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

April 24, 1946

At 11:00 A.M., the Executive Committee of the Federal Advisory Council convened in the Conference Room of the Federal Reserve Building, Washington, D. C., on Wednesday, April 24, 1946, the President, Mr. Brown, in the Chair.

Present: Mr. Edward E. Brown, President; Mr. Charles E. Spencer, Jr., Vice President; Messrs. John C. Traphagen, John H. McCoy, A. L. M. Wiggins, and Herbert V. Prochnow, Acting Secretary.

Absent: Mr. David E. Williams.

The Executive Committee discussed at some length the reclassification of reserve cities which the Board of Governors had proposed. The Board's proposal provided that only cities which had a Federal Reserve bank or branch of a Federal Reserve bank should be classified as reserve cities. It was the conclusion of the Executive Committee that the proposal which the Board had made was not advisable.

The Executive Committee discussed briefly the question of whether non-members of the Federal Reserve System should be denied certain benefits of the System which they now enjoy. It was the judgment of the Executive Committee that it would not be advisable to raise this question at present.

The question of the examination of Federal Reserve banks and branches was raised and it was decided that this was a problem of internal operation of the System and one outside the responsibilities of the Federal Advisory Council.

The President of the Federal Advisory Council reported that there is an increasing sentiment among bankers for the abolishment of the preferential rate.

The Executive Committee discussed briefly the general condition of the government bond market, various proposed plans for the management of the Federal debt, the bill for the reorganization of the government agencies and a suggestion some bankers had made about permitting an amount in excess of 10 per cent of the capital funds of a bank to be invested in loans made or guaranteed by the International Bank for Reconstruction and Development.

The meeting adjourned at 12:00 noon.

HERBERT V. PROCHNOW
Acting Secretary.

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

April 24, 1946

At 12:10 P.M., a joint conference of the Executive Committee 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:

Chairman Marriner S. Eccles; Vice Chairman Ronald Ransom; Governors M. S. Szymczak, Ernest G. Draper, R. M. Evans, James K. Vardaman, Jr.; Elliott Thurston, Assistant to the Chairman; Chester Morrill, Special Adviser to the Board of Governors; S. R. Carpenter, Secretary, Board of Governors; Bray Hammond, Assistant Secretary, Board of Governors; George B. Vest, General Counsel, Legal Division; Woodlief Thomas, Director, Division of Research and Statistics; Leo H. Paulger, Director, Division of Examinations; Edward L. Smead, Director, Division of Bank Operations; and Carl E. Parry, Director, Division of Security Loans.

Present: Members of the Executive Committee of the Federal Advisory Council:

Mr. Edward E. Brown, President; Mr. Charles E. Spencer, Jr., Vice President; Messrs. John C. Traphagen, John H. McCoy, A. L. M. Wiggins, and Mr. Herbert V. Prochnow, Acting Secretary.

Absent: Mr. David E. Williams.

A lengthy discussion took place regarding the proposal of the Board of Governors for the reclassification of reserve cities under which only cities having a Federal Reserve bank or a branch of a Federal Reserve bank would be classified as reserve cities. The President of the Federal Advisory Council reported that it was the opinion of the Executive Committee that the proposal was not advisable.

There was a general discussion regarding the preferential rate and both the Executive Committee and the Board of Governors favor elimination of this rate.

The Chairman of the Board reported that the Board expected to send a revised Bank Holding Company Bill to Congress and also that the Board had made no proposals regarding the reorganization of the banking agencies under the Reorganization Bill.

The meeting adjourned at 1:35 P.M.

HERBERT V. PROCHNOW
Acting Secretary.

NOTE: This transcript of the Acting Secretary's notes is not to be regarded as complete or necessarily accurate. The transcript is strictly for the sole use of the members of the Federal Advisory Council.

H. V. P.

The Acting Secretary's notes on the meeting of the Executive Committee of the Federal Advisory Council on April 24, 1946, at 11:00 A. M., in the Conference Room of the Federal Reserve Building. All members of the Executive Committee of the Federal Advisory Council were present, except Mr. Williams.

