

# Operation of the National and Federal Reserve Banking Systems

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## HEARINGS

BEFORE A

SUBCOMMITTEE OF THE  
COMMITTEE ON BANKING AND CURRENCY  
UNITED STATES SENATE

SEVENTY-FIRST CONGRESS

THIRD SESSION

PURSUANT TO

### S. Res. 71

A RESOLUTION TO MAKE A COMPLETE SURVEY OF THE  
NATIONAL AND FEDERAL RESERVE  
BANKING SYSTEMS

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#### PART 1

JANUARY 19, 20, 22, 23, 26, 29, AND 30, 1931

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# OPERATION OF THE NATIONAL AND FEDERAL RESERVE BANKING SYSTEMS

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MONDAY, JANUARY 19, 1931

UNITED STATES SENATE,  
COMMITTEE ON BANKING AND CURRENCY,  
*Washington, D. C.*

The subcommittee met, pursuant to call of the chairman at the room of the Committee on Banking and Currency, Senate Office Building, at 10.30 o'clock a. m., Senator Carter Glass (chairman) presiding.

Present: Senators Norbeck, Townsend, Walcott, and Bulkley; also present, Senators Wagner and Brookhart, and H. P. Willis, special counsel of the committee.

The CHAIRMAN. The committee will come to order. As a matter for the record, I may state that this subcommittee is proceeding under Senate Resolution 71, which I will hand to the stenographer to be inserted in the record of the proceedings.

As will be noted, it gives the committee complete authority to inquire into the banking situation of the country and the committee is authorized and directed to inquire specifically into the administration of the Federal Reserve and National banking systems with respect to the use of their facilities for trading in and carrying speculative securities; the extent of call loans to brokers by member banks for such purposes; the effect on the systems of the formation of investment and security trusts; the desirability of chain banking; the development of branch banking as a part of the national system, together with any related problems which the committee may think it important to investigate.

(The resolution in full is as follows:)

## RESOLUTION

*Resolved*, That in order to provide for a more effective operation of the national and Federal reserve banking systems of the country the Committee on Banking and Currency of the Senate, or a duly authorized subcommittee thereof, be, and is hereby, empowered and directed to make a complete survey of the systems and a full compilation of the essential facts and to report the result of its findings as soon as practicable, together with such recommendations for legislation as the committee deems advisable. The inquiry thus authorized and directed is to comprehend specifically the administration of these banking systems with respect to the use of their facilities for trading in and carrying speculative securities; the extent of call loans to brokers by member banks for such purposes; the effect on the systems of the formation of investment and security trusts; the desirability of chain banking; the development of branch banking as a part of the national system, together with any related problems which the committee may think it important to investigate.

For the purpose of this resolution the committee, or any duly authorized subcommittee thereof, is authorized to hold hearings, to sit and act at such times and places during the sessions and recesses of the Seventy-first and succeeding Congresses until the final report is submitted, to employ such clerical and other assistants, to require by subpoena or otherwise the attendance of such witnesses and the production of such books, papers, and documents, to administer such oaths, and to take such testimony, and make such expenditures as it deems advisable. The cost of stenographic services to report such hearings shall not be in excess of 25 cents per hundred words. The expenses of the committee, which shall not exceed \$15,000, shall be paid from the contingent fund of the Senate upon vouchers approved by the chairman.

The CHAIRMAN. I may state that, as a matter of procedure, it had been arranged that we should begin at the top of the Federal reserve system and first hear Mr. Eugene Meyer, who has been nominated and reported to the Senate for membership on the Federal Reserve Board, and is now acting as governor of the Federal Reserve Board; but, upon consultation, it is the consensus of opinion of the committee that for obvious reasons we would better defer the examination of Mr. Meyer to a later date and begin the hearings by asking the Comptroller of the Currency, Mr. Pole, to let us hear from him with a general statement, if you please, Mr. Comptroller.

Mr. POLE. Yes, sir.

The CHAIRMAN. With a general statement of the present situation of banking matters and what, if any, suggestions you have to offer for the modification of either the Federal reserve act or of the national banking act to meet the situation, and to prevent, if it may be done by legislation, a recurrence of what some of us regard as a very perilous situation at this time.

We shall be glad to have you proceed in your own way, and reserve to ourselves the privilege of propounding questions when you shall have made your statement.

#### **STATEMENT OF HON. J. W. POLE, COMPTROLLER OF THE CURRENCY**

Mr. POLE. Mr. Chairman, I have prepared a brief statement which I should like to give to the committee.

The CHAIRMAN. Very well.

Mr. POLE. Mr. Chairman, I have heretofore, in my annual report to Congress for 1929, in my appearance before the House Committee on Banking and Currency and in my annual report to Congress for the year 1930, made statements and recommendations with reference to new banking legislation. These documents are available to your committee and I shall not at this time engage in a repetition other than to attempt briefly to summarize the position I have taken.

This can be stated under two heads: First, branch banking emanating from commercial centers should be permitted gradually to be established in the rural communities in order to give to them the benefits of the best type of banking we have developed, and, second, that the question is national in scope and Congress alone has the power to make effective a policy which will put this type of branch banking into effect.

I have already presented to Congress considerable information on bank failures in the agricultural communities and I have cited as a fundamental cause for these failures the great changes which have occurred, economic and social, within the past quarter of a century,

which make it extremely difficult, if not impossible, for a unit bank in a small agricultural community to meet the fundamental requirement of banking, namely, a diversification in its business. Good management is of little avail in the absence of a sufficient volume and diversification of local business.

Much of the business which once went to the local bank now goes to the large bank in the nearest city. The local bank does not have access to the most important business originating in its local territory. This is true both of corporate enterprises and of individual persons of considerable means. While many small country banks are still strong and may continue in operation for many years to come, I see no future for this type of banking as a system of banking and in my opinion, it is unjust to the rural communities to subject them to the hazards of a banking policy which permits this condition to exist. More than 6,000 bank failures, nearly all in the agricultural communities, during the past 10 years is sufficient to indicate the existence of some fundamental adverse condition.

On the other hand, we have developed in the large commercial centers a type of banking which is fundamentally strong and efficient. They hold the bulk of the banking resources of the country and they are the real support of the Federal reserve system. They have not only developed a wide diversification of banking business within the cities in which they are located but they have an active business in the entire geographical area in the rural communities within the circumference of the trade zone or trade influence of such a city. It is for this reason that I have recommended that banks of this type be authorized to establish branches within the regional trade area of the city in which they are situated. Many inhabitants of rural communities are now dealing directly with these banks or with branches of them but this is a cause of inconvenience. Would it not be a sounder policy to permit the best type of banks we have to establish branches in the surrounding local communities in order that these outlying populations may enjoy the same safety and the same variety of banking facilities which they could obtain by making a journey to the city? Under this theory these branches would no doubt be established through business negotiations between the local bank and the city bank through the ordinary processes of merger or purchase.

It is recognized that Congress can enlarge the charter powers only of the national banks. In the present situation, it seems to me that a positive declaration of a national policy for the further extension of branch banking is essential. I have, therefore, predicated my recommendations for trade area branch banking upon the theory that it is necessary to disregard State boundary lines with respect to the trade areas of many cities just as it was necessary to disregard State boundary lines in many cases when the Federal reserve districts were established. I see no relief to be gained from branch banking for the rural communities unless Congress is willing to permit the national banks in the commercial centers to establish branches in the trade area of the city, notwithstanding the fact that such trade areas of some cities may embrace territory in more than one State and that the States in question have no similar branch banking laws. Congress could not, of course, give to the large city

State banks and trust companies in commercial centers a similar authority to establish branches, but a way would be open for such banks to convert into national banks for the purpose of gaining these branch banking privileges if it carried with it an operating advantage sufficient to justify such action. Many national banks have taken out State charters for the reason that the State law gave them operating advantages of much less importance over the national law.

The year 1930 has been one of great economic depression. It has had its effect upon the city banks, but not to any serious extent. There have been a few failures of city banks of considerable size, but these may be regarded as exceptional. On the other hand, the failures of small country banks have been continuous throughout the postwar period. The failure of a large city bank in every case may be traced to some specific abnormal situation, whereas in the case of country bank failures there is evidence of a general breakdown in that system of banking, which calls for positive remedial action.

May I take this occasion to offer to your committee the full cooperation of my office with respect to any information which it may possess or be able to obtain.

The CHAIRMAN. Mr. Comptroller, to begin at the beginning, it has been periodically suggested that the office of the Comptroller of the Currency be abolished and its functions transferred to the Federal Reserve Board, and the reason given for such a suggestion is that there is a large duplication of functions. Do you concur in that belief that there is a large duplication of functions?

Mr. POLE. I do not see, Mr. Chairman, that there is any duplication of functions. If the comptroller's office were attached to the Federal Reserve Board, they would necessarily have to designate somebody to take charge of the comptroller's duties, and while the Federal Reserve Board has the right, and does make examinations of banks from time to time, I think that the board is generally perfectly willing to rely upon the reports of the comptroller's office and indeed of the State superintendents of banks, and where they are not they have the right to make their own examinations. Moreover, the Federal Reserve Board is a deliberative body, whereas the functions of the comptroller are primarily executive.

The CHAIRMAN. Right upon that point: Can you tell the committee what, if anything, is the matter with the examination system of the comptroller's office or/and of the Federal Reserve Board, and have you any suggestions to make to the committee with respect to a modification of either the Federal reserve act or the national bank act concerning bank examinations?

Mr. POLE. The examinations of the comptroller's office, as time has gone on, have gradually been improved until to-day I think they are about as complete as can be made. The one weakness, perhaps, is the fact that notwithstanding an examination may develop certain practices in banks which are objectionable, we have very little beyond moral suasion to enable us to correct those conditions except for direct violations of law, as distinguished from bad practices which may eventually bring the bank into trouble. But there are two things: In the case of violation of law, we may

request the Attorney General to bring suit for forfeiture of charter. However, in most instances, the punishment is out of all proportion to the offense. In cases of bad practices, we can put the banks on the list for frequent examinations—examine them as frequently as we feel necessary—and usually that is a question of making bad matters worse. So that we have often thought that under a proper arrangement, if the comptroller's office had the right to recommend to a board such as the Secretary of the Treasury and the Comptroller of the Currency and the governor of the Federal reserve bank in the district in which the bank might be located or, in fact, the Federal Reserve Board, for that matter—has the right to remove officers of the bank, I doubt whether it would be very necessary ever to put that into practice. I think the mere fact it was on the statute book would be a deterrent which would be very valuable and enable us to be more effective in certain cases than we are now.

The CHAIRMAN. I had long labored under the impression that the powers of the Comptroller of the Currency were rather autocratic and he had a right to summon the board of directors of any national bank and require the board to correct irregularities that might lead to disaster.

Mr. POLE. He has the right, Mr. Chairman, to summon boards of directors, which is very frequently done. But he has no power beyond exacting from them a promise to do certain things which might be necessary to improve the condition of the bank. But beyond that he has no power except to put that bank on the list for frequent examinations, or, in cases of the violation of law, to bring suit for forfeiture of charter through the office of the Attorney General.

The CHAIRMAN. Well, would not the threat of repeated examination and of ultimate forfeiture of charter be very effective in correcting irregularities in a bank?

Mr. POLE. In many cases quite effective—in many cases quite effective. In others, Mr. Chairman, where the board may be obdurate or the bank may be under the domination of a single person, which is very often the case, you can exact any sort of promise but performance is another thing.

The CHAIRMAN. Well, I am asking you these particular questions, Mr. Comptroller, for the reason that since it has become known that this subcommittee is to prosecute an inquiry into the banking situation, I have received numerous letters from various parts of the country where there have been bank failures, asking to be told how it could happen that in some cases within 60 days after national-bank examiners reported a bank in solvent condition it would fail disastrously, and, to be specific, I have had many complaints from Kentucky about a large bank failure in that State, saying that your examiners had, at a quite recent date, reported the bank in a perfectly sound condition, and yet it failed and has created consternation throughout that State.

Is there any remedy which you could propose for a thing of that sort? Ought not your examiners have been able to determine whether that bank was properly conducted and in a sound condition?

Mr. POLE. Yes, sir; and did do so. I do not know what statements you refer to, Mr. Chairman, but, of course, the only statement which



was made was the published statement of the bank's condition. As far as any statement being made by our office or by the examiner in the field, that, of course, is unthinkable with respect to any individual bank.

This bank to which I am sure you refer was an extremely important bank. They had a very large number of deposits and a large number of depositors, both individuals and banks, and the bank was regarded as one of the very important banks of that whole part of the country.

There is a great deal of information that I might file for the benefit of this committee in connection with which I might not be able to express myself now and which I shall be glad to do if you wish to have me do so. But in a general way I will say that there was a typical bank under the domination of a single arrogant person and the condition of that bank was well known to our office.

The CHAIRMAN. What you would call a 1-man bank?

Mr. POLE. It was a 1-man bank, Mr. Chairman. The condition was well known to our office. The bank has been getting in bad shape for a number of years, gradually getting worse, until some action was taken which was effective in requiring a large number of losses to be taken out of the bank.

Now, that has been done over a period of years. The one salvation which we saw was that the bank was a tremendous earner. The bank was earning a million dollars a year and a large part of that was, of course, being used to take out losses. The control of that bank passed from the individuals to the Banco Kentucky Corporation, a holding corporation, which corporation, in turn, invested a large sum of money in an investment house or a real estate broker's firm—I do not know exactly what they would call themselves—which failed, and the connection was so well known that a run started on the bank to which you refer and it was so heavy that there seemed to be nothing to do in order to conserve the resources of that bank for the general creditors, but to close it, and it is easily possible—may I add this, Mr. Chairman—that that bank is not such a dismal failure as seems, perhaps, to be in your mind.

The CHAIRMAN. Well, I know nothing of the details except that these matters have repeatedly, in recent days, been brought to my attention. But you state that the bank was badly managed and conducting an irregular, if not an illicit, business over a period of years. Of what effective use, then, is your examination system if you are not authorized to correct irregularities of that kind?

Mr. POLE. Of course, there was a case, it is true, where we did force a great many corrections. We did correct them and the bank was showing some improvement, because we were gradually getting losses out of the bank, but what closed the bank, of course, was the withdrawal of deposits occasioned by the failure of the company referred to.

It is our effort, always, to see what we can possibly do to keep a bank from failing and we go to every length possible in order to prevent the necessity of taking such a step, but in this particular instance we did find it extremely difficult to get the officers and directors to cooperate with us in cleaning the bank up anything like as rapidly as it should.

The CHAIRMAN. As I understand it, your only suggestion for the correction of a situation of this kind is that somebody—either the Comptroller of the Currency, or some other official or body—be given authority to remove officers of individual banks.

Mr. POLE. There is not any doubt but that if we had had authority to remove officers of that bank that that would have been one of the cases where it would have been employed.

Now, to elaborate a little bit more, Senator, as to why it is not possible to bring more effective measures to play, I may say that while, of course, the public is well aware of a bank failure—there is not any doubt about that—it is not aware of the hundreds of banks which are saved from failure by our office, and I will venture to say that within the last five years as many as 500 banks have been saved from failure through the activities of the comptroller's office.

The CHAIRMAN. Mr. Comptroller, what do you conceive to be the general cause of the numerous bank failures for the last five or six years?

Mr. POLE. Well, 90 per cent of the banks are in the small rural communities. Economic changes have put those small communities within easy distances of the larger commercial centers where the banks are stronger and more efficient in every respect, and as a consequence of this ready access to these centers, the cream of the banking business has gone to those centers, which has had the effect of reducing the opportunities of the small country banks to such an extent that they find it difficult to earn a sufficient amount of money to charge off their losses and to pay a reasonable dividend, and neither can they offer anything like the facilities which the city bank can offer, and with these opportunities removed, the bank is not able to maintain itself.

The CHAIRMAN. You think that this may be partially corrected by a system of branch banking?

Mr. POLE. I do, Mr. Chairman, and furthermore the fact that the small bank has little or no opportunity of diversifying its investments is a fundamental condition.

Senator NORBECK. You say the cream has gone to the centers. How does it come that the centers do not show the increase like, for instance, the Twin Cities, Sioux Falls, Sioux City, and so forth?

Mr. POLE. That is not a system of branch banking, Senator.

Senator NORBECK. But speaking of a general condition: You are speaking of a general condition—the failure of the local bank in the agricultural communities, which is due to the fact that the funds have gravitated to the centers. However, you do not find it in the centers. Where is it, then?

Mr. POLE. Well, the business of the large banks of the Twin Cities has grown very, very markedly, over a period of several years.

Senator NORBECK. If you include their consolidations in the country—not their own business—and take Sioux City (Sioux City is one of the large cities in the Northwest), it shows a shrinkage in deposits, and not a gain.

Mr. POLE. But Sioux City is a particular case.

Senator NORBECK. Well, all right.

Mr. POLE. That is, Sioux City has been subject to criticism, as a bank, for a great deal of the time, and people have, I think, generally understood there has been some trouble in Sioux City.

Senator NORBECK. Well, how much gain has there been, say in Des Moines, if business has, as you say, gravitated to Des Moines?

Mr. POLE. I am not prepared to give exact figures on these various individual banks.

Senator NORBECK. Very well; I will withdraw the question.

Mr. POLE. If I may answer your first question. I say, under a system of branch banking that the business of the Twin Cities has grown tremendously, but that is not a branch-banking system. That is a group-banking system. So, instead of embracing in their statements the statements of these various 150 banks which they have allied with them those individual banks themselves would still publish their own statements and maintain their own identity.

Senator NORBECK. But they include in that statement the deposits from the 150 country banks they control. But here, let us leave that matter. Go on to the question of bank failures in rural communities. I think the comptroller is quite right when he says the last 5 or 10 years has shown a large amount of them. Does that necessarily mean it is due to the banking system?

Mr. POLE. Aggravated, of course, by the local present conditions of depression in farm prices, and so forth.

Senator NORBECK. Now, you are getting down to the point—the inability of the producer to pay, of course. Is it not a fact that, in the decades preceding the last one, the banks in the agricultural communities stood up better than in other places and you had less bank failures in Iowa, for instance, and the agricultural communities than in the industrial sections in the East? Why not take the 50-year experience instead of only the last 5 or 6 years?

Mr. POLE. Well, of course, we have only gone back for 10 years, Senator.

Senator NORBECK. Since the agricultural deflation the farmer does not get a fair price for his product.

Mr. POLE. We are faced with entirely different conditions to-day than we were 50 years ago, so we have felt that to go back for a period of 10 years would ordinarily be sufficient to prove and substantiate the statement that there is something wrong with the agricultural communities from the standpoint of banking, and the principal thing is, I would say, that the bank is utterly unable to diversify its investments. That is one of the outstanding things.

Senator NORBECK. Let me carry that a little further: The comptroller says that the chain banking system will grow out of the consolidation of other banks. Now, we have a system of chain banks under the holding-company plan, and the comptroller is well aware of the fact that a large number of them have been absorbed and have gone into this form of chain banking.

Here is the question: Is it not a fact that the banks they have absorbed are the banks of agricultural communities that have weathered all this deflation and stood up in good shape?

Mr. POLE. That is true in part.

Senator NORBECK. Because they have been very conservative banks; have been hard-boiled and have stood up. Are not those the banks that they have taken over into these chains?

Mr. POLE. In quite a number of cases; yes.

Senator NORBECK. The comptroller and I have talked this over before. I do not want to go into those details now, because it borders on personalities; but is it not a fact that every single bank taken over in South Dakota was a sound unit bank that weathered the storm, and how can the chain bank make them better by the process of taking them over? Does that improve them?

Mr. POLE. By no means were they all sound.

The CHAIRMAN. Mr. Comptroller, I do not understand that you advocate chain banking.

Mr. POLE. Not at all; but the Senator's statement is not in accord with our information—not only with our information but with our actual knowledge. While it is true there have been a great many banks which were quite good banks—the best in that whole section of the country—which have been taken over by these groups, at the same time the groups have come to the relief of many banks which would not have weathered the storm without that relief.

Senator NORBECK. In the same way that banks in the large cities have come to the relief of their correspondent banks out in the country. And that condition has existed for 50 years. Therefore the chain part does not enter into it.

Mr. POLE. Of course, you understand I am not advocating chain banking.

Senator NORBECK. I thought that was the thing you advocated.

Mr. POLE. No. Perhaps you do not distinguish in your mind between chain, group, and branch banking.

Senator NORBECK. Well, they are all controlled from the center; they are all alike in being controlled from the center.

Mr. POLE. Not with respect to group and chain banking. The group-bank system is generally controlled from the center.

Senator NORBECK. And branch banks—are they not alike in being controlled from the center?

Mr. POLE. Yes, there is central control.

Senator NORBECK. Well, I do not get the distinction.

The CHAIRMAN. There is a vast difference in responsibility between branch banking and chain banking, is there not?

Mr. POLE. You put your finger on the very thing, then, Mr. Chairman. Branch banking would operate entirely differently with respect to the very thing you have in mind. Under a group-banking system the members of the group, which are community banks, retain their local identity, have their own boards of directors, separate officers, and operate independently, theoretically, but are more or less managed from a head office, and necessarily have all the overhead incident to an independent bank; whereas, if branch banking were permitted, the parent bank could go out and throw all of its resources and all of its facilities to the smallest hamlet, if you please.

Senator NORBECK. And could likewise draw the reserves from the smallest hamlet.

Mr. POLE. Without doubt, but what is the history of it? The history of it, as far as branch banking has been carried in this country, particularly in California, is that the parent banks have thrown far more of their funds to the small rural communities than they have ever drawn from them.

Senator NORBECK. That is a California condition; if they had foreseen that they probably would not have acquired all these branches.

The CHAIRMAN. Is not that conspicuously true of the Canadian system, Mr. Comptroller?

Mr. POLE. I do not think there is any doubt about it, Senator.

Senator NORBECK. Is the branch banking you advocate similar to the Canadian system?

Mr. POLE. It is similar, but not as comprehensive. I will say that. My idea is that branch banking should develop gradually and that it should develop from centers of importance, to the limits of what I term the trade areas of those particular centers, so that I have no idea of advocating, nor have I ever done so, a branch-banking system which would comprehend the whole United States, which is the case in Canada.

Senator NORBECK. Now, then, I want to ask some more questions. The comptroller speaks of 6,000 banks which have failed, mostly in rural communities. Is that the statement?

Mr. POLE. I think that is a correct statement.

Senator NORBECK. Now much of that is rural communities and how much not?

Mr. POLE. Ninety per cent rural communities.

Senator NORBECK. How would they compare, for instance—these banks—with the other 10 per cent? Would the other 10 per cent, taking into consideration their capital, resources, and deposits, represent even greater failures and involve more people in distress than the 90 per cent of the small banks that failed?

Mr. POLE. No, sir.

Senator NORBECK. Is it not a fact that the scope of a \$200,000,000 bank failure in New York involved as much loss as all the bank failures in several agricultural States?

Mr. POLE. I think, of course, that is an extremely important failure in New York.

Senator NORBECK. Well, the one in Philadelphia was not very much different, was it?

Mr. POLE. As to whether or not the importance of that failure would exceed that of 90 per cent of the rural failures is a very serious question in my mind.

Senator NORBECK. Was it not fortunate indeed that bank did not have hundreds of branches over the country?

Mr. POLE. Under my recommended system, Senator, that bank would not have had country branches.

Senator NORBECK. Is it not fortunate indeed that they were not allowed to have branches outside of New York? As a matter of fact, they had 50 or 60 there.

Mr. POLE. I think it was fortunate, Senator, but I am not advocating that that bank should ever have been permitted to—

Senator NORBECK. But you are advocating a system that would permit banks like that to have branches?

Mr. POLE. I beg your pardon, Senator, not like that—unlike that.

Senator NORBECK. I want to clear up one more question, Mr. Chairman. The comptroller also made a statement that a large number of national banks have taken out State charters. Am I correct in that being your statement?

Mr. POLE. That is true, Senator.

Senator NORBECK. Now then, the comptroller said nothing about State banks that have taken out national charters? How do they compare?

Mr. POLE. Unfavorably.

Senator NORBECK. In number, but speaking of capital. Speaking of capital?

Mr. POLE. Yes.

Senator NORBECK. When we are told that 90 per cent of the bank failures are in agricultural communities it sounds awful, but when we learn that 10 per cent of the city bank failures involve about as many dollars, as many people, and just as much disaster, then we have a more correct picture of the whole country.

The CHAIRMAN. As a matter of fact, Mr. Comptroller, is it not true that the amount written off by the large national banks is far in excess of the losses of a larger number of the smaller banks? That is just a repetition of the question that Senator Norbeck asked and which I think you have answered.

Mr. POLE. As to whether or not the small proportion of large banks was not larger in the matter of deposits?

The CHAIRMAN. Yes; the losses written off of their books by the larger banks in the large money centers, were not far in excess of the losses of the larger number of small banks?

Mr. POLE. Of course it is important, the losses in the banks in the important centers, but it is true, of course, speaking from the standpoint of national banks, that we have had only a relatively few failures of national banks within the last 10 years. However, with respect to question of losses a distinction must be made between losses to depositors suffered through bank failures and losses written off by going banks without affecting their solvency.

With respect to the latter class of losses figures are not available for either country or city banks, but losses to depositors through the failure of small country banks during the last 10 years are vastly in excess of those to depositors in large city banks; in fact, the latter will appear negligible by comparison.

The CHAIRMAN. What do you estimate, approximately, as the number of bank failures since 1920?

Mr. POLE. In number?

The CHAIRMAN. Approximately the total number.

Mr. POLE. There have been, oh, say, roughly, 6,000.

The CHAIRMAN. Of all banks?

Mr. POLE. Of all banks; yes, sir.

The CHAIRMAN. I believe you said that in your judgment the examination by the comptroller's office has a large influence in stopping failures of banks.

Mr. POLE. A very large influence, Senator; so much so that I have prepared a statement showing precisely the number of banks which have been saved from failure through the activities of the comptroller's office over a period of five years, and the number is very impressive.

The CHAIRMAN. Will you file that statement for the record?

Mr. POLE. I shall be very glad to.

The CHAIRMAN. I do not mean naming the banks, but as to the number of banks, with their resources, and so forth.

Mr. POLE. I shall be glad to do that.

Senator TOWNSEND. Will that show the number of national banks and State banks?

Mr. POLE. The national banks only.

Senator TOWNSEND. The 6,000 are national banks?

Mr. POLE. No, sir; all banks.

Senator TOWNSEND. What proportion are national banks and what proportion are State banks?

Mr. POLE. It is less than 1,000 national banks.

Senator TOWNSEND. And 5,000 State banks?

Mr. POLE. Five thousand State banks; yes, sir. We might put the exact number in the statement.

The number of banks saved through the efforts of this office and the examiners in the field for a period of six years, exclusive of those banks saved by voluntary contribution or by assessment in accordance with law, is 559, with total capital of \$64,411,800; total deposits of \$547,054,335; and total resources of \$714,073,513.

The total number of bank suspensions in the United States, from figures furnished by the Federal Reserve Board, for the 10-year period 1921-1930 was 6,968. Of this number, 797 were reopened, leaving a balance of 6,171. Of this total of 6,171, 827 were national banks and 230 were State member banks; 5,114 were nonmember banks.

*Bank suspensions, 1921-1930*

	All banks	National banks	State member banks	State nonmember banks
Suspended.....	6,968	925	257	5,786
Reopened.....	797	98	27	672
Total closed.....	6,171	827	230	5,114

The CHAIRMAN. Very well. In what measure have loans on securities—security loans—caused losses and shrinkage in bank assets?

Mr. POLE. I am satisfied that the shrinkage in securities, probably more than the losses in security loans, would be an important figure. I have not the figures with me. I had no idea what you would ask me to-day.

The CHAIRMAN. The shrinkage of securities may or may not be an inevitable aspect of security loans. What I am trying to arrive at is to what extent security loans which, in large degree, may be called frozen assets, are responsible for bank difficulties.

Mr. POLE. I think it can fairly be said that I know of no instance where the shrinkage in value of collateral or bank investments as far as national banks are concerned, has been responsible for any bank failure or very, very few of them.

The CHAIRMAN. When a bank can not realize on its frozen assets, what happens?

Mr. POLE. Those assets, Senator, are frequently not of the character which you describe.

The CHAIRMAN. Yes; but they frequently are.

Mr. POLE. To an extent—yes; to an extent.

The CHAIRMAN. Has the comptroller's office been disposed to discourage security loans by commercial banks—by national banks which are supposed to be commercial banks?

Mr. POLE. If, in any way the amount of those security loans would seem to be interfering with its ability to accommodate its commercial customers; yes. Otherwise, I should say no.

The CHAIRMAN. Is it your opinion, Mr. Comptroller, that what we call brokers' loans is a good form of banking for a commercial bank?

Mr. POLE. It has proved to be a very profitable form of commercial banking.

The CHAIRMAN. But has it proved to be a very safe form?

Mr. POLE. I know of no instance where a bank has lost anything through its loans to brokers.

The CHAIRMAN. You think, then, it is a sound form of banking for commercial banks, to put out their funds in call loans on the market?

Mr. POLE. I should say, in answer to that, Senator, that if a bank has accommodated its commercial customers, which is its first duty, and attended to its local needs, that whatever surplus funds it has may be so invested without criticism.

The CHAIRMAN. Does it not frequently happen that a commercial bank fails to accommodate its commercial customers in order that it may use the funds for call loans?

Mr. POLE. I have no doubt there are cases of that.

The CHAIRMAN. Mr. Comptroller, do you think our reserve requirements at the present time are adequate?

Mr. POLE. Are adequate?

The CHAIRMAN. Yes. You know they have been twice very materially reduced since the original passage of the Federal reserve banking act.

Mr. POLE. I feel, Mr. Chairman, that that is rather a broad question and which I think is now being studied by the Federal Reserve Board, and I should like to reserve my reply to that question until perhaps I have had a little further opportunity of looking into it and giving it further study.

The CHAIRMAN. Your examiners have had access to the business of all of these national banks. Is it or is it not a fact that the banks—some of them, if not a great many—have adopted the practice of manipulating their reserves and transferring from their demand-deposit accounts to their time-deposit accounts, in order to avail themselves of the 3 per cent reserve on time deposits?

Mr. POLE. There have been cases of that kind, Senator.

The CHAIRMAN. Have there not been many cases of that kind?

Mr. POLE. I do not know of many cases of that kind. I think, as a general thing, banks calculate their reserves on a proper basis. I think, particularly in the West, there have been efforts made to create special deposits and perhaps use certain artifices whereby what would be a proper demand deposit is converted into a time deposit. I would not say that that is at all general, however, that matter is being investigated with a view to correction, in connection with the same investigation as to the reserves, by the Federal Reserve Board.

The CHAIRMAN. Well, we want to investigate it also.



Mr. POLE. Yes.

The CHAIRMAN. If that is not true, I am sure I am at a loss to account for the enormous increase—relative increase—in time deposits as contrasted with demand deposits and upon inquiry, the answer made to me has been—not public, because there has been no public inquiry, but privately—that that has been a source of great abuse in the banking system.

Do you think national banks should be permitted to take time deposits?

Mr. POLE. Yes, I think so, Senator.

The CHAIRMAN. You know, from time to time, Mr. Comptroller, when we have had occasion to propose modifications of either the Federal reserve act or the national banking act it has seemed to me that instead of creating a national standard of sound banking which the State systems might be induced to follow, we have introduced into the national banking system some, if not many, of the abuses of the State systems, in order to enable national banks to compete with State banks. Do you think that is a sound policy?

Mr. POLE. I think such a policy is positively unsound. I have upon several occasions emphasized the need for a strong independent national policy in Federal banking legislation regardless of the status of the 48 State banking codes. The State banks engaged in receiving savings deposits and in trust activities and the trust companies engaged in commercial banking and in taking savings before the national banks invaded either of these fields.

The CHAIRMAN. But they have finally invaded the State practices and engaged in the trust business and fiduciary business.

Mr. POLE. Yes.

The CHAIRMAN. Do you think a commercial bank should be permitted to do that?

Mr. POLE. Well, of course, Senator, they are in it now, and it would be very difficult, I imagine, to unscramble them. Of course, that was not your question, I realize.

The CHAIRMAN. The function of this committee is to correct things that ought not to be done, notwithstanding they exist, and without indicating what my own view is, I thought, perhaps, we might obtain your experienced conception of what a commercial bank ought to be permitted to do.

Mr. POLE. I think it would be an ideal situation, indeed—

The CHAIRMAN. Well, I can tell you that we can not do anything that is ideal. I can tell you that right now. People are disposed to deride politicians and politics, but when you come to making banking laws, you must reckon with politics and politicians, too, and as I take it, it is a question of what you can do and not what you may do in an ideal way.

Senator NORBECK. Would it not be well to let Mr. Pole amplify the distinction between chain banks and branch banks? He makes quite a distinction. I do not make so much. Let us have the distinction, in his own words.

The CHAIRMAN. All right. Go ahead, Senator. You are privileged to ask any questions you please.

Mr. POLE. A chain bank is a system of independent banks usually owned—the stock of which, either a majority or in an important

measure—by an individual or a group of individuals without central management.

A group-banking system is usually a number of banks, the stock of each owned or controlled in an important measure, by a holding corporation formed for that purpose, and the management of these independent banks being usually through a central member of the holding corporation, which is located at a central point.

Senator NORBECK. What designation would you give under that definition to the chain system that exists in the Northwest now?

Mr. POLE. I would call that a group banking system where the stock of the individual bank is held by the holding corporation.

Senator NORBECK. With a branch banking system such as you suggest, there would be no stock owned by a holding company? The banks themselves would issue no stock?

Mr. POLE. No stock at all.

Senator NORBECK. And they would have no stockholders—the branches would not?

Mr. POLE. Not as a branch.

Senator NORBECK. They would have no local board of directors?

Mr. POLE. Not in the sense that the independent bank has. It would probably have a local advisory board.

Senator NORBECK. Yes; but not local directors. The power—

Mr. POLE. Unless you would call this local advisory board the local board, which is the custom now—

Senator NORBECK. But their function would be only advisory. They would have no power. For instance, if the central bank should say, "Send us \$50,000," they would have to send it?

Mr. POLE. Yes.

Senator NORBECK. The control would be in the center, as in the chain-banking system?

Mr. POLE. Yes.

Senator NORBECK. In that northwestern situation, the comptroller's view is that this thing has rather been a good thing for the Northwest—this acquiring of the branches or these chain banks throughout the Northwest has been rather a good thing for the banking situation?

Mr. POLE. I think so.

Senator NORBECK. What benefit has accrued to the small banks or to the communities where the acquired banks are located?

Mr. POLE. They have loaned money—probably not quite as great an amount as loaned formerly, but they have done it more scientifically; they have prevented many banks from failing and, in a great many instances, the very banks they took over would have failed.

Senator NORBECK. The banks acquired by the Northwest chain system are banks that have stood the test of the deflation. They were recognized as sound. I think the comptroller will agree with me that all South Dakota banks acquired by the chains enjoyed the confidence of the community, with the possible exception of one, against which some withdrawals were being made, but it must have been financially sound or it would not have been taken over by the chain. Do you believe they would have bought one that was not good?

Mr. POLE. Not without readjustment.

Senator NORBECK. In other words, it had to be susceptible of readjustment or they would not have bought it.

Mr. POLE. They seemed to be very willing to go in and give a reasonable premium on whatever good business there might be there.

Senator NORBECK. But the comptroller will also agree with me that helping a community also consists of pushing out money to the community in times like this?

Mr. POLE. Yes; where it can be done soundly.

Senator NORBECK. But the comptroller insists that it has been going the other way—it has been pulled into the centers. The comptroller has called attention to the fact that this great growth of branch banking in the Twin Cities has progressed to the extent of acquiring 150 branches. He says the Twin Cities showed increased deposits.

Mr. POLE. We are talking about two different things. I think each has helped the other.

Senator NORBECK. But if there are more funds in Minneapolis, and less in South Dakota, who is helped?

Mr. POLE. I do not know of any good account in the small communities which the First Bank stock or the Northwest Bank Corporation is permitting to suffer.

Senator NORBECK. That, of course, is a matter of opinion. A banker can say "We are not making any loans and therefore nobody is suffering." That is their view. The fact of the matter is that they are hardly making any loans, are they?

