301 2

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date October 15, 1930

To Governor Meyer.

Subject: 333

From Mr. McClelland.

2—8495

Referring to the discussion which took place at the meeting this morning with regard to the effect of purchases and sales by Federal reserve banks of foreign exchange, and the responsibility of the Board in connection with such purchases and sales, there is given below a short memorandum of the consideration which has been given by the Board to this matter.

At the meeting on June 30, 1927, Mr. Miller stated he thought some action should be taken by the Board to clarify its responsibility with respect to the purchase and sale by Federal reserve banks of bills of exchange and bankers' acceptances in foreign money markets and that he would bring the following motion up for action at the next meeting:

> "That it be the sense of the Federal Reserve Board that the authority conferred upon it in Section 13 of the Federal Reserve Act reading: 'The discount and rediscount and the purchase and sale by any Federal reserve bank of any bills receivable and of domestic and foreign bills of exchange, and of acceptances authorized by this Act, shall be subject to such restrictions, limitations, and regulations as may be imposed by the Federal Reserve Board', applies to the purchase and sale of bills of exchange and acceptances made abroad as well as at home and that the Board rule that such purchases and sales are subject to such restrictions, limitations and regulations as it may see fit to impose."

In response to a request that he submit an opinion as to whether Mr. Miller's motion was a correct statement of the legal situation, the Board's Counsel advised that in his opinion there could be no doubt as to the correctness of the conclusions stated in Mr. Miller's motion; also, that the language of the Act is all-inclusive and applies to the purchase and sale of bills of exchange and bankers' acceptances abroad as well as to purchases and sales at home appears so clearly from a reading of the statute itself that no argument was necessary to support Mr. Miller's conclusion.

The entire matter was considered at the meeting of the Board on July 6, and the following motion was adopted:

> "That it be the sense of the Federal Reserve Board that the authority conferred upon it by Sections13 and 14 of the Federal Reserve Act, with respect to the purchase and sale of bills of exchange and acceptances, applies to such purchases and sales made abroad as well as at home, and that the Board rule that such purchases and sales are subject to its regulation and approval."

At the meeting of the Executive Committee on July 12, the Board's Counsel was instructed to prepare and submit a regulation such as contemplated by the above action. Under date of August 17, Mr. Wyatt submitted a memorandum to

the Board requesting more specific instructions as to the character of the regulations which the Board desired to promulgate on this subject and the general nature of the restrictions, if any, which the Board desired to place upon the purchase and sale of bills of exchange and bankers' acceptances abroad.

With Mr. Wyatt's request before it, the Board gave further consideration to the matter at the meeting on August 30, 1927, but action was deferred. Since that time, while the question has been discussed in connection with other subjects which have come before the Board, no action has been taken. However, under date of October 20, 1927, Mr. Wyatt submitted a detailed memorandum on the subject, "The Board's Power Over Foreign Transactions of the Federal Reserve Banks", a copy of which is attached for your information.

Form No. 131.

Office Correspondence

FEDERAL RESERVE BOARD

Date October 3, 1930.

To File

From Mr. Carpenter.

Subject:

333.4-3

At the meeting of the Board on November 7, 1929, following a discussion of a possible regulation covering open market operations, Governor Young stated that he would endeavor to work out a form of regulation along the lines discussed and submit it to the Board later.

In view of the later adoption, by the System, of the revised plan of open market procedure, no further consideration was given to the matter of a regulation.

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date February 21, 1930

To Dr. Miller

Subject: 333.4-3

From Mr. McClelland.

o-r-o 2—8495

In accordance with your request, there is given below the record of the Board's action, as shown by the minutes, with regard to:

1. The proposed regulation by the Board of the purchase and sale by Federal reserve banks of bills of exchange and bankers' acceptances abroad.

2. The question of the procedure to be followed in the establishment of buying rates on acceptances at Federal reserve banks.

3. The proposed regulation covering open market operations at Federal reserve banks.

1. Regulation by the Board of the purchase and sale by Federal reserve banks of bills of exchange and bankers' acceptances abroad.

At the meeting of the Board on June 30, 1927, you stated you thought some action should be taken by the Board to clarify its responsibility with respect to the purchase and sale by Federal reserve banks of bills of exchange and bankers' acceptances in foreign money markets and that you would bring the following motion up for action at the next meeting:

"That it be the sense of the Federal Reserve Board that the authority conferred upon it in Section 13 of the Federal Reserve Act reading: 'The discount and rediscount and the purchase and sale by any Federal reserve bank of any bills receivable and of domestic and foreign bills of exchange, and of acceptances authorized by this Act, shall be subject to such restrictions, limitations, and regulations as may be imposed by the Federal Reserve Board', applies to the purchase and sale of bills of exchange and acceptances made abroad as well as at home and that the Board rule that such purchases and sales are subject to such restrictions, limitations and regulations as it may see fit to impose."

This matter was considered at the meeting on July 6, 1927, and the following motion, submitted by you, was adopted:

"That it be the sense of the Federal Reserve Board that the authority conferred upon it by Sections 13 and 14 of the Federal Reserve Act, with respect to the purchase and sale of bills of exchange and acceptances, applies to such purchases and sales made abroad as well as at home, and that the Board rule that such purchases and sales are subject to its regulation and approval."

At the meeting of the Executive Committee on July 12, 1927, counsel was instructed to prepare and submit to the Board a regulation such as contemplated by the above action, and at the meeting on Aug. 30, at which time a memorandum from counsel requesting further information as to the character of the regulation which the Board desired his office to prepare was discussed, action on the matter was deferred. Since that date no further action has been taken by the Board. However, the motion introduced by you on October 29, 1929, referred to la-

ter in this memorandum, contemplated the regulation by the Board of the purchase and sale of bills abroad.

2. The question of procedure to be followed in the establishment of buying rates on acceptances at Federal reserve banks.

At the meeting of the Board on January 3, 1929, following receipt of advice from the Federal Reserve Bank of New York of an intended change in the schedule of effective buying rates at that bank, the Governor stated that in his opinion new schedules of buying rates should not be made effective until approved by the Board. A general discussion followed regarding the procedure which has grown up in the matter of the establishment of buying rates at the Federal reserve banks, whereby, after approval by the Board of a minimum rate, currently effective rates are established by the bank without prior reference to the Board, and it was the consensus of opinion that such rates should be established, subject to the review and determination of the Board, in the same manner as rates of discount and that the present procedure should be revised.

The need of a change in the present procedure was discussed further at the meeting on January 4, and upon your motion, the Governor was "requested to prepare for action by the Board, draft of a regulation superseding all existing regulations or practices governing bill rates, which will make all rates subject to review and determination by the Board in the same manner as discount rates are now subject to review". It was also suggested by Mr. Cunningham that a meeting be held for the purpose of discussing fully the policy of the Federal Reserve System with regard to the purchase and holding of acceptances, with a view to having the Board fully informed as to just what the effect of the policy is and with the further thought of creating, if possible, a broader distribution of bills.

Occasioned by an advance in the schedule of effective buying rates at the Federal Reserve Bank of New York, at the meeting on February 15, 1929, the Governor was authorized, on the occasion of his next visit to New York, to discuss with the directors of the New York Bank the formulation of a procedure under which buying rates could be considered by the Board before they are made effective by the bank. At the meeting on March 21 the Governor reported that he had discussed the matter while in New York, particularly with Deputy Governor Kenzel who advised him that in ordinary times he believed the bank could operate if it were authorized to adjust the bill rate within one-half of one percent under the discount rate of the bank, but that at the present time with the bill market so uncertain he did not feel that anything could be done except to follow the market rates. The Governor also suggested that it would be desirable to have a conference between the members of the Board and the directors of the Federal Reserve Bank of New York for a full exchange of views regarding the situation. This suggestion was taken up with the New York directors through Governor Harrison who reported that the idea of a conference with the Board appealed to his directors and that they had asked Mr. Woolley and Governor Harrison to meet with the Board in Washington as soon as convenient. On June 5, 1929, Messrs. McGarrah, Mitchell, Reyburn and Treman met with the Board, but as the matter of the proposed increase in the discount rate of the Federal Reserve Bank of New York was of first importance at that time, there was no discussion of procedure in connection with the establishment of buying rates for bills.

Discussion with regard to the present procedure was had at the meet-

ing on August 9, at which time another change in the New York schedule of buying rates was noted with approval by the Board. Following further discussion at the meeting on August 10, you submitted the following memorandum as a basis for discussion of a new temporary procedure with regard to the determination of buying rates on bills by the Federal Reserve Board:

"1. The successful application of the general lines of credit policy adopted by the Board at the conclusion of the recent conference with the Governors depends largely if not mainly, upon the degree of accuracy with which purchases of bills are adjusted to the trend of conditions from week to week and possibly sometimes during short intervals.

2. The matter is one of too much importance, involving as it does the application of a national policy, to be left to the determination of the Reserve Bank of New York even though the great bulk of the bills will originate and be offered there. It should have the joint attention of the Federal Reserve Board and such other leading reserve banks beside New York as can conveniently be consulted.

3. For this purpose some temporary working arrangement during the remainder of the year seems desirable. Later, when the Reserve System is on a more normal basis of operation, a change in the working arrangement can be made, better adapted to ordinary conditions. That is a matter that might well be considered at the autumn conferences of banks with the Board.

4. Change of rate being the method by which the flow of bills to the reserve bank is chiefly regulated, constant attention will have to be given to the rate at which offerings of bills are coming under any given rate, with the view of determining whether they are coming too rapidly or too slowly to satisfy the objectives of the System's autumn policy.

5. The bill rate should, therefore, be under constant review by the Board, with power in a committee or in the Governor of the Board to authorize and approve changes in buying rates in accordance with the views of the Board or in accordance with sudden changes of conditions which call for immediate action.

6. It is suggested that the Board should begin the autumn policy by determining the lower limit of the buying rate of bankers acceptances at 5% - this rate to remain in effect until changed by joint action of the banks and Board. Changes in the actual buying rate above the 5% rate could, as suggested above, be made by a committee of the Board or by the Governor alone, should the committee not be promptly available. In order that the committee should be fully informed on conditions suggesting a change of rate, the Governor should keep in close touch with reserve banks as far as practicable.

7. Consideration should be given to the authorization of buying rates under 5% in districts outside of New York on acceptances originating within the districts, as long as they have 5% discount rates."

This memorandum was made the special order of business for the meeting on the 15th at which time further discussion ensued with regard to the possibility of working out a new procedure. Governor Harrison and Mr. Kenzel were present and advised the Board of the present procedure and the desirability of continuing to give the operating officers of the New York bank some leeway in the matter of changing the effective bill rates. Governor Harrison suggested that the minimum rate authorized by the Board should have some relation to the discount rate of the bank, running in normal times, one-half percent below the discount rate with a maximum one-half percent above that rate. Governor Young suggested a minimum rate of

5% with a maximum of 6%, and after some discussion suggested a procedure along the following lines:

"That the Board authorize a minimum rate of 5% and a maximum rate of 6%, that the Board then give to the Executive Committee or the Executive Officer authority to approve effective rates within the minimum and maximum approved by the Board; and that the operation of the bill policy be left to the officers of the New York Bank until a point is reached where the New York directors or the Board feel that bills are being accumulated too rapidly or too slowly, in which event the matter of a change in the effective rate, and if necessary, the minimum and maximum rates would be brought up for discussion."

You then suggested a maximum of 5-1/2% instead of 6% and after some discussion it was voted "that in the absence of a quorum of the Board the Executive Committee, or in its absence, the Executive Officer of the Board be authorized to approve effective buying rates within the limits of a 5% minimum and the 5-1/2% maximum, excepting the Federal Reserve Banks of Dallas and Atlanta where 4-7/8% and 4-1/2% rates are now in effect on short maturities and the Federal Reserve Bank of Richmond, where a rate of 5-5/8% has been established on long maturities, such rates applying to bills originating in the respective districts."

Further discussion was had at the meeting on October 28 at which time you moved to have the action of the Board voted on August 15 amended to read as follows:

"That no change in bill rates shall be effective until after approval by the Federal Reserve Board and that in the absence of a quorum of the Board, the Executive Committee, or in its absence, the Executive Officer of the Board, be authorized to approve effective buying rates within such minimum and maximum rates as may be approved by the Board."

Action on this motion was deferred and since that date no further action has been taken by the Board, any possible discussion regarding the matter being in connection with changes in buying rates at the New York Bank.

3. Proposed regulation covering open market operations at Federal reserve banks.

At the meeting on October 29, 1929, following a report by the Governor of the Purchase by the Federal Reserve Bank of New York, upon authority of its directors but without previous approval by the Board, of $50,000,000 of Government securities, Mr. James submitted the following motion:

"Whereas, the action of the Federal Reserve Bank of New York in purchasing Government securities for its own account, without first securing the approval of the Federal Reserve Board and/or the Open Market Investment Committee, is contrary to the letter and spirit of the so-called 'gentlemen's agreement' under which the Open Market Investment Committee was formed and has functioned during the last five years or more, and

"Whereas, it was obviously the intention of Congress in passing the Federal Reserve Act, that the Federal Reserve Board should have consideration in open market operations,

"Now, therefore, be it resolved, that Counsel be instructed to draw up and submit to the Board a suitable regulation putting the final approval of open

market operations with the Federal Reserve Board."

Mr. Hamlin then submitted the following resolution, as a substitute for the one submitted by Mr. James:

"Whereas, a difference of opinion has arisen in the Board as to the expediency of the action of the Federal Reserve Bank of New York, - whether acting on its own initiative or under the Open Market Investment Committee, or both, in purchasing $50,000,000 of Government securities,

"Now, therefore, be it resolved, that Counsel be directed to prepare a draft of regulation covering all purchases, in the future, of Government securities by the Open Market Investment Committee or by any individual Federal reserve bank."

You then moved as a substitute for the resolutions submitted by Messrs. James and Hamlin, the following:

"That Counsel be instructed to prepare for submission to the Board draft of an Open Market regulation covering purchases and sales of bills, purchases and sales of Government securities and purchases and sales of foreign bills, the latter in accordance with action taken by the Board on July 6, 1927".

At the meeting on October 31, 1929, Mr. James submitted draft of a proposed regulation on the subject of open market operations, consideration of which was made the special order of business for the meeting on November 5. At that meeting Mr. James filed two alternative drafts of the proposed regulation, and Governor Young suggested that the Board consider the adoption of a very brief regulation providing merely that except with the approval of the Federal Reserve Board, no Federal Reserve bank shall engage in open market operations in securities having a maturity in excess of 15 days, and that a letter then be addressed to all Federal reserve banks advising that the Board contemplates putting such a regulation into effect and asking for their reactions. He submitted a form of regulation which was amended during the discussion and adopted as follows, it being the understanding that the effective date would be left for subsequent determination:

"Except with the approval of the Federal Reserve Board, no Federal reserve bank shall (a) buy any bonds, notes, certificates of indebtedness or Treasury bills of the United States, having a maturity in excess of 15 days, or (b) sell any bonds, notes, certificates of indebtedness, or Treasury bills of the United States."