CLASSIFICATION OF RESERVE CITIES

BROWN. In connection with the classification of reserve cities which the Board of Governors has proposed, Brown states that the wording of the letter which went out to the banks was unfortunate. The letter indicated that only cities which had a Federal Reserve Bank or branch of a Federal Reserve Bank would be classified as reserve cities.

WIGGINS comments that apparently this is an attempt to make everything logical, but democracy does not always work that way.

BROWN states that in a city like Milwaukee the banks have accounts from practically all the banks in the state. Dubuque was formerly a leading city in Iowa because of lead and zinc mines and the river traffic, but the importance of these industries has declined and Des Moines is the city in which almost all Iowa banks carry accounts. Cedar Rapids was also formerly one of the wealthiest cities in the state, but other cities have passed it. Grand Rapids which was formerly in the lead in Michigan has been eclipsed by Detroit because of the automotive industry. Almost all Indiana banks carry accounts in Indianapolis which makes that city extremely important.

SPENCER reports that this question is not of significance in his district because Boston is the only reserve city in the district.

TRAPHAGEN advises also that it is not of particular importance in his district, as Buffalo is the only reserve city in that district.

WIGGINS states that Fleming has written a letter in connection with Washington.

BROWN points out that St. Paul is an important banking center, and is greatly concerned over the proposed reclassification. Tulsa as an important banking and industrial center is also very much concerned over the proposal.

TRAPHAGEN advises that a banker from St. Joseph has written him stating that the reclassification would be most unfortunate for that city. Traphagen does not see why the question of reclassification was brought up by the Board at the present time.

BROWN. At one time St. Joseph was a great center, but Kansas City has now taken the lead. Although the idea is illogical, there is no question but that if Kansas City remains a reserve city and St. Joseph does not, some bankers will feel that St. Joseph is not as liquid and will therefore prefer Kansas City. The cities of Lincoln and Omaha will present another problem. Fort Worth is also necessarily very much disturbed by this matter.

WIGGINS asks whether this problem does not resolve itself into three parts: (1) Cities that ought to carry higher reserves because of the nature of their deposits; (2) Cities which have no reason to be reserve cities because of the nature of their deposits and other factors; (3) Cities where pride and other factors enter. This latter group is the one in which there may be difficulty.

TRAPHAGEN states that not only pride but important business considerations also may be factors in the third group.

BROWN believes that the major tests are (1) whether a bank carries large correspondent bank deposits and (2) has substantial business deposits from outside its area. New York and Chicago are perhaps the clearest examples of cities which would qualify in these respects. Other cities, for example, are Milwaukee, Indianapolis, Des Moines, St. Paul, Columbus, Tulsa, and Fort Worth. Brown does not believe it is possible to find a satisfactory fixed formula that will fit all cities.

TRAPHAGEN does not understand why the problem is brought up by the Board at the present time if the banks are satisfied with the situation.

BROWN reports that the present situation was probably precipitated by Grand Rapids. Savannah left the reserve city classification in 1945 when some bank there figured that it was costing money to retain the classification.

MCCOY states that some cities obviously have more justification for having the classification of reserve cities than other communities. In a conversation he had with Eccles this morning, Eccles expressed the idea that banks would be better off with lower reserve requirements.

BROWN replies that Eccles' idea of loosening reserves is contrary to Eccles' idea of tightening reserves in Chicago and New York.

McCoy reports that Eccles told him the reserves which might be lost by the reclassification proposal could be more than made up by raising the requirements in New York and Chicago. McCoy does not favor more branches of the Federal Reserve banks as these branches lead to more government participation in banking.

BROWN states that although it may be said reserves do not have any significance from the standpoint of security, they do nevertheless affect liquidity. Whether it is logical or illogical, the facts are that banks in cities losing the reserve city classification will lose business. The conclusions of this Committee as they have been expressed are that the Committee does not understand why this matter should be agitated at the present time. The basis for designating a reserve city may logically be whether the banks in that city have large correspondent bank deposits and also substantial business deposits from outside the local area. If the banks of a city wish to retain their reserve city classification, they should be permitted to do so. If there is a division of opinion among the banks in a community, the Board can examine the facts of the situation and make a decision. It is not logical to attempt to establish a fixed formula such as the Board has proposed with a country having such a wide diversity in its economic and banking activities. It is possible that some cities may develop economically and financially, so that they should be made reserve cities.

