

MINUTES OF MEETING
of the
FEDERAL ADVISORY COUNCIL
February 15-16, 1942
and of the
MONTHLY MEETING
of the
EXECUTIVE COMMITTEE
March 12, 1942

OFFICERS AND MEMBERS OF THE FEDERAL ADVISORY COUNCIL

For the Year 1942

OFFICERS:

President, Edward E. Brown
Vice President, George L. Harrison
Secretary, Walter Lichtenstein

EXECUTIVE COMMITTEE:

Edward E. Brown
George L. Harrison
William Fulton Kurtz
B. G. Huntington
Robert V. Fleming
S. E. Ragland

MEMBERS:

Charles E. Spencer, Jr.	Federal Reserve District No. 1
George L. Harrison	Federal Reserve District No. 2
William Fulton Kurtz	Federal Reserve District No. 3
B. G. Huntington	Federal Reserve District No. 4
Robert V. Fleming	Federal Reserve District No. 5
H. Lane Young	Federal Reserve District No. 6
Edward E. Brown	Federal Reserve District No. 7
S. E. Ragland	Federal Reserve District No. 8
Lyman E. Wakefield	Federal Reserve District No. 9
W. Dale Clark	Federal Reserve District No. 10
Nathan Adams	Federal Reserve District No. 11
George M. Wallace	Federal Reserve District No. 12

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; 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. To fill a vacancy, the President, or in his absence, the Vice President shall be authorized to designate as a member of the Executive Committee for a given meeting another member of the Council other than one elected to the Executive Committee.

ARTICLE V. DUTIES OF THE EXECUTIVE COMMITTEE

It shall be the duty of the Executive Committee to keep in close touch with the Board of Governors of the Federal Reserve System 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 its 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 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 Tuesday of the months of February, May, September, and November of each year, unless otherwise directed by the Executive Committee.

A preliminary meeting of the Federal Advisory Council shall be called by the Secretary in accordance with instructions to be given by the President of the Council.

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. ALTERNATES

In the absence of the regular representative of any Federal Reserve District, the Board of Directors of the Federal Reserve Bank of that District may appoint an alternate. The alternate so appointed shall have the right to be present at all the meetings of the Council for which he has been appointed. He shall have the right to take part in all discussions of the Council but shall not be entitled to vote.

ARTICLE VIII. AMENDMENTS

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

February 15, 1942.

MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

February 15, 1942

The first and organization meeting of the Federal Advisory Council for 1942 was convened in Room 336 of the Mayflower Hotel, Washington, D. C., on Sunday, February 15, 1942, at 2:15 P. M.

Present:

Mr. Charles E. Spencer, Jr.	District No. 1
Mr. George L. Harrison	District No. 2
Mr. William Fulton Kurtz	District No. 3
Mr. B. G. Huntington	District No. 4
Mr. Robert V. Fleming	District No. 5
Mr. H. Lane Young	District No. 6
Mr. Edward E. Brown	District No. 7
Mr. S. E. Ragland	District No. 8
Mr. Lyman E. Wakefield	District No. 9
Mr. W. Dale Clark	District No. 10
Mr. George M. Wallace	District No. 12
Mr. Walter Lichtenstein	Secretary

Absent:

Mr. Nathan Adams	District No. 11
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Mr. Edward E. Brown was elected Chairman *pro tem* and Mr. Walter Lichtenstein Secretary *pro tem*.

The Secretary stated that communications had been received from the twelve Federal Reserve banks, certifying to the election of their representatives in accordance with the above list.

Upon nominations for the office of the President of the Council being called for, Mr. Edward E. Brown was nominated. On motion, duly made and seconded, the nominations were closed, and the Secretary was instructed to cast the ballot for Mr. Brown, who was thereupon declared elected President of the Council for the year 1942.

Upon nominations for the office of the Vice President being called for, Mr. George L. Harrison was nominated. On motion, duly made and seconded, the nominations were closed, and the Secretary was instructed to cast a ballot for Mr. Harrison, who was thereupon declared elected Vice President of the Council for the year 1942.

The President, Mr. Brown, thereupon called for nominations for the four appointive members of the Executive Committee. Messrs. W. F. Kurtz, B. G. Huntington, Robert V. Fleming, and S. E. Ragland were nominated. On motion duly made and seconded, these gentlemen were unanimously elected members of the Executive Committee for the year 1942, the President and Vice President being *ex officio* members.

On motion, duly made and seconded, Mr. Walter Lichtenstein was elected Secretary of the Federal Advisory Council for the year 1942 at a salary of \$2500.00 per annum.

On motion, duly made and seconded, the Council readopted the existing by-laws, which are attached hereto and made a part of these minutes.

On motion, duly made and seconded, the minutes of the Council meeting of November 16-17, 1941, copies of which had been previously sent to the members, were approved.

The Secretary presented his financial report for the year 1941, which had been audited by Mr. J. J. Buechner, Assistant Auditor of The First National Bank of Chicago, which on motion, duly made and seconded, was approved and ordered to be printed. The report is attached hereto and made a part of these minutes.

On motion, duly made and seconded, the following resolution was unanimously adopted:

“Resolved that the Secretary be and he is hereby authorized to ask each Federal Reserve bank to contribute \$350.00 toward the Secretarial and incidental expenses of the Federal Advisory Council for the year 1942 and to draw on it for that purpose.”

The President of the Council discussed various suggestions made for the amendment of Regulation W, and he also discussed at some length the proposed amendment to Section 7(d) of the Securities Exchange Act of 1934. He pointed out that this proposed amendment had been inadequately discussed at the hearings held by the Committee on Interstate and Foreign Commerce of the House of Representatives, but that the Federal Advisory Council had reserved the right to file a statement opposing the proposed amendment.

A lengthy discussion took place regarding the question of direct purchases by the Federal Reserve System from the Treasury of issues of securities. In general, the members of the Council were opposed to this, but recognized that, under existing conditions, it might be necessary to give permission to the Federal Reserve System to make direct purchases of government securities from the Treasury.

At 2:45 P. M. Mr. Adams joined the meeting.

A formal resolution was not adopted, but Mr. Harrison formulated the views of the Council, as follows:

“The Federal Advisory Council believes that there is objection in principle to the unrestricted right of a central bank to make advances to the Treasury, but in view of the seriousness of the present emergency and in view of the interpretation put upon the proposed law that purchase of Government securities directly from the Treasury is subject to the judgment of each Federal Reserve bank and not subject to the unrestricted direction of the Open Market Committee, there is no practicable objection to the proposed amendment.”

The subject of the pattern of financing the gap in the war program, which will have to be closed by the banks, was then considered. At the end of the discussion, the President of the Council pointed out that the members of the Council did not have any unanimity of opinion and that, in fact, their views were so diverse that a general statement could not be drawn up, but that the matter might well be discussed with the Board.

A discussion of reserve requirements then ensued. The Council unanimously voted, on motion by Mr. Harrison, seconded by Mr. Fleming, that reserve requirements should not be changed at present. The resolution, as finally adopted, reads as follows:

"The Federal Advisory Council believes that in principle, at least, reserve requirements should remain as stable as possible and that changes in such requirements should not be made unless clearly required by the credit situation. The Council is of the opinion that there is no present need for a change in reserve requirements."

On motion made by Mr. Harrison, seconded by Mr. Ragland, the following resolution was unanimously adopted:

"The Federal Advisory Council suggests the desirability of the Treasury considering favorably an increase in the amount of Treasury bills to be issued each week."

It was decided not to take any action with respect to Regulation W, as the whole situation had been altered as the result of the introduction of priorities and allocations.

In respect to the proposed amendment to Section 7(d) of the Securities Exchange Act of 1934, it was decided that the President of the Council be asked to prepare a statement, giving the reasons for the opposition of the Council to the proposed amendment, and that this statement should be forwarded to the Committee on Interstate and Foreign Commerce of the House of Representatives.

The meeting adjourned at 6:00 P. M.

WALTER LICHTENSTEIN,
Secretary.

NOTE: The President of the Council prepared a statement, dated March 2, 1942, stating the reasons for the opposition of the Federal Advisory Council to the proposed amendment to Section 7(d) of the Securities Act of 1934. A draft of this statement was sent to each member of the Council, and the members of the Council having expressed their approval of the statement, it was duly transmitted to the Chairman of the Committee on Interstate and Foreign Commerce of the House of Representatives. It is attached hereto and made a part of these minutes.

