

MISCELLANEOUS BANKING AND CREDIT UNION BILLS

HEARING
BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
OF THE
COMMITTEE ON BANKING AND CURRENCY
UNITED STATES SENATE
NINETIETH CONGRESS
FIRST SESSION
ON
S. 714, S. 965, and S. 966
BILLS TO AMEND THE FEDERAL RESERVE ACT AND
OTHER STATUTES

MARCH 14, 1967

Printed for the use of the
Committee on Banking and Currency



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CONTENTS

	Page
S. 714 (loans to certain officers of member banks and Federal credit unions) .	17
Agency reports:	
Federal Reserve	20
Federal Deposit Insurance Corporation	21
Treasury Department	22
S. 965 (Federal Reserve Bank investments in foreign government obligations)	23
Agency reports:	
Federal Reserve	25
Treasury Department	26
S. 966 (eligible paper)	27
Agency reports:	
Federal Reserve	33
Federal Deposit Insurance Corporation	44
Treasury Department	45

WITNESSES

Gannon, J. Deane, Director of the Bureau of Federal Credit Unions	8
Grant, Richard H., vice president, CUNA International, Inc.; accompanied by J. Orrin Shippe, managing director	13
Jennings, Lewellyn A., chairman of the board of Riggs National Bank, and chairman of the Federal Legislative Committee of the American Bankers Association	10
Robertson, J. L., Vice Chairman of the Federal Reserve Board	2

LETTERS AND DATA

American Bankers Association; comments on:	
S. 714	13
S. 965	12
S. 966	11
Eligible paper presented by member banks as collateral for borrowing at Federal Reserve banks, 1959-66, table	8
Federal Deposit Insurance Corporation:	
Report on—	
S. 714	21
S. 966	44
Federal Reserve:	
Draft of—	
S. 714	20
S. 965	25
S. 966	34
Explanation of proposed bill regarding advances by Federal Reserve banks	36
Letter proposing—	
S. 714	20
S. 965	25
S. 966	33
Textual changes in present law that would be made by proposed bill regarding advances by Federal Reserve banks	38
First National City Bank of New York, letter to Senator Proxmire, from Carl W. Desch, senior vice president and cashier	22

Independent Bankers Association of America, letter to Senator Proxmire, from Stanley R. Barber, president.....	Page 46
Member banks borrowing one or more times during year as percent of total number of member banks, 1959-66, table.....	8
Number of member banks borrowing one or more times during year from Federal Reserve, 1959-66, table.....	8
Treasury Department: Report on—	
S. 714.....	22
S. 965.....	26
S. 966.....	45

MISCELLANEOUS BANKING AND CREDIT UNION BILLS

TUESDAY, MARCH 14, 1967

U.S. SENATE,
COMMITTEE ON BANKING AND CURRENCY,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS,
Washington, D.C.

The subcommittee met at 10:05 a.m., in room 5302, New Senate Office Building, Senator William Proxmire, chairman of the subcommittee, presiding.

Present: Senators Proxmire and Hickenlooper.

Senator PROXMIRE. The committee will come to order. We are holding hearings today on three bills:

S. 714, loans to certain officers of member banks and Federal credit unions;

S. 965, Federal Reserve bank investments in foreign government obligations; and

S. 966, eligible paper.

These bills are the same as S. 1558, S. 1557, and S. 1559 of the last Congress with the single exception that S. 714 also includes a provision taken from S. 2330 of the last Congress increasing the amounts which Federal credit unions may lend to certain officers.

S. 1557, S. 1558, and S. 1559 were reported by the committee and were passed by the Senate without objection during the last Congress. However, they were not acted on in the House. I introduced these three bills this year in accordance with the suggestion of the majority leader that committees renew action on bills which had previously been considered by the committees and the Senate.

The Federal Reserve Board has again recommended the same three proposals—not including, of course, the Federal credit union proposal—and without objection their letters, together with their draft bills, will be included in the record of the hearings. Favorable reports on all three of my bills have been received from the Treasury Department, and the FDIC has reported favorably on S. 714 and S. 966. These letters will also be included in the record.

The other comments which have been received include a letter recommending that loans to executive officers of member banks for the purpose of financing their children's education should be increased to \$10,000, not just to \$5,000. Copies of these letters will also be inserted in the record.

Copies of last year's hearings and the reports on these three bills last year are before us. Copies of last year's hearings and of a memorandum explaining the bills coming before this hearing were sent around to the subcommittee members last night for their information.

(The bills and letters appear at the end of the hearing at page 16.)

Senator PROXMIRE. Our first witness is J. L. Robertson, Vice Chairman of the Federal Reserve Board. We are very happy to have you with us. You are an old friend of the committee. Go right ahead.

STATEMENT OF J. L. ROBERTSON, VICE CHAIRMAN, FEDERAL RESERVE BOARD

Mr. ROBERTSON. Thank you, Mr. Chairman.

In view of the fact that these three bills have previously been passed by the Senate, I have not only prepared a statement which I would like to insert in the record—

Senator PROXMIRE. Yes, indeed.

Mr. ROBERTSON (continuing). But I have boiled it down to save time and if it is agreeable I can present it in say 5 minutes instead of 20.

Senator PROXMIRE. Very considerate. Without objection, your full statement will be printed in the record.

You may proceed.

Mr. ROBERTSON. S. 966 relates to one of the Federal Reserve System's principal responsibilities—the extension of credit to the commercial banking system.

Banks borrow from the Federal Reserve banks on their promissory notes secured either by Government obligations or by so-called eligible paper. The latter category is based on a concept, embodied in the original Federal Reserve Act, that the credit needs of the country could be measured and satisfied by the rise and fall of commercial banks' holdings of their customers' short-term commercial paper. Although this concept has been outmoded for decades, the ability of the Federal Reserve System to meet the country's needs through the so-called discount window is still limited, to some extent, by rules that were imposed 50 years ago.

This system has at least two adverse effects. It unnecessarily imposes upon commercial banks and Federal Reserve banks the burden of ascertaining whether a large number of notes and other instruments meet highly technical tests of eligibility. In addition, since banks prefer to hold discount-eligible paper, at times they may not feel free to allocate credit solely on the basis of creditworthiness and market considerations, as is most desirable.

S. 966 would eliminate the "eligibility" standards that now complicate the procedure by which commercial banks borrow from the Federal Reserve System. In lieu thereof, it would authorize each Federal Reserve bank to make advances at the regular discount rate to its member banks "secured to the satisfaction of such Federal Reserve bank," subject to regulations prescribed by the Board of Governors. Its enactment would simplify and modernize the mechanism through which Federal Reserve credit flows to the banking system in order to accommodate commerce, industry, and agriculture.

S. 965 would authorize Federal Reserve banks to buy and sell short-term foreign government securities that are payable in convertible currencies. Despite its general terms, this legislative proposal has a specific purpose. As a part of its efforts to safeguard the international value of the dollar, the Federal Reserve System has entered into reciprocal currency agreements—the so-called swap arrange-

ments—with a number of other countries. As a result of such transactions, we hold, from time to time, currency balances in such other countries. These can be used for appropriate investment abroad, but obligations in which the Reserve banks are permitted to invest are not always readily available. The proposed change in the law would enable such funds to be invested in suitable foreign government securities, thereby yielding a return to the United States instead of lying idle.

The Board believes that S. 965 would enable us to conduct the foreign currency operations more efficiently and economically.

S. 714 relates to borrowing by executive officers of banks that are members of the Federal Reserve System. In the 1930's, Congress prohibited an executive officer from borrowing more than \$2,500 from his own bank, and even such a loan could be made only "with the prior approval of a majority of the entire board of directors." Such officers were also required to give their banks detailed information regarding indebtedness to other banks.

The first of these provisions was designed to prevent overreaching by an influential official of a bank, whose dominance might otherwise enable him to obtain credit that he could not have obtained as an ordinary member of the banking public. The second was intended to inform member banks' directors of excessive borrowing by their chief officers, because they should be alert to situations that might lead to embezzlement or other misconduct.

S. 714 would raise to \$5,000 the permissible amount of an officer's "ordinary" borrowing from his own bank and would permit him to borrow up to \$30,000 on the security of a first mortgage on his home, and in no case could the terms of his loan be more favorable than those extended to other borrowers. If he borrowed from another bank, a report to his own bank would be required only if such "outside" borrowing exceeded the amount he could lawfully borrow from it.

The Board of Governors believes that this bill would adjust the Federal Reserve Act, in this respect, to current economic conditions and still provide the safeguards that were sought when the statutory provision was originally enacted.

I would be very glad to attempt to answer any questions that you may have with respect to these three bills. We think they are all desirable and we would hope, not controversial.

Senator PROXMIRE. Governor Robertson, do you express the unanimous position of the board?

Mr. ROBERTSON. On all three.

Senator PROXMIRE. Do I understand that S. 966 and S. 965 would be neutral as far as the money supply and the quantity of credit is concerned?

Mr. ROBERTSON. We can do exactly the same thing now that we could do after the bill is enacted, but it is much more cumbersome and frustrating. Over the years, most of the borrowing from Federal Reserve banks has been on notes secured by government bonds. But in the past few years commercial bank holdings of government bonds have diminished, and at the same time public deposits at commercial banks which must be secured by government bonds have risen, so that the amount of government obligations available to member banks for use as collateral on advances from the Federal Reserve banks has

diminished. As a result, we have had a situation where the banks have been obliged to go back to using eligible paper, which was the original form of obtaining funds from the Federal Reserve banks and which, by the way, was found to be inadequate even in 1916, when the statute was amended, and again in 1932 and again in 1935.

Last year, for example, paper having a face value of 20 billion was analyzed to see whether it was eligible or ineligible in connection with loans from Federal Reserve banks. This takes an awful lot of time and serves no purpose because merely by paying a half percent more you can make exactly the same loan on any paper that is satisfactory to the Federal Reserve. Of course, banks want to borrow at the discount rate. As a result, they try to keep enough paper available that is eligible in order to use that as collateral for the purposes of borrowing from Federal Reserve banks.

Senator PROXMIRE. And they have no trouble keeping enough paper available for that. Then you have to go through the procedure of examining the paper, which is time consuming and inefficient.

Mr. ROBERTSON. Yes, but even having that kind of paper is difficult, too, because the situation has changed very much over the past 50 years.

For example, the needs of agriculture, which used to be financed on a very short term basis, now must be financed on a much longer basis. A combine is a big investment for a farmer that calls for long-term financing. Therefore, that sort of paper would not be eligible, if it were over the statutory maturity limit, for discount.

Now, what we are doing is attempting to eliminate all of these eligibility requirements and merely put everything on the basis of whether it is acceptable or is not acceptable. This has nothing to do with the volume of our lending to commercial banks. It has to do with the ease, the facility of meeting the needs.

Senator PROXMIRE. Why is it that these bills did not pass the House? Was there objection in the House, to your knowledge? Was there any opposition in the banking community or business community or elsewhere?

Mr. ROBERTSON. So far as I know, there is no opposition to this in the banking community or in the business community. I do not have the slightest notion of why it was not approved by the House. I hope it will be passed by the House this year.

Senator PROXMIRE. You have never heard any objection from a Member of Congress against the bill?

Mr. ROBERTSON. I have not testified on these bills on the House side, so I do not know.

Senator PROXMIRE. There have been no communications, to your knowledge, to the Federal Reserve Board complaining about this?

Mr. ROBERTSON. There may be some, but I do not know of them, Mr. Chairman.

Senator PROXMIRE. To your knowledge?

Mr. ROBERTSON. No.

Senator PROXMIRE. Now, there is just one other question I have. That refers to the comment in the letter recommending loans to execu-

tive officers for the purpose of financing their children's education to be increased to \$10,000, not \$5,000. Do you have any position on this?

Mr. ROBERTSON. We could not possibly be opposed to educational loans. We would have no objection if this bill were amended to include them.

Senator PROXMIRE. Senator Hickenlooper?

Senator HICKENLOOPER. No questions.

Senator PROXMIRE. Thank you very much.

(The prepared statement of Mr. Robertson follows:)

STATEMENT OF J. L. ROBERTSON, VICE CHAIRMAN, BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

On behalf of the Board of Governors, let me express our appreciation, Mr. Chairman, for the actions you have taken to assure prompt consideration of three of the Board's legislative proposals. Two of the three bills you have introduced and scheduled for this morning's hearing are identical with drafts submitted by the Board and passed by the Senate in the last Congress. These are S. 966, which would modernize the laws relating to borrowings by member banks from the Federal Reserve Banks, and S. 965, which would facilitate Federal Reserve operations in foreign currencies by permitting investment of such currencies in obligations of foreign governments. The third bill, S. 714, incorporates another of the Board's recommendations—also passed by the Senate in 1965—concerning loans by member banks to their executive officers, as well as other provisions relating to Federal credit unions.

ADVANCES BY FEDERAL RESERVE BANKS (S. 966)

S. 966 would eliminate provisions of the Federal Reserve Act that now require imposition of a "penalty" rate of interest where a member bank borrows from a Reserve Bank on collateral other than U.S. obligations, and the security—even though it is fully acceptable to the Reserve Bank—does not meet obsolete and complex eligibility requirements specified in the statute. In such cases, the Act authorizes the reserve Banks to extend the credit, but the rate of interest must be one-half per cent higher than the regular discount rate applicable to advances secured by "eligible paper." Naturally, member banks wish to borrow at the regular discount rate rather than a rate one-half per cent higher, and consequently the question repeatedly arises whether paper offered as collateral for such advances actually does comply with the eligibility tests.

Under the Federal Reserve Act as originally enacted member banks could borrow from the Reserve Banks only by discounting eligible paper, consisting essentially of "notes, drafts, and bills of exchange arising out of actual commercial transactions; that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes." Paper eligible for discounting was also generally restricted to that having a maturity at the time of discount of not more than 90 days. The statutory requirements as to eligibility for discount have remained substantially unchanged since 1913. The limitations in the Act were imposed on the assumption that the legitimate needs of the economy for bank credit would always be exactly reflected in the volume of these short-term, self-liquidating loans. Thus an automatic control mechanism over discounting was provided, insuring (it was thought) that the amount of reserves created in the process would vary directly with the needs of the economy.

This concept was found inadequate relative to needs as early as 1916, at which time Federal Reserve Banks were authorized to make advances to member banks on their promissory notes secured by direct obligations of the United States. Again in 1932 conditions made it necessary to relax further the narrow restrictions on discounting. At that time section 10(b) was added to the Act, making it possible for member banks to borrow on their own notes secured to

the satisfaction of the Reserve Bank, but only at a rate of interest at least one per cent above the "regular" discount rate. In 1935 this mandatory differential was reduced to $\frac{1}{2}$ of one per cent, which is the requirement in the present law.