The Governor was then requested to prepare for consideration by the Board, draft of a letter to all Federal reserve banks transmitting the regulation, and at the meeting on November 7 he reported that he had consulted the Board's counsel who advised him that after further consideration he is of the opinion that there is considerable doubt of the legality of the regulation adopted by the Board. Other legal forms of a regulation were discussed at this meeting and the Governor stated he would endeavor to work out another form of regulation along the lines discussed and submit it to the Board later. Since that time no action has been taken.

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date February 21, 1930

To Mr. Miller

Subject:

From Mr. McClelland.

In accordance with your request, there is given below the record of the Board's action, as shown by the minutes, with regard to:

1. The proposed regulation by the Board of the purchase and sale by Federal reserve banks of bills of exchange and bankers' acceptances abroad.

2. The question of the procedure to be followed in the establishment of buying rates on acceptances at Federal reserve banks.

3. The proposed regulation covering open market operations at Federal reserve banks.

1. Regulation by the Board of the purchase and sale by Federal reserve banks of bills of exchange and bankers' acceptances abroad.

At the meeting of the Board on June 30, 1927, you stated you thought some action should be taken by the Board to clarify its responsibility with respect to the purchase and sale by Federal reserve banks of bills of exchange and bankers' acceptances in foreign money markets and that you would bring the following motion up for action at the next meeting:

"That it be the sense of the Federal Reserve Board that the authority conferred upon it in Section 13 of the Federal Reserve Act reading: 'The discount and rediscount and the purchase and sale by any Federal reserve bank of any bills receivable and of domestic and foreign bills of exchange, and of acceptances authorized by this Act, shall be subject to such restrictions, limitations, and regulations as may be imposed by the Federal Reserve Board', applies to the purchase and sale of bills of exchange and acceptances made abroad as well as at home and that the Board rules that such purchases and sales are subject to such restrictions, limitations and regulations as it may see fit to impose."

This matter was considered at the meeting on July 6, 1927, and the following motion, submitted by you, was adopted:

"That it be the sense of the Federal Reserve Board that the authority conferred upon it by Sections 13 and 14 of the Federal Reserve Act, with respect to the purchase and sale of bills of exchange and acceptances, applies to such purchases and sales made abroad as well as at home, and that the Board rule that such purchases and sales are subject to its regulation and approval."

At the meeting of the Executive Committee on July 12, 1927, counsel was instructed to prepare and submit to the Board a regulation such as contemplated by the above action, and at the meeting on Aug. 30, at which time a memorandum from counsel requesting further information as to the character of the regulation which the Board desired his office to prepare was discussed, action on the matter was deferred. Since that date no further action has been taken by the Board. However, the motion introduced by you on October 29, 1929, referred to la-

ter in this memorandum, contemplated the regulation by the Board of the purchase and sale of bills abroad.

2. The question of procedure to be followed in the establishment of buying rates on acceptances at Federal reserve banks.

At the meeting of the Board on January 3, 1929, following receipt of advice from the Federal Reserve Bank of New York of an intended change in the schedule of effective buying rates at that bank, the Governor stated that in his opinion new schedules of buying rates should not be made effective until approved by the Board. A general discussion followed regarding the procedure which has grown up in the matter of the establishment of buying rates at the Federal reserve banks, whereby, after approval by the Board of a minimum rate, currently effective rates are established by the bank without prior reference to the Board, and it was the consensus of opinion that such rates should be established, subject to the review and determination of the Board, in the same manner as rates of discount and that the present procedure should be revised.

The need of a change in the present procedure was discussed further at the meeting on January 4, 1929, and upon ~~your~~ motion, the Governor was "requested to prepare for action by the Board, draft of a regulation superseding all existing regulations or practices governing bill rates, which will make all rates subject to review and determination by the Board in the same manner as discount rates are now subject to review". It was also suggested by Mr. Cunningham that a meeting be held for the purpose of discussing fully the policy of the Federal Reserve System with regard to the purchase and holding of acceptances, with a view to having the Board fully informed as to just what the effect of the policy is and with the further thought of creating, if possible, a broader distribution of bills.

Occasioned by an advance in the schedule of effective buying rates at the Federal Reserve Bank of New York, at the meeting on February 15, 1929, the Governor was authorized, on the occasion of his next visit to New York, to discuss with the directors of the New York Bank the formulation of a procedure under which buying rates could be considered by the Board before they are made effective by the bank. At the meeting on March 21 the Governor reported that he had discussed the matter while in New York, particularly with Deputy Governor Kenzel who advised him that in ordinary times he believed the bank could operate if it were authorized to adjust the bill rate within one-half of one percent under the discount rate of the bank, but that at the present time with the bill market so uncertain he did not feel that anything could be done except to follow the market rates. The Governor also suggested that it would be desirable to have a conference between the members of the Board and the directors of the Federal Reserve Bank of New York for a full exchange of views regarding the situation. This suggestion was taken up with the New York directors through Governor Harrison who reported that the idea of a conference with the Board appealed to his directors and that they had asked Mr. Woolley and Governor Harrison to meet with the Board in Washington as soon as convenient. On June 5, 1929, Messrs. McGarrah, Mitchell, Reyburn and Treman met with the Board, but as the matter of the proposed increase in the discount rate of the Federal Reserve Bank of New York was of first importance at that time, there was no discussion of procedure in connection with the establishment of buying rates for bills.

Discussion with regard to the present procedure was had at the meet-

ing on August 9, at which time another change in the New York schedule of buying rates was noted with approval by the Board. Following further discussion at the meeting on August 10, you submitted the following memorandum as a basis for discussion of a new temporary procedure with regard to the determination of buying rates on bills by the Federal Reserve Board:

"1. The successful application of the general lines of credit policy adopted by the Board at the conclusion of the recent conference with the Governors depends largely if not mainly, upon the degree of accuracy with which purchases of bills are adjusted to the trend of conditions from week to week and possibly sometimes during short intervals.

2. The matter is one of too much importance, involving as it does the application of a national policy, to be left to the determination of the Reserve Bank of New York even though the great bulk of the bills will originate and be offered there. It should have the joint attention of the Federal Reserve Board and such other leading reserve banks beside New York as can conveniently be consulted.

3. For this purpose some temporary working arrangement during the remainder of the year seems desirable. Later, when the Reserve System is on a more normal basis of operation, a change in the working arrangement can be made, better adapted to ordinary conditions. That is a matter that might well be considered at the autumn conferences of banks with the Board.

4. Change of rate being the method by which the flow of bills to the reserve bank is chiefly regulated, constant attention will have to be given to the rate at which offerings of bills are coming under any given rate, with the view of determining whether they are coming too rapidly or too slowly to satisfy the objectives of the System's autumn policy.

5. The bill rate should, therefore, be under constant review by the Board, with power in a committee or in the Governor of the Board to authorize and approve changes in buying rates in accordance with the views of the Board or in accordance with sudden changes of conditions which call for immediate action.

6. It is suggested that the Board should begin the autumn policy by determining the lower limit of the buying rate of bankers acceptances at 5% - this rate to remain in effect until changed by joint action of the banks and Board. Changes in the actual buying rate above the 5% rate could, as suggested above, be made by a committee of the Board or by the Governor alone, should the committee not be promptly available. In order that the committee should be fully informed on conditions suggesting a change of rate, the Governor should keep in close touch with reserve banks as far as practicable.

7. Consideration should be given to the authorization of buying rates under 5% in districts outside of New York on acceptances originating within the districts, as long as they have 5% discount rates."

This memorandum was made the special order of business for the meeting on the 15th at which time further discussion ensued with regard to the possibility of working out a new procedure. Governor Harrison and Mr. Kenzel were present and advised the Board of the present procedure and the desirability of continuing to give the operating officers of the New York bank some leeway in the matter of changing the effective bill rates. Governor Harrison suggested that the minimum rate authorized by the Board should have some relation to the discount rate of the bank, running in normal times, one-half percent below the discount rate with a maximum one-half percent above that rate. Governor Young suggested a minimum rate of

5% with a maximum of 6%, and after some discussion suggested a procedure along the following lines:

"That the Board authorize a minimum rate of 5% and a maximum rate of 6%, that the Board then give to the Executive Committee or the Executive Officer authority to approve effective rates within the minimum and maximum approved by the Board; and that the operation of the bill policy be left to the officers of the New York Bank until a point is reached where the New York directors or the Board feel that bills are being accumulated too rapidly or too slowly, in which event the matter of a change in the effective rate, and if necessary, the minimum and maximum rates would be brought up for discussion."

You then suggested a maximum of 5-1/2% instead of 6% and after some discussion it was voted that in the absence of a quorum of the Board the Executive Committee, or in its absence, the Executive Officer of the Board be authorized to approve effective buying rates within the limits of a 5% minimum and the 5-1/2% maximum, excepting the Federal Reserve Banks of Dallas and Atlanta where 4-7/8% and 4-1/2% rates are now in effect on short maturities and the Federal Reserve Bank of Richmond, where a rate of 5-5/8% has been established on long maturities, such rates applying to bills originating in the respective districts."

Further discussion was had at the meeting on October 28 at which time you moved to have the action of the Board voted on August 15 amended to read as follows:

"That no change in bill rates shall be effective until after approval by the Federal Reserve Board and that in the absence of a quorum of the Board, the Executive Committee, or in its absence, the Executive Officer of the Board, be authorized to approve effective buying rates within such minimum and maximum rates as may be approved by the Board."

Action on this motion was deferred and since that date no further action has been taken by the Board, any possible discussion regarding the matter being in connection with changes in buying rates at the New York Bank.

3. Proposed regulation covering open market operations at Federal reserve banks.

At the meeting on October 29, 1929, following a report by the Governor of the purchase by the Federal Reserve Bank of New York, upon authority of its directors but without previous approval by the Board, of $50,000,000 of Government securities, Mr. James submitted the following motion:

"Whereas, the action of the Federal Reserve Bank of New York in purchasing Government securities for its own account, without first securing the approval of the Federal Reserve Board and/or the Open Market Investment Committee, is contrary to the letter and spirit of the so-called 'gentlemen's agreement' under which the Open Market Investment Committee was formed and has functioned during the last five years or more, and

"Whereas, it was obviously the intention of Congress in passing the Federal Reserve Act, that the Federal Reserve Board should have consideration in open market operations,

"Now, therefore, be it resolved, that Counsel be instructed to draw up and submit to the Board a suitable regulation putting the final approval of open

market operations with the Federal Reserve Board."

Mr. Hamlin then submitted the following resolution, as a substitute for the one submitted by Mr. James:

"Whereas, a difference of opinion has arisen in the Board as to the expediency of the action of the Federal Reserve Bank of New York, - whether acting on its own initiative or under the Open Market Investment Committee, or both, in purchasing $50,000,000 of Government securities,

"Now, therefore, be it resolved, that Counsel be directed to prepare a draft of regulation covering all purchases, in the future, of Government securities by the Open Market Investment Committee or by any individual Federal reserve bank."

You then moved as a substitute for the resolutions submitted by Messrs. James and Hamlin, the following:

"That Counsel be instructed to prepare for submission to the Board draft of an Open Market regulation covering purchases and sales of bills, purchases and sales of Government securities and purchases and sales of foreign bills, the latter in accordance with action taken by the Board on July 6, 1927".

At the meeting on October 31, 1929, Mr. James submitted draft of a proposed regulation on the subject of open market operations, consideration of which was made the special order of business for the meeting on November 5. At that meeting Mr. James filed two alternative drafts of the proposed regulation, and Governor Young suggested that the Board consider the adoption of a very brief regulation providing merely that except with the approval of the Federal Reserve Board, no Federal Reserve bank shall engage in open market operations in securities having a maturity in excess of 15 days, and that a letter then be addressed to all Federal reserve banks advising that the Board contemplates putting such a regulation into effect and asking for their reactions. He submitted a form of regulation which was amended during the discussion and adopted as follows, it being the understanding that the effective date would be left for subsequent determination:

"Except with the approval of the Federal Reserve Board, no Federal reserve bank shall (a) buy any bonds, notes, certificates of indebtedness or Treasury bills of the United States, having a maturity in excess of 15 days, or (b) sell any bonds, notes, certificates of indebtedness, or Treasury bills of the United States."

The Governor was then requested to prepare for consideration by the Board, draft of a letter to all Federal reserve banks transmitting the regulation, and at the meeting on November 7 he reported that he had consulted the Board's counsel who advised him that after further consideration he is of the opinion that there is considerable doubt of the legality of the regulation adopted by the Board. Other legal forms of a regulation were discussed at this meeting and the Governor stated he would endeavor to work out another form of regulation along the lines discussed and submit it to the Board later. Since that time no action has been taken.

November 8, 1929.

Dear Sir :

Section 14(b) of the Federal Reserve Act authorizes every Federal reserve bank, "To buy and sell, at home or abroad, bonds and notes of the United States, * * * such purchases to be made in accordance with rules and regulations prescribed by the Federal Reserve Board."

Under this provision the Federal Reserve Board has promulgated the following regulation to become effective at a future date to be fixed by the Federal Reserve Board:

> "Except with the approval of the Federal Reserve Board, a Federal Reserve Bank shall not buy or hold for its own account obligations of the United States Government having a maturity in excess of one day in an amount in excess of the subscribed capital of such Federal Reserve Bank."

The words "for its own account" are intended to exclude the purchase of Government obligations under resale agreements and transactions, whereby Federal reserve banks buy Government obligations for the account of member banks and own them for not more than one day pending delivery.

The exclusion from the limitation of Government obligations not "having a maturity in excess of one day" will enable the reserve banks to continue their practice of giving the Treasury the necessary assistance to cover day to day overdrafts during tax paying periods.

Kindly advise the Board at the earliest possible date what exceptions, if any, to the above regulation your bank desires to have approved for it at the time the regulation is made effective, in order to avoid any undue disturbance of your present situation.

Very truly yours,

R. A. Young,
Governor.

WW omc sad

Young filed 252. - B

file date 11/6/29

1c

PROPOSAL FOR REGULATION.

The purchase or sale of Government securities shall be governed primarily with regard to their effect upon the general credit situation, and they shall not be purchased by any individual reserve bank for the purpose of increasing earnings. Generally speaking all future purchases of Government securities shall be made by the open market investment committee, but if the directors of any Federal reserve bank consider that a local emergency requires a purchase of Governments a prompt report must be made to the Federal Reserve Board and such purchases shall not exceed the capital of the local reserve bank, without prior approval by the Federal Reserve Board. This shall not apply, however, to the purchase and sale of securities having a maturity of 15 days or less.

E. P.

This may be a good working arrangement but not a regulation — that the Board could issue and make it stand up and stand up legally.