March 2, 1942

HONORABLE CLARENCE F. LEA,
CHAIRMAN, COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE,
HOUSE OF REPRESENTATIVES,
WASHINGTON, D. C.

My dear Mr. Lea:

Your Committee's hearings having been concluded, the Federal Advisory Council of the Federal Reserve System desires to express its attitude on the proposed amendment to Sec. 7(d) of the Securities Exchange Act of 1934 through the means of this letter,— in accordance with the privilege reserved for us by you last month through the good offices of the Board of Governors of the Federal Reserve System. Inasmuch as the Committee Print states that this amendment is proposed by the Board of Governors, we have refrained from comment pending our discussion of it with the Board of Governors at our meeting with them on February 16, 1942 in Washington. They are aware of our intention to file a memorandum in opposition to the amendment and interpose no objection to our doing so.

The presentation of the American Bankers Association in opposition to this proposed amendment (by memorandum, dated January 28, 1942, signed by Mr. A. L. M. Wiggins, Chairman of the Association's Committee on Federal Legislation) clearly discloses the purpose and limited scope of the existing Sec. 7(d) of the Securities Exchange Act of 1934, to-wit,— the regulation of loans secured directly or indirectly by securities "for the purpose of purchasing or carrying any security *registered on a national securities exchange*". In other words, borrowings from banks, secured by the pledge of securities, were to be and are subject to regulation only to the extent that the purpose of such borrowings brings them within the scope of the Securities Exchange Act (Sec. 2) as a transaction in securities "commonly conducted upon securities exchanges and over-the-counter markets".

The proposed amendment would confer authority on the Board of Governors of the Federal Reserve System to regulate any extension of credit by anyone to anyone for the purpose of purchasing or carrying any type of security in transactions unrelated to the purposes and scope of the Securities Exchange Act. Under the amendment, for instance, a man working his way up in a small corporation, the stock of which is unregistered, could borrow money to purchase some of such stock only within such margin limitations as might be set by the Board of Governors of the Federal Reserve System. A bank, familiar with the corporation and its management and the capacity and character of the borrowing purchaser, frequently meets the requirement of the purchaser by loaning him substantially the full purchase price of the stock. Such a transaction, of course, has no relation to the purpose of the Securities Exchange Act of 1934 and any loan limitation predicated on some arbitrary valuation of the stock to be purchased and pledged behind the loan serves no useful economic purpose. Another illustration,— if on the death of the owner of a closed corporation, the stock of which is unregistered, his heirs, none of whom are qualified to carry on the business, desire to avail themselves of the best, if not the only, market for the stock by selling it to men active in the management of the corporation, any loan for the purpose of purchasing such stock, to be secured by a pledge of the stock when acquired, should obviously be left to stand on its own merits and any arbitrary limitation on such a transaction can serve no purpose contemplated in the Securities Exchange Act of 1934 or any other useful purpose that we can envisage. Again, the beginnings of many small corporate enterprises depend on the ability of the incorporators to borrow liberally against the value of their stock in the new corporation,— from banks or individuals or jointly from both. What is the occasion for imposing limitations on their capacity to do so? As a general query, why should anyone be limited, other than by the

merits of the particular case, in his capacity to borrow money to buy any security, if the acquisition of that security is unrelated to any purpose contemplated by the Securities Exchange Act of 1934?

Incidentally, if the power sought under the proposed Sec. 7(d) were granted, how could it be administered as a practical matter in any workable regulatory formula? The maximum loan value of the particular security would have to be related percentage-wise to some price. The regulatory formula must predicate the determination of that price on some reasonably simple and clear standard in order to avoid utter confusion or substantial elimination of the type of transaction being regulated. The "current market price" of securities dealt with on the security exchanges affords a simple and readily ascertainable figure on which to base the loan values of securities traded on the exchanges. Stocks not registered on an exchange or dealt in actively in over-the-counter markets, encompassed by the proposed amendment, have no such current market price and the determination of their price for loan purposes in ordinary banking transactions depends on a multitude of circumstances and considerations, rarely the same in any two cases, which cannot be rationally reflected in any workable regulatory formula. There are limits to the regulatory refinements within which the national economy can effectively function.

The Federal Advisory Council unanimously opposes the adoption of the proposed amendment to Sec. 7(d) because the new regulatory power therein sought (1) does not belong in the Securities Exchange Act of 1934, not being pertinent to the accomplishment of any purpose of that Act, and (2), standing independently, is both unnecessary and undesirable. If, in view of war requirements, it is deemed necessary to impose such credit controls, they should and can be effected under existing emergency legislation. A control, such as contemplated in the amendment to Sec. 7(d), should not under any circumstances, we believe, be incorporated in non-emergency legislation until its necessity and desirability have been clearly demonstrated.

It should be remembered that the proposed amendment to Sec. 7(d), concededly, is not designed as a regulatory control over the merits of a particular loan for the protection of the lending bank. Existing supervisory controls over banks in such respects have proved sufficient. Moreover, the proposed amendment is not designed for the protection of the banking structure as a whole, i.e., as a limitation on the aggregate extensions of such credits based on the over-all quantity which may be prudently and safely absorbed by the banking structure. Sec. 11(m) of the Federal Reserve Act (1935) already provides the Board of Governors of the Federal Reserve System with a power to establish loan limitations to prevent "the undue use of bank loans for the speculative carrying of securities". Incidentally, the Board of Governors has found no occasion for the exercise of this Sec. 11(m) power,— because, it may be assumed, (1) its regulation of loan values in respect of *registered* securities under the existing Sec. 7(d) of the Securities Exchange Act of 1934 has apparently removed any need for the exercise of its Sec. 11(m) powers over banks in respect of credit extensions involving a purchase or carry of *registered* securities and (2), presumably, no need for the exercise of the Sec. 11(m) powers has arisen in respect of the purchase or carry of any other type of securities.

The avowed objective of the proposed amendment to Sec. 7(d) is to create a mechanism for imposing loan limitations on any borrowing, from banks or elsewhere, involving the purchase or carry of any *unregistered* security,— in other words, to extend the existing Sec. 7(d) regulatory power into the unregistered security field and apply it to borrowings having no relation to a transaction in securities "commonly conducted on security exchanges and over-the-counter markets". We fail to see any public interest that justifies such an additional regulatory power. We can foresee, however, the disruptive and destructive impacts on every day transactions affecting intimately the aspirations and welfare of numberless individuals,— if such an unlimited regulatory power should ever be granted and applied. It is to be hoped that the proposed amendment will not be adopted

in the absence of some preponderant showing that it is requisite for the protection of some specific public interest which outweighs the individual hardships it will entail.

Mr. Parry, Chief of the Division of Security Loans of the Board of Governors of the Federal Reserve System and apparently the most active proponent of the amendment, in his testimony before your Committee on January 20, 1942 in its support, concedes that it goes beyond the scope of the Securities Exchange Act of 1934 and states frankly that the additional type of control sought by the amendment is not predicated on any need for it up to the present time but should be made available as an independent control measure against the potentiality of its need in the future. We submit that a governmental regulatory power should not be created on any such hypothesis,— particularly so in this instance in the absence of any inquiry into the potential imminence of its potential need and its potential desirability in the light of the degree of such potential need if and when it may arise. Moreover, the granting of such regulatory power in anticipation of its future need automatically raises at least the prospect of any untimely exercise of the power by the grantees on the simple human defensive reaction that they will be charged with dereliction of duty if they do not proceed to carry out the "Congressional mandate".

We readily accept any governmental control of our national economy essential to war requirements. We may easily reconcile ourselves to the necessity of governmental controls of our peace-time economy in the light of a demonstrated national interest. Without any inconsistency, however, we can, we believe, validly oppose the creation of regulatory powers in the absence of any national interest or requirement. We, therefore, urge that the proposed amendment of Sec. 7(d) be rejected.

This memorandum has the unanimous approval of all of the twelve members of the Federal Advisory Council and is respectfully submitted on their behalf.

