

# MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

November 14, 1954

The fourth statutory meeting of the Federal Advisory Council for 1954 was convened in Room 932 of the Mayflower Hotel, Washington, D. C., on November 14, 1954, at 2:10 P.M., the President, Mr. Brown, in the Chair.

## Present:

William D. Ireland	District No. 1
Henry C. Alexander	District No. 2
Geoffrey S. Smith	District No. 3
George Gund	District No. 4
Robert V. Fleming	District No. 5
Wallace M. Davis	District No. 6
Edward E. Brown	District No. 7
W. W. Campbell	District No. 8
Joseph F. Ringland	District No. 9
Charles J. Chandler	District No. 10
George G. Matkin	District No. 11
John M. Wallace	District No. 12
Herbert V. Prochnow	Secretary

On motion duly made and seconded, the mimeographed notes of the meeting of the Council held on September 19, 20 and 21, 1954, copies of which had been sent previously to the members of the Council, were approved.

A complete list of the items on the agenda and the conclusions of the Council are to be found in the *Confidential Memorandum to the Board of Governors from the Federal Advisory Council*, which follows on pages 30, 31 and 32.

The meeting adjourned at 6 P.M.

HERBERT V. PROCHNOW  
Secretary

# MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

November 15, 1954

At 10 A.M., the Federal Advisory Council reconvened in Room 932 at the Mayflower Hotel, Washington, D. C.

Present: Mr. Edward E. Brown, President; Messrs. William D. Ireland, Henry C. Alexander, Geoffrey S. Smith, George Gund, Robert V. Fleming, Wallace M. Davis, W. W. Campbell, Joseph F. Ringland, Charles J. Chandler, George G. Matkin, John M. Wallace, and Herbert V. Prochnow, Secretary.

The Council reviewed its conclusions of the previous day regarding the items on the agenda and sent to the Secretary of the Board of Governors the *Confidential Memorandum* which follows on pages 30, 31 and 32, listing the agenda items with conclusions reached by the Council. The *Memorandum* was delivered to the Secretary of the Board of Governors at 12 noon on November 15, 1954.

The meeting adjourned at 11:40 A.M.

HERBERT V. PROCHNOW  
Secretary

MEMORANDUM TO THE BOARD OF GOVERNORS FROM THE FEDERAL  
ADVISORY COUNCIL RELATIVE TO THE AGENDA FOR  
THE JOINT MEETING ON NOVEMBER 16, 1954

1. What are the views of the Council with respect to the prospective business situation during the remainder of this year and the first six months of next year and the probable changes that will take place in the volume and purpose of bank loans in each of these periods?

Business generally is at a good level, but in a complex industrial economy there are necessarily variations from district to district and from industry to industry. The effects of the liquidation of inventories, some decline in investment in new plant and equipment, the drop in defense expenditures, and the decrease in farm income have been largely offset by substantial outlays for residential and public construction and by continued high consumer spending. Aggregate economic activity has remained relatively stable. The slight improvement which business has experienced this fall should continue during the balance of 1954. There are at present no indications of any significant change, either upward or downward, in the volume of business. After allowing for the usual seasonal movements, the Council believes that the volume of business in the first six months of 1955 will continue the present slight upward trend.

So far this fall the increase in bank loans has been less than seasonal. The members of the Council believe that, aside from loans to the Commodity Credit Corporation, the volume of bank loans for the rest of the year will show less than the usual increase in this period, and that banks will experience the normal loan liquidation after the first of the year, followed by a seasonal increase in loans in the spring. The Council does not expect any important change in the purpose of bank loans. There is, however, a continuing tendency for the percentage of term loans made by banks to increase.

The foregoing conclusions are based upon the assumption that the Government will not in the next six months, directly or by loans or guarantees to states or political subdivisions, bring about a considerably enlarged public works program, or substantially increase defense expenditures. Such developments would undoubtedly be reflected in an increase in economic activity and in the volume of bank loans.

2. What are the views of the members of the Council with respect to the System's current credit policies and what, if any, changes might be called for by developments during the balance of this calendar year or during the first two months of 1955?

The Council believes that current credit policies of the System have been helpful in lessening the effects of the economic readjustments that have been taking place, and have contributed to the maintenance of a good level of business activity. No important change in these policies is at present indicated.

In general, open market operations have been well handled, but the Council is of the opinion that the bill rate has in the last few weeks been unreasonably low and should now be moderately higher. As the Council stated in its memorandum to the Board in February 1954, "the danger of disturbing the economy by making money unduly and artificially

cheap is as great as the danger of restricting business by too high interest rates, and a consequent reduction in the use of credit." A slight increase in the bill rate would have a salutary economic effect and tend to restrain speculative activity.

3. In the light of the comments of the Federal Advisory Council at its meeting with the Board in September, and the suggestions received from the Federal Reserve Banks, the Board has given further study to the revising of Regulation A, adopted by the Board in 1937. As a result of this study, certain changes have been made in the draft sent to the members of the Council with Chairman Martin's letter of July 22, 1954. These changes will be forwarded to you as soon as possible and the Board will be glad to have any comments that the Council might wish to make at its November meeting.

The Council has carefully considered the redraft of Regulation A, dated November 1, 1954. The Council believes that the preface which it is proposed to print only in the Federal Register should be incorporated in substance in the proposed statement of General Principles. Most bankers never see the Federal Register, and unless the substance of the preface is incorporated in the statement of General Principles, very few bankers will know the preface was ever published by the Board. If the preface is incorporated in substance in the statement of General Principles, instead of printing it only in the Federal Register, the Council sees no objection to the November 1 redraft of Regulation A.

4. What are the views of the Council on the question whether a commercial bank should be authorized to issue preferred stock or debentures as a means of augmenting capital funds? If the policy of giving such authority were adopted, in what circumstances should it be granted and what limitations should be applied?

There is a major difference between debentures, even if subordinated, and preferred stock. Under present law interest on debentures is a deductible income tax item, but dividends on preferred stock are not deductible. Consequently, primarily to gain a tax benefit many banks if they had the authority might issue debentures rather than sell additional preferred or common stock. The issuance of debentures or preferred stock with questions of voting rights, sinking funds, and premiums for retirement would raise many problems and should be permitted only under adequate supervision.