The CHAIRMAN. Mr. Comptroller—

Mr. POLE. I hope you understand, Senator, that I am not advocating or defending the group or chain systems.

The CHAIRMAN. On that point, Mr. Comptroller, have you examined—

Senator NORBECK. But there is this distinction between a chain and group: You do not recommend the group, but you recommend the chain. But the group has certain advantages; for instance, local capital and a local board and partially local management. The chain would have none. It would be all governed from the center.

Mr. POLE. That is branch banking.

Senator NORBECK. I beg your pardon. I said chain, did I not?

Mr. POLE. Yes.

The CHAIRMAN. Would not the branch have its local office and local agents and local establishments?

Mr. POLE. I think one of the things which the Senator overlooks is the fact that, while it is true that under a group banking system the member of the group must be a bank of a character which could be profitably operated under this—

Senator NORBECK. In other words, it must have been a good bank, or they would not have bought it; therefore they are not helping a community by buying good banks which have been getting along all right and getting control of them and taking funds out of the community.

Mr. POLE. They do not always do that. But under the central management with better management it is better able to operate successfully. Under the branch banking system the large bank could throw its resources into the small communities that might need them.

Senator NORBECK. I note the word "could."

Mr. POLE. Could throw its facilities and resources to the farthest corner within its district, whatever its district may be, and deal with that branch as though you were dealing with the main office in Minneapolis.

The CHAIRMAN. Would it not have been the same acquisitive inducement to do that with the local bank?

Mr. POLE. Precisely.

Senator NORBECK. Would not the management of any bank put the money where it was worst needed, or where they could gain the most from its use? Human nature is the same in banks as in politics.

Mr. POLE. Well, banking is a business.

Senator NORBECK. It is a business for gain.

Mr. POLE. Banking is a business in which people engage for profit as in any other business; and if they are simply going to bleed the business for some particular selfish interest, of course the end of that business is disaster.

Now, they are going to operate that business scientifically, which means that they would distribute their funds over the district, because they are not going to make an investment in an outlying district and then starve it to death; they are going to build it up.

Senator NORBECK. Exactly, but they will have no investment. You propose that they should do away with the local stock and management and have no investment there. You prefer the branch.

Mr. POLE. It would be a distribution of the investment they make as a part of their whole system. A part would be made to the small hamlet—a small part because the amount of business is small—but having invested that in the banking house, salaries of officers, stationery, and general expenses of that bank, there would be that investment, be it large or small. It would be large or small in proportion to the amount of business done. They will not make any investment there and starve it to death. They will foster it, nourish it, and feed it funds when necessary, and experience has shown that in very many instances money is sent out from the head office far in excess of the amount of the deposits which may be collected from that little community.

Senator NORBECK. The comptroller of course does not maintain that is true of the present system, because he said that the increase in the Twin Cities banks has been drawn from the smaller communities.

Mr. POLE. That, of course, in the State banks, has been due perhaps to two causes; in the first place, I was covering a period of years during which the economic conditions have changed and where St. Paul and Minneapolis are readily accessible to many communities which, 10 years ago, would have been a two days' trip. Now they can reach it in 30 minutes, and the important deposits now naturally go to the more important banks.

Senator NORBECK. Of course, we have always been dealing with Minneapolis. We have no quarrel with Minneapolis. We have a community of interest. I do not see how that community of interest can be helped by their getting absolute control of the credit situation in our State.

But is not this a fact now, that during the high money rate in New York a great many country banks sent a great deal of money down there?

Mr. POLE. During the high money period?

Senator NORBECK. Yes.

Mr. POLE. I am satisfied they did.

Senator NORBECK. And do you not think many sent money down there that might have loaned it at home where needed, because the rate was better in New York?

Mr. POLE. I have no doubt that condition obtained in a measure. I am not prepared to say, Senator, that any commercial business was overlooked.

Senator NORBECK. Well, of course, I know that is a matter of opinion, whether there are certain communities entitled to any credit or not. But the fact is money was sent there because it was more profitable to have it down there.

Now, then, when we lodge control of our whole credit and funds in one place, are they not more likely to go to New York when the next boom comes than to lend it to the farmers, because New York can pay a bigger rate and without any effective way of controlling it, are we not going to be helpless?

Mr. POLE. I do not think it works that way.

The CHAIRMAN. On this question of chain banking: Have you examined S. 4723? Look at section 3 and see if you think that abates the evil of chain banking, if it may be said to be an evil? I am not asking you if you think it would be a valid exercise of authority or whether the authority would be valid. I am asking what you think the effect of it would be.

Mr. POLE. I am not prepared at this time to say what the effect of that would be, Senator.

The CHAIRMAN. That would at least maintain control of the bank in the local community, would it not?

Mr. POLE. Yes, sir. I think that the history of the disposition of these corporations which hold stock is naturally in the direction of the idea of having that stock pretty well distributed and undoubtedly if it were a branch of a bank established in a certain locality, it would be the disposition of the parent bank to distribute a reasonable amount of that stock within that community which, of course, would be held by individuals and voted as such.

The CHAIRMAN. That would not permit a central bank to vote its stock in the local bank?

Mr. POLE. No.

The CHAIRMAN. That does not relate to branch banking.

Mr. POLE. I understand that.

The CHAIRMAN. It relates to chain banking. Do you want to ask any questions, Senator?

Senator BULKLEY. Just a couple. You referred a while ago to a large bank in Kentucky where conditions got progressively worse over a number of years and ultimately turned out pretty badly. Could you give us, for the record or otherwise, the history of your actions with respect to that bank, going all the way back to the time when you first began to see trouble?

Mr. POLE. Yes.

Senator BULKLEY. I think it would be most instructive to the committee to see just what the efforts were and try to trace out wherein the failure came.

Mr. POLE. It is a very interesting story and I shall be very happy to do that.

Senator BULKLEY. There is one other thing I—

Mr. POLE. Was it your idea that that should be for the committee and not for the public?

Senator BULKLEY. Well, I would take your judgment about that.

Mr. POLE. Such portions of that document as might be regarded as confidential would be respected?

Senator BULKLEY. I do not see why it should not be. My questions are for the information of the committee.

Mr. POLE. If I might give it to the committee for the committee, I should be glad to go into a little fuller detail than otherwise.

Senator BULKLEY. I think that is all right, is it not, Mr. Chairman?

The CHAIRMAN. Yes.

Senator BULKLEY. The other thing I wanted to ask you about is this: You said under your proposal there would be no branches at all established by such a bank as the one that recently had trouble in New York City. Will you amplify that a little bit? I did not quite catch the distinction.

Mr. POLE. That is a State bank, and my information with respect to it is only from the newspapers, but I have been led to understand that it was a bank which indulged in unsound banking practices, and I am taking it for granted that by any comptroller there would be no branch banks permitted to any bank unless the bank itself were a bank which had proven itself to be sound and indulged in safe and sound banking.

Senator BULKLEY. Your plan would be for each bank to get the approval of the comptroller with respect to the establishment of each branch?

Mr. POLE. That is my recommendation.

Senator NORBECK. Is it not a fact that many banks well organized and well set up and well managed go wrong gradually afterwards and make the comptroller a lot of trouble?

Mr. POLE. Yes.

Senator NORBECK. Would the fact that they have branches tend to obviate—would that make them virtuous or would they be subject to the same peculiarities of human nature?

Mr. POLE. That might happen to any business, Senator. In other words, we can not foresee what will happen, and if a bank is in good shape now you can not deny it privileges because, say, six years from now it may have gone down instead of up.

Senator NORBECK. And the same might happen with a branch-banking system as might happen to a bank without branches?

Mr. POLE. Yes.

Senator NORBECK. And, therefore, what might happen in one case might happen in another.

The CHAIRMAN. Mr. Comptroller, do you think this thing of permitting national banks, which are supposed to be strictly commercial institutions, to have affiliated investment companies is a sound species of banking?

Mr. POLE. I think that it is in a great many instances productive of unsound assets in the bank with which these corporations may be affiliated.

The CHAIRMAN. Well, we saw that recently.

Mr. POLE. Yes.

The CHAIRMAN. In one single bank that had to write off over \$39,000,000 of one investment company affiliated with a notable national bank—which had to write off \$18,000,000 in losses or \$57,000,000 in all.

Mr. POLE. The method, Senator, is undoubtedly susceptible of a great many evils.

The CHAIRMAN. And a great many evils have been applied in the operation, have there not?

Mr. POLE. Yes, sir.

The CHAIRMAN. Doctor Willis, have you any questions you desire to ask?

Mr. WILLIS. I have one or two things following up the points which have already been raised. Mr. Comptroller, do you, at the present time, examine the security companies in New York and elsewhere which are affiliated with national banks?

Mr. POLE. We do that in a great many instances by permission of the bank itself.

Mr. WILLIS. In what proportion of them do you do that?

Mr. POLE. In New York City, you mean?

Mr. WILLIS. Everywhere.

Mr. POLE. Oh, yes. Well, of course, everywhere—

Mr. WILLIS. Under your jurisdiction, I mean.

Mr. POLE. Quite a percentage of them.

Mr. WILLIS. Fifty per cent?

Mr. POLE. I doubt whether it amounts to as high as 50 per cent.

The CHAIRMAN. Have you really any official jurisdiction over them?

Mr. POLE. No official jurisdiction whatever.

The CHAIRMAN. Is it not a very bad thing for the comptroller's office to undertake to perform a task or service with which it has no lawful connection?

Mr. POLE. It is quite embarrassing sometimes. If we invite ourselves into the securities company, or whatever the affiliated company may be, we may be declined, but we do go into a great many of them and feel it is quite necessary to do so, because, from the very close affiliation, whatever might happen to the security company would happen to the bank. It becomes necessary for the bank to support the securities company by making it loans which might be unwarranted, but necessary in order to save it.

The CHAIRMAN. It seems to me if that is ever necessary, it ought to be imperative.

Mr. POLE. I agree with you.

The CHAIRMAN. And we ought to embrace something in the statute.

Mr. WILLIS. Why not insist on it in all cases, if you think it necessary?

Mr. POLE. We have no power.

Mr. WILLIS. Of course, no legal power.

Mr. POLE. And of course it is not every securities company or not every loan company, or whatever the affiliate may be, that we feel it is necessary. Of course the character of the management of the bank will often indicate the character of the management of the investment company.

Mr. WILLIS. But you do go into a large percentage of them?

Mr. POLE. We do; yes, sir.

Mr. WILLIS. So, you have a fair knowledge of what is being done by those companies?

Mr. POLE. A general knowledge; yes.

The CHAIRMAN. But no power to correct them?

Mr. POLE. No, sir; no power to correct them.

Mr. WILLIS. What is your policy as to the use of a bank's money in such corporations, or have you any settled policy with respect to that?

Mr. POLE. There is no policy. If the banks are loaning an inordinate amount to the securities companies we call attention to it in the report.

Mr. WILLIS. What would be an inordinate amount, for illustration?

Mr. POLE. An inordinate amount would be an amount that would be regarded as inordinate from the standpoint of a bank's own investments for itself.

Mr. WILLIS. In the case of a typical bank, what would be an inordinate amount?

Mr. POLE. Well, for example, a bank with \$1,000,000 capital, a loan of \$250,000 would be an inordinate amount, regardless of the collateral behind it.

Mr. WILLIS. In general, do you find in many cases loans as large as that—loans in that proportion?

Mr. POLE. No. While it would be possible to go through the list of affiliates which we examined and develop a great number in the aggregate of their actions which would be subject to criticism, in the main I would not say that we find any great and very important violations of banking ethics or principles.

Mr. WILLIS. You hold those companies subject to the same provisions of the law, of course, as you do all other borrowers? In other words, the 10 per cent rule applies?

Mr. POLE. Yes, sir.

Mr. WILLIS. If a bank is working strictly according to the law, in what circumstances would you say the amount of the loan would become excessive?

Mr. POLE. They would be subject to the provisions of section 5200 just as an individual or any other corporation not affiliated.

Mr. WILLIS. But different securities companies habitually borrow securities from other sources and borrow on them, as collateral, from the parent bank?

Mr. POLE. Habitually? No.

Mr. WILLIS. Well, frequently?

Mr. POLE. I would not be able to answer that.

Mr. WILLIS. Do they ever borrow from the parent bank, with its own securities as collateral, which they have borrowed from it in the first place?



Mr. POLE. I know of no instances like that.

The CHAIRMAN. Do you see no embarrassment, Mr. Comptroller, to your office in making examinations not authorized by law?

Mr. POLE. The banks are quite often very reasonable and are glad to cooperate with us in permitting us to look through the securities companies.

The CHAIRMAN. But when you make an examination of that sort as a mere accommodation to the national bank, what happens? Does not the bank, for instance, disseminate the information that its affiliated company has been examined by the Comptroller of the Currency and found all right?

Mr. POLE. I think not, Senator.

Mr. WILLIS. Now, you speak of this practice as quite possibly productive of a great many evils.

Mr. POLE. Yes.

Mr. WILLIS. You have not recommended any legislation on the subject?

Mr. POLE. Yes; in the annual report of 1930 it is recommended that the comptroller be authorized to examine any affiliated corporations.

Mr. WILLIS. But you are doing it now, as a matter of fact. You have gone no further than that? As I understood you, you said that the existence of the securities companies might be productive of pretty serious evils. You have recommended nothing in the way of the separation of the securities companies or anything other than the examination?

Mr. POLE. That is all.

Mr. WILLIS. Do you think that would be putting things in exactly the right situation?

Mr. POLE. It would be a step in the right direction.

Mr. WILLIS. Is that all you would be prepared to recommend?

Mr. POLE. I think with a penal clause in there it might be very effective.

Mr. WILLIS. You are aware, are you not, that in New York the superintendent of banks has recommended an entire separation of the bank from the affiliated companies? What do you think of that?

Mr. POLE. I think that is a matter that might have very serious consideration.

Mr. WILLIS. You mean from yourself or the committee?

Mr. POLE. From the committee or anybody.

Mr. WILLIS. Do you mean by serious consideration favorable consideration?

Mr. POLE. Well, it is such a large question to answer as to whether or not that would be an advisable thing to do in the light of the long-established relations of securities companies with banks and the manner in which it could be practically done, I would say that it would be advisable that serious consideration be given before steps are taken to that end.

Mr. WILLIS. Are you familiar with the provisions of the bill to which the chairman called attention as regards this matter?

The CHAIRMAN. Section 7. I sent you a copy of the bill.

Mr. POLE. Yes, Senator.

The CHAIRMAN. Would that accomplish quite the purpose of this, Mr. Comptroller?

Mr. POLE. That is with respect to the report, Senator? It would be helpful, but it would not be enough.

Mr. WILLIS. Now, with respect to the limitation of loans to be made by such banks to their securities companies, do you approve of that—the limitation of the total amount the securities company could get—to say 10 per cent of the capital and surplus of the parent bank?

Mr. POLE. That is applicable to the securities companies?

Mr. WILLIS. No; under section 5200 the amount possibly to be borrowed is very much larger.

Mr. POLE. Not to the securities companies?

Mr. WILLIS. It might borrow in other ways.

Mr. POLE. Not in excess of 10 per cent.

Mr. WILLIS. What would you think of a limitation of 10 per cent to all affiliates that the bank might have? Suppose the bank might have a dozen affiliates; would you approve of limiting the total amount to 10 per cent?

Mr. POLE. Yes; that applies to individuals. But in the aggregate, you mean?

Mr. WILLIS. Yes; in the aggregate.

Mr. POLE. I would be in favor of that?

The CHAIRMAN. Mr. Comptroller, I want you to feel at liberty to offer any suggestions—not here, but hereafter. You say that section 7 does not go far enough. I want you to feel quite at liberty to offer any suggested modification that might occur to you.

Mr. POLE. Thank you.

The CHAIRMAN. Because we want it to go far enough.

Mr. WILLIS. You speak of the securities companies and their loans as being under very careful scrutiny, through the courtesy of the parent banks?

Mr. POLE. Yes.

Mr. WILLIS. How far does the Comptroller's office go in actually checking up the security loans of other banks and suggesting or dictating to them to cut off this, that, or the other line of security loans? In other words, does the comptroller's office ever undertake to suggest to a bank that it is concentrating its securities loans too much?

Mr. POLE. We suggest matters which we feel are, in a general way, subject to criticism. Of course, we do not give the securities companies close scrutiny. We are in there simply by courtesy.

Mr. WILLIS. Yes.

Mr. POLE. And we want to know in a general way, and we feel we do not want to abuse a privilege that is extended to us. We go, in a general way, to see if there is any outstanding thing.

Mr. WILLIS. But loans of a parent bank to affiliate are kept under your direct legal scrutiny?

Mr. POLE. Yes, sir.

Mr. WILLIS. If you find a bank is concentrating its loans upon any particular bank or securities company, does that call for criticism?

Mr. POLE. In the bank?

Mr. WILLIS. Yes.

Mr. POLE. Decidedly so.

Mr. WILLIS. You make an effort to prevent any overconcentration?

Mr. POLE. Yes, sir.

Mr. WILLIS. Do you make a similar effort on the lines of loans to brokers, and so forth?

Mr. POLE. With respect to concentration in loans to individuals or corporations?

Mr. WILLIS. Where there is a concentration on one particular stock or kind of security.

Mr. POLE. Decidedly so.

Mr. WILLIS. What has been your policy with respect to that?

Mr. POLE. To list in each report of an examination what we call large lines, and that large line might consist of a large loan to a particular industry or a large line to corporations which had affiliations or an individual with divergent and various interests, and summed up, those would present an aggregate line which might be dependent upon any one of those things mentioned.

Mr. WILLIS. Would those large lines apply to what is called security loans, so that the action would cover an excess loaning on one stock or a few?

Mr. POLE. Decidedly.

Mr. WILLIS. And in that case you call attention to it as in other cases?

Mr. POLE. We call attention to it in emphatic terms, if it is necessary.

Mr. WILLIS. If losses occur due to rapid depreciation of collateral, and so forth, what liability does that create on the part of directors who have not observed your suggestions?

Mr. POLE. The question might be one of judgment. If it were, then, of course, there would be no liability attaching. If it were a violation of banking principles in which the directors would overstep their authority as directors, then, of course, the question of individual responsibility would obtain. In the case of a bank's insolvency, if the directors had been remiss in their duties or neglectful, the receiver usually ascertains those facts and endeavors to—

Mr. WILLIS. That is, in the case of failure?

Mr. POLE. In the case of failures; yes, sir.

The CHAIRMAN. Should there not be applied, by authority of the statute itself, some remedy for a situation of that sort before the bank fails?

Mr. POLE. A stockholder has always the right, if he can establish malfeasance or misfeasance in office—particularly misfeasance—a shareholder has always his day in court and can proceed on his own initiative.

The CHAIRMAN. I know, Mr. Comptroller, and you know too, that the average shareholder does not give attention to details of mismanagement.

Mr. POLE. That is true.

The CHAIRMAN. But your office comes into actual contact with it.

Mr. POLE. What we very frequently do, Senator, is, in the case of a loss in a technically excessive loan, is to use pressure on the directors to make them personally reimburse the bank for such loss.

The CHAIRMAN. Should they not be required to do it without moral suasion?

Mr. POLE. Well, I think that——

The CHAIRMAN. You make a poor stockholder—and I have right here in my pocket now a letter from an estimable woman, the wife of a farmer in my county, who is a stockholder in that national bank that failed not long ago in Brooklyn, in which she advises me that she not only lost the \$1,000 she had invested in the stock but, under the national banking act, she is required to pay another \$1,000, under the double liability requirement, which she can ill afford to do. It seems to me if a stockholder can be required to do that, the director of a bank should be made to pay also.

Mr. POLE. I think so too, Senator.

Mr. WILLIS. Do you find, from your observations of it, that during the past year there has been a great movement of credit out of the so-called brokers' loan accounts into the direct securities loans of the banks, so that lately the brokers' loans have been greatly reduced?

Mr. POLE. There has been a considerable reduction in brokers loans but no increase in other security loans.

Mr. WILLIS. How do you account for it?

Mr. POLE. In cases where it has happened, I would account for it in some measure by reason of perhaps more liberal treatment on the part of the bank toward its customers than toward the bank brokers.

Mr. WILLIS. Has that not had the tendency of making the loans of the banks more seriously frozen than a year ago?

Mr. POLE. In such cases it has had an effect in that direction.

Mr. WILLIS. What have you done to check that progressive freezing up?

Mr. POLE. We make, through our examiners, every effort to have banks strengthen loans that might perhaps be slightly under margin.

Mr. WILLIS. That is to protect the bank?

Mr. POLE. Always to protect the bank; yes.

Mr. WILLIS. From the general banking standpoint, have you done anything to try to prevent the freezing up of the assets of the banks, as a body, through this stereotyping of credit through securities loans and brokers' loans?

Mr. POLE. We endeavor to get the banks to divest themselves of their security loans if they have a disproportionate amount of them.

Mr. WILLIS. They have a disproportionate amount now, have they not?

Mr. POLE. There may be, over the country, a disproportionate amount of collateral loans of this character, but perhaps on the other hand there is a somewhat limited demand for commercial loans that banks, in an effort to keep their money invested in something or other, are not disposed quickly to dispose of these collateral loans.

Mr. WILLIS. I was anxious to know if you were adopting any particular policy. It might not be wise to do it now. I merely wanted to know if the office had any definite policy.

Mr. POLE. There is a policy to do so provided it appears that commercial investors are not being properly served, but if a bank is in funds and it has good collateral loans, we do not take any active steps in seeing that they dispose of them.

Mr. WILLIS. I have one or two questions about the savings situation. The Chairman asked you about what you thought of the reserve against savings—that is, the 3 per cent requirement. It is 3 per cent, is it not?

Mr. POLE. Yes, sir.

Mr. WILLIS. With a possible 30-day notice?

Mr. POLE. Thirty to sixty days, in the option of the bank.

Mr. WILLIS. And has that ever been invoked?

Mr. POLE. Oh, yes.

Mr. WILLIS. In what proportion of the cases?

Mr. POLE. In very, very few.

Mr. WILLIS. Why is that?

Mr. POLE. More frequently of recent months, the reason for it is that the public is on notice that it can not get its money for 60 days and the public immediately wants its money that much more quickly and the result is that, as an illustration, I have in mind a large building and loan corporation with \$8,000,000 in deposits, a perfectly sound corporation according to the examiners, and they put on their 30-day notice, and inside of 10 days they had, out of \$8,000,000 deposits, \$4,000,000 applications for withdrawals causing the association to close.

Mr. WILLIS. If that is practically a dead letter—and it seems to me you have indicated that it is—then the banks' savings deposits are practically subject to withdrawal as the demand deposits?

Mr. POLE. As a practical matter that is so.

Mr. WILLIS. And yet they have only 3 per cent of reserves behind them. Does that suggest to you at all that there should be a change in that 3 per cent requirement?

Mr. POLE. It does not suggest so much to me there should be a change in the 3 per cent as it does perhaps denying the right of the savings depositor to withdraw his funds, while you are giving that right to the commercial depositor. You are theoretically preferring the commercial depositor. If that is the case, would it not then be possible to see that the savings depositors were protected by segregating their assets?

Mr. WILLIS. In other words, do I understand you propose or advocate segregation of the assets behind the savings deposits?

Mr. POLE. I am inclined to think there is considerable advantage and fairness in such a plan.

Mr. WILLIS. Is there more advantage to that than to any other plan? Would you recommend it?

Mr. POLE. It is a matter that is decidedly debatable—very debatable. There are many arguments in favor of and against it, but I think that if the banks have the privilege of withholding a savings deposit for 30 or 60 days, the savings depositor should have protection and that protection should be in the segregation of the assets.

Mr. WILLIS. That would protect the depositors as to the ultimate solvency, but it would still leave the banks with a low reserve as to the balance of the depositors—the demand depositors.

Mr. POLE. I think the reserve of 3 per cent against time deposits is ample.

Mr. WILLIS. You think that is ample?

Mr. POLE. Yes. I think the fact that higher interest rates are paid on that account and that they are savings; that, in a general sense, people do not expect to withdraw those savings and they are more or less dormant, there is no reason to my mind why there should be any increase in the reserve requirements. I am speaking of legitimate savings and not those savings which may, in fact, be commercial savings but transferred to the savings deposits under some arrangement.

The CHAIRMAN. Is not that largely done? Has not that manipulation gone on ever since we modified the law and made this 3 per cent reserve behind it?

Mr. POLE. I am not prepared to say to what extent that is done, but I am inclined to think it is not a large extent.

The CHAIRMAN. I am sure you ought to have knowledge of the fact it is largely done.

Mr. POLE. I think it is largely done in perhaps a single section of the country. It has become a habit, I think in a measure, in California to rig up special arrangements about savings contracts, but otherwise I would not be prepared to say it is general at all.

The CHAIRMAN. I have never been able to expel from my mind an incident that happened, as I recall, before the Banking and Currency Committee of the House, or the subcommittee, during its money trust investigation. They had under examination one of the notable figures of the banking community and he was asked if his bank ever violated the statutes and his very frank response was, as I recall it, "Why, yes. What do we hire the best legal talent in the world for except to evade the law? Anybody can comply with the law."

It has seemed to me that in this very particular matter of the manipulation of the deposits many of the banks have just taken that view of it; they want to evade the law rather than comply with it.

Mr. WILLIS. I have one question about chain banking, Mr. Comptroller. When you have a situation like that which existed in the Northwest, how does it affect the double liability of the shareholders provision?

Mr. POLE. We call that a group-banking system in the Northwest. In the case of the Northwest and the First Bank Stock Corporation, I think that their stock is not subject to the double liability, although the stock of some holding corporations is subject to double liability. But in the case of those two corporations, in those particular cases—not that it obtains too generally—they have invested in securities other than bank stocks, so that a judgment against either one of those corporations would be good for the assessment.

Mr. WILLIS. In those particular cases?

Mr. POLE. In those particular cases; yes, sir.

Mr. WILLIS. But there are cases where they are not subject to the assessment?

Mr. POLE. There are cases where they are not subject to the assessment; yes, and where they hold nothing but bank stocks.

Mr. WILLIS. In those cases where you have an affiliated bank that buys all the stock of the bank itself, what becomes of the double liability of the shareholder?

Mr. POLE. The securities company where it buys the stock of the bank itself, would be the holder of the stock and subject to assessment.

Mr. WILLIS. Yes; they buy it.

Mr. POLE. They would be subject to the assessment.

Mr. WILLIS. That would be the bank itself—if you had a failure?

Mr. POLE. Yes; that would be equivalent to being the bank itself.

Mr. WILLIS. If it made large loans on the stock of the bank, how would that affect the double liability?

Mr. POLE. The individuals would be still responsible.

Mr. WILLIS. They would be the same as shareholders?

Mr. POLE. The individual would be responsible regardless of whether the stock was held as collateral in that or any other bank. The individual holders of the stock, if it were in their names.

Mr. WILLIS. If it were not, but held in a broker's account, how would it be then?

Mr. POLE. It would be the record holder of the stock.

Mr. WILLIS. It would be the record holder of the stock?

Mr. POLE. Yes.

Mr. WILLIS. And if it were the securities holding company, the double liability would be against—

Mr. POLE. It would be against the securities company.

Mr. WILLIS. Is not the double liability then very largely neutralized?

Mr. POLE. Yes.

Mr. WILLIS. What have you done to correct that?

Mr. POLE. We have done nothing to correct it.

Mr. WILLIS. What can be done by law to correct it?

Mr. POLE. That is a big problem.

Mr. WILLIS. Can you make a recommendation covering that along with your other problems?

Mr. POLE. Yes.

Mr. WILLIS. It ought to be done, should it not?

Mr. POLE. We hear a good deal about double liability. It is not so important as at first one might so regard it. As an illustration, the deposits, we will say, of a bank with \$100,000 capital would be ordinarily \$1,000,000. If you collected the entire 10 per cent assessment, you only would collect 10 per cent of your deposits after all.

Mr. WILLIS. Still it would be something.

Mr. POLE. But in practice you would not collect over 50 per cent of that. We do collect, as a matter of fact, just about 50 per cent.

Mr. WILLIS. The double-liability clause then is one, I gather from you, that needs pretty serious overhauling.

Mr. POLE. I think there are instances where we have gone through the corporation to an individual and collected and got judgment against individuals whose stock was held in the corporation, but that is only in cases where it was evident that it was done for the purpose of fraud; and in other cases, where the stock of the failed banks is held in corporations, our counsel is now preparing to demonstrate that we either can or can not go through that corporation to the individual through the courts.

Mr. WILLIS. Do you find many cases in your examination of banks where the banks have discounted eligible paper in the reserve banks and then been required to put up collateral securities to protect the paper?

Mr. POLE. I think there are plenty of those cases; yes.

Mr. WILLIS. What is the effect of that upon the depositor in the case of a bank failing?

Mr. POLE. The effect is that the bank holding the paper has a very much better claim than the one who has a general claim.

Mr. WILLIS. A preferred creditor, so to speak?

Mr. POLE. In a measure preferred to that extent—secured rather than preferred.

Mr. WILLIS. Do you find any warrant for that in the Federal reserve act? Do you think that is permissible under the Federal reserve act?

Mr. POLE. We have always so thought. We have never taken any exception to it and have not felt it is within our province to do so.

The CHAIRMAN. At least the Federal reserve agent may require additional security for a credit loan?

Mr. POLE. Yes.

The CHAIRMAN. The Federal reserve agent who issues the notes to the reserve bank is authorized by the act, if I remember it correctly, to demand additional security. That would seem to me a plain implication, at any rate, that the reserve bank, in turn, could demand from the rediscounting bank additional security.

Mr. POLE. We have never taken any exception to that at all.

Mr. WILLIS. At any rate, that is the practice?

Mr. POLE. That is the practice and perhaps a very necessary practice in view of the character of paper that the Federal reserve bank sometimes has to take.

The CHAIRMAN. There has been a very vigorous protest against that practice recently presented from some point in North Carolina. I do not just recall what point.

Mr. POLE. I think that is true, but at the same time the Federal reserve banks of the various districts have exhibited great liberality in the extension of credits to member banks and in order to justify, as far as possible, that extension of credit they have necessarily had to protect themselves in some measure by additional collateral.

Mr. WILLIS. That makes it much harder for the smaller banks to get the rediscount credit they need?

Mr. POLE. It would have that tendency.

Mr. WILLIS. And it would leave the bank much less in case of failure?

Mr. POLE. If indeed the bank could get the money at all. Its assets might be of such a character that the Federal reserve bank in the district would not feel justified in making a loan at all without further collateral.



Mr. WILLIS. Can you file with the committee here a digest of the reports of security companies that you have in hand—not by name, but simply listing the assets under given suitable heads—

The CHAIRMAN. Just for the confidential information of the committee.

Mr. POLE. Yes; I shall be glad to do that, Mr. Chairman.

The CHAIRMAN. Are there any further questions?

Mr. Comptroller, we thank you very cordially for the information you have given us, and I want to repeat that I hope you will not hesitate to offer us any suggestions as to what might be properly done to strengthen the banking structure.

We shall adjourn now until 10.30 to-morrow morning.

(Whereupon, at 12.30 o'clock p. m., the subcommittee adjourned until to-morrow, Tuesday, January 20, 1931, at 10.30 o'clock a. m.)

# OPERATION OF THE NATIONAL AND FEDERAL RESERVE BANKING SYSTEMS

TUESDAY, JANUARY 20, 1931

UNITED STATES SENATE,  
COMMITTEE ON BANKING AND CURRENCY.  
*Washington, D. C.*

The subcommittee met, pursuant to ajournment, at the room of the Committee on Banking and Currency, Senate Office Building, at 10.30 o'clock a. m., Hon. Carter Glass (chairman) presiding.

The CHAIRMAN. The subcommittee will please come to order.

## STATEMENT OF GEORGE L. HARRISON, GOVERNOR OF THE FEDERAL RESERVE BANK OF NEW YORK

The CHAIRMAN. Governor Harrison, as you very likely know, this is a subcommittee of the Banking and Currency Committee of the Senate, authorized to make a thorough inquiry into the banking situation with a view to determining, as exactly as we may, what that situation is and has been for the last 12 months or more; and what, if anything, is required to be done to modify the statutes dealing with the Federal reserve system and with the national banking system and the banking system of the country generally, and we have asked you to come down, as chief executive officer of the largest Federal reserve bank, with the hope and confident expectation that you may tell us of the situation and suggest to us any remedies against a recurrence of what has happened and that which has so much disturbed the country in the last two years or more. We should be glad to have you make any initial statement that you care to make and then we will exercise the privilege of asking you some questions on particular points.

Governor HARRISON. Mr. Chairman, I have no prepared statement. I was not certain of the exact nature of the inquiry, so far as it related to me or to the New York bank. I have received questionnaires which the committee has submitted to us and our final and formal replies we hope to have ready for your committee very shortly.

Those inquiries and replies more or less logically outline the operations and policies of the Federal Reserve Bank of New York, not only during the recent period but during the last six or eight years, so that I am here at your wish with what I hope you will consider the assurance that anything at all that I, or any officers of the Federal Reserve Bank of New York, can contribute to your inquiry, we will

be only too happy to do, because we, as you, have been much interested in seeing how we could take stock of what has transpired in the past two or three years in the effort possibly to minimize the risk of a repetition of some of the things that have occurred during that period.

Generally speaking, if you will let me go back a little, the difficulties may be considered in two categories; those that are fundamental in the banking system and those that are more superficial and which may require only certain minor amendments to the Federal reserve act or the banking laws.

From the fundamental aspect, I think it is appropriate to make a historical comparison with the development of the banking systems of England and other countries and the United States.

In England the banking business is done without any legislative restrictions whatever either as to capital, reserves, percentage of loans to individuals, or any of the other details of operation which we have found to be necessary in this country. The only legal limitation as relating to any bank in England is that on note issues which relates solely to the Bank of England because, except for a small issue of 500,000 pounds, no other bank in England issues notes. The development of the banking system in that fashion in England is quite consistent with its traditions of centuries, leaving the banking business to the judgment of the bankers themselves rather than to the dictates of the legislature. Obviously such a system as that would not have been possible in a country such as the United States, growing as rapidly as we were, both in population and in area and without any of the banking facilities at all when we first started in 1800, we will say, that had existed for centuries in other countries.

Even in those days, there was bitter controversy about the incorporation of banks. The opposition was based largely upon the fact that people in authority felt that the banking business was just a means to aid speculation, to favor the rich and not to accommodate the poor. Indeed, in 1803 there were two banking statutes vetoed in Vermont precisely on that ground, that it was nothing but an aid and machinery by which speculation might be encouraged. There were similar debates in other States, but finally, in the period 1811 to 1814, there was a very rapid growth of the banking business under individual charters, and the number of banks in the country increased from 88 to 208. In 1814 they had a wave of failures due to the fact, first, that the banks were run by inexperienced persons who had not had an opportunity to learn anything about banking and, secondly, the laws under which they were operated were very loosely conceived and not strictly administered any way.

It was only in 1838 that we had the first "free banking system" which was initiated by the State of New York and quickly followed by other States. That was a State banking law under which any group of persons could get together and organize a bank for the conduct of the banking business. That law set forth certain limitations as to capital, reserves, and other requirements. As I say, it was quickly followed by other States and we had a wave—almost a mania—of banking growth following that period under these general banking laws which led eventually to the passage of the national banking act and to more strict limitations in the various State laws.

After the passage of the national bank act every State in the Union adopted some sort of free banking law. At the present time, therefore, we are confronted not with one banking system, not with one set of banking laws providing sound and safe restrictions for the operation of all banks, but rather with 49 banking systems with the Federal reserve system superimposed.

The CHAIRMAN. Do you think it is desirable to have this dual system or multiplicity of banking systems?

Governor HARRISON. Senator, my belief is that that multiplicity of banking laws has perhaps done as much to encourage or make possible bad banking as any other one thing in the fundamental set-up that we have got, because the competition between the Federal and State Governments, or between the various State governments, to increase the number of their own organizations has, from time to time, led to the adoption of liberalizing laws which have made possible—I will not say have provoked—but have made possible, some developments which I think contribute to our present trouble; in other words, I think that we have had over 6,000 bank failures during the past 10 years, as you have all heard here, and I should imagine—and the comptroller can check this up if I am in error—I should imagine that a great part of those failures was attributable not to any violations of law but rather to the abuse of the privileges provided by law. In other words, the limitations of the law, instead of being restrictions on bad banking, have become an invitation to bankers to use what Congress or the State legislatures have defined as proper limits of banking.