FEDERAL ADVISORY COUNCIL

(Signed) E. E. BROWN,
President

REPORT OF THE SECRETARY OF THE FEDERAL ADVISORY COUNCIL

For the Year Ending December 31, 1941

Balance on hand December 31, 1940.....	\$4,596.58	Salary.....	\$2,500.00
Assessment—Twelve Federal Reserve Banks.....	4,200.00	Conference expenses.....	834.74
		Printing & stationery.....	362.25
		Postage, telephone, and telegraph.....	71.03
		Miscellaneous.....	35.78
		Balance on hand December 31, 1941.....	4,992.78
	<u>\$8,796.58</u>		<u>\$8,796.58</u>

Chicago, Illinois
January 6, 1942

To the Federal Advisory Council:

I have audited the books, vouchers, and accounts of the Secretary of the Federal Advisory Council for the year ending December 31, 1941, and certify that the above statement agrees therewith.

Respectfully,

THE FIRST NATIONAL BANK OF CHICAGO,
By J. J. Buechner,
Asst. Auditor

MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

February 16, 1942

At 10:00 A. M., the Federal Advisory Council reconvened in the Board Room of the Federal Reserve Building, Washington, D. C., the President, Mr. Brown, in the Chair.

Present:

Mr. Charles E. Spencer, Jr.	District No. 1
Mr. George L. Harrison	District No. 2
Mr. William Fulton Kurtz	District No. 3
Mr. B. G. Huntington	District No. 4
Mr. H. Lane Young	District No. 6
Mr. Edward E. Brown	District No. 7
Mr. S. E. Ragland	District No. 8
Mr. Lyman E. Wakefield	District No. 9
Mr. W. Dale Clark	District No. 10
Mr. George M. Wallace	District No. 12
Mr. Walter Lichtenstein	Secretary

Absent:

Mr. Robert V. Fleming	District No. 5
Mr. Nathan Adams	District No. 11

The draft of the resolution dealing with reserve requirements, which will be found in the minutes of the previous meeting, was presented and approved.

The draft of the resolution dealing with the issue of Treasury Bills, which was adopted at the previous meeting, was presented and approved.

The meeting adjourned at 10:15 A. M.

WALTER LICHTENSTEIN,
Secretary.

MINUTES OF JOINT CONFERENCE OF THE FEDERAL ADVISORY COUNCIL
AND THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

February 16, 1942

At 10:30 A. M., a joint conference of Federal Advisory Council and the Board of Governors of the Federal Reserve System was held in the Board Room of the Federal Reserve Building, Washington, D. C.

Present: Members of the Board of Governors of the Federal Reserve System:

Chairman Marriner S. Eccles; Vice Chairman Ronald Ransom; Governors M. S. Szymczak and Ernest G. Draper; also, Lawrence Clayton, Assistant to the Chairman; Elliott Thurston, Special Assistant to the Chairman; Chester Morrill, Secretary of the Board of Governors; Liston P. Bethea and S. R. Carpenter, Assistant Secretaries; Walter Wyatt, General Counsel; Magruder Wingfield, Assistant General Counsel; E. A. Goldenweiser, Director, Division of Research and Statistics; Leo H. Paulger, Chief, Division of Examination; Edward L. Smead, Chief, Division of Bank Operations, and Carl E. Parry, Chief, Division of Security Loans.

Present: Members of the Federal Advisory Council:

Mr. Edward E. Brown, President; Mr. George L. Harrison, Vice President; Messrs. Charles E. Spencer, Jr., William Fulton Kurtz, B. G. Huntington, Robert V. Fleming, H. Lane Young, S. E. Ragland, Lyman E. Wakefield, W. Dale Clark, Nathan Adams, George M. Wallace, and Walter Lichtenstein, Secretary.

The President of the Council brought up the matter of reserve requirements, and the Chairman of the Board of Governors discussed the issue at considerable length.

The President of the Council stated that he thought there was not any disagreement between the Board and the Council on the subject of reserve requirements.

The Chairman of the Board of Governors discussed at some length the whole fiscal situation.

The Secretary of the Council read the resolution dealing with the issue of Treasury bills.

The President of the Council read the statement, as drawn up by Mr. Harrison, giving the views of the Council as to the direct purchases of government securities by the Federal Reserve Bank.

The Chairman of the Board of Governors denied that he had ever said that a local Federal Reserve bank should have any voice as to the decision as to when direct purchases are to be made. In his opinion, the whole matter would have to be left in the hands of the Open Market Committee.

Governor McKee joined the meeting at 12:10 P. M.

A lengthy discussion took place about war financing in respect to which the Chairman of the Board of Governors made a lengthy statement.

The President of the Council brought up the matter of the proposed amendment to Section 7(d) of the Securities Exchange Act of 1934. He stated that the Council felt

that permanent power to regulate the margin requirements in the case of collateral loans made on unregistered securities should not be given to the Board of Governors. He pointed out some of the reasons why the members of the Council are opposed to the proposed amendment.

The President of the Council stated, furthermore, that the Council wished to file a statement with the Committee on Interstate and Foreign Commerce of the House of Representatives.

The Chairman of the Board of Governors stated that the Board did not have any objections to the filing of such a statement as proposed by the Federal Advisory Council.

The President of the Council asked the Board of Governors what its attitude would be if the Executive Committee of the Council arranged to meet with the Board of Governors once a month, even though it be for only a brief period. He said that the members of the Council felt that such meetings during the present emergency would be advantageous. The members of the Board of Governors stated that they were willing to meet with the Executive Committee of the Council once a month. The Secretary of the Board of Governors and the Secretary of the Council were instructed to work out a schedule for such monthly meetings.

The meeting adjourned at 1:55 P. M.

WALTER LICHTENSTEIN,
Secretary.

MINUTES OF JOINT CONFERENCE OF THE FEDERAL ADVISORY COUNCIL
AND THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

February 16, 1942

At 2:50 P. M., a joint conference of the Federal Advisory Council and the Board of Governors of the Federal Reserve System was held in the Board Room of the Federal Reserve Building, Washington, D. C.

Present: Members of the Board of Governors of the Federal Reserve System:

Vice Chairman Ronald Ransom; Governors M. S. Szymczak, John K. McKee; also, Chester Morrill, Secretary of the Board of Governors; Liston P. Bethea and S. R. Carpenter, Assistant Secretaries of the Board; Walter Wyatt, General Counsel; George B. Vest and Magruder Wingfield, Assistant General Counsels; E. A. Goldenweiser, Director, Division of Research and Statistics; Leo H. Paulger, Chief, Division of Examination; Edward L. Smead, Chief, Division of Bank Operations, and Carl E. Parry, Chief, Division of Security Loans.

Present: Members of Federal Advisory Council:

Edward E. Brown, President; Messrs. Charles E. Spencer, Jr., William Fulton Kurtz, B. G. Huntington, Robert V. Fleming, H. Lane Young, S. E. Ragland, Lyman E. Wakefield, W. Dale Clark, Nathan Adams, George M. Wallace, and Walter Lichtenstein, Secretary.

Governor McKee stated that he had in mind three subjects concerning which he wished the advice of the Council:

- 1—Certain provisions under Regulation Q
- 2—Taxation of bank stock dividends and the effect on bank supervision
- 3—Proposal to repeal the prohibition against member banks of the Federal Reserve System paying dividends or making loans while their reserves are deficient.

In respect to 1, Governor McKee expressed the opinion that there ought to be a notice of withdrawal required from savings bank depositors.

The sentiment of the Council seemed to be to let matters rest and not attempt to make any changes at this time. In respect to 2, Governor McKee felt that stock dividends by banks should not be treated as current income, for it is desirable in certain instances that banks increase their capital, and, at the present time, it is difficult for banks to increase their capital by selling stock in the open market. A request for legislation of this kind would have to come from the supervising authorities for the purpose of placing banks in position to protect exposed assets.

There was some discussion. The President of the Council summed up the feeling of the members that, while being in sympathy with the suggestion of Governor McKee, it seemed doubtful whether it would be possible to obtain legislation to exempt bank stockholders from any tax levied on others.

In respect to item 3, Governor McKee stated that he believed it was inadvisable, especially under present conditions, to maintain the rigid requirement that reserves must be intact at all times. He believed, e. g., that when, at tax periods in some states, withdrawals are unusually heavy, banks might, for a very temporary period, be allowed to

make use of their reserves and thus avoid the necessity of liquidating any of their bond portfolio. There was a feeling on the part of members of the Council that exceptions made in connection with reserve requirements would create trouble, and the President of the Council stated that if the computation of reserves in the case of banks located in reserve and central reserve cities was on a weekly basis, as is true of country banks at the present time, the difficulties, to which Governor McKee referred, would in large part be averted.