The Council believes that debentures should be issued only in emergencies, when capital funds cannot be obtained otherwise, and where it is essential to protect depositors.

The Council believes that the right to issue preferred stock should be given only (1) in emergencies to protect depositors, or (2) when it is clearly desirable to increase a bank's capital funds, and when the issuance of additional common stock could only be accomplished at a price which would seriously dilute the value of presently outstanding common stock and materially injure existing shareholders.

The Council believes that any authority to issue debentures or preferred stock should require the approval of the following Federal agencies for the different groups of banks:

1. National banks—Comptroller of the Currency;
2. State member banks—Board of Governors; and
3. State nonmember banks—Federal Deposit Insurance Corporation.

The Council believes that a revision of Regulation F which would allow the exercise

of rights on its own bank stock held in the bank's trust accounts would in many instances facilitate the issuance of additional common stock by banks.

5. The Board would be glad to have any comments that the Council may wish to make with respect to the report of the joint committee on check collections, which was discussed briefly at the meeting of the Board and the Council in September and at which time it was stated that the matter would be taken up with representatives of the American Bankers Association at the time of its convention in October.

Both its own committee which the Council appointed to study the question and the members of the Council have reviewed the report recommending changes in the check collection system. There are differences of opinion within the Council's committee and within the Council as a whole regarding various sections of the report.

The American Bankers Association, whose Administrative Committee discussed the report at the time of the annual convention of the American Bankers Association in October, will further consider the report at the spring meeting of its Executive Council in April, and the Association of Reserve City Bankers will discuss the report again at its May meeting. The Council understands that there are wide divergences of opinion within both organizations regarding the report. The recommendations of the report cannot be made effective without the support of both organizations. The Council and its committee also wish to give further consideration to a number of the complicated questions which the report presents.

# MINUTES OF THE MEETING OF THE FEDERAL ADVISORY COUNCIL

November 15, 1954

At 2:15 P.M., the Federal Advisory Council convened in the Board Room of the Federal Reserve Building, Washington, D. C., the President, Mr. Brown, in the Chair.

Present: Mr. Edward E. Brown, President; Messrs. William D. Ireland, Henry C. Alexander, Geoffrey S. Smith, George Gund, Robert V. Fleming, Wallace M. Davis, W. W. Campbell, Joseph F. Ringland, Charles J. Chandler, George G. Matkin, John M. Wallace, and Herbert V. Prochnow, Secretary.

Dr. Woodlief Thomas, Economic Adviser to the Board of Governors presented a confidential summary of studies which the staff has made of various types of proposals relative to reserve requirements. Each member of the Council was given a confidential copy of "Review of Reserve Requirement Proposals and Studies."

The meeting adjourned at 3:50 P.M.

HERBERT V. PROCHNOW  
Secretary

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

November 16, 1954

At 10:30 A.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:

Chairman William McC. Martin, Jr.; Governors M. S. Szymczak, A. L. Mills, Jr., and C. Canby Balderston; also Mr. S. R. Carpenter, Secretary, and Mr. Merritt Sherman, Assistant Secretary, of the Board of Governors.

Present: Members of the Federal Advisory Council:

Mr. Edward E. Brown, President; Messrs. William D. Ireland, Henry C. Alexander, Geoffrey S. Smith, George Gund, Robert V. Fleming, Wallace M. Davis, W. W. Campbell, Joseph F. Ringland, Charles J. Chandler, George G. Matkin, John M. Wallace, and Herbert V. Prochnow, Secretary.

President Brown read the first item on the agenda and the conclusions of the Council as given in the *Confidential Memorandum to the Board of Governors from the Federal Advisory Council*, as printed on pages 30, 31 and 32 of these minutes. A brief discussion of this item followed, in which members of the Council and the Board participated.

President Brown then read the second agenda item and the conclusions of the Council as given in the *Confidential Memorandum* mentioned above.

President Brown read the third item on the agenda and the conclusions of the Council as expressed in the *Confidential Memorandum* cited above. A brief discussion followed.

The fourth item on the agenda, together with the Council's conclusion as noted in the *Confidential Memorandum* previously mentioned, then was read by President Brown.

In response to a query from President Brown, Chairman Martin stated that the Board had received a number of inquiries on this matter.

President Brown then read the fifth item on the agenda and the conclusions of the Council as stated in the aforementioned *Memorandum*.

Chairman Martin stated that the Board is continuing to study the subject.

The meeting adjourned at 12:40 P.M.

HERBERT V. PROCHNOW  
Secretary

NOTE: This transcript of the Secretary's notes is not to be regarded as complete or necessarily entirely accurate. The transcript is for the sole use of the members of the Federal Advisory Council. The concise official minutes for the entire year are printed and distributed later.

The Secretary's notes of the meeting of the Federal Advisory Council on November 14, 1954, at 2:10 P. M. in Room 932 of the Mayflower Hotel, Washington, D. C. All members of the Federal Advisory Council were present.

The Council approved the Secretary's notes for the meeting of the Council on September 19-20-21, 1954.

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(Off-the-record comments on the hearings of the Joint Committee on the Economic Report to be held on December 6 and 7, 1954.)

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#### ITEM I

WHAT ARE THE VIEWS OF THE COUNCIL WITH RESPECT TO THE PROSPECTIVE BUSINESS SITUATION DURING THE REMAINDER OF THIS YEAR AND THE FIRST SIX MONTHS OF NEXT YEAR AND THE PROBABLE CHANGES THAT WILL TAKE PLACE IN THE VOLUME AND PURPOSE OF BANK LOANS IN EACH OF THESE PERIODS?

Ireland. The business situation in the first district is showing some improvement. Retail sales are up. There has been a sharp increase also in construction. Bank loans have increased, contrary to the national pattern. Ireland looks for some moderate improvement in the months immediately ahead.