The CHAIRMAN. Is it not largely the business of the comptroller himself, as to the national banks, and State bank examiners or State bank superintendents, as to State banks, to cure a situation of that sort?

Governor HARRISON. I think the difficulty there, Senator, is—

The CHAIRMAN. I mean where bad banking occurs and where the law is flouted.

Governor HARRISON. Where the law is flouted, I think there is no question of the jurisdiction of the comptroller or the State bank superintendents and possibly the Federal reserve system. My own belief, however, is that the difficulties into which banks get, that are the forerunners of failure, are difficulties not caused by violation of law—certainly not in the first instance—but rather by the exercise of poor judgment within the law, and at that stage it is very difficult to say what the comptroller or the State banking superintendents can do.

The CHAIRMAN. How do you distinguish between poor judgment within the law and violations of the banking laws?

Governor HARRISON. There are certain things prohibited, and if a bank violates those prohibitions of the law the comptroller has definite powers in regard to the indictment and prosecution of the officers; or, in the Federal reserve act, we have definite authority in the case of national banks to ask the comptroller to bring suit for forfeiture of charter and, in the case of State banks, to expel them from the Federal reserve system. That is in the case of violation of law. Even that is a pretty drastic remedy for what might be a technical violation of the minor provisions of the statutes.

But the difficulty is largely, what are you going to do with a bank acting quite within the legal provisions, whether of the national banking act or a State law, but which, in our judgment, is on the way to difficulty. I remember that when I had the privilege of being with the Federal Reserve Board any State bank that applied for membership in the Federal reserve system was required by a condition imposed by the Federal Reserve Board to limit the amount of its real-estate loans to some percentage, depending upon the kind of business that the bank was doing. That condition of membership was very much resisted by the State banks applying for membership and the pressure was so great that Congress amended the law so as to provide specifically that any State bank that came into the Federal reserve system should retain all of its State charter rights. From then on, it was not competent for the Federal Reserve Board to limit the amount of real-estate loans that a bank could engage in. That is what I meant a moment ago by the competition between the different banking systems that results in a gradual development that tends to break down the barriers.

Now, at the present time—and the comptroller will probably bear me out in this—part of the difficulty of a number of these banks that have failed is the loans that they have been authorized to make on real estate. But those loans are not illegal loans in many cases. They are specifically authorized by the State law and the Federal reserve act, and the Federal reserve banks probably could not place any binding restriction as to the percentage of real-estate loans that a bank can engage in.

Now, if I may go on, unless you have something you want to question me on, I do not mean by that that it is possible at this time to conceive of one banking law—and I am not advocating that because that involves practical and political considerations that have great ramifications—but I do think this, that if it were competent for this committee to consider a banking system anew to-day, without consideration of the past and if it were possible for it to devise one set of laws that would apply to all deposit banks in the United States, and if all those deposit banks in some fashion were in the Federal reserve system, you would do much in that fashion to protect the depositors in commercial banks.

That not being possible at the moment, I should imagine, because of the multiplicity of laws, whatever you can do to approach that ideal at the present time by some possible amendments to the law would, I should think, be most important for your committee to consider.

There are a number of State banks doing deposit banking business that might perhaps better be in the Federal reserve system. Whether it is possible or wise to provide a law whereby all State banks doing a deposit banking business should be members of the Federal reserve system, I am not certain. My own preference would be to look forward to the time when that will be possible, provided two things: Provided the capital structure of those banks which are admitted to membership is raised to a point that is much higher than permitted in many of the States, and provided further, that some system of branch banking be authorized so as to provide the service that was heretofore performed by the smaller banks which

might be gradually dispensed with—that is, the too small banks not large enough to be members of the Federal reserve system.

Now, under this multiplicity of laws, you had this development: A bank to-day perfectly properly and perfectly legally incorporates and either directly or through subsidiaries or affiliates, does a commercial banking business, a savings bank business, a trust-company business, a securities business, and even an issue-house business. We have then not only the legal set-up which permits of departmental financial service but which, in some cases, has encouraged it. I do not see now that it would be wise to destroy that system even if it were possible, because the American business man who is in a great rush always, finds great service in going to a banking institution and discussing with his banker not only the possibility of opening a deposit with him, but getting his advice as to investments and perhaps advice and help as to a trust that he wants to organize or the writing of his will and providing for the future executorship under the will—all those things that can be well done under one roof to the convenience of the customer. There is a danger that if you do not permit that and the customer goes to a bank that is authorized to do only one kind of business, the banker may encourage him to do something that is not most suitable for that one man. If, on the other hand, the banker has the capacity to offer him not merely a deposit service but perhaps some means of investing his funds that would be better for that customer, he has, in that situation, some freedom or alternative in advice, without the risk of losing the business.

But if you are going to authorize this departmental banking, then I do think that there are certain things that ought to be done and done fairly promptly, which will better safeguard it. I think one of the principal developments in the past two or three years which should be of the greatest concern to your committee, is the development of a savings banking or thrift deposit business by banks doing a commercial banking business. A good percentage of the growth in deposits in the past few years has been in time deposits. It has been due to a number of causes, but one of them no doubt is that under the laws of many States a bank does not have to carry any reserve against time deposits and, under the Federal Reserve Act, a bank carries only 3 per cent as contrasted with 7, 10, or 13 per cent, dependent on its location, on demand deposits.

The CHAIRMAN. What has been the result of that with respect to the reserves carried by the banks?

Governor HARRISON. I think it has encouraged the bankers to solicit a bigger proportion of time deposits than they would have solicited or would have obtained otherwise.

The CHAIRMAN. And has it not caused many banks to manipulate their deposits and transfer their demand deposits to the savings accounts in order to avail themselves of the 3 per cent reserve?

Governor HARRISON. This has doubtless been done in some cases.

The CHAIRMAN. In large measure do you think that that accounts for the very large proportion or the larger increase in savings deposits as against demand deposits?

Governor HARRISON. Of course it is no doubt true in this period of prosperity which we have had up until two years ago, savings deposits increased very rapidly in savings banks and it was only

natural they would increase rapidly in commercial banks that were doing a savings-bank business, but I do think also, as I stated at the outset, that the differential in the reserve requirement has been a great encouragement to banks to solicit accounts on that basis instead of as regular commercial demand deposits.

The CHAIRMAN. You think then we ought to alter the reserve requirements of the act?

Governor HARRISON. Senator, that has been so much a matter of concern to the reserve system for several years now that about a year ago a Federal reserve system committee was organized to study the question of reserves. They are making a thorough academic report on it. I do not know just when they will be able to make that report, but they have made great progress. My own impression—and I am speaking personally—is that the differential in reserves between a demand deposit and a savings deposit in one bank that is doing the two kinds of business, is wrong. I think that you have got to realize this. Take one institution doing both kinds of business. A savings deposit theoretically authorizes the requirement of 30 days' notice. Having that protection or that nominal protection, the banker invests a part of his savings funds in slower and less liquid investments than he would invest in were he doing a strictly commercial banking business, or did he admit the fact that, in effect, those savings deposits are demand deposits. I do not care what the privilege is or what the law is, any bank on which there is a run that has got commercial demand deposits and savings deposits must do either one of two things—pay them all off on demand or else ask for his 30 days' notice which, in its turn, will do one of two things, close the bank at once, if the State authorities or the Comptroller of the Currency thought it was wise—and I think they would think it was wise—or else run the risk of giving a preference to all demand depositors who could come in and get all the most liquid assets and let the savings and thrift depositors take what is left.

I should think myself that the sound way to approach the question—and I am giving you not the considered opinion of the Federal Reserve Bank of New York, but my own personal reaction—the sound way to approach it would be by law to require a commercial bank that is taking thrift accounts to admit the fact that, in effect and in substance, those accounts are demand deposits and the corollary to that is to make them carry the same reserve that they carry against demand deposits.

Senator BULKLEY. Would not you avoid the difficulties you are speaking of if you had segregation of assets?

Governor HARRISON. Personally, I do not believe in the segregation of assets in one bank under one roof with all its deposits in one pool, because as soon as you segregate assets in that fashion you imply that the deposits against which those segregated assets are placed are in a different category from the others; otherwise there is no point in doing it.

Senator BULKLEY. I am just talking about what you say now amounts to a preference in favor of the demand depositors, which would not exist if you had the assets segregated.

Governor HARRISON. The only difference is if you segregate the assets against the time deposits, those depositors would have the slower and less liquid assets against those deposits.

Senator BULKLEY. They would have the kind of assets that savings funds have been invested in—admittedly so.

Governor HARRISON. That is quite right, and if that were all there were to it, I would agree with you.

Senator BULKLEY. Well, suppose you go ahead and develop it.

Governor HARRISON. Supposing you do segregate the assets against savings deposits in one institution. If you do that, in order to insure the soundness of those assets, you have got to make very strict limitations as to their character. That would probably mean some laws such as the laws in some States that I am familiar with where savings banks investments are specifically set forth and there is no alternative in the judgment of the officers of the bank.

Now, assuming that bank X is doing both a savings bank business and a commercial deposit business and assuming that it gets 50 per cent of one kind and 50 per cent of another, and that the segregated assets against the time deposits or thrift accounts would be the kind specified in the law. They are, by hypothesis, slow assets. If anything should happen, as has happened in the past, to cause any concern or distress in the minds of the depositors that there is any difficulty with the bank, the savings depositors are usually the first that start to withdraw. They are of a smaller individual amount, but the number of depositors who get excited is greater.

Now, at that point, if the bank is going to pay off those savings deposits, it has got to use the unsegregated liquid assets that are back of the demand deposits or else it has got to demand the 30 days' notice, and if it demands 30 days' notice, that is notice to the world that there is something wrong in the bank and you invite every depositor in the demand department to get his money out. I think it is a large risk for the institution to take as a whole. It may mean this, that everybody will be paid off in full. It may not. But it would take time and it would be very apt to force a closing of the bank. That is my fear about it.

On the other hand, if you do it the other way, as long as you have the two different departments and admit in effect you can not demand a 30 days' notice without forcing the withdrawal of all the demand deposits, and then impose the same reserve, you impress upon the mind of the banker that, in effect and fact, those thrift accounts and savings accounts are demand accounts, and the conservative-minded banker ought to build up a corresponding liquidity in his institution upon recognition of that fact, rather than assume that because he has a 30-day notice he has a protection.

The CHAIRMAN. Governor, I was a little diverted here by a statement made a while ago that was contrary to my recollection of the statute, though I must confess that in recent years I have not made any particular effort to familiarize myself again with the provisions of the law. But I understood from what you said as to the action of Congress in authorizing State member banks to exercise their charter rights, particularly with respect to real estate—I understood from what you said that the Federal Reserve Board would have no right to limit their loans upon real estate?



Governor HARRISON. That was my impression of that provision, because it was a fact that, prior to the adoption of that provision, the Federal Reserve Board did place conditions in practically all approvals of memberships of State banks in some fashion limiting the volume of their real-estate loans.

The CHAIRMAN. Has it not an unrestricted right to do that now under the law?

Governor HARRISON. That action upon the part of the board caused a great deal of discussion and unhappiness in the minds of some State bankers who wanted to become members of the system. Subsequently, if my recollection of this is right—and I have not looked at it for a number of years either—subsequently, the law was amended specifically to provide that all State banks becoming members of the system should retain all their State charter rights.

The CHAIRMAN. No; subject to the provisions of this act and to the regulations of the board made pursuant thereto.

Governor HARRISON. Well, perhaps. I do not remember all the circumstances surrounding that amendment, but I do know that subsequent to it the board abandoned the practice of requiring this condition, and I think it was because they felt they no longer had the authority to require it.

The CHAIRMAN. It has full authority to require it, and if you will note paragraph 3 of section 9 of the Federal reserve act, you will see that it is so. So, if there has been any abandonment of a policy or practice, it has not been due to the statute itself, but to the regulations of the board. This paragraph reads:

In acting upon such application—

That is, the application of a State bank for membership in the Federal reserve system—

the Federal Reserve Board shall consider the financial condition of the applying bank, the general character of its management, and whether or not the corporate powers exercised are consistent with the purposes of this act.

Therefore, if the board should reach a determination that excessive loans in the commercial bank on real estate are contrary to the policy of the board and the requirements of this act, certainly it is within the power of the board to prohibit any such thing by a member bank, whether State or national. But that is not important. It just struck me—

Governor HARRISON. I was reviewing only the chain of events at that time and the fact that the board did stop, as I remember, requiring that condition, in view of that provision of the law. They may have been wrong in their interpretation of it.

One other effect of the multiplicity of laws which makes it possible for one institution to do not only a bank of deposit business but engage in other kinds of business, is the development of these security affiliates.

The CHAIRMAN. Yes.

Governor HARRISON. And I think if we were considering a virgin field and wanted to devise a brand-new banking system in the light of present-day experience, I myself, would prefer that no commercial bank be permitted to have such an affiliate.

The CHAIRMAN. Well, if it be an evil, why not correct it? Why let an evil persist simply because we did not correct it to begin with?

Governor HARRISON. After all, the lapse of time makes a difference if only because of the fact that it teaches customers of banks the privileges and facilities they now get under this departmental system. If that is true and there is an advantage in it, is there any way in which you can accomplish the same purpose without completely divorcing them, but by some amendment to the law that protects the depositors in the bank?

The CHAIRMAN. Is there not some way of correcting it?

Governor HARRISON. I feel certain that if I were Comptroller of the Currency or State superintendent of banks I would not want to be responsible for a commercial bank unless I had the authority to examine the security affiliates, and while there may be some question as to the next step, my own present opinion tends toward the belief that they ought to be required to publish a statement of their condition.

The CHAIRMAN. You will note in the bill offered by me in the Senate on the 17th of last June there is a requirement of that sort.

Governor HARRISON. Now, I think that it is true that some institutions that are under the jurisdiction of the Comptroller of the Currency authorize voluntarily the comptroller to examine the security company. Where that is done, I think it is helpful. I think they are wise.

The CHAIRMAN. They are wise, but is the comptroller wise in assuming to do something for which there is no sanction in law?

Governor HARRISON. I should think that he could imply authority to do that. It did not occur to me he could not and I hope I am not out of my jurisdiction in mentioning this. But certainly, if a national bank has a security affiliate, 100 per cent owned by the same shareholders of the national bank, through which certain business is carried on that is not specifically authorized for national banks under the present law, the national bank and the affiliate psychologically and, in fact, are so close, especially where there is an interplay of transactions between them, which is also perfectly legal, that I think the comptroller could properly go into the security company and examine it just as he would examine the statements of any borrower from the bank.

The CHAIRMAN. Then, if there subsequently should be a failure of the affiliate, and those interested in it should have the assurance that it is in a sound condition because it has been examined by the Comptroller of the Currency, although it is without the authority of law to pronounce it sound, would not there be a moral responsibility upon the comptroller's office?

In other words, what right has the Comptroller of the Currency to employ his attachés, their time and skill and experience, in examining an institution that is not under his jurisdiction?

Governor HARRISON. I should consider it along this line, Senator, that if the national bank has an affiliate that is so close as one such as I have described, and the comptroller is examining the national bank, and it is recognized that, one way or another, it may have a lot to do with the condition of the national bank, and if they give

the examining authority, whether the State superintendent or the comptroller, access to the books or records of that affiliate, I should think there would be no question as to his legal authority to go into it. I think, however, there would be great question as to his right to demand access.

The CHAIRMAN. If he has not the right under the law to demand it, and he has no right to make the examination except as an accommodation—well, why is there an affiliate? Is it not because the parent bank, the national bank, itself under the law is not permitted to do certain things?

Governor HARRISON. That is quite right.

The CHAIRMAN. Exactly. It is an institution primarily and congenitally for the evasion of the national banking act, is it not?

Governor HARRISON. Well, it is primarily to do a certain character of business through a corporation other than a national bank which the national bank is not authorized to do.

The CHAIRMAN. Yes, a particular business that the national bank is not authorized to do.

Governor HARRISON. That is quite right.

The CHAIRMAN. Then, it is indirection, is it not? You need not say so. I will say so.

Governor HARRISON. Do not misunderstand me, Senator. I am not, myself, advocating the set-up or trying to pass upon the legal question whether the superintendent of banks of the State of New York or the Comptroller of the Currency has a legal right to go into one of the affiliates. My only point in mentioning this is that as long as you have been good enough to give me an opportunity of making suggestions, I believe the comptroller should have the authority to examine the affiliates.

The CHAIRMAN. I agree with you if the existence of them is to continue. If they are permitted to have affiliates, I think there should be some authority of law—if we are authorized to enact such a law—that will require their examination and publicity of the statements.

Governor HARRISON. I think there ought to be another provision, if I may suggest another one, in the law itself, that no member bank should, either in the commercial department of the bank or in the trust department, be permitted to buy any of the bonds on the shelf of the security company. I know it is the practice in a great many banks specifically, as a matter of internal procedure, to prohibit such a practice, and the better banks do not do it. But there are other banks that do do it and in order to make it uniform and require those that have not the same ethical sense that others have, to conduct the business in a uniform fashion, I think it would be a wise thing to have a provision in the law specifically covering it. That, again, is all on the assumption that the security companies are permitted to continue. If, as you indicate, there is any question of abolishing them, then I should think that question does not arise.

The CHAIRMAN. Well I myself, for the reason indicated by you, rather question the feasibility maybe of abolishing them because they have been permitted for so long to exist. It might create a confusion and embarrassment that would be worse than the evil itself.

Governor HARRISON. It might result in a real disservice to the community, especially if it is possible properly to control them.

The CHAIRMAN. If it is not possible to control them in some way, I should be agreeable to prohibiting them.

Senator NORBECK. Is there not this distinction between the bank itself and the affiliates, that the laws are intended for the protection of the depositors in the investment of their money, and the affiliate does not lend the depositor's money? Is not that right?

Governor HARRISON. That is quite right.

The CHAIRMAN. Governor, you remarked a while ago something about implied authority. You know, I think, one of the bases of administration is the exercise of what a person chooses to interpret as implied authority both by the courts and administrative officials. I am going to ask you a question or two that may seem personal, but they are not intended to be, nor in any degree embarrassing.

You are governor of one of the Federal reserve banks. What authority of law is there for the establishment of any such office?

Governor HARRISON. Of governor of a Federal reserve bank?

The CHAIRMAN. Yes.

Governor HARRISON. Well, I have not recently reviewed the provisions of the law which relate to the authority of the directors to appoint the officers of a bank, but my recollection is that the directors of the bank are authorized to appoint all the officers of the bank and to fix their salaries, subject to the approval of the Federal Reserve Board. It is necessarily incumbent upon the directors, who are not operating officers, to provide the machinery for running the bank. It is necessary, therefore, by hypothesis, for them to appoint some officers.

The CHAIRMAN. Yes; some officers.

Governor HARRISON. How many officers they should appoint or how high up they should go in executive authority I have not considered specifically; but I should think there is no limitation upon the right to appoint both senior and junior executive officers.

The CHAIRMAN. Well, the provisions of the statute, as I understand it now, are akin to the same provision of law in the national banking act that authorizes a board of directors of a national bank to appoint such officers and attachés as are not otherwise provided for in the law, the meaning of that being that the board of directors may appoint minor officials and attachés of the institution; and to show that that was the purpose of the act—mind you, I think the governor of a Federal reserve bank is a very useful if not an essential officer, but I just want to know how it came about—

Governor HARRISON. I never questioned the legality of my appointment before. I shall look into that provision with a great deal more interest from now on.

The CHAIRMAN. I do not exactly question the legality of it now, though I am sometimes disposed to question the judiciousness of some things that governors do.

Governor HARRISON. Well, in retrospect, I agree with you.

The CHAIRMAN. I have said the questions I was about to propound were not personal. It seemed to me at the time and, upon a further examination of the law, now, that the proponents of the act and the Congress itself, had intended that the chairman of the board of directors of a Federal reserve bank should be the chief executive officer of the bank. Is not that official, as a matter of fact, the chief executive officer of the average large national bank?

Governor HARRISON. It depends upon the by-laws of the bank, Mr. Chairman.

The CHAIRMAN. But do not the by-laws of the bank usually make him the chief executive officer of the bank?

Governor HARRISON. I do not think that is true.

The CHAIRMAN. I had rather supposed so. The statute here sets out that one of the class C directors of the Federal reserve bank shall be the chairman of the board of directors and that in addition to his duties as chairman of the board, he shall be regarded as the peculiar representative of the Government at the bank and it sets forth that he shall be a man experienced in the knowledge of banking—tested in banking experience—and that he shall establish an office in the bank and make regular reports to the reserve board and act as its official representative for the performance of functions conferred by this act and the Federal Reserve Board, rather than the bank, fixes his salary and he is the only officer of the Federal reserve bank under the statute who is authorized to appoint his own assistants, subject to the approval of the Federal Reserve Board. So that it seemed to me at the time—and I do not know that this is of very great importance except that I have been a little disposed to ascertain at this inquiry how far removed from its original conception and purposes, the Federal reserve banks have been taken by administrative action rather than by statutory warrant—that the importance of this official is obvious in the statute. Then, as stated, it goes on to say that the board of directors may appoint such other officers—meaning, as I took it, and take it, minor officials and attachés of the bank.

Now, then, the governor of the bank is regarded as the chief executive officer of the bank, is he not?

Governor HARRISON. That is so under our by-laws.

The CHAIRMAN. And all communications except the formal reports required and sent in by the Government agent and the chairman of the board of directors—all communications are made by the governor of the bank?

Governor HARRISON. Regarding the executive operations of the bank.

The CHAIRMAN. My examination of the law and such examination of the minutes of the board as I have been permitted to make, show that the board itself created the office of governor of the Federal reserve bank, and if it has any authority of law for having done it I have been unable to find it. I do not want to disturb you in the security of your position, because I think it is quite well established. But now, along that line, Governor, do you consider that the United States has a central banking system?

Governor HARRISON. The term—

The CHAIRMAN. I mean in the European sense of the term.

Governor HARRISON. No; I do not think so.

The CHAIRMAN. Do you think the New York bank is the central bank of the United States?

Governor HARRISON. I would be loath to think so.

The CHAIRMAN. Well, do you not think the impression is ingrained in Europe that it is?

Governor HARRISON. Of course, the further you get away, the less knowledge there is of the real facts. It is true that, because under the law, the Federal Reserve Bank of New York has opened accounts for foreign banks of issue, subject to the approval of the Federal Reserve Board, in which, under the law as amended, all other Federal reserve banks are authorized to participate, all correspondence and all contact between those foreign correspondents and the Federal reserve system as a whole, are necessarily through the one bank operating the accounts. I agree with you—

The CHAIRMAN. Do the other banks participate to any extent?

Governor HARRISON. Participate pro rata in everything we do.

The CHAIRMAN. They do?

Governor HARRISON. Yes, sir.

The CHAIRMAN. Right in this connection, Governor: The law itself authorizes the Federal reserve bank, by sanction of the board and under the regulations, to be prescribed by the board, to establish foreign agencies, does it not?

Governor HARRISON. Yes; it does.

The CHAIRMAN. It does specifically?

Governor HARRISON. Yes.

The CHAIRMAN. That being so, what right has the Secretary of State to make a public announcement that no Federal reserve bank official would be permitted to have anything to do with the international bank? Perhaps you would not like to comment on that.

Governor HARRISON. I would prefer not to discuss that.

The CHAIRMAN. You are unable to cite me to-day any sanction of law for that?

Governor HARRISON. I think there is no provision of law which relates to it one way or another.

The CHAIRMAN. Exactly. Well, if you have completed your general statement, I should like to ask you some questions about—

Senator NORBECK. May I ask one or two questions?

The CHAIRMAN. Certainly, Senator.

Senator NORBECK. In your opening remark, you made reference to a very large number of bank failures in the last 10 years. To what do you attribute that; especially?

Governor HARRISON. I should like to answer negatively first. I think it is not attributable to one of the defects in our earlier banking system which the Federal reserve act was primarily intended to remedy and that was an inflexible currency system. Prior to the inauguration of the Federal reserve act there were a great many bank failures. Going back to the class I referred to in 1814, those failures were due principally to a shortage of specie at the time it was demanded. I think it was probably true that few, if any, banks that have failed in the past 10 years have failed because of the fact that the Federal reserve system was not prepared and able to provide currency when needed on eligible paper.

Senator NORBECK. We have had more failures since the Federal reserve act than before.

Governor HARRISON. Yes. I do not know whether we have had more proportionately. I think the percentage of failures in the past 10 years has been about the same as in the period of 1893. But it is no doubt true that the proportion of banks that have failed in

the past 10 years has increased during the past year to a point where, in the last few months of the year, we had a greater number of failures than ever before.

The CHAIRMAN. Suppose there had been no Federal reserve system during the last 10 years. What would have happened?

Governor HARRISON. I think the number of failures that would have occurred, had we not had the system, would have been far greater than we have had, in the face of it.

The CHAIRMAN. When we speak of failures, we mean an actual failure of a bank where it is thrown into the hands of a receiver. But as a matter of fact, prior to the adoption of the Federal reserve system, did we not have periodically a practical breakdown of the entire banking system from one end of the country to the other?

Governor HARRISON. Yes, sir.

The CHAIRMAN. So that banks could not function in a legal way and were compelled to resort to expedients to avert a greater disaster than that then upon the country?

Governor HARRISON. Quite right.

Senator NORBECK. Then you do not attribute the breakdown in the banking structure in the country in the last 10 years to the banking laws?

Governor HARRISON. Senator, I think that the Federal reserve system during the war and postwar depression, performed service which it is impossible for the country or the rest of the world to measure, and had it not been for the Federal reserve system during those periods, no one could imagine what might have happened.

Now, as to the determination of the causes of the failures of these 6,000 banks in the past 10 years, I answered you negatively first, not as a complete answer, but to show that I do not think it was because of the cause of the earlier failures—shortage of currency. It was not that. It was due, in part, I think, to the changed economic set-up in the whole country; due to the fact that, with the automobile and improved roads, the smaller banks in some cases, with nominal capital, out in the small rural communities, no longer had any reason really to exist. Their depositors welcomed the opportunity to get into their automobiles and go to the larger centers where they could put their money.

Senator NORBECK. But that would imply that the money did go to the larger centers.

Governor HARRISON. That is quite right.

Senator NORBECK. Is it not a fact that it did not?

Governor HARRISON. No; but I should like to check that definitely in the statistics.

Senator NORBECK. I am speaking of the centers. I am thinking of the larger towns not in the East but in the Western States where the automobile has been an immense influence in bringing the trade to the centers. I recognize the influences you speak of, but I think they are not major but minor.

Governor HARRISON. I agree with you that there is no one cause that can be specified as the cause of the failures.

Senator NORBECK. Is not the main cause of the failures due to the change in economic conditions?

Governor HARRISON. Probably so.

Senator NORBECK. Is it inability to pay, or has the banker lost his brains in the last 10 years, so that he is less competent than in the decade before?

Governor HARRISON. Under the law, he was authorized to make certain loans up to a certain percentage of his capital and surplus to certain customers. Having done that up to 8 or 10 years ago, he finds that the little community in which he is located is suffering from the postwar depression following the great expansion that occurred in 1919 and in 1920; his customers in many cases either were not able to liquidate their loans at once or, as I think is probably largely true, those customers who had deposits, following the cycle that I have mentioned, removed the deposits to other sections of the country or to bigger centers and left the bank with the less liquid assets, because when a withdrawal of money takes place, the banker has to pay out of cash or his most liquid holdings, and what is left is less liquid. That does not necessarily mean it is not as sound ultimately, but it is slower. If his deposits continue to go too rapidly, there comes a point where he has not enough liquid assets to pay off the demand depositors, and the bank must close.

Senator NORBECK. The shrinkage in the Northwest States has not been in the small towns but also in the centers. There has been a shrinkage that included the whole territory. I quite agree with you that it is due to changed economic conditions.

Governor HARRISON. You see, you have had a deflation in commodity prices of all kinds all over the world.

Senator NORBECK. And how can a change in the banking system remedy it?

Governor HARRISON. I think that you can never set up a system that is going to protect depositors against dishonesty or bad judgment, even though you have the strongest banking laws.

Senator NORBECK. Nor against the falling prices of commodities that affect all property values, can you?

Governor HARRISON. If you could devise a law that would, in effect, guarantee the immediate payment of all deposits, I think the country would be much worse off than it is; in other words, it would have to be so constructed that the banks in a given community would have to keep so very liquid that they could not do the business that the community demands. Therefore, while I think we can not and should not attempt the English system of no regulation, I believe we should strive to get as nearly uniform laws in the 49 jurisdictions as possible to control deposit banking along sound lines, and then do what I think is one of the things not done now as much as it should be—have the directors of each bank realize the responsibility they legally have to see that their officers are complying with the law and to see to it that they are conducting business soundly within the law. I think the banking directorates are too big and that they leave too much leeway, in some cases, to the executives of the banks. If it were possible, perhaps, through some limitation on the size of directorates of banks, to impress upon the directors the real responsibility they have got in controlling the management of the bank within the law, I think we could obviate many of the difficulties we have had, because then you would have the combined judgment of a group of directors who are directly controlling the bank's business



instead of having directors many of whom are merely new business getters.

The CHAIRMAN. The Comptroller of Currency yesterday suggested that in addition to the severer penalty, which the comptroller at all times perhaps is reluctant to impose, of closing up a bank and taking away its charter, that the comptroller might have some authority to suspend or even remove an official of a national bank. What would you say as to that?

Governor HARRISON. I am faced with two difficulties. I think some power other than what the comptroller has got now, which is merely to close a bank, should be given him. I am very sympathetic with anything that would give some right of removal to the comptroller, but without any question of personal reference, the big question, in principle, is whether one individual should be given such a drastic right as removal of an officer not for any violation of a law, but merely because he does not like the way he is doing business. If there was no other way of doing it, I think he should have that right, but I am turning over in my own mind and trying to devise some other procedure which would be as effective, but, at the same time, less paternalistic, perhaps, than that.

The CHAIRMAN. Well, the Federal Reserve Board has the peremptory right to remove any director or official of a Federal reserve bank.

Governor HARRISON. That is less dangerous as an institution—I mean as an American institution—than saying one individual shall have the right of removal.

The CHAIRMAN. That means the exercise of judgment of eight persons rather than one. Governor, right there, before it slips my mind, do you not think that we have a mathematical demonstration of the measurable efficiency of the Federal reserve banking system in the fact that, as to the number of failures for the last 10 years—6,000—the overwhelming majority of them were nonmember banks rather than member banks of the system?

Governor HARRISON. Yes; I think that is true. I think over two-thirds were nonmember banks.

Senator TOWNSEND. The percentage was even larger than that, as stated by Mr. Pole yesterday.

The CHAIRMAN. I think the comptroller said about 85 per cent.

Governor HARRISON. I hope he is right. I thought it was about two-thirds.

Senator TOWNSEND. He said 1,000 out of 6,000.

The CHAIRMAN. The distinction was as to national banks as against State banks instead of member banks against nonmember banks.

Senator TOWNSEND. Yes; that is right.

The CHAIRMAN. The percentage of nonmember bank failures was approximately 70 per cent—68 or 70 per cent.

Governor HARRISON. That is about the figure that was in my mind.

I think the committee may wish to consider, since you raised the question of the authority of the comptroller to do something short of closing a bank, whether the Federal reserve system can do something short of expelling a bank from membership in the system. Of course the actual expulsion, which becomes public notice, will of itself precipitate the very thing you want to avoid—closing the bank.

The CHAIRMAN. The Federal Reserve Board, under the most extreme provocation, has never even exercised its authority to remove a director of a Federal reserve bank.

Governor HARRISON. Query: Whether it would be possible and proper—and I throw this out as a suggestion to the committee—to give to the Federal Reserve Board or to the Federal reserve banks the right to suspend a member bank from any or all of the privileges of membership during a given period in the event that the bank has not, in our judgment, conducted itself in the safest way for the depositors.

If that could be done in some fashion that would not involve publicity, and would not then necessarily invite what you are trying to avoid by expelling the bank from membership, which necessarily becomes public, it would give us a very much stronger hand in dealing with a recalcitrant bank than we have now.

The CHAIRMAN. You are speaking of member banks?

Governor HARRISON. Yes, of course, only member banks—and by recalcitrant banks, I do not mean a bank violating the law, which is in a category of its own, but one which we believe is getting itself into a position demanding more and more or a bigger and bigger proportion of our assets in loans.

It has been asserted that we have the authority of denying borrowing privileges.

The CHAIRMAN. You have that authority complete.

Governor HARRISON. I think that myself. I agree with you that legally we have. The only difficulty with the exercise of that sort of power, Senator, is this, that a bank borrows from the Federal reserve bank not for the purpose of taking the money and applying it to a particular loan or to a particular purpose but rather to make good an already existing deficiency in its reserves.

At the end of a day—and I am talking principally of the banks in the principal money centers with which I am most familiar—at the end of a day the bank finds itself with either an excess of reserves or a deficiency of reserves as a result of a myriad of transactions, due to new deposits, a loss of deposits, wire transfers to other sections of the country, new loans, and perhaps transfers abroad or incoming transfers—at any rate, at the end of the day it will find itself with a deficiency, we will say, of \$10,000,000, and they come to us with perfectly eligible paper and ask us to give them \$10,000,000. We have two alternatives. We can say, “Yes, you can have that at our rediscount rate, because you have eligible paper and need it to repair your reserves,” or, if we exercise the authority to refuse to make that loan, which right has been questioned by many people, the only thing that happens is that they are deficient in reserves, and they borrow the money in a way, by having a shortage in their reserves rather than by a straight loan. It is true that the shortage carries with it a higher rate because they have to pay a penalty on the deficiency. But that is not the sound way of trying to correct the bank in its management even if we thought it was wise—that is, force them to be deficient.

My thought was that if the committee could consider the possibility and propriety of giving to the reserve bank, subject to the

approval of the Federal Reserve Board, the right of suspension from any or all of the privileges of membership so that we would have the decision, in given circumstances, of what privileges we will deprive them, there would be no question about that and it could be handled with such dexterity as to avoid certain undesirable consequences that we might otherwise precipitate.

The CHAIRMAN. I can't conceive why you should say or think that you have not complete authority to refuse the rediscount privilege.

Governor HARRISON. When I was counsel for the Federal Reserve Board I gave an opinion to the effect that we had complete authority and I have not changed my mind about it, Senator.

The CHAIRMAN. I understood you to suggest that there was good reason to oppose that view.

Governor HARRISON. No; I merely meant to suggest that I saw the points that some on the opposite side raise. I do not agree with them.

The CHAIRMAN. Do you take the view that member banks, in the first instance, or the Federal reserve banks, in the second instance, have no right to inquire or to know to what use a borrower is going to put the funds obtained?

Governor HARRISON. Senator, I do not believe that it is a practicable thing, regardless of our legal right, to inquire what a borrowing member bank is going to do with the money it gets from the Federal reserve bank, for the reason, as mentioned a while ago, that it is an impracticable thing for the Federal reserve bank to try to control the application of the proceeds of a loan. In the first place, by and large, the banks themselves do not know what particular transaction or group of transactions have made the loan necessary. They are running various departments, and at the end of the day they concentrate all their figures and find they are deficient in their reserves and they come in to borrow because the law requires them to maintain their reserve position. If the Federal reserve bank should undertake to predicate its loans upon an agreement from the banks as to what they were going to do with the money, the bank would probably say to us, "We do not know; we are just filling up the void that has occurred as the result of the total of our day's transactions."

The CHAIRMAN. Did it not know?

Governor HARRISON. Well, it may have been, for instance, that the \$10,000,000 that I referred to a moment ago was due, first, to a withdrawal of \$10,000,000 of deposits by a foreign correspondent taking the money over the cable transfers. On the same day the bank may have made a loan of \$10,000,000 to a broker on stock exchange collateral. Without either one or the other they would not have had the deficiency. Now, to say which it is that caused the need for that particular \$10,000,000 is, of course, impossible to determine. It is the sum total of all transactions that made it necessary, but even if you could determine that, then comes the further question in my mind as to whether the Federal reserve bank should, even if it could with propriety and with adequate wisdom, control the business of member banks within the law by a threat of a refusal to make the loans, whether you and the country as a whole would be satisfied to have one group of men in a Federal reserve bank outlining the policies and controlling the operations of

all the individual institutions that are members of the Federal Reserve system.