The meeting adjourned at 3:30 P. M.

WALTER LICHTENSTEIN,
Secretary.

MINUTES OF MEETING OF THE FEDERAL ADVISORY COUNCIL

February 16, 1942

At 3:35 P. M., the Federal Advisory Council reconvened in the Board Room of the Federal Reserve Building, Washington, D. C., the President, Mr. Brown, in the chair.

Present: Edward E. Brown, President; Messrs. Charles E. Spencer, Jr., William Fulton Kurtz, B. G. Huntington, Robert V. Fleming, H. Lane Young, S. E. Ragland, Lyman E. Wakefield, W. Dale Clark, Nathan Adams, George M. Wallace, and Walter Lichtenstein, Secretary.

The Council listened to a discussion of business conditions presented by Dr. E. A. Goldenweiser, Director of Research and Statistics of the Board of Governors. He discussed in considerable detail the questions arising as a result of the war, the effect of the war on business conditions, the fiscal policy of the government, and the role of the Federal Reserve System in the present emergency.

The meeting adjourned at 4:15 P. M.

WALTER LICHTENSTEIN,
Secretary.

Note: The transcript of the Secretary's notes is not to be regarded as complete or necessarily entirely accurate. The transcript should be considered as being strictly for the sole use of the members of the Federal Advisory Council.

W. L.

Secretary's notes on meeting of the Federal Advisory Council on February 15, 1942, at 2:00 p. m., in room 336 of the Mayflower Hotel, Washington, D. C.

All the regular members of the Federal Advisory Council were present at the beginning except Mr. Nathan Adams who joined the meeting at 2:45 p. m. Mr. Edward E. Brown was elected Chairman pro tem, and Mr. Walter Lichtenstein Secretary pro tem.

The Secretary stated that communications had been received from all the twelve Federal Reserve Banks certifying to the election of their representatives.

Upon nominations for the office of President of the Council being called for, Mr. Edward E. Brown was nominated and unanimously elected.

Upon nominations for the office of Vice President being called for, Mr. George L. Harrison was nominated and unanimously elected.

The following four members of the Council were elected as appointive members of the Executive Committee: Messrs. W. F. Kurtz, B. G. Huntington, Robert V. Fleming, and S. E. Ragland.

Mr. Walter Lichtenstein was elected Secretary of the Federal Advisory Council for the year 1942 at a salary of \$2500 per annum.

The Council readopted the existing By-laws which will be printed and attached to the formal minutes of the Council when these are distributed to the members.

The Secretary presented his financial report for the year 1941 which was approved and ordered to be printed. As usual, it was voted to authorize the Secretary to draw upon each Federal Reserve Bank for \$350 to pay for secretarial and incidental expenses.

The minutes of the Council meeting of November 16-17, 1941 were approved.

Brown referred to the various suggestions made for the amendment of Regulation W. Then he spoke of the proposed amendment to 7(d) of the Securities and Exchange Commission Act of 1934, which is intended to give the Board of Governors of the Federal Reserve System the same power of regulation over unlisted securities which it now has over listed securities, bonds, and the like, an exception being made for Government bonds, as well as State and municipal bonds. Parry was the only representative of the Board who testified at the hearings of the House Committee on Interstate and Foreign Commerce, and he was on the stand only fifteen minutes. He spoke on 7(d) for only five minutes, and stated that speculation in listed securities might spill over into unlisted securities, and under existing conditions that might create an inflationary movement. It would, therefore, be very desirable if the Board had the power in case of necessity to prevent violent speculation in this class of securities if such should arise. Brown went on to point out that such a provision was unnecessary and might work considerable hardship. For example, if an owner of most of the shares of stock of a closely held corporation should die and his employees should want to buy the business, then a bank could not make a loan for such a purpose except subject to the regulations of the Board. Such power in the hands of the Board would mean a further step toward complete credit control. There isn't any point in providing against a speculative movement in these securities at the present time, for as long as the emergency lasts the President can now confer the necessary power upon the Board under the Trading with the Enemy Act; consequently there isn't any need for permanent legislation on this subject at this time. This whole matter was presented at the hearings of the Congressional Committee as if the suggestion had been fully agreed to by the Securities and Exchange Commission and the investment bankers.

Brown brought up the question of direct purchases by the Federal Reserve System from the Treasury of issues of securities. If direct purchases are to be made they should be limited probably to issues with maturity of not more than one year, and also limited as to amount. The Senate has passed the bill permitting direct purchases, and the bill has also been recommended by the House Committee. However, much opposition to it has arisen in the House. It may be recalled that when the bill which ultimately became the Banking Act of 1935 was being considered, Eccles wanted the power to make direct purchases and also the right to raise reserve requirements to 100%. He also asked that the functions of the Open Market Committee be transferred entirely to the Board.

Fleming regards the power as a very dangerous one, though recognizes in certain emergencies it might be needed.

Wakefield. Eccles has a plan to nullify all influence of local Federal Reserve Bank boards and to eliminate all banker influence on these boards. In other words, he wants the Board to have full control.

Harrison believes it very dangerous to give such a power without any limitation. He believes it was the power of the central banks to buy directly from the Treasury that caused the financial downfall after the last war of both

Germany and France. The power in question may be needed in an emergency, and it must be remembered that at times the Bank of England has gone into the market and bought up a whole issue in order to prevent any violent fluctuations.

Wakefield. We are at present partners in business with the Government helping it to finance the war, and it is essential to have the machinery to stave off a financial disaster and during the present emergency it may be necessary to give the Board the power for which it has asked. It simply cannot be permitted that a Government issue should fail.

Harrison does not know how effective any limitation that could be made may be, but at any rate the Congress and the Government generally will then be made to realize that the power may be a very dangerous one. He believes that direct purchases would be handled by the Open Market Committee, but he is under the impression that Eccles does not believe that it would rest in the Open Market Committee.

Brown made a statement that Congressman Charles S. Dewey saw Bell, and apparently Bell believes that the power should be limited to the purchase of six-months' bills. He goes on to say that he was rather of the opinion that the Administration wants the bill enacted into law.

Bagland does not think there is any need of Federal Reserve Banks buying directly from the Treasury.

Brown. In 1934-35 bankers felt that if Government credit wasn't good, then it was desirable to have Government securities decline in price and thus make the situation evident. Now we have a different situation and it would be a major disaster if an issue were to fail. At the present time the proposal is not coupled with any suggestion of unlimited control over reserves. As a matter of fact, the Treasury at the present time probably wants reserves lowered, and, furthermore, the proposed bill provides that the power granted cease either in 1944 or six months after the war is over. There is some danger that if too much opposition to the bill develops, it may result in proposals to give unlimited power to the Board and couple this with unlimited power over reserves.

Harrison suggests that the Council better not do anything that is futile, and it may be well simply to state that the Council has discussed the matter. While it is opposed to the general principle of direct purchases, nevertheless in view of Eccles' statement that the Open Market Committee can not give a mandate to make direct purchases but this would rest in the hands of the local Federal Reserve Banks, therefore the Council at the present time will not oppose the bill.

Spencer has also heard that the Treasury wants reserves lowered.

Fleming agrees with Harrison that accepting Eccles' interpretation of this would be a more effective limitation than the limitation to six-months bills or the like. As long as a governmental body does not have the full power to make the purchases, there isn't any serious objection.

Brown. At the present time commercial banks may accept war loan deposit accounts only up to 100% of capital and surplus. On February 13 the Treasury issued a regulation permitting commercial banks to take war loan deposit accounts amounting to 150% of capital and surplus. Furthermore, the local Federal Reserve Banks have been informed that in case of any special emergency, banks may be authorized to accept still larger war loan deposit accounts.

All the members present were asked as to their respective opinions and all agreed with Harrison who put into writing the view of the Council as follows:

"The Federal Advisory Council believes that there is objection in principle to the unrestricted right of a central bank to make advances to the Treasury, but in view of the seriousness of the present emergency and in view of the interpretation put upon the proposed law that purchase of Government securities directly from the Treasury is subject to the judgment of each Federal Reserve Bank and not subject to the unrestricted direction of the Open Market Committee, there is no practicable objection to the proposed amendment."

The subject of the pattern of financing the gap in the war program which will have to be closed by the banks was then considered.