Should be filed 333. 4-3

1C

The date upon which this regulation shall become effective has been left for future determination by the Board. The words "for its own account" can be interpreted to mean as excluding purchase and resale agreements and over-the-night transactions, where banks buy and own, pending of a one fixed rate. covering delivery. The limitation covered by the following words "having a maturity in excess of one day" will enable the Reserve Banks to follow the usual practice of the past of giving the Treasury the necessary assistance to cover day to day overdrafts during tax paying periods.

The Board, therefore, would appreciate your advising it at as early date as possible what approvals, in your opinion, the Board ~~would have to~~ should simultaneously give your bank so that the present position of your ~~institution~~ bank will not be unreasonably disturbed.

The date upon which this regulation shall become effective has been left for future determination by the Board. The words "for its own account" can be interpreted to mean as excluding purchase and resale agreements and over-the-night transactions, where banks buy and own, covering delivery. The limitation covered by the following words "having a maturity in excess of one day" will enable the Reserve Banks to follow the usual practice of the past of giving the Treasury the necessary assistance to cover day to day overdrafts during tax paying periods.

The Board, therefore, would appreciate your advising it at as early date as possible as to approvals, in your opinion, the Board would have to give your bank so that the present position of your institution will not be unreasonably disturbed

November 5, 1929

Dear Sir:

Section 14(b) of the Federal Reserve Act authorizes every Federal reserve bank "To buy and sell, at home or abroad, bonds and notes of the United States, and bills, notes, revenue bonds, and warrants with a maturity from date of purchase of not exceeding six months, * * *such purchases to be made in accordance with rules and regulations prescribed by the Federal Reserve Board."

Under this provision the following regulation has been adopted by the Board:

> Except with the approval of the Federal Reserve Board, no Federal reserve bank shall (a) buy any bonds, notes, certificates of indebtedness or Treasury bills of the United States, having a maturity in excess of fifteen days, or (b) sell any bonds, notes, certificates of indebtedness, or Treasury bills of the United States.

The date on which this regulation shall become effective has been left for future determination by the Board, which realizes that under its provisions, certain every-day operations, which are engaged in by the Federal reserve banks for their own account and for the account of their member banks in a more or less routine manner, may be unnecessarily hampered. The Board would, therefore, appreciate receiving from you at the earliest possible date, an expression of the views of your officers and directors on the matter.

Very truly yours,

R. A. Young,
Governor.

To be revised
AT BOARD MEETING,
NOV 6 1929

Regulation to be changed
AT BOARD MEETING,
NOV 7 1929

Filed 333.4-3

FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

November 5, 1929

Dear Sir:

Section 14(b) of the Federal Reserve Act authorizes every Federal reserve bank "To buy and sell, at home or abroad, bonds and notes of the United States, ~~and bills, notes, revenue bonds, and warrants with a maturity from date of purchase of not exceeding six months~~, * * *such purchases to be made in accordance with rules and regulations prescribed by the Federal Reserve Board."

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The date on which this regulation shall become effective has been left for future determination by the Board, which realizes that under its provisions, certain every-day operations, which are engaged in by the Federal reserve banks for their own account and for the account of their member banks in a more or less routine manner, may be unnecessarily hampered. The Board would, therefore, appreciate receiving from you at the earliest possible date, an expression of the views of your officers and directors on the matter.

Very truly yours,

R. A. Young,
Governor.

Form No. 121

Office Correspondence

FEDERAL RESERVE BOARD

Date 2-52 - B

To _____ Subject: _____

From _____

file date 11/1/29

2—3495 GPO

1C

Except with the approval of the Federal Reserve Board, no Federal Reserve Bank shall (A) buy [redacted] any obligations of the United States Government having a maturity in excess of fifteen days, [redacted]

[redacted]

Suggested by Governor

BOARD MEETING.

NOV 6 1929

9B

Filed 333.4-3

(CONFIDENTIAL - Fourth Preliminary Draft November 1,1929) B

REGULATION , SERIES OF 1929

OPEN MARKET OPERATIONS

Section I - General Principles

The time, manner, character and volume of all purchases and sales made by or for the account of Federal reserve banks in the open market, pursuant to the terms of Section 14 of the Federal Reserve Act, shall be governed primarily with a view of accommodating commerce and business and with regard to their effect upon the general credit situation.

Section II - Limitations

The amount of all investments acquired in the open market pursuant to the provisions of Section 14 of the Federal Reserve Act and held by or for the account of each Federal reserve bank shall not be less than a certain amount nor more than a certain other amount to be fixed from time to time by the Federal Reserve Board, except that this limitation shall not apply to:

(1) Temporary purchases and sales of United States bonds, notes, certificates of indebtedness and Treasury bills for the accommodation or account of the Treasury of the United States in amounts requested by the Treasury for periods not in excess of fifteen days; or

(2) Other investments made in emergencies to accommodate specific member banks.

Section III - Dealings in Gold

Except after applying for and receiving the approval of the Federal Reserve Board, no Federal reserve bank shall engage in, or make definite commitments for, transactions with foreign governments, foreign banks or foreign bankers involving the purchase, sale, exchange, loan, pledge, or earmarking of gold, gold coin or gold certificates.

Submitted by Mr. James

NOV 5 1929

Except with the approval of the Federal Reserve Board, no Federal Reserve Bank shall (a) buy any bonds, notes, certificates of indebtedness or Treasury bills of the United States, having a maturity in excess of fifteen days, or (b) sell any bonds, notes, certificates of indebtedness, or Treasury bills of the United States.

file date
11/1/29

1C

Except with the approval of the Federal Reserve Board, no Federal Reserve bank shall (a) buy any bonds, notes, certificates of indebtedness or Treasury bills of the United States, having a maturity in excess of fifteen days, or (b) sell any ~~United States government obligations.~~ any bonds notes, certificates of indebtedness or Treasury bills of the United States.

Adopted
See Minutes

NOV 6 1929

2

Except with the ~~permission~~ of the Federal Reserve Board, no Federal Reserve Bank shall ~~engage in open market transactions authorized under the provisions of the Federal Reserve Act,~~ ~~or~~ purchase, sell (8) ~~or hold~~ any bonds, notes, or certificates of indebtedness or Treasury bills of the United States, having a maturity ~~at the time of purchase~~ in excess of fifteen days.

6

(CONFIDENTIAL - Third preliminary draft - November 1, 1929)

Regulation ___, Series of 1929.

OPEN MARKET OPERATIONS

Section I - General Principles

1C

The time, manner, character and volume of all open market operations engaged in by Federal reserve banks under Section 14 of the Federal Reserve Act shall be governed primarily with a view of accommodating commerce and business and with regard to their effect upon the general credit situation.

Section II - Limitations

The aggregate amount of all open market investments made by or for the account of the Federal reserve banks under Section 14 of the Federal Reserve Act shall conform to limitations imposed from time to time by the Federal Reserve Board, except that such limitations shall not apply to:

(1) Temporary purchases and sales of United States bonds, notes, certificates of indebtedness and Treasury bills for the accommodation or account of the Treasury of the United States in amounts requested by the Treasury for periods not in excess of fifteen days; or

(2) Other investments made in emergencies to accommodate specific member banks.

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Submitted by Mr. James

NOV 5 1929

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date October 31, 1939

To Gov. Young

Subject:

From Mr. McClelland

At the meeting today Mr. James submitted and furnished to each member of the Board, a draft of a proposed regulation governing open market operations. Consideration of this proposed regulation was made the special order of business for the meeting of the Board on Tuesday, November 5.

Reg. Fed 252.-B

Form No. 131.

Office Correspondence

FEDERAL RESERVE BOARD

Date January 28, 1929.

To Dr. Miller

Subject:

From Mr. McClelland

2-8495 ero

In accordance with your request, there is quoted below the resolution adopted by the Board on July 6, 1927:

> "That it be the sense of the Federal Reserve Board that the authority conferred upon it by Sections 13 and 14 of the Federal Reserve Act, with respect to the purchase and sale of bills of exchange and acceptances, applies to such purchases and sales made abroad as well as at home, and that the Board rule that such purchases and sales are subject to its regulation and approval."

C2, Fed 252. - B

(Confidential)

X-4980

333.4-3

October 20, 1927.

To: The Federal Reserve Board,

From: Mr. Wyatt- General Counsel.

Subject: The Board's power over foreign transactions of Federal Reserve Banks.

The Board has requested an opinion with respect to what regulations, limitations and restrictions it is authorized to prescribe as to foreign or international transactions of Federal reserve banks, and as to its general authority over such transactions. I understand that the Board desires to have the following points covered in this opinion:

(1) Whether the Board has power to regulate, limit, or restrict transactions involving the opening of accounts, the appointment of correspondents, or the establishment of agencies in foreign countries;

(2) Whether the Board has power to regulate, limit, or restrict dealings in bills of exchange and bankers' acceptances between Federal reserve banks and foreign central banks;

(3) Whether the Board has power to regulate, limit, or restrict dealings in gold between Federal reserve banks and foreign central banks; and

(4) Whether the Federal reserve banks may lawfully charge a commission or fee in connection with such foreign transactions.

CONCLUSIONS.

After careful consideration of these questions, I have reached the following conclusions:

(1) Under the specific terms of section 14(e) of the Federal Reserve Act, no Federal reserve bank may lawfully open or main-

tain accounts, appoint correspondents, or establish agencies in foreign countries without first obtaining the consent of the Federal Reserve Board; and the opening and maintenance of such accounts, the appointment of such correspondents, the establishment of such agencies and the conduct through such correspondents or agencies of "any transaction" authorized by section 14 of the Federal Reserve Act for or on behalf of other Federal reserve banks is expressly made subject to such rules and regulations as the Federal Reserve Board may prescribe. In addition, the Board has the power to order or direct Federal reserve banks to open and maintain accounts, appoint correspondents and establish agencies in foreign countries.

(2) By virtue of specific provisions of the Federal Reserve Act, the Federal Reserve Board is authorized and empowered to prescribe regulations, restrictions and limitations governing dealings in bills of exchange between Federal reserve banks and foreign central banks.

(3) By virtue of its right to exercise general supervision over Federal reserve banks, and by virtue of certain other powers specifically granted in the Federal Reserve Act, the Federal Reserve Board is authorized to regulate, limit or restrict important dealings in gold involving large amounts between Federal reserve banks and foreign central banks under section 14(a) of the Federal Reserve Act.

(4) Whenever the Federal reserve banks enter into any lawful transaction involving the extension of credit to, or the performance of any service for, a foreign central bank, they may lawfully charge a reasonable commission or fee for the extension of such credit or the rendition of such services.

From a mere reading of this language it is obvious that the Federal Reserve Board is given full control of all transactions conducted thereunder. No Federal reserve bank may open or maintain accounts, appoint correspondents, or establish agencies in foreign countries except with the consent and subject to the regulations of the Federal Reserve Board; and any Federal reserve bank must open and maintain accounts, appoint correspondents, or establish agencies in foreign countries if ordered or directed to do so by the Federal Reserve Board. The opening and maintaining of such accounts, the appointment of such correspondents, and the establishment of such agencies is expressly made subject to "regulations to be prescribed by said board." No Federal reserve bank may open and maintain banking accounts through such foreign correspondents or agencies without the consent of the Federal Reserve Board. Other Federal reserve banks may participate in such transactions only with the consent and approval of the Federal Reserve Board. And all transactions through such correspondents or agencies in which other Federal reserve banks participate must be conducted "under rules and regulations to be prescribed by the Board."

This gives the Board the fullest possible measure of control, and it is important to note that the rules and regulations which may be prescribed by the Board governing transactions in which other of the Federal reserve banks participate pertain to all transactions authorized by any part of Section 14, and is not limited to transactions under subdivision (e).

DEALINGS IN BILLS OF EXCHANGE AND ACCEPTANCES.

The power of the Federal reserve banks to deal on the open market in bills of exchange and bankers' acceptances is conferred by the

first paragraph of section 14, which reads as follows:

> "Sec. 14. Any Federal reserve bank may, under rules and regulations prescribed by the Federal Reserve Board, purchase and sell in the open market, at home or abroad, either from or to domestic or foreign banks, firms, corporations, or individuals, cable transfers and bankers' acceptances and bills of exchange of the kinds and maturities by this Act made eligible for rediscount, with or without the indorsement of a member bank."

It is obvious that all transactions conducted under authority of this paragraph are expressly made subject to "rules and regulations prescribed by the Federal Reserve Board."

Further and more complete authority to control such transactions is conferred upon the Federal Reserve Board by the following paragraph of section 13:

> "The discount and rediscount and the purchase and sale by any Federal reserve bank of any bills receivable and of domestic and foreign bills of exchange, and of acceptances authorized by this Act, shall be subject to such restrictions, limitations, and regulations as may be imposed by the Federal Reserve Board."

It has been suggested that this paragraph pertains only to domestic transactions and gives the Board no power over transactions in foreign countries; but, the broad language used by Congress is not subject to any such restricted interpretation. It will be noted that it applies not only to the discount and rediscount but also to the purchase and sale by any Federal reserve banks of any bills receivable and of domestic and foreign bills of exchange and of acceptances authorized by this Act. It is not limited in terms to domestic transactions but is couched in the broadest possible language and is obviously intended to include all purchases and sales by any Federal reserve bank of any bills receivable, domestic and foreign bills of exchange, or acceptances authorized by the Federal Reserve Act.

(Confidential)

X-4980
332.4-3
October 20, 1927.

To: The Federal Reserve Board,

From: Mr. Wyatt- General Counsel.

Subject: The Board's power over foreign transactions of Federal Reserve Banks.

The Board has requested an opinion with respect to what regulations, limitations and restrictions it is authorized to prescribe as to foreign or international transactions of Federal reserve banks, and as to its general authority over such transactions. I understand that the Board desires to have the following points covered in this opinion:

(1) Whether the Board has power to regulate, limit, or restrict transactions involving the opening of accounts, the appointment of correspondents, or the establishment of agencies in foreign countries;

(2) Whether the Board has power to regulate, limit, or restrict dealings in bills of exchange and bankers' acceptances between Federal reserve banks and foreign central banks;

(3) Whether the Board has power to regulate, limit, or restrict dealings in gold between Federal reserve banks and foreign central banks; and

(4) Whether the Federal reserve banks may lawfully charge a commission or fee in connection with such foreign transactions.

CONCLUSIONS.

After careful consideration of these questions, I have reached the following conclusions:

(1) Under the specific terms of section 14(e) of the Federal Reserve Act, no Federal reserve bank may lawfully open or main-

tain accounts, appoint correspondents, or establish agencies in foreign countries without first obtaining the consent of the Federal Reserve Board; and the opening and maintenance of such accounts, the appointment of such correspondents, the establishment of such agencies and the conduct through such correspondents or agencies of "any transaction" authorized by section 14 of the Federal Reserve Act for or on behalf of other Federal reserve banks is expressly made subject to such rules and regulations as the Federal Reserve Board may prescribe. In addition, the Board has the power to order or direct Federal reserve banks to open and maintain accounts, appoint correspondents and establish agencies in foreign countries.