It is for that reason that I feel more strongly than I can tell you, that so long as a bank is within the law, the directors are primarily responsible for the direction the management takes within the law in the matter of its business.

The CHAIRMAN. Do you regard the Canadian banking system as a rational and sane system of banking?

Governor HARRISON. If I may answer the question a little differently, I should think the English system for England is excellent; that is, where they have got four or five principal joint-stock banks with branches all over the country.

The CHAIRMAN. I am not asking the question strictly with reference to branch banking. I am talking about the soundness of the system, its readiness and ability to respond to commercial requirements.

Governor HARRISON. I do not know, Senator, that I am familiar enough with the details of it really to give you a helpful answer to that question.

The CHAIRMAN. I am asking the question because, as I recall the testimony of Sir Edmund Walker, who was at that time the chief executive officer of the Canadian banking system in 1913, he told us that the customers of the Canadian banks were required at the beginning of each fiscal year, to submit to the bank a budget of their contemplated requirements and expenditures for the ensuing fiscal year and that, upon the basis of that budget, the loans for the year were made, so that they seemed to think that it was the desirable and essential thing to do, I am told, to know what use was to be made of the money borrowed from the bank.

Governor HARRISON. That is a little different, is it not, though, because there you have an individual customer? You or I or any other man in business, especially in these days, usually makes up a budget of his needs for the year and that is a well-defined budget based upon perhaps years of experience in his operations. But when a bank embarks upon its business for the new year, the position in which it is going to be in the course of the year, is one that no wisdom in the directors or officers would be wholly able to anticipate, because of the fact that their business depends upon the individual businesses of their customers, plus the whims of depositors and, in some cases, unexpected runs. It is too big an order to expect individual member banks—certainly a sizable member bank in one of the big money centers—to anticipate those needs. The smaller the bank, the less variable its business and the more likely it can, and in some cases they do, come before us and talk over their needs for the coming season.

For instance, in some of the smaller banks uptown in the cloak and fur district we know, as a matter of experience over a period of years, that they will require funds from us beginning in the spring and running through three or four months. That usually works pretty well according to rule, but the larger money market banks would find it almost impossible for them to make up a budget of their needs from the Federal reserve bank.

The CHAIRMAN. Maybe so. The Federal reserve system, as I understand it, if I do understand it, was intended to be a commercial system and its primary purpose, if not sole purpose, was to respond to the requirements of commerce and business and industry. That being so, the Federal reserve bank was given the right, by the statute, to discount the paper of member banks—paper such as notes, drafts and bills of exchange, drawn for agricultural, industrial, or commercial purposes. Those were the purposes set out in the law for which discounts might be made by the Federal reserve bank of eligible paper of its member banks and to the Federal Reserve Board is delegated by law the power to define the character and eligibility of paper that may be discounted, and in the same section which confers this authority upon the bank and the board, it is textually stated that 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.

Now, what do you interpret that to mean? What is the prohibition there, in that case?

Governor HARRISON. I think it means this, that if any one of us should undertake to go to a bank and borrow \$1,000 from the bank for the purpose of purchasing, say, \$1,000 worth of stock and carrying that stock, that bank which loaned us that money could not then bring that note, secured by that stock, to the Federal reserve bank and have it rediscounted.

But it does not mean, in my mind, that if a bank makes such a loan as that to its customers and at the end of a day it is deficient in reserves for a variety of reasons, that we should say to it that, having made this loan of \$1,000, on this collateral, the bank is no longer entitled to accommodation from the Federal reserve bank.

The CHAIRMAN. You say you are not authorized to inquire into what purpose the bank is going to use the money it gets from the Federal reserve bank. How do you determine—

Governor HARRISON. If a bank comes to us with a note of a commercial concern, or a farmer, or someone in a small merchandise business, or a big merchandise business, and the note is for \$5,000 or \$10,000, and they ask us if we will discount it, we will ask for a statement of the original borrower to find out whether their condition is such as to indicate that the loan that they have made from the bank was for a commercial purpose rather than a capital purpose and if their statement shows a situation which would indicate to us that they are not borrowing for a capital purpose, but rather to conduct their business commercially, to buy an inventory pending sale or buy seeds pending planting of a crop, we then make the discount. We would not feel free, if a bank came to us with that kind of paper, to say they could not have the accommodation merely because, on the same day, they had loaned \$10,000 to Bill Jones to buy stock.

The CHAIRMAN. You think then that this law is practically futile and a dead letter? In other words, you think that a member bank that wants to engage in the business of making loans for the purchase and carrying of stocks on the market, has a right to do that

ad libitum and take its eligible paper to supply the deficiency in its funds thus created by engaging in the stock transactions?

Governor HARRISON. It is a pretty hard question, Senator, for this reason, that, for a great many years prior to the beginning of this great era of speculation the business of banks has included the making of loans upon equities in approved American concerns. It has been one of the businesses of banks for many years, for generations, to make loans upon the stock of corporations or the bonds of corporations. Now, those loans are not necessarily speculative loans. They may be a perfectly proper means of securing a loan.

Over a period of years those loans in banks may have been for a perfectly legitimate financing of the needs of the American people quite apart from speculation. Now, what happens? We come into an era of speculation such as we had commencing with 1928 and those loans go up very rapidly, and then the question comes, who is going to determine whether they are going up too rapidly or not too rapidly, and if someone in the Reserve, in his judgment, thinks they are going up too rapidly, shall he use the threat of refusing a loan on legally eligible paper to restrain that one particular kind of business which in itself is not prohibited by law?

Actually, all through this period of speculation, the New York City banks' loan accounts on call loans, varied hardly at all. They stayed around a billion dollars, which has been about the figure it has been ever since we began collecting figures, and when the stock loans were mounting with great rapidity the loans by the New York City banks stayed fairly level.

It would not have been competent for us, at that time, with no evidence of increase in that character of business which admittedly is legal, to say they should not have accommodation from us if they lost deposits or needed to repair a deficiency in reserves for any reason whatsoever.

The CHAIRMAN. I am not addressing myself to any specific instances. I want to adduce your opinion as to the intent of that prohibition of the law there. What had the proponents of the Federal reserve bank system in mind when they inserted that prohibition in the law?

Governor HARRISON. Of course you know much better than I, but I should not think one of their purposes was to try to control gambling or speculation by the American citizens.

The CHAIRMAN. Was not the intent—not to control it or to prohibit it—was not the intent clearly to prohibit the use of Federal reserve banking facilities for that purpose?

Governor HARRISON. I was going to state that second step. I do not think it was intended to control or even prohibit speculation upon the part of the American people because I do not think through the Federal reserve act, that it was possible. But it was intended to keep out of the Federal reserve banks loans which were made for speculative purposes.

The CHAIRMAN. Yes.

Governor HARRISON. Now, the question which you are asking is an intermediate question; whether loans perfectly eligible under the terms of the law must not be made because of the fact the bank that is trying to obtain accommodations from us on those loans, has made

some other advance to another customer for, perhaps, a speculative purpose.

The CHAIRMAN. Then we get back to the crux of the whole matter. It is your opinion that this provision of the Federal reserve act is totally futile because a bank may use its funds and its rediscount privileges at the Federal reserve bank to supply the deficiency in its credits, created by stock-speculative purposes?

Governor HARRISON. That would be my interpretation of that provision, that—

The CHAIRMAN. That it could do that?

Governor HARRISON. That we could not refuse to make the loan solely because—

The CHAIRMAN. That is what I said, that you could practically nullify this provision of the Federal reserve act by, nevertheless, accommodating a bank which had been engaged in the wildest sort of speculation, in order that it might replenish its credits out of borrowings on eligible paper; it might replenish its credits used for stock-speculative purposes.

Governor HARRISON. I would not say that we nullify that, that way, because of two reasons; first, if that bank is unique and only one bank in a group, then we would control that bank in its borrowing, as we have ever since I have been with the Federal reserve bank, not through telling them we do not like their particular type of business, but on the ground they are borrowing from us disproportionately or too continuously, out of line with the other banks in the community.

Now if, on the other hand—

The CHAIRMAN. You tell them that without any knowledge of the use they are making of the funds?

Governor HARRISON. We have their statements, of course, which indicate that their commercial loans have gone up so much or their collateral loans have gone up so much or their investments have gone up so much—

The CHAIRMAN. I say you know it if your examiners are worth a threepence.

Governor HARRISON. We know that, and any time they are borrowing out of proportion, we bring pressure upon them.

The CHAIRMAN. You do not think you have any right, notwithstanding you have full knowledge of the character of the loans the member banks are making—you do not think you have any right to decline, under the law, to rediscount for that bank which obviously is proposing to use the assets of the Federal reserve bank to supply deficiencies in its credits already used for stock speculative purposes?

Governor HARRISON. Of course, the difficulty, Senator, is to get your hypothesis. I mean the mere fact collateral loans are going up does not necessarily signify that those loans are speculative. Let us forget the last two years—

The CHAIRMAN. Let us not forget anything. What is the use of that language if the Federal reserve assets or facilities may be used as you indicate you think they may be used?

Governor HARRISON. It keeps out of the Federal reserve what we call nonself-liquidating loans. It does not permit us to purchase or to collateral Federal reserve notes with a loan that is predicated

upon the purchase or carrying of stocks or bonds, and we think that is a very definite, concrete provision, and I think it is a wise provision.

The CHAIRMAN. What effect has it if a bank may shift its credit, as you indicate it may do; if it may use its funds legally in stock speculations or loans to brokers for that purpose and recoup itself and replenish its exchequer by rediscounting with the Federal reserve bank?

Governor HARRISON. It has this effect, that it insures a very definite complexion of the portfolio of the Federal reserve bank. It keeps in the Federal reserve bank a much more liquid and self-liquidating asset than if we are permitted to rediscount these loans upon stocks.

The CHAIRMAN. Yet the bank will be availing itself of the Federal reserve facilities to do the very thing that the law plainly was enacted to prevent; in other words, Governor, I think I may say with some degree of confidence—I had something to do with it—the plain intent of the proponents of this act was to remove the assets of the Federal reserve banking system as far away from stock speculative activities and purposes as it was possible, by statute, to get it.

Governor HARRISON. That is true, and I think it has done that.

The CHAIRMAN. It has not done it if banks do as you say they may do.

Governor HARRISON. But the assets that we hold in the portfolio are free from speculative—

The CHAIRMAN. That simply relates to the securities for your loans—to the soundness of those loans. It does not relate to the purposes of them.

Governor HARRISON. Then, Senator, if that is true, if we can not go by the face of the note—

The CHAIRMAN. You do not have to go by the face of the note. You know what the bank is doing.

Governor HARRISON. Then, if that is true, there would be no purpose in limiting the eligibility of paper for rediscount with the Federal Reserve Bank. We might as well lend to those banks on bonds—

The CHAIRMAN. As a matter of fact, you could not lend them on bonds at all if, at that time the proponents of the act had ever had any conception of the fact that there would be billions of dollars of outstanding United States bonds. You know when the act was passed there was less than \$1,000,000,000 of outstanding United States bonds and they were rapidly disappearing. We never would have included the right to use United States bonds as collateral for those purposes, but for the fact that they were at that time rapidly disappearing.

Governor HARRISON. No; what I intended to say is this—and I want you to help me because it is a practical difficulty in the operation of the bank—either we have got to try to control the management and investment policy and loan policy of a member bank or not.

The CHAIRMAN. No; only with respect to what the law prohibits and what the law permits.



Governor HARRISON. But the law, as I thought we both agreed at the outset, did not attempt to control what others than the Federal Reserve Banks were doing. It could not. I have always interpreted that provision that way. All it intended to do was to make sure that the Federal Reserve Bank took into its assets the kind of loans limited to agricultural or commercial purposes. If we can not predicate our judgment upon the paper presented to us and rely upon that—if we have to go beyond that and say “We do not like this bank because it makes a loan to Bill Smith, a gambler”——

The CHAIRMAN. It is not a question of going back of the paper.

Governor HARRISON. If we have to go beyond the paper presented and determine the loan upon not the character of the paper, but the business of that bank——

The CHAIRMAN. You have to determine it upon the purpose for which that borrowing banks wants money from you.

Governor HARRISON. In the usual case I would have to say that I could not tell.

The CHAIRMAN. What are your examiners for if you can not tell?

Governor HARRISON. Even the examiners, and the best examiners, go into a bank and they find their security loans are so much. They can not necessarily assume that those security loans are speculative loans. In many cases they are not. Some place along the line this other theory would involve some man saying that a bank has gone beyond a commercial or an investment business and is helping somebody in a speculative business, but there is no way of knowing it. At times, the banks themselves do not know whether the borrower is speculating.

The CHAIRMAN. But ought they not to know that?

Governor HARRISON. It is sometimes pretty difficult to find out.

Senator NORBECK. You said a while ago if a farmer or a merchant submits an application for a loan, you go into the question of whether it is for capital or other purposes.

Governor HARRISON. Yes.

Senator NORBECK. In other words, a farmer wants \$5,000, and the question comes up whether it is for feeding cows or buying cows.

Governor HARRISON. Yes. However, Senator, I will say that loans under \$5,000 we handle in a different category. We do not require statements, but other than that, your statement is correct. We still do that with every bank of the kind that the chairman is talking about. When that note of the farmer comes in and we determine that it is of the kind you suggest, we discount it. But the question is if the bank that is wanting a loan from us is making a collateral loan to some one else, should we decline to take the farmer's paper because of that.

Senator NORBECK. I have reference to going into the application for those loans very carefully. You stated how carefully you went into some of them, and that the chairman was asking about some others.

Governor HARRISON. I think there has been a misunderstanding. We go into all loans that come to us from whatever bank and if the paper is eligible, in accordance with the terms of section 13, we take it unless we consider that the bank has been borrowing too long or disproportionately larger amounts in line with the rest of the community.

Now, the only question that I understand the chairman is asking me is whether if a bank which presents us with this paper of this farmer that you have just mentioned—hands us that paper and we find out on the same date, at the same time or currently, they are making other collateral loans to someone else that are speculative loans, we should refuse to take the farmer's paper.

Senator NORBECK. I thought you said you did not go into the matter. I am sorry I interrupted. Go ahead.

The CHAIRMAN. That is all right, Senator. You are privileged to ask any questions you desire and at any time.

Senator WALCOTT. Does not this all fall back on the definition of what a speculative loan is? Is it not a seasonable thing—

Governor HARRISON. Senator, that was the second point I mentioned when the Senator asked me if we have any control. If the community is borrowing too much money and the credit in the country is expanding too rapidly or beyond the normal seasonal growth, determined by the total volume of trade and business, then I believe it is incumbent upon the Federal reserve system to control the expansion in the way the law has given us, by putting on the brake of the rediscount rate. I think that brake of the rediscount rate should be applied in such a case whether the expansion is due to speculation in real estate, securities, or commodities, or whether it is due to abnormal growth in business. I think if credit is going up too fast, whatever the cause and beyond a rate we can stand very long, then you have given the power to put on the brakes through the rediscount rate.

But to particularize as to a particular bank and to determine whether certain loans are or are not speculative loans, is a very difficult thing for one group of men to determine for 900 banks.

The CHAIRMAN. It is neither difficult nor impossible to apply what this statute regards as speculative loans. It says expressly that you are not to permit the facilities of the Federal reserve banks to be used to purchase or to carry—

Governor HARRISON. We do not—

The CHAIRMAN. To purchase or to carry—oh, you may not do it directly, but you practically vitiate this act in the way you do it.

Senator WALCOTT. The borrowing bank does it.

The CHAIRMAN. The Federal reserve bank permits the borrowing bank to do it. It is the business of the Federal reserve bank to know what the borrowing is doing and for what purpose it is doing it. If that is not the meaning of this act, why should they feel—your board of directors ever feel, in any sense or degree—warranted in admonishing member banks in New York to reduce their loans to brokers?

Governor HARRISON. Senator, we never did it.

The CHAIRMAN. You did not?

Governor HARRISON. No, sir. We did it—

The CHAIRMAN. Did not the Federal Reserve Board do it?

Governor HARRISON. That is a matter of public record. We never did it in New York—

The CHAIRMAN. Should not you have done it?

Governor HARRISON. For two reasons: In the first place, the so-called brokers' loans of the New York banks were not going up.

They were staying stable at the figure at which they rested even before the period of speculation began and, in the second place, our directors felt from the beginning the proper method of breaking such expansion, if it occurred, was through the rate rather than through a particular admonition to particular banks.

The CHAIRMAN. Right there now. If not to be controlled, if you have no authority to abate or control that sort of thing, why do you do it through the rediscount rate? Why do you apply the rediscount rate to a situation of that sort and penalize the legitimate commerce in order to control something you say you have no right to control?

Governor HARRISON. I think we have a perfect right to control an expansion of credit, regardless of the cause of it, when credit is expanding as it was in 1928 and 1929 at a great rate all through the country. Because of the demand for money for speculative purposes, we wanted to put up our rediscount rate believing that was a proper means of limiting a too rapid use of the country's assets for speculative or other purposes.

The CHAIRMAN. Could you not more effectively have done it by declining to let the assets of the Federal reserve bank be used for that purpose?

Governor HARRISON. I do not believe we could.

The CHAIRMAN. I disagree with you. I think you could. We see now what is the result of the failure to do it.

Senator WALCOTT. Suppose you recognize—you and your associates—that the whole tendency of the country is toward rapid inflation as it was pretty generally admitted, say, in 1928 or 1929. There is no difference of opinion about it except perhaps with a new group of younger persons who have never had experience with this thing—do you feel that you, as governor of a Federal reserve bank, have not the legal power to put the brakes on? This is one of the prime objects of this investigation.

Governor HARRISON. I think we have. I think the power to put the brakes on through the rediscount rate, which, in usual circumstances, is always effective if attacked promptly and courageously, is given us. We made mistakes. I do not think we went up fast enough.

Senator BULKLEY. You say you did not go up fast enough?

Governor HARRISON. No, sir; I do not think we did.

Senator WALCOTT. Without making a record of the mistakes, do you not think there are other ways just as effective as advancing the rate, which penalizes business which you want to succeed and in which there may be no marked inflation?

Governor HARRISON. No, for this reason; that if you try to do it through so-called direct action, what would happen in a community such as New York? You would, perhaps, squeeze such loans out of one bank only to have them slip around into another bank and you can not by questioning an individual bank, force down the whole level of any one character of loans.

The effective way to do it is to put a rate control into effect which will invariably result in a liquidation of those loans least desirable first; in other words, if you are a borrowing bank and we put the pressure of a 6 per cent rate on you, and you want to get out of our debt, you will not call the commercial customers' loans, but the

least desirable loans or the most liquid loans or call loans, which are used as secondary reserves. When the rate pressure begins to work in New York, the first loans that begin to go are the call loans. Why? The banks trying to get out of debt will look at the collateral loans and will pick out the least desirable of the call loans and then, if the pressure is still too great, they will go up to the second level of call loans. That is where they adjust their position first.

The rate at that time, in my judgment, would have been effective had it not been for these loans "for others," which did more than anything else to make all Federal reserve policies less effective than they would have been otherwise.

The CHAIRMAN. We want to discuss the loans for others.

Governor HARRISON. I think that is the biggest problem in the discussion to-day.

The CHAIRMAN. I simply do not agree with the governor that the rate of discount was based upon a desire to control the market. I think it was intended as a responsive method of administering to local requirements, and I have never been able to see, and I did not see in 1920, either the fairness or the effectiveness of increasing the discount rate and thereby imposing a penalty upon the ordinary business of the country, commercial or industrial, in order to control the activities of the stock market. It was not effective then and a great many experienced bankers did not think it would be or was effective more recently. When people are betting on margin—or putting it in a less offensive way, when people are operating on marginal transactions in which they usually hope to make large profits—they do not pause to consider the change of one-half or one-quarter of 1 per cent in the discount rate, do they?

Governor HARRISON. No; but the bank itself considers very seriously whether, with an increase in the reserve rate, it wants to borrow the reserve against an expansion of loans.

The CHAIRMAN. The Federal Reserve Board did not agree with the view of the New York bank about that, did they?

Governor HARRISON. No, sir.

The CHAIRMAN. And the Federal reserve advisory council, composed exclusively of more or less experienced and skilled bankers, did not agree, did they?

Governor HARRISON. I thought they did. They, at one time, disagreed, but when they were asked the specific question whether we should be allowed an increase in our discount rate, they voted unanimously in favor of it.

The CHAIRMAN. At the very last—but did not the advisory council advise against it?

Governor HARRISON. Against increasing the discount rate?

The CHAIRMAN. Yes.

Governor HARRISON. I do not think they did. I thought they specifically said they approved of what the Federal Reserve Board was trying to do through direct action in February but that they were not then questioned as to the discount rate.

The CHAIRMAN. If they approved that, they could not approve the rate.

Governor HARRISON. They may have done both.

The CHAIRMAN. I may have been misinformed, but I think I am right in the statement that they did.

Senator WALCOTT. What do you think the effect would be if we removed the tax on the profit from the sale of securities, on what we are talking about—the effect on the speculative market?

Governor HARRISON. I think it would have a stabilizing influence, Senator—not necessarily if withdrawn, but reduced—because it would remove some of the inhibitions some people have on selling when stocks go up.

Senator, may I—

The CHAIRMAN. Governor, right there, and as a corollary to the question the Senator has just asked: Do people invest their funds for a day, or an hour, or a week, or a month? Is that your conception of that terminology—investing?

Governor HARRISON. Of course the question of the motive at the time of the original purchase is difficult to determine. If I buy 100 shares of stock to-day, intending to put them in my vault to keep them indefinitely, and then I find something has happened to me or my family within 10 days that forces me to sell them, I think I am not out of the investment class.

The CHAIRMAN. If it has been your habit, however, to buy them at one hour of the day and sell them at the next hour of the day, or the next week, would you regard that as an investment?

Governor HARRISON. I should not.

The CHAIRMAN. What would be the effect—

Governor HARRISON. Except this: I mean dealers in various securities who buy securities merely for the purpose of reselling, of course, could not be said to be speculators on that ground just because they sell within a short period. They are merchants in securities.

The CHAIRMAN. What would be the effect of a tax on transactions on the stock market where the stock had been held for less than 60 days?

Governor HARRISON. I do not believe, myself, Senator, that would be wise.

The CHAIRMAN. I am asking you what you think the effect would be.

Governor HARRISON. I think it may deter a lot of these traders in securities in the volume in which they trade—the fellows that are in and out all the time—but whatever else you may say about their motives, they are stabilizers in the market rather than otherwise. It may deter that.

I am wondering whether, though, it may not do something else—put at a discount great volumes of securities which are dealt in day after day purely as investments, because I or someone else may not want to buy securities subject to a prohibitive tax if I were to sell out within a day or so.

The CHAIRMAN. I did not say a prohibitive tax.

Governor HARRISON. Well, an effective tax. It may be a deterrent also to perfectly legitimate investments, because a man may say, "I do not like to buy something that has such a tag on it."

The CHAIRMAN. There is incidentally and inevitably associated with every proposition something to which an objection may be raised. That is a casual objection. That is a thing that would happen, perhaps not so frequently, but it might happen.

Governor HARRISON. I think I would rather see, myself, a general increase in the tax on the purchase and sale of securities, provided it was coupled with something such as Senator Walcott mentioned to you, a reduction in the capital tax for profits. I think that would make an improved situation.

The CHAIRMAN. I was a little interested in that phase of the matter by reason of the fact that I had a chart prepared—how accurately it was prepared I do not know, because I have no skill in such matters—but from it it appeared that the time of holding the average stock dealt in on the New York Stock Exchange had receded from 67 days 14 years ago to 22 days now.

Governor HARRISON. Yes; it is a very much more rapid turnover. Senator, I do not feel that my comments about the discount rate would be wholly complete unless I referred to the fact that any effort to control the expansion of credit, such as was going on in 1928 and 1929, becomes prejudiced by the fact and to the extent that loans can be made for speculative purposes wholly outside of the banking system. Several times in that period when Federal reserve policy became influential in checking the expansion of so-called speculative loans, our purposes were defeated. Why? Primarily because of loans for others from corporations and individuals wholly outside of the banking structure, who sent in money for the purpose of making loans to handle transactions on the stock exchange because they were invited to do so by rates that ordinarily deter the banker from doing it.

There were three different occasions in 1928 and 1929 when it is fair to say that a check in the speculative rise was turned into an advance again by virtue of the fact that these loans from others went up at such an inordinate rate, and quite apart from the speculative feature, the huge volume of these so-called outside loans was always a potential threat upon the banking structure because of the fact that whenever the situation went into reverse those loans were sure to be thrown back on the banks. In 1929 there were \$3,000,000,000 of those loans thrown back onto the banking system. It does not mean that that amount net was taken over by banks, because the total of all brokers' loans went down at that time.

The CHAIRMAN. Well, what seemed singular to me, Governor, was that the New York bankers seemed to think that the discount rate was intended to control the stock market rather than to relate itself directly if not exclusively to agricultural and commercial transactions.

Governor HARRISON. I do not think it is possible, through any action on the part of the reserve system or any other central banking authority to make money cheap for business and expensive for speculation. The credit pool is too big and fluid a pool for any group of men, whoever they may be, to dictate the rates for funds that are to be put to different purposes.

The CHAIRMAN. I hope it shall, on the other hand, be possible to prohibit it in a more effective way than it appears we have been able to do in connection with the use of Federal reserve facilities for speculative purposes.

Governor HARRISON. Well, I think there are things that can be done to help, if we can control, for instance, the amount of these

loans for others on the outside, so that the pressure of the rate relates itself to all reserves against those loans in the banks. Then you will have a more effective control, in my judgment, than you can have in any other fashion. Prompt action in cases of that kind will effectively accomplish its object without any great deterrent to business because business does not mind a high rate for a very short while—up and then down. The thing that hurts business is a prolongation of a rate structure which gradually kills off the bond and mortgage markets, followed by the effects of that inaction going through the whole economic structure. If, on the other hand, you can advance the rate quickly enough without regard to any temporary effect on the business rate, you can probably accomplish what you want to accomplish without too severe pressure on business because the higher discount rate will, in the first instance, put pressure on the banks to liquidate their call loans and not their customers' business loans. It has always been that way.

The CHAIRMAN. Governor, it is now the lunch hour and I had hoped that we might continue the hearing this afternoon, but we find it is not feasible to do that. Would you mind waiting over until morning?

Governor HARRISON. I am completely at your service.

The CHAIRMAN. I want to inconvenience you as little as possible.

Governor HARRISON. I would prefer, if you could give me another day than to-morrow, because I have a meeting with all the governors of the other Federal reserve banks to-morrow.

The CHAIRMAN. How about returning Friday?

Governor HARRISON. That will be quite agreeable to me.

The CHAIRMAN. Could you be here Thursday morning?

Governor HARRISON. Yes, sir.

The CHAIRMAN. Very well; we will adjourn, then, until Thursday morning at 10.30.

(Whereupon, at 1 o'clock p. m., the subcommittee adjourned until Thursday, January 22, 1931, at 10.30 o'clock a. m.)

# OPERATION OF THE NATIONAL AND FEDERAL RESERVE BANKING SYSTEMS

THURSDAY, JANUARY 22, 1931

UNITED STATES SENATE,  
COMMITTEE ON BANKING AND CURRENCY,  
*Washington, D. C.*

The subcommittee met, pursuant to adjournment, at 10.30 o'clock a. m., Hon. Carter Glass, chairman, presiding.

The CHAIRMAN. The committee will come to order. Governor Harrison, I believe when we adjourned the hearing day before yesterday I was interrogating you on the matter of doing something to control in some degree security loans by member banks and incidentally rediscounts of Federal reserve banks to such member banks. Have you examined section 11 of the bill that I proposed last June in the Senate? I think I may add this, that the intention of the proponents of the Federal reserve act in permitting the 15-day direct loans on either eligible paper or United States bonds or notes was solely to tide a bank over an unexpected emergency in which it might have largely extended itself accommodations for commercial purposes. As a matter of fact, has not that provision of the act been very extensively used to increase stock-market operations?

## STATEMENT OF GEORGE L. HARRISON, GOVERNOR OF THE FEDERAL RESERVE BANK OF NEW YORK—Resumed

Governor HARRISON. Mr. Chairman, there is no doubt that the authority conferred in section 13 of that act has been extensively used. I do not know that I would agree with you that that privilege has been used or abused for the purpose of extending accommodations for speculative purposes, and I feel that way largely for this reason: At the time the law was amended so as to authorize the 15-day advance, provided it was collateralized by eligible paper or Government bonds, there was a feeling, I know, on the part of the reserve banks and a great many of the member banks, that it would be a great facility to them to have the privilege and avoid what was mechanically a very cumbersome operation in rediscounting to maturity a great many individual notes; in other words under the law we had the right—I am not talking about Governments now, I will get back to that—under the law we had the right to rediscount individual pieces of paper of certain definite maturities, provided they were eligible. If a bank needed an accommodation of \$50,000, a small bank, it was able to bring to us a great number of different pieces of paper of different maturities which we would



have to purchase at the rediscount rate, figuring up maturities on each individual note, and figuring up the discount on each individual note separately. This was mechanically a very cumbersome operation for a great many institutions and for the Federal reserve bank.

The CHAIRMAN. And yet it would seem inseparable from the process of rediscounting eligible paper.

Governor HARRISON. Well, it was felt that the spirit of law—and I am still not talking about Governments—would be complied with quite as satisfactorily if we were authorized to make an advance to the member bank of that \$50,000 on its own note for 15 days, collateralized by all of this composite of different kinds and different maturities of eligible paper. In that event all that we had to do was to figure the maturity of 15 days on the one note, figure the discount for that 15 days, and be certain that the collateral back of it was adequate in face value and in goodness to cover the face amount of that note.

The CHAIRMAN. The other collateral would be the United States securities, would it not?

Governor HARRISON. Yes, sir; the other collateral made available was United States securities.

The CHAIRMAN. Would not that be shifting us right back to the very thing that the Federal reserve act was enacted to take us away from; would not that be shifting us back on bond and security currency instead of upon currency based on commercial transactions?

Governor HARRISON. I agree with you that the right of member banks to borrow on notes secured by Government securities provides an additional mechanism which might be used to further an inflation in the currency. If banks used the mechanism in this way, then in principle and in fact it would be bad; but, as a matter of fact, what happens is this: Almost every bank that seeks accommodations from the Federal reserve bank on the security of Government securities has plenty of eligible paper to present to us and chooses the Government securities in preference to commercial paper, because that is a more simple operation than using individual collateral notes of different maturities, which they would have to submit to us. In fact, they go even further than that. A great many of our country banks, not city banks, not knowing when they are going to be deficient in reserves, not knowing when their deposits are going down, and needing accommodation from us, maintain with us Government securities in safe-keeping. Just as a custodian, we hold these securities in safe-keeping, available for instant use and for accommodation to them if for any reason they are short of currency; otherwise, if we do not do that, they would be compelled, as a great many of them are, because they have no Government securities, to ship eligible commercial paper from whatever part of the district they are located in, and then, if we get the paper the next day and find it to be eligible, we go through the discount procedure I mentioned a moment ago.

The CHAIRMAN. But the intent of the law was always to meet just such emergencies as that, to avoid the sudden embarrassment of the bank that might find itself in need of additional funds to accommodate the commerce of each community. It was not intended

to be a regular practice. Suppose, for example, to show more clearly what the intent of the law was, suppose we did not happen to have a war and had not issued billions of dollars of United States securities, to what extent would this practice prevail.

Governor HARRISON. I question whether the law would ever have been amended to have permitted it unless and until the volume of eligible paper, as defined by section 13, should decline to the point where it would be inadequate to support the volume of the country's business and reserve-credit requirements.

The CHAIRMAN. How could the eligible commercial paper be inadequate to support the country's business, if you mean by country's business the commerce of the country?

Governor HARRISON. Mr. Chairman, I may not be quite accurate in my figures, so take these subject to amendment, but in 1920, as I remember it, the total volume of eligible paper in the hands of the national banks was over \$4,000,000,000, and it is now considerably below \$3,000,000,000, in spite of the fact that you would expect in that period of 10 years to have a natural, normal growth proportionate to the growth of business and population of the country.

Now, something has happened to change the means by which business and commerce is financing itself. The commercial paper, as defined by section 13, is no longer in as great a quantity in absolute figures and relatively is in much less quantity. However, I do not think you could say that as yet, as a total for the country, it is inadequate, although as related to some individual banks it may be inadequate. By and large, whatever abuse the privilege of advances upon the security of Government bonds may in theory be subject to, I do not believe it has yet been abused or has in itself contributed to the increase in the speculative fervor to which you have referred. This is because the machinery or means by which a member bank comes to us for accommodation, is merely a matter of preference and not merely a matter of necessity. That being so, and I am sure it is true of all the principal banks in my district, if you should make Government securities ineligible as collateral for advances of this character, I do not believe it would change the volume of the Federal reserve credit and Federal reserve notes outstanding \$1. I do not believe it would change the need of the member banks for accommodation in any degree whatever. All it would do would be to put a different form of asset into the Federal reserve bank without in any way changing the substantial picture of the credit situation.

The CHAIRMAN. Then you think it has in no measure been abused or used for stock speculative purposes? You think it has been used altogether for commercial purposes?

Governor HARRISON. If you will let me answer your question the other way around, I would rather do it.

The CHAIRMAN. But is not that your conclusion?

Governor HARRISON. No; I can not say that. To put it differently, I do not say that no member bank has ever used Federal reserve credit as a means of building up its reserve at a time when it has collateral loans, some of which may be for speculative purposes. That is a fact that we will all admit.

But the question of the practicability or feasibility of determining at what point or when a member bank's collateral loans have been made for a normal day to day object or are in the speculative field, is one about which we are at a loss. I would like to put it this way, if you will let me, because I think this is one of the most important things from our standpoint as well as the standpoint of your committee.

If a bank of \$150,000 of assets, we will say, has \$50,000 in Governments, \$50,000 in commercial paper, and \$50,000 in security loans, those security loans may have been made to their customers to pay doctor's bills or grocer's bills, or in some cases to buy a merchandise inventory because of the fact that the bank did not trust the credit of the merchant sufficiently without collateral. There may have been a myriad of purposes back of those security loans. Some of them may have been for speculative purposes. But the sum total of the bank's portfolio is \$50,000 Governments, \$50,000 of commercial paper, and \$50,000 of these security loans. Now they are not borrowing from the Federal reserve bank at that point. To-morrow some depositor, needing some of his money, withdraws \$5,000. The bank needs \$5,000 in cash. One of the purposes for which the Federal reserve bank was created was to enable the bank to come to us for cash to meet the withdrawal of these deposits.

There are three questions: First, should we at that stage before making the required loan examine into the security account of the bank to determine whether any of these loans are speculative loans or not? Second, if we should examine, would we be competent to determine that question? Third, if we do not determine that question at that point, but give them the amount required and then say their security loans should not further increase, as this proposed bill undertakes to do, are we not then putting ourselves up as arbiters of the fact that every loan secured by collateral must necessarily be speculative? Suppose we gave the bank the accommodation they asked for and to-morrow Bill Smith's house is burned down, and he needs immediately an accommodation for one reason or another to help himself, or his wife is sick and he has to get a doctor, and he goes to the bank and says, "I want a thousand dollars." The bank says, "I do not like your credit now as much as I did yesterday, because your house is gone and it was not insured. Have you got any collateral?" Bill Smith says, "Yes; I have some Steel stock; I will put that up as collateral for my note." Under this bill and under those circumstances so long as that note to us was outstanding—no, I will put it differently. Under this bill if they had previously secured the \$5,000 discount from us for the legitimate reason we have just been discussing it would not be possible for that bank to take on that thousand-dollar loan for Bill Smith, even though the loan was not for speculative purposes, because it was collateralized by stock-exchange collateral.

The CHAIRMAN. In other words, you are stating what is in my view, if my information is at all accurate, you are stating a very exceptional case for the general guidance of the Federal Reserve bank.

Governor HARRISON. I admit that it is a simple and homely case.

The CHAIRMAN. And a very exceptional one, too.