Kurtz is very much concerned by possible attempts of the Treasury to stick too closely to financing the war by orthodox methods. This would result in the trebling of Government holdings in commercial banks. Kurtz points out that banking institutions would not be able to stand up against demands made by the Treasury. If every few months a new issue is put out, then bonds will gradually decline with very bad results. He believes that arrangements should be made to put out long-term bonds at a fixed rate in a sort of tap issue. This will make investment funds available and the bill market can then be held in reserve. Banks can do a good job if bond prices remain more or less stable, otherwise in 15 to 18 months we may suddenly discover that bonds have fallen greatly in price. After all he questions whether our banking structure can absorb an indefinite amount of bonds.

Eakefield does not believe the maturity is an all-important factor, while Kurtz thinks there is a great difference between bonds having a maturity up to 10 years, and those running for 25 to 30 years.

Harrison thinks many of these special issues by the Treasury are wrong, but a survey should be made as to how much investment money is really available and give each class of investors what it wants.

Wakefield thinks it would be much better if there wasn't all this oversubscription of bonds because the result is it is impossible to tell how strong the market really is.

Spencer thinks there ought to be some limitation placed upon indefinite growth of deposits resulting in the capital structure of banks being completely out of line with their liabilities. He believes that after the limit of deposits is reached all future investments should be in a Government security of a low rate which does not fluctuate in value to any extent. He believes that a ten-year maturity is too long a period.

Brown says he does not see why the bill market would not take care of the situation just as well as bonds.

Spencer says that his idea is to have a certain class of issues open only to banks and that they should be in the nature of a tap issue. Study should be made of how banks can use increased deposits to buy this special type of bonds available only for banks.

Wallace is afraid of the suggestion as it would limit the market for bonds outstanding at the present time.

Huntington believes a special issue of bonds would be good but it would be rather difficult to fix a rate fair to all. He does not think there ought to be anything compulsory about the buying of bonds, and the bonds should carry a rate sufficiently high to enable banks to live.

Wakefield says he doesn't have a very fixed opinion on the subject but he does object to a legal restriction on the amount of deposits a bank may receive. He feels that this would simply involve further control by the Government over money, and would result in credit becoming a purely governmental function. Banks then would be more or less service institutions. He thinks if such provisions were put into effect as suggested they would remain to haunt banks for all time, and very careful consideration should be given to any such measures.

Clerk would leave things as they are except provide for a tap issue of fairly long-term maturity.

Harrison thinks it is a question of sound fiscal administration. There ought to be special issues for investors of different categories. In Britain the banks are financing the war and bills are issued with a rate of 1-1/8%, and so in a sense the banks are being subsidized. He objects to securities which really represent a demand liability on the part of the Government, and he would like to see the amount of issue of defense bonds limited to a given percentage of the total national debt.

Brown wants to know what is being done about having banks buy long-term bonds with relatively high prices, and in case of trouble, depending upon the Government to take care of the situation.

Harrison says that there ought to be a security to take care of special needs.

Fleming objects to further restrictions to be imposed upon banks. He believes that the present orthodox system might well be continued but the banks should not take securities having a maturity of more than ten years. Insurance companies and similar investors might well take the longer term securities. He would be entirely in favor of having banks forbidden to take securities of more than ten years.

Ragland thinks a study should be made of the situation but go on with the present method at this time.

Young believes in a study of Treasury needs, and a second study of the sources to meet the various needs. He is in favor of limiting banks to ten-year maturities.

Adams says that all this needs a lot of study. He believes defense bonds are bad. There ought to be certain types of bonds which banks cannot buy, and an issue of bonds at a rate which will make them attractive to general investors. He believes a non-negotiable bond is fundamentally undesirable.

Brown points out that the members of the Council do not have any unanimity of opinion, and in fact, their views are so diverse that a general statement could not be drawn up but the matter might well be discussed with the Board.

Brown then suggested discussion of the attitude of the Council toward reserve requirements. Morgenthau wants reserves lowered to induce banks to buy more bonds, while Eccles wants reserve requirements, if anything, increased in order to force funds into the Federal Reserve Banks which then can buy the bonds. He also suggests that the Executive Committee of the Council in future meet once a month as long as the emergency lasts.

Brown also points out that changes in reserve requirements might be made by executive order.

Adams says he prefers to leave the reserve requirements as at present since the lowering of requirements would merely increase deposits as a result of pyramiding.

Huntington believes that it is wrong to let reserve requirements be determined by the shifting need for the sale of bonds.

Brown points out that when the joint statement of December 31, 1940 was issued we were faced by a spiral of inflation. We were not at war, there weren't any controls over prices or the like, there wasn't any Lend-Lease, and the result of it all was that gold was flowing in very large amounts into the country. Morgenthau fears the reserve situation in New York is such that

very soon New York banks will not be in a position to buy bonds freely. New York banks have lost large amounts of deposits, while practically all other sections of the country have gained.

Fleming says that at present we are faced with shortages in many things, and the needs have changed completely since December 31, 1940.

Wakefield states that in his opinion it is not wise to reduce reserve requirements at present, but if the needs of the Treasury should require it, it would have to be done.

Harrison feels that the mechanism of changing reserve requirements should not be resorted to except in case of great need, and he doubts whether the Council believes that the need is sufficiently great at this time. There should be as far as possible stability in reserve requirements, and there should not be frequent changes. At the moment the Treasury does not need new financing, and so certainly at this time reserve requirements should be left as they are.

Brown believes that the Council might well pass a resolution on the subject.

The Council unanimously voted, on motion by Harrison seconded by Fleming, that reserve requirements should not be changed at present. The resolution as finally adopted reads as follows:

The Federal Advisory Council believes that in principal at least, reserve requirements should remain as stable as possible and that changes in such requirements should not be made unless clearly required by the credit situation. The Council is of the opinion that there is no present need for a change in reserve requirements.

Harrison points out that the British have always had during the war a much larger issue of bills than we have ever had.

Brown would like to see a larger issue of bills, which would help to deflate deposits. If the rate on bills were fixed between $\frac{3}{8}$ and $\frac{3}{4}$ of 1%, a large amount of corporate funds and unused funds of States and municipalities would be put into bills and thus taken out of banks.

On motion made by Harrison and seconded by Bagland, the following resolution was unanimously adopted:

The Federal Advisory Council suggests the desirability of the Treasury considering favorably an increase in the amount of Treasury bills to be issued each week.

Loans to industry

Kurtz suggests that the Council find out what the Board really has in mind. The Council is opposed, as it does not believe in direct loans to industry by the central banking system.

Regulation W

Harrison suggests that nothing be done about Regulation W. After all, it has little importance at present as the whole situation is taken care of by priorities and allocations.

Brown discusses the proposed amendment to section 7(d) of the Securities and Exchange Act of 1934. He feels certain that the Council is opposed to this amendment, and he suggests that it be discussed with the Board and a letter sent to the Interstate and Foreign Commerce Committee of the House stating the position of the Council.

Harrison believes that the whole purpose is to enable Henderson of the Office of Price Administration and Civilian Supply to get control of the mortgage loans made by insurance companies

Brown makes the statement that he understands the Council is opposed to the proposed amendment, and that he will send a letter to the Interstate and Foreign Commerce Committee of the House stating the position of the Council.

Wakefield suggests that Government officials be warned to be more careful in statements such as tapping savings, which cause trouble all over the country. He also discussed false statements in advertising put out by the Federal Savings and Loan Associations

The meeting adjourned at 6 p. m.

Secretary's notes on meeting of the Federal
Advisory Council on February 16, 1942, at
10:00 a. m., in the Board Room of the Federal
Reserve Building, Washington, D. C.

All members of the Council were present except
Messrs. Fleming and Adams.

The draft of the resolution dealing with reserve re-
quirements, which was adopted at the previous meeting, was pre-
sented and approved.

The draft of the resolution dealing with the issue
of Treasury bills, which was adopted at the previous meeting,
was presented and approved.

The meeting adjourned at 10:15 a. m.

Secretary's notes on meeting of the Federal Advisory Council on February 16, 1942, at 10:30 a. m., in the Board Room of the Federal Reserve Building, Washington, D. C.