Alexander. The New York district is lagging somewhat behind the national pattern. Conditions in the apparel industry are not good. Farm income is down somewhat more than for the country as a whole. Alexander expects a modest improvement in business over the next few months. He thinks bank loans for the rest of the year will show less than the usual seasonal increase, and that they will tend to follow the seasonal pattern in the first half of 1955. The character of loans is changing somewhat in that more and more term loans are being made.

Smith. Consumer spending is at a high level. Employment has picked up slightly. Retail sales in Philadelphia are down, but retail sales in the suburbs are higher. Construction is good. Smith expects a moderate increase in business over the next few months. Bank loans will probably follow the usual seasonal pattern and will stay at a reasonably good level. Construction at present may be unnaturally high because of liberal financing terms.

Gund. Business is quite good because of activity in connection with the new automobile models. Some improvement in employment is expected in the district. Department store sales are down. Home building has been stimulated by the new liberal financing terms. Loans declined in October but in November have increased slightly. Bank loans will probably follow, in general, a seasonal pattern in the next few months.

Fleming. Bank loans are higher. Business conditions generally are good in the district. Department store sales are higher, except in Baltimore and Richmond, where they are a little lower. Construction is booming, primarily residential, and there has been some pickup in the sale of old houses. Conditions in the coal industry are not satisfactory. Business prospects over the next six months look reasonably good. Bank loans will probably follow a seasonal trend for the rest of 1954 and for the first half of 1955.

Davis. Consumer spending is good. The construction industry is strong. There has been no real upswing or substantial improvement in business. The crops are somewhat less than 1953. Oddly enough, the drought has had little influence on retail sales, but the effects of the drought may be felt in sales a little later. Business generally is moderately better and Davis expects this to continue. Bank loans in the district may be a little below a year ago.

Brown. Business generally is good. Housing construction has been stimulated because of liberal financing terms. Bank loan demand shows less than the usual seasonal increase. There is some trend to term loans. Business will probably continue the present slight upward trend. Brown is concerned about the future of residential construction in the latter part of 1955, and what might happen in the automobile industry if car sales should fall below estimates.

Campbell. Business in the district is a little below last year. Retail sales are holding up well. Campbell is concerned over the agricultural situation and the problem of acreage restriction. He anticipates bank loans will show the usual seasonal trend during the latter part of this year and the first six months of 1955.

Ringland. Business generally is good. The crop is the second largest in history. Department store sales are at a good level. Banks in the district have more loans, except in the metropolitan areas. At present the demand for loans, except for term loans, is somewhat lower than a year ago. Bank loans in 1955 will probably follow the usual seasonal pattern.

Chandler. Department store sales are up. Construction is strong. The agricultural situation is spotty, because some areas have had sufficient rain, whereas other areas have had drought conditions. Cattle prices have held up quite well. The city banks have had a reasonably good demand for credit. Except for the usual seasonal trend, Chandler does not believe there will be an exceptionally strong demand for bank loans. Public construction continues at a high level. The expenditures for the Air Academy in Colorado are adding to the volume of business in that area.

Matkin. Business is generally good. Department store sales are about two per cent below a year ago. Employment is at the best level for the year. Bank deposits are up about ten per cent. Agricultural production is down for the year. Loans are above a year ago. Matkin expects bank loans will follow the usual seasonal trend in the months immediately ahead. Business will probably continue to show a slight upward trend in the next few months, except that agricultural income and oil income may be lower.

Wallace. Business has been quiet this summer because of the lumber strike in the Northwest, but business in the Northwest is now good. In Utah the copper strike is over, and labor conditions in the industry are back to normal. Bank loans have declined and there has been some trend to term loans. Loans for the balance of 1954 will probably show some increase. California is experiencing a strong increase in its population. By the middle of next year, Wallace believes the construction industry may reach its zenith. Loans for modernization of homes may help real estate loan volume next year. Supplies in the agricultural industry and in real estate are high and it may be that these big segments of our economy will have to slow down. The first six months of next year look reasonably good, but there may be a softening in the economy after that period.

Brown. The Council may state to the Board that conditions vary from district to district and from industry to industry, but as a whole, business is at a good level. The volume of business will probably continue the present slight upward trend during the first half of next year. So far, the seasonal increase in bank loans has been less than usual. Apart from Commodity Credit Corporation paper, bank loans will probably show less than the usual seasonal increase during the remainder of 1954. Bank loans in 1955 are expected to follow the normal seasonal pattern, with a decrease early in the year and an increase in the spring. The foregoing views are based upon the assumption that the government will not embark on large public works or make exceptionally large defense expenditures. Such large expenditures would undoubtedly be reflected in an increase in the volume of bank loans and in business activity.

Alexander. In order to take advantage of low rates, some borrowers are using term loans rather than borrowing on a short term basis.

Smith. The pressure from the standpoint of business is interest costs.

## ITEM II

WHAT ARE THE VIEWS OF THE MEMBERS OF THE COUNCIL WITH RESPECT TO THE SYSTEM'S CURRENT CREDIT POLICIES AND WHAT, IF ANY, CHANGES MIGHT BE CALLED FOR BY DEVELOPMENTS DURING THE BALANCE OF THIS CALENDAR YEAR OR DURING THE FIRST TWO MONTHS OF 1955?

Brown mentions that in a letter to him, Gund has raised the question of a higher margin on stocks. (Off-the-record comments). Brown thinks the bill rate has been sloppy. (Members of the Council all agree.)

Alexander believes that excess reserves of \$1 billion are too large, but that excess reserves of \$200 million to \$300 million are too low. He thinks the bill rate should be a little higher, and a little tightening in the money market would be desirable.

Brown believes a bill rate of 1.05 per cent to 1.25 per cent would be better than .85 per cent to .88 per cent. The speculation in the stock market concerns him. (Off-the-record comments on business mergers and present trends).

Smith believes money is too easy (Other members agree).

Brown can see no justification for increasing present stock margins. The Board might issue a warning on speculation without changing the margins.

Alexander would not favor raising the margin to 75 per cent.

Fleming would not favor raising the margin to 75 per cent unless loans to brokers went up substantially.

Alexander. In general, open market operations have been well conducted.