Governor HARRISON. The difficulty, though, is, Mr. Chairman, if we discuss the more usual case that you have in mind, then the problem becomes even more complicated as far as the practical operation of the Federal reserve bank is concerned, because it relates to one of the larger banks with even more complicated problems. In the case of New York banks, as I pointed out day before yesterday, they all for a period of a great many years have loaned money on stock-exchange collateral. The banking system of the country has been built up in large part upon the credits which equities in industry afford, and a collateral loan does not necessarily mean speculation. Over a period of years we find that the principal banks of New York have loaned in the aggregate about a billion dollars, we will say, on collateral—call loans to brokers and dealers. All through this speculative fever of 1928 and 1929, the aggregate of these loans of these principal New York banks varied very little over or above that figure. If, however, one of these banks during that period found it necessary to come to us for an accommodation to meet a substantial withdrawal of deposits, because of the transfer or withdrawal of deposits of an individual customer or anything else, they come to us and borrow, say, \$5,000,000, as they would to make good that withdrawal, and then to-morrow an old, long, well-established customer comes to it for accommodation on collateral, they would not be allowed under the proposed bill to give him the loan so long as they were in debt to the reserve bank.

The CHAIRMAN. Well, the intent of the provision of the law, Governor, was to provide against emergency embarrassment. It was not intended to enable the bank to get loans from Federal reserve banks for stock speculative purposes. I wish I could think, as you seem to imply, that there is not any excess in stock speculative activities in New York.

Governor HARRISON. Well, I want to complete my statement on that because if I leave the record at this point it will appear that I am disingenuous, which I do not want to be. Of course, there was speculation in New York; there was speculation all over the country and all over the world. It was a matter of the greatest concern, not only to you but to all of us in the Federal reserve system. We exercised our imagination and ingenuity, I think, to the limit to do what was proper to control it.

Beginning in 1928 we raised our discount rate three times. We sold over four hundred millions of Government securities. We lost \$500,000,000 in gold. Had anybody said two years before that it was possible to raise the discount rate three times and sell \$400,000,000 of Government securities and export \$500,000,000 of gold without checking inflation, it would have been thought impossible; but that is just what happened.

The CHAIRMAN. Did your rediscount rate for 1928 stop speculation?

Governor HARRISON. No; it did not.

The CHAIRMAN. That question is important because I understand it is your view that the raising of the commercial rediscount rate has a tendency to put a stop to speculation.

Governor HARRISON. I think it has.

The CHAIRMAN. Did it do so in 1928?

Governor HARRISON. No; it did not. I think, in looking back, in retrospect, we made mistakes and probably will again in years to come. We want, however, to minimize the number of those errors in future and to decrease their effect. I hope we are learning as we go on. This inquiry of yours will be most helpful to us. When I look back on 1928, I feel that we made two particular mistakes—first, we raised our rate the first time too late, and, second, we did not raise it enough. I mean that had we had at that time the light of the experience we have since had, it would have been better perhaps to have raised the rate 1 per cent in December of 1927. I do not think except once in our history we have ever raised our rate more than 1 per cent. Instead of that we waited until January, after the turn of the year, when we raised it only one-half of 1 per cent. I think that more prompt, vigorous rate action at that time would have been more helpful. The difficulty with Federal reserve control, through rate action, over excessive use of credits for speculation, such as we experienced in 1928 and 1929, was very much enhanced by the fact that we developed in this country what has been called a bootleg banking system; that is, corporations and individuals seeing the opportunity to get higher returns on readily available funds, started loaning first in moderate amounts and then rapidly growing amounts, to brokers and dealers in stock on stock-exchange collateral. In other words, loans that have been reported as “loans for others.” At one time over half the total volume of money borrowed by brokers and dealers was money advanced in that fashion. It was money that was wholly outside of the control of the banking system; it was money loaned by lenders who had no responsibility to the money market or to the banking system. It was loaned without any responsibility on their part to maintain reserves of any character.

So what happened was this: When we raised our rate and put pressure upon the bank reserves, instead of putting a grind, as we call it, on the judgment and the freedom of the lending officers of a member bank, instead of putting a pressure upon them to contract, in a way which might be effective in reducing loans, the higher rates resulted importantly in attracting other lenders quite outside of the banking system to come in and lend their funds to speculators.

Now if rate control by the Federal reserve system, and I believe it has the right of rate control, of any undue extension of credit is to become effective, and that is to be our means of control, then I feel something ought to be done and must be done to limit the facility with which corporations and others loan money for speculative purposes direct to the stock exchange.

The CHAIRMAN. Undoubtedly that should be done.

Governor HARRISON. I admit further that as long as you have that facility in such tremendous amounts the effectiveness of the discount rate, in the control of speculation, is very much minimized.

The CHAIRMAN. It was nil, was it not?

Governor HARRISON. Well, no one can say whether if we had increased our discount rate more promptly and in greater amounts whether the speculative mania would not have culminated sooner, or maybe not have gone so high; you can not tell; it is a matter of guess.

The CHAIRMAN. What is the use of the banking reserve, and what relation has the required reserve of the Federal reserve bank to its rediscount activities; in other words, is not the Federal reserve bank governed in some measure, if not in large measure in its rediscount operations, by the amount of its reserve?

Governor HARRISON. There are various yardsticks; it is just a matter of management. We are always considering and determining whether a member bank is out of line or borrowing excessively in proportion to the needs of the community. Another yardstick is the amount of the member bank's reserve with us, and still another is its capital and surplus, but I do not know any one of them that I would say is a controlling yardstick. It depends on the whole situation.

For instance, you have a community of 10 banks and because of a drought or plague or peculiarly poor business, because of the kind of business they are dealing with, those banks, all of them, need a great deal of Federal reserve accommodation. All their borrowings go up proportionately for the same reason, which is a community reason. We would be less severe or reluctant to lend a borrower of that kind because he is not himself abusing the privileges for his own profit; in other words, he is using our privileges because the needs of the community are such that the whole banking group needs our help. But if in that same community of 10 banks some one bank gets overambitious and develops an investment policy of buying first-rate or second-rate bonds or even call loans, that requires its borrowing from the Reserve bank, we will usually have them come to our office and talk over the whole situation with them intending to restrain the bank, not on the ground that we do not like the particular bonds they had bought or do not like the particular customer they are dealing with, not on the ground that we do not like their making a loan on collateral but rather that their investment policy is an exaggerated one, designed solely to make a profit because of the differential between our rate and the rate on their investments.

The CHAIRMAN. I thought you took the view day before yesterday that you had no right to inquire into the uses of it, of the credit?

Governor HARRISON. I made a note here to ask you to let me go on with a statement that I started to make a few days ago. When I made that statement you may remember that I mentioned an exception that I did not have an opportunity to explain or go back to.

The CHAIRMAN. Governor, before we get away from the question that I asked you a while ago, for my own information, and I suppose it will be of service to the committee, I would like to know a little more about your reserve question. If the Federal reserve bank has an 80 per cent reserve under the law that requires a 40 per cent minimum against notes, what excuse would it give for refusing, for raising, its commercial rediscount rate to the business of the country?

Governor HARRISON. Mr. Chairman, that is a matter of monetary policy, of banking judgment, about which a great many of us will always differ; but I feel this, that as it is an orthodox principle of central banking operation, that if central banking authorities see and have reason to believe in view of the statistics available to them that the total volume of credit of the country is expanding at a rate and volume faster than any normal growth of business could justify,

it is incumbent upon the central banking authorities to put pressure or restraint on that growth by an increase in the rediscount rate.

The CHAIRMAN. You do not object to the growth of legitimate business, do you—commerce and industry?

Governor HARRISON. No; but I think I would go this far: That if the expansion of credit was at an inordinate rate, and the only reason we could see for it was the demand for credit for business, it would be a healthy thing for business to put the rate up.

The CHAIRMAN. You put the brake on legitimate business then?

Governor HARRISON. No; because when business gets going too fast—

The CHAIRMAN. How do you mean, too fast? Do you mean sound business could go too fast?

Governor HARRISON. I think that business that thinks it is sound may be going too fast.

The CHAIRMAN. Undoubtedly that. I am talking about legitimate business. It was not supposed that a Federal Reserve bank—

Senator WALCOTT. Who is to be the judge?

The CHAIRMAN. The banker is to be the judge or is supposed to be the judge, I think.

Governor HARRISON. But is not the growth of the credit of the country itself a pretty good indication of whether or not business is being conducted legitimately? In other words, supposing you had a case where no one claimed that there was any speculation in securities, no one claimed that there was any real-estate boom involving any unusual use of credit, and where the only thing we could see which made us very happy and prosperous, was the growth of what appeared to be sound business. Suppose that at that time the Federal reserve system authorities saw that the credit of the country was expanding at a rate very much out of proportion to any normal growth of the country's business in the past, say for an extreme case, 18 or 20 per cent, contrasted with the normal 3 or 4 per cent, why then I would say that even though we thought we were in a business paradise and were in for a period of wonderful American prosperity, we should raise the rate in an effort to check the too rapid expansion of credit.

The CHAIRMAN. Do you know when there has ever been an increase from 3 to 20 per cent in ordinary legitimate business of the country?

Governor HARRISON. No; I do not, but I do think that as a part of, or as a result or incident of, the great expansion of speculation that took place in 1928-29 business got a disproportionate view of what was proper for itself and that if it had had some of the restraint that would have been incident to an increased rediscount rate at that time it would have been a healthy thing, and we would not, perhaps, now find ourselves in as great distress as to-day.

The CHAIRMAN. Do you think that the demand for rediscounts by the Federal reserve banks in 1928-29 was a demand of legitimate business, legitimate commerce, and industry?

Governor HARRISON. In a way.

The CHAIRMAN. But in a very small way.

Governor HARRISON. No. Business expanded very rapidly during those periods, not by borrowing on commercial paper, not by borrow-

ing on direct loans from banks, but by issuing their securities which subsequently became an object of speculation. They got their accommodations through the security markets rather than through commercial loans and used their new capital for expansion, which, perhaps, was unduly rapid, merely because they thought speculative-paper profits were going to sustain their business at an increased rate.

The CHAIRMAN. But the issuance of the securities and the placing of them on the stock exchange, listing them on the stock exchange, did not affect that rediscount policy for commercial purposes.

Governor HARRISON. Well, if I may be permitted, I think I would not agree with you for this reason, that if business is going ahead too fast on the credit that it is obtaining directly from investors, and at the same time is getting additional credit for some lines of business from banks, while it is true that we have not any direct pressure upon the fellow who is getting his credit through the issue of securities, it is equally true that the restraining influence of the increased rediscount rate in a period like that is a healthy thing for the country.

I do not think that central-bank authorities—as much as I wish they could be—can be wise enough to analyze in detail the motives or the precise character of the investments of individual banks, or indeed the exact cause of a general expansion of credit that is going on in the country as a whole. We may all of us have ideas about it and hunches about it; we may be right, but the best guide and the one in the long run that will be at least subject to abuse or mismanagement is the guide of the total volume of credit being used in the country in relation to the growth of production and business. If we try to particularize too much beyond that we run the risk of making the Federal reserve system or the Federal reserve bank, a paternalistic system, and undertaking to do things which I do not believe frankly we are wise enough to do.

The CHAIRMAN. Well, in a word, it seems to me you belong to the school of thought that insists that the way to minimize speculative activities is to penalize legitimate commerce by raising the rediscount rate?

Governor HARRISON. May I make comment on that?

The CHAIRMAN. Yes.

Governor HARRISON. If your hypothesis is true, then I think it is possible that my theory is wrong. But I do not quite believe that in practice your hypothesis is correct, for this reason, that when we raise the rate in a situation such as in 1929, we serve notice on the community that we think it is going too fast and that there must be restraint. Now if you are a member bank in New York City, and you are borrowing \$20,000,000 from us, or \$50,000,000 from us, at the time we raise that rate from 5 to 6 per cent, it is an indication to you that we want your borrowings from us to go down and you accordingly would seek to reduce your loans.

The CHAIRMAN. Governor, you have admitted that in 1928 and 1929 the advance of the rediscount rate did not accomplish its purpose; it did not abate its fever of riot in speculation. It continued until it broke down of its own force, didn't it?

Governor HARRISON. I agree that it did, but I also believe that it might have been much worse had we not raised our rate; and I feel also that we would have had more effective control and speculation



would not have gone so far had we raised our rate more promptly and more courageously than we did. I want to supplement that by saying that the ineffectiveness of the rate was contributed to by this vast amount of loans made on the outside. But if we are looking toward the future, and we all need your help to find the means of effective control of inordinate speculation, which I hope is one of the purposes of your inquiry, then I think we have got to puzzle out as a matter both of theory and practice—because the two are not always entirely consistent—what can be done most effectively to restrain an inordinate growth of credit for speculative purposes.

The CHAIRMAN. That is what we want to do, and what I am trying to find out right on this point, whether your theory is that the raising of the rediscount rate, whether it be moderate or severe, can accomplish the purpose; and if it can accomplish the purpose, what must we do to accomplish it?

Governor HARRISON. My honest judgment is that it can be made to accomplish the purpose, if we do the things we are now considering, and which I considered in some brief measure day before yesterday. I was just reciting a minute ago the way the increase of rate operates and how it makes a pressure on the loans in each member bank. I was discussing it in relation to the possible bad effect on business.

At this point, when the president of a bank says, "We must reduce our borrowings from the Federal reserve bank because they have raised the rate and it is too big a penalty," the loaning officers of the bank will not go out and call their commercial loans. They will not attempt to do it at that stage even by raising their rate on commercial loans. They will look over their portfolio and find the most available or the most liquid loans, and those loans are brokers loans, and not personal or individual loans. In the majority of cases they are loans to the market and bankers have no restraint whatever upon calling such loans. The first thing they will call will be the broker's loans.

The CHAIRMAN. Did they do it in 1928 and 1929?

Governor HARRISON. They did that. That is just what I am trying to establish. I think I could show you by the statistics, that in three different periods through those years, when the Federal Reserve System, both through the discount rate and the sale of Government securities, evidenced pressure for liquidation, and when both brokers' loans and stocks had been going up, the stock market stopped going up or was checked, and on each of the three occasions outside lenders came in with funds, attracted by the higher rates that we had contributed to by our operations, attracted by the higher rates that we had partly caused, and by loaning their funds largely defeated what was being done by the banking system, and enabled the speculators to go on.

Now, if we could have stopped that leak, and it was a serious and vital leak, because it was over 57 per cent of the total brokers' loans, I think the policies of the system would have been much more effective than they were and much more effective than they can be made by direct action, as it is called.

The CHAIRMAN. You do not believe in direct action?

Governor HARRISON. No; I am afraid I do not.

Senator TOWNSEND. Have you any knowledge that there were individuals who sold stock in their own companies and loaned the money back to the stock exchange attracted by these high rates?

Governor HARRISON. I have no definite, concrete evidence of that, but I think you can accept it as a fact that that was true. There was a general report to that effect, and I have no doubt it was true.

The CHAIRMAN. Governor, in 1928, when the Federal reserve bank authorities came to the conclusion that there were excessive activities on the stock exchange, what did the banks in New York do about it? I believe you said you declined to admonish a member bank against excessive extensions. What, then, did you do besides proposing to raise the rediscount rate?

Governor HARRISON. Of course, we did raise our rate from 3½ to 5 in different steps. The system as a whole sold \$400,000,000 of Government securities in the face of the loss of \$500,000,000 of gold, and that ordinarily should have been adequate restraint. We wanted to go one step further. We wanted to go to 6 per cent, and I would say that had we done so, had we gone to 6 per cent, and if then it had been necessary, I would have been willing to recommend going to 7 per cent.

The CHAIRMAN. Then 8 and 9 and 10, and so on? If your theory that the rediscount rate controls, there would be no reasonable termination, would there, to your raising the rediscount rate?

Governor HARRISON. Of course, the turn never did come until after we got our rate to 6 per cent. At the same time, the Bank of England went to 6½ per cent.

The CHAIRMAN. Do you think that is why the turn came?

Governor HARRISON. I think it came from a variety of reasons. First, when business started to decline in July, 1929, it later began to have its effect on speculation; second, very definite nervousness was contributed to by the Hatry failure in England, the ramifications of which were great; third, restraint was contributed to by the increase in our rediscount rate in August; fourth, even though we can not estimate its effect, the increase of the Bank of England rediscount rate was a factor; and then, fifth, and perhaps the most important, things had gotten so top-heavy that they could not go on any further.

The CHAIRMAN. All that was most important, was it not, to cause a season of famine that came about? People began to think that the thing could not be skyrocketed any further.

Governor HARRISON. The only question was whether any of the steps that we wanted to take would have brought back sanity any quicker, or whether we could have limited the drop to the tenth story instead of the twentieth story. But I do want, Mr. Chairman, to make an amplification of the statement I made day before yesterday, if you will permit me, when I said that we did not apply "direct action" and pressure to New York City banks in an effort to restrict their collateral loans to brokers.

The CHAIRMAN. You said you declined to remonstrate with the member banks even about the inexpediency of such an excessive expansion.

Governor HARRISON. That answer related primarily to the New York City banks, because until the break occurred on the 29th of

October their brokers' loans stayed along at a fairly stationary level, and they were not in a category where they deserved any vigorous remonstrance. But it is true with some of the smaller country banks—and this looks like discrimination so I wish you would let me explain fully before you reach a judgment on it—with some of the smaller country banks we did remonstrate, and for this reason, that we have a general policy that if any particular bank is borrowing from us out of proportion to the rest of the banks of the same community, disproportionately or for too long a time, we would put them on inquiry, get them to come to us and ask them for their reasons. If we find that they are borrowing because of the unavoidable withdrawal of deposits or because of some peculiar conditions in that particular community that related to them, we have not attempted to make them pay up. If, on the other hand, we find they have gotten into this fix not because of any demand of the community for a withdrawal of deposits, not on account of a demand or call for additional accommodations by their customers but rather because of the fact that they have adopted a deliberate policy, an investment policy, to make new investments and to make a profit out of the rediscount rate, in that instance we do remonstrate with them and urge them to adopt some policy to pay off their debts.

I go one step further. A country bank that participates in call loans with or through New York banks is making an investment, almost precisely as if it were buying bonds.

There is a vast difference in one sense between call loans and bonds but as far as the use of the Federal Reserve facilities is concerned, I do not believe there is any real difference in the case of a country bank since in their case call loans to brokers and dealers in securities in New York are in effect investments which they make not as a result of any demand from their customers but because they, in the exercise of their judgment in the management of the bank, want to increase their earnings. That is very different from the bank which is expanding its loans because of the legitimate demands of its customers, and it is a very different thing even from New York City banks lending directly on call as part of their responsibility to the money market in which they are located. Our policy in that respect is to be found in the long letter which we sent to the Federal Reserve Board, and which will be found in our replies to your questionnaire. I think myself that it is the only practicable policy of operation. I think if it is followed assiduously and earnestly, with prompt and reasonable rate action, it will be effective if we can do something about stopping this leak in these "loans for others." I predicate most of what I am saying upon the possibility of doing that.

The CHAIRMAN. Would you like to see a statutory prohibition against making loans for others?

Governor HARRISON. If that is the only way that we can get it, I think it might be wise, but it would be better to accomplish it by cooperative community action, if possible, and for this reason: Even if we could contemplate that the associated banks in New York, through whom 80 per cent of these loans for others are made, were to agree voluntarily not to make them, there is still the risk that you will force the organization of an outside corporation through

which all these other lenders will route their funds to the stock exchange, and a statutory prohibition on the banks against making these loans might definitely force that event.

Therefore I say I believe it would be better to accomplish it by complete voluntary arrangement if possible. If you can get the banks to agree not to do it, and at the same time get the cooperation of the stock exchange in not availing themselves of the facilities of such a corporation organized just for the purpose of handling such loans, then you would have a stoppage both ways, on the part of the lender and on the part of the borrower. But statutory regulation, I believe, could not relate itself to the borrower and probably could not relate itself to the individual lending corporation. I imagine that it would not be competent for Congress to say that the private XYZ company could not lend any money to the ABC brokerage firm. If this is to be effective it ought to be by community cooperation which would show a complete disinclination to handle loans to brokers of this character and concentrate such loans through the banks of the country, where the pressure of rates is effective upon the reserves carried by the banks.

The CHAIRMAN. Do you think there is any statutory obligation or authority, express or implied, for the Federal reserve bank to either control or be controlled by the money market?

Governor HARRISON. That is a big question. I think certainly the Federal Reserve Bank of New York would not be complying with the spirit or the intention of the law which set up the Federal reserve system, if it failed to recognize the relationship between its operations and especially its rate operations, and money market rates, because if we do fail to recognize that relationship, and fail to adapt our rate to the market, we will by our own action or lack of action, abandon control of the market.

The CHAIRMAN. Why should you control the market?

Governor HARRISON. For the very reason we have been discussing for two days, in the hope that we can maintain a control that will check or prevent an inordinate use of credit beyond the legitimate demands of commerce and industry.

The CHAIRMAN. Does that not come to this, in the last analysis, that the commerce and industry of this country is to be controlled by the speculative activities of the stock exchange in New York, and does it not mean, in the last analysis, that the accommodations to commercial and industrial borrowers must be regulated by the stock market rather than by the ability of the Federal reserve bank to accommodate commerce and industry?

Governor HARRISON. You have in the country a credit pool of a vast amount. I do not believe it is possible to conceive that if too much of that pool is being used for any one purpose whether it is speculation in real estate or securities or commodities, that credit will be available for other purposes at the same old rates; in other words the law of supply and demand will necessarily affect the rates for other credit. There is a lag, however, in the change of these other rates if only because of commitments and other arrangements that the banks have with their customers. But I fear I was not very clear about this: If this credit pool begins to be tapped too vigorously for any one or more purposes, and you have

a credit structure expanding on the basis of a demand that is out of proportion to the needs of the country, it is in these circumstances that we try to put on pressure. The pressure works first on the least desirable or the most liquid loan and not on the business loan, so that if we act promptly enough and actively enough to make that pressure effective at once, you will probably cure the sore spot before it has had an opportunity to have any substantial effect on business.

The CHAIRMAN. And you regard the speculative loan as the least desirable loan, do you?

Governor HARRISON. I think that from the point of view of the banker in New York, collateral loans or call loans, as he calls them, are regarded as secondary reserve. That is just what he calls them and has always called them. So perhaps the words "least desirable" are not descriptive. When you begin to put pressure on, the natural thing for the bank to do is to turn to its secondary reserve and get the cash with which to pay off its debt to the reserve bank.

The CHAIRMAN. As a matter of fact to the bankers they are the most profitable loans, are they not?

Governor HARRISON. Today, almost the least profitable.

The CHAIRMAN. Least what?

Governor HARRISON. The least profitable.

The CHAIRMAN. Yes, that is indicated by your reduction of the rediscount rate to 2 per cent—

Governor HARRISON. The call rate is  $1\frac{1}{2}$ .

The CHAIRMAN. Let me ask you this on that point: When you reduced your rediscount rate in New York to 2 per cent, did you imagine that would stimulate legitimate business, or did you have any fear that it would revive speculation in securities?

Governor HARRISON. I had no fear that it would revive speculation.

The CHAIRMAN. Why? Because nobody has anything to speculate with any more?

Governor HARRISON. I think that it will be some while after business has shown more evidence of revival than it has shown, before the community will become overinterested in equities, but I believe it is a fundamental reserve bank policy, that in a period of depression rates should be lowered just as they should be raised in a period of undue expansion of credit.

The CHAIRMAN. Just why did you reduce your rate to 2 per cent, which is an abnormally low rate?

Governor HARRISON. It is quite low. But I think you can say it is not a disproportionately low rate in relation to other rates in the market.

The CHAIRMAN. In the market?

Governor HARRISON. Yes; and which I think we have got to recognize, Senator.

The CHAIRMAN. I am not troubling about your recognizing it. Of course, it is the business of an intelligent skillful bank officer to recognize those conditions. What some people object to is that you are being controlled by it.

Governor HARRISON. Well, of course, that is a question of fact and depends upon the integrity of the management of the bank.

The CHAIRMAN. I say so; yes.

Governor HARRISON. Going back to the discount rate, I believe that when you are in a period of depression in business activity, when it shows a greater decline than in almost any comparable period, exports having fallen off 25 to 30 per cent, commodity prices having shown a more rapid decline than they have in any period since the postwar deflation, bank of issue authorities quite properly should do everything they can to remove any possible brake or restriction or restraint upon the revival of expansion and activity—business expansion and activity. Whether you should go to 3 per cent or 2 per cent in their effort or desire to remove that brake, is a matter of judgment. I think as long as that depression continues, you should go as low as you can go in relation to the outside rates without inviting any abuse of your privileges, and I think we have not done that because banks are borrowing relatively nothing.

The CHAIRMAN. Do you think there has been, in consequence of that abnormally low rediscount rate, any reflected advantage throughout the country to borrowers of credit for legitimate commercial purposes; in other words, do you think the standard, or what they call the standard, discount rate that the individual bank has been brought about with the abnormally low rediscount rate of the Federal reserve bank?

Governor HARRISON. Yes and no. So far as being accommodated through the acceptance market is concerned, and a vast volume of our business is accommodated in that fashion, business is being accommodated at a much lower rate.

The CHAIRMAN. To the foreign or domestic acceptance market?

Governor HARRISON. Both. Of course, the great volume of our acceptances relate to foreign trade and not trade wholly within this country. Commercial paper rates have also gone down from 6 per cent to  $2\frac{3}{4}$  per cent in the last year, and customers' rates have gone down from  $5\frac{1}{2}$  to  $3\frac{1}{4}$ . Interest rates generally have declined materially, but whether this is due to any particular discount rate reduction, or to the general condition of depression or to the liquidation in the stock market, nobody can say. It is no doubt due to a great number of factors.

The CHAIRMAN. That has reference exclusively to large borrowers, to people who engage in very large transactions.

Governor HARRISON. Unfortunately, practically everything I say about this rate relationship must refer to the money market, because in this country the barriers between the principal money centers and the country districts are very great. There is great reluctance on the part of funds to seep out from the money centers to the more remote districts even when rates get as easy as they are in New York to-day.

That reluctance is due to a number of causes. New York City banks may have a large overage of funds that they do not know what to do with, an overage of reserves in excess of requirements, because they have not employed their funds. Those funds may not go out of town for two reasons—first, there may not be an active demand of the kind or in the sections that these banks have been accustomed to dealing with, and, second, the conservative attitude on the part of the banking community in periods such as we have been hearing about and a consequent desire to keep in a very liquid position. In this connection, Mr. Chairman, there has never been a time since I

have been in New York, in 10 years, when I have considered the principal banks in New York generally as liquid as they are to-day.

Now, if it were possible to develop a system of branch banking which would enable banks in New York City and in other money centers to feed out their surplus funds to the interior through management and officers who are their own, and whom they know, and who know their policies, I think you would take one great step toward a more effective distribution of credit now available in the various centers.

The CHAIRMAN. You mean nation-wide branch banking?

Governor HARRISON. I imagine that is not practicable, and I would not advocate it. I like the phrase that the comptroller has used, trade areas, although I do not know exactly what it would mean. The difficulty is a practical one. The normal and natural thing to do, and I felt five years ago that it might be wise, is to authorize State-wide branch banking because it is a definite and concrete limitation to prescribe. On the other hand, that obviously works some injustices. There may be very much more reason why you should authorize branches within a radius of a hundred miles than within State limits. In the case of New York City, for instance, if you authorize a New York City bank to put a branch in White Plains, N. Y., and not in Newark, N. J., it would not seem a logical distinction to make. On the other hand, a definition of a trade area that would permit a branch being established in Newark as well as in White Plains would, I think, be quite reasonable. Whether you can define trade area by geographical radius or not I do not know, but I think the thing your committee will likely wish to consider is what sort of limitation you may put upon branch banking that will be adequately restrictive without defeating the very purpose that you are trying to accomplish. The Federal Reserve System has done a good deal to equalize interest rates throughout the country already. It has also done much to equalize interest rates in the different seasons throughout the year, as well as throughout the country, but there is yet much to be accomplished in making for a better distribution of credit from the principal centers out to the more remote country districts, where rates have been much more reluctant to decline. That is due to two reasons: First of all there is a natural shortage, or not so much credit available, in more remote districts, and, secondly, in the agricultural or other sections where borrowers have already been forced by economic conditions to hold over their loans for a year or more, bankers are a little reluctant to loan at a lesser rate, and, indeed, are entitled to lend at a higher rate. Even so, I think branch banking would do much to make for a somewhat better distribution of credit at more equal rates in the different sections of the country.

The CHAIRMAN. On that point I am going to ask leave of the committee, if there is no objection, to insert in the record a brief that I have asked to be prepared giving the court decisions on the question of branch banking and the right to have the system adopted across State lines. I may incidentally say that my own view is that it is not feasible to attempt to do anything of the kind, but I would like that to go into the record, so that the members of the committee and others may see what has been the court decision on the question.

(The paper referred to is printed in full, as follows:)

## THE CONSTITUTIONAL POWER OF CONGRESS TO AUTHORIZE THE ESTABLISHMENT OF BRANCHES BY NATIONAL BANKS IRRESPECTIVE OF STATE LAWS

*The first Bank of the United States, 1791-1811.*—The legal theory upon which Congress enacted the national bank act and the Federal reserve act is the same as that upon which Congress authorized the establishment of the first Bank of the United States in 1791 and the second Bank of the United States in 1816. When the first bank was proposed in Congress the constitutionality of the bill was seriously debated, but a majority of both Houses supported it. President Washington signed the bill after considering the official opinions both for and against its constitutionality.

The first Bank of the United States was opened December 12, 1791, and established eight branches in several States, namely, at Boston, New York, Baltimore, Washington, Norfolk, Charleston, Savannah, and New Orleans. This is the first precedent of the establishment of branches by a national bank. Upon the occasion of the failure of Congress to renew the charter of the bank, which expired in 1811, the constitutional question was again raised, and some of the opposition against the renewal was upon the ground that Congress was without power to establish and maintain a national bank.

*The second National Bank of the United States, 1816-1836.*—The attempt to finance the War of 1812-1814 without any banking instrumentality under the control of the Federal Government proved so disastrous that Congress in 1816 passed a new bill to charter a Bank of the United States similar to the first bank, President Madison approving the act, having the year before vetoed a similar measure which did not meet his views. As compared with the first Bank of the United States, there was little difference between their organization and purpose.

The second Bank of the United States likewise established branches in various States in the Union. In 1818 the Legislature of the State of Maryland passed an act, the effect of which was to place a special tax upon the branch of the Bank of the United States in operation in Baltimore. The Baltimore branch refused to pay this tax, its cashier, McCulloch, was sued in the State court, and a judgment sustained against him by the court of final jurisdiction. He thereupon sued out a writ of error under which the case was brought before the Supreme Court of the United States. Here for the first time the constitutional power of Congress to establish the bank and of the bank to establish branches was considered by that tribunal. (*McCulloch v. Maryland*, 4 Wheat. 424.)

In the following year, 1819, the State of Ohio imposed a tax of \$50,000 on each of the two branches of the Bank of the United States established at Cincinnati and Chillicothe. Upon the refusal of these branches to pay the tax the sheriff on behalf of the State seized \$98,000 in money. The State officials concerned were arrested by the Federal authorities and tried in the Federal circuit court, where judgment was rendered against them to restore to the bank with interest the funds seized. An appeal was taken to the Supreme Court of the United States (*Osborn v. Bank of the United States*, 9 Wheat. 738), where again the constitutional power of Congress was brought into question and formed the basis of the opinion.

The opinions in both of these cases were written by Chief Justice Marshall and for practical purposes can be considered as one case, the second being an elaboration and a review of the first.

The principles decided in these cases may be briefly stated as follows:

- (1) Congress has the constitutional power to incorporate a national bank.
- (2) The existence of State banks can have no influence upon the question of this paramount power of Congress.
- (3) "After the most deliberate consideration, it is the unanimous and decided opinion of this court that the act to incorporate the Bank of the United States is a law made in pursuance of the Constitution, and is a part of the supreme law of the land. The branches proceeding from the same stock, and being conducive to the complete accomplishment of the object, are equally constitutional." (*McCulloch case*, 4 Wheat. 424.)

(4) Congress having the constitutional power to create a national bank has also the constitutional power to determine, authorize, or create the faculties necessary to enable it to perform the services for which it was created, and Congress alone is the judge of the means to be employed in the exercise of these faculties.



The Supreme Court of the United States in these two cases upheld the power of a national bank to establish branches in the various States without permission or authority from the State Governments.

*The national bank act of 1863.*—With the failure of Congress to renew the charter of the second Bank of the United States the Federal Government operated without a banking instrumentality under its control until the enactment of the national bank act in 1863. That act set up a system of independent national banks rather than one central national bank with branches. The question of the power of national banks to establish branches did not again come before the Supreme Court of the United States until 1924, more than a century after the decisions of *McCulloch v. Maryland*, and *Osborn v. Bank of the United States*, when it was presented in the case of the First National Bank in St. Louis *v. Missouri* (263 U. S. 640).

In the meantime, however many cases had come before the Supreme Court of the United States in which it became necessary to interpret and construe the national bank act with reference to the charter powers of national banks in their relationship to the State legislatures, in all of which the fundamental principles enunciated in the *McCulloch* and the *Osborn* cases were sustained and followed. It seems appropriate to consider some of these cases before proceeding to the First National Bank in St. Louis *v. Missouri*.

*Farmers & Mechanics' National Bank v. Dearing* (91 U. S. 29, 1875).—This was the first case before the Supreme Court which construed the national-bank act with reference to the authority of the State governments and involved the application of the usury law of the State of New York. The court said:

"The constitutionality of the act of 1864 is not questioned. It rests on the same principle as the act creating the second Bank of the United States. The reasoning of Secretary Hamilton and of this court in *McCulloch v. Maryland* (4 Wheat. 316) and in *Osborn v. Bank* (9 Wheat. 738) therefore applies. The national banks organized under the act are instruments designed to be used to aid the Government in the administration of an important branch of the public service. They are means appropriate to that end. Of the degree of the necessity which existed for creating them Congress is the sole judge.

"Being such means, brought into existence for this purpose, and intended to be so employed, the States can exercise no control over them, nor in any wise affect their operation except in so far as Congress may see proper to permit. Anything beyond this is 'an abuse, because it is the usurpation of power which a single State can not give.' Against the national will 'the States have no power, by taxation or otherwise, to retard, impede, burthen, or in any manner control the operation of the constitutional laws enacted by Congress to carry into execution the powers vested in the General Government.' *Osborn v. Bank*, supra; *Weston v. Charleston* (2 Pet. 466); *Brown v. Maryland* (12 Wheat. 419); *Dobbins v. Erie Co.* (16 Pet. 435).

"The power to create carries with it the power to preserve. The latter is a corollary from the former.

The principle, announced in the authorities cited, is indispensable to the efficiency, the independence, and, indeed, to the beneficial existence of the General Government; otherwise it would be liable, in the discharge of its most important trusts, to be annoyed and thwarted by the will or caprice of every State in the Union. Infinite confusion would follow. The Government would be reduced to a pitiable condition of weakness. The form might remain, but the vital essence would have departed. In the complex system of polity which obtains in this country the powers of government may be divided into four classes:

"Those which belong exclusively to the States;

"Those which belong exclusively to the National Government;

"Those which may be exercised concurrently and independently by both;

"And those which may be exercised by the States, but only with the consent, express or implied, of Congress.

"Whenever the will of the Nation intervenes exclusively in this class of cases the authority of the State retires and lies in abeyance until a proper occasion for its exercise shall recur. *Gilman v. Philadelphia* (3 Wall. 713, 18 L. Ed. 96); *Ex parte McNeil* (13 Wall. 240, 20 L. Ed. 625).

"The power of the States to tax the existing national banks lies within the category last mentioned.

"It must always be borne in mind that the Constitution of the United States and the laws which shall be made in pursuance thereof are 'the supreme law of the land' (Const. Art. VI), and that this law is as much a part of the law

of each State, and as binding upon its authorities and people, as its own local constitution and laws."

*Casey v. Gall* (94 U. S. 673, 1877).—This case held that Congress had the power to authorize a State-chartered bank to convert into a national bank without any assent or permission by the State, upon the ground that no authority from the State was necessary.

