

A meeting of the Executive Committee of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Wednesday, June 24, 1936, at 9:45 a.m.

PRESENT: Mr. Eccles, Chairman
Mr. Szymczak
Mr. Broderick (as alternate for Mr. Ransom)
Mr. Harrison
Mr. Fleming

Mr. Morrill, Secretary
Mr. Wyatt, General Counsel
Mr. Goldenweiser, Economist
Mr. Williams, Associate Economist
Mr. Burgess, Manager of the System
Open Market Account

Chairman Eccles stated that the meeting had been called for the purpose of determining the precise method by which transfers of Government securities held in separate investment accounts of Federal reserve banks to the system open market account and the reallocation of the securities held in that account should be accomplished in order to carry out the resolution adopted by the Federal Open Market Committee on May 25, 1936. The developments which had taken place since that meeting were outlined. In attempting to formulate a plan for carrying out the resolution problems had arisen which were not easy of solution and in order to allow more time for their consideration the members of the Federal Open Market Committee who had participated in the action of May 25 had approved a suggestion that the effective date of the transfers and reallocation be deferred from June 15 to June 23. It then became apparent that it would not be possible to clear up all of the questions in this period and that it would be desirable for the executive committee

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to meet for the purpose of discussing them. Therefore the members of the full committee had agreed to a further extension until June 30. The results of a preliminary study of possible methods of carrying into effect the committee's resolution were set forth in a memorandum dated June 15, 1936, entitled "Plan for Reallocation of Government Securities among Reserve Banks" which summarized the action of the full committee on May 25 as follows:

"The action of the committee on May 25 provides for:

- (a) Purchase of individual holdings of Federal reserve banks by the system account at market prices.
- (b) Reallocation of securities within the account following past practice,—that is, effecting transfers at book values and basing allotments on requirements of the several banks for expenses, dividends and charge-offs.
- (c) Continuing past practice as set up in 1929 for holding realized profits in suspense account until end of the year and then distributing them in proportion to each bank's average holding in the account during the year."

The memorandum contained a recommendation that realized profits should be used in the future to write down the book value of securities in the account but pointed out that action on this recommendation could be taken later without affecting the operations necessary to carry out the plan of reallocation.

Among other things in the memorandum attention was directed to the fact that Mr. Roy A. Young, President of the Federal Reserve Bank of Boston, in a letter dated June 8, 1936, which was attached to the memorandum, had suggested that all holdings in the system account as well

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as in the individual accounts be valued at market, that the resulting appreciation, together with profits from actual sales in the pool as of June 15 be distributed, and that such appreciation and profits be set up as a special reserve by each bank. Mr. Young stated that this would result in marking up the figures for total holdings by about \$40,000,000 with corresponding reserves. In addition, there was submitted with the memorandum a copy of a "proposal made by Governor Harrison at the Governors' Conference held in December, 1929, to change method of profit and loss accounting in connection with system open market investment account transactions", which was adopted by the Open Market Committee in December, 1929, and followed by the Committee since that time, under which all securities were transferred between reserve banks at book values and any profits or losses were held in suspense account until the close of each year. There were also attached to the memorandum of June 15 a tabulation entitled "Government security holdings of individual Federal reserve banks as reported to the executive committee of the system open market account close of business June 10, 1936" and a "Plan for reallocation of United States Government securities in system open market account following transfer to system open market account on June 23, 1936, of United States Government securities held in investment accounts of Federal reserve banks".

After an analysis of the suggestion made by Mr. Young, it was proposed in the memorandum of June 15 that in carrying out the resolution of the Federal Open Market Committee of May 25 the Government securities in the system account be distributed among the reserve banks

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in the first instance in such amounts to each bank as might be necessary to meet estimated expenses, normal depreciation allowances and fixed charges, after allowance for current earnings from other sources (excluding non-recurring profits from the sale of Government securities); and that the balance of the securities remaining after this distribution be distributed on the basis of each bank's dividend requirements, this plan having the effect of equalizing current income of each bank available for the purpose of paying dividends. The plan further contemplated that, if any balance remained over the amount needed to meet the estimated requirements for expenses, depreciation allowance, fixed charges and dividends, such excess should be distributed on the basis of estimates of unusual charge-offs.