Brown. The Council may state it feels open market operations and current credit policies of the Board have been useful. In recent weeks the bill rate has dropped sharply. Open market operations should be conducted to bring the bill rate up to a figure of 1.10 per cent to 1.25 per cent. Unless the Treasury should sell a considerable amount of new issues to banks in the balance of the year, which seems unlikely, the present credit policies should be continued and the bill rate should be kept approximately within the limits stated above. The Council believes even such a slight increase in the bill rate as suggested would have a salutary economic effect. The Council pointed out in its Memorandum to the Board in February 1954 that "...the danger of disturbing the economy by making money unduly and artificially cheap is as great as the danger of restricting business by too high interest rates, and a consequent reduction in the use of credit."

Alexander believes it may not be desirable to mention specific rates. (All members of the Council agree).

Wallace asks whether any comment should be made on reducing reserve requirements.

Brown does not believe conditions now justify reducing reserve requirements. (Members of the Council agree).

### ITEM III

IN THE LIGHT OF THE COMMENTS OF THE FEDERAL ADVISORY COUNCIL AT ITS MEETING WITH THE BOARD IN SEPTEMBER, AND THE SUGGESTIONS RECEIVED FROM THE FEDERAL RESERVE BANKS, THE BOARD HAS GIVEN FURTHER STUDY TO THE REVISING OF REGULATION A, ADOPTED BY THE BOARD IN 1937. AS A RESULT OF THIS STUDY, CERTAIN CHANGES HAVE BEEN MADE IN THE DRAFT SENT TO THE MEMBERS OF THE COUNCIL WITH CHAIRMAN MARTIN'S LETTER OF JULY 22, 1954. THESE CHANGES WILL BE FORWARDED TO YOU AS SOON AS POSSIBLE AND THE BOARD WILL BE GLAD TO HAVE ANY COMMENTS THAT THE COUNCIL MIGHT WISH TO MAKE AT ITS NOVEMBER MEETING.

Brown does not see why the regulation should be changed, but the present draft is much better than the previous revisions of the regulation. (Off-the-record comments).

Chandler thinks the present draft is perhaps as good as may be obtained.

Ringland believes the draft has undesirable aspects.

Ireland. What is the purpose of two forewords?

Matkin believes the first foreword is stronger than any statement that has previously been made.

Ringland The Council might say that the new statement of General Principles with the foreword incorporated is agreeable, but that the Council sees nothing to be gained in comparison with the present statement of General Principles. (Off-the-record comments).

Brown. The first foreword will only be printed in the Federal Register and not in the regulation itself.

Alexander. If the revision were put in right shape, he would accept it since the Board seems to wish to revise it. However, he can see no real need for the revision.

Brown thinks the substance of the foreword which is to appear in the Federal Register should be incorporated in the statement of General Principles.

Wallace moves that the redraft, dated November 1, 1954, be approved if the preface to be printed in the Federal Register is included in substance in the statement of General Principles. (All members of the Council agree).

Brown. The Council may state it has considered the redraft of Regulation A, dated November 1, 1954. The Council urges and feels strongly that the foreword, which it is proposed be printed only in the Federal Register, be incorporated in substance in the statement of General Principles. Once the regulation is printed, many banks not having access to the Federal Register will not recall the foreword printed in the Federal Register. If the proposed foreword to appear only in the Federal Register is incorporated in the statement of General Principles, the Council would see no objection to the November 1, 1954 redraft of Regulation A.

#### ITEM IV

WHAT ARE THE VIEWS OF THE COUNCIL ON THE QUESTION WHETHER A COMMERCIAL BANK SHOULD BE AUTHORIZED TO ISSUE PREFERRED STOCK OR DEBENTURES AS A MEANS OF AUGMENTING CAPITAL FUNDS? IF THE POLICY OF GIVING SUCH AUTHORITY WERE ADOPTED, IN WHAT CIRCUMSTANCES SHOULD IT BE GRANTED AND WHAT LIMITATIONS SHOULD BE APPLIED?

Brown does not know from what original source this item actually came.

Ireland, Fleming, Alexander (Off-the-record comments).

Brown states that it is necessary to differentiate between debentures and preferred stock. The interest on debentures is a tax deductible item, but the dividends on preferred stock are not deductible. There might therefore be considerable pressure on banks to issue debentures because of the tax deduction. If banks are loaded up with preferred stock or debentures, it would tend to lessen the opportunity to increase capital in the future by common stock. Some banks wish to issue preferred stock because they do not want to dilute their common stock. Sometimes also banks are faced with problems of increasing common stock because a part of their stock is held in trust accounts in their banks and these accounts, under Regulation F, cannot exercise their rights. Debentures should be issued only in emergencies and where it is necessary to protect the depositors. Preferred stock should be issued only in emergencies to protect depositors and when the issuance of additional common stock would seriously dilute the value of the present common stock and injure the existing shareholders. Regulation F. should be amended to allow the exercise of rights on bank stock held in the banks' own trust accounts.

Fleming states that the rights in trust accounts can be sold in sufficient amounts to get cash to buy stock of the bank.

Ringland. In the case of either preferred stock or debentures, the public would probably consider it as borrowed money.

Alexander believes the authorities should withdraw their ban on the issuance of preferred stock and debentures. He favors granting the right to issue preferred stock or debentures in modest amounts under proper supervision.

Fleming. National banks can issue only preferred stocks, and cannot issue debentures. A state member bank can issue debentures, so we might have some disintegration in the national banking system.

Ringland. A national bank might change to a state charter to get the advantage.

Wallace thinks it might be unwise to give an answer to this whole question until it can be discussed with banks in areas growing rapidly in population, but which have not accumulated capital in adequate amounts to meet the needs of the community.

Alexander states that the Comptroller formerly argued that issuing a preferred stock placed a still heavier burden on the common stock which was already over-burdened. Alexander, however, thinks it gives additional protection to depositors. He believes each case should be studied individually.

Smith believes that banks, subject to proper supervision, should be free to do essentially what private corporations may do in this respect.