*Davis v. Elmira Savings Bank* (161 U. S. 275, 1896).—The court in denying the validity of a statute of the State of New York fixing preference in cases of insolvency, in so far as it applied to national banks, through Mr. Justice White, said:

"National banks are instrumentalities of the Federal Government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States. It follows that an attempt by a State to define their duties or control the conduct of their affairs is absolutely void, wherever such attempted exercise of authority expressly conflicts with the laws of the United States, and either frustrates the purpose of the national legislation or impairs the efficiency of these agencies of the Federal Government to discharge the duties for the performance of which they were created. These principles are axiomatic and are sanctioned by the repeated adjudications of this court."

*Easton v. Iowa* (188 U. S. 220, 1903).—In this case the president of a national bank was sentenced under a criminal statute of the State penalizing the receipt of deposits with knowledge of the insolvency of the bank.

In taking issue with the supreme court of the State Mr. Justice Shiras, in delivering the opinion of the court, said:

"We think that this view of the subject is not based on a correct conception of the Federal legislation creating and regulating national banks. That legislation has in view the erection of a system extending throughout the country, and independent, so far as powers conferred are concerned, of State legislation which, if permitted to be applicable, might impose limitations and restrictions as various and as numerous as the States. Having due regard to the national character and purposes of that system, we can not concur in the suggestions that national banks, in respect to the powers conferred upon them, are to be viewed as solely organized and operated for private gain. The principles enunciated in *McCullough v. Maryland* (4 Wheat. 425, 4 L. ed. 606) and in *Osborn v. Bank of United States* (9 Wheat. 738, 6 L. ed. 204), though expressed in respect to banks incorporated directly by acts of Congress, are yet applicable to the later and present system of national banks.

"Such being the nature of these national institutions, it must be obvious that their operations can not be limited or controlled by State legislation, and the Supreme Court of Iowa was in error when it held that national banks are organized and their business prosecuted for private gain, and that there is no reason why the officers of such banks should be exempt from the penalties prescribed for fraudulent banking."

*First National Bank v. Fellows* (244 U. S. 416, 1917).—In this case the State of Michigan contested the power of Congress to enact the provisions of the Federal reserve act conferring trust powers upon national banks. The Supreme Court of the United States (opinion delivered by Mr. Chief Justice White) reversed the Supreme Court of Michigan and upheld the powers of Congress, citing with approval the principles enunciated in *McCullough v. Maryland* and *Osborn v. Bank of the United States*. Referring to the basic principles of constitutional law laid down in the above two cases, the court further said: "The doctrines thus announced have been reiterated in a multitude of judicial decisions, and have been undeviatingly applied in legislative and enforced in administrative action."

*Burnes National Bank v. Duncan* (265 U. S. 17, 1924).—In this case the State of Missouri attempted to enforce against a national bank the State law regulating the exercise of trust powers. The Supreme Court of the United States reversed the State supreme court upon the authority of the *Fellows* case and others above cited. Mr. Justice Holmes in delivering the opinion of the court reiterated the principle that the constitutional power of Congress was to be tested by the right to create the bank and the authority to attach to it that which was revelant in the judgment of Congress to make the business of the bank successful, and that this excluded the power of the State in such cases.

*First National Bank in St. Louis v. Missouri* (263 U. S. 640, 1924).—This case involved primarily the question of the power of national banks to estab-

lish branches under the authority of the national bank act and rests upon a state of facts different from that of *McCulloch v. Maryland*, in which the question of branches for national banks was first considered by the Supreme Court.

The First National Bank, upon the advice of its own counsel, proceeded to establish and conduct a branch bank in the city of St. Louis upon the theory that whereas the Federal statutes did not expressly authorize national banks to establish branches, such banks nevertheless possessed the incidental charter power so to do. No permission from the comptroller was obtained for the establishment of the branch. There was upon the statute books of the State a law prohibiting the establishment of branch banks in that State. The attorney general of Missouri on behalf of the State took the position, first, that the national bank exceeded its charter powers under the national bank act when it established the branch and, second, that there being no permissive Federal statute, the State was competent to enforce against the national bank its own law against branches. The following propositions are quoted from the brief of the attorney general of the State, which he filed before the Supreme Court of the United States:

(1) "Branch banking by a national bank in a State is conduct in excess of any authority from the Nation."

(2) "Acts of a national bank in a State which are in excess of any authority from the Nation, and in contravention of State law, can be stopped by the State."

(3) "An unauthorized, unlawful act of a national bank in a State should stand upon the same footing as the unauthorized, unlawful act of any other corporation."

(4) "A national agency is no more free from responsibility to the State for unlawful acts done in the State beyond the scope of its powers and authority than is a State agent."

(5) "The same conduct may be an offense against both State and national sovereignty, and may be restrained by both Nation and State."

It was upon these grounds that the action was brought by the State in the supreme court of the State in the nature of quo warranto. The formal allegation of the State was to the effect, first, that the bank was not authorized by Congress to establish a branch and, second, that in establishing the branch it violated a statute of the State expressly prohibiting the establishment of branch banks.

At the request of the Comptroller of the Currency the Attorney General of the United States intervened in this case, not, however, for the purpose of upholding the right of the national bank to establish the branch but to contest the jurisdiction of the State to inquire into the question whether Congress had authorized a national bank to establish a branch.

It was shown before the court that the office of the Comptroller of the Currency had for years construed the national bank act as denying the right of national banks to establish branches. This opinion was supported by an opinion of the Attorney General, May 11, 1911, which was cited with approval in the opinion of the court in this case. The principal argument of counsel on both sides before the court, and the bulk of the opinion of the court, is devoted to the question of whether Congress had authorized national banks to establish branches. The court reached the conclusion that there was no doubt, especially in view of the long-continued construction of the national bank act by the Comptroller of the Currency, that Congress had not conferred upon national banks the charter power to establish branches.

In view, therefore, of this condition precedent the court held that the State was competent to enforce its own law against the national bank. The question, therefore, of the constitutional power of Congress to permit national banks to establish branches was not involved in this case. The case is in harmony with the previous decisions of the court hereinabove considered. Had there been upon the Federal statute books an amendment to the national bank act permitting national banks to establish branches the Supreme Court of the United States would have undoubtedly held the State law invalid as applied to national banks. The question asked by the court of the State law, "Does it conflict with the laws of the United States?" would have been necessarily answered in the affirmative. In the absence of such an amendment the question was answered in the negative.

Congress inserted in the so-called *McFadden-Pepper Act* of February 25, 1927, a clause in its branch banking section that branches of national banks

would be permitted only in those States which permitted the State banks to establish branches. This clause was a concession to the States not as a matter of constitutional necessity but rather as a matter of legislative policy.

In view of the above consideration there appears to be no doubt of the constitutional power of Congress to permit the national banks to establish branches in any State of the Union, irrespective of the laws of the State. If Congress determines that the national banks could better serve as instrumentalities of the Federal Government through the establishment of branches it would not be within the jurisdiction of a State to prohibit or restrict the purpose of the National Legislature to this effect.

Governor HARRISON. Senator, you asked about changes in rates of interest. Here is a chart that will portray what has happened in regard to some rates [exhibiting paper].

Senator WALCOTT. Money rates?

Governor HARRISON. Yes; since the end of October, 1929, in order to give you the general trend of a very precipitous drop.

The CHAIRMAN. The thing that disturbs me, and has for a long time, is that we undoubtedly thought and hoped that we would accomplish the removal of the Federal reserve system as far as possible from the money market, the speculative money market. In our effort to do that we put an actual textual prohibition in the statute, and now to find that the operations of the Federal reserve banking system are practically controlled by the stock exchange rate is rather disturbing.

Governor HARRISON. Mr. Chairman, I want very quickly for the record and everybody here to correct any inference that my discussion of the money market means necessarily only the stock exchange call rate. The money market in New York is very much more complex and intricate than that and relates itself to a vast number of different rates, not merely the rates that banks charge their customers on collateral loans but rates they charge them on their commercial paper, rates at which commercial paper dealers are able to float commercial paper in the market, bankers' acceptance rates, even the yields on Government securities and short-time securities of that kind. Quite apart from that you have the rates which banks pay for deposits in New York, which is an important factor in the determination of what position the money market is in.

The CHAIRMAN. Right on that point—

Governor HARRISON. When I use that term money market, we mean that vast conglomeration of different kinds of short-term money.

The CHAIRMAN. I am glad you supplemented that remark.

Governor HARRISON. That is the danger of using general phrases of that kind.

The CHAIRMAN. Right there, do you think the banks in money centers ought to be permitted to pay interest on bank deposits? I do not mean on individual or concerns or corporate deposits; I mean on deposits from the interior banks; does that not have a tendency to draw a vast amount of funds and credits from interior banks to the money centers?

Governor HARRISON. I think it does, but unfortunately such a big percentage of the banks of the country are not members of the Federal reserve system that under our State laws their reserves either have to be or may be carried in other banks. As a result of that, in having some fourteen or fifteen thousand nonmember

banks, you have competition on the part of big banks in the money centers to get that reserve business, and that is what in part, at least, makes for interest rates on bank deposits. But you take New York to-day, for instance, the rate paid upon bank deposits by the clearing-house banks, which is really the effective deposit rate in New York, is only 1 per cent, but some other cities not so far removed from New York are paying as high as 3 per cent. I do not see how they do it.

The CHAIRMAN. I have understood that a very distinguished official of a very notable Federal reserve bank takes the view that Congress may control that under the interstate commerce laws of the Constitution.

Governor HARRISON. I should feel very much happier if it were possible without too great a readjustment in the process, if all banks of deposit—I use those words advisedly—were members of the Federal reserve system. If that were ever required, however, I believe it should be only under some limitation as to the minimum amount of their capital, because some banks of deposit in existence to-day have a capital that is too small fairly to entitle them to membership. But if you could build up a minimum capital requirement for all banks of deposit and then in some fashion get them under the roof of the Federal reserve system, I think the country would be much better off. Among other things, the distribution of credit, which is now checked for the reasons I mentioned some time ago, would tend to be much more liquid than it is now.

Take, for instance, the years 1920 and 1921 and last year, as well as the present time, country banks that are not members of the Federal reserve system, instead of being able to come to the Federal reserve bank with eligible paper to meet their withdrawals, have to concentrate their requests upon city banks. The city banks, even assuming they may be in a position to know as much about these country banks as the Federal reserve bank, are necessarily more limited in their ability to help and necessarily more reluctant to do so in the very times when their help is most needed. If, therefore, all those banks were members of the reserve bank, in sound condition with appropriate working capital, the banking structure would be much more effective and sounder than it is now.

Senator WALCOTT. That presents a pretty interesting picture if you put in all banks of deposit. You mean by that the State banks?

Governor HARRISON. Yes, sir; because the national banks are required to do so.

Senator WALCOTT. That would include all trust companies with a minimum capital requirement?

Governor HARRISON. All trust companies that are doing a deposit banking business. There are some of those companies in some sections of the country I understand that are prohibited from doing a regular deposit business.

Senator WALCOTT. I would like to refer for a moment to the banking system. Are you familiar with the English system of branch banking?

Governor HARRISON. Just generally.

Senator WALCOTT. In the method of controlling the organization there you had a system which is exceedingly flexible, where you have

a maximum responsibility on the branch banks rather than in the dictation from headquarters. Take Lloyds, for instance, or any large bank; take Midland, which is a good example, where you have now a pretty well-defined tendency of different groups or different banks to go into what we are trying to define as trade areas, trades, certain trades, into which certain banks ramify, or on which they specialize and with great flexibility and broad powers lodged in the branches themselves, because they are supposed to be expert, and because they are localized; they are in that particular trade center, like Manchester textiles, like steel in Lancaster, and so forth, and shipping in Liverpool.

Governor HARRISON. Yes.

Senator WALCOTT. Are we working toward that or are we not? Apparently, I judge from the conversations that we are not working toward it at all.

Governor HARRISON. I think we have not worked very far in that direction as yet. Of course you can never do it in this country in the same degree that they have in England, in my judgment, because of the difference in geographical area, and also secondarily because of the complication of conflicting State and Federal laws. We have never looked into the question whether Congress could authorize a national bank to have branches in several different States, but I suppose that would be possible.

The CHAIRMAN. You know it took us 14 months, do you not, under the so-called McFadden bill, to get a fragmentary branch banking authorization.

Governor HARRISON. But if our experience is demonstrating, Mr. Chairman, that the small country bank is finding less and less need for its existence, if the small banks will not find it profitable or necessary for them to continue in small communities, is there not the risk that sooner or later there will be certain sections of the country that will need some sort of banking accommodation with credit supplies from the central reservoirs where it is more plentiful? I feel that there is a real need for that system of conduits from the centers to the more remote communities.

The CHAIRMAN. Yes, I have felt that for a long time, but I have never been able to show it to Congress.

Governor HARRISON. One danger of not doing so we are facing now in the development of the chain and group banking, which in my judgment is unsound and fraught with risk.

The CHAIRMAN. Governor, to go back to the theories on the rediscount rate, that the Federal reserve bank is not effective in repressing excessive speculation, I believe you said you raised your rate in 1928 three times.

Governor HARRISON. Well, that is my recollection, Senator. May be I am wrong but I think that is right.

The CHAIRMAN. Of course you did that with the sanction of the Federal Reserve Board?

Governor HARRISON. Yes, sir.

The CHAIRMAN. And went as high as 6 per cent?

Governor HARRISON. We reached 6 per cent in August, 1929.

The CHAIRMAN. Then you proposed somewhat before that, did you not, to raise the rate and failed to get the sanction of the Federal Reserve Board?

Governor HARRISON. We first requested the board's approval of an increase in the rate on, I think it was, February 14; it was the middle of February of 1929.

The CHAIRMAN. Was your board quite unanimous in asking to increase the rate?

Governor HARRISON. The directors of the Federal Reserve Bank of New York voted unanimously for the increase in rate week after week until the end of May, I think it was, and in all that period, as I remember, there was only one dissenting vote and that was only on one occasion for a particular reason.

The CHAIRMAN. Did your board give an explicit reason for its desire to increase the rate?

Governor HARRISON. Of course, the action of the board of directors with regard to the discount rate must represent the sum total of the impressions which the directors get from a myriad of different factors which affect their judgment. It is very hard to define the motive which prompts the individual directors at an individual time to take specific action. For that reason it has always been difficult in specific cases to give in a short paragraph a composite reason for action by a group. On the other hand, I do not think there was ever a time when the reasons that prompted our directors to act were more clear, or to them more convincing than during that period in 1929. Time after time we discussed the propriety of the action and the need for the action.

The CHAIRMAN. Of course I understand that, but it seems to me that when that board, having the right to initiate a rate but with the distinct reservation that the Federal Reserve Board would review and determine the rate that your bank would give some more or less definite reason why you wanted to raise the rate or lower the rate, as the case may be.

Governor HARRISON. I did not mean to imply that we did not. We did it this way: On various occasions the directors asked me and the chairman of the board to go to Washington to review the whole situation as we saw it. We discussed the many elements in the situation which prompted our directors to take action. There was never a time, I think, when the Federal Reserve Board was not completely and wholly familiar with what reasons we had. Furthermore, there were one or two occasions during the period when we wrote the Federal Reserve Board concerning the various factors that operated upon the judgment of the directors in voting to increase the rate.

The CHAIRMAN. You say your own view is that excessive speculation is to be controlled by the operation of the discount rate? Did your board ever give to the Federal Reserve Board as a reason why you wanted to raise the rate, the desire to repress excessive speculation?

Governor HARRISON. I think what we did—and we were careful to do it that way—was to advise the board that we wanted to raise the rate to control the continued rapid expansion in the country's credit structure which was contributed to primarily by the demand for loans upon stock exchange collateral.

The CHAIRMAN. You would not be willing to modify that expression by saying exclusively instead of primarily?

Governor HARRISON. Well, you could not say it was exclusively because there were periods when we had real-estate speculation in Florida and real-estate speculation elsewhere that contributed to it. Furthermore, when I look backwards I can not help but be convinced that indirectly business was getting too much credit for its own good at that time, not only through commercial borrowing but through new capital funds with which, for instance, they built up factories that tended to overcapacitate them.

The CHAIRMAN. It is astonishing to me that if business demands were so many that they demanded increased credit that there are so many people idle.

Governor HARRISON. I beg your pardon; I did not catch that.

The CHAIRMAN. I say it is astonishing to me that if business activities were so great as to demand largely increased credit that there are so many people said to be idle now, unemployed.

Governor HARRISON. Perhaps that is one of the contributing reasons that they are now unemployed.

The CHAIRMAN. Business should afford such activities to the unemployed.

Governor HARRISON. That business may be and probably was potentially overcapacitated through improved machinery and methods of output, plus some overexpansion in factory equipment, most of which was accomplished by new credit of one fashion or another, there now seems reason to believe. Industry built up this productive power to a point proportioned to the excessive spending power resulting in some measure from large profits arising out of stock-exchange speculation. I would not, of course, say that the present business depression is due wholly to overcapacity or to overproduction, because the decline in commodity prices has related itself almost as much to commodities that we know to be not overproduced as to those that we feel have been overproduced. The other side of the picture is that there is a large underconsumption of goods due to the fact that in many parts of the world as a result of the war and postwar deflation there has been a loss of capital which has destroyed their purchasing power of our goods and which can not be revived, in my judgment, until those countries are able to import capital in the form of foreign loans from other countries.

The CHAIRMAN. Did the Federal Reserve Board ever give you any reason, or give your board any definite reason, for its refusal to sanction your increased discount rate?

Governor HARRISON. Senator, I think perhaps that is a question they can answer better than I, but certainly whether it is in the records or not, our understanding was that they believed it to be a more effective way to control the credit situation by so-called direct action than by rate action.

Mr. Chairman, may I make this one observation—

The CHAIRMAN. Pardon me for interrupting the proceedings, but there has been a suggestion made that the committee take a recess as the nomination of Mr. Meyer as governor of the board is now pending in the Senate. However, I think upon consideration that we will proceed with the hearing.

Governor HARRISON. Mr. Case has called my attention to the fact that the committee might misunderstand one statement that I made, .



to the effect that we have not remonstrated with or restrained the city banks. What I said day before yesterday I hope did not necessarily imply that. We have often, when occasion arose, remonstrated with them whenever they have violated any one of the principles which I have enunciated as applicable to country banks. Of course the same principles are applicable to the city banks as to the country banks. If they are borrowing disproportionately larger amounts than the community demands, we do put pressure on their borrowings, and I do not want to have any misunderstanding as to that. What I said day before yesterday was also true, that we did not criticize the management of a bank merely because of the fact that they have collateral loans in their portfolio, or even if those loans may be increasing, provided they are not borrowing too continuously or too long or in disproportionate amounts.

The CHAIRMAN. There is no reason why you should criticize the banks at all or remonstrate with them at all if they are not borrowing from you, no matter what they do.

Governor HARRISON. A great many people feel to-day that we have a responsibility for doing that because they say if we do not—

The CHAIRMAN. Your only contact with the individual bank is when it is proposing to rediscount with you, or when your examiners go there under the law to examine the banks.

Governor HARRISON. Yes; and that exemplifies the difficulty in the matter of direct action that we have been discussing. Suppose a bank has not been borrowing from us for a period of months, and suppose between examinations they come to us for a loan of a million dollars. We find out in the interim that their collateral loans have gone up very rapidly, and such a situation as you have been critical of exists, the bank comes to us at that moment to get funds to meet a large withdrawal of deposits. If we refuse to make the loan we run the risk of closing the bank, which may be proper punishment for the management but is very severe and disproportionate punishment for the depositors. But even if we should assume that some collateral loans are speculative loans, the situation in a large bank is a most complex one and most difficult to interpret. Those banks, especially the banks of New York City, do not often borrow continuously unless there is great stress in the community as a whole such as we had in 1920 or 1921 when all loans were expanded and when the banks were forced to borrow to make good the deficiencies in their reserves. Then again in certain seasons of the year, in certain times of the month and on certain days of the week we have by experience learned that funds are transferred out of New York to the interior of the country and that the banks must borrow to make good the withdrawals. On other days, we find by experience, that those funds are coming back again and that the borrowings will be repaid. We can not well refuse to lend in such cases even though the borrowing banks have outstanding loans on securities.

The CHAIRMAN. In the degree that bank credits are useful for speculative purposes, for stock-market purposes, that activity affects the money market, does it not, in the matter of commercial credits?

Governor HARRISON. I am sorry, but I did not understand the preliminary part of your question, Mr. Chairman.

The CHAIRMAN. I say, just in the degree that bank facilities are used for stock-speculative purposes, in that measure the credit of the market for other business is affected, is it not?

Governor HARRISON. That is bound to be so, just as I said day before yesterday, and the converse is true, that you can not control one without controlling the other.

The CHAIRMAN. Then, the Federal reserve system having been established as an incident to commerce—and you think there is some obligation upon it to supervise or control the money market—would not the obligation be theirs primarily to so control it as to enable those who are in other business than speculative transactions to get their credit at a reasonable rate of interest?

Governor HARRISON. I think if that were possible to be done it would of course be a wise thing. If there is any way by which any group of men or any organization can insure a perfectly level flow of credit year in and year out without stress or strain or without variation in rates caused by heavy demands from a particular class of the community, that would be a splendid solution of our difficulties. But where I am afraid that I differ with you is not so much in principle as in its application. First of all, I do not see how any of us can define what a speculative loan is. I have tried my hardest to but I can not define it and never have been able to find anybody who could define it in any fashion that would not work an injustice on perfectly legitimate borrowing.

The CHAIRMAN. Well, under the law, no matter what it is, you can pick out any one of the ten commandments under the law which would work apparently an exceptional injustice, or rather an injustice in exceptional cases, but as a general proposition it is not very difficult to define what a speculative loan is, is it?

Governor HARRISON. Well, take for instance the year 1929 in New York, when these banks of ours were still lending, continuing to lend, a billion dollars on collateral call loans to brokers which they had loaned for some time even before great speculation began. Would a continuous but steady loan at a time like that be considered as sustaining a speculative movement?

The CHAIRMAN. Had it been continuous over a period of time that might very largely be regarded as an investment loan, but the fact is that the chart shows that the stocks dealt in on the New York Stock Exchange are held on the average now 22 days, or at least that was so a year ago—22 days as against 67 days 14 years theretofore.

Governor HARRISON. Yes; I think that is true.

The CHAIRMAN. Has that no significance?

Governor HARRISON. Yes; it is very significant.

The CHAIRMAN. And might we not reasonably regard a situation like that as a purely speculative situation?

Governor HARRISON. Yes, I think that is true; but I am troubled with a practical difficulty when we come to apply that principle in practice to the handling of an operation in the Federal Reserve Bank of New York. When an individual bank comes to us for a loan, we can not say for certain that that particular bank is fostering any appreciable amount of speculative activity.

Senator BULKLEY. I would like to get away from the use of the word "speculative" in order to get away from an argumentative point. Do you see any merit in a bank using its facilities for short-time borrowing from the Federal Reserve Board by depositing Government securities as collateral and at the same time increasing its loans made for the purpose of carrying investment securities?

Governor HARRISON. Senator, I think we are apt to make our answers in the light of the experience we have just gone through; but looking ahead—

Senator BULKLEY. I mean looking ahead.

Governor HARRISON. Looking ahead to the normal period of operation when I hope we will not be faced with a repetition of what we have had, if that proposed law is in effect and a bank comes to us for a loan for one of the reasons to which reference has been made here so often, such as to meet a withdrawal of deposits, and then a customer goes to them the next day and asks for accommodation upon stock-exchange collateral, should the customer be denied the facility—a good customer of the bank—of getting the accommodation which he believes to be perfectly proper for his business or for his personal needs—not speculation—would he feel it was proper that he should be denied that accommodation merely because the bank is already borrowing from the reserve bank?

Senator BULKLEY. Now you are getting away from the question I asked you by asking me something different.

Governor HARRISON. I did not intend to do that, Senator.

Senator BULKLEY. I am putting a perfectly plain hypothesis to you, where a customer is asking the bank for a loan to carry investment securities. I am trying to avoid the word "speculative," because I appreciate that that is argumentative; but there is such a thing as a loan to carry investment securities, no matter what he might ask for other purposes, but in what I am asking the purpose is clear—it is the carrying of investment securities. Do you advocate the increase of that sort of loan at the same time that the bank is using its facilities for short-time borrowing by the deposit of Government securities?

The CHAIRMAN. May I suggest right there, if my colleague will permit me, do you advocate it as a policy—we are not talking about exceptional cases or emergency cases—but do you advocate it as a policy?

Governor HARRISON. I must apologize to the Senator. I misunderstood his question.

Senator BULKLEY. I did not mean to be impatient about it. I want to get the question to you clearly.

Governor HARRISON. I think to permit it as a general policy might be a matter of abuse; on the other hand, I do not see anything inherently wrong in a man borrowing or a bank lending, even though it happened to be a member of the Federal reserve bank, funds to a customer who is desiring to buy stock as a permanent investment to put in his box and to pay for it out of his earnings. The difficulty of a law of that kind is that we can not separate the different categories of loans very clearly and eliminate less desirable loans, and at the same time permit what I believe to be perfectly proper loans. I believe one way in which people may properly save and

invest, as has been done in the past, is to borrow money for investment in real estate or equities, or anything else, and to pay it off out of income as time goes on. But to say that any bank which is accommodating the public in that sort of investment shall not be entitled to Federal reserve privileges is, I think, running a real risk. I admit that if there is too great abuse and if it can not be controlled by the discount rate, the only way of controlling the abuse may be as Senator Glass proposes, even if the innocent will have to suffer with the rest for the general good.

Senator BULKLEY. First, my question, inspired by section 11 of this proposed bill, is not to deny Federal reserve facilities at all; it is only to limit the use of them in what seems to me to be rather a reasonable way, and I was just trying to develop your opinion as to whether there should be any limitation at all. Maybe the limitation is not exactly right as it is.

The CHAIRMAN. Governor, do many people very often find it necessary to borrow money on United States bonds, and buy securities and put them away as an investment in their strong boxes; I mean borrow for 15 days; you know this is an emergency provision exclusively, put in for that purpose to avoid embarrassment for a bank whose deposits may have been unexpectedly withdrawn? Is it often that a man or institution desires to borrow, for a period of 15 days or less on United States securities, money to invest?

Governor HARRISON. I think it is not often that an individual customer of the bank does that, except, of course, dealers in securities who do just that.

The CHAIRMAN. One more question. Would it be possible for brokers to do their own financing as brokers rather than through the bank in making what we call brokers' loans?

Governor HARRISON. You mean out of capital?

The CHAIRMAN. Yes; I mean out of their own resources rather than borrowings from the banks.

Governor HARRISON. It would mean a change in our whole system, of course. Whether it could be done without too big a readjustment, I do not know.

The CHAIRMAN. Is it done abroad frequently?

Governor HARRISON. I would agree that it might be wise to reduce the amount that brokers may borrow in proportion to their capital. I think it is too high now, but whether you can very substantially limit it or not, I do not know.

The CHAIRMAN. Governor, I think the committee will have to suspend its hearings now for our recess. Doctor Willis, the expert adviser of the committee, wants to ask you a few questions if you could come back.

Governor HARRISON. I shall be very glad to, Mr. Chairman.

The CHAIRMAN. The committee will now take a recess until 2.30 o'clock p. m.

(Accordingly, at 12.30 o'clock, the committee took a recess until 2.30 o'clock p. m. to-day.)

#### AFTER RECESS

The subcommittee reassembled at the conclusion of the recess at 2.30 o'clock p. m., Hon. Carter Glass (chairman) presiding.

**STATEMENT OF GEORGE L. HARRISON, GOVERNOR OF THE FEDERAL RESERVE BANK OF NEW YORK—Resumed**

The CHAIRMAN. The committee will come to order. Governor, I believe I adverted to the fact the other day that the Federal reserve act contains provisions that its proponents from time to time regard it as ample to enable the system to establish branches or agencies abroad to look after our foreign trade, which I recall was done upon special request of the then President, Mr. Wilson, who was very anxious to look at our foreign trade, and Doctor Willis, the expert of the committee, wants to ask you some questions with respect to our European connections, and it may be that I may want to ask a question or two after he gets through.

Mr. WILLIS. First of all, I want to ask you a few questions about the foreign operations. Why is it that bills stated in foreign currencies held by the Federal reserve banks have shown such a marked increase in recent months? In what currencies are these bills stated?

Governor HARRISON. What bills?

Mr. WILLIS. Bills stated in foreign currency, held by the New York reserve bank?

Governor HARRISON. Senator, if I may just make a short statement as a preface to our discussion, it will enable me more frankly and fully to answer the inquiries. If I may assume that you do not want me to disclose the business of the individual customers that do business with us it will be appreciated. I feel that it would not be proper to do so, and I would prefer, unless the committee specifically requests me to do so, to assume that I may discuss this question without disclosing individual accounts of individual customers.

The CHAIRMAN. I should think that that could be done.

Governor HARRISON. It would be a little embarrassing and I mention it only to indicate that if I appear at all unfrank it is just to safeguard the interests of some of our customers. Other than that, I have no reservations, Mr. Willis.

The reference that you have made to our holdings of foreign currency bills is obviously to the increase that has taken place in the past two months, amounting to approximately \$35,000,000 in foreign bills which we commenced buying, I think it was, in October, or maybe in September.

The CHAIRMAN. Is that under the open-market provisions of the act?

Governor HARRISON. Yes, Mr. Chairman; it is under the provisions of subparagraph E of section 14, I think which authorizes the Federal reserve bank, with the approval of the Federal Reserve Board, to appoint foreign correspondents. It is in the same paragraph, in other words, as that in which we are authorized to establish agencies abroad. As you know the seasonal pressure upon the foreign exchanges usually occurs in the fall, at the time our agricultural products are moving abroad, or are ready to be moved abroad. We can almost always anticipate that that will be the season of the heaviest pressure, although in recent years there has been some disturbance to the normal on account of extraordinary conditions in many markets resulting from the inflation here two years

ago. At the time we commenced to purchase these foreign currency bills this past fall—and I am sorry I do not remember the exact date—the foreign exchanges, and especially sterling, were very weak and near the gold import point. Now, we know from experience that one of the factors which influences the purchase of our goods is the fluctuation in the exchanges, and at a period when the exchanges normally would be weak on account of the movement of goods we can lend some support to the foreign exchanges through the purchase of foreign currency bills.

We not only thus avoid the import of gold, for which we have no immediate use, but it would also strengthen or tend to strengthen those exchanges that make for stability at a time when the foreigners are purchasing our marketable goods. We usually contemplate at the time of making these purchases that after the turn of the year, in February and March, when the exchanges are beginning to strengthen, we can then dispose of these sterling or franc or mark bills. The exchanges are always stronger at a time when our agricultural products are not moving abroad.

Mr. WILLIS. In what currency are those bills chiefly stated?

Governor HARRISON. That, of course, would disclose the particular account.

Mr. WILLIS. Not necessarily, at all. Many transactions of that kind are stated in sterling, for example, or francs, in operations on behalf of almost any other country.

Governor HARRISON. No; because we do not buy any foreign currency bills except those that we buy through the central bank of the country of the currency in question. I think it makes no important difference in this case, but I would prefer unless this committee wants me, not to make a public statement as to that.

Mr. WILLIS. Very well, I will pass that.

Governor HARRISON. I do not mean to be obstinate about it.

The CHAIRMAN. You obviously are not obstinate about it.

Mr. WILLIS. How is the decision reached in the Federal reserve system to purchase bills stated in foreign currencies? How do you arrive at such conclusion?

Governor HARRISON. It is one of the factors which the directors of the Federal Reserve Bank of New York constantly have under consideration. We do not believe we can properly administer the affairs of the Federal Reserve Bank of New York without some consideration of the foreign aspect of our rate situation in its relation to the whole credit situation.

Mr. WILLIS. What proportion of the bill holdings of the Federal reserve bank for its own account is acquired through the operation of the open-market investment committee?

Governor HARRISON. You are talking about the domestic bills now, are you?

Mr. WILLIS. Yes; and also bills in general. You say that the New York bank directors have charge of the general decision here as one of the factors that they have in mind for the management and yet you buy those pro rata for all banks, do you not?

Governor HARRISON. We are still talking of the foreign currency bills?

Mr. WILLIS. Very well; let us speak of those for the moment.

Governor HARRISON. As I explained to you day before yesterday, under the law it is provided one Federal reserve bank may appoint agents and correspondents abroad and open accounts with them, with the understanding that other Federal reserve banks may participate in such accounts. We have never sought a foreign account in our history. They have opened these accounts with us only after we have been requested to open them and have made an investigation of the bank and approved of it.

Mr. WILLIS. What proportion of them are acquired through open-market investment in foreign bills?

Governor HARRISON. None of them.

Mr. WILLIS. But they are bought pro rata for all banks?

Governor HARRISON. That is quite right.

Mr. WILLIS. And the reason you were going to give?

Governor HARRISON. As I explained at the outset, the directors of the Federal Reserve Bank of New York have these matters under consideration all of the time. We buy sterling or marks or whatever the exchange is that we buy under the circumstances that I have defined, and after we have bought the currency abroad we then endeavor to convert as much of it into bills as is possible rather than to leave it on deposit. That is the way bills are acquired and that is the way they are reflected in our account or statement. Now, those accounts, at the request of all other Federal reserve banks, are participated among all Federal reserve banks.

Mr. WILLIS. Proportionately?

Governor HARRISON. Yes, sir; that is right; participated pro rata among all the reserve banks with complete information to them as to any transaction engaged in.

Mr. WILLIS. But you are really a central bank in foreign exchange in this general control of the transactions?

Governor HARRISON. Yes. And I think that is contemplated by law.

Mr. WILLIS. What is the rate of commission received by the Federal reserve banks for the indorsement of the bills held for foreign account?

Governor HARRISON. We do not indorse any bills. We purchase bills for foreign account, and guarantee them, for which we charge one-eighth per cent per annum to any bank.

Mr. WILLIS. One-eighth. Have the acceptances of any banks that subsequently failed been so indorsed?

Governor HARRISON. Have what?

Mr. WILLIS. Have the acceptances of any of the local banks that subsequently failed been so indorsed?

Governor HARRISON. They have been guaranteed, yes.

Mr. WILLIS. What proportion has there been of those?

Governor HARRISON. There has been an insignificant amount of one bank, only one bank. Incidentally there has never been any loss. We purchase for foreign account and guarantee only 3-named paper—drawer, acceptor, and acceptable indorser.

Mr. WILLIS. How much capital must a recognized dealer in acceptances possess?

Governor HARRISON. I forgot to say, Mr. Willis, that we are preparing specific, concrete answers to the questionnaire sent to us.

I have got some of them here, in a preliminary draft of the answers to the questions.

Mr. WILLIS. On this particular one I want to make inquiry.

Governor HARRISON. May I hear the specific inquiry again?

Mr. WILLIS. How much capital must a recognized dealer in acceptances possess?

Governor HARRISON. Recognized for what purpose?

Mr. WILLIS. For dealing with you.

Governor HARRISON. Do you mean the dealer from whom we buy acceptances?

Mr. WILLIS. Yes, sir.

Governor HARRISON. We may buy acceptances from any dealer regardless of the amount of capital. But we do some other things with dealers than purchasing acceptances.

Mr. WILLIS. What other things are they?

Governor HARRISON. As we require a third indorsement we take an indorsement from some dealer, and, obviously we must be satisfied with the value of the indorsement. We go into the question of their whole statement.

Mr. WILLIS. How much do you require them to have as capital?

Governor HARRISON. I do not know that we have any specific minimum. I can say as a practical matter there is none that has less than \$1,000,000 capital.

Mr. WILLIS. You have never fixed the million as a basic minimum?

Governor HARRISON. It has never been fixed as I am aware of, certainly not by any specific action since I have been governor.

Mr. WILLIS. Is it an understanding in the New York market that it is \$1,000,000, and that no one else need apply?

Governor HARRISON. I do not believe so, because we have had some apply with less than that from whom for one reason or another we were not content to accept an indorsement.

Mr. WILLIS. But in a general way you want \$1,000,000 capital before you deal with a dealer of that kind.

Governor HARRISON. Mr. Willis, when you talk about dealing with a dealer, there are many different ways of dealing with a dealer.

Mr. WILLIS. We are speaking about dealer's operations and so forth.

Governor HARRISON. But it is not "and so forth" that I am speaking about. The indorsement is what I am speaking about.

Mr. WILLIS. Speak of that, then.

Governor HARRISON. There is no dealer whose indorsement we accept as a valid indorsement, who has a capital of less than a million dollars.