The executive committee was advised that this recommendation had been brought to the attention of the members of the full committee who participated in the action of May 25 and that it had received their informal approval. In addition, copies of the memorandum and the attachments above described had been submitted under confidential covers to the Presidents of all the Federal reserve banks (except that in the case of Minneapolis the material was sent to Vice President Ziemer because of the absence of Mr. Peyton and the fact that Mr. Ziemer had attended the Presidents' Conference on May 26) and that advices had been received that all of them agreed in principle with the proposed plan, except Mr. Young, who adhered to his previous position. President Sinclair of the Federal Reserve Bank of Philadelphia informally directed attention to the fact that the proposed plan apparently would result

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in an increase in the participation of the Federal Reserve Bank of Philadelphia by approximately \$60,000,000, this increase being in large part due to the fact that the results of operations of the Federal Reserve Bank of Philadelphia for the first six months of the calendar year 1936 would indicate a deficit of approximately \$132,000. It appeared that Mr. Sinclair did not object to the general principles of the proposed plan, but that his bank would be opposed to such a large increase in its holdings. President Newton, of Atlanta, in expressing accord with the proposed plan, called attention to the fact that the operation of the plan would result apparently in a reduction of the participation of the Federal Reserve Bank of Atlanta to approximately \$95,517,000, whereas the bank desired to be allowed to retain a participation equal to its interest at that time, namely \$100,209,000. It appeared also that the Federal Reserve Bank of Kansas City, while approving the plan, would like a larger participation than that provided. In these circumstances the plan had been restudied and the executive committee was advised that the suggestion had been made that, as the necessary transfers and reallocations would not be made before June 30, the actual results of operation of the Federal reserve banks for the first six months of the calendar year 1936 be disregarded and the prospective earnings and expenses of each bank for the remainder of the year be used as a basis of calculation. This modification of the plan, it was pointed out, would result in an increase for the Federal Reserve Bank of Philadelphia of approximately only \$54,000,000 instead of \$60,000,000 and would change the allotments of other Federal reserve banks to the extent necessary

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to absorb the difference, thus tending also to meet to a large extent the desire which had been expressed on behalf of the Atlanta bank for an increased participation. In this connection, it was pointed out that the first plan proposed would have necessitated a substantial readjustment at the end of the year on the basis of the current rate of earnings and expenses, whereas the revised plan would probably result in very few or relatively minor adjustments from time to time.

At this point Mr. Smead, Chief of the Division of Bank Operations of the Board of Governors of the Federal Reserve System, entered the meeting. Mr. Burgess then distributed a tabulation designated "Plan No. 2", which would show how the modified proposal would operate.

Chairman Eccles reported that he had talked to President Young on the previous day regarding his objection to the plan and had told him about the call for the meeting of the executive committee and invited him to come to the meeting for the purpose of discussing the matter if he wished, but that Mr. Young had a bad cold which had confined him to his home and felt that he could not safely make the trip. The Chairman said that President Young had pointed out that under the resolution of the Federal Open Market Committee the individual holdings of certain Federal reserve banks would be transferred to the system account at market value whereas the reallocation which would be effected among the Federal reserve banks of the total holdings in the system account would be on the basis of their book values and that he felt that this would not be fair to all the banks. The Chairman added that he had pointed out to President Young the practical differences between the situation

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growing out of the conditions under which the individual Federal reserve banks had acquired their present holdings which would be transferred to the system account and the conditions under which the system account had reached its present status on the basis of the formula which had been observed by the open market committee for a number of years past. In this connection President Harrison observed that all the other Federal reserve banks had had an opportunity to participate with New York from time to time in the purchases which the latter bank had made in the past and that the extent of their investments represented their voluntary action.

It was also pointed out that to write up the carrying value of the Government securities in the system account to current market value would result in a very large apparent book profit which would have to be carried in the bond premium account and very likely would never be realized, that this would represent a departure from sound banking principles, and that moreover it would result in great practical difficulty in the future operation of the account in the endeavor to keep the carrying values adjusted to current market values whenever changes were made in allotments among the Federal reserve banks.