The Council met with the Board. All members of the Council were present except Mr. Fleming, who joined the meeting at 10:50 a. m. Of the Board, the following were present: Eccles, Ransom, Szymczak, McKee, Draper, Clayton, Thurston, Morrill, Bethea, Carpenter, Wyatt, Wingfield, Goldenweiser, Paulger, Smead, and Parry. It should be noted that Governor McKee was not present at the beginning of the meeting, but joined it at 12:10 p. m. The Secretary of the Council read the resolution dealing with reserve requirements.

Brown says that the Council recognizes that in the present situation there may have to be sudden changes, but thinks that at present change is not needed.

Eccles: Reserve requirements have not been formally considered by the Board and the Treasury. However, it has been suggested that the problem may have to be considered within a month or so. He does not believe that the reserve requirements should be lowered at present. If rates of the short-term money market are at present still below $3/8$ of 1%, it would not appear as if there were any need to ease up the situation any further. To be sure, New York, at this time, does not have as large a proportion of excess reserves as it has had in the past. It all gets down to a question of how to finance the war. If the Treasury desires to continue to have over-subscriptions by banks and wants the banks to be the chief buyers of bonds, then it is desirable, obviously, to have larger amounts of excess reserves. If the Treasury, however, means what it says - that it wishes to have as much of the financing as possible done outside of the banks, then, obviously, large funds in the banks must be tapped. With banks having larger deposits and fewer Governmental securities available for investors, everything ought to be done to avoid a further expansion of bank deposits by having banks buy most of the Government securities. If money in circulation continues to increase and hoarding goes on, then it may become necessary to do something about reserve requirements. On the whole, open market operations are to be preferred to changes in reserve requirements. Something might be done in connection with changing the present arrangement of the three classes of banks, to-wit: banks in central reserve cities, banks in reserve cities, and all others. If the statute were amended, Chicago ought not to be a central reserve city, for after all, the flow of money is fundamentally in and out of New York and rates are largely determined by the situation in the New York money market. For this reason, it may at times be highly desirable to have reserve requirements in New York changed and not affect other parts of

the country. Eccles states that these are merely his personal views, but he believes the other members of the Board agree.

Ranson, Szymczak, and Draper thereupon stated that they were in agreement with the Chairman.

Brown states that he does not believe there is any disagreement between the Board and the Council and that the matter has been merely brought up in consequence of a personal and confidential remark made to Brown by Secretary of the Treasury Morgenthau.

Ranson agrees with Brown that in these times changes may have to be made rather suddenly.

Eccles: Morgenthau said to Eccles that he would like a discussion about reserve requirements after the income tax collections of March 15 are out of the way. Eccles told him that before reserve requirements were considered, it might be well to have some consideration given to a long range program for everything depended on what the Treasury really wanted. If financing is to be done largely through banks, then reserves may have to be lowered. The Secretary of the Treasury agreed to have a full discussion of the whole program before giving consideration specifically to the question of reserve requirements. Eccles notes that there might well be some other types of securities besides merely defense bonds. When financing of 2½ billion dollars a month is required, as will shortly be the case, the situation requires very different measures from those taken in more normal times.

Harrison says life insurance companies must know what the long range program is to be because at the present time, they do not feel free to buy Government bonds at the present low rate to the extent that they would if they knew what the future situation in connection with the Government bond market is to be. If the insurance companies were told to buy 2½% bonds freely as a patriotic duty, they would do so without any hesitation.

Eccles: It is true everywhere in the world that there is a feeling that central banks do not play any part in the war economy. In this view, the quantity of money is not important as prices are controlled and goods are rationed, and as a result, people cannot do anything with money. Henderson does not believe this to be true and Eccles is in agreement with Henderson on this subject. The British and the Germans also recognize that everything possible must be done to reduce funds in the hands of the people. A proper tax system and proper financing will use the existing funds for the purpose of purchasing Government securities and will avoid, as far as possible, creating new funds. There are people in the Treasury who lean toward the school which holds the view that the amount of money is unimportant. However, the whole trend is toward the view that funds in the hands of the people should be

restricted, as far as possible. Even in Germany, in spite of her great, direct control over the situation, it was found that price control and rationing, alone, will not do the job. Consequently, so-called "iron savings" were introduced by which savings are forced into the purchase of Government securities, bearing a rate of $3\frac{1}{2}\%$.

The Secretary of the Council read the resolution dealing with the issue of Treasury Bills.

Brown points out that it would be most desirable to have a larger supply of Treasury bills than exists at present and suggests that instead of issuing around 150 million dollars a week, the amount be raised to 300 million dollars a week. If this were done, many corporations, states, and municipalities would be willing to put their surplus funds into Treasury bills. They are not interested in the present low rate, but they would be if the rate went to about $1/4$ of 1% . If this were done, the rise in bank deposits would be checked somewhat and also the flow of funds between banks would diminish. He pointed out that since the rate has gone above $1/4$ of 1% , the State of Illinois and some railroads, about which he is informed, have begun to buy Treasury bills. There is needed, however, a more stable market for these bills and a larger supply of them.

Eccles: The Open Market Committee has suggested to the Treasury that there should be more bills issued but the Open Market Committee is not undertaking to suggest the amount. The Treasury officials do not seem to disagree with this view, but simply have not done anything about the matter. There are various ways of preventing savings from becoming too large. Thus, for example, the Treasury might reduce balances in the banks and have the Open Market Committee buy just prior to the various tax periods; then, in addition, withholding taxes of various kinds might also be introduced.

Brown says bills would work automatically, while the other methods would not. It might be if the supply of bills were increased and other similar steps taken that the great swings, now existing in the flow of funds into and out of individual banks, might be prevented, and also the present large swings between various districts might be checked somewhat. This large flow of funds in and out of districts is due to the action of Lend-Lease and production of war goods, which, at various times, result in unusually large payments being made in certain districts, the funds for this purpose being withdrawn from other districts. In connection with the longer range program, there is not any consensus on the part of the Council. In connection with direct purchases of issues by the Federal Reserve Banks, the statement as drawn up by Harrison, giving the views of the Council, was read by Brown: namely, that "the Federal Advisory Council believes that there is objection in principle to the unrestricted right of a central bank to make advances to the

Treasury, but in view of the seriousness of the present emergency, and in view of the interpretation put upon the proposed law that the purchase of Government securities directly from the Treasury is subject to the judgment of each Federal Reserve Bank and not subject to the unrestricted direction of the Open Market Committee, there is no practicable objection to the proposed amendment."

Eccles denied that he ever said that the local Federal Reserve Bank should have any voice in the decision of the direct purchases. The law would be useless if any such interpretation were made and no action would be taken under it, and the matter would be left in the hands of the Open Market Committee, as at present.

Ransom pointed out that the bill pending in Congress could not possibly have the meaning stated by Brown, and he pointed out that all the bill proposes is to take out the last six words, reading: "but only in the open market" of Section 14, 3(b) of the Federal Reserve Act. Ransom also referred to Section 12A under which the present Open Market Committee is constituted.

Harrison said he had an idea when he heard of the interpretation presented by Brown that the argument was that direct purchases are not open market operations and that, therefore, the right of decision to make them would revert to the local Federal Reserve Bank.

Eccles disagrees with the Council on the whole question and also does not believe that the direct purchases caused the difficulties in Germany and France, and he had Dr. Goldenweiser distribute a memorandum discussing this question.

Harrison states that he does not feel there is any real difference between the Council and the Board on the need of the enactment of the proposed bill. The Council believes that with or without the supposed interpretation, the bill should be passed.

Brown agrees with Harrison.

Ransom states his view that with some limitation as to possible amount and character, the direct purchasing should be permitted, even after the present emergency has passed.

Brown reiterates that the Council is in favor of the present bill and as to permanent arrangements - that, at the moment, after all, is an academic question.

Brown brings up the question of the pattern of war financing. The members of the Council were not in agreement except that they all felt that there should be some plan. The Treasury seems to be following a hand-to-mouth policy, borrowing as the spending departments of the Government need money. The defense bonds are a demand liability on the Treasury and therefore involve

a certain amount of danger. There are many schools of thought as to what should be done. The Council feels that the Board must have considered the problems, and the members of the Council would very much like to have the Board's views.

Ransom in turn suggests that it would be of great value to the Board to know what the different lines of thought of the members of the Council were. The Board has had discussions for months with the Treasury and while there has been some progress made, no definite plan has been evolved.

Brown says that the Council has about eight different plans in mind.

Fleming says that there was an agreement among members of the Council that securities bought by banks should not have a maturity beyond ten years.