Both substantive and operational problems have developed in the implementation of the so-called "eligible paper" concept. As the economy has grown, increasing needs for bank credit have developed which are wider in scope and longer in duration than those which may be satisfied within the definition of eligibility. These are largely the result of the growing capital investment needs of a mechanized agricultural and industrial society. For example, farmers today make much greater use of expensive equipment; a modern combine represents a big investment and requires longer-term financing. In filling these needs, member banks make many loans which are as sound and acceptable as short-term commercial loans but which are not eligible as collateral for Federal Reserve credit at the usual discount rate. In other words, credit needs now exceed the supply of short-term, self-liquidating loans classified as "eligible" and vary for the most part independently of changes in that supply. Experience has also demonstrated that the provision of a given type of collateral does not necessarily indicate the use to which the member bank will put the credit.

Aside from these substantive shortcomings, the eligible paper concept poses practical problems for the Reserve Banks, for member banks, and perhaps to a certain extent for banking customers. The Reserve Bank must analyze each instrument presented to it, not only for its soundness and acceptability, but also for its eligibility under the narrow and complex standards specified by the Federal Reserve Act. The member bank also must make this analysis when it contemplates borrowing on the security of commercial paper, and may at times, depending on the extent to which it must use eligible paper to obtain Federal Reserve credit, tailor its lending practices to these standards. When a member bank finds it necessary to so alter its lending policy, hardship—or at least inconvenience—can result for some of its credit-worthy borrowers.

These problems did not cause any great difficulties for Reserve Banks or member banks in the immediate post-war years, largely because banks then held ample supplies of U.S. Government securities. For two decades, the bulk of the credit provided through the discount window has been collateralized by such securities. However, in recent years non-Federal debt has increased far more rapidly than Federal debt, and bank portfolios have reflected this development. Furthermore, bank holdings of Government securities available for use as collateral at the discount window have been curtailed by the rise in the level of public deposits which typically must be secured by a pledge of these same assets.

The declining supply of free Government obligations—that is, holdings not needed as security for public deposits—has led in the past several years to a dramatic increase in borrowing on the basis of eligible paper. The face amount of eligible paper analyzed at the Federal Reserve's discount window increased from about \$250 million in 1964 to more than \$20 billion in 1966. The number of pieces of eligible paper analyzed increased from 833 in 1964 to 24,345 in 1966. The number of banks using this paper is still small, but also is increasing rapidly (from 20 in 1964 to 82 in 1966). Overall use of the window has shown no such dramatic increases, but it has remained fairly substantial and has grown in the past several years. The above and other data for the last eight years are shown in the attached tabulation.

These increases have resulted in an increasing administrative burden for member banks and Reserve Banks for the reasons cited earlier. And if this rate of increase continues it is only a matter of time before banks begin to face shortages of eligible paper, which represents only a small fraction of their total loans.

In sum, we feel that all relevant factors argue for elimination of the eligibility standards. It would do away with what are today artificial limitations, originally imposed for reasons which in the light of history have proven not valid or workable, and would thus bring the operation of the discount mechanism more into line with current realities. It would also relieve the member banks and the Reserve Banks of an unnecessary administrative burden, and would enable them to serve the needs of the financial system and the economy more effectively, without being confined by outmoded limitations. The Board, therefore, strongly urges approval of this bill.

INVESTMENT OF FOREIGN CURRENCIES HELD BY FEDERAL RESERVE (S. 965)

As a part of its efforts to safeguard the value of the dollar in international exchange markets, the Federal Reserve System has entered into reciprocal currency agreements—the so-called “swap arrangements”—with a number of central banks in other countries. Under these arrangements, the Federal Reserve can obtain a stated amount of foreign currency in exchange for a corresponding amount of dollars. In the event of a drawing—which may be initiated by either party—the balances acquired have to be repaid at the same exchange rate, thus protecting each party against any loss from currency devaluation. The currencies acquired may be sold to smooth out abrupt changes in exchange rates or to prevent fluctuations in U.S. gold reserves or dollar liabilities due to temporary forces acting in the exchange markets.

A drawing by one party under one of these arrangements puts currencies into the hands of the other party. Balances so acquired may be invested at a pre-agreed rate of interest (the same for both parties). Present law, however, needlessly restricts the means available to us to invest such balances. Under the Federal Reserve Act idle balances of foreign currencies held by the System may be invested in short-term commercial paper in the foreign country or placed in an interest-bearing time account with the same or some other foreign bank. In most countries, however, there is a scarcity of commercial paper for investment, and in some countries time deposit facilities are not conveniently available. Present law contains no authority for the investment of such idle funds in obligations of foreign governments, such as foreign treasury bills. On the other hand, a foreign central bank may—and generally does—invest its excess *dollar* balances in interest-bearing securities of the United States Government.

S. 965 would authorize the Federal Reserve to buy and sell securities of a foreign government or monetary authority that have maturities of not more than 12 months and are payable in a convertible currency. This would insure that any foreign currencies we acquire in excess of current operating needs may be safely and conveniently invested in income-producing securities. For this reason, the Board recommends enactment of this bill.

LOANS TO EXECUTIVE OFFICERS (S. 714)

Section 22(g) of the Federal Reserve Act prohibits a member bank of the Federal Reserve System from making a loan of more than \$2,500 to any of its executive officers, and loans up to \$2,500 may be made only with the prior approval of a majority of the bank's board of directors. The section further requires every executive officer to file a written report with his board of directors regarding any loan obtained by him from another bank.

The underlying purpose of these restrictions is unquestionably sound. However, they seem unrealistically severe in the light of changes in economic conditions that have taken place since they were enacted in 1933 and 1935. The President's Committee on Financial Institutions in 1963 recognized the desirability of increasing the \$2,500 ceiling on the amount that an executive officer may borrow from his own bank. In addition, it would seem appropriate to provide a considerably higher ceiling on a mortgage loan covering the purchase of an executive officer's home. Under present law, such an officer is compelled to obtain home mortgage financing from another financial institution.

The first section of S. 714 would amend section 22(g) so as (1) to raise the “general” loan ceiling from \$2,500 to \$5,000, and (2) to permit executive officers to borrow up to \$30,000 from their own banks on home mortgage loans. Member banks would be prohibited from making such loans on terms more favorable than those extended to other borrowers. Instead of requiring prior approval of such loans by the board of directors of the officer's bank—a time-consuming formality that is unnecessary in view of the other safeguards provided—the bill would require only that the officer report the borrowings to his board of directors. Finally, reports of borrowings from other banks would be required only where they exceed in the aggregate the applicable ceiling (\$5,000 or \$30,000, depending on the purpose of the loan) on borrowing from his own bank.

The Board believes that these liberalizing amendments would be consistent with the basic purposes of present law and that such liberalization is desirable. Accordingly, the Board recommends their enactment. Since the provisions of section 2 of S. 714 do not relate to the Board's area of responsibility, we have no comments with respect to that section.

*Eligible paper presented by member banks as collateral for borrowing at
Federal Reserve banks, 1959-66*

[Face amounts in millions of dollars]

	1959	1960	1961	1962	1963	1964	1965	1966
All member banks:								
Number of pieces.....	527	1,006	123	397	277	841	18,343	24,345
Face amount.....	153.0	673.0	5.4	71.3	133.7	248.6	7,186.4	20,085.2
Number of banks.....	13	21	5	7	8	20	40	82
Reserve city banks:								
Number of pieces.....	355	448	5	131	223	271	11,934	16,606
Face amount.....	82.3	241.3	4.2	56.9	133.4	239.3	7,084.9	19,630.4
Number of banks.....	8	9	1	3	5	8	21	43
Country banks:								
Number of pieces.....	172	558	118	266	54	570	6,409	7,739
Face amount.....	70.7	431.7	1.2	14.4	.3	9.2	121.5	454.8
Number of banks.....	5	12	4	4	3	12	19	39

Source: Federal Reserve banks.

NOTE.—Eligible paper is counted for this table only when it is initially analyzed. If paper is left at the Reserve Bank and offered as collateral again without requiring further analysis, it does not enter into these totals a second time.

*Number of member banks borrowing 1 or more times during year from
Federal Reserve, 1959-66*

	1959	1960	1961	1962	1963	1964	1965	1966
All member banks.....	1,911	1,903	1,268	1,102	1,222	1,232	1,157	1,614
Reserve city banks.....	238	207	161	150	168	168	161	166
Country banks.....	1,673	1,696	1,107	952	1,054	1,074	996	1,448

*Member banks borrowing 1 or more times during year as percent of total number
of member banks, year-end 1959-66*

	1959	1960	1961	1962	1963	1964	1965	1966
All members banks.....	30.7	30.8	20.7	18.2	20.0	19.8	18.6	26.3
Reserve city banks.....	81.2	86.2	71.6	68.2	78.1	76.0	83.0	86.5
Country banks.....	28.2	28.6	18.8	16.4	17.9	17.9	16.5	24.3

Source: Federal Reserve Banks.

Senator PROXMIRE. The next witness is Mr. J. Deane Gannon, Director of the Bureau of Federal Credit Unions. Mr. Gannon, it is my understanding that these three bills were unobjected to in the Senate last time. Senator Hickenlooper wisely suggested that you might, if you see fit, simply put your testimony into the record. However, if you would like to make any particular point, this is your opportunity to do so, and go right ahead and do it. Your testimony will be printed in full.

**STATEMENT OF J. DEANE GANNON, DIRECTOR, BUREAU OF
FEDERAL CREDIT UNIONS**

Mr. GANNON. All right.

Senator HICKENLOOPER. I go on the old legal theory that many a lawyer lost his case by overtrying it.

If there is no objection, I do not see why we cannot go back and answer our mail in the office.

Mr. GANNON. I think my statement covers our position, so I am perfectly agreeable to filing my statement.

Senator PROXMIRE. Fine. You have nothing else you would like to add to that?

Mr. GANNON. No.

Senator PROXMIRE. All right, fine. Thank you very much for appearing.

(The prepared statement of Mr. Gannon follows:)

STATEMENT OF J. DEANE GANNON, DIRECTOR, BUREAU OF FEDERAL CREDIT UNIONS, SOCIAL SECURITY ADMINISTRATION, DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE

Mr. Chairman and members of the subcommittee, I am J. Deane Gannon director of the Bureau of Federal Credit Unions. I appreciate very much this opportunity to appear before the subcommittee in order to comment briefly on that portion of S. 714 which would amend the Federal Credit Union Act. Section 2 of the bill would amend subsection (5) of section 8 of the Federal Credit Union Act by permitting loans to a director or member of the supervisory or credit committees in an amount not exceeding that of the statutory unsecured loan limit plus the amount of his shareholdings and any unencumbered shareholdings of a member pledged as security on the loan.

Without going into great detail, our position is that the interests of Federal credit unions would be better served if the committee were to adopt a somewhat different approach, which I shall briefly explain.

The original Federal Credit Union Act, approved in 1934, provided that "No loans to a director, officer, or member of a committee shall exceed the amount of his holdings in the Federal credit union as represented by shares thereof." The sponsors of the Act believed that the limitations on borrowing and the prohibition against the compensation of officials except the treasurer contained in Section 13 assured that the officials could not personally profit or gain undue advantage by virtue of their responsibilities. In 1959, the borrowing restriction was eased slightly to include in the amount an official could borrow the total unencumbered shareholdings of a member who would serve as a cosigner. There is no doubt that the strict requirements of the law have had the desired effect, since no significant regulatory problems have developed in this area. By far the majority of Federal credit union officials have conducted themselves in a completely responsible way. The few who have not have been dealt with properly and firmly.

We have become aware, nevertheless, that the present restrictions on borrowing by officials continues to work a hardship in certain instances. The liberalization permitted in the 1959 amendments provided an indication that Congress was aware of the difficulties some officials were encountering. The present restrictions discriminate against officials who have a genuine need to borrow. Some officials have resigned in order to become fully eligible for the borrowing privileges accorded ordinary members. Others have reluctantly declined to serve at all, knowing in advance that they will need to borrow but being unwilling to undergo the embarrassment and difficulty of obtaining a cosigner. The restriction, in sum, has had the effect of placing an impediment in the way of full member participation in the operation of Federal credit unions. Obviously such participation is a highly desirable goal in these mutual institutions.

The problem is even more pronounced in Federal credit unions serving largely low-income members, where particular attention is paid to encouraging the poor themselves to participate in the operation of the credit union. There is understandable reluctance on the part of the poor to accept official positions, because, by doing so, they lessen to a great degree their eligibility for borrowing from their credit union. There are now approximately 530 Federal credit unions defined as serving low-income groups, but nearly all Federal credit unions have significant numbers of their membership at or near the poverty level. Consequently, the restriction not only limits the chances for full member participation in low-income credit unions, but it also is a factor in credit unions whose members, on average, have higher incomes. The result, in many instances, is that board and committee positions are filled by those who can afford to sacrifice

the borrowing privilege while there may be well qualified members with lower incomes who would be willing to serve but find themselves unable to do so because of the present restriction.

The language of section 2 of S. 714 would limit borrowing by officials to the amount of the present statutory unsecured loan limit of \$750, plus the amount that they may presently borrow. The additional amount allowed—\$750—is relatively small and would not, in our opinion, significantly assist in meeting the problems I have cited. We feel that the solution to this problem lies rather in regulating officials' borrowing activity through disclosure of their loan activity to the board of directors, subject to an overall dollar limitation that takes into consideration the legitimate needs of the officials consistent with the basic purposes of the Act.

We would therefore recommend that section 2 of S. 714 be amended to incorporate three desirable objectives: First, liberalization of the present restrictions on borrowing by board or committee members of Federal credit unions beyond that in the bill—perhaps patterned generally after the limits for bank officials; second, establishing adequate safeguards against self-dealing by these officials by requiring full disclosure of existing loans and delinquencies, if any, of these officials and approval of each loan by the board in addition to the credit committee; and third, providing an additional barrier against improper conduct by requiring that any board or committee member submitting a loan application would be disqualified from taking part in any actions involving the loan. Enactment of an amendment along these lines would, in our view, continue to furnish an appropriate atmosphere of fiduciary responsibility while adding a desirable degree of flexibility in Federal credit union operations.

We have been advised informally by the Bureau of the Budget that it interposes no objection to the presentation of this statement from the standpoint of the Administration's program.

Senator PROXMIER. Our next witness is Mr. L. A. Jennings, chairman of the board of the Riggs National Bank and chairman of the Federal Legislative Committee of the American Bankers Association.

Mr. Jennings, the same suggestion applies to you, and, once again, we are happy to have you handle this any way you wish, but it would be convenient if you would simply like to file your statement and make any observation you would like to make.

**STATEMENT OF L. A. JENNINGS, CHAIRMAN OF THE BOARD OF
RIGGS NATIONAL BANK AND CHAIRMAN, FEDERAL LEGISLA-
TIVE COMMITTEE OF THE AMERICAN BANKERS ASSOCIATION**

Mr. JENNINGS. Mr. Chairman, I would be delighted to file my statement.

