th.

S E C R E T A R Y.

MINUTES OF THE
EXECUTIVE COMMITTEE
OF
THE FEDERAL ADVISORY COUNCIL.

Feb. 17, 1920.

As arranged the Executive Committee met in the Federal Reserve Board room at 10 A M Tuesday, Feb. 17th, 1920.

Present: Messrs. James B. Forgan, L L Rue, and W S Rowe, also Merritt H. Grim, Secretary.

Absent: Messrs. Philip Stockton, A B Hepburn and F O Watts.

The typewritten copies of the recommendations prepared at the meeting held yesterday afternoon were carefully gone over and after some amendments were approved.

The Committee also prepared for submission to the Council the following as an additional recommendation:

Topic: Are balances due from foreign banks deductible from balances due to banks for the purpose of determining reserves.

Recommendation:-

We have read the opinion of your Counsel undertaking to refute the opinions of Messrs. Sherman & Sterling; White & Case; Mayer, Meyer, Austrian & Platt; Stetson, Jennings & Russell, and Edward E Brown, all eminent bank counsel, who agree that balances due from foreign banks can lawfully be deducted from balances due to banks for the purpose of determining reserves in the manner provided by Section 19 of the Federal Reserve Act.

We submit that the great preponderance of counsel is on the side of the opinion expressed by us to the effect that balances due from foreign banks may legally be so deducted. Wholly apart, however, from the legal question on which the lawyers seem to differ five to one, itis the opinion of this Council that the question should be considered and decided by your Board along the lines of good banking practice.

The practice has heretofore existed and we know of no good reason why it should be changed now. At the present time it makes very little difference to banks carrying foreign balances, as nearly all of them have little or no balance due them in foreign countries. In normal times, however, these balances mount up into very substantial figures and there are no balances on their books more easily and more readily convertible into legal reserve balances with the Federal Reserve Banks than they are. In the interest of financing the foreign trade of this country, we therefore again respectfully urge a reconsideration of your ruling in this matter."

The Chairman was requested to present the report of the Executive Committee to the Federal Advisory Council.

SECRETARY.

MINUTES OF MEETING

OF THE

FEDERAL ADVISORY COUNCIL.

Feb. 17, 1920

The second meeting of the Federal Advisory Council was held in the Federal Reserve Board room at 10 A M Tuesday, February 17, 1920.

Present: Messrs. James B. Forgan, President, in the chair, L L Rue, Vice-President, W S Rowe, J G Brown, Oscar Wells, C T Jaffray, R L Ball, A L Mills, and Merritt H. Grim, Secretary.

Absent: Messrs. Philip Stockton, A B Hepburn, F O Watts and E. F. Swinney.

Mr. Forgan announced that an arrangement had been made with the Federal Reserve Board to meet with the Council at 12 O'clock to receive its Recommendations.

The report of the Executive Committee was then laid before the meeting and each topic was carefully read and considered.

See Recommendation as they were finally adopted following minutes of the joint conference held immediately after this meeting.

At twelve o'clock the members of the Federal Reserve Board having arrived the Council went into joint session.

SECRETARY.

MINUTES OF JOINT SESSION
OF THE
FEDERAL ADVISORY COUNCIL.
AND
THE FEDERAL RESERVE BOARD.

Feb. 17, 1920.

At 12 M. Tuesday, February 17th, 1920, the members of the Federal Advisory Council and Federal Reserve Board met in joint session.

Present: Members of the Federal Advisory Council: Messrs J B Forgan, President, L L Rue, Vice-President, W S Rowe, J G Brown, Oscar Wells, C T Jaffray, R L Ball, A L Mills, and Merritt H. Grim, Secretary.

Members of the Federal Reserve Board: Governor W P G Harding, A C Miller, Albert Strass, C S Hamlin, J S Williams, and W T Chapman, Secretary.

Governor Harding asked Mr Forgan, as President of the Federal Advisory Council, to read its recommendations.

Mr Forgan then read the Council's recommendations, after which there was a general discussion regarding the various recommendations.

After an explanation made by Governor Harding in regard to the Federal Reserve Board's attitude towards Senator Gore's bill (s 3773) it was unanimously agreed by the Council (on motion of Mr Rue, seconded by Mr Wells) that its recommendation in connection therewith should not form a part of its regular recommendations but should be handed to the Board informally with the understanding that the Board could make such use of it as in its judgement would best serve the purpose of defeating the bill.

The Council's regular recommendations as submitted to the Federal Reserve Board are attached in printed form and made a part of these minutes.

The Council's recommendation (informal) regarding Senate bill 3773 is also hereto attached and made a part of these minutes. (typewritten copy).