Eccles states that he does not see any difference between registered and non-negotiable instruments on the one hand and other bonds in so far as demand liability is concerned. He believes it would be inappropriate to discuss in detail the memorandum submitted by the Board to the Treasury prior to discussing it with the Treasury. He does not see any objection, however, in telling the members of the Council of certain of the principles upon which the memorandum submitted to the Treasury is based.

At this point Governor McKee joined the meeting, it being 12:10 p. m.

Eccles says the feeling of the Board is that banks should be used for financing only as a last resort, i. e., after all other funds have been tapped as far as possible. The Board feels the Treasury has not gone as far as it might in this direction. It would be inadvisable to do the financing on the scale required through the open market. If that were to be done, then excess reserves would have to be increased and the Board would have to take action on reserve requirements much sooner than it might wish to do. In the case of open market operations, banks are the underwriters and if banks sold off some of their securities, there would arise the problem of a secondary market. If private investors buy under such conditions, they have found they must usually pay a premium. There are large corporation balances that are not being used and there are also private investors with large uninvested funds, such as trusts and the like. At present there are rarely any Government securities which these people wish to buy. The defense bonds now being sold were designed for a certain class and there should be other securities designed for other classes. There should be a tap issue. It might be provided that this last class of security could be cashed only after giving notice say of anywhere between thirty and ninety days. There might be a further provision that the rate of interest might increase the longer the security was held. Par would be paid, but the instrument would not be negotiable and banks would not be allowed to buy this instrument. Then there might well be another issue somewhat similar to Series G which would be made available to insurance companies and similar long-term investors.

Brown questions whether corporations have as large funds as sometimes are thought to be available. A discussion took place about railroad funds and the like.

At 12:20 P. M. Eccles left the meeting.

McKee says there ought to be a variety of bonds to meet various needs, to which Harrison agrees. There are too many banks whose limitation of capital structure is out of line with their deposits. There is a danger they would buy too many bonds and get into serious trouble.

Wakefield points out how trusts are limited in subscribing for bonds. For example, a bank cannot sell Government bonds to a trust from its own portfolio and to buy these bonds in the open market is most unsatisfactory.

Harrison thinks a registered bond which had a six-months period before it could be redeemed would cut out the so-called "free riders", but probably would not eliminate the small banks. To be sure, when the war is over and people may need the money badly, there may be a sudden great demand on the Treasury at a time when it will be hardest for the Treasury to meet the demand.

Wakefield: Banks are involved with the Government now to such an extent that their solvency depends almost entirely upon Government securities. The result is that there is needed a long-range view as to what the rate pattern is to be.

At 12:40 P. M. Eccles returned.

Wakefield: For this reason he believes the Federal Reserve System must have the right to buy directly from the Treasury so as to have complete control of the rate structure.

Ransom says he does not believe that direct purchasing necessarily should become a permanent feature, but after the emergency is over, this question should be given careful consideration.

McKee says that there is a scheme for permitting banks to buy bonds for individuals and advance the funds for this purpose for a certain period, for which a service charge would be made. Then if the individual could not keep his contract with the bank, the bank would have the right to redeem the bond in question immediately. In this way the banks would get a little back of their expenses incurred by selling defense bonds.

Eccles, resuming his former discussion: To accomplish the maximum financing outside of banks, there should be tap issues provided to meet the needs of different types of investors. If this did not bring in enough funds, then issues designed principally for banks would have to be put out and perhaps in that case banks would have some preference in the purchase of such

issues. This would reduce the amount of market issues and banks would not have to buy as much; the pressure on the Board to reduce reserve requirements would lessen as banks under such conditions would have sufficient funds to buy all the Government securities necessary, in so far as these were not taken up by non-banking purchases.

Wallace asks whether banks could be prohibited from buying long term securities.

Eccles says that it is conceivable that the purchase of long term securities by banks, i. e., beyond ten years, might be limited to some ratio of amount of such bonds purchased to the amount of the true savings deposits of a bank.

Harrison suggests a non-negotiable registered tap issue on which it might be permitted to borrow money so that the Treasury would not be called upon to meet as large a demand liability as might otherwise be the case.

Eccles thinks this might be done. He believes it would mean that investors might buy more freely, knowing that, if necessary, they could borrow on the bonds even though they might never do so. If the short term rate should reach a point where it caused the rate on the long term issues to go up, then the Treasury would have to support the short term rate in order to prevent the price of long term bonds from dropping. He is sorry that the rate of a year ago was not maintained. If an attempt were made to revert to the rate of a year ago, it would mean that issues which have been put out since and which are now selling at a premium would drop in price. So far the very slight increase in the short term rate has not affected the long term rate. In Britain the banks were practically subsidized at the outbreak of the war. The British Government allowed the bond market to decline. Then a price was fixed below which securities could not be sold. This lower limit has gradually been raised, and the tap issue, open to purchase by banks, pays a little better rate so that banks get a certain advantage. We started in the war at a time when rates were getting lower and maturities lengthening and this situation fixed a kind of a bench mark which it is rather difficult to change, though we may have to do so. In Britain banks are called upon only as a last resort.

Brown brings up the matter of the amendment to Section 7(d) of the Securities Exchange Act of 1934. The Council feels that a permanent power to regulate the amount of margin requirement in connection with unregistered securities ought not be given to the Board of Governors. In so far as this may be needed for the present emergency, the President now has the power to confer such authority under the Trading with the Enemy Act. There are too many cases where loans must be made on unregistered securities in order to settle estates and the like. Furthermore, in most instances unregistered securities are those of smaller corporations closely held, and it is just impossible to determine under a regulation the value of such securities. He questions very seriously whether there is any danger of inflation from this source.

McKee points out that when this matter of the proposed amendments to the Securities Exchange Act of 1934 was discussed the Board had before it a memorandum, of which a copy had also been given to the members of the Council. McKee confessed, however, that he did not realize that the suggested amendment was included in the memorandum.

Brown says he is not discussing the past but would like to go into the merits of the question.

Parry: More than a year ago when the matter came up, the investment bankers and the Securities Exchange Commission submitted to Congress all the suggestions that had been made. Parry himself sat in on the conferences held by the Securities Exchange Commission at that time. The Federal Reserve System made some suggestions merely intended to clarify the law, but the suggestion to amend Section 7(d) was one which went beyond the mere matter of clarification. The Board was desirous of obtaining the same power over unregistered securities as it now has over registered securities. He wished to point out, however, that this power does not cover loans on securities as such, but merely loans made for the purpose of buying or trading in such securities. The Board's feeling was that it would make its regulation covering purchase of securities such simpler and the idea was solely to give the Board power in case the public should rush into the purchasing of unregistered securities. He admitted it might be impossible to draw a regulation which could be made to apply to closely held securities which are never traded in.

Eccles asked who made the suggestion.

Parry answered that it came from the Federal Reserve System, was approved by the Securities Exchange Commission, and was not objected to by the representatives of the investment bankers.

Eccles wanted to know from Parry if the Securities Exchange Commission would want to take over this power if the Board opposed the amendment.

Parry stated that he believed the Securities Exchange Commission would try to take over the power if the Board did not have it.

McKee says that in his opinion if the amendment were adopted, it would impede the flow of capital into new enterprises.

Eccles says that the whole discussion strikes him as purely academic because he does not believe that the suggestions made to Congress will result in a bill and therefore questions whether any law will be enacted. So far the hearings have dealt purely with suggestions, and the House Committee on Interstate and Foreign Commerce did not have an actual bill before it.

Brown says the Council wishes to file a statement with the Interstate and Foreign Commerce Committee of the House. He doubts whether the

amendment to Section 7(d) will be approved by the House Committee. As he said before, as far as danger of inflation is concerned if that should arise, the President has ample power to give the Board, or anyone else, control over the situation during the period of the emergency.

Eccles says the Council should file its objections with the House Committee.

Ransom also states that there aren't any objections to having the Council file an adverse report with the House Committee on the proposed amendment to Section 7(d).

Parry: There is a proposal before Congress that there be transferred to the Board of Governors the present power of the Securities Exchange Commission to investigate the solvency of brokers for the purpose of protecting investors. The Board stated to the House Committee that it preferred to leave matters as they are at present.

Brown: How would the Board of Governors feel if the Executive Committee of the Council arranged to meet with the Board once a month even if it be only for an hour? The members of the Council feel that such meetings would be advantageous during the present emergency.