FEDERAL RESERVE SYSTEM MEMBERSHIP

BROWN states that a member of the Council has asked whether the time has come to deny the non-member bank the privilege of carrying an account and enjoying the benefits of the Federal Reserve System without becoming a member of the System. These privileges were established a number of years ago in connection with the extension of the par list and generally to facilitate the operation of the banking system. After a discussion of the question, it was the judgment of the Committee that it would not be advisable to raise this question at the present time.

EXAMINATION OF FEDERAL RESERVE BANKS AND BRANCHES

BROWN states that a member of the Council has asked the following question: Is it possible for the R. F. C. , the Federal Reserve Bank, and the Federal Reserve Board examiners to examine the Federal Reserve banks and their branches in a common examination rather than having the examinations separately as is now done? After discussing the question it was decided that this was a problem of internal operation of the System and one which might be considered outside the responsibilities of the Council.

PREFERENTIAL RATE

BROWN advises that he was informed by some members of the Board of the Federal Reserve Bank of Philadelphia that they would recommend the abolishment of the preferential rate. The American Bankers Association would also like to see it abolished, and the Federal Advisory Council has made a similar recommendation.

GOVERNMENT BOND MARKET

BROWN believes the recent decline in governments is a healthy movement.

SPENCER agrees. He states the situation may be influenced somewhat by the 2-1/4's and 2-1/2's now held by speculators, and that by the end of June when the speculators are out, it will be possible to get a clearer picture.

TRAPHAGEN thinks some New York groups have tended to shy away from government bonds in the last two weeks. Bonds eligible for bank investment have turned somewhat weak probably due to a shrinkage in deposits. Some of the banks are also pressed by demands for commercial loans.

BROWN. Almost all banks have substantial premiums and many may wish to dispose of securities to save these profits. He presumes the Board of Governors is probably satisfied with the present downward trend in bond prices, but he wonders what the viewpoint of the Treasury may be.

MCCOY understands the national banks have paid premiums on bonds of over 11 per cent of their capital structure, and in some cases the percentage runs much higher.

TRAPHAGEN states that some banks have been buying long term corporate issues.

WIGGINS believes some banks will experience losses because they went too far in their bond programs.

TRAPHAGEN thinks some banks felt the bond market was a one-way street and that they could not lose.

SPENCER believes the pressure of money in the banks was a considerable factor in causing the rise in bond prices.

WIGGINS states many banks purchase bonds without being aware of the problems involved in bond portfolios. He believes the present trend in the bond market is healthy.

PLANS FOR MANAGING THE DEBT

TRAPHAGEN asks whether this Committee should inquire of the Board today about the status of Eccles' certificate reserve plan.

BROWN believes it would be unwise to raise the question as Eccles has indicated it is deat, at least for the present. Brown reports that Harold Amberg has talked with Senator Wagner who advised Amberg that no banking legislation would be introduced now because of unsettled conditions and the wide differences of opinion regarding legislation.

WIGGINS thinks it is futile to talk of banking legislation and he believes also that Congress may filibuster in connection with the British loan.

BROWN states that Eccles' idea is that banks should keep a certain percentage of their demand deposits in short term government securities, but there is no chance of any legislation along these lines at this session of Congress.

REORGANIZATION BILL

WIGGINS asks what is being done in connection with the proposal for the reorganization of government agencies as it applies to the banking agencies. He believes this is a very important matter, and he is concerned over the possibilities inherent in any reorganization proposals.

BROWN comments that John Snyder had promised he would talk with him and Fleming before anything was done in reorganizing the banking agencies. However, Snyder is not so influential now. The Treasury is opposed to a reorganization of the banking agencies.

WIGGINS. Those who would have a hand in these reorganizations have far more theories than they have sound ideas.