(2) By virtue of specific provisions of the Federal Reserve Act, the Federal Reserve Board is authorized and empowered to prescribe regulations, restrictions and limitations governing dealings in bills of exchange between Federal reserve banks and foreign central banks.

(3) By virtue of its right to exercise general supervision over Federal reserve banks, and by virtue of certain other powers specifically granted in the Federal Reserve Act, the Federal Reserve Board is authorized to regulate, limit or restrict important dealings in gold involving large amounts between Federal reserve banks and foreign central banks under section 14(a) of the Federal Reserve Act.

(4) Whenever the Federal reserve banks enter into any lawful transaction involving the extension of credit to, or the performance of any service for, a foreign central bank, they may lawfully charge a reasonable commission or fee for the extension of such credit or the rendition of such services.

DISCUSSION.

The only one of these questions which presents any difficulty is the question whether the Board has the power to regulate, limit or restrict dealings in gold between Federal reserve banks and foreign central banks. I shall, therefore, discuss the other questions first and take up this more difficult question last.

FOREIGN ACCOUNTS, CORRESPONDENTS AND AGENCIES.

The authority for Federal reserve banks to open and maintain accounts, appoint correspondents, and establish agencies in foreign countries is conferred by the following language of Section 14:

"Every Federal reserve bank shall have power:

"(e) To establish accounts with other Federal reserve banks for exchange purposes and, with the consent or upon the order and direction of the Federal Reserve Board and under regulations to be prescribed by said board, to open and maintain accounts in foreign countries, appoint correspondents, and establish agencies in such countries wheresoever it may be deemed best for the purpose of purchasing, selling, and collecting bills of exchange, and to buy and sell, with or without its indorsement, through such correspondents or agencies, bills of exchange (or acceptances) arising out of actual commercial transactions which have not more than ninety days to run, exclusive of days of grace, and which bear the signature of two or more responsible parties, and, with the consent of the Federal Reserve Board, to open and maintain banking accounts for such foreign correspondents or agencies. Whenever any such account has been opened or agency or correspondent has been appointed by a Federal reserve bank, with the consent of or under the order and direction of the Federal Reserve Board, any other Federal reserve bank may, with the consent and approval of the Federal Reserve Board, be permitted to carry on or conduct, through the Federal reserve bank opening such account or appointing such agency or correspondent, any transaction authorized by this section under rules and regulations to be prescribed by the board."

From a mere reading of this language it is obvious that the Federal Reserve Board is given full control of all transactions conducted thereunder. No Federal reserve bank may open or maintain accounts, appoint correspondents, or establish agencies in foreign countries except with the consent and subject to the regulations of the Federal Reserve Board; and any Federal reserve bank must open and maintain accounts, appoint correspondents, or establish agencies in foreign countries if ordered or directed to do so by the Federal Reserve Board. The opening and maintaining of such accounts, the appointment of such correspondents, and the establishment of such agencies is expressly made subject to "regulations to be prescribed by said board." No Federal reserve bank may open and maintain banking accounts through such foreign correspondents or agencies without the consent of the Federal Reserve Board. Other Federal reserve banks may participate in such transactions only with the consent and approval of the Federal Reserve Board. And all transactions through such correspondents or agencies in which other Federal reserve banks participate must be conducted "under rules and regulations to be prescribed by the Board."

This gives the Board the fullest possible measure of control, and it is important to note that the rules and regulations which may be prescribed by the Board governing transactions in which other of the Federal reserve banks participate pertain to all transactions authorized by any part of Section 14, and is not limited to transactions under subdivision (e).

DEALINGS IN BILLS OF EXCHANGE AND ACCEPTANCES.

The power of the Federal reserve banks to deal on the open market in bills of exchange and bankers' acceptances is conferred by the

first paragraph of section 14, which reads as follows:

> "Sec. 14. Any Federal reserve bank may, under rules and regulations prescribed by the Federal Reserve Board, purchase and sell in the open market, at home or abroad, either from or to domestic or foreign banks, firms, corporations, or individuals, cable transfers and bankers' acceptances and bills of exchange of the kinds and maturities by this Act made eligible for rediscount, with or without the indorsement of a member bank."

It is obvious that all transactions conducted under authority of this paragraph are expressly made subject to "rules and regulations prescribed by the Federal Reserve Board."

Further and more complete authority to control such transactions is conferred upon the Federal Reserve Board by the following paragraph of section 13:

> "The discount and rediscount and the purchase and sale by any Federal reserve bank of any bills receivable and of domestic and foreign bills of exchange, and of acceptances authorized by this Act, shall be subject to such restrictions, limitations, and regulations as may be imposed by the Federal Reserve Board."

It has been suggested that this paragraph pertains only to domestic transactions and gives the Board no power over transactions in foreign countries; but, the broad language used by Congress is not subject to any such restricted interpretation. It will be noted that it applies not only to the discount and rediscount but also to the purchase and sale by any Federal reserve banks of any bills receivable and of domestic and foreign bills of exchange and of acceptances authorized by this Act. It is not limited in terms to domestic transactions but is couched in the broadest possible language and is obviously intended to include all purchases and sales by any Federal reserve bank of any bills receivable, domestic and foreign bills of exchange, or acceptances authorized by the Federal Reserve Act.

It has been suggested that it was intended to apply only to transactions under section 13 and does not apply to dealings under section 14. A glance at the legislative history of this provision, however, shows that it could not possibly have been intended to apply only to section 13. As contained in the original Federal Reserve Act, this provision applied only to rediscounts but it was amended by the Act of September 7, 1916, so as to apply also to purchases and sales. At that time section 13 did not authorize Federal reserve banks to purchase and sell bills receivable, bills of exchange or bankers' acceptances but dealt with discounts and rediscounts and the only authority for the purchase and sale of bills of exchange and acceptances by Federal reserve banks was contained in section 14. Even at this late date, the only authority in section 13 to purchase and sell bills of exchange is the authority added by the Agricultural Credits Act of March 4, 1923, to purchase and sell bills of exchange payable at sight or on demand which are drawn to finance the domestic shipment of nonperishable readily marketable staple agricultural products.

It is obvious, therefore, that the authority conferred upon the Federal Reserve Board by the above quoted provision of section 13 is intended to apply to the purchase and sale of bills of exchange and bankers' acceptances by Federal reserve banks at home or abroad under section 14.

In my opinion, therefore, the specific provisions of the Federal Reserve Act authorize and empower the Federal Reserve Board to prescribe regulations, restrictions, and limitations covering dealings in bills of exchange and bankers' acceptances between Federal reserve banks and foreign central banks.

RIGHT OF FEDERAL RESERVE BANKS TO MAKE A REASONABLE CHARGE IN CONNECTION WITH FOREIGN TRANSACTIONS.

Assuming that Federal reserve banks have power to engage in transactions whereby they sell or lend gold to foreign banks, purchase bills for the account of foreign banks or extend credit in any way to foreign banks, have the Federal reserve banks the right to charge a reasonable commission or fee for so doing?

In my opinion it is an incidental power of Federal reserve banks to make a reasonable charge for any service lawfully rendered by them, unless such charge is prohibited by statute or is contrary to public policy. There is no statute prohibiting the making of charges by Federal reserve banks in connection with dealings in gold or bills of exchange with foreign central banks, nor is there anything in the Federal Reserve Act to indicate that such a charge should be considered contrary to public policy. Assuming that the Federal reserve banks have power to engage in these foreign transactions, I am of the opinion, therefore, that they are legally authorized to make a reasonable charge for the services which they render in that connection.

GOLD TRANSACTIONS.

Section 14(a) authorizes and empowers the Federal reserve banks:

> "(a) To deal in gold coin and bullion at home or abroad, to make loans thereon, exchange Federal reserve notes for gold, gold coin, or gold certificates, and to contract for loans of gold coin or bullion, giving therefor, when necessary, acceptable security, including the hypothecation of United States bonds or other securities which Federal reserve banks are authorized to hold;"

This section does not expressly authorize the Federal Reserve Board to regulate, limit or restrict the exercise of the powers conferred thereby; but I am of the opinion that such authority is to be found else-

where in the Act.

I am not familiar with the details of the arrangements between the Federal Reserve Bank of New York and the various central banks of foreign countries; but it is my understanding that, whenever the Federal Reserve Banks have undertaken to enter into transactions with foreign central banks involving the purchase and sale of bills of exchange or dealings in gold, the Federal Reserve Bank of New York has first entered into mutual arrangements with such central banks whereby each bank appoints the other its correspondent or agent, and that the transactions which take place under these arrangements are conducted by the Federal Reserve Bank of New York on behalf of all Federal Reserve Banks on a pro rata basis. Where this is done there can be no doubt of the Board's power to prescribe rules and regulations governing all such transactions which are authorized by any part of Section 14; because the last sentence of Section 14(e) provides that:

> "Whenever any such account has been opened or agency or correspondent has been appointed by a Federal reserve bank, with the consent of or under the order and direction of the Federal Reserve Board, any other Federal reserve bank may, with the consent and approval of the Federal Reserve Board, be permitted to carry on or conduct, through the Federal reserve bank opening such account or appointing such agency or correspondent, any transaction authorized by this section under rules and regulations to be prescribed by the board."

It has been suggested that the words "any transactions" as used here refer only to the purchasing, selling and collecting of bills of exchange under authority of subdivision (e) of Section 14; but, in my opinion, no such restricted interpretation can properly be given to these words. The words "any transaction authorized by this section"

are very broad in their scope and clearly include every transaction authorized by any part of Section 14, including the power granted by Subdivision (a) to deal in gold coin and bullion at home or abroad. In my opinion, therefore, this provision of subdivision (e) of Section 14 specifically authorizes the Board to prescribe rules and regulations governing any and all transactions in gold between a Federal reserve bank and a foreign central bank which has been appointed as the agent or correspondent of such Federal reserve bank, if other Federal reserve banks participate in such transactions.

Independently of the power conferred by section 14(e), however, I am further of the opinion that the Federal Reserve Board is authorized to regulate, limit or restrict international gold transactions of the Federal reserve banks, even when such transactions are not conducted through correspondents or agencies opened or established pursuant to section 14(e). This power in my opinion is included in the power conferred by section 11(j) "to exercise general supervision over said Federal reserve banks" and the power conferred by Section 11(i) to "perform the duties, functions, or services specified in this Act, and make all rules and regulations necessary to enable said Board effectively to perform the same.

In view of the great importance of this question, I shall discuss at length the nature and extent of the Board's power of general supervision, the legislative history of the open market powers of the Federal reserve banks, the respective functions of the Federal reserve banks and the Federal Reserve Board in the Federal Reserve System and the relation of international gold transactions to other

transactions over which the Board has been given specific powers. Before entering upon such a lengthy discussion, however, I shall state briefly my reasons for the above conclusion.

1. It has long been recognized that banking is a business affected with the public interest and that banks are subject to regulation under the police power for the protection of the general welfare of the people.

2. Because of their very nature and because of the far-reaching effects of their policies and transactions on the general welfare of the people, this is especially true of Federal reserve banks.

3. Federal reserve banks are instrumentalities of the Federal government created for public purposes and are at all times and in all respects subject to the paramount authority of the Federal government.

4. The Federal Reserve Board is an arm of the Federal government created for the purpose of administering the Federal Reserve Act and exercising general supervision over the Federal reserve banks, to the end that they may function in a manner best calculated to carry out the purposes of the Federal Reserve Act, to serve the public policy of the United States, and to benefit the people of the United States.

5. The Board's general power of supervision includes the power to see that the Federal reserve banks preserve and protect the banking reserves of the country with which they are entrusted, that they do nothing which may endanger the solvency or soundness of their currency, that they carry out faithfully the purposes of the Federal Reserve Act and that they comply in all respects with both the letter and the spirit of the law. This power carries with it the power to

require the Federal reserve banks to cease doing anything which is ultra-vires or which might defeat the purposes of the Federal Reserve Act or which might be detrimental to the public interest. Moreover, this power is to be construed liberally so as to enable the Board effectively to safeguard the great public interests confided to it.

6. From an examination of the Committee reports and legislative debates on the Federal Reserve Act it is perfectly clear that the power of carrying on the regular routine everyday business of the Federal reserve banks and the power of determining local policies was entrusted to their respective board of directors, but the Federal Reserve Board was created as "a general board of management" entrusted with the power to overlook and direct the general functions of the banks in order that the Board, on behalf of the government, might retain some power over the exercise of the "broader banking functions" affecting the country as a whole.

7. To this end, the Board was given power, among other things, to review and determine the rates of discount to be fixed by each Federal reserve bank from time to time, to regulate the open market transactions of the Federal reserve banks, to exercise general supervision over the Federal reserve banks, and to make all rules and regulations necessary to enable the Board to perform the duties, functions or services specified in the Federal Reserve Act.

8. The power to purchase and sell bills of exchange and bankers' acceptances in the open market was conferred upon the Federal reserve banks in order to enable them to make their rediscount rates effective and to protect their gold reserves, but this power was subjected to

regulation by the Federal Reserve Board in order that the Board might have some control over the reserve positions of the banks, the rediscount rates, and general credit conditions throughout the country.

9. For the same reason, the Board was given a great measure of control over the other open market operations of the Federal reserve banks, over their power to appoint correspondents, open accounts and establish agencies abroad, and over the transactions which might be conducted through such foreign correspondents and agencies.

10. The effectiveness of the powers thus conferred upon the Board would be seriously impaired and the Board's ability to exercise some control over the rediscount rates, open market operations and foreign transactions of the Federal reserve banks with a view to protecting the general credit situation and overseeing the "broader banking functions" affecting the country as a whole might be rendered nugatory if the Federal reserve banks could enter into transactions with foreign banks involving the purchase and sale, lending, borrowing and earmarking of gold, thereby moving great quantities of gold into or out of the country, without being subject to any regulation or check by the Federal Reserve Board.

11. Any statute must be construed as a whole and in such a way as to carry out the intent of the legislature. The intent of the legislature must be obtained by reading the act as a whole and not by construing isolated provisions of the same without any reference to their relation to the other provisions of the act or the effect of such construction upon other provisions of the act.

12. To construe the Board's powers "to exercise general supervision over the Federal reserve banks" and "to perform the duties,

functions or services specified in this act and to make all rules and regulations necessary to enable said Board effectively to perform the same" strictly and in such a way as not to include the power to exercise some control over international gold transactions, would clearly defeat the broad purposes of the Federal Reserve Act and greatly impair the Board's function as a "general board of management" entrusted with the power to overlook and direct the general functions of the banks in order that the Board, on behalf of the government, might retain some power over the exercise of the "broader banking functions" affecting the country as a whole.