Senator PROXMIER. Fine.

Mr. JENNINGS. I would like to make one comment. It pertains to loans to executive officers of Federal Reserve member banks.

The bill would authorize home mortgage loans to officers up to \$30,000 and we support that. However, we would recommend that language be inserted to make it clear that in no case shall the amount loaned be in excess of the legal lending limit of any bank.

We have in this country, of course, a situation where the lending limits of banks depend on their size—in the case of national banks section 5200 of the Revised Statutes sets a limit of 10 percent of capital and surplus. The limits vary from let us say \$10,000 for very small institutions all the way up to the largest banks with perhaps \$50-million lending limits. \$30,000 to many banks is a very reasonable and acceptable figure, but not if a bank has a legal lending limit of \$15,000 or \$20,000. I do not believe that the proposed bill would

authorize violating section 5200 or any similar statute. However, it might be just as well to have it crystal clear that the bill means that mortgage loans may be made up to \$30,000 only if the bank's legal lending limit will permit it.

Senator PROXMIRE. Mr. Jennings, that is a fine suggestion. I discussed this briefly with Mr. Hale and he agreed we could make that explicit in the bill. We will check it with the Federal Reserve, but I think this is a fine suggestion and is very much appreciated.

Senator HICKENLOOPER. It has been called to my attention that in the hearings last year the \$30,000 figure was arbitrarily put as a limit because that was the FHA limit and that was the yardstick which they used for some reason.

Mr. JENNINGS. May I say this: My lawyers tell me that the way the bill is presently written, it provides for the \$30,000 maximum amount to a bank officer against a mortgage on his home but it would be looked upon as not superseding the 10 percent of capital and surplus limitation placed on national banks, for example, under section 5200 and if the 10-percent limitation on a small bank happened to be \$10,000 or \$15,000 or \$20,000, the bank would have to stay within that legal lending limit.

On the other hand, it is always easier, it seems to me, to have it crystal clear in the bill that there was no intention to supersede another statute. That would be, of course, a big loan for some banks, particularly a mortgage loan on a home in a very small community—\$30,000—it is unlikely, of course, that they would make such a loan.

Senator PROXMIRE. Thank you again very much. Was there something else you wanted to add?

Mr. JENNINGS. No. I just want to say we are wholeheartedly back of all three bills. We think there is not any question about their soundness and that it would act to the benefit of the banking community and business community generally to have them enacted into law. Thank you very much.

Senator PROXMIRE. Thank you.

(The prepared statement of Mr. Jennings follows:)

STATEMENT OF LEWELLYN A. JENNINGS ON BEHALF OF THE AMERICAN
BANKERS ASSOCIATION

Mr. Chairman, members of the Subcommittee, I am Lewellyn A. Jennings, Chairman of the Board of The Riggs National Bank of Washington, D. C. I am appearing before your Subcommittee on behalf of The American Bankers Association. At the outset I want to say that The American Bankers Association favors enactment of S. 714, S. 965, and S. 966. I would like to make a brief statement on each issue.

ELIGIBLE PAPER (S. 966)

S. 966 is similar to S. 1559, which our Association supported and which passed the Senate in the 89th Congress. It would permit member banks of the Federal Reserve System to borrow from the Federal Reserve banks on the security of any sound asset without paying a "penalty" rate of interest. Under present law, only U. S. Government obligations and short-term, self-liquidating commercial loans of up to 90 days, or agricultural loans of up to 9 months, are eligible as security against advances obtained at regular discount rates from Federal Reserve banks. Most other loans, including such a major category as real estate loans, regardless of their maturity, are ineligible for discount under present law. The difficulties which this bill is designed to correct stem from practices and economic theories prevailing prior to, and at the time of, the enactment of the

Federal Reserve Act. In 1913, the Act reflected the view then commonly accepted that the liquidity and soundness of the commercial banking system depended upon short-term, self-liquidating bank loans. Consequently, Reserve banks were authorized to discount only certain types of paper "arising out of actual commercial transactions—for agricultural, industrial, or commercial purposes" and subject to a maturity limitation of 90 days. These restrictions were slightly modified by amendments in 1916, 1932, and in 1935.

The make-up of a bank's loan portfolio today differs markedly from that which existed in the early days of the Federal Reserve System. For example, at that time residential real estate mortgage loans amounted to about 12 percent of all loans of commercial banks. At national banks the ratio was less than 2 percent. Of course, FHA and GI loans were unheard of and such loans are still not eligible as security for advances made by Reserve banks. Today, real estate loans account for 24 percent of all loans at commercial banks. Likewise, consumer instalment loans and term loans to farmers and other businessmen were then of minor importance, and are not yet considered eligible paper in most instances, because of maturity restrictions or for other reasons—no matter how well secured such paper may be. Because of the narrow definition in the present law, the percentage of eligible loans in the loan portfolios of banks today is very small.

There is a tedious burden upon both the borrowing bank and the Reserve bank in reviewing loan portfolios to determine which loans, if any, are eligible. For example, loans to farmers for purchasing farm implements are eligible if they meet the maturity restrictions, but a loan to acquire a silo or to build a barn would be ineligible because these are considered to be permanent or fixed investments.

We believe that the amendments to the Federal Reserve Act contained in S. 966 would bring the lending authority of the Reserve banks into conformity with modern banking practices. If enacted, the bill would replace the present requirement for conformity to outmodel technical details with a provision that paper to secure advances must be sound and appropriate. There is no good reason why the Reserve banks should be bound by the technical requirements written into the law a half century ago, but instead should be guided by the quality of the loans offered for discount or for collateral. The proposed amendments would make this possible.

S. 966 provides that the Reserve banks will be "subject to such limitations, restrictions, and regulations as the Board of Governors may prescribe." It further provides that in making advances due regard shall be given to the maintenance of sound credit conditions, and that both the banks and the Board shall guard against undue or inappropriate use of the borrowing privilege by member banks.

The American Bankers Association recommends that your Subcommittee give favorable consideration to this bill.

FEDERAL RESERVE PURCHASE OF FOREIGN GOVERNMENT OBLIGATIONS (S. 965)

S. 965 would amend Section 14(e) of the Federal Reserve Act (12 U.S.C. 358) to authorize the investment of funds held by Federal Reserve banks in foreign central banks in securities which are direct obligations of, or fully guaranteed as to principal and interest by, any foreign government or monetary authority, and which have maturities from the date of purchase not exceeding 12 months and are denominated payable in any convertible currency. This has reference to idle amounts of foreign currency held by the Federal Reserve Bank of New York, acting for the System, in reciprocal credit balances or "swap" arrangements with foreign central banks. These funds are used, among other things, for currency exchange purposes. Under present law, Federal Reserve bank balances in accounts in foreign banks may only be invested in bills of exchange and acceptances resulting from commercial transactions, with maturities of not more than 90 days; or the funds may be placed in interest-bearing time accounts. The trouble is, there are instances when these investment media are just not available. As a result the Federal Reserve has to resort to various roundabout devices to earn interest on its idle funds.

The American Bankers Association supports S.965 because it would permit greater flexibility and would allow a more economic use of Federal Reserve bank balances held at foreign central banks.

LOANS TO EXECUTIVE OFFICERS OF FEDERAL RESERVE MEMBER BANKS (S. 714)

S. 714 would amend Section 22 (g) of the Federal Reserve Act by liberalizing the provisions relating to loans to executive officers by member banks of the Federal Reserve System. This bill (Section 2) also modifies the loan provisions of the Federal Credit Union Act; however, I am limiting my statement to those provisions of the bill dealing with the Federal Reserve Act.

At the present time, Section 22 (g) of the Federal Reserve Act prohibits a member bank of the Federal Reserve System from making loans to any of its executive officers in an amount exceeding \$2,500 and for loans under this authorization only with the prior approval of a majority of the bank's board of directors.

The bill presently before your Committee, S. 714, would raise the present \$2,500 limitation on loans to executive officers of Federal Reserve member banks to \$5,000 and would authorize home mortgage loans to such officers up to \$30,000. However, we would recommend that language be inserted to clarify that in no case shall the amount loaned be in excess of the legal lending limit of any bank. In addition, any loan of a member bank to its executive officers could only be made on terms not more favorable than those extended to other borrowers.

Conditions have changed since the initial restrictions were written into law (Banking Act of 1933). For one thing, the purchasing power of the dollar has decreased about 60 percent. Thus, a \$2,500 limitation as contained in the 1933 Banking Act would be equivalent to about a \$6,000 limitation today if allowance is made for price increases. In addition, methods of financing and the types of goods financed have drastically changed over this period. Loans for automobiles and other types of consumer goods, as well as homes, has become universal practice among U.S. banks.

The American Bankers Association believes that the \$5,000 limitation contained in the bill now before you appears to be reasonable and equitable for all concerned. Similarly, the A.B.A. believes that home mortgage loans by banks to their executive officers should be allowed, provided such loans are made on the same terms as those offered to other borrowers. The \$30,000 limitation is in line with current provisions pertaining to FHA-insured mortgages and seems to be an appropriate amount.

The American Bankers Association recommends that your Subcommittee give favorable consideration to the provisions of S. 714 relating to Federal Reserve member banks.

Senator PROXMIRE. Our last witness is Richard Grant, vice president of CUNA International.

Mr. Grant, I might say that Senator McIntyre is very sorry he cannot be here. I understand you are a constituent of his, sir.

STATEMENT OF RICHARD H. GRANT, VICE PRESIDENT OF CUNA INTERNATIONAL, INC., ACCOMPANIED BY J. ORRIN SHIPE, MANAGING DIRECTOR

Mr. GRANT. That is correct.

Senator PROXMIRE. The same thing applies to you; your statement will be printed in full in the record. If you would like to make any additional remark or highlight any part of it, please proceed.

Mr. GRANT. First of all, I would like to introduce Mr. J. Orrin Shipe, managing director.

Senator PROXMIRE. He needs no introduction. He is familiar to this committee. We are delighted to have you here, Mr. Shipe.

Mr. GRANT. The statement we submitted, Mr. Chairman, is still reasonably acceptable. However, in view of the position presented by the Bureau of Federal Credit Unions this morning, I would like to make an additional comment, if I may.

First of all, while the position taken in our statement is still our position, we do not think the liberalization as contained in section 2 of S. 714 goes far enough. We prefer to have the restriction removed and to substitute a disclosure requirement which would fully inform the board of directors and members of the credit committee of the borrowings of credit union officials. In this regard, we fully support the statement that the Bureau of Federal Credit Unions has presented. We would urge the committee to amend section 2 of S. 714 by substituting the following language:

Subsection 5 of Section 8 of the Federal Credit Union Act (12 U.S.C. 1757) is amended by striking out all that part of the first sentence beginning with the word "except" and inserting, in lieu thereof, the following:

"Except that loans made to a director or member of the supervisory or credit committee shall not exceed \$5,000 and any such loans shall be approved by the credit committee and by the board of directors."

If we may be permitted to——

Senator PROXMIRE. Tell me how this would change it.

Mr. GRANT. The first section of the bill, which does not refer to credit unions, establishes a \$5,000 limit for bank officers——

Senator PROXMIRE. You want credit unions included in this bill along with the banks.

Mr. GRANT. That is correct. The present bill provides that credit union officials could borrow up to the unsecured loan limit, in addition to the present authority for loans secured by shares in the credit union, but we do not feel that really goes far enough.

Senator PROXMIRE. I see. Very good. Well, we appreciate that. Senator Hickenlooper?

Senator HICKENLOOPER. I do not think I have any questions. I do not know if I quite understand this but—I am trying to read the statement here——

Senator PROXMIRE. Can you spell out exactly what the present amount would be and exactly what the future amount would be?

Mr. GRANT. Under the present bill, as it reads now?

Senator PROXMIRE. Let us do it in three ways: The law at present, the bill as it reads now, and the proposal that you have.

Mr. GRANT. All right. The present law, Mr. Chairman, limits officials of credit unions to a loan that does not exceed their own share amount plus the additional amount that might be pledged by a co-signer.

Senator HICKENLOOPER. No unsecured loan.

Mr. GRANT. No unsecured loan and no loan secured by anything other than shares within the credit union, itself, either by the borrowing official or by a cosigner. That is the present law which, of course, is very, very restrictive.

Section 2 of the bill, S. 714, that is before us, would permit unsecured loans to officials up to \$750, because this is the unsecured limit in the act, in addition to the passbook loans now permitted.

Senator PROXMIRE. Up to \$750.

Mr. GRANT. That is right. We do not feel this goes far enough and while we feel it would be an alleviation of the problem that exists, where a credit union official might need a larger loan, which is en-

tirely possible in today's economy, we are still going to have the problem of credit union officials being forced by this provision to resign or else express reluctance to accept an official position, so we would hope we could go a little further than that by allowing them the privilege—

Senator HICKENLOOPER. Can they not go someplace else and borrow the money?

Mr. GRANT. Certainly they can, but in their own member organization, we would hope their privileges would be expanded to equal those of the rest of the membership.

Senator HICKENLOOPER. You want them to have the same borrowing privileges and rights as other members, is that what you are saying?

Mr. GRANT. Except that it would have a \$5,000 limitation which the general membership does not have, plus the provision that the loan would be reviewed not only by the credit committee but by the board of directors as well. With the exception of these two restrictions, they would be permitted to use the credit union as does the general membership.

Senator PROXMIRE. That sounds reasonable to me.

Senator HICKENLOOPER. Do you want to change the maturity date period on these loans in any way; longer maturity period?

Mr. GRANT. Well, the Federal Credit Union Act has a 5-year amortization period in it.

Senator HICKENLOOPER. Do you want to extend that?

Mr. GRANT. That is another piece of legislation on which we may take a position when it is before us.

I would say yes, the credit union movement would be most favorable to this.

Senator HICKENLOOPER. So at the present time and under this bill, you are limited to a loan where the maturity would occur within a short period of time rather than a longer period of time.

Mr. GRANT. Yes. The Federal Credit Union Act now limits all loans, whether to officials or anyone else in the membership, to 5 years. This, of course, is another of the restrictive areas.

Senator HICKENLOOPER. Do you want to become a bank? Is that it?

Mr. GRANT. No, I would certainly not think that, Senator. We have a completely different philosophy and I doubt that any change in the present restrictions that are on us would cause us to be banking institutions.

Senator HICKENLOOPER. Well, I think the credit unions do a wonderful job and I have no objection to them, but I just do not know how far they are going here in this or how far they want to go. I think that is all.

Senator PROXMIRE. It is my understanding from the committee counsel, Mr. Hale, that we will check out this suggestion with the Budget Bureau, because we are not clear as yet what their position is on this.

(The prepared statement of Mr. Grant follows:)

STATEMENT OF RICHARD H. GRANT, VICE PRESIDENT, CUNA INTERNATIONAL, INC.

