MINUTES OF SPECIAL MEETING

of the

EXECUTIVE COMMITTEE

of the

FEDERAL ADVISORY COUNCIL

June 14, 1923

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A special meeting of the Executive Committee of the Federal Advisory Council was held at 31 Pine Street, New York City, Thursday, June 14, 1923.

The Chairman, Mr. Rue, called the meeting to order at 11.30 A. M.

Present:

Mr. L. L. Rue, Chairman	District No. 3
Mr. Paul M. Warburg	District No. 2
Mr. John M. Miller, Jr.	District No. 5
Mr. H. L. Hilyard	Secretary.

Absent:

Mr. A. L. Aiken	District No. 1
Mr. J. J. Mitchell	District No. 7
Mr. E. F. Swinney	District No. 10

Mr. Rue, Chairman, presented letter from the Federal Reserve Board dated June 7, 1923, enclosing copy of communication from the First Federal Foreign Banking Association of New York City, dated June 6, 1923, urging the Board to redraft its regulations covering Section 25-a of the Federal Reserve Act to provide for the following points:

> "(1) 'Edge Bill' banks shall be permitted to accept drafts and bills of exchange involving the exportation and importation of goods or the assembling and storage of goods destined for foreign export for periods ranging from three months to one year without having to obtain special authority for acceptances beyond the six months' period.
>
> (2) Such banking institutions may extend credits or make loans upon proper security or bank guarantee to foreign institutions for periods of one to five years, and may issue debentures, collateral trust notes or bonds against such credits or loans or may endorse or guarantee and sell such credits or loans with this endorsement or guarantee provided, however, that if such banking institution shall at the same time be conducting a general acceptance business the total amount of its acceptances, debentures, notes and all other outstanding obligations of any kind or nature shall not exceed eight times the amount of its paid-in capital stock, surplus or undivided profits."

A general discussion took place as to the merits of the questions submitted.

The Chairman presented letter from Mr. Mitchell giving his views and telegram from Mr. Swinney stating his opinion.

Mr. Warburg reported having had a conversation with Mr. Aiken on the subject the day before, and presented Mr. Aiken's views, which were substantially in accord with the reply which was subsequently adopted by the Executive Committee and forwarded to the Federal Reserve Board.

After due consideration, reply to the Federal Reserve Board's letter was drafted and unanimously adopted, and Mr. Rue, Chairman of the Executive Committee, was instructed to sign and forward it immediately to Governor Crissinger. Copy of the letter is attached hereto and made part of these minutes.

At 2.30 P. M., the meeting adjourned.

H. L. HILYARD,

Secretary.

RECOMMENDATION OF THE EXECUTIVE COMMITTEE OF THE FEDERAL ADVISORY COUNCIL TO THE FEDERAL RESERVE BOARD

June 14, 1923.

(Subsequently approved by the Council)

June 14th, 1923.

Hon. D. R. Crissinger,
Governor, Federal Reserve Board,
Washington, D. C.

Dear Governor Crissinger:

The Executive Committee of the Federal Advisory Council met today and considered the letter of the Federal Reserve Board dated June 7th, enclosing communication from the First Federal Foreign Banking Association of New York City, dated June 6th, urging the Board to re-draft its regulations covering Section 25-A of the Federal Reserve Act to provide for two requirements, marked (1) and (2) on page 2 of their letter.

The Executive Committee of the Federal Advisory Council begs to state its opinion as follows:

With regard to (1), the Committee does not consider it equitable to make rulings on the eligibility of acceptances made by acceptance corporations different from the rulings covering acceptances made by member banks. If it is necessary for member banks to secure the approval of the Federal Reserve authorities before issuing acceptances beyond six (6) months, the same rule should also be applied to acceptance corporations.

With regard to (2), the so-called Edge Law is a combination of two separate projects; one was a law prepared several years before by the Counsel of the Federal Reserve Board, which law was designed to provide for a Federal charter for banks or corporations in which national banks should have the privilege to invest, such corporations doing an acceptance business, and operating in foreign countries, either through branches or through the ownership of subsidiary corporations. In providing for acceptance corporations of this kind, two objects were had in mind:

1. That it should be possible for several banks to combine in the ownership of such a corporation, thereby creating a joint instrument with which to operate in foreign countries, it being realized that unless such a combination were permitted, only very few of the very strongest banks would be able to engage in foreign banking. The American Foreign Banking Corporation and the Mercantile Bank of the Americas were the immediate outgrowth of this legislation, which, it is interesting to remember, was proposed and adopted as against Mr. McAdoo's plan, who wished the Federal Reserve Banks themselves to go to foreign countries with organizations of their own acting as "agencies".

2. American deposit banks being properly restricted with regard to their acceptance powers to one hundred or one hundred fifty per cent. of their capital and surplus, while acceptance corporations were not permitted to accept domestic deposits, it was provided that acceptance corporations, like British acceptance houses, should be allowed to accept a multiple of their capital and surplus.

Congress amended the Federal Reserve Act so as to permit national banks to invest in acceptance corporations of this kind, but neglected to pass a law authorizing their existence under a Federal charter. The draft of the law remained, therefore, hanging fire until Senator Edge became interested in passing legislation permitting national banks to invest in investment corporations in a similar manner as they had been authorized to do with regard to acceptance corporations. He then took the draft of the law prepared for acceptance corporations and simply added to it the powers governing investment corporations. Two entirely distinct projects were thus covered by one law. When the Board was asked to write its regulation it quite properly proceeded to separate these two functions, and the Committee holds the view that it would be a mistake to make the changes now proposed by the First Federal Foreign Banking Association.

Investment banking and acceptance banking are two entirely different matters; acceptance banking deals entirely with short-termed credits of a commercial nature, the risk being short, and the funds of the corporation being kept liquid as a reserve fund to be available in case of default in payment on the part of any debtors. It would interfere with the liquidity and safety of these corporations, as acceptance corporations, if they locked up their funds in illiquid loans against which they would put out their own obligations. All banking traditions in Europe, where this acceptance business has been developed, abhor the thought of having an acceptance bank issuing its long term obligations in the market. It is obvious if any of these long term loans went bad, and the debentures of the acceptance corporation would begin to sell at a discount, that their acceptances could not be sold; also that in case the collateral of the securities, on which these debentures had been issued, could not be liquidated when the debentures matured, that the safety of the acceptances would be impaired.

As against these considerations, very little importance may be attached to the argument of the First Federal Foreign Banking Association to the effect that some business may be "switched" from acceptances into long term obligations. Such transactions, if they are really based on import and export transactions, are extremely unlikely, and if they existed, they could be carried temporarily by a cash advance, or an acceptance credit might be secured from others. It is true that acceptance corporations have no easy time in making both ends meet, and earning a dividend. If greater latitude, however, is to be given to them, it must be sought on other lines, which do not run counter to safe banking principles.

Very truly yours,

L. L. RUE,

Chairman, Executive Committee.