13. Dealings in gold between the Federal reserve banks and foreign central banks are transactions of importance to the entire Federal Reserve System and to the public interests of the United States as a whole. Normally large amounts are involved in these dealings. Frequently in such transactions the funds of the Federal reserve banks are invested in or represented by assets located in foreign countries. This use of large amounts of the funds of the Federal Reserve System might cause a serious restriction upon the amount of funds available for use in this country and harmful results upon the Federal Reserve System or upon the business interests of this country might ensue. It could seriously affect the gold reserves of the country and the effectiveness of the rediscount rate.

14. Under these circumstances, the question whether and to what extent Federal reserve banks should engage in transactions of this kind is an important question of policy to the Federal Reserve System as a whole. The practical responsibility of such transactions is one

which in the last analysis, must rest upon the Federal Reserve Board. If the Federal Reserve Board's power of general supervision over Federal reserve banks is to have any practical effect or is to be given any substantial meaning, it must be considered to extend to and include the regulation or restriction of such important activities of Federal reserve banks as these international dealings in gold, which may impair the effectiveness of the rediscount rate and the open market transactions over which the Board is expressly given a large measure of control.

I am of the opinion, therefore, that by virtue of its right to exercise general supervision over Federal reserve banks the Federal Reserve Board is empowered and authorized to restrict or regulate important dealings in gold involving substantial amounts between Federal reserve banks and foreign central banks under section 14(a) of the Federal Reserve Act and that accordingly the Federal Reserve Board may, if it so desires, require Federal reserve banks to obtain its approval before entering into such transactions.

FURTHER DISCUSSION AND CITATION OF AUTHORITIES.

The above is only a summary of the reasons for my conclusions regarding the Board's power to exercise supervision and control over international gold transactions. In view of the vast importance of this subject, I have made a very lengthy and complete study and feel that I should submit below for future reference the results of that study and the citations of such authorities as I have found.

GENERAL SUPERVISORY POWER.

I have made a careful and thorough study of the Board's general supervisory power and of the legal authorities regarding the general supervisory or visitatorial powers in general. I submit the following discussion of that subject for the Board's further information.

It is customary in American law to vest in some board, commission, or officer, the power to exercise general supervision over certain types of corporations such as common carriers, insurance companies, and banks, which are affected with a public interest. Furthermore, under American law all corporations are chartered by the Government and have only such powers as are expressly granted in their charters or in the laws under which they are incorporated and such incidental powers as are necessary to the exercise of the powers expressly granted. It is well settled that by implication they are forbidden to exercise any other powers. The State, therefore, is interested in any attempt by a corporation to exceed its corporate powers and it is well settled that the State is the one to complain of any ultra vires acts of a corporation and is the only one which can institute quo warranto proceedings to compel a corporation to cease performing ultra vires acts. The duties of boards, commissions or officers charged with general supervision over corporations affected with a public interest, therefore, are primarily to see that such corporations do not exceed their lawful powers and that they carry out the purposes of their organization in such a way as to benefit rather than injure the public, and to prevent or check any abuses of any character.

This power, in its general nature and purpose is quite similar to, if not the same as, the common law power of visitation. A discussion of the authorities on the subject of visitatorial powers, therefore, may throw some light on the extent of the Board's duties and powers in the premises.

The visitors of eleemosynary and ecclesiastical corporations at common law, however, frequently performed all the functions and possessed all the powers which are now divided between the directors of banks and the governmental authorities having supervision over them; and it is im-

portant to keep this in mind while reading the authorities quoted below:

Bouvier's Law Dictionary, (p. 3404) discusses this subject as follows:

"Visitation. The act of examining into the affairs of a corporation.

"The power of visitation is applicable only to ecclesiastical and eleemosynary corporations. 1 Bla. Com. 480. The visitation of civil corporations is by the government itself, through the medium of the courts of justice. See 2 Kent, 240. In the United States, the legislature is the visitor of all corporations founded by it for public purposes; Dartmouth College v. Woodward, 4 Wheat. (U.S.) 518 4 L. Ed. 629.

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"All eleemosynary corporations who are to receive the charity of the founder have visitors if they are ecclesiastical corporations; and if a particular visitor is not provided by the founder, then the Ordinary of the place is the visitor; if they are lay corporations, the founder and his heirs are perpetual visitors; 5 Mod. 404. It is a necessary incident of an eleemosynary corporation; 1 Mod. 82; "a power to correct abuses and to enforce due observance of the statutes of the charity, but not a power to revoke the gifts, to change uses or divest rights;" Allen v. McKean 1 Summ. 276, Fed. Cas. No. 229, per Story, J.

"A visitor has the right of inspecting the affairs of the corporation, and superintending all officers who have charge of them according to the statutes of the founder, without any control or revision of any other person or body, except the judicial tribunals, by whose authority and jurisdiction he may be restrained and kept within the limits of the granted powers, and made to regard the general laws of the land; in re Murdock, 24 Mass. 303. No. appeal lay from a visitor unless he visits qua Ordinary, when an appeal lay to the Crown in Chancery. It was said by Lord Camden that visitation is despotism uncontrolled and without appeal; Grant, Corp. 534. See, generally, Tudor, Charitable Trusts; Stephens, Statutes Relating to Ecclesiastical, etc., Institutions; Report of Oxford Commission (1852); 7 Com. Dig. 545; 21 Viner, Abr. 587. See 34 L. Mag. and Rev. 40, as to Oxford and Cambridge Universities.

"In Massachusetts it is held that the visitation of eleemosynary corporations according to the common law is in force except as altered by statute; In re Murdock, 24 Mass. 303; such statutes may vest visitatorial power in the courts, in the absence of a personal visitor, or even where there is one; In re Taylor Orphan Asylum, 36 Wis. 534; but where visitatorial power is conferred on certain public officers, the courts may not interfere unless such visitors should act contrary to law; Nelson v. Cushing, 2 Cush. (56 Mass.) 519.

"Even where a testator, in founding a hospital, directed that the trustees should annually report their acts to the court and give bonds, it was held that the court had no visitatorial power or other supervision;

Jenkins v. Berry, 119 Ky. 350, 83 S.W. 594.

"The visitatorial power of a court over a cemetery association does not authorize it to substitute its own business judgment for that of the association; Roanoke Cemetery Co. v. Goodwin, 101 Va. 605, 44 S.E. 769.

"Under the visitatorial powers of a state over corporations doing business within its borders, it is competent for it to compel such corporations to produce their books and papers for investigation and to require the testimony of their officers and employees to ascertain whether its laws have been complied with, and this power extends to the production of books and papers kept outside of the state, and a statute requiring such production does not amount to an unreasonable search or seizure or a denial of due process of law; Consolidated R. Co. v. Vermont, 207 U. S. 541, 28 Sup. Ct. 178, 52 L. Ed. 327, 12 Ann. Cas. 658; Hammond P. Co. v. Arkansas, 212 U.S. 322, 29 Sup. Ct. 370, 53 L. Ed. 530, 15 Ann. Cas. 645. A corporation, being the creature of the state, has not the constitutional right to refuse to submit its books and papers for an examination at the suit of the state, and an officer of a corporation charged with criminal violation of a statute cannot plead the criminality of the corporation as a refusal to produce its books; Hale v. Henkel, 201 U. S. 43, 26 Sup. Ct. 370, 50 L. Ed. 652. A corporation is bound to furnish information when called for by the state, so far as reasonably possible, and state the facts which excuse them from answering more fully; State v. Express Co., 81 Minn. 87, 83 N.W. 465, 50 L.R.A. 667, 83 Am. St. Rep. 366; by statute the right exists in Kansas; See Western U. Tel. Co. v. Austin, 67 Kan. 208, 72 Pac. 850.

"It may be considered that, to a certain extent, railroad commissions are the machinery created by law for the exercise of visitatorial power.

"This power does not include the common law right of the shareholder to inspect the books of the corporation; Guthrie v. Harkness, 199 U.S. 148, 26 Sup. Ct. 4, 50 L. Ed. 130, 4 Ann. Cas. 433."

In the famous Dartmouth College Case, 17 U.S. (4 Wheat) 517, 672, Mr. Justice Story discusses the subject of visitors of eleemosynary corporations as follows:

> "To all eleemosynary corporations, a visitatorial power attaches, as a necessary incident; for these corporations being composed of individuals, subject to human infirmities, are liable, as well as private persons, to deviate from the end of their institution. The law, therefore, has provided, that there shall somewhere exist a power to visit, inquire into, and correct all irregularities and abuses in such corporations, and to compel the original purposes of charity to be faithfully fulfilled. 1 Bl. Com. 480. The nature and extent of this visitatorial power has been expounded with admirable fulness and accuracy by Lord Holt in one of his most celebrated judgments. Phillips v. Bury, 1 Ld. Raym. 5; s.c. 2 T.R. 346. And of common right, by the dotation, the founder and his heirs are the legal visitors, unless the founder has appointed and assigned another person to be visitor. For the founder may, if he please, at the time of the

> endowment, part with his visitatorial power, and the person to whom it is assigned will, in that case, possess it in exclusion of the founder's heirs. 1. Bl. Com. 482. *** But where trustees or governors are incorporated to manage the charity, the visitatorial power is deemed to belong to them in their corporate character. Philips v. Bury, 1 Ld. Raym. 5; s.c. 2 T.R. 346; Green v. Rutherforth, 1 Ves. 472; Attorney-General v. Middleton, 2 Ibid.327; Case of Sutton Hospital, 10 Co. 23,31."

That the power to supervise and examine banks is a visitorial power is indicated by the following passage in Morse on Banks and Banking (5 Ed.) Vol 1, p.44:

> "A state may invest the supervision of banks in a bank commissioner or other examiner, and grant to him visitorial powers over banks and impose upon him the duty of examination of banks, the investigation of their solvency, and the winding up of their affairs if the protection of the depositors demands such action. He may examine the records of the bank, change the personnel of the board of directors, and establish rules for the proper discharge of his duty. His power should not be unduly narrowed by construction, nor can he be removed by the governor."

In Guthrie v. Harkness, 199 U.S. 148, a stockholder in a national bank applied for leave to inspect the books, accounts and loans of the bank for the purpose of ascertaining the value of his stock. Upon refusal to allow such inspection, he instituted proceedings to compel the officers of the bank to permit him to examine the books. One of the defenses made on behalf of the officers was that the common law right of the stockholder to inspect the books of a corporation is cut off as to stockholders of national banks by Section 5241 of the Revised Statutes, which provides that "No association shall be subject to any visitorial powers other than such as are authorized by this title or are vested in the courts of justice." The court held that the stockholder was entitled to examine the books of the bank and that the officers thereof must permit him to do so.

Mr. Justice Day said:

"But, it is said, the right of the shareholder to inspect the books is cut off by section 5241, providing 'no association shall be subject to any visitorial powers other than such as are authorized by this Title, or are vested in the courts of justice. 'We are unable to find any definition of 'visitorial powers' which can be held to include the common law right of the shareholder to inspect the books of the corporation * * *.

* * * * * * * * * * *

"The meaning of this section was before Judge Baxter in the case of First Nat. Bank of Youngstown v. Hughes, 6 Fed. Rep. 737, and of the meaning of the term 'visitorial powers', as used in section 5241, that learned judge said:

> 'Visitation, in law, is the act of a superior or superintending officer, who visits a corporation to examine into its manner of conducting business, and enforce an observance of its laws and regulations. Burrill defines the word to mean "inspection; superintendence; direction; regulation." '

"At common law the right of visitation was exercised by the King as to civil corporations and as to eleemosynary ones by the founder or donor. 1 Cooley's Blackstone, 481. 'In the United States the legislature is the visitor of all corporations created by it, where there is no individual founder or donor,. and may direct judicial proceedings against such corporations for such abuses or neglects as would at common law cause forfeiture of their charters.' 1 Cooley's Blackstone, 482, note.

"In the case before us the Supreme Court of Utah quotes from Merrill on Mandamus as follows:

> 'Visitors of corporations have power to keep them within the legitimate sphere of their operations, and to correct all abuses of authority, and to nullify all irregular proceedings. In America there are very few corporations which have private visitors, and in the absence of such, the State is the visitor of all corporations.'

"In no case or authority that we have been able to find has there been a definition of this right, which would include the private right of the shareholder to have an examination of the business in which he interested, and the right of discovery of the methods and means by which the agents of the corporation are conducting its affairs. The right of visitation being a public right, existing in the State for the purpose of examining into the conduct of the corporation with a view to keeping it within its legal powers, Congress had in mind in passing this section that in other sections of the law it had made full and complete provision for investigation by the Comptroller of the Currency and examiners appointed by him, and, authorizing the appointment of a receiver, to take possession of the business with a view to winding up the affairs of the bank. It was the intention that this statute should contain a full code of

"provisions upon the subject, and that no state law or enactment should undertake to exercise the right of visitation over a national corporation. Except in so far as such corporation was liable to control in the courts of justice, this act was to be the full measure of visitorial power."

The Board's power to exercise general supervision over Federal reserve banks and examine into their affairs is quite similar to the corresponding power of the Comptroller of the Currency over national banks, and it would seem that the nature and purpose of the Board's power must be practically the same as that of the Comptroller's.

In the case of State v. Morehead, (Nebr.) 155 N. W. 879, the court in discussing the right of the State Banking Board to refuse to issue a charter to a savings bank said:

"When the general rule of statutory construction is applied and section 16 is considered in connection with the other provisions, it must be held that the board is vested with authority not only to correct evils that may creep into the management of an existing bank, but to guard against dangers, that may threaten institutions about to be formed.

"'The power to compel, beforehand, co-operation, and thus, it is believed, to make a failure unlikely and a general panic almost impossible, must be recognized, if government is to do its proper work, unless we can say that the means have no reasonable relation to the end. Noble State Bank v. Haskell, 219 U.S. 104, 112, 31 Sup. Ct. 186, 188 (55 L. Ed. 112, 32 L.R.A.(N.S.) 1062, Am. Cas. 1912A,487).'

"* * * We think the intention of the Legislature was to vest the banking board with general control and with authority to do all things reasonably necessary for the protection of depositors throughout the state. The Board also stands in the nature of a trustee for this guarantee fund, and it is its duty to take such precautions as may be necessary to protect its integrity. The terms 'general supervision and control' vest the banking board with duties of a very high order, and they are not to be perfunctorily discharged, but to be administered with the highest degree of intelligence and discretion.

"It is customary for Legislatures to grant to administrative bodies of this character the power to adopt rules, by-laws, and regulations reasonably necessary to carry out the purpose for which they are created, and this grant is not an improper delegation

"of authority. Blue v. Beach, 155 Ind., 121, 56 N.E. 89, 50 L.R.A. 64, 80 Am. St. Rep. 195 and cases cited. This is held generally to be the rule in matters coming within the police power of the state. That the banking business comes within that power is no longer an open question.