Mr. Chairman and members of the committee, my name is Richard H. Grant. I am a Vice President of CUNA International, Inc., and Treasurer-Manager of the Pease Air Force Base Federal Credit Union, Portsmouth, New Hampshire. CUNA International, Inc., was formerly known as the Credit Union National Association and is the voice of the organized credit union movement. I appear here today to speak on behalf of the Federal credit unions who are vitally interested in this legislation.

Since the main concern of CUNA International is with Section 2 of S. 714, I will limit my remarks to that Section.

Section 2 of S. 714 would amend Section 8 of the Federal Credit Union Act to modify the loan provisions relating to directors, members of the supervisory committee, and members of the credit committee of Federal credit unions.

Under the present law, members of Federal credit unions serving on the board of directors, the supervisory committee, and the credit committee are severely limited as to the amount that they may borrow from their own Federal credit union. At the present time, these officials may borrow only up to their unencumbered shares, which they must pledge as security, and up to the unencumbered shares of a co-maker, which also must be pledged as security for the loan. In other words, no Federal credit union official may make a loan from the credit union which he serves unless he pledges his own shares and the shares of a co-signer in an amount equivalent to the amount of the loan that he desires.

Section 2 of S. 714 would liberalize the present law in that it would permit these officials to borrow from their own Federal credit unions up to the unsecured loan limit plus their own unencumbered pledged shares and those of a co-signer. The unsecured loan limit is \$750 for Federal credit unions with at least \$7,500 in paid-in and unimpaired shares and surplus. When its shares are between \$2,000 and \$7,500, the maximum unsecured loan is 10 per cent of the unimpaired shares and surplus. When it has less than \$2,000 in shares, the maximum unsecured limit is \$200.

The restriction on officer borrowing was first enacted into law in the original Federal Credit Union Act which was passed by Congress in 1934. At that time, the restriction was even more onerous than it is today. In the original Act, officials could not borrow in excess of their own pledged shareholdings. In 1959, the limit was extended to include the unencumbered shares of a co-signer.

The present restriction makes it extremely difficult for Federal credit unions to recruit volunteers to serve in an official capacity because many of the volunteers are unwilling to accept the borrowing restriction. We have found that in some cases officials have been forced to resign after taking office because they found it necessary to borrow and were unable to do so. The restriction of course automatically limits the number of persons eligible for office. The restriction is particularly onerous on young people who would like to get involved in an official capacity with a particular Federal credit union but who are unable to do so since their borrowing needs are so great during their family-formative years.

CUNA International therefore endorses Section 2 of S. 714 and urges this Committee to report favorably thereon.

Thank you for the opportunity of appearing before your Committee.

Senator PROXMIRE. Thank you very much. That concludes the hearing. We have additional credit union bills that Senator Sparkman has introduced that we will be taking up a little later on at a later session.

Might I ask if anyone else would like to be heard on these three bills? If not, I want to thank those who appeared this morning and thank Senator Hickenlooper.

(The bills and letters referred to by the chairman on p. 1 follow:)

90TH CONGRESS
1ST SESSION

S. 714

IN THE SENATE OF THE UNITED STATES

JANUARY 30, 1967

Mr. PROXMIRE introduced the following bill; which was read twice and referred to the Committee on Banking and Currency

A BILL

To amend section 22 (g) of the Federal Reserve Act relating to loans to executive officers by member banks of the Federal Reserve System, and to amend the Federal Credit Union Act to modify the loan provisions relating to directors, members of the supervisory committee, and members of the credit committee of Federal credit unions.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That subsection (g) of section 22 of the Federal Reserve
4 Act (12 U.S.C. 375a) is amended by striking out the first
5 two sentences thereof and inserting in lieu thereof the
6 following:

7 “(g) No executive officer of any member bank shall

1 borrow from or otherwise become indebted to any member
2 bank of which he is an executive officer, and no member
3 bank shall make any loan or extend credit in any other
4 manner to any of its own executive officers: *Provided*, That
5 any member bank may extend credit, on terms not more
6 favorable than those extended to other borrowers, to any
7 executive officer thereof, and such officer may become in-
8 debted thereto, in an amount not exceeding \$5,000, or, in the
9 case of a first mortgage loan on a home owned and occupied
10 or to be owned and occupied by such officer, in an amount
11 not exceeding \$30,000, but any such indebtedness shall be
12 promptly reported by such officer to the board of directors
13 of the bank of which he is an officer. If any executive officer
14 of any member bank borrows from or if he be or become
15 indebted to any other bank or banks in an aggregate amount
16 exceeding that which he could lawfully borrow from the
17 member bank of which he is an executive officer under this
18 section, he shall make a written report to the board of direc-
19 tors of such member bank, stating the date and amount of
20 such loan or loans or indebtedness, the security therefor, and
21 the purpose for which the proceeds have been or are to be
22 used."

23 SEC. 2. That subsection (5) of section (8) of the Fed-

3

1 eral Credit Union Act (12 U.S.C. 1757) is amended by
 2 inserting the following in the first sentence after the words
 3 “shall exceed” and before the words “the amount”: “the
 4 amount of the unsecured loan limit under this Act plus”.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
Washington, D.C., March 1, 1967.

HON. JOHN SPARKMAN,
Chairman, Committee on Banking and Currency,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The Board of Governors wishes to recommend certain amendments to the provisions of section 22(g) of the Federal Reserve Act regarding loans by member banks of the Federal Reserve System to their executive officers.

These provisions presently prohibit a member bank from making loans to any of its executive officers, except in an amount not exceeding \$2,500 and then only with the prior approval of a majority of the bank's board of directors. In addition, an executive officer is required to make a written report to his bank with respect to any loan obtained by him from any other bank.

The Board believes that these restrictions, first enacted in 1933, are unrealistically severe in the light of changed economic conditions and that they should be liberalized.

In 1956, in connection with the then proposed "Financial Institutions Act", the Board recommended that the \$2,500 exemption be increased to \$5,000. This change was included in that bill as it passed the Senate in 1957; and the bill would have also relieved executive officers from the burden of reporting borrowings from other banks where they would not exceed \$15,000 in the case of home mortgage loans or \$5,000 in the case of other loans. The Report of the President's Committee on Financial Institutions in April 1963 recognized the desirability of increasing the \$2,500 ceiling on the amount an executive officer may borrow from his bank.

The underlying purpose of restrictions on loans by member banks to their executive officers is unquestionably sound. However, the Board believes that some liberalization of these restrictions would not be contrary to the public interest. In addition to an increase in the basic ceiling on exempted loans, the law should provide a special exemption with respect to mortgage loans covering the purchase of an executive officer's home.

Accordingly, the Board recommends (1) that an executive officer of a member bank be permitted to borrow from his own bank up to \$5,000, or, in the case of home mortgage loans, up to \$30,000; (2) that, in lieu of the present requirement for prior approval by the bank's board of directors with respect to exempted borrowings by an executive officer from his own bank, the officer be required to report any such borrowing to the board of directors; and (3) that reports as to borrowing from *other* banks be required only where they would exceed in the aggregate the amount an executive officer could borrow from his own bank. In connection with these changes, certain obsolete provisions of the law should be repealed.

To preclude favoritism, these changes should be accompanied by a requirement that any loan to a bank's executive officer shall be made on terms not more favorable than those extended to other borrowers.

There is enclosed a draft of a bill that would amend section 22(g) of the Federal Reserve Act along the lines above described. The Board urges favorable consideration of such a bill by your Committee and by the Congress. This is identical with S. 1558, which passed the Senate in the last Congress.

Sincerely yours,

WM. MCC. MARTIN, JR.

DRAFT

A BILL To amend section 22(g) of the Federal Reserve Act relating to loans to executive officers by member banks of the Federal Reserve System, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That subsection (g) of section 22 of the Federal Reserve Act (12 U.S.C. 375a) is amended by striking out the first two sentences thereof and inserting in lieu thereof the following:

"(g) No executive officer of any member bank shall borrow from or otherwise become indebted to any member bank of which he is an executive officer, and no

member bank shall make any loan or extend credit in any other manner to any of its own executive officers: *Provided*, That any member bank may extend credit, on terms not more favorable than those extended to other borrowers, to any executive officer thereof, and such officer may become indebted thereto, in an amount not exceeding \$5,000, or, in the case of a first mortgage loan on a home owned and occupied or to be owned and occupied by such officer, in an amount not exceeding \$30,000, but any such indebtedness shall be promptly reported by such officer to the board of directors of the bank of which he is an officer. If any executive officer of any member bank borrows from or if he be or become indebted to any other bank or banks in an aggregate amount exceeding that which he could lawfully borrow from the member bank of which he is an executive officer under this section, he shall make a written report to the board of directors of such member bank, stating the date and amount of such loan or loans or indebtedness, the security therefor, and the purpose for which the proceeds have been or are to be used."

FEDERAL DEPOSIT INSURANCE CORPORATION,
Washington, March 13, 1967.

HON. JOHN SPARKMAN,
*Chairman, Committee on Banking and Currency,
U.S. Senate, Washington, D.C.*

DEAR MR. CHAIRMAN: Reference is made to your request for the views of this Corporation on S. 714, 90th Congress, a bill "To amend section 22(g) of the Federal Reserve Act relating to loans to executive officers by member banks of the Federal Reserve System, and to amend the Federal Credit Union Act to modify the loan provisions relating to directors, members of the supervisory committee, and members of the credit committee of Federal credit unions".

The purpose of the bill is to liberalize current restrictions on loans by member banks to their executive officers and by Federal credit unions to their directors and members of their supervisory and credit committees.

Section 22(g) of the Federal Reserve Act, as amended (12 U.S.C. 375a), presently permits a member bank, with the prior approval of a majority of its board of directors, to extend credit in an amount not exceeding \$2,500 to any executive officer thereof. Additionally, the section requires an executive officer of a member bank to report to the board of directors of the bank of which he is an executive officer any loan obtained by him from any other bank.

Section 1 of S. 714 would permit a member bank to extend credit to an executive officer thereof in an amount not exceeding \$5,000, or, in the case of a home mortgage loan, in an amount not exceeding \$30,000. Any such loan could be made only on terms not more favorable than those extended to other borrowers, and the officer to whom the loan was made would be required to report the loan to the bank's board of directors. Reports as to loans from other banks would be required only where they would exceed in the aggregate the amount an executive officer could borrow from his own bank.

Section 8(5) of the Federal Credit Union Act, as amended (12 U.S.C. 1757(5)), prohibits a Federal credit union from making any loan to a director or member of the supervisory or credit committee in an amount exceeding the amount of his holdings in the credit union plus the holdings of any member pledged as security for the loan. Section 2 of S. 714 would increase the amount which a Federal credit union might loan to such a person to an amount not exceeding the amount of the unsecured loan limit under the Federal Credit Union Act (\$750) plus the amount of his holdings in the credit union plus the holdings of any member pledged as security for the loan.

In the light of changed economic conditions and increases in the cost of living since they were established, we believe that current restrictions on loans by member banks to their executive officers are quite unrealistic and that the liberalization contemplated by S. 714 is fully justified and desirable. The Corporation therefore recommends the enactment of the bill.

The Bureau of the Budget has advised that it has no objection from the standpoint of the Administration's program to the submission of this letter.

Sincerely yours,

K. A. RANDALL, *Chairman.*

THE GENERAL COUNSEL OF THE TREASURY,
Washington, D.C., March 13, 1967.

HON. JOHN SPARKMAN,
*Chairman, Committee on Banking and Currency,
U.S. Senate, Washington, D.C.*

DEAR MR. CHAIRMAN: Reference is made to your request for the views of this Department on S. 714, "To amend section 22(g) of the Federal Reserve Act relating to loans to executive officers by member banks of the Federal Reserve System, and to amend the Federal Credit Union Act to modify the loan provisions relating to directors, members of the supervisory committee, and members of the credit committee of Federal credit unions."

The first section of the bill would increase from \$2,500 to \$5,000 the amount of a loan that a member bank of the Federal Reserve System may make to any of its executive officers; permit loans by a member bank to an executive officer up to \$30,000 in the case of a home mortgage loan; and revise the approval and reporting requirements with respect to loans to executive officers of member banks.

With respect to section 2 of the bill, existing law limits the amount that a director or member of a supervisory or credit committee of a Federal credit union may borrow from a Federal credit union to the amount of his shares in the credit union plus the shares of any cosigner. Section 2 would permit additional borrowing by such persons in the amount of the unsecured loan limit, which is \$750 at the present time.

The Department has no objection to the first section of the proposed legislation. The Department defers to the views of the Department of Health, Education, and Welfare as to the merits of section 2 of the bill.

The Department has been advised by the Bureau of the Budget that there is no objection from the standpoint of the Administration's program to the submission of this report to your Committee.

Sincerely yours,

FRED B. SMITH, *General Counsel.*

FIRST NATIONAL CITY BANK,
New York, N.Y., March 8, 1967.

HON. WILLIAM PROXMIRE,
Chairman, Subcommittee on Financial Institutions, Senate Banking and Currency Committee, New Senate Office Building, Washington, D.C.

DEAR SENATOR: We were pleased to learn of your introduction of S. 714 dealing with loans to executive officers of member banks, and that your subcommittee will consider this bill soon.

The increase in the individual loan limit from \$2,500 to \$5,000 is helpful. For example, it will enable a member bank to finance an officer's purchase of an automobile. However, there is a special category of loans which we think should be further liberalized. This is, loans to executive officers for the purpose of financing the education of their children.

We suggest a limit of \$10,000 on this type of loan. Under your bill, of course, the loans could not be made on more favorable terms than to other borrowers and they would have to be reported to the board of directors. We cannot conceive that this larger loan limit would be subject to abuse.

You are aware, of course, of the increase in costs of education over the past several years. We make many loans for this purpose and, frankly, it is embarrassing to us and, we think, needlessly discriminatory to have to deny our officers the privilege of borrowing from their own bank for such a salutary purpose.

Very truly yours,

CARL DESCH,
Senior Vice President and Cashier.

90TH CONGRESS
1ST SESSION

S. 965

IN THE SENATE OF THE UNITED STATES

FEBRUARY 15, 1967

Mr. PROXMIRE introduced the following bill; which was read twice and referred to the Committee on Banking and Currency

A BILL

To amend the Federal Reserve Act to enable Federal Reserve banks to invest in certain obligations of foreign governments.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 That the first sentence of subsection (e) of section 14 of
4 the Federal Reserve Act (12 U.S.C. 358) is amended to
5 read as follows:

6 “(e) To establish accounts with other Federal Reserve
7 banks for exchange purposes and, with the consent or upon
8 the order and direction of the Board of Governors of the
9 Federal Reserve System and under regulations to be pre-
10 scribed by said Board, to open and maintain accounts in
11 foreign countries, appoint correspondents, and establish

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1 agencies in such countries wheresoever it may be deemed
2 best for the purpose of purchasing, selling, and collecting
3 bills of exchange, and to buy and sell, with or without its
4 endorsement, through such correspondents or agencies, bills
5 of exchange (or acceptances) arising out of actual commer-
6 cial transactions which have not more than ninety days to
7 run, exclusive of days of grace, and which bear the signature
8 of two or more responsible parties, and to buy and sell any
9 securities which are direct obligations of, or fully guaranteed
10 as to principal and interest by, any foreign government or
11 monetary authority, and which have maturities from date
12 of purchase not exceeding twelve months and are denom-
13 inated payable in any convertible currency; and, with the
14 consent of the Board of Governors of the Federal Reserve
15 System, to open and maintain banking accounts for such
16 foreign correspondents or agencies, or for foreign banks or
17 bankers, or for foreign states as defined in section 25 (b)
18 of this Act.”