Various other matters were then discussed by the members of the two boards and 1:15 P M. the meeting adjourned.

SECRETARY.

RECOMMENDATIONS OF THE FEDERAL ADVISORY COUNCIL TO THE FEDERAL RESERVE BOARD

February 17, 1920

TOPIC NO. 1—Special rates for the rediscount of bankers' acceptances and the policy which should be pursued by Federal Reserve banks, having such rates, in their open market purchases.

Recommendation:

The special rate established by Federal Reserve banks for the rediscount of bankers' acceptances affords member banks the legitimate opportunity of purchasing them, carrying them as a secondary reserve, and realizing on them promptly whenever they have occasion to do so. It also, however, affords them the opportunity of purchasing them at current open market rates and having them rediscounted at the preferred rate simply for the profit in the transaction if this is permitted.

It should be understood that the object of the special rate is to encourage member banks to carry lines of this class of paper as a secondary reserve, promptly convertible into legal reserve balances when such conversion becomes necessary. With such an understanding prevailing many of the member banks would no doubt adopt the policy of carrying lines of bankers' acceptances as secondary reserves and the market for them would thus be materially broadened. In some districts this has already occurred.

The policy to be pursued therefore by Federal Reserve banks should be to leave the control of the open market for such acceptances in the hands of member banks and discount houses, so long as the former use the special rediscount rate legitimately and do not abuse it. The Federal Reserve banks should not therefore normally buy acceptances in the open market below the current rates at which the member banks and discount houses are buying them. Should it become urgently necessary to curtail rediscounts at the Federal Reserve banks rates can be raised and should it be found that the preferred rate for bankers' acceptances is being abused such discrimination in their favor should be discontinued.

TOPIC NO. 2—Rates of interest on deposits paid by member banks.

Recommendation:

The Council has had under consideration the rates of interest paid on the several classes of deposits by the banks located in the large cities of each Federal Reserve District as shown in a statement prepared by the Federal Reserve agents and submitted to a conference of bankers representing the twelve districts recently held in Chicago. As the banks in the three central reserve cities and those in all other cities, where the rate of interest paid on bank deposits has been regulated by the current rate of discount at the Federal Reserve banks on ninety day commercial paper, have already taken action limiting the maximum rate of interest to be paid on net and available daily balances of banks and trust companies to 2¼% and as such action enables the Federal Reserve banks to increase their discount rate without reference to existing clearing house rules regulating the payment of interest, we are of the opinion that no further steps are necessary or advisable looking to the regulation of the rates of interest to be paid on deposits.

TOPIC NO. 3—Effectiveness of the Federal Reserve Banks' 6% Rediscount rate.

Recommendation:

It is the opinion of the Council that the Federal Reserve Banks' 6% rate for the rediscount of ninety day commercial paper has not been without its effect on the credit situation but this rate has not been long enough in operation to determine whether or not it is high enough to effect the control desired.

TOPIC NO. 4—Differential rates for loans secured by Government bonds:

Recommendation:

In the opinion of the Council the differential rates now established in favor of loans secured by the Liberty and Victory loan bonds will ultimately have to be discontinued but we do not believe that the time has yet arrived when it should be done.

TOPIC NO. 5—The Federal Reserve Board recommends to Congress that an additional power be granted it by adding to subdivision (d), Section 14, a proviso that each Federal Reserve Bank may, with the approval of the Federal Reserve Board, determine by uniform rule, applicable to all its member banks alike, the normal maximum rediscount line of each member bank and that it may submit for the review and determination of the Federal Reserve Board graduated rates on an ascending scale to apply equally and ratably to all its member banks rediscounting amounts in excess of the normal line so determined. In this way, in the opinion of the Board, it would be possible to reduce excessive borrowings of member banks and to induce them to hold their own large borrowers in check without raising basic rates.

Recommendation:

The Council approves the principle of applying regulatory rates to such banks as are making an excessive use of the facilities of the Federal Reserve Banks, but doubts the practicability of establishing a normal maximum rediscount line applicable alike to all member banks. In determining the line of discounts and loans to be granted to a member bank due regard must be given to the nature of the business of each member bank, as it is obvious that a bank serving a commercial clientele would legitimately require a larger rediscount line than one which did not serve customers who require considerable borrowing facilities, and such bank should not be penalized for performing its proper function in financing commerce and trade.

TOPIC NO 6—Rate of interest at which future government certificates of indebtedness should be issued.

Recommendation:

If such certificates are to be of short maturity, not exceeding three months, the Council believes they may be marketed if they bear a rate of 4¾%. If, however, they are issued to mature in nine or twelve months, it is the opinion of the Council that a higher rate, bearing a closer relation to the rates current in the investment market, will be necessary in order to find a market for them. In either case a more general distribution of them should be aimed at and their concentration in the Federal Reserve banks as security for loans to member banks should be discouraged. For this purpose the Federal reserve banks' rate for loans to member banks secured by them should be not less than ¼ of 1% above the rate of interest at which they are issued.