"'The police power extends to all the great public needs (Camfield v. United States, 167 U.S. 518, (17 Sup. Ct. 864, 42 L. Ed. 260) and includes the enforcement of commercial conditions such as the protection of bank deposits and checks drawn against them by compelling cooperation so as to prevent failure and panic.' (Noble State Bank v. Haskell, 219 U. S. 104)

"The business of banking coming within the police power of the state, the same rule of construction may be applied to banking acts and to rules and regulations established by banking boards as applies to acts creating other administrative bodies coming within the police power. The Supreme Court of Judicature of Indiana, in discussing this phase of the question, in Blue v. Beach, supra, says:

> " 'While it is true that the character or nature of such boards is administrative only, still the powers conferred upon them by the Legislature, in view of the great public interests confided to them, have always received from the courts a liberal construction, and the right of the Legislature to confer upon them the power to make reasonable rules, by-laws, and regulations, is generally recognized by the authorities.'"

The case of Great Northern Railway Company v. Snohomish County, 48 Wash. 478, 93 Pac. 924, involved the construction of a State statute requiring the State Board of Tax Commissioners to exercise "general supervision" over assessors and county boards of equalization and the assessment of taxable property in order to secure equality in taxation. The case turned upon the proper meaning of the term "general supervision" - whether it authorized the Commissioners to act merely in an advisory capacity or whether it authorized them to classify inter-county railroads and fix the value thereof for the purpose of taxation. The court held that the statute authorized the Commissioners to classify inter-county railroads and fix the value thereof for purposes of taxation; that the words "general supervision" imply something

more than a mere power to advise and suggest; that they confer authority to oversee and review the acts and correct errors of those over whom the right of supervision is granted. In the course of the opinion the court said:

> "While these several provisions bear more or less directly on the question under consideration, the case turns principally on the meaning of the term 'general supervision' in the act defining the powers and duties of the state board of tax commissioners. * * * The state board of tax commissioners is given general supervision over assessors and county boards of equalization, to the end that all taxable property shall be placed on the assessment rolls and equalized as between the different counties and municipalities, so that equality of taxation shall be secured according to the provisions of law. What is meant by 'general supervision'? Counsel for respondents contend that it means to confer with, to advise, and that the board acts in an advisory capacity only. We cannot believe that the Legislature went through the idle formality of creating a board thus impotent. Defining the term 'general supervision' in Vantongeren v. Hefferman, 5 Dak. 180, 38 N.W. 52, the court said: 'The Secretary of the Interior, and under his direction, the Commissioner of the General Land Office, has a general "supervision over all public business relating to the public lands." What is meant by "supervision"? Webster says supervision means "to oversee for direction; to superintend; to inspect; as to supervise the press for correction." And, used in its general and accepted meaning, the Secretary has the power to oversee all the acts of the local officers for their direction, or, as illustrated by Mr. Webster, he has the power to supervise their acts for the purpose of correcting the same; and the same power is exercised by the Commissioner under the Secretary of the Interior. It is clear, then, that a fair construction of the statute gives the Secretary of the Interior, and under his direction, the Commissioner of the General Land Office, the power to review all the acts of the local officers, and to correct, or direct a correction of, any errors committed by them. Any less power than this would make the "supervision" an idle act - a mere overlooking without power of correction or suggestion.' Defining the like term in State v. F.E. & M.V. R.R. Co., 22 Nebr. 313, 35 N.W. 118, the court said: 'Webster defines the word "supervision" to be "the act of overseeing; inspection; superintending." The board therefore is clothed with the power of overseeing, inspecting, and superintending the railways within the state, for the purpose of carrying into effect the provisions of this act, and they are clothed with the power to prevent unjust discrimination against either persons or places.' It seems to us that the term 'general supervision' is correctly defined in these cases. Certainly a person or officer who can only advise or suggest to another has no general supervision over him, his acts or his conduct."

Similarly, it would seem that the Board's power to exercise "general

supervision" over the Federal reserve banks would include the power to require the Federal reserve banks to carry out the purposes of the Act and to check any practices which would be detrimental to the public interest or inconsistent with the purposes of the Act. Certainly, the Board's power of general supervision should not be construed in such a way as to "make the 'supervision' an idle act - a mere overlooking without power of correction or suggestion."

On the other hand, there are some cases indicating the limitations on this power of general supervision.

One of such cases is that of State v. Bronson, (Mo.) 21 S.W.1125. The constitution of Missouri provides that "The supervision of instruction in the public schools shall be vested in a board of education whose powers and duties shall be prescribed by law." The legislature passed a law creating a commission to purchase the books necessary for use in the schools. This law was objected to by the directors of a school district as being unconstitutional on the ground that it was in violation of the powers vested in the board of education by the constitution.

The court held that the selection and purchase of the school books does not come within the fair meaning of the words "the supervision of instruction" and the law does not violate the constitutional provision. In so holding the court said:

> "With such a general system of public schools it must be evident that when the constitution says the supervision of instruction shall be vested in the state board of education, it does not mean that this board shall enter into the details of giving instruction or carrying on the schools. All this is and may be left to subordinate officers. It means no more than a general oversight over the matter of instruction."

In the case of Roanoke Cemetery Co. v. Goodwin, 101 Va. 605, 44 S.E. 769, the lower court had reviewed the reasonableness of regulations prescribed by the cemetery association for the conduct of its business and the fees charged for opening graves and had issued a decree whereby the court undertook to prescribe its own rules and regulations for the management of the affairs of the company, even going to the extent of determining the fund out of which the salary of the superintendent should be paid. The Supreme Court of Appeals in Virginia held that the decree exceeded the power of the court and said:

> "It is not permissible for a court to thus substitute its own business discretion and judgment for that of the company; its visitorial powers have no such scope. 1 Clark & Marshall, p. 547. "

Similarly, it might be said that the authority to exercise general supervision over the Federal reserve banks does not carry with it the duty to enter into the details of operating the banks nor the authority for the Federal Reserve Board to substitute its own business judgment and discretion for that of the directors.

Without attempting to lay down a precise definition of the Board's power of general supervision, it may be said that generally it includes the power and carries with it the duty to see that Federal reserve banks do not exceed their corporate powers; that they do not discriminate in favor of or against any class of the public or any member banks; that they preserve and protect the banking reserves of the country with which they are entrusted; that they do not do anything which may endanger their solvency or the soundness of their currency; that they carry out faithfully the purposes of the Federal Reserve Act; and that they comply in all respects with both the letter and spirit of

the law. I am further of the opinion that this power carries with it the power to require the Federal reserve banks to cease doing anything which is ultra vires which might defeat the purposes of the Federal Reserve Act or which might be detrimental to the public interest.

Moreover, this power is to be construed liberally so as to enable the Board effectively to safeguard the great public interests confided to it. Blue v. Beach, 155 Ind. 121, 45 N.E. 89. As stated in State v. Moreland, supra, "The terms 'general supervision and control' vest the banking board with duties of a very high order, and they are not to be perfunctorily discharged, but to be administered with the highest degree of intelligence and discretion."

On the other hand, I am of the opinion that this power does not carry with it either the duty or the power to interfere in the details of the operation of the Federal reserve banks or to substitute the Board's own business judgment and discretion for that of the directors of the Federal reserve banks.

It does, however, include the power to check any actions on the part of the Federal reserve banks which would nullify or impair the effective exercise of any lawful powers of the Federal Reserve Board or which would constitute an evasion of any control which the Federal Reserve Board is authorized to exercise over the general credit policies of the System as a whole. Within this class of actions which are subject to regulation under the Board's general supervisory power would clearly be included international dealings in gold, which might tend to affect or impair the effectiveness of the rediscount rate, which is expressly made subject to review and determination by the Federal Reserve Board, or which would nullify the effect of the Board's restrictions on the open market operations of the banks.

THE RELATIVE FUNCTIONS OF THE BOARD AND THE BANKS AS SHOWN BY LEGISLATIVE HISTORY.

That these views, based upon a purely legal interpretation of the Board's powers, are in accordance with the intent of Congress at the time it enacted the Federal Reserve Act appears from the following passages in the report on the original Federal Reserve Act submitted to the House of Representatives by Mr. Glass, on behalf of the Banking and Currency Committee, under date of September 9, 1913 (pages 16, 18, 19, 42 and 46):

> "In order that the banks may be effectively inspected, and in order that they may pursue a banking policy which shall be uniform and harmonious for the country as a whole, the committee proposes a general board of management intrusted with the power to overlook and direct the general functions of the banks referred to. To this it assigns the title of 'The Federal reserve board.'"

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> "The only factor of centralization which has been provided in the committee's plan is found in the Federal reserve board, which is to be a strictly Government organization created for the purpose of inspecting existing banking institutions and of regulating relationships between Federal reserve banks and between them and the Government itself. Careful study of the elements of the problem has convinced the committee that every element of advantage found to exist in cooperative or central banks abroad can be realized by the degree of cooperation which will be secured through the reserve-bank plan recommended, while many dangers and possibilities of undue control of the resources of one section by another will be avoided. Local control of banking, local application of resources to necessities, combined with Federal supervision, and limited by Federal authority to compel the joint application of bank resources to the relief of dangerous or stringent conditions in any locality are the characteristic features of the plan as now put forward. The limitation of business which is proposed in the sections governing rediscounts, and the maintenance of all operations upon a footing of relatively short time will keep the assets of the proposed institutions in a strictly fluid and available condition, and will insure the presence of the means of accommodation when banks apply for loans to enable them to extend to their clients larger degrees of assistance in business. It is proposed that the Government shall retain a sufficient power over the reserve banks to enable it to exercise a directing authority when necessary to do so, but that it shall in no way attempt to carry on through its own mechanism the routine operations of banking which require detailed

knowledge of local and individual credits and which determine the actual use of the funds of the community in any given instance. In other words, the reserve-bank plan retains to the Government power over the exercise of the broader banking functions, while it leaves to individuals and privately owned institutions the actual direction of routine."

* * * * * * *

"In this section provision has been made for the creation of a general board of control acting on behalf of the national Government for the purpose of over-seeing the reserve banks and of adjusting the banking transactions of one portion of the country, as well as the Government deposits therein, to those of other portions."

"(e) In paragraphs (e), (f), (g), (h), and (i) are conveyed powers which are largely self-explanatory and about which there can be little or no question, granting the general idea of effective Government oversight through a Federal reserve board or some similar organization."

The power of carrying on the regular routine every-day business of the Federal reserve banks, therefore, and of determining the local policies was entrusted to their respective boards of directors, but the Federal Reserve Board was created as "a general board of management" entrusted with the power to overlook and direct the general functions of the banks in order that the Board, on behalf of the Government, might retain some power over the exercise of the "broader banking functions" affecting the country as a whole.

That the open market operations of the Federal reserve banks and their transactions with foreign central banks in gold, credits and bills of exchange is a function affecting the country as a whole, seems perfectly obvious, and it would seem to follow that the Board was intended to have a control over all such operations. This will appear more clearly from a consideration of the history and nature of such transactions.

HISTORY AND NATURE OF OPEN MARKET FUNCTIONS.

The report of the House Banking and Currency Committee (pp. 52 and 53) discusses section 15 of the original Federal Reserve Bill, which later became section 14 of the Federal Reserve Act as follows:

"Section 15.

"It will have been observed that the transactions authorized in section 14 (now section 13 of the Federal Reserve Act) were entirely of a nature originating with member banks and involving a rediscount operation. It is clearly necessary to extend the permitted transactions of the Federal reserve banks beyond this very narrow scope for two reasons:

"1. The desirability of enabling Federal reserve banks to make their rate of discount effective in the general market at those times and under those conditions when rediscounts were slack and when therefore there might have been accumulation of funds in the reserve banks without any motive on the part of member banks to apply for rediscounts or perhaps with a strong motive on their part not to do so.

"2. The desirability of opening an outlet through which the funds of Federal reserve banks might be profitably used at times when it was sought to facilitate transactions in foreign exchange or to regulate gold movements.

"In order to attain these ends it is deemed wise to allow a reserve bank, first of all, to buy and sell from anyone whom it chooses the classes of bills which it is authorized to rediscount. The reserve bank evidently would not do this unless it should be in a position which, as already stated, furnished a strong motive for so doing. Outright purchases in the open market would of course require the payment of the face of the paper less discount, whereas rediscount operations would require simply the holding of a reserve of 33 1/3 per cent behind the notes issued or deposit accounts created in the course of the rediscount operation. Apart from this fundamental permission, it was deemed wise to allow the banks to buy coin and bullion and borrow or loan thereon and to deal in Government bonds. The power granted in subsection (d) to fix a rate of discount is an obvious incident to the existence of the reserve banks, but the power has been vested in the Federal reserve board to review this rate of discount when fixed by the local reserve bank at its discretion. This is intended to provide against the possibility that the local bank might be establishing a dangerously low rate of interest, which the reserve board,

familiar as it would be with credit conditions throughout the country, would deem best to raise.

"The final power to open and maintain banking accounts in foreign countries for the purpose of dealing in exchange and of buying foreign bills is necessary in order to enable a reserve bank to exercise its full power in controlling gold movements and in facilitating payments and collections abroad."

The open market powers granted to Federal reserve banks under Section 14, therefore, were designed primarily to enable the Federal reserve banks to make their discount rates effective, to facilitate transactions in foreign exchange, and to regulate and control gold movements. The banks were given power to fix discount rates subject to review and determination by the Federal Reserve Board, and it was explained that the power to review discount rates was vested in the Federal Reserve Board in order to provide against the possibility that a Federal reserve bank might establish a dangerously low rate which the Federal Reserve Board, in view of general credit conditions throughout the country, might consider inadvisable.

Having the power to review and determine rediscount rates it would seem necessary that the Federal Reserve Board should also have power to review, regulate, and restrict any transactions which might have a bearing on the effectiveness of the rediscount rate.

Obviously, the investment of Federal reserve funds abroad would have a bearing on the effectiveness of the rediscount rate and the Federal Reserve Board was given specific power to regulate, limit and restrict the purchase and sale of bills of exchange. While no specific power to control gold movements was given to the Federal Reserve Board, it would seem clear that the Federal Reserve Board was intended, in the exercise

of its general supervisory power, to have some control over gold transactions which might have a bearing on the effectiveness of the rediscount rate or which might affect general credit conditions in this country. This is entirely consistent with the theory that the Boards of Directors of the Federal reserve banks are intended to manage the local transactions of the Federal reserve banks, but that the Federal Reserve Board is given power to control any transactions which might have a bearing on general credit conditions in this country, or in the position of this country in the international money market.

RELATIONS BETWEEN OPEN MARKET TRANSACTIONS, REDISCOUNT RATES AND GOLD RESERVES.