In the further discussion of the plan it was suggested that it should be made clear that at the end of each quarter in the future, beginning with the first quarter ending September 30, if it should be found as a result of the actual results of the operations of the Federal reserve banks for such quarter that a material change would be necessary

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in the allotments in order to equalize the earnings of the Federal reserve banks, the necessary adjustment should be made at that time and likewise at the end of each succeeding quarter. It was agreed unanimously that this suggestion should be followed.

Mr. Burgess called attention to the necessity under the resolution of the full committee of effecting the transfers and reallocations on the basis of the market values of the same day and suggested that the prices at 11:00 a.m. on the New York market be used for this purpose. This suggestion was approved unanimously.

The Chairman then brought up the question of the desirability of making available to the public some explanation of the changes that would result in the figures as to the holdings of individual Federal reserve banks as they would appear in the statements of condition of the banks as of June 30, and approval was given to a paragraph which had been proposed for inclusion in the published statement of condition to be issued by the Board of Governors as of June 30 as follows:

"Changes for the week in the holdings of Government securities of individual Federal reserve banks resulted from the transfer of all Government securities previously held in the separate investment accounts of these banks to the system open market account and the reallocation of participations in this account among the Federal reserve banks. Total holdings of Government securities of the Federal reserve banks remain unchanged."

A discussion then took place as to the procedure for advising the Federal reserve banks of the proposed Plan No. 2 and for its adoption in order to put it into effect on June 30. The view was expressed for

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various reasons discussed by the Committee that it would be desirable to ascertain not only that the members of the Federal Open Market Committee in addition to those participating in the meeting of the executive committee approved the plan but also that it would not meet with objection on the part of any of the Federal reserve banks, particularly the Federal Reserve Bank of Boston, in view of the position which had been taken by President Young.

A recess was taken at 12:40 and the meeting reconvened at 2:50 p.m.

The discussion of the procedure for putting the plan into effect was resumed and upon motion of Mr. Harrison it was voted unanimously, as the committee had been advised of the approval in principle by eleven of the Federal reserve banks of the plan for reallocation of Government securities held in the system open market account on the basis of the book values, to recommend to the members of the Federal Open Market Committee the approval of "Plan No. 2", to take effect on June 30 provided that prior to putting it into effect all Federal reserve banks were advised of the plan and that following such advice no objection was filed by the Federal Reserve Bank of Boston.

The executive committee, upon motion of Mr. Harrison, authorized the Secretary, upon the approval of the plan by the members of the full committee, to send to each Federal reserve bank a letter to be agreed upon by Messrs. Burgess, Smead and Morrill. The letter thus agreed upon was as follows:

"The Executive Committee of the Federal Open Market Committee met on June 24 to give further consideration to the precise methods for carrying into effect the resolution adopted by the Federal Open Market Committee on May 25, 1936, with respect to transferring to the System account the Government security holdings of individual Reserve Banks and re-allocating participations in the System account.

"After consideration of the comments made by the several Federal Reserve Banks upon the proposals submitted with my letter of June 17, the Executive Committee has agreed that they should be modified in the direction of a somewhat smaller general readjustment of participations between the Reserve Banks at this time, and that the adjustments that are made now should be for the purpose of equalizing the earnings position of the Reserve Banks for the future, without any attempt to compensate for inequalities which may have resulted from operations during the first six months of this year. The plan also contemplates that each bank's participation in the System account will be adjusted quarterly to the extent necessary to meet earning requirements. Otherwise the plan is the same as that outlined in the memorandum enclosed with my letter of June 17.

"The modified plan has been approved by the members of the Open Market Committee, and it is proposed that the plan be put into operation on June 30, 1936.

"The adjustments required by this proposal and the method of computation are shown in the attached table.

"As stated in the previous memorandum, it is the view of the Executive Committee that realized profits should be used in the future to write down the book value of securities in the account, but action upon this point can be deferred until a later time when there has been further opportunity to discuss the question."

The executive committee approved the minutes of the two meetings held by the executive committee on May 25 and the meeting held by the executive committee on May 27.

The executive committee also ratified and confirmed the transactions on behalf of the system open market account as set forth in the

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weekly reports which had been submitted to all members of the committee by Mr. Burgess.

The executive committee then adjourned at 4:50 p.m.

Charles Moriel
Secretary.

Approved:

W. H. ...
Chairman.