Brown. The Council may point out the essential differences between preferred stock and debentures. If debentures are permitted, many banks would use this route to get a tax advantage. The issuance by banks of preferred stock with different voting and retirement provisions would raise many complicated problems. The Council is not prepared to say that debentures should never be issued, but the restrictions should be greater. Debentures should be issued only in emergencies when it is essential to protect depositors. Preferred stock should be issued (1) only in emergencies to

protect depositors or (2) when it is necessary to increase a bank's capital funds, and when the issuance of additional common stock would only be possible at a price which would seriously dilute the value of the outstanding common stock and injure the existing share-holders. Any authority to issue debentures or preferred stock should require the approval of the Comptroller of the Currency for national banks, the Board of Governors for state member banks and the Federal Deposit Insurance Corporation for state non-member banks. The Council may also suggest that a revision of Regulation F would be desirable to permit the exercise of rights on its own bank stock held in the bank's trust accounts.

ITEM V

THE BOARD WOULD BE GLAD TO HAVE ANY COMMENTS THAT THE COUNCIL MAY WISH TO MAKE WITH RESPECT TO THE REPORT OF THE JOINT COMMITTEE ON CHECK COLLECTIONS, WHICH WAS DISCUSSED BRIEFLY AT THE MEETING OF THE BOARD AND THE COUNCIL IN SEPTEMBER AND AT WHICH TIME IT WAS STATED THAT THE MATTER WOULD BE TAKEN UP WITH REPRESENTATIVES OF THE AMERICAN BANKERS ASSOCIATION AT THE TIME OF ITS CONVENTION IN OCTOBER.

Fleming. All members of the committee have had copies of the report. It is generally agreed that the return of items to the original collecting bank should not be approved. The American Bankers Association will consider the report further at its Spring meeting in April. The Association of Reserve City Bankers will consider the report at its May meeting. There are wide differences <sup>on</sup> some of the recommendations in the report. Fleming states that the Council committee is not yet ready to report.

Davis. (Off-the-record comments). The report is to be considered further by the Reserve City Committee. Davis presents objections to some features of the report and gives illustrations of the routing of some items at present.

Ringland. (Off-the-record comments).

Brown believes it is not desirable for the Council to make any recommendation or report now. The Council may state to the Board that the report has been carefully discussed, and that there are differences of opinion in the Council and in the committee of the Council. The American Bankers Association will consider the report at the Spring meeting of its Executive Council, and the Association of Reserve City Bankers will discuss the report at its May meeting. The Council will keep the matter under discussion.

The meeting adjourned at 6 P.M.

THE FEDERAL ADVISORY COUNCIL CONVENED AT 10 A. M. ON NOVEMBER 15, 1954, IN ROOM 932 OF THE MAYFLOWER HOTEL, WASHINGTON, D.C. ALL MEMBERS OF THE COUNCIL WERE PRESENT.

The Council prepared and approved the attached Confidential Memorandum to be sent to the Board of Governors relative to the Agenda for the joint meeting of the Council and the Board on November 16, 1954. The memorandum was delivered to Mr. Carpenter, Secretary of the Board of Governors at 12 noon on November 15, 1954. It will be noted that each item of the Agenda is listed together with the comments of the Council.

The meeting adjourned at 11:40 A. M.

CONFIDENTIAL

MEMORANDUM TO THE BOARD OF GOVERNORS  
FROM THE  
FEDERAL ADVISORY COUNCIL  
RELATIVE TO THE AGENDA FOR THE JOINT MEETING  
ON NOVEMBER 16, 1954

1. What are the views of the Council with respect to the prospective business situation during the remainder of this year and the first six months of next year and the probable changes that will take place in the volume and purpose of bank loans in each of these periods?

Business generally is at a good level, but in a complex industrial economy there are necessarily variations from district to district and from industry to industry. The effects of the liquidation of inventories, some decline in investment in new plant and equipment, the drop in defense expenditures, and the decrease in farm income have been largely offset by substantial outlays for residential and public construction and by continued high consumer spending. Aggregate economic activity has remained relatively stable. The slight improvement which business has experienced this fall should continue during the balance of 1954. There are at present no indications of any significant change, either upward or downward, in the volume of business. After allowing for the usual seasonal movements, the Council believes that the volume of business in the first six months of 1955 will continue the present slight upward trend.

So far this fall the increase in bank loans has been less than seasonal. The members of the Council believe that, aside from loans to the Commodity Credit Corporation, the volume of bank loans for the rest of the year will show less than the usual increase in this period, and that banks will experience the normal loan liquidation after the first of the year, followed by a seasonal increase in loans in the spring. The Council does not expect any important change in the purpose of bank loans. There is, however, a continuing tendency for the percentage of term loans made by banks to increase.

The foregoing conclusions are based upon the assumption that the Government will not in the next six months, directly or by loans or guarantees to states or political subdivisions, bring about a considerably enlarged public works program, or substantially increase defense expenditures. Such developments would undoubtedly be reflected in an increase in economic activity and in the volume of bank loans.

2. What are the views of the members of the Council with respect to the System's current credit policies and what, if any, changes might be called for by developments during the balance of this calendar year or during the first two months of 1955?

The Council believes that current credit policies of the System have been helpful in lessening the effects of the economic readjustments that

have been taking place, and have contributed to the maintenance of a good level of business activity. No important change in these policies is at present indicated.

In general, open market operations have been well handled, but the Council is of the opinion that the bill rate has in the last few weeks been unreasonably low and should now be moderately higher. As the Council stated in its memorandum to the Board in February 1954, "the danger of disturbing the economy by making money unduly and artificially cheap is as great as the danger of restricting business by too high interest rates, and a consequent reduction in the use of credit." A slight increase in the bill rate would have a salutary economic effect and tend to restrain speculative activity.

3. In the light of the comments of the Federal Advisory Council at its meeting with the Board in September, and the suggestions received from the Federal Reserve Banks, the Board has given further study to the revising of Regulation A, adopted by the Board in 1937. As a result of this study, certain changes have been made in the draft sent to the members of the Council with Chairman Martin's letter of July 22, 1954. These changes will be forwarded to you as soon as possible and the Board will be glad to have any comments that the Council might wish to make at its November meeting.