The intimate relation between open market transactions, the rediscount rate and international gold movements is further illustrated by a report submitted to the Federal Reserve Board under date of October 12, 1915, by Messrs. Warburg and Delano. The Boerd at that time had been giving very careful study to a proposal made by Mr. McAdoo, Secretary of the Treasury, to have the Federal reserve banks establish branches or agencies in Latin-American countries; and the above mentioned report discussed the open market powers of the Federal reserve banks in great detail, pointed out the proper scope and purpose of such transactions, and the disadvantage of having too large a proportion of the Federal reserve banks' funds invested in foreign countries. This entire report is very illuminating and the following passage is of especial interest in this connection:

"The Federal Reserve Banks have been organized as custodians and conservators of the reserve money of the member banks. The law permits member banks to count as part of their reserve the balances kept by them with these Federal Reserve Banks, and it is the first duty of the Federal Reserve Banks to maintain their funds in a condition so liquid that their member banks may confidently rely upon the ability of the Reserve Banks to provide gold and credit when required. This function of the Federal Reserve Banks is at no time to be considered lightly, and in times of stress involves grave responsibilities and difficulties. It is from this point of view that the law has imposed very distinct restrictions as to the character of the investments which may be made by the Federal Reserve Banks, permitting only a certain proportion of their funds to be normally invested and requiring that such investments as are made be essentially of a self-liquidating character, and of a short maturity. It would be unsafe and would shake the foundations of confidence on the part of the member banks as well as of other nations should Federal Reserve Banks use a substantial portion of their resources for investment in Latin American credits.

"Such procedure would run counter to all banking practice in those countries where banks of the character of the Federal Reserve Banks have been in successful operation for generations. Neither the Bank of England, the German Reichsbank, the Banque of France, nor any other of the government banks of the less important countries has ever adopted such a policy. The operations of those banks are primarily confined to transactions at home, and foreign exchange transactions are engaged in only as far as they may be considered necessary for the protection of the gold holdings of these government banks. The leading government banks normally maintain a substantial holding of ninety-day bills on such foreign countries as are apt to become important creditor nations from time to time, but these bills are drawn only on such countries as have a well-established gold standard, well-developed discount facilities, and a broad market where these bills can be promptly resold. The object of these foreign holdings can best be illustrated by a concrete case, e.g., should the Bank of the Netherlands find that exchange on London advanced to a point where gold began to move from Holland to England, it would offer for sale drafts on London in order to counteract this movement. When its English cash balance had been exhausted, the Bank of the Netherlands would rediscount in London the long bills that it might previously have accumulated and thus create new balances with which to stop the outflow of gold.

"Such foreign bills are taken only on the few foremost financial powers. It is to be expected that American bankers' acceptances will in the future, when peace shall have been restored, become one of the privileged investments of these government banks. In order to maintain their 'position' in the foreign exchange market, it is necessary for government banks to renew from time to time their foreign paper as it matures, and it is for this purpose that they use accounts with correspondents in those few countries, none but the strongest firms being selected to act in this capacity. These firms or banks are permitted to buy only first class banking paper, and they endorse this paper to the government banks so that such government banks do not run any risk of loss of capital in the transactions and so that the government banks hold only paper which can at any time be resold in the open market or to the foreign government banks if need be.

"It was this function of foreign correspondents or agents that the writers of the Federal Reserve Act had in mind when they provided that Federal Reserve Banks should have the right, with the consent of the Federal Reserve Board,

> " 'to open and maintain banking accounts in foreign countries, appoint correspondents, and establish agencies in such countries wheresoever it may deem best for the purpose of purchasing, selling, and collecting bills of exchange, and to buy and sell with or without its indorsement, through such correspondents or agencies, bills of exchange arising out of actual commercial transactions which have not more than ninety days to run and which bear the signature of two or more responsible parties.'

"For operations as above described the powers granted by the Act will no doubt be availed of to good advantage, when normal conditions shall have been restored in the important foreign exchange markets.

"Your committee wishes to emphasize the fact that the purpose of this paragraph was to give to the Federal Reserve Banks a greater strength and additional liquidity by enabling them to maintain a secondary gold reserve and to possess themselves of assets upon which the Federal Reserve Banks could realize in case of need without being forced to contract the credit facilities granted at home - the liquid element of these foreign investments and the additional protection that they would give to the Federal Reserve System being the essential ground for permitting Federal Reserve Banks to enter a foreign field."

The following passage from a preliminary report on this subject prepared by Mr. Warburg under date of October 4, 1915, also throws much light on the history and purpose of Section 14 of the Federal Reserve Act:

"When dealing with interpretations of the Act, a great deal has often been said concerning the 'intention of the writers of the law'. Inasmuch as paragraph (e) of Section 14 has been bodily taken over from the Aldrich Plan, we have to go beyond the writers of the Federal Reserve Act in order to find the true intent of this paragraph, and inasmuch as Senator Aldrich consulted me concerning this particular phase of the intended act, and inasmuch as I suggested to Senator Aldrich the insertion of this very paragraph, I may be pardoned for venturing to explain what its original intention was.

"The two paragraphs read as follows:

Section 14(e) of the Federal Reserve Act provides that every Federal Reserve Bank shall have power:

"with the consent of the Federal Reserve Board, to open and maintain banking accounts in foreign countries, appoint correspondents, and establish agencies in such countries wheresoever it may deem best.

for the purpose of purchasing, selling, and collecting bills of exchange, and to buy and sell, with or without its indorsement, through such correspondents or agencies, bills of exchange arising out of actual commercial transactions which have not more than ninety days to run and which bear the signature of two or more responsible parties.'

Section 36 of the Aldrich Plan reads:

"National Reserve Association to have power

to open and maintain banking accounts in foreign countries; to establish agencies in foreign countries for the purpose of purchasing, selling and collecting foreign bills of exchange; to buy and sell, with or without its indorsement, through such correspondents or agencies, checks or prime foreign bills arising out of commercial transactions having not exceeding 90 days to run and bearing the signature of two or more responsible parties.'

"It will be seen that the only substantial change was the insertion of the words 'bill of exchange' where the Aldrich Plan read 'foreign bills of exchange' and 'prime foreign bills'.

"From actual operation (having been active in several banks

"in foreign countries acting as correspondents or agents for government banks in other countries) I was in a position to appreciate from my own experience the importance of the functions of foreign correspondents or agents, and was anxious to secure the advantages of such connections for our future financial system. The operations of these foreign agents for their government banks are substantially as follows:

"Let me choose the Bank of the Netherlands as an illustration, though practically all important government banks have been operating on similar lines.

"There will be certain times when, for economic reasons, through the movement of products from or to the Netherlands into or from other countries, or for extraordinary reasons, exchange on Holland will move up to the gold exporting point or down to the gold importing point. When the point is reached where gold may leave the country, the Bank of the Netherlands has two main means of protecting itself; one is by increasing the discount rate, which measure will result in higher interest rates apt to attract foreign money into Holland and thereby to counteract the flow of money from the country. The other is to sell from its portfolio bills on foreign countries in order to create balances in those countries and thereby provide means of payment without shipping the yellow metal. It, therefore, has been the policy of foreign government banks to acquire foreign bills of exchange on such countries as are apt to be creditor nations from time to time and such countries only as have safe gold standards and enjoy first class banking credit. These purchases of foreign exchange on such countries are being carried on whenever exchange is low or when interest rates in the home country are so low that it would seem prudent for the government bank to withdraw its funds from active employment at home and invest the funds thus withdrawn in foreign countries, whence they can be called back whenever rates become active at home and whenever the influence of the government bank may be used to advantage in preventing home rates from becoming burdensome to the borrowing community.

"When acquiring a ninety day draft on a British bank, the Bank of the Netherlands will draw interest on this bill at the discount rate; but when the bill matures or if the Bank of the Netherlands acquires checks on London, it creates a balance which needs to be converted into an interest bearing investment. These balances will then be employed by the correspondents or agencies (whichever name we may give to them) for the purchase of other ninety day drafts on London. According to its requirements, the Bank of the Netherlands will renew from time to time its foreign investments. The Bank

of the Netherlands considers these foreign holdings as a secondary gold reserve and continues them almost perpetually, with such casual interruptions as may become necessary for the protection of its own gold holdings.

"It was the consideration of these conditions that led to the insertion in the Aldrich draft of the clause above quoted, and it will now become apparent what was meant when it was provided that the National Reserve Association - or the Federal Reserve Banks - should have power to 'open and maintain banking accounts in foreign countries * * *, establish agencies in such countries * * * for the purpose of purchasing, selling and collecting bills of exchange' and that they should be able to 'buy and sell with or without its indorsement, through such correspondents or agencies, bills of exchange * * *'. In case of a 'pinch' the Bank of the Netherlands was to be in a position of ordering its correspondent to rediscount with the Bank of England or in the open market millions of its holdings of British acceptances so as to enable the Bank of the Netherlands to draw a check against the balance so produced and so to protect its gold. That is why it was stipulated that the bills to be purchased by these agents should be 'prime bills' and should not run beyond ninety days and should bear the signature of two or more responsible parties, so that these bills should be current bills that the correspondents should be able to sell freely at all times and bills on which a loss should practically be excluded.

"It ought to be stated that the foreign governments select the strongest possible firms in foreign countries to act for them as agents, and that they invariably buy these bills with the indorsement of their agent (or correspondent) so that they could lose only in case, not only the foreign correspondent or agent should fail, but also the two additional signatures on the bill.

"I am well aware of the fact that these banking habits have developed as a protection in times of peace but that in times of war these large foreign balances may be a source of some anxiety. It must be borne in mind, however, that government banks normally work in times of peace and that these methods of protecting their country against acute gold withdrawals or against the tendency of too low rates of interest have effectually met many an acute emergency, and furthermore that even in times of war these balances have eventually been paid. I might draw attention to the fact that a year ago, when we were called upon to meet our large debts abroad, it would have been a great protection for us if at that time balances could have been made available in London to meet this first onrush.

"My object in reviewing the origin and original intent of this paragraph is to show that this clause was inserted for the sole purpose of providing an additional piece of machinery for the protection of the Federal Reserve System. Clearly, no other intention was underlying this section!"

The question whether the Federal reserve banks should establish branches or agencies in Latin American countries was submitted to the Governors' Conference, the Conference of Federal Reserve Agents and the Federal Advisory Council, and, after obtaining the views of these three different bodies, a further report was submitted to the Federal Reserve Board under date of January 8, 1916, by a committee consisting of Governor Harding and Messrs. Delano and Warburg. This final report reads in part as follows:

"Your Committee is happy to report that complete agreement was found to exist in all three bodies with the principles expressed by the Board at its meeting on October 27th, the substance of which was published on that day in a notice (Mimeograph 385) of which a copy is appended hereto. * * * It is the first duty of the Federal reserve banks to maintain their funds in a condition so liquid that their member banks may confidently rely upon the ability of the Federal reserve banks to provide gold and credit when required. This function of the Federal reserve banks is at no time to be considered lightly and in times of stress involves grave responsibilities and difficulties. * * * It would be unsafe and would shake the foundation of confidence on the part of the member banks as well as of other nations, should Federal reserve banks use a substantial portion of their resources for investment in Latin-American credit. Such procedure would run counter to all banking practices in those countries where banks of the character of the Federal reserve banks have been successfully operated for generations * * *. The operations of these banks are primarily confined to transactions at home, and foreign exchange transactions are engaged in only as far as they may be considered necessary for the protection of the gold holdings of these Government banks. * * * (Discussion of operations of European Central banks). In order to maintain their 'position' in the foreign exchange market, it will be necessary for Government banks to renew from time to time their foreign paper as it matures, and it is for this purpose

> that they use accounts with correspondents in those foreign countries, none but the strongest firms being selected to act in this capacity. * * * It was this function of foreign correspondents or agencies that your committee is confident the writers of the Federal Reserve Act had in mind when they provided that the Federal reserve banks should have the right, with the consent of the Federal Reserve Board, to exercise the powers conferred under Section 14 (e) * * * . Your committee has no doubt that the purpose of this paragraph was to give to the Federal reserve banks greater strength and additional liquidity by enabling them to maintain a secondary gold reserve and to possess themselves of assets upon which the Federal reserve banks could realize in case of need without being forced to contract the credit facilities granted at home - the liquid element of these foreign investments and the additional protection that they would give to the Federal Reserve System being the essential ground for permitting Federal reserve banks to enter a foreign field. * * * Should Federal reserve banks be empowered to lend to foreign Governments notwithstanding the law distinctly provides that Federal reserve banks can now purchase only United States Government securities and warrants of United States municipalities, carefully circumscribed and having a maturity of not exceeding six months ? * * * Should Federal reserve banks be allowed to embarrass the Government by being themselves important creditors of foreign Governments in case of war with, or revolution in, such countries? Your committee is very positive in its view that such enlarged powers should not be granted; * * * "

While these reports arose out of a controversy entirely different from, and extraneous to, the question now under consideration, they serve to show the intimate connection between the open market powers of the Federal reserve banks, the effectiveness of the rediscount rate, and the protection of the gold reserves of the Federal Reserve System.

They show clearly that one of the most important purposes of the rediscount rate and the open market purchase of bills of exchange is to protect the gold reserves of the Federal Reserve System. Over the rediscount rates and the open market transactions the Federal Reserve

Board is given a great measure of control. To say that the Federal Reserve Board could exercise this control over rediscount rates and open market transactions with a view of protecting the gold reserves of the Federal Reserve System but that it could do nothing to prevent the Federal reserve banks from engaging in international transactions in gold in such a way as to impair the gold reserves would be to give the Federal Reserve Act an interpretation which clearly would defeat the will of Congress.

Respectfully,

Walter Wyatt
General Counsel

WW-WLM-OMC-SAD

No. 131.

Office Correspondence

FEDERAL RESERVE BOARD

Date August 17, 1927

To Federal Reserve Board

From Mr. Wyatt - General Counsel.

Subject: Proposed Regulation on Purchase and Sale of Bills of ~~Exchange~~ and Bankers' Acceptances Abroad.

On July 6th the Board adopted the following resolution:

> "That it be the sense of the Federal Reserve Board that the authority conferred upon it by Sections 13 and 14 of the Federal Reserve Act, with respect to the purchase and sale of bills of exchange and acceptances, applies to such purchases and sales made abroad as well as at home, and that the Board rule that such purchases and sales are subject to its regulation and approval."

I am advised by Mr. Eddy that on July 12th the Board voted to request this office "to prepare and submit to the Board in due course the regulation contemplated by the above resolution".

With the utmost respect, I desire to call attention to the fact that the question as to what restrictions or regulations the Board desires to prescribe covering the purchase and sale of bills of exchange and bankers' acceptances abroad is purely a question of policy and I have not the slightest idea as to the character of regulations or restrictions the Board desires to promulgate on this subject. I respectfully request, therefore, that the Board give me more specific instructions as to the character of the regulations and the general nature of the restrictions, if any, which it desires to place upon the purchase and sale of bills of exchange and bankers' acceptances abroad, in order that I may intelligently proceed to the preparation of a regulation on this subject.