TRAPHAGEN assumes that the Treasury and Comptroller will be opposed.

WIGGINS states that all except those who benefit may be opposed.

AMENDMENT TO BANKING ACT

BROWN states that Burgess and some other bankers had spoken to him about the question of an amendment to the Banking Act which would permit something in excess of 10 per cent of the capital funds of a bank to be invested in loans made or guaranteed by the International Bank for Reconstruction and Developmeht. He believes it would be a mistake to introduce legislation of this kind now because it would be like opening Pandora's box and a great number of other amendments might also be suggested. It was agreed by the Committee, it would be better to do nothing on this matter now.

The meeting adjourned at 12:00 noon.

On April 24, 1946, at 12:10 P. M., a joint meeting of the Executive Committee 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.

All the members of the Executive Committee were present, except Mr. Williams. The following were present from the Board of Governors: Chairman Eccles, Vice Chairman Ronald Ransom; Governors Szymczak, Draper, Evans and Vardaman; also, Messrs. Thurston, Morrill, Carpenter, Hammond, Vest, Thomas, Paulger, Smead and Parry.

CLASSIFICATION OF RESERVE CITIES

BROWN. In connection with the classification of reserve cities which the Board of Governors has proposed, Brown states that the Executive Committee realizes there are some cities now designated as reserve cities which should not be so designated and that there are other cities which probably should be so designated but do not have that classification now. He states that the Executive Committee does not believe it is advisable to follow the proposed basis the Board has suggested of designating as a reserve city any city in which a Federal Reserve bank or the branch of a Federal Reserve bank is located. The test of whether a city should be classified as a reserve city should probably be based on two primary considerations: (1) whether the banks of a community have large deposits from correspondent banks; and (2) whether the banks of a community have substantial business deposits from outside their local trade area. Because of the diversity of the economic and banking interests in a country as large as the United States, Brown does not believe it is desirable to set up a fixed formula by which communities are to be classified as reserve cities. If the banks of a city wish to remain a reserve city, they should be permitted to do so. If the banks of a city wish to give up the reserve city classification, they should also be permitted to do so. If there is a division of opinion among the banks of a city, then the Board of Governors should pass upon the matter based upon a study of the facts. Almost every bank in Wisconsin has an account in Milwaukee. The banks in Indiana carry accounts in Indianapolis, and the banks in Iowa carry accounts in Des Moines. Milwaukee, Indianapolis and Des Moines are very much concerned about the proposed re-classification. The banks in these cities feel that they will lose country bank accounts and commercial business if the reserve city classification is taken away from them. Brown points out the importance of this classification also to St. Paul, Tulsa, Fort Worth, and other cities which have substantial correspondent bank business and have large business deposits from outside their immediate trade areas.

MCCOY agrees with Brown's summary.

ECCLES states that there is a great deal of discussion about the matter now and there are many objections from cities which would lose the classification under the Board's proposal. However, he feels that eventually these objections will be forgotten, and some time after the changes have been made, no one will express any further concern or objection. He believes the objections will subside with time and be forgotten. He points out that this matter was discussed in 1938, and he believes it can be settled now, once and for all time. He comments that many banks argued against the Federal Reserve System when it was established, but they now accept it. He also adds that banks objected to the Banking Act of 1935 but that they now accept it. He states that bankers have always opposed all changes, and later they invariably agree that many of the changes to which they objected were desirable. The Board of Governors has requested each Federal Reserve bank to ask the banks in the communities concerned to express their views in writing. After these written statements are received, the Board will consider them all. The Board is inclined to believe there should be a formula by which the Board could automatically determine whether a city should be classified as a reserve city.

BROWN comments that cities have been added to and also deducted from the reserve city list over the years.

ECCLES believes there should be some logical fixed formula other than just the opinion of the Board of Governors on a matter of this kind. It is impossible to give every city in the country a hearing.

RANSOM states that he had hoped the bankers would suggest a formula. He does not believe the administrative agencies should have too much latitude in their decisions on questions of this character.

MCCOY believes many bank accounts have come to banks in his city because Columbus is classified as a reserve city.