The Council has carefully considered the redraft of Regulation A, dated November 1, 1954. The Council believes that the preface which it is proposed to print only in the Federal Register should be incorporated in substance in the proposed statement of General Principles. Most bankers never see the Federal Register, and unless the substance of the preface is incorporated in the statement of General Principles, very few bankers will know the preface was ever published by the Board. If the preface is incorporated in substance in the statement of General Principles, instead of printing it only in the Federal Register, the Council sees no objection to the November 1 redraft of Regulation A.

4. What are the views of the Council on the question whether a commercial bank should be authorized to issue preferred stock or debentures as a means of augmenting capital funds? If the policy of giving such authority were adopted, in what circumstances should it be granted and what limitations should be applied?

There is a major difference between debentures, even if subordinated, and preferred stock. Under present law interest on debentures is a deductible income tax item, but dividends on preferred stock are not deductible. Consequently, primarily to gain a tax benefit many banks if they had the authority might issue debentures rather than sell additional preferred or common stock. The issuance of debentures or preferred stock with questions of voting rights, sinking funds, and premiums for retirement would raise many problems and should be permitted only under adequate supervision.

The Council believes that debentures should be issued only in emergencies, when capital funds cannot be obtained otherwise, and where it is essential to protect depositors.

The Council believes that the right to issue preferred stock should be given only (1) in emergencies to protect depositors, or (2) when it is clearly desirable to increase a bank's capital funds, and when the issuance of additional common stock could only be accomplished at a price which would seriously dilute the value of presently outstanding common stock and materially injure existing shareholders.

The Council believes that any authority to issue debentures or preferred stock should require the approval of the following Federal agencies for the different groups of banks:

1. National banks--Comptroller of the Currency;
2. State member banks--Board of Governors; and
3. State nonmember banks--Federal Deposit Insurance Corporation.

The Council believes that a revision of Regulation F which would allow the exercise of rights on its own bank stock held in the bank's trust accounts would in many instances facilitate the issuance of additional common stock by banks.

5. The Board would be glad to have any comments that the Council may wish to make with respect to the report of the joint committee on check collections, which was discussed briefly at the meeting of the Board and the Council in September and at which time it was stated that the matter would be taken up with representatives of the American Bankers Association at the time of its convention in October.

Both its own committee which the Council appointed to study the question and the members of the Council have reviewed the report recommending changes in the check collection system. There are differences of opinion within the Council's committee and within the Council as a whole regarding various sections of the report.

The American Bankers Association, whose Administrative Committee discussed the report at the time of the annual convention of the American Bankers Association in October, will further consider the report at the spring meeting of its Executive Council in April, and the Association of Reserve City Bankers will discuss the report again at its May meeting. The Council understands that there are wide divergences of opinion within both organizations regarding the report. The recommendations of the report cannot be made effective without the support of both organizations. The Council and its committee also wish to give further consideration to a number of the complicated questions which the report presents.

THE FEDERAL ADVISORY COUNCIL CONVENED IN THE BOARD ROOM OF THE FEDERAL RESERVE BUILDING, WASHINGTON, D.C. AT 2:15 P.M. ON NOVEMBER 15, 1954. ALL MEMBERS OF THE COUNCIL WERE PRESENT.

Dr. Woodlief Thomas, Economic Adviser to the Board presented a confidential summary of studies which the Staff has made of various types of proposals relative to reserve requirements. Each member of the Council was given a confidential copy of "Review of Reserve Requirement Proposals and Studies."

The meeting adjourned at 3:50 P.M.

WHAT ARE THE VIEWS OF THE COUNCIL WITH REGARD TO THE PROSPECTIVE BUSINESS SITUATION DURING THE REMAINDER OF THIS YEAR AND THE FIRST SIX MONTHS OF NEXT YEAR AND THE TYPES OF CHANGES THAT WILL TAKE PLACE IN THE YEARS AND WHETHER OR HOW LONG IN EACH OF THESE PERIODS?

When asked item 1 and the conclusions of the Council as expressed in the Confidential Memorandum to the Board attached, business was open to be slightly more optimistic than they were a few months ago. Fortunately, the Board did not ask for the Council's views for the next twelve months instead of the next six months. The liberalized terms for real estate financing may prove to be a temporary stimulus, and this stimulus may not last all of next year. There is a tendency for bank loan portfolios to show an increasing percentage of long loans, and in some cases the maturities are as long as ten years.

Further down during the current improvement in business is seasonal activity more than seasonal.

Woods. Business in his district is below the national level. The general business is not good. The railroad equipment business is slow. Distribution is up, but not as much as it is near the nation. Farm income is down. He does not believe the present improvement is a little more than seasonal. Many business men think that the stimulus-of-the-year policy should apply to Washington.

Lowery. Business in his district is at a good level. The steel, paper and several industries are not doing better. Retail sales are up. Distribution is up. The year is a little more than seasonal.

Martin. Will the estimated 1,400,000 cars to be produced in November December 1954 be a bit in the air about after the first of the year?

Stewart. It is indicated that business for 1955 for the automobile industry as a whole will be about the same as 1954. The inventory at 1954 was not very low. Consequently, 1955 starts at a reasonably good level. It is a good automobile year. It is very looking for loans. Many banks are refinancing their short-term debt into longer term loans at attractive rates.

Smith. Farm loans are being made in great volume in Philadelphia. There is a feeling among business men. All telephone reported a general improvement in the orders in follow.

ON NOVEMBER 16, 1954, AT 10:30 A.M., THE FEDERAL ADVISORY COUNCIL HELD A JOINT MEETING WITH THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM IN THE BOARD ROOM OF THE FEDERAL RESERVE BUILDING, WASHINGTON, D. C.

ALL MEMBERS OF THE COUNCIL WERE PRESENT. THE FOLLOWING MEMBERS OF THE BOARD OF GOVERNORS WERE PRESENT: CHAIRMAN MARTIN, AND GOVERNORS SZYMCAK, MILLS AND BALDERSTON. GOVERNORS VARDAMAN AND ROBERTSON WERE ABSENT. MR. CARPENTER, SECRETARY, AND MR. SHERMAN, ASSISTANT SECRETARY OF THE BOARD OF GOVERNORS, WERE ALSO PRESENT.