Referred for Board AT MEETING.

AUG 30 1927

Respectfully,

Walter Wyatt,
General Counsel.

WW MD

Our present regulations refer wholly to the eligibility of bills, & limit the kind of bills that can be purchased or discounted. I don't believe we need any further rules for foreign bills

E. P.

Central file 333.4-3

Form No. 131.

Office Correspondence

FEDERAL RESERVE BOARD

Date July 12, 1927.

To General Counsel.

Subject:

From Mr. Eddy.

July 12 1927

OFFICE OF COUNSEL

At the meeting of the Board held on July 6th, the following resolution was adopted:

"That it be the sense of the Federal Reserve Board that the authority conferred upon it by Sections 13 and 14 of the Federal Reserve Act, with respect to the purchase and sale of bills of exchange and acceptances, applies to such purchases and sales made abroad as well as at home, and that the Board rule that such purchases and sales are subject to its regulation and approval."

At the meeting this morning, it was voted to request you to prepare and submit to the Board in due course the regulation contemplated by the above resolution.

See memo 8/17/27

Copy filed 353. 4-3

Form No. 131.

Office Correspondence

FEDERAL RESERVE BOARD

Date July 7, 1927

To Governor Crissinger

Subject:

From Mr. Noell

Ken

sec 7/8/27

With respect to the attached memoranda from Mr. Miller and the Board's Counsel with reference to the responsibility of the Board in connection with the purchase and sale by Federal reserve banks of bills of exchange and bankers' acceptances in foreign markets, there is quoted below the motion adopted by the Board at the meeting yesterday:

> "That it be the sense of the Federal Reserve Board that the authority conferred upon it by Sections 13 and 14 of the Federal Reserve Act, with respect to the purchase and sale of bills of exchange and acceptances, applies to such purchases and sales made abroad as well as at home, and that the Board rule that such purchases and sales are subject to its regulation and approval."

Form No. 131.

Office Correspondence

FEDERAL RESERVE BOARD

APR 17 1940

Date July 5, 1927.

To Federal Reserve Board.

From Mr. Wyatt

Subject: Board's responsibility re purchase and sale of bills of exchange and bankers' acceptances in foreign markets.

Under date of June 30th Dr. Miller addressed a memorandum to the Board which read as follows:

"In order to clarify the situation and responsibility of the Board with respect to the purchase and sale by Federal Reserve Banks of bills of exchange and bankers acceptances in foreign money markets, I move -

"'That it be the sense of the Federal Reserve Board that the authority conferred upon it in Section 13 of the Federal Reserve Act reading:

"'"The discount and rediscount and the purchase and sale by any Federal reserve bank of any bills receivable and of domestic and foreign bills of exchange, and of acceptances authorized by this Act, shall be subject to such restrictions, limitations, and regulations as may be imposed by the Federal Reserve Board."'

applies to the purchase and sale of bills of exchange and acceptances made abroad as well as at home and that the Board rule that such purchases and sales are subject to such restrictions, limitations and regulations as it may see fit to impose."

An opinion has been requested on the question whether the above is a correct statement of the legal situation.

In my opinion there can be no doubt as to the correctness of the conclusions stated in Dr. Miller's memorandum. That the language of the Act is all-inclusive and applies to the purchase and sale of bills of exchange and bankers' acceptances abroad as well as to purchases and sales at home appears so clearly from a reading of the statute itself that no argument is necessary to support Dr. Miller's conclusion.

Pursuant to another request made by the Board, I am preparing a comprehensive memorandum covering this and a number of related questions, but it will not be ready for several days. There is room for some difference of opinion as to the correct answer to some of the other questions involved in the memorandum which I am preparing, but there is no doubt about the point covered in Dr. Miller's memorandum of June 30th.

Respectfully,

Walter Wyatt,
General Counsel.

WW MD

see memo 7/7/27

filed 333.4-3

Form No. 131.

Office Correspondence

FEDERAL RESERVE BOARD

Date June 30, 1927.

To Federal Reserve Board

Subject:

From A. C. Miller.

1c

In order to clarify the situation and responsibility of the Board with respect to the purchase and sale by Federal Reserve Banks of bills of exchange and bankers acceptances in foreign money markets, I move -

"That it be the sense of the Federal Reserve Board that the authority conferred upon it in Section 13 of the Federal Reserve Act reading:

> "The discount and rediscount and the purchase and sale by any Federal reserve bank of any bills receivable and of domestic and foreign bills of exchange, and of acceptances authorized by this Act, shall be subject to such restrictions, limitations, and regulations as may be imposed by the Federal Reserve Board."

applies to the purchase and sale of bills of exchange and acceptances made abroad as well as at home and that the Board rule that such purchases and sales are subject to such restrictions, limitations and regulations as it may see fit to impose."

A. C. M.

Next meeting
See Minutes
AT BOARD MEETING
JUN 30 1927

Tomorrow
AT BOARD MEETING
JUL - 5 1927

See Minutes
AT BOARD MEETING
JUL - 6 1927

see memo 7/5/27 - 7/7/27

Copy filed 333.4-3

Form No. 131.

Office Correspondence

FEDERAL RESERVE BOARD

Date June 27, 1927.

To Federal Reserve Board

Subject: 333.4-2

From A. C. Miller

2—8495

In order to clarify the situation and responsibility of the Board with respect to the purchase and sale by Federal Reserve Banks of bills of exchange and bankers acceptances in foreign money markets, I move -

That it be the sense of the Federal Reserve Board that the authority conferred upon the Board in Section 13 of the Federal Reserve Act to impose "restrictions and limitations" upon such purchase and sales applies to purchase and sales made abroad as well as at home.

April 26, 1916.

Dear Governor Strong:

I have your note of April 25th. We have asked our Counsel, Mr. Elliott, to inform us whether it would not be possible to make a ruling, without any change in the law, such as you desire as to days of grace. As soon as I hear from him I will let you know at once. I have no doubt, however, that the Committee will accept the proposed amendment.

Sincerely yours,

(Signed) C. S. Hamlin.

Governor.

Hon. Benjamin Strong, Jr.,
Governor, Federal Reserve Bank,
New York.

FEDERAL RESERVE BANK
OF NEW YORK

April 25th, 1916.

My dear Governor Hamlin:

Referring to my note of the 18th inst., written while I was in Washington, I feel convinced that the slight changes required in the Federal Reserve Act to enable us to purchase bills in the London market are of great importance and should, if possible, be passed with other amendments that are now pending.

Since returning home it has occurred to me that some of the members of the Committee may feel that more extended statements of the reasons for this amendment are necessary than the ones presented in my very brief letter. If that develops to be the case, may I ask you to advise me and I will be very glad to attend in person or present a memorandum in detail on the subject.

Very truly yours,

Benj. Strong Jr.

Governor.

Hon. C. S. Hamlin,
Governor, Federal Reserve Board,
Washington, D. C.

BS Jr/VCM-2

Lee Letter 4/26/16

333.4-13

X 144

February 2, 1915.

SUBJECT: Conditions attached to bills of exchange and acceptances affecting negotiability.

CARDED

My dear Governor:

I have the honor to acknowledge receipt of your request for an opinion on the subject of conditions attached to bills of exchange and acceptances which affect their negotiability.

It is somewhat difficult to define in specific terms what conditions may or may not be prescribed in a bill of exchange without affecting the negotiability of such bill since the negotiable instruments laws of all the states are not identical and the decisions of the various courts are by no means uniform on this subject.

As I understand it, the Board has under consideration the question of prescribing a method by which bills of exchange or acceptances dealt in by member banks or Federal reserve banks may show that such bills or acceptances grow out of transactions involving the exportation or importation of goods without affecting their negotiability, and it is primarily upon this question that you desire an opinion.

In dealing with this subject, it is important to keep in mind the distinctive difference between a bill of exchange and an acceptance, and also the difference in status between an acceptor and a drawer of a bill.

Section 126 of the negotiable instruments law adopted by forty-one states and the District of Columbia, defines a bill of exchange as an

> "Unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to order or to bearer".

Copy filed 332.2-41

Section 127 states that -

"A bill of itself does not operate as an assignment of the funds in the hands of the drawee available for the payment thereof, and the drawee is not liable on the bill unless and until he accepts the same".

Until the bill is accepted, therefore, the drawer is primarily liable and the bank discounting such bill can have recourse only against the drawer or a prior endorser in the event that the drawee declines to pay such bill when presented.

On the other hand, acceptance is defined by Section 132 of the negotiable instruments law as -

"The signification by the drawee of his assent to the order of the drawer. The acceptance must be in writing and signed by the drawee. It must not express that the drawee will perform his promise by any other means than the payment of money".

When a bill has been accepted, the acceptor becomes primarily liable and the contract of the drawer is substantially changed to that of endorser.

It will be observed from the foregoing that a bill of exchange, in order to be negotiable, must not only be payable to order or bearer, so that title may be transferred by the holder, but it must also be an unconditional order to pay in money.

A conditional acceptance is defined in 4 Am. & Eng. Encl. of Law, 224, as an undertaking by a drawee to pay, dependent, however, upon the performance or happening of a stipulated condition or contingency. But as shown later, a general acceptance of a conditional bill is also in effect a conditional acceptance. The terms, therefore, both of the order to pay, as indicated by the bill of exchange when drawn, and the acceptance as indicated by the language used by the acceptor, must be free from qualifications or conditions if the bill or acceptance is to retain in all respects its negotiability and to be free from equities existing between the drawer and the drawee or the acceptor. This being true, the question arises as to what form may be used to show the transaction on which the acceptance is based without destroying its negotiability.

The Federal Reserve Act provides that such bills or acceptances must grow out of transactions involving the exportation or importation of goods. It is to be assumed, therefore, that ultimately the proceeds of the sale of the goods imported or exported are to be used to extinguish the debt evidenced by the acceptance. To avoid any question of negotiability, however, neither the bill as drawn nor the acceptance made must be in terms to indicate that the payment is to be confined to such proceeds. As stated by Norton, on Bills and Notes, Third Edition, Page 138, -

> "The true test is whether the drawee is confined to the particular fund, or whether, though a particular fund is mentioned, the drawee may charge the bill up to the general account of the drawer if the designated fund turn out to be insufficient. It must appear that the bill of exchange is drawn on the general credit of the drawer. It must carry with it the personal credit of the drawer, not confined to any fund".

This being true of a bill of exchange, the question arises whether or not the contract of acceptance is wholly independent of the terms contained in the bill. The cases and authorities all agree that a general acceptance of a bill of exchange is an undertaking on the part of the drawee to pay the bill absolutely according to its tenor.

4 Am. & Eng. Encl. of Law 207.
English Bills of Exch., Act, Sec. 17.
Cox v. National Bank, 100 U. S. 712
Bailey on Bills (2nd Am. Ed.) 154.

Consequently if the bill orders payment out of a particular fund, a general acceptance thereof is an undertaking to pay out of that fund and no more, and it is, therefore, a conditional acceptance, though general in form.

Hoagland v. Erck, 11 Neb. 580.
Newhall v. Clark, 3 Cush. (Mass) 376.
Smith v. Wood, 1 N. J. Eq. 74.
Cook v. Wolfendale, 105, Mass., 401.

It is to be remembered, of course, that an acceptance may be conditional and therefore non-negotiable, even though the bill itself was unconditional, if the terms in the contract of acceptance specify that payment is to be made out of a particular fund or is dependent upon the hap-

pening of a certain contingency. As Justice Clifford stated in Cox v. National Bank, supra, "An acceptance is an engagement to pay the bill according to the tenor of the acceptance and * * * a general acceptance is an engagement to pay according to the tenor of the bill. "

The difficult question, however, is to construe the words used, to apply the test given in Norton, to determine whether in fact the acceptance is conditional; or, more specifically, to determine whether the drawee is confined to a particular fund merely by a reference on the bill or in the acceptance to that fund. It is a question for the court to determine in each individual case, because, the facts being proved or admitted, the question whether an undertaking is a conditional acceptance is a question of law for the court to decide. Sproat v. Matthews 1 Term. R. 182.

It was held in Corbett v. Clark, 45 Wis., 403, that an order to "pay C. A. Corbett $183 and take the same out of our share of the grain " was an unconditional bill and a general acceptance thereof also unconditional. The court held that this was a mere direction as to the fund out of which the drawee was to reimburse himself. In Redman v. Adams, 51 Maine, 433, where the words of the bill were "charge the same against whatever amount may be due me for my share of fish caught on board schooner 'Morning Star' ", and the acceptance was general, the court held that this was a mere reference to the fund to call the attention to the drawee to his means of reimbursement.

The great majority of cases incline to the view that the presumption is in favor of an unconditional order and unless the direction on the bill or acceptance clearly and expressly directs payment to be made out of a certain fund, the court will consider it merely as a reference to the mode of reimbursement rather than an absolute restriction to the particular fund mentioned.

In a case now pending before the U. S. Circuit Court of Appeals, for the Second Circuit, Guaranty Trust v. Hannay, the lower court held that "Value received and charge the same to account of 100/RSMI bales of cotton," written on a draft made it conditional because it limited payment to the proceeds of this particular cotton. The draft being conditional, a general acceptance thereof was conditional. Thus it is seen how difficult it is to determine how a court will rule on any specific case. The rule or test is always the same, but whether the facts are within or without the rule is always a matter of opinion. Extreme cases are easy to decide but as the cases verge toward the center, the line of demarcation becomes hazy and difficult of determination.

It would seem, therefore, that Federal reserve banks and member banks should consider carefully the risk involved in discounting bills of exchange or acceptances which in terms indicate any particular fund or any particular property out of which payment of the draft is to be made, because of the doubt as to the construction that might be put upon such an acceptance. It would be far more prudent to require that the directions in a bill of exchange be to pay in money and to charge to the account of the drawer, without any qualification as to any particular fund. There is no doubt, however, that a reference, in general terms, on the face of a bill to the fact that it is based on the importation or exportation of goods would not make it conditional and non-negotiable.

Respectfully,

(Signed) M. C. ELLIOTT.

Counsel.

2/5/15.

333 4-3

January 21, 1915.

Dear Mr. Elliott:

I have read over your opinion as to the discount of bills of exchange drawn in good faith against actually existing values. I am a little puzzled at the summary of conclusions stated by you on page 6.

Am I right in inferring that (a) refers to cases where the bill is discounted before acceptance, in which case there must be a lien?

Turning to (b), would not practically in every case the acceptor hold the bill of lading and take it from the bill which he accepts? In other words, do you mean that the discount of such a bill after acceptance may have no security, the acceptor being directly liable whether or not he has security?

Sincerely yours,

(Signed) W. S. Hamlin.

M. C. Elliott, Esq., Counsel,
Federal Reserve Board.