RANSOM asks whether the designation "country bank" is objectionable. It might be possible to change this designation.

BROWN replies that it is not a question simply of the designation, "country banks", but rather a matter of tradition and custom by which reserve cities have become known as cities with higher reserve requirements where you could get your money readily.

ECCLES states that bank accounts should go only where they get the best service, and the designation "reserve city", should have nothing to do with it. The idea that a high reserve means safety is not sound. A low reserve of say five per cent with the balance in short term bills means that a bank is more liquid than a bank with 20 per cent tied up in "frozen" reserves.

BROWN replies that on that theory we should abolish reserves entirely. He adds that whether Eccles is right or not, the customs and beliefs which have been established over the years are of primary consideration. The mere fact that a city has a branch now does not make it more important than cities without branches of Federal Reserve banks.

ECCLES states that a branch of a Federal Reserve bank does help a community in its clearings, in obtaining cash, and in other ways. He points out that El Paso and Helena are good illustrations.

BROWN emphasizes that the Committee does not believe the basis which the Board has chosen for designating reserve cities is sound. He does not believe a formula is desirable, but if one is needed, he would suggest in general that it include a consideration of the total country bank deposits held in a community, plus a certain percentage of the demand deposits, particularly if these deposits originate outside the trade area of that community. If the sum of these two classes of deposits are over a certain amount, the city might be called a reserve city. This is at least a general outline of how the problem might be approached on a more reasonable basis. He does not believe the Board should force lower reserve requirements at the same time when its views otherwise are in the direction of tightening reserves.

ECCLES cites certain cities such as Chattanooga, Albany and Oakland which have dropped the reserve city classification, and he also mentions some cities which have requested the reserve city classification. Still other cities have become reserve cities and have later asked to be declassified. He indicates that cities have changed their views on the importance of the reserve city classification from time to time.

VARDAMAN asks whether the fact that this matter is being considered is in any way injuring any of the banks. Is it desirable for the Board to say that it will do nothing until a certain date, and that it will then have a hearing.

MCCOY points out that the matter has had little publicity but that once it is widely known it will unquestionably hurt the banks in the cities which lose the reserve city classification.

BROWN states that a city like Lincoln, for example, may suffer.

ECCLES believes that this week all the letters will have been received from the banks in various communities on this matter, as a tentative deadline had been set for the receipt of such letters as of this week.

VARDAMAN believes that damage may be done to those towns on the doubtful list, that is, those which may lose their reserve city classification.

MCCOY asks whether the opinion of the Federal Reserve banks will have any weight in the matter.

SZYMCZAK replies that the opinion of the Federal Reserve banks has always carried weight.

VARDAMAN asks whether a definite date should be set for the completion of the matter.

ECCLES replies that it can probably be settled by June 20.

RANSOM states that he believes a government agency such as the Board of Governors should not have too much latitude in making decisions, and he has always assumed that Brown agreed with this viewpoint.

BROWN replies that if it were advisable to have banking legislation at this time, he would be willing to have Congress name the reserve cities.

VARDAMAN points out that the Reserve City Bankers Association has a basis for determining membership upon which he worked a number of years ago.

PREFERENTIAL RATE

BROWN mentions the written resolution which was presented to the Board following the last meeting of the Federal Advisory Council and he asks particularly whether the attitudes of the Board and the Treasury have changed on the preferential rate.

ECCLES replies that the attitudes of the Treasury and the Board have not changed. The Treasury wishes no change in the preferential rate or in the present situation regarding puts and calls, but the Board continues to be in favor of eliminating the preferential rate and abolishing puts and calls. He points out that 75 per cent or 80 per cent of the bills outstanding are held by the Federal Reserve banks. The bills are no longer a money market piece of paper. Eccles has suggested that the bills in the Federal Reserve banks be made continuous in order to eliminate the turnover and that the market should be offered a little more paper than it takes in order to keep the market supplied with the small amount of its requirements. The Treasury does not favor this proposal. Eccles states that less than $2 billion of bills are held by commercial banks, and if the bills held by the Federal Reserve banks were made continuous, it would eliminate the offering of bills each week which are now taken almost entirely by the Federal Reserve banks. Eccles also states that the Treasury has indicated its willingness to operate on balances of approximately $2 to $3 billion. He hopes before too long to be able to get the Treasury to agree to eliminate puts and calls. In connection with the preferential rate the Open Market Committee felt it was worthwhile and helpful during the war, but should now be discontinued. Eccles hopes for action eventually

SPENCER asks how action can be obtained.