TOPIC NO. 7—Are balances due from foreign banks deductible from balances due to banks for the purpose of determining reserves.

Recommendation:

We have read the opinion of your Counsel undertaking to refute the opinions of Messrs. Sherman & Sterling, White & Case, Mayer, Meyer, Austrian & Platt, Stetson, Jennings & Russell, and Edward E. Brown, all eminent bank counsel, who agree that balances due from foreign banks can lawfully be deducted from balances due to banks for the purpose of determining reserves in the manner provided by Section 19, of the Federal Reserve Act.

We submit that the great preponderance of counsel is on the side of the opinion expressed by us to the effect that balances due from foreign banks may legally be so deducted. Wholly apart, however, from the legal question on which the lawyers seem to differ five to one, it is the opinion of this Council that the question should be considered and decided by your Board along the lines of good banking practice.

The practice has heretofore existed and we know of no good reason why it should be changed now. At the present time it makes very little difference to banks carrying foreign balances, as nearly all of them have little or no balances due them in foreign countries. In normal times, however, these balances mount up into very substantial figures and there are no balances on their books more easily and more readily convertible into legal reserve balances with the Federal Reserve Banks than they are.

In the interest of financing the foreign trade of this country, we therefore again respectfully urge a reconsideration of your ruling in this matter.

The following members of the Federal Advisory Council were present at this meeting: Messrs. James B. Forgan, President; L. L. Rue, Vice-President; Philip Stockton, W. S. Rowe, J. G. Brown, Oscar Wells, F. O. Watts, C. T. Jaffray, R. L. Ball, A. L. Mills, and Merritt H. Grim, Secretary.

C-O-P-Y

FEDERAL RESERVE BANK OF CHICAGO.

January 31, 1930.

Memorandum for Mr. Forgan:-

In re Senate bill 3773, introduced January 22, 1930 by Mr. Gore, referred to Committee on Banking and Currency, to provide for the payment of interest on reserve balances in Federal Reserve Banks:

Amending Section 19 of the Federal Reserve Act:

Each Federal Reserve Bank shall pay to each member bank interest on reserve balances, to be computed on the daily balance at the current rate prevailing on demand deposits in the reserve or central reserve city in which such reserve bank is located:
Provided that in case the earnings of such Federal Reserve Bank after all necessary expenses and dividends have been paid, are not sufficient to pay such rate, then interest shall be paid on such reserve balances at such rate as such earnings will permit.

INFORMAL RECOMMENDATION
FEDERAL ADVISORY COUNCIL
Senate Bill 3773

FEB 17 1920

Recommendation:

The Council's attention has been drawn to Senate Bill 3773 introduced by Senator Gore, January 22, 1920, and referred to the Committee on Banking and Currency which provides for the payment of interest on reserve balances in Federal Reserve banks.

In the opinion of the Council this proposed legislation is fundamentally unsound and would lead to dangerous results. The Federal Reserve system was not intended to be, and should not be, subversive of the general banking methods of the country, that have long existed and which have grown up with and been adapted to the wants and convenience of the public. The growing policy of the Federal Reserve banks is to offer their member banks through the country every facility and service which they have hitherto had from their correspondents of long standing in the reserve and central reserve cities. The result of such policy certainly tends to the elimination of correspondent banks, other than the Federal Reserve banks or their branches in what are still designated reserve and central reserve cities. The payment by the Federal Reserve banks of interest on bank balances at the same rate now being paid by other correspondent banks would, beyond doubt, greatly enhance this tendency and would result in the transfer of a large portion of the balances still being carried by the banks through the country as secondary reserves with their correspondents in the reserve and central reserve cities

These secondary reserve deposits amount to over $3,000,000,000 in the national banks, according to the last published combined statement of their condition, to which may be added an estimated amount of $1,500,000,000 in the State banks and trust companies, making together the large sum of $4,500,000,000. The present amount due by the Federal Reserve banks to member banks on reserve deposit balances is $1,850,000,000. The combined balances of the banks with the Federal Reserve banks and with other correspondents is therefore (partly estimated) $6,350,000,000, of which the former have now 34% and the latter 66%.