#### ITEM I

WHAT ARE THE VIEWS OF THE COUNCIL WITH RESPECT TO THE PROSPECTIVE BUSINESS SITUATION DURING THE REMAINDER OF THIS YEAR AND THE FIRST SIX MONTHS OF NEXT YEAR AND THE PROBABLE CHANGES THAT WILL TAKE PLACE IN THE VOLUME AND PURPOSE OF BANK LOANS IN EACH OF THESE PERIODS?

Brown reads Item 1 and the conclusions of the Council as expressed in the Confidential Memorandum to the Board attached. Business men seem to be slightly more optimistic than they were a few months ago. Fortunately, the Board did not ask for the Council's views for the next twelve months instead of the next six months. The liberalized terms for real estate financing may prove to be a temporary stimulant, and this stimulant may not last all of next year. There is a tendency for bank loan portfolios to show an increasing percentage of term loans, and in some cases the maturities are as long as ten years.

Martin asks whether the current improvement in business is seasonal or slightly more than seasonal.

Alexander. Business in his district is below the national level. The apparel business is not good. The railroad equipment business is slow. Construction is up, but not as much as it is over the nation. Farm income is down. Alexander believes the present improvement is a little more than seasonal. Many business men think that the middle-of-the-road policy stood up well in the election.

Ireland. Business in the first district is at a good level. The shoe, paper and apparel industries are all doing better. Retail sales are up. Construction awards are high. The upturn is a little more than seasonal.

Martin. Will the estimated 1,100,000 cars to be produced in November-December cause a glut in the car market after the first of the year?

Alexander. It is estimated that business for 1955 for the automobile industry as a whole will be about the same as 1954. The inventory of 1954 models is very low. Consequently, 1955 starts on a reasonably good basis. 1954 was a good automobile year. Banks are looking for loans. Many companies are refunding their short-term debt into longer term loans at attractive rates.

Smith. Term loans are being made in great volume in Philadelphia. There is a better feeling among business men. Bell Telephone reported a substantial improvement in new orders in October.

Balderston. Are a large number of term loans for more than five years?

Smith. Many are over five years.

Chandler. Business in the 10th district is not up more than seasonal. The fact that farmers voted as they did does not indicate any great dissatisfaction on their part.

Gund. The coal industry is in somewhat better condition. Retail sales are down. Savings have increased markedly.

Fleming. The coal industry is better, but it is still five per cent off from a year ago. Construction is strong. Bank loans are up a little. Department store sales are good, except for Baltimore and Richmond. The gross national product is off from about \$365 billion in 1953 to about \$356 billion in 1954. Term loans are increasing.

Brown. (Off-the-record comments on term loans).

Martin. Is there apprehension regarding real estate credit and consumer credit terms?

Gund. There is no apprehension on consumer credit in his district.

Brown states that he did not include consumer credit in his comments.

Ringland understands there is some weakening of consumer credit terms by some finance companies, and that the banks are relaxing terms in order to compete.

Smith. There is a tendency to push out the terms on modernization loans.

Szymczak. Is there any apprehension for the last half of 1955 because of liberal mortgage financing?

Brown. Any apprehension regarding the last half of 1955 is not entirely based on mortgage financing. The time is approaching when the demand for housing may be largely met. In addition, if only 5,000,000 cars should be sold in 1955, compared to some preliminary estimates of approximately 5,300,000, there may be some problems, especially with large production in the last two months of 1954. Brown believes that residential construction may be a problem in the last half of 1955.

Balderston. Did the Council discuss the agricultural situation?

Brown. The Council discussed the agricultural situation in a general way. Despite the assumed dissatisfaction of the farmer, the election did not reflect dissatisfaction in many states. Brown expects farm income may show a further decline of four or five per cent.

Wallace. By the middle of next year the whole economy may need a new appraisal, because of the large supplies in such fields as agriculture and housing.

Davis. The Southeast was hit hard by drought. However, cities in that area have not yet felt the effects of the drought. There are some who believe the effects of the drought may not be felt in retail sales until February.

Campbell believes the comments Davis has made also apply to his district. With a good season in 1955, the farm situation would be improved. Business has held up in the district. Retail store sales are satisfactory.

Matkin. Farm income is off slightly and Matkin expects it to be off more next year. The decrease in acreage is one of the real problems. Each year the farmers are expected to cultivate smaller acreage and this creates serious income problems. New residential construction is near the saturation point.

## ITEM II

WHAT ARE THE VIEWS OF THE MEMBERS OF THE COUNCIL WITH RESPECT TO THE SYSTEM'S CURRENT CREDIT POLICIES AND WHAT, IF ANY, CHANGES MIGHT BE CALLED FOR BY DEVELOPMENTS DURING THE BALANCE OF THIS CALENDAR YEAR OR DURING THE FIRST TWO MONTHS OF 1955?

Brown reads Item II and the conclusions of the Council as expressed in the Memorandum to the Board attached. The Council was reluctant to suggest a specific range of rates for bills, but in the discussion, the rates mentioned ranged from a little above one per cent to one and one-fourth per cent. When the bill rate goes too low, there is a tendency to make loans for longer terms and even to finance stocks and mergers. (Off-the-record comments on the stock market).

Alexander believes the bill rate should be increased moderately. The present tendency to combine companies is one outcome of an overabundance of money. Perhaps a little less active ease would be desirable. A bill rate around one per cent or a little higher would be salutary.

Martin. The Board has no fixed views on these matters. We watch the money markets every day.

Fleming understands there will be no new cash requirements this fall on the part of the Treasury.

Martin has the same understanding. The Board is aware of the money market situation and studies it every day.