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
Washington, March 1, 1967.

The Hon. JOHN SPARKMAN,
Chairman, Committee on Banking and Currency,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Since February 1962, the Federal Reserve Bank of New York has engaged in foreign currency operations on behalf of the System Open Market Account and under directions of the Federal Open Market Committee. These operations have been encouragingly successful in accomplishing their basic purposes, and have thus helped to safeguard the value of the dollar in international exchange markets.

These operations have been implemented in part by the establishment of reciprocal credit balances or "swap" arrangements between the New York Reserve Bank and foreign central banks. The authorization for System foreign currency operations adopted by the Federal Open Market Committee requires that foreign currency holdings in excess of minimum working balances be invested insofar as practicable, and that such investments be in accordance with the provisions of section 14(e) of the Federal Reserve Act.

Under section 14(e), idle amounts held by the Reserve Bank in an account with a foreign bank may be invested in bills of exchange and acceptances that arise out of actual commercial transactions and have maturities of not more than 90 days, or they may be placed in an interest-bearing time account with the same or some other foreign bank. However, in certain instances there has been a scarcity of such paper for investment, time deposit facilities have not always been conveniently available, and, under present law, such idle funds could not be invested in obligations of foreign governments, such as foreign treasury bills. On the other hand, a foreign central bank having a balance or reciprocal credit or "swap" arrangement with the Federal Reserve Bank of New York may invest idle funds in its account with the Reserve Bank in interest-bearing United States securities.

The disadvantage in this respect under which the Reserve Bank must operate would be remedied by an amendment to section 14(e) of the Federal Reserve Act that would specifically authorize Federal Reserve Banks to buy and sell securities with maturities not exceeding 12 months that are issued or guaranteed by foreign governments.

The Board recommends the enactment of such an amendment to the law. A suggested draft of a bill for this purpose is enclosed. This draft is identical with S.1557, which passed the Senate in the last Congress, and S.965, introduced this year by Senator Proxmire.

Sincerely yours,

WM. MCC. MARTIN, JR.

DRAFT

A BILL To amend the Federal Reserve Act to enable Federal Reserve banks to invest in certain obligations of foreign governments

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the first sentence of subsection (e) of section 14 of the Federal Reserve Act (12 U.S.C. 358) is amended to read as follows:

"(e) To establish accounts with other Federal reserve banks for exchange purposes and, with the consent or upon the order and direction of the Board of Governors of the Federal Reserve System 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 endorsement, 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 to buy and sell any securities which are direct obligations of, or fully guaranteed as to principal and interest by, any foreign government or monetary authority, and which have maturities from date of purchase not ex-

ceeding twelve months and are denominated payable in any convertible currency; and, with the consent of the Board of Governors of the Federal Reserve System, to open and maintain banking accounts for such foreign correspondents or agencies, or for foreign banks or bankers, or for foreign states as defined in section 25 (b) of this Act."

THE GENERAL COUNSEL OF THE TREASURY,
Washington, D.C., March 13, 1967.

HON. JOHN SPARKMAN,
*Chairman, Committee on Banking and Currency,
U.S. Senate, Washington, D.C.*

DEAR MR. CHAIRMAN: Reference is made to your request for the views of this Department on S. 965, "To amend the Federal Reserve Act to enable Federal Reserve banks to invest in certain obligations of foreign governments."

S. 965 would amend section 14(e) of the Federal Reserve Act (12 U.S.C. 358) to authorize the investment of funds held by Federal Reserve banks in foreign central banks in securities which are direct obligations of, or fully guaranteed as to principal and interest by, any foreign government or monetary authority, and which have maturities from the date of purchase not exceeding twelve months and are denominated payable in any convertible currency.

The Department believes that the enactment of the proposed legislation would improve the operation of the Federal Reserve foreign currency program which is designed to safeguard the value of the dollar in international exchange markets. Consequently, the Department recommends favorable consideration of S. 965.

The Department has been advised by the Bureau of the Budget that there is no objection from the standpoint of the Administrations' program to the submission of this report to your Committee.

Sincerely yours,

FRED B. SMITH,
General Counsel.

90TH CONGRESS
1ST SESSION

S. 966

IN THE SENATE OF THE UNITED STATES

FEBRUARY 15, 1967

Mr. PROXMIRE introduced the following bill; which was read twice and referred to the Committee on Banking and Currency

A BILL

To amend the Federal Reserve Act in order to enable the Federal Reserve banks to extend credit to member banks and others in accordance with current economic conditions, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 That the following new section is inserted in the Federal
4 Reserve Act immediately preceding section 14:

5 “SEC. 13A. (a) Any Federal Reserve bank may make
6 advances to any of its member banks on the time or demand
7 notes of such banks secured to the satisfaction of such Fed-
8 eral Reserve bank, subject to such limitations, restrictions,

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1 and regulations as the Board of Governors of the Federal
2 Reserve System may prescribe.

3 “(b) In making advances pursuant to this section, each
4 Federal Reserve bank shall give due regard to the mainte-
5 nance of sound credit conditions and the accommodation of
6 commerce, industry, and agriculture. Each Federal Reserve
7 bank shall keep itself informed of the general character and
8 amount of the loans and investments of its member banks
9 with a view to ascertaining whether undue or inappropriate
10 use is being made of bank credit for the speculative carrying
11 of or trading in securities, real estate, or commodities, or for
12 any other purpose inconsistent with the maintenance of
13 sound credit conditions; and, in determining whether to
14 grant or refuse advances, the Federal Reserve bank shall
15 give consideration to such information. Whenever the
16 Board of Governors of the Federal Reserve System, in the
17 light of any reports made to it by a Federal Reserve bank,
18 determines that any member bank is making such undue
19 or inappropriate use of bank credit, the Board may, in its
20 discretion, after reasonable notice and an opportunity for a
21 hearing, suspend such bank from the use of the credit facil-
22 ities of the Federal Reserve System and may terminate such
23 suspension or may renew it from time to time.

24 “(c) Any Federal Reserve bank may make advances to
25 any individual, partnership, or corporation, on its promis-

1 sory notes, secured by direct obligations of the United States,
2 subject to such limitations, restrictions, and regulations as
3 the Board of Governors of the Federal Reserve System may
4 prescribe.”

5 SEC. 2. The following provisions of the Federal Reserve
6 Act are hereby repealed: section 10 (a) (12 U.S.C. 347a) ;
7 section 10 (b) (12 U.S.C. 347b) ; section 11 (b) (12 U.S.C.
8 248 (b)) ; the second, third, fourth, fifth, sixth, eighth, tenth,
9 and thirteenth paragraphs of section 13 (12 U.S.C. 343,
10 344, 345, 346, 347, 361, 347c) ; section 13a (12 U.S.C.
11 348-352) ; and the last sentence of the third paragraph of
12 section 24 (12 U.S.C. 371) .

13 SEC. 3. The eighth paragraph of section 4 of the Federal
14 Reserve Act (12 U.S.C. 301) is amended to read as follows:

15 “Said board of directors shall administer the affairs of
16 said bank fairly and impartially and without discrimination
17 in favor of or against any member bank or banks.”

18 SEC. 4. The thirteenth paragraph of section 9 of the
19 Federal Reserve Act (12 U.S.C. 330) is amended by
20 changing the colon after the words “member banks” in the
21 second sentence to a period and by striking out, commencing
22 with the words “*Provided, however,*”, the remainder of the
23 paragraph.

24 SEC. 5. In the last sentence of section 11 (c) of the
25 Federal Reserve Act (12 U.S.C. 248 (c)) the words “and

1 discount fixed by the Board of Governors of the Federal
2 Reserve System” are changed to read “charged by the
3 Reserve bank on advances under section 13A (a) of this
4 Act”.

5 SEC. 6. In the last sentence of section 11 (m) of the
6 Federal Reserve Act (12 U.S.C. 248 (m)) the words “of all
7 rediscount privileges at Federal reserve banks” are changed
8 to read “from the use of the credit facilities of the Federal
9 Reserve banks.”

10 SEC. 7. In the second paragraph of section 12 of the
11 Federal Reserve Act (12 U.S.C. 262) the words “discount
12 rates, rediscount business” are changed to read “advances
13 under section 13A of this Act, rates of interest charged by
14 the Federal Reserve banks on such advances”.

15 SEC. 8. The first paragraph of section 14 of the Federal
16 Reserve Act (12 U.S.C. 353) is amended to read as follows:

17 “Any Federal Reserve bank may, subject to the regula-
18 tions of the Federal Open Market Committee, purchase and
19 sell in the open market, at home or abroad, either from or to
20 domestic or foreign banks, firms, corporations, or individuals,
21 cable transfers, bankers’ acceptances, and bills of exchange,
22 with or without the endorsement of a member bank.”

23 SEC. 9. Section 14 (c) of the Federal Reserve Act (12
24 U.S.C. 356) is amended by striking out the words “arising
25 out of commercial transactions, as hereinbefore defined”.

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1 SEC. 10. Section 14 (d) of the Federal Reserve Act (12
2 U.S.C. 357) is amended to read as follows:

3 “(d) To establish from time to time, subject to review
4 and determination of the Board of Governors of the Federal
5 Reserve System, (1) rates of interest to be charged by the
6 Federal Reserve bank on advances under section 13A (a) of
7 this Act, which shall be fixed with a view of accommodating
8 commerce, business, and agriculture, and of maintaining
9 sound credit conditions; and different rates may be fixed for
10 different classes of paper or according to such other basis or
11 bases as may be deemed necessary in order to accomplish
12 such purposes; but each such bank shall establish such rates
13 every fourteen days, or oftener if deemed necessary by the
14 Board; and (2) rates of interest to be charged by the Fed-
15 eral Reserve bank on advances under section 13A (c) of
16 this Act;”.

17 SEC. 11. The second paragraph of section 16 of the Fed-
18 eral Reserve Act (12 U.S.C. 412) is amended by striking
19 out the third sentence and substituting therefor the follow-
20 ing: “The collateral security thus offered shall be notes of
21 member banks or others acquired under the provisions of
22 section 13A of this Act, or bills of exchange or bankers’ ac-
23 ceptances purchased under section 14 of this Act, or gold
24 certificates, or direct obligations of the United States.”

25 SEC. 12. The second sentence of the ninth paragraph of

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1 section 19 of the Federal Reserve Act (12 U.S.C. 463) is
2 amended by changing the word “discounts” in such sentence
3 to read “advances”.

4 SEC. 13. The second paragraph of section 23A of the
5 Federal Reserve Act (12 U.S.C. 371c) is amended by
6 striking out the words “drafts,” and “for rediscount or” from
7 the clause beginning with the word “*Provided,*”.

8 SEC. 14. Section 201 (e) of the Act of July 21, 1932, as
9 amended (12 U.S.C. 1148) is amended by striking out the
10 words “various Federal Reserve banks and” from that
11 section.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
Washington, March 1, 1967.

The Hon. JOHN SPARKMAN,
Chairman, Committee on Banking and Currency,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The Board of Governors again wishes to recommend legislation that would permit member banks of the Federal Reserve System to borrow from the Federal Reserve Banks on the security of any sound assets without paying a "penalty" rate of interest whenever technically ineligible paper is presented. This legislation would replace present provisions of the Federal Reserve Act that permit borrowings without a penalty interest rate only on the security of Government obligations or paper that meets certain outmoded "eligibility" requirements. These restrictive provisions should be amended so as to facilitate rather than penalize efforts by banks to meet the public's changing credit needs.

The original Federal Reserve Act authorized the Reserve Banks to discount only certain types of paper arising out of "actual" commercial or agricultural transactions, subject to specified maturity limitations. The concept underlying this limited authority was that the liquidity of commercial banks could be assured only if the loans made by them were short term and self-liquidating in character. Related to this concept was the assumption that the pledging of such discounted paper by the Reserve Banks as security for the issuance of Federal Reserve notes would serve as the basis for an elastic currency; it was expected that the volume of currency would expand and contract directly in response to the varying credit needs of the economy, as reflected by the volume of short-term borrowing by commercial and agricultural enterprises.

The principle that Federal Reserve credit should be extended only on the basis of short-term, self-liquidating paper was departed from as early as 1916, during the First World War, when the law was amended to authorize the Reserve Banks to make 15-day advances to member banks, not only on the security of "eligible paper" but also on the security of direct obligations of the United States. A more significant departure occurred in 1932, when Congress authorized the Reserve Banks to make advances to member banks in exceptional and unusual circumstances on any security satisfactory to the Reserve Banks, although at a penalty rate of interest. This authority, at first temporary, was made permanent in 1935, and it is no longer limited to exceptional and unusual circumstances, although such advances continue to carry a penalty rate of interest.

The concept that limitation of discounts to short-term, self-liquidating paper would serve automatically to regulate the volume of Federal Reserve notes in circulation has also been departed from by amendments to the law and has been refuted by experience. In 1932, Congress authorized the issuance of Federal Reserve notes on the security of Government obligations in addition to eligible paper and gold. This authority was originally of a temporary nature, but it was made permanent in 1945. The volume of Federal Reserve notes today fluctuates with the changing demands of the economy without regard to the nature of the paper offered as collateral for Federal Reserve credit or pledged as security for Federal Reserve notes.

Each of these legislative changes took place during a period of economic stress that served to make clear the inadequacy of the original framework for Federal Reserve credit extension. The credit needs of American businessmen, farmers, and consumers were evolving in many ways that could not be adequately handled by the old instrument of short-term, commercial-type paper; and the rapid growth of both private and Governmental economic activity generated credit requirements far in excess of those that could be supported by the relatively small volume of "eligible paper". For example, farmers today make much greater use of mechanized equipment; a modern combine represents a big investment, and requires longer-term financing. Another example is the entry of banks into consumer lending in response to credit needs created by the mass marketing of automobiles and other durable consumer goods. Banks are now making term loans to business, too, in substantial volume, partly in response to economic changes and partly in recognition that a two-year loan may be sounder than a 90-day loan made in the expectation of repeated renewals.