It might be well to consider the effect of the transfer of any considerable portion of these secondary reserve balances from present correspondent banks to the Federal Reserve banks. It can be shown that to the extent of such transfer takes place the availability of such funds for loaning purposes will be reduced 26%. This is shown as follows:

The present bank deposits in National banks according to their last published combined statement are	$3,053,000,000
Estimated bank deposits in State banks and trust companies	1,500,000,000
	4,553,000,000
Deduct average legal reserves carried by banks in reserve and central reserve cities, say 12%,	546,360,000
Present amount available for direct loans to customers engaged in trade and commerce	$4,006,640,000
These bank deposits all transferred to Federal Reserve banks would increase their deposits by	4,553,000,000
against which their required gold reserve would be 35%	1,593,550,000
The available loanable amount would be	2,959,450,000
but this amount could only be loaned in the channels of trade and commerce through the process of member banks rediscounting their loans at the Federal Reserve Banks.	

The amount of these bank deposits now available for direct loans made by member banks to their customers is	$4,006,640,000
The amount of the same funds available for re-discounts by Federal Reserve banks and therefore not directly loanable to trade and commerce would be	2,959,450,000
The shrinkage in useable funds would therefore be 26% or.	$1,047,190,000
It will be noticed that the member banks now have their legal reserve against bank deposits in the Federal Reserve banks, presumably in gold, amounting to	546,360,000
Transferring these deposits to the Federal Reserve banks would increase the legal reserve required on them, also in gold, to	1,593,550,000
The Federal Reserve banks would therefore have to find somewhere	1,047,190,000
additional gold reserve, or an amount exactly equal to the amount of the shrinkage in available loanable funds; where would they get it.	

The next point to be considered is, that the correspondent banks, would of necessity have to call in and curtail their loans to an amount practically equal to the amount transferred from them to the Federal Reserve banks. It may be said that they could rediscount at the Federal Reserve banks, but with the increased gold reserves these banks would have to find for their increased deposits their ability to thus protect the situation is open to serious doubt. The inevitable result would be to produce a violent contraction of commercial credit resulting in serious confusion and distress.

The profits of the twelve Federal Reserve banks for the year 1919 in excess of their dividends paid were $97,000,000. These were of course quite abnormal due to the extraordinary conditions prevailing and connot be accepted as a criterion for what they will be in normal times. Had the banks paid interest on reserve deposits at the average current rate paid by other banks, say 2-1/4% their profits would have been reduced by about $40,000,000.

Under ordinary conditions owing to the gold reserves they must carry, the Federal Reserve banks cannot afford to pay interest on balances as the other member banks in the reserve and central reserve cities can, illustrated as follows:

On deposit of	$100.00	
reserve city banks carry legal reserve of 10%	10.00	
and have available for loaning purposes	90.00	
Loanable at present at, say 6%, yields		$5.40
The overhead expense may be placed at 1-1/2%	1.50	
and present average interest paid is 2-1/4%	2.25	3.75
The net profit is therefore		1.65%

On a deposit of	$100.00	
central reserve city banks carry legal reserve of 13%	13.00	
and have left for loaning purposes	87.00	
Loanable at present at, say 6%		5.22
Less overhead expenses 1-1/2%	1.50	
Less interest paid 2-1/4%	2.25	3.75
Their net profit is therefore		1.47%

On a deposit of	$100.00	
Federal Reserve banks carry gold reserve of 35%	35.00	
and have left for rediscount purposes	65.00	
At their present 90 days' rediscount rate 6% yields		3.90
Less overhead expenses 1-1/2%	1.50	
Less interest paid 2-1/4%	2.25	3.75
Their net profit would be		.15/100th of 1%

This shows that the Federal Reserve banks' profits under normal conditions are very largely dependent on their not paying interest on deposits.

Moreover, the payment of interest on reserve deposits is opposed to all sound principles of reserve banking. If interest is paid on such deposits they must be kept steadily invested while the correct policy of Federal Reserve banks in normal times should be to invest as little as possible.

It has been suggested that interest might be paid on the amount of legally required balances only, which would simply mean that the stockholders would receive a dividend not of 6% but 6% plus interest on their reserve balances, which might please the individual member bank but would be a most unsound course to pursue as it entails the necessity of keeping such balances steadily invested.

It should be also borne in mind that the Federal Reserve banks pay neither local nor Federal Taxes and that after their surpluses have been built up equal to their subscribed capitals, all profits above dividends, less 10% to be added to surplus, go to the U. S. Government in lieu of taxes. They could easily have paid interest on reserve deposits the past two years but instead they have been permitted to materially strengthen themselves in their capitalization and have no doubt laid the foundations for a substantial government revenue in the future, while in the meantime their member banks have practically all had unusually large earnings and have therefore no good grounds for complaint in that connection.

The fears herein expressed are all contingencies to be guarded against, and to us they appear so ominous that we would strongly urge the Federal Reserve Board to use their influence and their effort to prevent Senate Bill 3773 from being enacted into law.