Mr. WILLIS. And is there none you would accept at less than that no matter what the capital investment was?

Governor HARRISON. I think before we approve of it in our own operating departments the indorsement of a particular dealer of less than a million dollars would go to our directors for their authority.

Mr. WILLIS. Of what protective value is the dealer's indorsement on bills? Considering the small ratio of his net worth to his contingent liabilities, how much is that protective value?

Governor HARRISON. That depends on the dealer, his net worth, and amount of acceptances from that dealer.



Mr. WILLIS. Taking it as an average, is it high or low in value, like the discount average?

Governor HARRISON. We consider it has got a real value.

Mr. WILLIS. Has that ever been tested in any way at all?

Governor HARRISON. We have held some acceptances, which we have guaranteed, that had three names, where the acceptor failed. We lost no money. Whether they happened to be indorsed by banks, or trust companies, or dealers, I am not sure, but we have never lost any money on our guaranty.

Mr. WILLIS. Are bills bought for foreign account purchased largely from dealers?

Governor HARRISON. Yes, sir. I think it is probably true that most are from dealers, although I would prefer, if you will let me, to leave that answer subject to the exact figures which are in the memorandum we are preparing for the committee.

Mr. WILLIS. Does the open market investment committee control the total volume of acceptances purchased by the Federal reserve banks in the open market each fall?

Governor HARRISON. No; the open-market committee does not.

Mr. WILLIS. Have you any definite agreement with foreign central banks as to the relations existing; that is, agreements in writing, definite agreements with the foreign central banks as to the mutual relationship existing in the purchase of bills in the respective markets?

Governor HARRISON. Yes; we have exchanged letters with all of our correspondents, outlining what we will undertake to do for them, and what we expect them to do for us.

Mr. WILLIS. Will you file them with the committee?

Governor HARRISON. I will be glad to file them, but I would rather not disclose the details. I would not like to mention the terms here.

Mr. WILLIS. Have you any dealings with respect to the Bank of International Settlements?

Governor HARRISON. Yes; we have.

Mr. WILLIS. Does that differ from any other central bank or is it the same?

Governor HARRISON. It is the same, substantially the same. I think it is exactly the same.

The CHAIRMAN. Let me ask you if you have had any dealings with the International Bank, as you say you have, and as I assume you would have; what becomes of the order of the State Department that the Federal reserve system shall have no relations with international banks?

Governor HARRISON. As I understand the situation, Mr. Chairman, neither the Federal reserve bank nor the Federal Reserve Board, as far as I am aware, ever got any communication from the State Department as to what we should or should not do.

The CHAIRMAN. You saw the public statement in the newspapers?

Governor HARRISON. I saw the public statement, and as I recollect that statement the inhibition or prohibition, however it was expressed, was against our participation in the organization or management of the International Bank.

The CHAIRMAN. What had the State Department to do with it?

Governor HARRISON. Well, as I stated at the hearing day before yesterday, I would really prefer not to discuss the public statement of the State Department.

The CHAIRMAN. What I am trying to develop is: Do you know of any provision of law now authorizing the State Department to have anything at all to do with the Federal reserve system?

Governor HARRISON. No; I am not aware of any such provision.

The CHAIRMAN. Is there any provision of the law that would enable the President of the United States to discharge a messenger boy in the bank?

Governor HARRISON. None, that I know of.

Mr. WILLIS. Have you any representative at the International Bank who reports to you regularly?

Governor HARRISON. None, whatever.

Mr. WILLIS. I have one or two questions on the money situation which were raised this morning. What is the relationship between the Federal Reserve Bank of New York and the money committee of the Stock Exchange?

Governor HARRISON. There is no relationship.

Mr. WILLIS. You never have had membership on that committee of any kind?

Governor HARRISON. None, at all.

Mr. WILLIS. And there is no assistance or cooperation in fixing the rate in any way?

Governor HARRISON. No; although on various occasions they advise us the state of the money situation, and what they think the rate ought to be.

Mr. WILLIS. Is there ever any rediscounting with the Federal reserve bank for the purpose of regulating the call money position; that is to say, when there is danger of the call money rate going up, when the member banks obtain from the Federal reserve bank rediscount funds, and hence keep the call money rate down?

Governor HARRISON. Oh, there have been frequent occasions when that has been done.

Mr. WILLIS. And, of course, with the knowledge of the bank and its board of directors.

Governor HARRISON. Yes, that is right. Take the period of October and November, 1929, when in the span of 4 or 5 or 6 days, that is within a week, between a billion and a half or two billion dollars of these so-called outside loans, or loans for others, were called. Had not the New York City banks been in a position to take over some of those loans that were called, you might have had a gyrations in call money rates with consequent pressure upon the exchange that might have resulted in disaster.

Mr. WILLIS. Is it fair to say then that the reserve bank in New York is habitually a regulator of the call money rate in this way?

Governor HARRISON. Not at all; I think it is fair to say, however, that the associated banks in New York feel that they have got some responsibility for the call money rate, and that when occasion develops they feel it is necessary to put money out and that that involves the creation of new deposits and higher reserve requirements which at times forces the banks to borrow reserves from us.

Mr. WILLIS. As to borrowing reserves, what is the attitude of the bank toward the so-called market for Federal funds?

Governor HARRISON. My own opinion is that the market for Federal funds if properly handled and executed by the banks participating in it, is a wise thing for the reason that I was mentioning this morning. If for one reason or another money is very much over in New York, and we will say tight in Chicago, and the banks of New York have surplus reserves, the banks in Chicago instead of borrowing from their own Federal reserve bank and creating new discounts, which in the total are not needed, purchase Federal reserve funds through the New York market, not from us but from any bank that has excess reserves. That machinery tends to make the credit picture much more fluid than it would be otherwise. It enables the Chicago bank—I am using it for an example—to acquire some of the excess reserves floating around New York at a rate lower than their own rediscount rate. And that has the effect of stabilizing or equalizing, or tending to harmonize the rate in both communities.

Mr. WILLIS. The effect of that, then, is to reduce the amount of total reserve funds that would ordinarily be carried?

Governor HARRISON. You mean the amount of discounts that would be otherwise created?

Mr. WILLIS. I mean that the amount of total reserve credit existing on your books is smaller than it would otherwise be?

Governor HARRISON. Yes, sir. It means that if a bank has surplus reserves of over 13 per cent, the minimum required by law, they go out—

Mr. WILLIS. And as you have remarked, the savings deposit reserves have been affected in a similar way by cutting, down to their 3 per cent?

Governor HARRISON. I am afraid I do not understand.

Mr. WILLIS. I understood you the other day to say that the savings deposits reserves were legally 3 per cent, and inasmuch as the tendency was to cut reserves against deposits by shifting to savings accounts at a 3 per cent reserve, that that was rather too small.

Governor HARRISON. I believe it is.

Mr. WILLIS. It would seem, then, that the present reserve is cut at one end and also the other. That is due to this practice?

Governor HARRISON. No; I do not believe it is.

Mr. WILLIS. I thought you just said so.

Governor HARRISON. I said the legal reserves. In one case you were talking about actual reserves and in the other case you were talking about the legally required reserves. I say that 3 per cent reserve on savings deposits is too low, in my judgment. I claim also that when a bank has money over and above their 13 per cent requirement in the Federal bank they can do any one of three things. They can leave it with the Reserve bank, they can sell it, or they have a perfect right to withdraw it in currency and put it in their vaults. There is no legal provision as to that.

Mr. WILLIS. No doubt they have a right to do it just as they have a right to make the savings reserve 3 per cent. No one questions the fact, no one questions the right to keep savings reserves at a minimum.

Governor HARRISON. The reason is that——

Mr. WILLIS (interposing). Do not interrupt me for a moment. Will you advocate the reserve requirement on savings deposits be raised to a rate higher than 3 per cent?

Governor HARRISON. I would like to defer my final judgment pending the report of the committee which is studying the whole reserve question. When it completes its study it will give very much more complete and academic discussion than we could go into at this moment. But my own impression is, and my own personal belief is, that the reserve requirement on savings deposits, for the reason that I defined day before yesterday, should be raised. Whether you should do that without some corresponding adjustment in the rate on demand deposits or not is a very broad question which is being considered by the committee. I should think you might perhaps want to make some adjustments.

The CHAIRMAN. Will the report of that committee be made soon enough to have attention from this subcommittee in the preparation of any legislation we may design?

Governor HARRISON. I think they have made great progress. Mr. Rounds has informed me that he is of the opinion that it probably will not be ready until some time early in the summer.

The CHAIRMAN. I do not imagine we shall prepare legislation before some time next summer.

Governor HARRISON. I confess that I am disappointed that it will not be ready sooner than that, because I had hoped it was nearly ready now. But it is a very delicate, intricate subject, as you know, and requires all sorts of careful calculations to see what would happen if we used this, that, or the other reserve ratio. The volume of detail is great. I think that is the explanation of the delay.

Mr. WILLIS. Can you file a copy of it as soon as it is reasonably ready?

Governor HARRISON. If I have any voice in it I will be glad to.

Mr. WILLIS. I think you have data with reference to the current amount of brokers' loans. Can you file them with the committee?

Governor HARRISON. Yes, sir; I will be glad to do that. And I think it will be very interesting to the committee. We have been working on that for some while. It is a very long and detailed study. I have a summary of it with me. The summary itself is 18 pages.

Mr. WILLIS. A summary probably will be sufficient if you will file that (said summary to be submitted for the committee files).

The CHAIRMAN. Right at that point have you any concrete suggestion to make to the committee as to what might be done in a legislative way to either abate the danger or prohibit altogether the peril of these loans for others?

Governor HARRISON. Mr. Chairman, I hope that legislation won't be necessary, but if it is, I mean if we can not accomplish it by voluntary arrangement with the money market, and by that I mean both the banks and brokers, I hope that something might be done which will limit these loans through legislative action.

The CHAIRMAN. You are unprepared right now to suggest what should be done?

Governor HARRISON. Only for one reason, and that is the fear that if a prohibition is made now in the law it would relate necessarily only to member banks, and that would leave open too many avenues of escape or leakage. I think that by voluntary arrangement, if the community as a whole wants to operate by voluntary arrangement, we can accomplish much more effectively what we have in mind than we could by legislative action.

The CHAIRMAN. A very vital question which is involved right there is whether it must necessarily relate to member banks only.

Governor HARRISON. Of course, I can not answer that.

The CHAIRMAN. You have a very distinguished authority in New York who thinks not, so I am told.

Governor HARRISON. Well, I am surprised to hear it, but rather glad to hear it. All that I had in mind was that I did not know whether it was competent for Congress to say that you or I could not lend some money to Bill Smith if we want to.

The CHAIRMAN. Maybe it might not apply to individuals, but it might apply to corporations.

Mr. WILLIS. Coming to the question, do you habitually buy Treasury certificates for the purpose of maintaining a market for those certificates?

Governor HARRISON. I do not think it is an accurate statement to say that we ever do that now, Mr. Willis.

Mr. WILLIS. What is your policy with regard to buying Treasury certificates?

Governor HARRISON. The policy with respect to the purchase of Treasury certificates now is one which is in the hands of the system committee, called the open-market policy conference. That conference has been meeting quite frequently to consider the whole credit picture in its relation to industry and trade. Whether we decide to purchase or sell securities depends altogether on credit conditions at the time the committee meets.

Mr. WILLIS. Has it been the policy in the past to maintain it that way, to maintain the market for the bonds?

Governor HARRISON. Not that I know of.

Mr. WILLIS. You spoke of it as being not entirely an accurate statement, but at the same time it may be true that you are not familiar with it?

Governor HARRISON. I made that reservation only because I am not familiar with the earlier days.

Mr. WILLIS. Are repurchase agreements ever entered into with reference to buying Treasury certificates so that the holders sell them back to the bank under the repurchase agreement?

Governor HARRISON. I think that falls in line with what you have covered in the prior question. There are dealers in Government securities as there are dealers in bills. There are retailers and there are times when they have stocked up with Government securities, pending resale of their wares, which are Treasury certificates, they need accommodation. Ordinarily in the usual course they go to the banks in the community to get that accommodation. If for one reason or another the funds are not available at rates anything proportionate to the yield upon the certificates, either they would have to dump them on the market or get some accommodation at a

rate that would enable them to carry them pending their orderly sale. In order to take care of such cases we do purchase them from the dealers under repurchase agreements.

Mr. WILLIS. What is the effect of that on the current rates?

Governor HARRISON. We do it always at our rediscount rate.

Mr. WILLIS. At your regular rediscount rate?

Governor HARRISON. Yes, sir.

Mr. WILLIS. What effect has it on the regular rediscount rate, if any?

Governor HARRISON. I do not think it has any effect on the rediscount rate but it does do this, whenever we purchase them that way it puts money in the market for that period of time.

Mr. WILLIS. What leads the open market committee to buy Treasury certificates more or less in any given time?

Governor HARRISON. As I said a moment ago, that involves my making a generalization only. It depends entirely on the whole economic, trade, business, and credit set-up. I would be glad to discuss any specific case because then it would perhaps be easier to develop the thought.

The CHAIRMAN. Let me ask you one question right there. Does the Treasury undertake to influence the action of the New York bank, or any other Federal reserve Bank, in transactions of that sort?

Governor HARRISON. Never, now.

The CHAIRMAN. I know it did when I was Secretary of the Treasury.

Governor HARRISON. That is the reason I said "now."

The CHAIRMAN. And I thought it was a pretty vicious thing to do and was only done under war necessities, or immediate postwar necessities rather, and I wondered whether it were continued or not.

Governor HARRISON. I think there was a time when as a result of the pressure of war necessity the interest of the Treasury was a very strong factor in certain Federal reserve policies. I think that was really not a matter of very severe criticism in the circumstances, but in recent years, and since that period has terminated, there has never been any effort on the part of any of the Treasury officials that I know of, as far as the Federal Reserve Bank of New York is concerned, to influence our rate policies or our operations in Government securities.

Mr. WILLIS. Now a question or two on the matter of the open-market rates. Why was the open market buying rate on bankers' acceptances cut down in the fall of 1928 and during 1929, while the discount rate was advanced, so that finally the buying rate was a full 1 per cent above the bill rate?

Governor HARRISON. That involves a pretty academic study of Federal reserve policy. First of all, when we go into the fall we are going into a period when we usually have seasonal tightening of money, when crops are being moved, and when business demands a certain amount of accommodation. This usually results in the Federal reserve assets expanding between August and December, between \$400,000,000 and \$450,000,000. Therefore when we go into August the system has three alternatives: We can say we will not do anything affirmatively, which forces the banks to come in and bor-

row \$400,000,000. When they borrow \$400,000,000 there is a heavy increase in the pressure upon the credit structure because when banks are in debt to the Federal reserve they are naturally putting on the brakes in an effort not to expand any too fast. So if for any reason when we are approaching the fall season we need to put that pressure upon the credit structure we do so by purchasing as few bills as possible, purchasing no Governments, possibly advancing the discount rate and forcing the banks to come in to get requisite reserves by borrowing from us. If, on the other hand, for one reason or other, it seems wiser not to put that pressure on the community, we can offset the seasonal demand for Federal reserve credit, which amounts to \$400,000,000, in the average year, either (a) by voluntarily purchasing Government securities or else (b) by freely accepting acceptances that are offered to us for sale.

Now during the fall period we usually get in the normal course of events around \$200,000,000 of new acceptances which are offered to us. Those acceptances are being drawn to facilitate the orderly movement of the crops. If we keep the acceptance rate down it facilitates the offering of these acceptances, and avoids the need of borrowing, which puts the pressure on.

Mr. WILLIS. Did the open-market acceptance policy of the reserve bank interfere with its general policy of restrictive control of speculative credit expansion at any time during 1928 or 1929?

Governor HARRISON. I personally would have preferred to advance the acceptance rate in the fall of 1928.

Mr. WILLIS. You mean the rediscount rate?

Governor HARRISON. No; I am talking of the bill rate.

Mr. WILLIS. Why did you not do it?

Governor HARRISON. Well, there was a difference of opinion.

Mr. WILLIS. In the Reserve Bank of New York?

Governor HARRISON. Some in the Reserve Bank of New York and some in the Reserve Board.

Mr. WILLIS. Would the rediscount rate advances have been more effective if seasonal purchases of acceptances at relatively low stated buying rates had not been made during this period?

Governor HARRISON. Yes; I think they would have been.

Mr. WILLIS. That would have been better?

Governor HARRISON. Yes.

Mr. WILLIS. In a general way, do you reduce the rate on acceptances in advance of reduction of the discount rate and raise it in advance of an increase in the discount rate?

Governor HARRISON. No; because usually the conditions that lead up to the reduction of the discount rate have previously forced the acceptance rate down so that we are then in the position of following a reduction in the bill rate by a reduction in the discount rate.

Mr. WILLIS. I looked at your statement, and it occurred to me to ask whether the present acceptance rates were too low. Country banks, of course, habitually rediscount while city banks get more through acceptances?

Governor HARRISON. It gives a lower rate of accommodation to any bank that happens to have acceptances to bring to us.

Mr. WILLIS. And those banks are habitually which ones?

Governor HARRISON. Unfortunately they are not habitually any one group. I wish they all were habitual holders of acceptances.

Mr. WILLIS. For the most part do you find the acceptances in the country or in the city?

Governor HARRISON. Until the past year and a half the city banks held a small proportion of the acceptances, unquestionably, and while I have not prepared the figures, no doubt you will get them, I assume that relatively the country banks had more before 1929 than the city banks.

Mr. WILLIS. What is the differential in favor of acceptances—I mean the differential in favor of acceptances, instead of acceptance credit—about how much cheaper does it run?

Governor HARRISON. At the present time our bill rate is  $1\frac{5}{8}$ , as contrasted with a 2 per cent discount rate.

Mr. WILLIS. And how about when the rate was 6 per cent or 5?

Governor HARRISON. In 1929 the bill rate was  $5\frac{5}{8}$ , when the discount rate was 5 per cent, because we were not authorized to advance our discount rate. We wanted it over the bill rate.

The CHAIRMAN. Governor, speaking of acceptances, has the volume of domestic acceptances in recent years materially increased or decreased?

Governor HARRISON. The volume of domestic warehouse acceptances, Mr. Chairman, has gone up—I do not know whether I have got the chart here or not—but that increase is due to this fact: That each fall, and especially in 1927 and 1929, when there was a large volume of agricultural products on the market not being sold, they were being carried in warehouses. Many of the owners of those products carried them through the medium of warehouse acceptances which are authorized by section 13 of the Federal reserve act. Generally the peak in the volume of acceptances drawn against warehouse receipts is reached in November and December, representing the peak of accumulated products taken off the farms. It then goes down to a minimum, around June and July. At the end of December of this past year I think the volume of warehouse acceptances outstanding was around \$270,000,000, as contrasted with a low in June or July of around \$120,000,000.

Mr. WILLIS. Was that increase largely due to the growth in warehoused products stored abroad, in Germany?

Governor HARRISON. I am talking of domestic acceptances.

Mr. WILLIS. But there was an increase in foreign acceptances?

Governor HARRISON. Did you say our foreign ones?

Mr. WILLIS. I did not say your foreign ones. I said foreign acceptances.

Governor HARRISON. I want to be careful; I do not want any misunderstanding. These figures do not represent the holdings of the Federal Reserve Bank. They represent the total volume of acceptances outstanding in the United States; that is, the acceptances accepted by American banks and bankers.

The CHAIRMAN. I want the information as to domestic acceptances. I want in the course of this inquiry, if I may, to develop just what use you think that domestic-acceptances provision in the bill has been to the commerce of the country, because it was the view of the Banking and Currency Committee, at least of the House, confirmed by the action of Congress itself, that the domestic acceptances, the establishment of domestic acceptances, was to take form not only



to end the practice in this country but in other civilized countries; and Mr. Walker, who appeared before the House Committee, made a very emphatic statement that nothing like it was ever heard of in banking, either in England or Continental Europe, and that a system of that sort, if largely used, would come pretty nearly destroying the banking system of any country where it was tolerated. I just wondered what had been the result of that authorization made, as I recall, as a war measure?

Governor HARRISON. I think there are many of us in the reserve system who looked with some reservation on the extension of the facilities of domestic acceptance credits, but I do not believe, as far as I am able to judge, that it has been abused. I think those acceptance credits against warehouse receipts are serving a very useful and stabilizing purpose in that they enable the carrying of farm products, especially pending marketing, over this heavy period in the late fall.

The CHAIRMAN. Would you not say it was an abuse in the system for an acceptance house to be sending these agents around the country and inducing banks to accept in order that they may buy acceptances?

Governor HARRISON. I did not know that that was being done, Mr. Chairman.

The CHAIRMAN. I say would you not regard that as an abuse of the system?

Governor HARRISON. I suppose that is just educational propaganda to try to tell the banks how to help with their facilities.

The CHAIRMAN. Is there not a vast difference between the acceptance system as it is practiced in Europe within the limited geographical areas, and the domestic acceptance system here in this country, with 30,000 banks authorized to accept?

Governor HARRISON. I think the difference is very great. The extraordinary part in my judgment is that the acceptance business, which was wholly new to the United States up to the time of the Federal reserve act, has developed as soundly as it has. There have been some abuses but I think on the whole it serves a very important economic purpose in our whole set-up to-day. I am not arguing for any one kind of acceptance as against the other. As I say, originally I was opposed to domestic acceptances myself, but they have been permitted and I do not believe they have been abused. The percentage of domestic acceptances as contrasted with the whole, is very low.

The CHAIRMAN. That being so, we may say that the representation made to Congress at the time they incorporated that provision in the act was greatly magnified because they were told that it was a necessary war measure. If it is not feasible or desirable to abolish the system, Governor, would you say that there should be a minimum capital required for any bank making acceptances?

Governor HARRISON. I think that would be a wise limitation. Of course what happens is this: When a bank with too small capital does accept, its bills do not float with freedom in the bill markets and a taboo comes on them eventually.

The CHAIRMAN. Eventually; yes; after the damage has been done.

Governor HARRISON. I do not think that the advantages that are offered by even our domestic acceptance facilities would be severely limited if Congress put a limitation on the capital of the accepting bank.

Mr. WILLIS. One more question, Governor, and then I shall have finished. It is a matter of interpretation. I understood you this morning to take the case of an individual who borrowed money and used his collateral, his stock in United States Steel, a loan being contemplated for some urgent purpose—to replace the burning down of his establishment, and so forth. I understood you to say that that note would not be eligible for rediscount by a reserve bank. Did I understand you in that way?

Governor HARRISON. Under no circumstances is such a note as that eligible.

Mr. WILLIS. I beg your pardon. Is it not true that the reserve banks are constantly discounting paper that has stock attached to it in that way—just for protection, I mean?

Governor HARRISON. I think it is true that on some occasions reserve banks rediscount perfectly eligible paper, and in the exercise of prudent business judgment require that the paper have some additional collateral. As to additional collateral, there is no legal limitation at all; and rather than take from the banks other eligible paper that they could offer us, we are prepared in those cases to take additional collateral of an ineligible character.

Mr. WILLIS. Was not that the case with the man whom you suggested this morning, where you assumed the man had his store or house burned down and wanted to restore it; and where you spoke of his experience of going to the bank to borrow money, but the bank does not regard his condition as good as it was, whereupon he says, "I will put up my shares of United States Steel as collateral," which he does. That would be an eligible note, would it not?

Governor HARRISON. I see what you mean. There are such cases, although I do not think many were offered to us.

Mr. WILLIS. That was the case you put before us this morning showing why collateral paper would be ruled out in some instances but not any such instances as the chairman spoke of in the case of "Bill Smith."

Senator BULKLEY. I think his illustration was where a man's home burned down.

Mr. WILLIS. That paper has been ruled out by the Federal reserve bank?

Senator BUCKLEY. It was to rebuild a home.

Mr. WILLIS. Yet I understand that farmers' notes have been held eligible for just such purposes as that.

Governor HARRISON. I do not know of any case where we have ever accepted such paper in New York. I do not think that it would be eligible since it involves putting money into bricks and mortar. It is a different thing, however, where a contractor wants to buy some bricks from a factory to put into a house.

The CHAIRMAN. That is a mercantile transaction.

Governor HARRISON. Yes, a mercantile transaction, and it is perfectly eligible.

Mr. WILLIS. So the presence of steel stock attached to it would not have anything to do with it whatever except to make it safer?

Governor HARRISON. Not in that case.

Mr. WILLIS. There are many cases in which the reserve banks do discount such paper with such collateral attached?

Governor HARRISON. I do not know. We do not do that.

Mr. WILLIS. You spoke of a long letter this morning to the Reserve Board outlining your discount policy. Can that be filed with the committee?

Governor HARRISON. I will be glad to file it with the committee, but if so, I would like to have the privilege of looking over the vast amount of correspondence we have had with the board and possibly submit other letters as well, otherwise this letter may be misleading in itself.

Senator WALCOTT. Before we leave that matter, Mr. Chairman, we have discussed to some extent the question of acceptances. I would like to ask the governor if he thinks there is anything in our domestic situation here which might be improved by borrowing from the English system, which is a very different thing? Is there anything about that that we ought to be building up on?

Governor HARRISON. I have wondered about that, Senator. The main difference, as I see it, is that the English system provides for borrowing on overdrafts. Of course, we have always considered that as bad practice in this country. The English system of lending on overdrafts is, however, little different from our stock collateral loans, because what they do is this—

Senator WALCOTT. That is, the intervention of the Bank of England.

Governor HARRISON. An English bank tells a customer to put with the bank stock-exchange collateral of one kind or another, so as to protect the bank whenever the owner of the collateral overdrafts. In effect, it is nothing but a loan collateralized by the stock-exchange collateral which is deposited with the loaning bank. Now, as to that kind of loan there is no paper at all; there is nothing that can be rediscounted. As I understand it, there is no evidence of it except the entry on the books of the bank; that is, the withdrawal of funds. The difference in our system, of course, is that we require documentary evidence in the form of a note, collateralized or not, as the bank sees fit. In that case there is evidence in the portfolio of the bank rather than the overdraft on the ledger of the bank.

Mr. WILLIS. Of course, they have their regular periods of settlement, which helps that a good deal—settlement days.

Governor HARRISON. Yes, sir.

Mr. WILLIS. And the Bank of England plays a very important part in that transaction, too.

Governor HARRISON. But, of course, the Bank of England has no way of rendering accommodation on the overdraft.

Senator WALCOTT. No; they are a factor, though, in the security of that loan.

Governor HARRISON. Yes; because if the bank needs more funds they let their bills run off or call loans made to bill houses, which they can always do because the Bank of England stands behind the bill market, ready to buy bills or make loans to dealers.

Senator WALCOTT. It makes the Bank of England practically the supervisor of it. But you think there is nothing in that system that we ought to be working toward?

Governor HARRISON. There are a great many things in the English system which would be very helpful in our own country if we were adaptable to them. The difficulty is that both because of the limited geographical area, and centuries of experience in conservative banking, the situation in England is quite different from our own. We have quite a different setup.

Now I have wondered in the past whether this call loan market, which is the source of so much trouble at all times such as we have been through, could not be modified or corrected in some measure if we adopted the term settlement, for stock-exchange transactions, as they do in London. There have been numerous committees that have studied that and investigated it. We have had men from our bank this year going over it with the idea of seeing if it could not be applied to our situation. One difficulty is that it may still further encourage speculation, for it gives you one week or two weeks of trading before you need make a settlement.

The CHAIRMAN. Governor Harrison, I want to clarify in my own mind the reasonableness of a complaint brought to me not long ago by a Senator, which was brought to him by an attorney in a State engaged in litigation with a Federal reserve bank, in the requirement of the Federal reserve bank of additional collateral security for a loan. He took the position that that was practically making the Federal reserve bank a preferred creditor, exacting collateral security largely in excess of the amount borrowed, or the amount of bills discounted. Ought not the bank, in your opinion, to have the right to fortify the collateral security for a loan by demanding additional security if they think what they have is not sufficient?

Governor HARRISON. I personally always have had some reluctance in giving my assent to the Federal reserve bank asking for collateral protection over and above the eligible paper which the bank gives us.

The CHAIRMAN. The Federal reserve agent was authorized to demand that at the bank, was he?

Governor HARRISON. We have considered it four or five times, lastly not over six weeks ago in a meeting of the board of directors.

The question presents itself in this way: Suppose that a member bank X is in difficulty. The more difficulty it is in the greater the accommodation it needs. It has previously rediscounted with us its best eligible paper. What remains is less desirable. The question is: Shall we say that the remaining paper is no longer sufficient to justify the reserve bank in buying it and thus refuse to accommodate the bank, or should we say, in order to keep the bank open, as we ought to do, that we will take the eligible paper if they will give us as additional collateral some other form of paper that would not be eligible for discount.

That has been the practice in New York for many years, although the number of instances in which we have done that has been very few. I do not believe it is a preference, although I may not be fully posted on the law; I do not believe it is a preference where we take the extra collateral for a present loan. If we ask to-day for collateral for a loan that we are considering making to-day, I think we have a perfectly legal right, without any question of preference, in asking for the extra protection. If that were not true no debtor in difficulty could ever get relief.

The CHAIRMAN. Is there any textual, or modified authority in the act, for asking supplemental security for a loan already made?

Governor HARRISON. I suppose it is one of the incidental powers in the conduct of our business—powers given to the bank by law.

The CHAIRMAN. It is explicitly given to the Federal reserve agent.

Governor HARRISON. Yes; he can ask for excess collateral to Federal reserve notes.

The CHAIRMAN. It seems to me that that is an implied authority to the bank.

Governor HARRISON. Putting it a little differently, Mr. Chairman, I do not think the management of the reserve bank could properly and safely go ahead and make loans which they believe not to be sound, or a loan which they believe would not be paid in full, if they did not have the right to ask for additional collateral. Of course, if Congress should say we should not ask for additional collateral but should rely solely on the paper that is eligible, plus the indorsement of the bank, our responsibility would be removed. Short of that, I do not see how the reserve management could conservatively and wisely make a loan to a member bank that it believes to be in a risky condition, or where there is questionable paper, without taking collateral, especially as we have a mandate from Congress to make only such loans as can be safely made. That is in section 4 of the act.

The CHAIRMAN. Do any of you gentlemen desire to ask further questions of Governor Harrison? Otherwise, Governor, we will excuse you, and thank you for your very patient and interesting testimony.

Governor HARRISON. I appreciate the opportunity of being with you, Mr. Chairman. I wonder if it would be improper to ask if I may have the privilege, if I think it is necessary after going over the transcript, to submit, perhaps, a written summary covering some of the disjointed statements that I have made.

The CHAIRMAN. Yes; you have the privilege of correcting your testimony if you care to do so.

Governor HARRISON. I thank you.

#### **STATEMENT OF J. H. CASE, OF NEW YORK, CHAIRMAN OF THE BOARD OF DIRECTORS OF THE FEDERAL RESERVE BANK OF NEW YORK**

The CHAIRMAN. Mr. Case, I believe you are chairman of the board of directors of the New York Federal Reserve Bank and the Government agent there?

Mr. CASE. Yes, sir.

The CHAIRMAN. Some of us thought that when we enacted the Federal reserve act that you were a very important personage, if not the chief executive officer of the bank, and we never had any idea that any of your implied functions would be taken over by some appointee of the board of directors. But that seems to have been done.

Just what duties have you, Mr. Case, outside of those textually prescribed by the act itself?

Mr. CASE. I have charge of the reports and examining functions of the bank, and as one of the senior officers of the bank I act in an advisory capacity to any of the officers of the bank from time to time in connection with problems that come up, and serve on a number of committees.

The CHAIRMAN. I do not see that there is a great deal of use in having a repetition of questions and very likely repetition of answers with respect to Federal reserve policies. If Mr. Case would care to make any general statement that would be helpful to the committee, or if you have in mind any modification of the provisions of the law of any description that would be helpful, we would be very glad to have you make the statement and offer the suggestions.

Mr. CASE. Senator, I have been here since Monday and have listened to the questions and answers with a great deal of interest. I have made a few observations of my own and reduced them to writing. If you like I would be glad to present them.

The CHAIRMAN. We would be glad to have you present them.

Mr. CASE. The past 18 months have tested and revealed certain of the virtues and certain of the limitations of the Federal reserve system. In October, 1929, and in December, 1930, the Federal reserve mechanism was tested in two different emergencies relatively new in its experience. The 1929 events have been recounted a number of times, but let me remind you briefly of what occurred. The bull market of 1928-29 was largely financed not by the banks but by corporations, firms, and individuals, in the form of advances classified in the reports as "loans for account of others." These loans by corporations, firms, and individuals not in the banking business, attracted by high rates, rose from \$1,500,000 at the beginning of 1928 to something like \$5,500,000,000 if the figures from all sources are put together. It was the fact that these funds were not bank funds that made the speculative movement so difficult to control.

When stock prices broke in later October of 1929 many of these lenders became alarmed as to the safety of their loans and promptly withdrew their funds. In about two weeks they withdrew \$2,500,000,000. To prevent a panic the New York City banks stepped in and replaced as much of these funds as was necessary. Not all had to be replaced because of the decline in security prices. But the New York banks found it necessary in meeting this demand to increase their own loans, both to brokers and directly to customers, by \$1,500,000,000. With this increase in loans went a corresponding increase in deposits and consequently a sizeable increase in reserve requirements. In fact these banks suddenly found themselves in a single week in need of \$200,000,000 additional reserve funds. This emergency demand was met promptly, about half by borrowing at the reserve bank and about half by funds supplied voluntarily by the reserve banks by purchase of Government securities. The smoothness with which this operation went through is indicated by the fact that there was no major disturbance in money markets. This was a demand for funds which the old money mechanism could have met only with the greatest of difficulty, if at all, but which the Federal reserve mechanism was able to handle without strain.

An equally severe but different type of emergency occurred in the month of December just past. The transition from public belief

in a short-term depression to one of longer duration was marked by a growing apprehension as to the solvency of various foreign countries, business concerns, and the value of their securities, and, last of all, banks.

Senator W<sup>A</sup>L<sup>C</sup>O<sup>T</sup>T. Does the word "foreign" apply to all of those?

Mr. C<sup>A</sup>S<sup>E</sup>. No, sir; if the word "domestic" were inserted following the words "foreign countries" my meaning would be made entirely clear.

Depressed commodity prices, business inactivity, and declining bond values had in fact endangered the position of some banks, but regardless of their true position the very state of apprehension which existed was sufficient to endanger some institutions which were undoubtedly solvent, though not highly liquid. There were runs on several banks in the West and South resulting in the closing of a number of institutions, including several chains.

At about the same time or in December a situation which had been culminating in New York City resulted in the closing of two banks there.

These are the only closures in New York City for some years past, in fact the one member bank which closed is the only member bank which has closed there since the reserve system was established.

There have been altogether nine other member banks in the second district which have closed since the system was established, 17 years, all small institutions, 7 of them having been closed as a direct result of defalcation on the part of an officer or officers.

The closing of these banks in New York was followed by large withdrawals from several other New York City banks doing business with a somewhat similar type of customers and in the same general localities. These banks called upon the reserve banks for large amounts of currency. Other banks also drew more than the usual amounts of currency to be prepared with cash in till for any exceptional withdrawals. These large demands for currency happened to come just at the time of year when currency demand is ordinarily at its maximum for the holiday season. Thus in a single week, ended December 13, 1930, over \$170,000,000 of currency was drawn from the Federal Reserve Bank of New York.

For the country as a whole it is estimated that withdrawals of currency from the reserve banks due to this cause, over and above the usual seasonal requirements, totaled over \$300,000,000 before the emergency passed and the return flow began early in the new year. This added demand for Federal reserve credit, largely concentrated in New York and occurring at the time of maximum seasonal demand, was met without any market disturbance. Money rose from 2 to 2½ per cent for three days and then reverted to 2 per cent. Banks secured the extra currency they required largely by borrowing at the reserve banks, though there was also some increase in Federal reserve holdings of Government securities and bankers' acceptances. The acceptances which member banks had acquired this autumn in larger amounts than ever before proved a particularly convenient means of securing funds for emergency or seasonal needs. The effect of these operations on the position of the Federal Reserve Bank of New York is indicated by the reserve percentage which declined from 82.7 on December 10 to 76 on December 17.