Brown. (Off-the-record comments on stock market margins)

Martin. (Off-the-record comments on stock market margins)

-15-

ITEM III

IN THE LIGHT OF THE COMMENTS OF THE FEDERAL ADVISORY COUNCIL AT ITS MEETING WITH THE BOARD IN SEPTEMBER, AND THE SUGGESTIONS RECEIVED FROM THE FEDERAL RESERVE BANKS, THE BOARD HAS GIVEN FURTHER STUDY TO THE REVISING OF REGULATION A, ADOPTED BY THE BOARD IN 1937. AS A RESULT OF THIS STUDY, CERTAIN CHANGES HAVE BEEN MADE IN THE DRAFT SENT TO THE MEMBERS OF THE COUNCIL WITH CHAIRMAN MARTIN'S LETTER OF JULY 22, 1954. THESE CHANGES WILL BE FORWARDED TO YOU AS SOON AS POSSIBLE AND THE BOARD WILL BE GLAD TO HAVE ANY COMMENTS THAT THE COUNCIL MIGHT WISH TO MAKE AT ITS NOVEMBER MEETING.

Brown reads Item III and the conclusions of the Council as expressed in the Memorandum to the Board attached. The Council feels strongly that the substance of the foreword should be in the statement of General Principles. Probably not one-tenth of one per cent of the banks keep files of the Federal Register.

Martin. Governor Mills has made a careful study of Regulation A and has done much work on it.

Mills. We have provided a uniform application of principles for all banks, but we have permitted some latitude for each Federal Reserve Bank to use its judgment. There is some room for individual judgment.

Brown commends Mills for the work he has done on Regulation A, but Brown again emphasizes that the substance of the foreword should be in the statement of General Principles.

Mills. Governor Robertson is the one who suggested that the foreword be printed only in the Federal Register. The foreword could be included in a letter of transmittal.

Brown does not believe that sending the foreword in a letter of transmittal would be adequate.

Smith. In view of previous discussions in which the Council indicated it felt the new regulation was planned to be restrictive, Smith believes that including the substance of the foreword in the statement of General Principles is desirable.

Alexander. The statement of General Principles could open or close with the substance of the foreword.

ITEM IV

WHAT ARE THE VIEWS OF THE COUNCIL ON THE QUESTION WHETHER A COMMERCIAL BANK SHOULD BE AUTHORIZED TO ISSUE PREFERRED STOCK OR DEBENTURES AS A MEANS OF AUGMENTING CAPITAL FUNDS? IF THE POLICY OF GIVING SUCH AUTHORITY WERE ADOPTED, IN WHAT CIRCUMSTANCES SHOULD IT BE GRANTED AND WHAT LIMITATIONS SHOULD BE APPLIED?

Brown reads Item IV and the conclusions of the Council as expressed in the Memorandum to the Board attached. The Council has assumed that the debentures would be deferred to other liabilities, although the agenda item did not give this information. The policy of issuing preferred stocks or debentures was very useful in the 1930's. One argument against debentures

is that they are somewhat like issuing post-dated checks. The bank must set aside earnings each year to retire them. Consequently, the bank gradually loses the benefits of the capital obtained by the debentures. Preferred stock may also be used for acquiring banks, but Brown does not believe that is generally desirable. The Council recommended Federal supervision, but all state banks would necessarily also have to obtain state approval.

Brown suggests that the Board reexamine Regulation F. He states that this item of the agenda presents a new subject, and he does not know what precipitated the question.

Martin indicates that Governor Robertson placed the question on the agenda and Robertson is out of the city. The Board is receiving various inquiries on this matter. Many inquiries grow out of a desire to acquire other banks. It is extremely difficult to pass upon these inquiries as each case differs from the others. Martin says he has been guided by the question of what is in the best public interest. The Board must approve any issuance of preferred or common stock of a state member bank.

Brown. There are cases where it is not desirable to give permission to issue preferred stock. However, there are cases where the price of the common stock is depressed and a preferred issue would be desirable.

Smith does not believe that it should be said that preferred stock cannot be issued. Sometimes it is desirable to issue preferred stock, but adequate safeguards should surround the issuance of the stock. It is a matter of using judgment.

Martin. Many times an element of judgment is involved, and Martin does not wish judgment to play too large a part in the Board's decisions.

Fleming. It is possible to have three types of preferred, and then the problems become even more complicated. The public interest and the interest of the common stockholders should be considered.

Alexander. The Council makes a strong distinction between debentures and preferred stock.

#### ITEM V

THE BOARD WOULD BE GLAD TO HAVE ANY COMMENTS THAT THE COUNCIL MAY WISH TO MAKE WITH RESPECT TO THE REPORT OF THE JOINT COMMITTEE ON CHECK COLLECTIONS, WHICH WAS DISCUSSED BRIEFLY AT THE MEETING OF THE BOARD AND THE COUNCIL IN SEPTEMBER AND AT WHICH TIME IT WAS STATED THAT THE MATTER WOULD BE TAKEN UP WITH REPRESENTATIVES OF THE AMERICAN BANKERS ASSOCIATION AT THE TIME OF ITS CONVENTION IN OCTOBER.

Brown reads Item V and the conclusions of the Council as expressed in the Memorandum to the Board attached. Frankly, the answer of the Council to this question defers the answer. However, the report presents some difficult problems which require thorough consideration. There are wide differences of opinion on parts of the report. The Council cannot well give a final decision until the American Bankers Association and the Association of Reserve City Bankers have arrived at their conclusions. The cooperation of these two associations is necessary.

Martin says that at this juncture he should like to report that the Board has no proposal on which all its members are agreed relative to reserve requirements.

Alexander states that although the Board has arrived at no proposal on which it has agreed, he assumes the Board has not given up working on the matter.

Martin replies that the Board has not given up studying the subject.

Szymczak. Even if the Board comes to an agreement on a reserve proposal, it must still pass Congress, and that means it must have the approval of the banks. The Board has no bill ready, unless the bankers have one to submit.

Martin. (Off-the-record comments on the possibility of a reserve proposal passing the Congress.

Alexander. If a proposal could be worked out so the banks could increase their earning assets, he believes the banks would approve it. He feels the 1948 proposal comes closest to being generally acceptable.

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The meeting adjourned at 12:40 P.M.

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The next meeting of the Council will be held on February 13, 14, 15, 1955.