

MINUTES OF MEETING
of the
EXECUTIVE COMMITTEE
of the
FEDERAL ADVISORY COUNCIL
held in Washington, D. C.
December 18, 1932

MINUTES OF MEETING OF THE EXECUTIVE COMMITTEE OF THE
FEDERAL ADVISORY COUNCIL

December 18, 1932.

At 10:00 A. M. Mr. Smith called the meeting to order at the Mayflower Hotel, Washington, D. C.

Present: Mr. W. W. Smith, President; Messrs. W. C. Potter, Alternate for R. H. Treman, H. A. Loeb, J. K. Ottley, M. A. Traylor, and Walter S. McLucas.

This Special Meeting of the Executive Committee was called by the President in view of advice that the Glass Bill was to be presented to the Senate for immediate consideration and passage, and it was deemed advisable to present the Council's views and recommendations to the members of the Banking and Currency Committee.

After thorough discussion of the Bill, in which Mr. R. V. Fleming, Chairman of the Legislative Committee of the American Bankers' Association, participated by invitation, a report was drafted, copy of which is attached hereto and made a part of these Minutes, recommending certain changes and amendments to the Bill. The Committee requested the President to file a copy of said report with the Hon. Peter Norbeck, Chairman of the Banking and Currency Committee, and to send an additional copy to each member of the Banking and Currency Committee and to Governor Meyer of the Federal Reserve Board.

Mr. W. C. Potter submitted to the Committee drafts of the suggested amendments (prepared by Mr. Potter's attorneys in New York) which would carry out the recommendations of the report. It was decided that the President should send twenty copies of the Committee's recommendations to each member of the Council with the request that the members of the Council get in touch with the Senators in their respective Federal Reserve Districts in an endeavor to point out to the Senators the objectionable and harmful features of the Bill, and Mr. Potter agreed to forward copies of the proposed amendments, which, if adopted, would make the Bill conform to the recommendations. These reports and amendments were sent to the various members of the Council and favorable letters were received from a number of members of the Council indicating the results of their activities.

Messrs. McLucas and Traylor were compelled to leave the meeting at four o'clock, but signified their assent to the original draft of the report and recommendations.

The Committee adjourned at 11:15 P. M., and on Monday, December 19, Messrs. Ottley, Potter, and Smith, called upon a number of Senators, members of the Banking and Currency Committee.

WALTER W. SMITH,
President.

FEDERAL ADVISORY COUNCIL

From Washington, D. C.,
December 19, 1932.

Hon. Peter Norbeck, Chairman,
Banking and Currency Committee,
United States Senate,
Washington.

Sir:

The Executive Committee of the Advisory Council has given careful consideration to S. 4412. It desires to make the following suggestions which are in part covered by amendments which have already been offered in the Senate of the United States. They represent matters which we deem of vital importance. For convenience, our conclusions are divided into two parts: Part One, dealing with matters more directly affecting the operations of member banks, and Part Two, dealing with the basic principles of the structure and operations of the Federal Reserve System. The sections of the Bill are discussed in the sequence in which they occur in the Bill and without reference to their relative importance.

PART ONE

1. Section 5 (b):

In June, 1917, Section 9 of the Federal Reserve Act was amended to incorporate that—

. . . . "any bank becoming a member of the Federal Reserve System shall retain its full charter and statutory rights as a State bank or trust company, and may continue to exercise all corporate powers granted it by the State in which it was created,"

Many State banks were induced to come into the System in reliance upon this provision. The present Bill deprives State member banks of important charter and statutory rights, by the provision of Section 5 (b), which requires that State member banks shall be subject to the same limitations and conditions with regard to purchasing, selling, underwriting and holding of investment securities and stock as are applicable to national banks under Section 5136 of the Revised Statutes, as that Section is to be amended by Section 14 of this Bill. We believe, if the provision in Section 9 of the Federal Reserve Act, which we have quoted, means anything, it means that by entering the Federal Reserve System, State banks and trust companies are not to be deprived of rights which they enjoy under their charters and under State law, and which relate to the conduct of each individual bank, as a bank, and do not affect the operations of the Federal Reserve System, as a system. No other interpretation of this language would give to it any substantial meaning at all.

The rights hereinbefore referred to, granted in the Act of June, 1917, led many State banks to take membership in the Federal Reserve System and to continue the character of investments which would be barred under the proposed Act. This provision would compel State member banks to sell these investments, which would, under present conditions, result in great loss. We regard Section 5 (b) as a violation of the terms which were used to induce a large number of State banks to join the Federal Reserve System.

2. Section 7 (12B) Page 14. Liquidating Corporation:

In general, the Council endorses the idea of a liquidating corporation. It is, however, not in harmony with the provisions as set forth under Section 7 (12B) of the proposed Act. The Council is of the opinion that such a corporation as is proposed should be financed by the United States Treasury. The subscription to the capital stock of the liquidating corporation required under S. 4412 can be ill afforded by a very large number of member banks.

3. Section 14, Page 34:

By abolishing the present rights of national and state member banks to deal in and underwrite investment securities and by imposing certain restrictions upon the holding of investment securities and by requiring the elimination of security affiliates of member banks, the Bill would dangerously curtail the existing facilities for providing long-term capital funds. The functioning of this service as fully and efficiently as possible is of vital importance to states, municipalities, railroads, utilities and, generally to commerce and industry, especially at this time when the constantly recurring maturities of obligations made for capital purposes, is one of the principal retarding factors. The present facilities for obtaining long-term capital have been built up and are maintained, in a very large part, by the participation of member banks, either directly or through the medium of security affiliates. We believe that unless member banks are permitted to continue their contribution toward the maintenance of these facilities, the resulting inability of American business to obtain long-term funds will become a major source of difficulty.