Despite changes in the character of paper held by commercial banks and the repeated and necessary departures from the original concept that discounts

should be based only on short-term, self-liquidating paper, the law continues to impose unduly restrictive requirements as to the nature and maturity of the paper that may be discounted by the Reserve Banks or offered as security for advances by the Reserve Banks without payment of a penalty rate of interest.

For many years, it has been generally recognized that the concept of an elastic currency based on short-term, self-liquidating paper is no longer in consonance with banking practice and the needs of the economy. It has long been apparent that the narrow requirements of the law regarding "eligible paper" serve no useful purpose and that it would be preferable to place emphasis on the soundness of the paper offered as security for advances and the appropriateness of the purposes for which member banks borrow. The one-year paper of many bank customers that is not now eligible for discount may be as satisfactory collateral as the 90-day notes of other customers. Moreover, the nature of the collateral provides no assurance that the borrowing bank will use the proceeds for an appropriate purpose.

As long as member banks hold a large enough volume of Government securities, they need not, of course, be particularly concerned as to the eligibility for discount with the Reserve Banks of customers' paper held by them. Since World War II, however, there has been a sharp net decline in the aggregate holdings of Government securities by member banks. Consequently, a number of banks are being obliged to tender other kinds of collateral when they seek to obtain Federal Reserve credit, and this development will be sharply accelerated if a further substantial increase in economic activity should cause banks further to reduce their holdings of Government securities in order to meet increased credit demands.

In such a situation, the Reserve Banks can accept technically "ineligible" paper as collateral for advances to their member banks only under section 10(b) of the Federal Reserve Act at a rate of interest one-half of one percent above the regular discount rate. However, the necessity for distinguishing between "eligible" and "ineligible" paper gives rise to cumbersome administrative procedures that are not warranted by the exigencies of current banking conditions. In order to avoid these problems, it would clearly be preferable to revise and update the law so as to eliminate the existing restrictions with respect to "eligible paper".

The Board of Governors and the Federal Reserve Banks believe that such a revision of the law would be desirable so that the Reserve Banks will always be in a position to perform promptly and efficiently one of their principal responsibilities—the extension of appropriate credit assistance to member banks to enable the latter to meet the legitimate credit needs of the economy.

Accordingly, the Board again urges that legislation of the kind here proposed be given favorable consideration by your Committee and by the Congress. A draft of the bill in the form as passed by the Senate in the last Congress is enclosed herewith, along with a section-by-section explanation and a document showing textual changes that would be made in present law. This draft is identical with S. 966, which we note has been introduced this year by Senator Proxmire.

Sincerely yours,

WM. MCC. MARTIN, Jr.

DRAFT OF PROPOSED BILL REGARDING ADVANCES BY FEDERAL RESERVE BANKS

A BILL To amend the Federal Reserve Act in order to enable the Federal Reserve Banks to extend credit to member banks and others in accordance with current economic conditions, and for other purposes

Be it enacted by the Senate and House of Representatives in Congress assembled, That the following new section is inserted in the Federal Reserve Act immediately preceding section 14 :

"SEC. 13A. (a) Any Federal Reserve Bank may make advances to any of its member banks on the time or demand notes of such banks secured to the satisfaction of such Federal Reserve Bank, subject to such limitations, restrictions, and regulations as the Board of Governors of the Federal Reserve System may prescribe.

"(b) In making advances pursuant to this section, each Federal Reserve Bank shall give due regard to the maintenance of sound credit conditions and the accommodation of commerce, industry, and agriculture. Each Federal Reserve Bank shall keep itself informed of the general character and amount of the loans and investments of its member banks with a view to ascertaining

whether undue or inappropriate use is being made of bank credit for the speculative carrying of or trading in securities, real estate, or commodities, or for any other purpose inconsistent with the maintenance of sound credit conditions; and, in determining whether to grant or refuse advances, the Federal Reserve Bank shall give consideration to such information. Whenever the Board of Governors of the Federal Reserve System, in the light of any reports made to it by a Federal Reserve Bank, determines that any member bank is making such undue or inappropriate use of bank credit, the Board may, in its discretion, after reasonable notice and an opportunity for a hearing, suspend such bank from the use of the credit facilities of the Federal Reserve System and may terminate such suspension or may renew it from time to time.

"(c) Any Federal Reserve Bank may make advances to any individual, partnership, or corporation, on its promissory notes, secured by direct obligations of the United States, subject to such limitations, restrictions, and regulations as the Board of Governors of the Federal Reserve System may prescribe."

SEC. 2. The following provisions of the Federal Reserve Act are hereby repealed: section 10(a) (12 U.S.C. 347a); section 10(b) (12 U.S.C. 347b); section 11(b) (12 U.S.C. 248(b)); the second, third, fourth, fifth, sixth, eighth, tenth, and thirteenth paragraphs of section 13 (12 U.S.C. 343, 344, 345, 346, 347, 361, 347c); section 13a (12 U.S.C. 348-352); and the last sentence of the third paragraph of section 24 (12 U.S.C. 371).

SEC. 3. The eighth paragraph of section 4 of the Federal Reserve Act (12 U.S.C. 301) is amended to read as follows:

"Said board of directors shall administer the affairs of said bank fairly and impartially and without discrimination in favor of or against any member bank or banks."

SEC. 4. The thirteenth paragraph of section 9 of the Federal Reserve Act (12 U.S.C. 330) is amended by changing the colon after the words "member banks" in the second sentence to a period and by striking out, commencing with the words "*Provided, however,*", the remainder of the paragraph.

SEC. 5. In the last sentence of section 11(c) of the Federal Reserve Act (12 U.S.C. 248(c)) the words "and discount fixed by the Board of Governors of the Federal Reserve System" are changed to read "charged by the Reserve Bank on advances under section 13A of this Act".

SEC. 6. In the last sentence of section 11(m) of the Federal Reserve Act (12 U.S.C. 248(m)) the words "of all rediscount privileges at Federal reserve banks" are changed to read "from the use of the credit facilities of the Federal Reserve Banks."

SEC. 7. In the second paragraph of section 12 of the Federal Reserve Act (12 U.S.C. 262) the words "discount rates, rediscount business" are changed to read "advances under section 13A of this Act, rates of interest charged by the Federal Reserve Banks on such advances".

SEC. 8. The first paragraph of section 14 of the Federal Reserve Act (12 U.S.C. 353) is amended to read as follows:

"Any Federal Reserve Bank may, subject to the regulations of the Federal Open Market Committee, 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, bankers' acceptances, and bills of exchange, with or without the indorsement of a member bank."

SEC. 9. Section 14(c) of the Federal Reserve Act (12 U.S.C. 356) is amended by striking out the words "arising out of commercial transactions, as hereinbefore defined".

SEC. 10. Section 14(d) of the Federal Reserve Act (12 U.S.C. 357) is amended to read as follows:

"(d) To establish from time to time, subject to review and determination of the Board of Governors of the Federal Reserve System, (1) rates of interest to be charged by the Federal Reserve Bank on advances under section 13A(a) of this Act, which shall be fixed with a view of accommodating commerce, business, and agriculture, and of maintaining sound credit conditions; and different rates may be fixed for different classes of paper or according to such other basis or bases as may be deemed necessary in order to accomplish such purposes; but each such bank shall establish such rates every fourteen days, or oftener if deemed necessary by the Board; and (2) rates of interest to be charged by the Federal Reserve Bank on advances under section 13A(c) of this Act;"

SEC. 11. The second paragraph of section 16 of the Federal Reserve Act (12 U.S.C. 412) is amended by striking out the third sentence and substituting therefor the following: "The collateral security thus offered shall be notes of member banks or others acquired under the provisions of section 13A of this Act, or bills of exchange or bankers' acceptances purchased under section 14 of this Act, or gold certificates, or direct obligations of the United States."

SEC. 12. The second sentence of section 19(e) of the Federal Reserve Act (12 U.S.C. 374) is amended by changing the word "discounts" in such sentence to read "advances".

SEC. 13. The second paragraph of section 23A of the Federal Reserve Act (12 U.S.C. 371c) is amended by striking out the words "drafts," and "for rediscount or" from the clause beginning with the word "*Provided*,".

SEC. 14. Section 201(e) of the Act of July 21, 1932, as amended (12 U.S.C. 1148) is amended by striking out the words "various Federal reserve banks and" from that section.

EXPLANATION OF PROPOSED BILL REGARDING ADVANCES BY FEDERAL RESERVE BANKS

In general, the first section of this bill would confer upon the Federal Reserve Banks broad authority to make advances on any satisfactory security; and the remaining sections of the bill are largely of a conforming nature.

Section 1.—A new section 13A would be inserted in the Federal Reserve Act. It would authorize any Federal Reserve Bank to make advances to any of its member banks on the note of the member bank secured to the satisfaction of the Reserve Bank, subject to such limitations, restrictions, and regulations as the Board of Governors of the Federal Reserve System may prescribe. In making such advances, the Reserve Bank would be required to give due regard to the "maintenance of sound credit conditions and the accommodation of commerce, industry, and agriculture" and to keep itself informed as to the character and amount of the loans and investment of its member banks, with a view to determining whether undue or inappropriate use is being made of bank credit for speculative purposes or for purposes inconsistent with the maintenance of sound credit conditions. These requirements are substantially the same as those now prescribed by the eighth paragraph of section 4 of the Federal Reserve Act.

In addition to advances to member banks, the Reserve Banks would be authorized to make advances to individuals, partnerships, and corporations on the security of obligations of the United States, an authority similar to that now contained in the last paragraph of section 13 of the Federal Reserve Act, although the new authority, like that with respect to advances to member banks, would not specify any maturity limitation. As under present law, the authority to make advances to "corporations" would cover advances to nonmember banks.

Section 2.—Because they would be superseded or rendered obsolete by the authority conferred by the new section 13A, the provisions of the Federal Reserve Act hereafter described would be repealed.

Section 10(a) of the Act (12 U.S.C. 347a), enacted in 1932, authorizes advances to groups of five or more member banks. This authority has never been utilized and would be unnecessary in the light of the new authority.

Section 10(b) (12 U.S.C. 347b), containing authority for advances to member banks on any satisfactory security but at a one-half of one percent penalty interest rate, would likewise be rendered unnecessary by the new legislation.

Section 11(b) of the Act (12 U.S.C. 248(b)), authorizing the Board of Governors to permit or require a Federal Reserve Bank to rediscount the discounted paper of other Reserve Banks, has not been used since 1933 and is of no practical importance today.

The second, third, fourth, fifth, sixth, eighth, tenth, and thirteenth paragraphs of section 13 of the Act (12 U.S.C. 343, 344, 345, 346, 347, 361, and 347c, respectively), contain the basic provisions of present law regarding discounts and advances by the Federal Reserve Banks. These provisions limit "eligible paper" to paper "issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes"; provide emergency authority (never used) for the discounting of "eligible paper" for individuals, partnerships, and corporations; authorize the discounting of "sight" drafts in certain limited circumstances; authorize the discounting of bankers' acceptances and "dollar exchange" acceptances of the kinds described in paragraphs 7 and 12 of section 13; limit the amount of paper of one obligor

that may be discounted for a member bank; authorize advances (as distinguished from "discounts") to member banks secured by Government obligations or "eligible paper"; provide for the regulation of discounts by the Board; authorize advances to individuals, partnerships, and corporations on the security of Government obligations; authorize the discounting of agricultural paper, paper held by Federal intermediate credit banks, and paper of cooperative marketing associations; and provide that certain types of real estate loans by national banks shall be regarded as "commercial" paper for discount purposes. All of these provisions would either be superseded or covered by the new section 13A added by section 1 of the present bill.

Section 3.—The eighth paragraph of section 4 of the Act (12 U.S.C. 301) presently requires each Federal Reserve Bank to consider the maintenance of sound credit conditions and the accommodation of commerce, industry, and agriculture in extending credit to member banks, and to keep itself informed regarding undue uses of bank credit for speculative purposes; and the Board of Governors is authorized to suspend any member bank from access to Federal Reserve credit for any such undue use of bank credit. These provisions would be retained in substance in the new section 13A. Accordingly, the similar provisions of section 4 would be repealed, so that the eighth paragraph of that section would provide only—as it does now—that the board of directors of each Federal Reserve Bank shall administer its affairs "fairly and impartially and without discrimination in favor of or against any member bank or banks."

Section 4.—The thirteenth paragraph of section 9 of the Act (12 U.S.C. 330) would be amended to repeal the proviso limiting the amount of paper of one obligor that may be discounted for any member bank. This limitation, like the similar limitation in section 9 of the Act, appears unnecessary in view of the fact that most State laws limit the amount of loans that may be made to one borrower by State banks, in terms similar to those applicable to national banks under section 5200 of the Revised Statutes.

Section 5.—The last sentence of section 11(c) of the Act (12 U.S.C. 248(c)), regarding the addition to the "discount" rate of any tax paid by the Reserve Banks on deficiencies in their reserves against Federal Reserve notes, would be modified to refer to the "interest" rate charged on advances under the new section 13A.

Section 6.—The language of the last sentence of section 11(m) of the Act (12 U.S.C. 248(m)), regarding suspension of "rediscount privileges" for certain increases in loans secured by stock or bond collateral, would be conformed to refer to suspension of "use of the credit facilities" of the Federal Reserve Banks.

Section 7.—The provision of section 12 of the Act (12 U.S.C. 262), authorizing the Federal Advisory Council to make recommendations in regard to "discount rates" and "rediscount business", would be changed to refer to advances under the new section 13A and interest rates on such advances.

Section 8.—The first paragraph of section 14 of the Act (12 U.S.C. 353) would be amended to eliminate a reference to paper "eligible for rediscount" and, at the same time, to omit a reference to regulation of Federal Reserve Bank open market operations by the Board of Governors, a function that has been subject to regulation since 1935 by the Federal Open Market Committee.

Section 9.—A conforming change would be made in section 14(c) of the Act (12 U.S.C. 356) to eliminate a reference to paper "arising out of commercial transactions, as hereinbefore defined".

Section 10.—Section 14(d) of the Act (12 U.S.C. 357), relating to the fixing of "discount" rates, would be amended to refer to "interest" rates under the new section 13A. At the same time, this provision would be broadened to authorize the fixing of different rates, not only for different classes of paper, but also "according to such other basis or bases as may be deemed necessary" to accomplish the purposes of this provision. The amended provision would also include separate authority as to rates on advances to individuals, partnerships, and corporations under subsection (c) of the new section 13A.

Section 11.—The provision of section 16 of the Act (12 U.S.C. 412) authorizing the use of paper acquired under section 13 as security for Federal Reserve notes would be modified to refer to "notes of member banks or others acquired under the provisions of [the new] section 13A of this Act."

Section 12.—The provision of section 19 of the Act (12 U.S.C. 374), prohibiting member banks from acting as agents for nonmember banks in obtaining Federal Reserve "discounts," without the Board's permission, would be conformed to refer to "advances" instead of discounts.