Eccles stated that he personally could not see any objection to such meetings provided they were on some regular schedule. At least a majority of the members of the Board could arrange to be present. Eccles asked the other members of the Board how they felt about it and none of them had any objections. It was decided that the Secretary of the Board of Governors and the Secretary of the Council should work out some schedule for these monthly meetings.

McKee wished to bring up some other matters, but it was decided to do so after lunch and the meeting adjourned at 1:55 p. m.

Secretary's notes on meeting of the Federal Advisory Council on February 16, 1942, at 2:50 P. M. in the Board Room of the Federal Reserve Building, Washington, D. C.

The Council met with the Board and all members of the Council were present except Mr. Harrison. Of the Board, the following were present: Ransom, Szymczak, McKee, Morrill, Bethea, Carpenter, Goldenweiser, Wyatt, Wingfield, Vest, Smead, Parry, and Paulger.

McKee said he had three subjects concerning which he wished the advice of the Council:

1. Certain provisions under Regulation Q,
2. Taxation of stock dividends and the effect on bank supervision,
3. Proposal to repeal the prohibition against member banks of the Federal Reserve System paying dividends or making loans while their reserves were deficient

1. In regard to the problem of Regulation Q the law provides that the Board of Governors and also the Federal Deposit Insurance Corporation are to make some regulations governing the withdrawal of savings from banks. Neither the Board nor the F. D. I. C. has done anything. Some States require notice of withdrawal and in others it can be waived. There is a question whether it might not be desirable to enforce notice in order that defense bonds be bought out of current income rather than out of accumulated savings. Also, savings banks are suffering from the withdrawal of their deposits, partly for the purpose of purchasing defense bonds and partly for purposes of hoarding. If notice were insisted upon, withdrawals would be more orderly. Pennsylvania requires a two weeks' notice but other States do not have a similar requirement. The conversion of savings into defense bonds may create trouble. If and when a customer desires to withdraw his savings to buy defense bonds, he should be allowed to do it. Apparently McKee wants all restrictions removed.

Brown says the sentiment of the Council seems to be to let the matter rest as it is at present and Regulation Q be allowed to stand without any change at the present time.

2. McKee: Capital distribution by stock dividend. There is a case pending in the Supreme Court on the subject as to whether a stock dividend is to be regarded as income. McKee would like to see a law which provided that in the case of banks where, after a stock dividend, the capital remained 5 per cent of the average liability of the previous year, the stock dividend would not be subject to tax. The present rule is that a stock dividend is not taxable as income, but there is some likelihood that the Supreme Court will overthrow this rule.

Brown says the Council has sympathy with the suggestion of McKee but he thinks it very dubious whether it would be possible to obtain legislation exempting bank stockholders from any tax levied on others.

McKee says that such a request for legislation would have to come from the supervising authorities and would be based on public interest, so the bank might be in a position to protect exposed assets. He points out that at present a bank might have a small capital and relatively large surplus, the large surplus wiped out but the capital not impaired. As long as the capital is not impaired, the supervising authorities cannot do anything, though as a matter of fact, the surplus is really a part of the capital structure of the bank. If banks were allowed to pay out surplus in the form of stock dividends for the purpose of increasing the capital itself, a sounder situation would prevail. At the present time the rule is that stock dividends are not regarded as income and McKee wishes the matter to be left as it is at present.

Brown points out that from the supervising authorities' standpoint there isn't any power to make good depleted surplus as long as capital is not impaired. McKee's point is that surplus is used as part of loan basis, but at present there isn't any way to compel a bank to make good its depletion of surplus.

3. McKee points out that the necessity of a bank at all times maintaining its reserves intact creates too much pressure. His belief is that this provision should be more flexible so that when at tax periods withdrawals are heavy, banks might for a very temporary period make use of their reserves and thus avoid the necessity of liquidating any of their bond portfolio. He believes this would also relieve some of the pressure now existing to lower reserve requirements.

Wakefield says if any such regulation were in force there would be constant pressure to have exceptions made by which a bank could use some of its reserves.

McKee wants to maintain the present reserve requirements but there is a feeling that if the Treasury is not able to sell issues easily, then reserve requirements will have to be lowered. If banks do not have to liquidate at intervals, as is true at present, then there will also be less need for the Federal Reserve System buying directly from the Treasury.

Brown thinks that exceptions made would create trouble and charges of favoritism. If reserve and central reserve cities were on a weekly basis as country banks are at present instead of being on a biweekly basis, it would help matters very much and such a change would not be subject to any of the difficulties which McKee's proposal might create.

McKee states that his aim is to keep off inflation and at the same time keep reserve requirements rigid.

The meeting adjourned at 3:30 p. m.

Secretary's notes on meeting of the Federal Advisory Council of February 16, 1942, at 3:35 P. M. in the Board Room of the Federal Reserve Building, Washington, D. C.

The Council met alone with Dr. Goldenweiser, all members of the Council except Mr. Harrison being present.

Dr. Goldenweiser discussed the business situation. The whole business situation is centered in the war and in questions related thereto, such as large Government expenditures, production, flow of money, where it goes, etc. Generally the problem has been to find employment and accelerating the production of the country in order to employ more people. Now the problem is to find the men to do the work and to bring production up to the point needed. The figures of the President of the United States for production are most important. His statement meant that about one-half of our national income is to go for war. This implies that if we take iron, non-ferrous metals, and shipping, these will have to take up about 30 billion dollars in 1942, while, as a matter of fact, at present those industries are only on the basis of about 15 billion dollars for the year. Probably these industries can use 5 billion dollars more and 6 billion further can be used up by conversion of plants. This still leaves a gap of 4 billion dollars, which, it must be remembered, is as much as the whole automobile industry amounted to in 1941.

Goldenweiser states that he is using the current price level. The limiting factors are lack of skilled labor, materials, capacity of plants, and, probably most serious, transportation. It must be remembered that in this war the time element is all important. To put the matter in a financial way, our national income, let us say, is approximately at present 110 billion dollars, of which about one-half is to go into war production, the other half being left for civilian use. If half of the national income goes into war production, which ultimately, after all, flows into the hands of the people, then how can a large price rise be prevented? What is it that must stop in order not to interfere with the creation of armament? One thing undoubtedly is that there will not be any new plants built for civilian purposes and the consumption of autos, refrigerators, and the like will be sharply reduced. Taxation is to be increased by 9 billion dollars. But when all is said and done much money is still left in the hands of corporations and in the hands of individuals. If the Treasury will issue securities appealing to large investors much can be accomplished. Even under such circumstances, banks would still have an ample place for the absorption of short and medium-term securities. The Federal Reserve System should start a campaign to find who the investors could be. Up to the present, a class of securities has not been issued to appeal to corporate investors.

The Federal Reserve System can do many things and can especially find out where the funds seeking investment are to be found. The money supply of the country is an essential feature of the economic structure, but some New Deal economists have been spreading the doctrine that the question of money isn't of any importance. To be sure it is perfectly true that not everything can be settled by the control of money and credits. On the other hand, it is also true that if the money problem is so handled that one country is drained of its resources while another is flooded, a bad situation will result. Naturally, this latter point is of more importance for the post war situation than it is at the present moment. It is necessary to get rid of many fetishes. The money mechanism has a world-wide function and all forms of government use it—democracy, totalitarianism, communism, etc.

Brown asks whether Goldenweiser has any opinion as to whether the spending of money will lag because materials are not available. He points out that the Government has asked soya bean growers to increase their production by 50 per cent, but, on the other hand, refiners have been unable to obtain stainless steel needed to increase their refining capacity.

Goldenweiser admits there are many difficulties, but believes the needed results can be attained. Historically speaking, except during the depression, we have usually had a shortage of labor, but now we are faced practically for the first time in the history of the country with a shortage of materials.

Ragland asks what effect our large gold supply will have on our war economy.

Goldenweiser answers, none at all. He does not see any way of redistributing the gold. He says we must be farsighted and the 23 billion dollars of gold might as well be written off for the time being. Germany and France were ruined by inflation because they could not or would not raise sufficient funds by means of taxation to meet their obligations—in one case reparations and in the other the cost of reconstruction. Under such conditions, inflation is bound to come and the exact means by which it is produced is relatively unimportant.

The meeting adjourned at 4:15 P. M.