For these reasons, we believe the provisions of the Bill further restricting the investment powers of member banks should be eliminated.

Section 14 further prohibits the purchase for its own account by a member bank of more than 10% of any issue of investment securities of any one obligor or maker. We believe it desirable to place restrictions in this respect, but we consider it more logical to base these restrictions on some reasonable percentage of the bank's capital and surplus, rather than upon any percentage of the particular issue of securities.

Section 14 further provides on Page 36, Lines 4 to 8, that the limitations contained in that section are not to be applied to obligations of the United States or "general obligations of any state or of any political subdivision thereof or obligations issued under the authority of the Federal Farm Loan Act as amended." This proviso as to Government obligations merely removes the *limitations* upon the amount of securities of any one obligor. It does not remove the general prohibition against underwriting or purchasing

such securities for resale. Such prohibition would vastly impair the ability of states and cities to do long-term financing. Today almost all state and municipal financing is done through groups of banks and bankers who purchase for immediate resale.

Even if Section 14 were amended in such a manner as to permit member banks to underwrite and distribute Government, state, and municipal obligations, member banks could not afford to maintain bond departments solely for this purpose. It may be noted that no exception is included in this Section as to obligations of the Reconstruction Finance Corporation or obligations of governmental agencies such as Port Authorities, etc.

4. Security Affiliates. Section 5 (b) Page 8, Lines 11 to 19. Section 16 and Section 18:

What we have said in Point 3 as to the necessity of maintaining present facilities for providing long-term capital, applies equally to the provisions in the Bill which require separation of security affiliates from member banks. This will, at least in some instances, result in the dissolution of the security affiliate and its elimination from the long-term capital market, since the distribution of the stock of the affiliate to stockholders even when freed from restrictions as to sale would not meet the requirements of the Bill, inasmuch as the Bill prohibits continued common stock ownership where a majority of the stock of each institution is held by the same stockholders.

We approve of examination of and reports by security affiliates as provided in the Bill, except as hereinafter stated. We also approve of the restrictions on loans to and investments in a security affiliate by a member bank, as provided in the Bill. Furthermore, we recommend the regulation of security affiliates by the Federal Reserve Board in such manner as it may see fit, but we believe the compulsory separation of affiliates would be detrimental to the public interest.

5. Section 22:

The Bill amends Section 5200 of the Revised Statutes by bringing all the subsidiaries of any corporation within the single limitation of loans to 10% of the capital and surplus of the bank. We believe this provision is essentially unwise in that it does not take into account the varying credit positions of many subsidiary companies in the country. Many large corporate groups have legitimate credit needs well in excess of this limitation, and the individual members thereof are able to support lines of credit on the basis of their statements and records. The attempt to apply such a hard and fast rule to the credit requirements of members of corporate groups is sure to result in inequity and hardship. This provision applies only to national banks.

6. Reports by and Examinations of Affiliates. Section 5 (b), Section 23 and Section 24 (a):

Section 5 (b), Page 7, Lines 7 to 9, and Section 23, Page 48, Lines 3 to 5, provide that reports of affiliates of member banks are to be published by the bank under the same conditions as govern its own condition reports. Since the reports required by these sections may include material in addition to a financial statement of condition, and since it seems

to be the clear intention of these sections that only the condition reports shall be published, we think these two sections of the Bill should be amended to provide that only the condition reports of such affiliates as are engaged in the banking business or a related business shall be published.

With regard to the examination of national banks and other affiliates, the Bill in Section 24 (a), Page 49, Lines 5 to 13, introduces a new penal provision allowing the Comptroller of the Currency to publish the report of the examination of any national bank or affiliate which does not comply with the recommendations of the Comptroller based on such examination. The clause as it stands is controversial in character and should be stricken out pending further study of the subject and the enactment of legislation which will apply equally to all banks in the Federal Reserve System.

PART TWO

8. Section 3 (a), Section 7 (12A), Section 8, and Section 9:

The Bill, in several places, increases the power of the Federal Reserve Board, and decreases the power of the Federal Reserve Bank. We believe that such a grant of additional power to the Board at the expense of the Federal Reserve Banks is contrary to the lines laid down in the original Federal Reserve plan; that is, twelve autonomous regional banks supervised, but not operated, by the Federal Reserve Board. This plan provides elasticity and local self-government properly adapted to the great expanse of territory over which it operates. Under it, the Federal Reserve Board supervises the Federal Reserve System, but does not actively engage in its operations. It seems to us of the greatest importance that the power of supervision in the Board shall not be transferred into the power to manage, since the function of the Board is, and must remain, to supervise and not to manage. So long as there is no central bank in Washington for the Board to manage, its powers should be carefully restricted to matters of supervision.

We suggest, therefore, that the Bill be amended so as to carry out the principle of a decentralized group of banks of issue, enjoying full autonomy and having full responsibility, subject always to supervision, rather than operation by the Federal Reserve Board in Washington.

In submitting the foregoing recommendations, the Federal Advisory Council does so with no spirit of obstructive criticism, but submits them simply as its conclusions from a practical viewpoint on the Bill as it has been presented to the Senate. We believe if this Bill is adopted with the modifications which we have suggested, it will be a desirable step forward in the progress of banking legislation. At the same time we cannot conclude this memorandum without expressing the opinion that such a Bill would by no means completely cover the field of desirable banking legislation. We feel that there are some very fundamental phases of the banking structure of the United States which deserve the most careful study and consideration and from which an improved banking structure might be evolved.

Respectfully submitted,

W. W. SMITH,
President.