Section 13.—A provision of section 23A of the Act, relating to security for loans to affiliates of member banks, would be conformed to eliminate a reference to drafts "eligible for rediscount."

Section 14.—A provision of the Act of July 21, 1932 (12 U.S.C. 1148), authorizing agricultural credit corporations to rediscount "eligible paper" with the Federal Reserve Banks, would be repealed.

TEXTUAL CHANGES IN PRESENT LAW THAT WOULD BE MADE BY PROPOSED BILL
REGARDING ADVANCES BY FEDERAL RESERVE BANKS

(Italic words indicate new matter to be added to the law ; bracketed words indicate provisions of the law currently in effect to be stricken from the law.)

Federal Reserve Act, section 4, par. 8; 12 U.S.C. 301, par. 3

Said board of directors shall administer the affairs of said bank fairly and impartially and without discrimination in favor of or against any member bank or banks. [and may, subject to the provisions of law and the orders of the Board of Governors of the Federal Reserve System, extend to each member bank such discounts, advancements, and accommodations as may be safely and reasonably made with due regard for the claims and demands of other member banks, the maintenance of sound credit conditions, and the accommodation of commerce, industry, and agriculture. The Board of Governors of the Federal Reserve System may prescribe regulations further defining within the limitations of this Act the conditions under which discounts, advancements, and the accommodations may be extended to member banks. Each Federal reserve bank shall keep itself informed of the general character and amount of the loans and investments of its member banks with a view to ascertaining whether undue use is being made of bank credit for the speculative carrying of or trading in securities, real estate, or commodities, or for any other purpose inconsistent with the maintenance of sound credit conditions; and, in determining whether to grant or refuse advances, rediscounts or other credit accommodations the Federal reserve bank shall give consideration to such information. The chairman of the Federal reserve bank shall report to the Board of Governors of the Federal Reserve System any such undue use of bank credit by any member bank, together with his recommendation. Whenever, in the judgment of the Board of Governors of the Federal Reserve System, any member bank is making such undue use of bank credit, the Board may, in its discretion, after reasonable notice and an opportunity for a hearing, suspend such bank from the use of the credit facilities of the Federal Reserve System and may terminate such suspension or may renew it from time to time.]

Federal Reserve Act, section 9, par. 13; 12 U.S.C. 330

Bank becoming members of the Federal Reserve System under authority of this section shall be subject to the provisions of this section and to those of this Act which relate specifically to member banks, but shall not subject to examination under the provisions of the first two paragraphs of section fifty-two hundred and forty of the Revised Statutes as amended by section twenty-one of this Act. Subject to the provisions of this Act and to the regulations of the board made pursuant thereto, any bank becoming a member of the Federal Reserve System shall retain its full character and statutory rights as a State bank or trust company, and may continue to exercise all corporate powers granted it by the State in which it was created, and shall be entitled to all privileges of member banks [; Provided, however, That no Federal reserve bank shall be permitted to discount for any State bank or trust company notes, drafts, or bills of exchange of any one borrower who is liable for borrowed money to such State bank or trust company in an amount greater than that which could be borrowed lawfully from such State bank or trust company were it a national banking association. The Federal reserve bank, as a condition of the discount of notes, drafts, and bills of exchange for such State bank or trust company, shall require a certificate or guaranty to the effect that the borrower is not liable to such bank in excess of the amount provided by this section, and will not be permitted to become liable in excess of this amount while such notes, drafts, or bills of exchange are under discount with the Federal reserve bank].

Federal Reserve Act, section 10(a) (entire) ; 12 U.S.C. 347a

Par. 1

【Upon receiving the consent of not less than five members of the Board of Governors of the Federal Reserve System, any Federal reserve bank may make advances, in such amount as the board of directors of such Federal reserve bank may determine, to groups of five or more member banks within its district, a majority of them independently owned and controlled, upon their time or demand promissory notes, provided the bank or banks which receive the proceeds of such advances as herein provided have no adequate amounts of eligible and acceptable assets available to enable such bank or banks to obtain sufficient credit accommodations from the Federal reserve bank through rediscounts or advances other than as provided in section 10(b). The liability of the individual banks in each group must be limited to such proportion of the total amount advanced to such group as to deposit liability of the respective banks bears to the aggregate deposit liability of all banks in such group, but such advances may be made to a lesser number of such member banks if the aggregate amount of their deposit liability constitutes at least 10 per centum of the entire deposit liability of the member banks within such district. Such banks shall be authorized to distribute the proceeds of such loans to such of their number and in such amount as they may agree upon, but before so doing they shall require such recipient banks to deposit with a suitable trustee, representing the entire group, their individual notes made in favor of the group protected by such collateral security as may be agreed upon. Any Federal reserve bank making such advance shall charge interest or discount thereon at a rate not less than 1 per centum above its discount rate in effect at the time of making such advance. No such note upon which advances are made by a Federal reserve bank under this section shall be eligible under section 16 of this Act as collateral security for Federal reserve notes.】

Par. 2

【No obligations of any foreign government, individual, partnership, association, or corporation organized under the laws thereof shall be eligible as collateral security for advances under this section.】

Par. 3

【Member banks are authorized to obligate themselves in accordance with the provisions of this section.】

Federal Reserve Act, section 10(b) ; 12 U.S.C. 347b

【Any Federal Reserve bank, under rules and regulations prescribed by the Board of Governors of the Federal Reserve System, may make advances to any member bank on its time or demand notes having maturities of not more than four months and which are secured to the satisfaction of such Federal Reserve bank. Each such note shall bear interest at a rate not less than one half of 1 per centum per annum higher than the highest discount rate in effect at such Federal Reserve bank on the date of such note.】

Federal Reserve Act, section 11, pars. 3, 4, and 13; 12 U.S.C. 248(b), (c), and (m)

Par. 3

【(b) To permit, or, on the affirmative vote of at least five members of the Board of Governors of the Federal Reserve System to require Federal reserve banks to rediscount the discounted paper of other Federal reserve banks at rates of interest to be fixed by the Board of Governors of the Federal Reserve System.】

Par. 4

(c) * * * The tax shall be paid by the Reserve bank, but the Reserve bank shall add an amount equal to said tax to the rates of the interest [and discount fixed by the Board of Governors of the Federal Reserve System] charged by the Reserve bank on advances under section 13A(a) of this Act.

Par. 13

(m) * * * The Board of Governors of the Federal Reserve System shall have power to direct any member bank to refrain from further increase of its loans secured by stock or bond collateral for any period up to one year under penalty

of suspension [of all rediscount privileges at] from the use of the credit facilities of the Federal [r] Reserve banks.

Federal Reserve Act, section 12, par. 2; 12 U.S.C. 262

The Federal Advisory Council shall have power, * * * (3) to call for information and to make recommendations in regard to [discount rates, rediscount business] advances under section 13A of this Act, rates of interest charged by the Federal Reserve banks on such advances, * * *.

Federal Reserve Act, section 13, pars. 2-6, 8, 10, and 13; 12 U.S.C. 343-347, 361, 347c

Par. 2; 12 U.S.C. 343

[Upon the endorsement of any of its member banks, which shall be deemed a waiver of demand, notice and protest by such bank as to its own endorsement exclusively, any Federal reserve bank may discount notes, drafts, and bills of exchange arising out of actual commercial transactions; that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes, the Board of Governors of the Federal Reserve System to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this Act. Nothing in this Act contained shall be construed to prohibit such notes, drafts, and bills of exchange, secured by staple agricultural products, or other goods, wares, or merchandise from being eligible for such discount, and the notes, drafts, and bills of exchange of factors issued as such making advances exclusively to producers of staple agricultural products in their raw state shall be eligible for such discount; but such definition shall not include notes, drafts, or bills covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States. Notes, drafts, and bills admitted to discount under the terms of this paragraph must have a maturity at the time of discount of not more than 90 days, exclusive of grace.]

Par. 3; 12 U.S.C. 343

[In unusual and exigent circumstances, the Board of Governors of the Federal Reserve System, by the affirmative vote of not less than five members, may authorize any Federal reserve bank, during such periods as the said board may determine, at rates established in accordance with the provisions of section 14, subdivision (d), of this Act, to discount for any individual, partnership, or corporation, notes, drafts, and bills of exchange of the kinds and maturities made eligible for discount for member banks under other provisions of this Act when such notes, drafts, and bills of exchange are endorsed or otherwise secured to the satisfaction of the Federal Reserve bank: Provided, That before discounting any such note, draft, or bill of exchange for an individual or a partnership or corporation the Federal reserve bank shall obtain evidence that such individual, partnership, or corporation is unable to secure adequate credit accommodations from other banking institutions. All such discounts for individuals, partnerships, or corporations shall be subject to such limitations, restrictions, and regulations as the Board of Governors of the Federal Reserve System may prescribe.]

Par. 4; 12 U.S.C. 344

[Upon the indorsement of any of its member banks, which shall be deemed a waiver of demand, notice, and protest by such bank as to its own indorsement exclusively, and subject to regulations and limitations to be prescribed by the Board of Governors of the Federal Reserve System, any Federal reserve bank may discount or purchase bills of exchange payable at sight or on demand which grow out of the domestic shipment or the exportation of nonperishable, readily marketable agricultural and other staples and are secured by bills of lading or other shipping documents conveying or securing title to such staples: Provided, That all such bills of exchange shall be forwarded promptly for collection, and demand for payment shall be made with reasonable promptness after the arrival of such staples at their destination: Provided further, That no such bill shall in any event be held by or for the account of a Federal reserve bank for a period in excess of ninety day. In discounting such bills Federal reserve banks may compute the interest to be deducted on the basis of the estimated life of each bill and adjust the discount after payment of such bills to conform to the actual life thereof.]

Par. 5; 12 U.S.C. 345

【The aggregate of notes, drafts, and bills upon which any person, copartnership, association, or corporation is liable as maker, acceptor, indorser, drawer, or guarantor, rediscounted for any member bank, shall at no time exceed the amount for which such person, copartnership, association, or corporation may lawfully become liable to a national banking association under the terms of section 5200 of the Revised Statutes, as amended: Provided, however, That nothing in this paragraph shall be construed to change the character or class of paper now eligible for rediscount by Federal reserve banks.】

Par. 6; 12 U.S.C. 346

【Any Federal reserve bank may discount acceptances of the kinds hereinafter described, which have a maturity at the time of discount of not more than 90 days' sight, exclusive of days of grace, and which are indorsed by at least one member bank: Provided, That such acceptances if drawn for an agricultural purpose and secured at the time of acceptance by warehouse receipts or other such documents conveying or securing title covering readily marketable staples may be discounted with a maturity at the time of discount of not more than six months' sight exclusive of days of grace.】

Par. 8; 12 U.S.C. 347

【Any Federal reserve bank may make advances for periods not exceeding fifteen days to its member banks on their promissory notes secured by the deposit or pledge of bonds, notes, certificates of indebtedness, or Treasury bills of the United States, or by the deposit or pledge of debentures or other such obligations of Federal intermediate credit banks which are eligible for purchase by Federal reserve banks under section 13(a) of this Act, or by the deposit or pledge of bonds issued under the provisions of subsection (e) of section 4 of the Home Owners' Loan Act of 1933, as amended, and any Federal reserve bank may make advances for periods not exceeding ninety days to its member banks on their promissory notes secured by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for rediscount or for purchase by Federal reserve banks under the provisions of this Act. All such advances shall be made at rates to be established by such Federal reserve banks, such rates to be subject to the review and determination of the Board of Governors of the Federal Reserve System. If any member bank to which any such advance has been made shall, during the life or continuance of such advance, and despite an official warning of the reserve bank of the district or of the Board of Governors of the Federal Reserve System to the contrary, increase its outstanding loans secured by collateral in the form of stocks, bonds, debentures, or other such obligations, or loans made to members of any organized stock exchange, investment house, or dealer in securities, upon any obligation, note, or bill, secured or unsecured, for the purpose of purchasing and/or carrying stocks, bonds, or other investment securities (except obligations of the United States) such advance shall be deemed immediately due and payable, and such member bank shall be ineligible as a borrower at the reserve bank of the district under the provisions of this paragraph for such period as the Board of Governors of the Federal Reserve System shall determine: Provided, That no temporary carrying or clearance loans made solely for the purpose of facilitating the purchase or delivery of securities offered for public subscription shall be included in the loans referred to in this paragraph.】

Par. 10; 12 U.S.C. 361

【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 Board of Governors of the Federal Reserve System.】

Par. 13; 12 U.S.C. 347c

【Subject to such limitations, restrictions and regulations as the Board of Governors of the Federal Reserve System may prescribe, any Federal reserve bank may make advances to any individual, partnership or corporation on the promissory notes of such individual, partnership or corporation secured by direct obligations of the United States. Such advances shall be made for periods not

exceeding 90 days and shall bear interest at rates fixed from time to time by the Federal reserve bank, subject to the review and determination of the Board of Governors of the Federal Reserve System.】

Federal Reserve Act, section 13a (entire)

Par. 1; 12 U.S.C. 348

【Upon the indorsement of any of its member banks, which shall be deemed a waiver of demand, notice, and protest by such bank as to its own indorsement exclusively, any Federal reserve bank may, subject to regulations and limitations to be prescribed by the Board of Governors of the Federal Reserve System, discount notes, drafts, and bills of exchange issued or drawn for an agricultural purpose, or based upon live stock, and having a maturity, at the time of discount, exclusive of days of grace, not exceeding nine months, and such notes, drafts, and bills of exchange may be offered as collateral security for the issuance of Federal reserve notes under the provisions of section 16 of this Act: Provided, That notes, drafts, and bills of exchange with maturities in excess of six months shall not be eligible as a basis for the issuance of Federal reserve notes unless secured by warehouse receipts or other such negotiable documents conveying or securing title to readily marketable staple agricultural products or by chattel mortgage upon live stock which is being fattened for market.】

Par. 2; 12 U.S.C. 349

【That any Federal reserve bank may, subject to regulations and limitations to be prescribed by the Board of Governors of the Federal Reserve System, rediscount such notes, drafts, and bills for any Federal Intermediate Credit Bank, except that no Federal reserve bank shall rediscount for a Federal Intermediate Credit Bank any such note or obligation which bears the indorsement of a non-member State bank or trust company which is eligible for membership in the Federal reserve system, in accordance with section 9 of this Act. Any Federal reserve bank may also, subject to regulations and limitations to be prescribed by the Board of Governors of the Federal Reserve System, discount notes payable to and bearing the indorsement of any Federal intermediate credit bank, covering loans or advances made by such bank pursuant to the provisions of section 202(a) of Title II of the Federal Farm Loan Act, as amended (U.S.C. title 12, ch. 8, sec. 1031), which have maturities at the time of discount of not more than nine months, exclusive of days of grace, and which are secured by notes, drafts, or bills of exchange eligible for rediscount by Federal Reserve banks.】

Par. 3; 12 U.S.C. 350

【Any Federal reserve bank may also buy and sell debentures and other such obligations issued by a Federal Intermediate Credit Bank or by a National Agricultural Credit Corporation, but only to the same extent as and subject to the same limitations as those upon which it may buy and sell bonds issued under Title I of the Federal Farm Loan Act.】

Par. 4; 12 U.S.C. 351

【Notes, drafts, bills of exchange or acceptances issued or drawn by cooperative marketing associations composed of producers of agricultural products shall be deemed to have been issued or drawn for an agricultural purpose, within the meaning of this section, if the proceeds thereof have been or are to be advanced by such association to any members thereof for an agricultural purpose, or have been or are to be used by such association in making payments to any members thereof on account of agricultural products delivered by such members to the association, or if such proceeds have been or are to be used by such association to meet expenditures incurred or to be incurred by the association in connection with the grading, processing, packing, preparation for market, or marketing of any agricultural product handled by such association for any of its members: Provided, That the express enumeration in this paragraph of certain classes of paper of cooperative marketing associations as eligible for rediscount shall not be construed as rendering ineligible any other class of paper of such associations which is now eligible for rediscount.】

Par. 5; 12 U.S.C. 352

【The Board of Governors of the Federal Reserve System may, by regulation, limit to a percentage of the assets of a Federal reserve bank the amount of notes, drafts, acceptances, or bills having a maturity in excess of three months, but not

exceeding six months, exclusive of days of grace, which may be discounted by such bank, and the amount of notes, drafts, bills, or acceptances having a maturity in excess of six months, but not exceeding nine months, which may be rediscounted by such bank.】

Federal Reserve Act, section 13A (new)

Sec. 13A. (a) Any Federal Reserve bank may make advances to any of its member banks on the time or demand notes of such banks secured to the satisfaction of such Federal Reserve bank, subject to such limitations, restrictions, and regulations as the Board of Governors of the Federal Reserve System may prescribe.