ECCLES replies the Federal Reserve banks must take action.

TRAPHAGEN says it will do away with lending under one per cent.

ECCLES states that it will reduce borrowing on governments, but it is a minor matter.

SZYMCZAK comments that it may be a minor matter in connection with the banking system, but it may be a major matter when dealers and others begin to see one after another of the war measures being eliminated.

THOMAS asks whether banks would raise rates on loans based on governments.

TRAPHAGEN believes it would affect rates under one per cent but not rates above one per cent.

THOMAS asks whether it would affect the willingness of banks to buy certificates.

TRAPHAGEN does not believe it would.

ECCLES reports that when the Board analyzed the federal budget they thought it looked more hopeful than the budget would seem to indicate, particularly if the E, F, and G bond redemptions did not increase. Consequently, the Board recommended that the Treasury use a substantial portion of its balances to retire government obligations. He believes that between the end of June and the end of the year, it will be possible to pay off $8 to $10 billion of the government debt and that some or all of the debt coming due in June will also be retired. He expects the Treasury balance to decline to an amount between $2 to $4 or $5 billion dollars. These steps will automatically dispose of the question of reserve requirements on war loan deposits as the war loan deposits will be used in the liquidation of the debt. The Board is opposed to the offering of any market bonds now. Some 2-1/4's and 2-1/2's should find their way into the insurance companies. By the end of May and the end of June, it will be possible to have a clearer idea of the situation as some of the speculators who bought bonds in the last drive will be out. Eccles states that in the next few months the banks will probably be under continuous pressure to borrow to meet their reserve requirements. It is difficult now to say how many of the long term bonds will be available, but it would be a mistake for the Treasury to offer any bonds now as the proceeds would have to be used to retire other obligations. Eccles points out how private business concerns are now borrowing at especially low rates for long periods and notes that banks are buying these corporate obligations.

TRAPHAGEN states that long term corporates are eligible for banks in contrast to long term governments.

BROWN asks what the opinion of the Treasury is in connection with the present decline in bond prices.

ECCLES replies that Vinson has never mentioned the matter to him, and he does not believe the Treasury is particularly concerned. The Treasury has no bonds to sell and it is paying 2-1/4 per cent and 2-1/2 per cent on outstanding bonds regardless of the market price. The Treasury, therefore, is probably not disturbed.

BROWN comments that there are some advisers in the Treasury who favor lower and lower rates.

ECCLES replies that there are such advisers in the Treasury and that they believe interest is an evil capitalistic device.

BROWN comments on the present limitation of 8/32nds in the movement of government bond prices and states that the market sometimes opens with a movement of over 8/32nds at the outset. Consequently, country banks sometimes find when they telephone to dispose of securities that they are unable to find a market. Brown states that some banks are becoming somewhat nervous regarding the situation.

ECCLES replies that what bankers wish is to have their premiums representing profits frozen at the same time they would like interest rates to rise.

HOLDING COMPANY BILL

ECCLES reports that the Board expects to send the Holding Company Bill to Congress. As long as the bill was in a discussion stage in the Board, it could not be shown to the Council. Neither the Treasury nor the F.D.I.C. has agreed to support it. The Treasury has no objections and the Board has not asked the opinion of the F.D.I.C.

REORGANIZATION BILL

BROWN asks whether the Board has made any proposal regarding the reorganization of the banking agencies.

ECCLES replies that the Board has made no proposals. He has heard rumors that other agencies have made suggestions, but he has no definite information.

RANSOM states that the time is not propitious for reorganization proposals.

The meeting adjourned at 1:35 P. M.