(b) In making advances pursuant to this section, each Federal Reserve bank shall give due regard to the maintenance of sound credit conditions, and the accommodation of commerce, industry and agriculture. Each Federal Reserve bank shall keep itself informed of the general character and amount of the loans and investments of its member banks with a view to ascertaining whether undue or inappropriate use is being made of bank credit for the speculative carrying of or trading in securities, real estate, or commodities, or for any other purpose inconsistent with the maintenance of sound credit conditions; and, in determining whether to grant or refuse advances, the Federal Reserve bank shall give consideration to such information. Whenever the Board of Governors of the Federal Reserve System, in the light of any reports made to it by a Federal Reserve bank, determines that any member bank is making such undue or inappropriate use of bank credit, the Board may, in its discretion, after reasonable notice and an opportunity for a hearing, suspend such bank from the use of the credit facilities of the Federal Reserve System and may terminate such suspension or may renew it from time to time.

(c) Any Federal Reserve bank may make advances to any individual, partnership, or corporation, on its promissory notes, secured by direct obligations of the United States, subject to such limitations, restrictions, and regulations as the Board of Governors of the Federal Reserve System may prescribe.

Federal Reserve Act, section 14

Par. 1; 12 U.S.C. 353

Any Federal [r]Reserve bank may, [under rules and] subject to the regulations [prescribed by the Board of Governors] of the Federal [Reserve System] Open Market Committee, 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.

Par. 4; 12 U.S.C. 356

To purchase from member banks and to sell, with or without its endorsement, bills of exchange [arising out of commercial transactions, as hereinbefore defined];

Par. 5; 12 U.S.C. 357

(d) To establish from time to time, subject to review and determination of the Board of Governors of the Federal Reserve System, (1) rates of [discount] interest to be charged by the Federal [r]Reserve bank [for each class of paper] on advances under section 13A (a) of this Act, which shall be fixed with a view of accommodating commerce [and], business, and agriculture, and of maintaining sound credit conditions; and different rates may be fixed for different classes of paper or according to such other basis or bases as may be deemed necessary in order to accomplish such purposes; but each such bank shall establish such rates every fourteen days, or oftener if deemed necessary by the Board; and (2) rates of interest to be charged by the Federal Reserve bank on advances under section 13A (c) of this Act;

Federal Reserve Act, section 16, par. 2; 12 U.S.C. 412

* * * The collateral security thus offered shall be notes [, drafts, bills of exchange, or acceptances] of member banks or others acquired under the provisions of section [13] 13A of this Act, or bills of exchange [endorsed by a member bank of any Federal Reserve district and purchased under the provisions of section 14 of this Act,] or banker's acceptances purchased under [the provision of said] section 14 of this Act, or gold certificates, or direct obligations of the United States. * * *

Federal Reserve Act, section 19, par. 9; 12 U.S.C. 463, 374

* * * No member bank shall act as the medium or agent of a nonmember bank in applying for or receiving [discounts] advances from a Federal reserve bank under the provisions of this Act, except by permission of the Board of Governors of the Federal Reserve System.

Federal Reserve Act, section 23A, par. 2; 12 U.S.C. 371c

* * * Provided, That the provisions of this paragraph shall not apply to loans or extensions of credit secured by obligations of the United States Government, . . . or by such notes, [drafts,] bills of exchange or bankers' acceptances as are eligible [for rediscount or] for purchase by Federal reserve banks. * * *

Federal Reserve Act, section 24, par. 3; 12 U.S.C. 371

* * * [Notes representing loans made under this section to finance the construction of residential or farm buildings and having maturities of not to exceed nine months shall be eligible for discount as commercial paper within the terms of the second paragraph of section 13 of this Act if accompanied by a valid and binding agreement to advance the full amount of the loan upon this completion of the building entered into by an individual, partnership, association, or corporation acceptable to the discounting bank.]

Act of July 21, 1932, Sec. 201(c) (12 U.S.C. 1148)

* * * Such corporations* are hereby authorized . . . to rediscount with the Farm Credit Administration and the [various Federal reserve banks and] Federal intermediate credit banks any paper that they acquire which is eligible for such purpose.

FEDERAL DEPOSIT INSURANCE CORPORATION,
Washington, March 13, 1967.

HON. JOHN SPARKMAN,
Chairman, Committee on Banking and Currency, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: You have requested the views of this Corporation on S. 966, 90th Congress, a bill to amend the Federal Reserve Act in order to enable the Federal Reserve banks to extend credit to member banks and others in accordance with current economic conditions, and for other purposes.

Under present law, only United States Government obligations and short-term, self-liquidating commercial or agricultural loans are eligible as security against advances obtained at regular discount rates from Federal Reserve banks by member banks. Federal Reserve banks are also authorized to make advances to member banks on any security satisfactory to the Reserve banks, but at "penalty" rates of interest of one-half of one percent above the regular discount rate. S. 966 would insert a new section 13A in the Federal Reserve Act which would authorize any Federal Reserve bank to make advances to any of its member banks on any satisfactory security, subject to such limitations, restrictions, and regulations as the Board of Governors of the Federal Reserve System may prescribe, without charging "penalty" rates of interest. In making such advances, a Federal Reserve bank would be required to give due regard to the "maintenance of sound credit conditions and the accommodation of commerce, industry, and agriculture" and to keep itself informed as to the character and amount of the loans and investments of its member banks, with a view to determining whether undue or inappropriate use is being made of bank credit for purposes inconsistent with the maintenance of sound credit conditions. These provisions of the bill would replace present requirements of the Federal Reserve Act relating to the "eligibility" of paper for discount or as security for advances by Federal Reserve banks and would, in effect, make such recently expanding loans as consumer loans on automobiles and other durables, long-term farm equipment loans, term loans to businesses, and perhaps other types of loans eligible as security against borrowings at regular discount rates.

In addition to advances to member banks, Federal Reserve banks would be authorized under the provisions of the proposed section 13A(c) of the Federal Reserve Act to make advances of individuals, partnerships, and corporations on the security of obligations of the United States. Similar authority is now con-

*Regional agricultural credit corporations.

tained in section 13 of the Federal Reserve Act, but with maturity and interest rate limitations.

Banks are continually developing new credit instruments to meet the demands of businessmen and consumers. These are, for the most part, represented by sound assets and could as safely serve as security for member bank borrowings as so-called "eligible" paper. The enactment of S. 966 would provide the credit system with much needed flexibility and would enable the Federal Reserve System to function more effectively.

As originally conceived in the Federal Reserve Act, "eligible" paper had to be "self-liquidating," short-term paper; that is, it had to be based on loans which would automatically generate funds for repayment. It was reasoned that paper originating from current short-term transactions would rise and fall with business. Consequently, it could never be superfluous nor create inflationary pressures. This concept is unrealistic today. First, there is no connection between the character of the paper offered for discount and the use to which the banks put the credit. Member banks generally borrow to build up their reserves, and they use the reserves in varying patterns. In the second place, this theory disregards the fact that banks can expand loans at a multiple rate on the basis of any Federal Reserve credit. Thus, funds obtained by discounts or borrowings can be used to multiply credit to several times the value of the discounts and in loans of perhaps an entirely different character from the original paper.

Section 2 of the Act of February 27, 1932, ch. 58 (47 Stat. 56) authorized a temporary departure from the original concept by providing that all sound securities and loans in a bank's portfolio were acceptable as security against borrowings, though, except for United States Government securities and "eligible" paper, at "penalty" rates of interest. This provision was made permanent by section 204 of the Banking Act of 1935 (12 U.S.C. 347b). The term "eligible" as used in present law has thus lost its real significance. Advances to member banks may be made on any security satisfactory to the Reserve banks. The higher interest rate charge is the only distinction between "eligible" and "ineligible" paper. There is no real justification for placing penalty rates on certain types of assets vis-a-vis other types. Emphasis should be placed on the soundness of the paper and the purpose of the member bank's borrowing, not on whether the paper meets an outmoded "eligible" classification.

Other changes in the pattern of banking and bank policy since enactment of the original Federal Reserve Act have made the existing law on "eligible" paper both somewhat redundant and unnecessarily restrictive. The stepped-up reliance on open market operations in the 1920's and the granting to the Board of Governors of the Federal Reserve System of discretionary power to change member bank reserve requirement percentages, temporarily by section 46 of the Emergency Farm Mortgage Act of 1933 (48 Stat. 54) and permanently by section 207 of the Banking Act of 1935, as amended (12 U.S.C. 462b), have combined to diminish the relative importance of discounts and advances as a tool of monetary policy. Thus, to rely on a restrictive definition of eligible paper for discounts and advances appears to be an outmoded requirement of monetary policy.

Another advantage to the banks of extending the regular discount and advance privileges to all sound assets would be the elimination of the tedious burden of reviewing portfolios to determine what is, and what is not, eligible. The distinction is meaningless in today's credit patterns and policies, and this Corporation favors its elimination by the enactment of S. 966.

The Bureau of the Budget has advised that enactment of this legislation would be consistent with the Administration's program.

Sincerely yours,

K. A. RANDALL, *Chairman*.

THE GENERAL COUNSEL OF THE TREASURY,
Washington, D.C., March 13, 1967.

HON. JOHN SPARKMAN,
Chairman, Committee on Banking and Currency,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Reference is made to your request for the views of this Department on S. 966, "To amend the Federal Reserve Act in order to enable the Federal Reserve banks to extend credit to member banks and others in accordance with current economic conditions, and for other purposes."

The purpose of the proposed legislation is to boarden substantially the kinds of security on which the Federal Reserve Banks may extend credit. Such liberalization of existing eligibility requirements, in the judgment of this Department, is highly desirable inasmuch as it will assure the continuing capacity of the Federal Reserve to discharge effectively its responsibility for providing credit to its member banks in timely fashion and adequate amounts. Retention of the present restrictive eligibility requirements not only might inhibit the ability of the Federal Reserve to lend to its members freely in time of need, but also could potentially create a growing impediment in the flexible distribution of bank credit among competing uses.

S. 966 would provide the Federal Reserve Banks, subject to such limitations, restrictions, and regulations as the Board of Governors may prescribe, with broad authority to make advances to member banks secured by any collateral satisfactory to it. This would, in turn, permit elimination of existing outmoded and restrictive eligibility requirements. Appropriately administered in the manner suggested by the Federal Reserve, these provisions of the proposed legislation would appear to achieve fully the purposes sought, with which the Treasury is in agreement.

The objective of liberalizing these requirements, thus protecting the ability of the Federal Reserve to discharge effectively its function of lending to its member banks in accordance with the needs of the economy and enhancing the flexible distribution of bank credit among competing uses, is clearly in the public interest. The Treasury Department strongly urges affirmative action in this respect.

The Department has been advised by the Bureau of the Budget that there is no objection from the standpoint of the Administration's program to the submission of this report to your Committee.

Sincerely yours,

FRED B. SMITH,
General Counsel.

INDEPENDENT BANKERS ASSOCIATION OF AMERICA,
Washington, D.C., March 15, 1967.

Senator WILLIAM PROXMIRE,
Chairman, Subcommittee on Financial Institutions of the Senate Banking and Currency Committee, New Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: The Independent Bankers Association of America, as the representative of some 6500 member community banks, takes this opportunity to record its support for S. 714, S. 965 and S. 966, which are the subject of hearings before the Subcommittee on Financial Institutions of the Senate Committee on Banking and Currency.

S. 965, intended to facilitate Federal Reserve System operations in foreign currencies by permitting investment of such currencies in the obligations of foreign governments, and S. 966, intended to modernize the laws and requirements relating to borrowings by member banks from the Federal Reserve Banks, are companion measures that are identical with bills passed by the Senate in the 89th Congress.

S. 714, to expand the limits for loans by member banks to their executive officers, on terms not more favorable than those extended to other borrowers, was likewise passed by the Senate in 1965.

We are confident that these measures have the support of the banking community, the business community, and are in accord with the sound business practices of the day and times. S. 966 was specifically the subject of reexamination by our Federal Legislative Committee, at our recent convention in New Orleans, and was specifically approved. We believe the amending language to the Federal Reserve Act update the lending authority of the Reserve banks in keeping with modern banking practices.

Our Association has given previous approval, by action of our Federal Legislative Committee, and in statements filed with your Committee, to the objectives of S. 714 and S. 965, as considered in previous legislative proposals. With regard to S. 714, we confine our comment to Section 1, of Section 22(g) of the Federal Reserve Act, to increase the present \$2,500 limitation on loans to executive officers of Fed member banks to \$5,000, and authorize home mortgage

loans to officers up to \$30,000. This is in line with current provisions of FHA-insured mortgages.

We do not comment on Section 2 in this bill, which modifies loan provisions of the Federal Credit Union Act.

Sincerely and respectfully,

STANLEY R. BARBER,
President.

Senator PROXMIRE. The subcommittee will recess.

(Whereupon, at 10:30 a.m., the subcommittee recessed subject to the call of the Chair.)