This emergency demand on the reserve mechanism was similar in amount to that of the autumn of 1929, but the nature was different—it was for currency rather than bank reserves—and it was more nearly like the kind of emergency the framers of the Federal reserve act had envisaged. They were thinking in terms of the currency panic of 1907. This recent currency emergency came nearer to fulfilling precisely their dreams of the proper functioning of the system than any event heretofore in the history of the system.

In respect to these two events, then, the history of recent months has tested the mechanism of the reserve system and has found it adequate. In certain other directions the necessary limitations of the system have become evident. The law assigns the duties of bank supervision in the first instance to the Comptroller of the Currency for national banks and to the State superintendents of banking for State banks. The reserve system is given no powers enabling it either to guarantee bank deposits or to control the management of banks. The system rather provides additional facilities to enable member banks to obtain currency and credit to meet emergencies and busy seasons. Bank supervision as developed under the jurisdiction of the Comptroller of the Currency and by the banking department of many States is only reasonably effective in correcting the abuses of bank management and in checking bad tendencies and practice. There is undoubtedly room for improvement in this regard all along the line, but it may be questioned whether any substantial part of the cure for the present situation is to be found in a more effective supervisory control of banks, particularly as long as banks function under 49 different jurisdictions. The supervisory authority can only aid the banker somewhat in exercising his responsibility.

The responsibility for the solvency of banks and the safety of depositors' money must inevitably be that of bank management. Responsibility and management can not be separated. Supervision can not and should not undertake the responsibility for passing on loans at the time they are made or for the purpose of investments.

The reserve system working with the supervising authorities can, undoubtedly, aid greatly in the sound conduct of banking business in the United States. We are fortunate at the present time in having in our district, national and State supervising forces of integrity, ability, and diligence it would be difficult to equal in any other part of the Union or in any other country. I believe these two groups of workers are steadily raising the standard of banking in this district. Progress will be aided from time to time by changes in the law. Mr. Broderick, the New York State superintendent of banks, has recently suggested some changes which deserve the most serious consideration. But until we are willing to delegate to central authorities autocratic control of every detail of banking, the primary responsibility for sound banking must rest with the management of each bank and with the development of a sound banking tradition. Responsibility must carry with it power—the power to make mistakes as well as successes. In a democracy we learn in part by making mistakes.

A study of recent bank failures indicates that during the past 30 years we have perhaps somewhat overdone the manufacture or creation of new banking institutions. In 1900 we had approximately



10,000 banks in this country. By 1920 this number had reached a total of 30,000 (an increase of 200 per cent). Consideration should be given to finding a way of avoiding this in future.

The Comptroller of the Currency testified on Monday that during the past 10 years we in this country have witnessed some 6,000 bank failures (20 per cent of the total existing in 1920). This leaves us with some 24,000 institutions and suggests that during the early days of this century banks were organized not only too rapidly but also without due regard to the actual banking needs of the community which the new institution was designed to serve. Our statistical information indicates that these 6,000 banks which failed during the past 10 years, and the major part of which were small country banks, had aggregate deposits of \$2,000,000,000. Assuming that the average deposit was \$400 per depositor, this means that these failures directly affected the lives of approximately 5,000,000 human beings and indirectly many more. Also, it is interesting to note that the average life of the banks which failed during this period was 18 years. The solution to this problem is not any easy one, but rather is one requiring a careful fact-finding survey similar to the survey and study made after the currency panic of 1907, out of which some years later the Federal reserve system was born.

The CHAIRMAN. Now, you will find a good many people that would question the accuracy of that statement, Mr. Case.

Mr. CASE. It seems to me, Mr. Chairman, on that point, that it is a fact that after the terrible experience of 1907 our bankers surveyed the situation throughout the world and found that these conditions did not obtain in other countries and agreed that something must be done about it.

The CHAIRMAN. It was out of that experience that the Federal reserve system was born.

Mr. CASE. I will stand corrected on that.

The CHAIRMAN. But not out of the subsequent conditions.

Mr. CASE. I am willing to substitute your language. "It was out of that experience that the Federal reserve system was born."

The CHAIRMAN. Oh, no; no.

Mr. CASE. In talking recently with a retired officer of one of the large Canadian banks—they have but 11 banks with hundreds of branches—he referred to the fact that the western part of Canada—the grain growing section—had substantially the same set of economic conditions and problems to deal with that we had experienced, but that, nevertheless, banking failures in Canada have been almost negligible. The inference to be drawn from this statement is that, under their system of branch banking, the large Canadian banks with home offices in the eastern part of Canada have absorbed the losses occurring in the western part of that country. That is to say, the losses fall upon bank shareholders rather than upon bank depositors.

Senator NORBECK. May I ask a question? I understand there was a supplementary loaning agency by the Government to the farmers of the western Provinces?

Mr. CASE. In this country?

Senator NORBECK. No; to the farmers of the western part of Canada.

Mr. CASE. Yes.

Senator NORBECK. Growing really out of the fact that the chain banks, or the banks as organized there, did not want to handle that kind of paper, and that the Government took substantial losses out of this inflation; is that correct?

Mr. CASE. I can not answer that, Senator. I did not know that was true.

Senator NORBECK. I have not much information on it, but I have heard the story told so often in the Northwest.

Mr. CASE. That may be true, but it was through one of the retired officials of one of the large Canadian banks that I learned that they had the same economic conditions there as obtained in the West.

As a matter of fact, our record of bank failures over a period of years compares most unfavorably with that of Canada and Great Britain.

There have been during the past decade three major speculative inflationary movements, each one of which has weakened the banking institutions in the territory affected and has been responsible for a number of failures. I refer (1) to the intensive speculation in farm lands in the Middle West and in the Northwest during the war and postwar inflationary period, (2) the unprecedented speculation in Florida real estate which followed and spread throughout the country and finally (3) the culmination of the bull stock market in the autumn of 1929, which adversely affected the general business of the country.

These three movements have each in turn culminated as they inevitably must in a deflation resulting in falling values; so that during the past year, there has been the most drastic liquidation in values of which we have any record in times of peace.

These are the conditions which in large measure are undoubtedly responsible for the great number of bank closures.

Senator NORBECK. I would rather be disposed to question that statement, that the Canadian Northwest had the same economic problems as the Northwestern States in this country, and the answer to it is that for a long period of time better prices prevailed for farm products in Canada than on this side due to the fact that the Government relieved some of the burden. But so much for that. I was going to ask the witness about the speculation and the rise of land values in the Northwest. Is it not a fact that taken on an average the rise was about 100 per cent, that land values doubled, notwithstanding some reports here and there about some lands selling at three or four hundred dollars an acre? I have seen the report frequently circulated that Iowa land went to \$208, a little more than double in value. Is it not a fact that that is what commodity prices went to, and individual land went no higher than anything else?

Mr. CASE. May I answer that?

Senator NORBECK. Yes.

Mr. CASE. It seems to me, Senator, that if wheat, a commodity, jumped from \$1 a bushel to \$3 a bushel, as the market value, and land simultaneously advanced in price from \$100 to \$200, or \$250—

Senator NORBECK (interposing). Maybe the witness did not understand me. By commodity prices I did not necessarily mean agricultural commodity prices.

Mr. CASE. No; but in any event it would be agricultural products that would visibly affect the land values, it seems to me.

Senator NORBECK. Yes.

Mr. CASE. I maintain that, if wheat normally sells at 80 cents to \$1 per bushel, land will not go up, but that if wheat sells at two or three dollars land values will go up. It seems to me that if at that point the banks loan money on the land at the inflated values they are in for trouble.

Senator NORBECK. Why use the term "inflation" on the farms which have increased 100 per cent, instead of using it on a locomotive that has increased 100 per cent, or an office building that has increased 100 per cent, or railway equipment that has increased proportionately? Why is one inflation and the other one not?

Mr. CASE. If you had Iowa land values charted, showing the average value over 50 years, and if the average value was X, say \$100 per acre, and presently, as the result of a war or some other condition that puts commodities up, the land should go up 100 or 150 per cent over the 50-year average the lender must, it seems to me, recognize that value is certainly well above the average for a period of years, and that he is running a risk in dealing in such values.

Senator NORBECK. I will admit that anyone who loans anything on a farm will run a risk, because we do not know the future of agriculture. I simply questioned the distinction of an inflation as to land just because land rose in value as compared with other commodities.

Mr. CASE. I think it is true, Senator, that a great many bank failures in that section, in the Chicago district, in Iowa, and in the Northwest, and in the Minneapolis district, were, in the judgment of the officials of the reserve banks of those districts, caused by the banks loaning money on these higher land values, which did not stay put, but dropped back again to normal value.

Senator NORBECK. But you speak of that as a criticism of the banking methods particularly.

Mr. CASE. That, it seems to me, deals with a very fundamental banking difficulty.

Senator NORBECK. Let me ask you what would have been the result in other sections of the country if they had taken a similar deflation in commodity and property values? Would not the banks have blown up in the same way?

Mr. CASE. Probably; yes.

Senator NORBECK. The answer is really interesting. We have been told that there is nothing the matter in the Northwest except the lack of judgment and lack of brains.

Mr. CASE. As I said a few moments ago, in these few observations I have been making it seems to me that new banks were chartered too freely, perhaps beyond what the needs of the communities were, and many of them had too small a capital. Under these circumstances a high degree of skill is required in order to run a bank successfully and avoid loans on overpriced lands and other products.

Senator NORBECK. Was not the same trouble with the northwest-ern banker two or three years ago the trouble with the eastern banker for the last 10 years—his inability to see into the values of these things?

Mr. CASE. Yes; I think that is part of the present difficulty; inability to correctly appraise real values and human nature being what it is, that is one reason why we have so many failures.

The CHAIRMAN. Mr. Case, does it occur to you to suggest to the committee any one or more particular modifications of either the Federal reserve act or the national bank act? For example, what may we do about this system of loans for others to abate the dangers of it?

Mr. CASE. Senator, of course that is a very large order. I think it should be carefully studied. In other words, what should be done about it is precisely what you are doing, making a very careful survey and study of it. It is a pretty large order to answer out of hand, to say that in a democracy the XYZ Corporation, which had a surplus of funds, might not make such use of it as seemed to it appropriate. The reason why they had this surplus of funds is a very interesting bit of history.

The CHAIRMAN. I think so, myself. Why the surplus of funds? Why not distribute those funds to the stockholders?

Mr. CASE. May I just go back a little on that?

The CHAIRMAN. Yes; you may proceed.

Mr. CASE. I think the reason that there is a surplus of funds, Senator, constitutes a very interesting background. You were speaking this morning to the governor as a witness about the possibility of business having an oversupply of credit. Personally, I think there is a danger, and I think that that danger not only existed, but that commerce and industry did have an oversupply of credit extended them in 1919 and 1920. In other words, during the war and the postwar inflationary period, it seems to me the record shows that commerce and industry were supplied with a larger amount of credit than was good for them or was good for the banks which loaned it.

Now, referring to 1919-20 we found that many of these corporations—large industrial corporations—were greatly overextended. We had lived through a long period of rising prices which was followed by a sharp drop. Industry and commerce found that not only were they overstocked with merchandise, but they had commitments out for the future. They had borrowed extensively on their own paper, which the banks held, and about which there was a good deal of distress and worry, both on the part of the borrower, and on the part of the banks. Now, there is an old adage that, "A singed cat dreads the fire." And I think it was out of that experience in 1919 and 1920 that we subsequently had this great emission of new securities. I think the XYZ Corporation that owed Bank A \$10,000,000 in 1920 on its own paper said, "Never again will we get caught this way; we will go out into the capital market and help ourselves to new capital." And so they went out and sold securities. If it was fashionable to sell bonds they sold bonds, and later when it became fashionable to sell equities they sold preferred and common stocks.

The CHAIRMAN. They quit patronizing the banks and went into financing.

Mr. CASE. That is right, sir. And it seems to me that it was that episode that has disturbed the management of some of our banks as to the apparent drop in eligible paper. I know that the banks

in New York, some of them at least, made a careful study of that, and were greatly concerned over the reduction in the amount of eligible paper which the associated banks as a whole owned. I think it was because of that situation that I have just alluded to about corporations being overextended in 1920 that led them to say "We will protect ourselves for the future." And I think that it is out of that experience that this great emission of new securities occurred. Perhaps they issued more securities than they actually needed to at the time, and if so that of course has given them surplus funds. And out of that surplus grew a large part of these loans for account of others.

The CHAIRMAN. And those others, neither the individuals nor the corporations, were authorized or chartered to engage in the banking business. I have sometimes wondered whether these corporations or individuals paid tax on the money that they used in competition with the banking business as required by law.

Mr. CASE. They only paid the customary tax, I would think, Senator, on their net earnings, whatever the source.

The CHAIRMAN. You mean they paid the income tax?

Mr. CASE. Yes.

The CHAIRMAN. But did they pay the tax on the funds that they were using in competition with national banks, as prescribed by the national bank act?

Mr. CASE. I should say not, other than the commission which the loaning bank, that acted as the vehicle for making the loan, charged as a commission.

The CHAIRMAN. Exactly. They paid no tax to the Government.

Mr. CASE. Not at all.

The CHAIRMAN. It seems to me that there should be some statutory means of abating that evil, if not of abolishing it.

Mr. CASE. As Governor Harrison said this morning, it is a very perplexing problem. It is one thing to provide reserve requirements and what not for your member banks. But if you have similar business being transacted by corporations and firms, who, as you say, pay no taxes, that is a pretty difficult thing for the banking fraternity to deal with.

The CHAIRMAN. It seems to me that the Federal reserve bank has a very powerful agency of control when it comes to the matter of bad banking. You seem to think that they have a little, and that the whole thing is not equally confined to the judgment of the board or to the individual bank management. The Federal reserve bank is not compelled to rediscount. On the contrary, it is specifically given the reserved right to decline to rediscount. And through its example first, and that of the comptroller's office, it seems to me that a reserve bank could thoroughly well know whether a member bank was being mismanaged or not; and in the event that it should know that a bank was being mismanaged it could bring tremendous pressure to bear upon it to correct its mismanagement, or to refuse to rediscount for it.

Mr. CASE. I listened with a good deal of interest to your question this morning and Governor Harrison's reply to that question, and I have precisely the same view that the governor expressed about it. If you can fix definitely the time and the moment when you

know that a bank is being badly managed, of course, you can use moral suasion, in talking to the officers about the management of their bank. And we do. But if they come in the bank to-day and say, "Our reserves are impaired; we have got to have \$100,000," or some other sum, it is questionable procedure, it seems to me, sir, to say to them, "You can not have it."

The CHAIRMAN. Could you not inquire why their reserves are impaired?

Mr. CASE. Oh, yes. In our discussions we would undertake to bring that out—to find out whether it is a loss of deposits, or some other cause that impaired their reserves. But, on the other hand, in a big city bank, it is very difficult indeed for them to know. I might say just a word on that.

During the war period I had charge of our loaning operations in the Federal reserve bank. And, as you know, some of the larger banks in New York were borrowing very heavily, as much as \$100,000,000. And some of our directors thought if a bank was borrowing \$100,000,000 and wanted five or ten million more, we should undertake to find the occasion for it. And I undertook to do that.

One of the very big banks, the head of which is very well known to you, a very broad-gauge and broad-minded banker, finally came over to see me. He said, "Mr. Case, you have asked an impossible question. Here is a bank with upward of \$500,000,000 of deposits, and we have a man stationed at point X whose duty it is to see that the reserve requirements of the Federal reserve bank are complied with. Now, we are receiving deposits and paying out money arising from myriads of transactions of all sorts all day. But at 10 minutes of 3 we are handed a check drawn upon us with instructions to wire the proceeds, \$25,000,000 to Chicago or \$15,000,000 to San Francisco. Now, we are not anticipating that. But it has come very suddenly. Our reserves are inadequate to pay it. We have got to make it good. There have been hundreds of other transactions during the day," he said, "and I can not pick out any single one of those and say which one is responsible for the impairment of our reserve and which causes the necessity of our borrowing." We went into that very thoroughly. And I might say that our directors were thoroughly satisfied not to undertake to require us to pursue that inquiry in that form. Banking to-day is not as simple as it was 30 or 40 years ago. Banks have so many different departments functioning that it is not easy to ascertain the real reason for impaired reserves. And so to undertake to deny a bank credit without having the best of reasons is something that should be done only after considerable prayer and fasting.

The CHAIRMAN. Some of us are disposed to think, Mr. Case, that there are some bankers in New York so big that they assume to tell directors what to do rather than have the directors tell them what to do.

Mr. CASE. Yes. Unfortunately, there have been situations of that sort. And as Governor Harrison suggested in his talk, if there were a small board of directors or an executive committee charged with the responsibility of running the bank while the others, who were going to be "business getters," were put into some other position than that of director it might be wise.

The CHAIRMAN. Do you care to ask him anything, Mr. Willis?

Mr. WILLIS. Mr. Case, I want to ask you a question or two about the situation in New York to which you have referred as to real-estate loans there. I want to know to what extent you think that bank loans against the securities of real-estate holding companies are made in your district.

Mr. CASE. My answer to that, Mr. Willis, is this: Among the large New York Clearing House banks I should say that the amount of that sort of collateral was negligible. I would say that they just simply would not loan against it. But among some of the smaller banks I think it does prevail to a moderate extent.

Mr. WILLIS. Was that true in the Bank of the United States?

Mr. CASE. To some extent. I think in that situation there was much more money loaned on notes of hand which merely represented real-estate equities than against the stock of real-estate companies.

Mr. WILLIS. At what time did the examiners of the reserve bank find out or know of the condition of the United States Bank?

Mr. CASE. Mr. Willis, one examiner of the Federal reserve bank, went in with the State superintendent of banks' examiners as of June 23. I should like to say, as you know, that they had some 48 or 49 branches. There were about 50 offices, and my recollection is that the State superintendent had a force of 130 or 140 people. Now, the report of that examination was not finished until well after the early part of November; that is, it was early November before we received a copy of it. But, going back of your question, I might say that the management of that bank did not have our full confidence for a period of years.

Mr. WILLIS. What steps were taken by the bank?

Mr. CASE. We had a number of interviews with the president, over a period of years. But let me say this: (There was some little discussion a few moments ago about the attitude of the Federal reserve banks when member banks are not borrowing.) For a considerable part of the period during recent years this bank was not a borrower. Moreover, the bank was steadily, with the approval of the superintendent of banks, absorbing other banking institutions. Let me say that we in the Federal reserve bank knew nothing of these mergers until after the event. But it is true, sir, that the management of that bank (like some of the corporations we were speaking of a moment ago), did go into the capital market and help themselves very liberally to new capital. So that on the date of this last examination, of which you speak, the bank had a capital of \$25,000,000, and surplus and undivided profits of some \$17,000,000. The examiners' report, which, as I say, we received in November, indicated that the surplus and undivided profits were wiped out. It also indicated that there were some additional items that were exceedingly difficult to appraise, including many notes that were predicated on real-estate equities.

Mr. WILLIS. Did you have any information in the Federal reserve bank of the methods employed by the affiliates of the United States Bank in the buying up of securities and the speculating in the stock of the bank itself?

Mr. CASE. No; not until this examination.

Mr. WILLIS. You knew nothing about it?

Mr. CASE. No. I remember I did hear a rumor that, in absorbing one of the institutions which they took over in the last year or so, a large number of units of the Bank of the United States were issued (consisting of shares of bank stock coupled with shares of stock of an affiliated securities corporation).

Mr. WILLIS. Now do you suppose, or have you been advised, that there are other banks in your district following that same plan, and security companies which are buying and speculating in bank stock?

Mr. CASE. Only rumors to that effect. You heard the comptroller's statement on Monday with respect to the examination of the affiliates, and I think that not many of them have been examined; but such speculation has been a matter of common report, I will say.

Mr. WILLIS. Have you discussed or joined in those examinations of security affiliates with the comptroller?

Mr. CASE. We have not.

Mr. WILLIS. You never have?

Mr. CASE. We have not, sir.

The CHAIRMAN. Mr. Case, do you think that something in the nature of legislative action should be taken to require examinations of affiliates and publicity of their statements?

Mr. CASE. I do; yes, sir.

Mr. WILLIS. Do you think the reserve bank should be given that power and authority, or share it with the comptroller, or what?

Mr. CASE. Mr. Willis, it seems to me that question is tied up very strongly with the question as to where the power of supervision and examination rests. If we had just one type of bank I would like to see them all under one central agency, as far as the examination is concerned, perhaps of the Federal reserve system. And in that event such agency should examine into all these affiliates.

Mr. WILLIS. Yes.

Mr. CASE. I feel that quite strongly.

Mr. WILLIS. What kind of an examination do you make of your members now?

Mr. CASE. Mr. Willis, as I mentioned in my memorandum a moment ago, we have, we think, very capable examinations on the part of the Comptroller of the Currency and of the superintendent of banks. And our directors, as provided in the statute or the regulations of the Federal Reserve Board, have authorized us to take the examination reports of the comptroller's office, or of the State superintendent of banks. Consequently, we have a very small examination staff.

Mr. WILLIS. You practically rely on them?

Mr. CASE. Yes; to a very great extent, sir.

Mr. WILLIS. Now in your monthly bulletin, I believe, of last summer, you spoke of the fact that there was very little in the way of undersecured collateral loans among members, and then I think that the same statement was made in the remarks of some member of your official staff.

Mr. CASE. Yes; I think that is correct, sir.

Mr. WILLIS. Was that the result of careful examination of all these collateral notes?



Mr. CASE. There was a survey made, Mr. Willis, of a considerable number of banks.

Mr. WILLIS. Can you say how many?

Mr. CASE. I can not say how many.

Mr. WILLIS. One hundred and sixteen I think was the statement.

Mr. CASE. All right. I was going to say a considerable cross section of the banks, member banks, in our district, were gone into thoroughly, and I think the statement to which you allude was predicated upon the facts at that time.

Mr. WILLIS. Could you hold to it now in view of what happened since then?

Mr. CASE. I would assume, without knowing what these banks have done day after day, that some of the loans might not be so well margined; that some of them might now be "under water."

Mr. WILLIS. And did that study involve active securities that had no active market?

Mr. CASE. Yes; I am sure that it had reference to the collateral which was up against the loans, and of course some sort of value must have been fixed upon this type of stock.

Mr. WILLIS. It seems like a hazardous thing to give positive assurance of that, if you have only the examination you speak of.

Mr. CASE. I think that is debatable, Mr. Willis. The charge had been made that a good many banks had collateral loans that were "under water." We thought it worth while to make some study of it and we did.

Mr. WILLIS. It seems there were a good many.

Mr. CASE. The statement that appeared in our monthly review is one that I think may be relied upon as to the banks covered by that inquiry.

The CHAIRMAN. Mr. Case, I take it from some of your observations there in your prepared statement, that you are rather disposed to favor a system of branch banking.

Mr. CASE. Mr. Chairman, it seems to me at the present time that we are gradually drifting toward branch banking. Personally, while I think we are a long way off—and I personally hope we shall continue to be a long way off—from nation-wide branch banking, it seems to me that it might be desirable to permit a gradual extension of the branch-banking privilege, allowing banks, for instance, to spread throughout their own county, and in course of time throughout the State. Then, as suggested by the comptroller, natural trade areas would develop.

The CHAIRMAN. Would it not be extremely difficult to determine what is a trade area?

Mr. CASE. Perhaps it would. Of course, I am thinking of the metropolitan area, and it seems to me that there it would not be difficult. In New York we have the northern part of New Jersey and one corner of Connecticut, the southern tier of Connecticut. It seems to me—I do not know whether Senator Walcott will agree with this—that perhaps Bridgeport and Stamford are large enough cities to become the center of a trade area in Connecticut, and that Newark, Paterson, Passaic, Elizabeth, and of course Jersey City and Hoboken and other places adjacent to the metropolis, might constitute trade areas of New York City.

The CHAIRMAN. Are not there in Connecticut towns or banks large enough which might have their branches throughout the State of Connecticut, confined to State lines of Connecticut, who could attend to the commercial and industrial requirements of that State pretty well?

Mr. CASE. I should think they might do that pretty well, although of course large corporations which are domiciled, say, in Bridgeport, might elect to either come to New York, or continue their banking connections in New York, which have been established over a period of years.

The CHAIRMAN. Of course, they do that under the State banking law.

Mr. CASE. Yes, that is true. Still I would think there are or could be developed suitable banking institutions in Connecticut.

The CHAIRMAN. You see the difficulty is, that we have to deal with this much contemned specimen of humanity called a politician, and there are some in Congress, as well as a large number of statesmen, and we can not jump right into the nation-wide branch banking.

Mr. CASE. No, I should hope we would not.

The CHAIRMAN. And probably with no expectation on earth of doing anything with it. It is very doubtful whether we can do much with the state-wide branch-banking proposition. I hope we may.

Mr. CASE. Yes.

The CHAIRMAN. But certainly we can not go beyond that.

Mr. CASE. These bank failures, of course, are very disconcerting, and when you consider the number of lives which are adversely affected by them it seems clear that we must try to find a solution. It seems to me that a banker in a small community occupies pretty much the same position toward that community in a financial way as the local physician does in looking after the physical health of the people of the community. If the physicians do not do a good job, you do not have a healthy community, and similarly it seems to me this is true of banks. When they are not able properly to adjust themselves to the economic changes, which have been alluded to, we have too many failures and the community suffers. It is our duty to study the problem and find some way of solving it.

The CHAIRMAN. You differentiate very greatly, do you not, between branch banking and chain and group banking?

Mr. CASE. Oh, my, yes, sir; I certainly do.

Senator WALCOTT. I hope, Mr. Chairman, we can bring that out before we are through with all of our questions, because that, to my mind, is very important and there is a great deal of misconception about it all.

The CHAIRMAN. A very small conception.

Senator WALCOTT. The public knows little about the difference.

The CHAIRMAN. I think we will be able to do that by our inquiries and the report which they shall make to the committee as a result of these inquiries.

Have you gentlemen any further questions to ask?

Mr. WILLIS. One more, Mr. Case. I followed with interest your account of the matters leading up to the panic, and so forth, and

there is one point I should like to ask you about. What was the cause of the change in the trend of the brokers' loans just after the early summer of 1929, resulting in a marked increase of brokers' loans for their own account by New York banks?

Mr. CASE. I am sorry I do not have the chart of those loan figures with me.

Mr. WILLIS. Just generally.

Senator WALCOTT. Did it run along at about a billion and jump up?

Mr. CASE. Yes.

Mr. WILLIS. Governor Harrison, as I remember it, brought out the fact that there had been no material increase in that for their own account.

Mr. CASE. Yes. And without any statistics in front of me I should say there was not a great increase until along in October, about the time the stock market crash came, when, as I said a moment ago, the banks had to take over in 10 days or 2 weeks about a billion and a half.

Mr. WILLIS. You do not think the attitude of the New York banks gave the stock market an additional lease of life for two months longer than it would have had, by dumping in additional funds in the early summer?

Mr. CASE. On the contrary, Mr. Willis, I think we would have had a catastrophe of tremendous importance if the New York banks had not stepped in. I think they displayed a great deal of courage.

Mr. WILLIS. That was just after the panic when loans of others were withdrawn. I am referring to a slightly earlier period than that. There has been a general impression that the dumping of funds in the market in August and July of 1929 had the effect of giving the market a sharp, upward trend, because at that time there was a very sharp upward movement on account of brokers' loans of New York banks.

Mr. CASE. Let me say this: We had a period of very high interest rates which resulted in drawing money into that market from all over the world, to the detriment, I think, of the rest of the world.

Mr. WILLIS. Yes.

Mr. CASE. Now, if you have an extra amount of brokers' loans required, a large amount, if you please, and the New York banks are riding along with a billion of them, and for one reason or another \$100,000,000 or \$200,000,000 of loans by others are withdrawn (let us say that occurred in August), why the answer to that, it seems to me, Mr. Willis, is that the banks must take those over, or you will have rates shoot through the ceiling.

Mr. WILLIS. There had been a pretty sharp falling off of the banks loans in 1929, and that was followed by this increase?

Mr. CASE. Yes.

Mr. WILLIS. As I understand you, it was due to the loans taken over by foreigners and withdrawn.

Mr. CASE. Foreigners and others; not exclusively foreigners; I mean individuals classified as "for the account of others."

Mr. WILLIS. You mean they were running down before the sharp drop?

Mr. CASE. I would not like to say definitely without any information in front of me.

Mr. WILLIS. You think it was the duty of some banks, as it was said at that time, to dump money into the market to prevent a panic?

Mr. CASE. I am inclined to think it was their duty to do it, and not talk very much about it.

Mr. WILLIS. There was a great deal of talk about it.

Mr. CASE. Yes.

The CHAIRMAN. I am disposed to felicitate you, Mr. Case, upon the fact that Mr. Harrison got all the disagreeable questions. We are greatly obliged to you, and if at any time pending our inquiry, or the subsequent deliberations of the committee, you have any suggestions to make to us as to remedying existing evils of the banking business, we should like to have you recommend them to us.

Mr. CASE. I should be very glad to.

The CHAIRMAN. The committee will now adjourn until to-morrow morning at 11 o'clock.

(Accordingly, at 4.35 p. m., the committee adjourned until to-morrow, Friday, January 23, 1931, at 11 o'clock.)



# OPERATION OF THE NATIONAL AND FEDERAL RESERVE BANKING SYSTEM

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FRIDAY, JANUARY 23, 1931

UNITED STATES SENATE,  
COMMITTEE ON BANKING AND CURRENCY  
*Washington, D. C.*

The subcommittee met, pursuant to adjournment, at 11 o'clock a. m., Hon. Carter Glass (chairman) presiding.

## STATEMENT OF A. C. MILLER, MEMBER OF THE FEDERAL RESERVE BOARD

The CHAIRMAN. The committee will come to order. Senator Bulkley and Senator Norbeck are in the adjoining room and we will count them as a quorum.

Doctor Miller, I was glad to see that you have been present in the committee room at most of the hearings. You know pretty well what the purpose of this inquiry is, and I have asked you and former Governor Hamlin of the Federal Reserve Board, as the oldest members in point of service, being among the original appointees to the Board, to appear and make any statement with respect to this problem that you may care to make and, thereafter, subject yourself to any reasonable inquiries that members of the committee may care to make.

We shall be glad to hear from you now

Mr. MILLER. Mr. Chairman and gentlemen of the committee: Your committee has been occupying itself largely with a study of banking conditions, I think, with an idea of finding what there is that makes them go wrong.

Let me say very briefly, in order to indicate my general position upon an inquiry of this kind, that bad banking conditions do not usually generate themselves. They usually grow out of antecedent disturbances either of an economic or a financial character. To say that banking conditions are bad because management is bad, overlooks the fact, I think, that banking conditions are bad sometimes when banking management is reasonably satisfactory. It is when a considerable change in the general economic conditions under which business is done and banking conducted takes place, that the hazards of banking judgment are increased and the problems of management particularly as they relate to the extension of credit, become more difficult.

The crop of bank failures in 1930 reflects, I think, the disturbed conditions that developed in the years 1927 to 1929, just as the great crop of bank failures in the twenties, reflected the disturbed conditions that developed acutely from 1919 to 1921.

You have referred, sir, to the fact that I am one of the original members of the Federal Reserve Board. That is true, and I have seen a great deal take place in the life history of the Federal reserve system. The system has twice been overwhelmed by crises of well nigh unprecedented magnitude and intensity. The first was the crisis of 1920-1921, growing out of an antecedent condition of inflation which was particularly acute in the field of commodities. That was primarily a commodity-price crisis, a violent deflation of commodity prices, following the antecedent acute inflation.

The breakdown of the autumn of 1929 was a breakdown primarily in the security markets of the country, a deflation of security values, or, let me better say, prices, which was made inevitable by the preceding extensive and extreme inflation of security prices.

From my standpoint, as a member of the Federal Reserve Board, the important preliminary to any understanding of the banking problems confronting the country and, more immediately, this committee, is to see what there is in these inflations, more particularly, the recent one, that involves the Federal reserve system in some responsibility for what has happened, or what might have been mitigated.

In general, the more nearly we can get at the source of any trouble, the more easily we can control it. I am skeptical of the efficacy of prohibitions, particularly concerning financial practices. In the long run, I think they are apt to turn out to be prohibitions that do not in fact prohibit. That is particularly true, I think, when we are dealing with a banking system in which the numbers of banks run high into the thousands. I am, therefore, more disposed to explore the possibilities of improving the operation of the banking machinery of the country by seeing what we can do to improve the operation and the administration of the reserve banks.

If you will permit me, in order that the presentation of what I have in mind may be brief, I should like to show to the committee some charts which have been prepared in the research division of the Federal Reserve Board. Will that be agreeable?

The CHAIRMAN. Yes; that will be agreeable to us.

Mr. MILLER. The key to an understanding of the changes that go on in banking, to my mind, is most immediately supplied by variations in the reserves of the banks of the country, more importantly, the member banks of the Federal reserve system. It is truer in banking as practiced to-day than before, that our banks do not carry surplus reserves. Whatever they have in the way of reserves, they endeavor to keep invested. Therefore, when we are trying to see what it is that causes variations in banking and credit conditions, the quickest guide is the changes in the amount of reserve money, or lending power so to speak, which the member banks of the Federal reserve system possess. (See Chart I on page 125.)

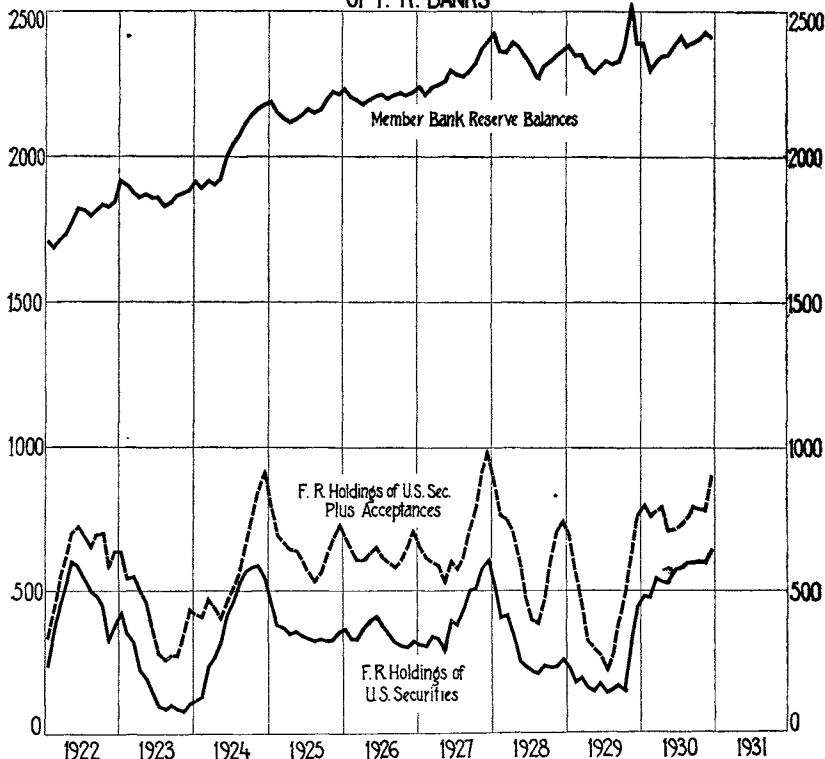
Now in reviewing the history of the period 1922 to date, the curve "Member bank reserve balances" (Chart I) shows these changes. The striking thing about that curve is that there has been, at times, a pronounced irregularity in its prevailing upward trend. Several times—for instance, in 1922, and again in 1924 and again in 1927—for some reason there has occurred a sudden and marked accession to the reserves or lending power of the member banks of the Federal reserve system; they came into possession of increased reserves

available for an expansion of their banking business or enlarged investments in their banking resources.

The same thing is brought out, Mr. Chairman, in Chart II, showing the important asset and liability items of our larger member banks where the upper curve "Net demand plus time deposits" indicates the movement of the deposits of the member banks of the country. This curve indicates the credit made available to the customers or depositors of the banks for use. The variations in that curve follow very closely the variations in the curve "Member bank reserve balances" (Chart I). The more money the banks acquire

CHART I

MEMBER BANK RESERVE BALANCES COMPARED WITH OPEN MARKET HOLDINGS OF F. R. BANKS



as reserves, the more lending power they have, obviously. So, it is brought out why there occurred these great increases in the deposits of the banks in 1922, again in 1924, and again in 1927. (See Chart II on page 126.)

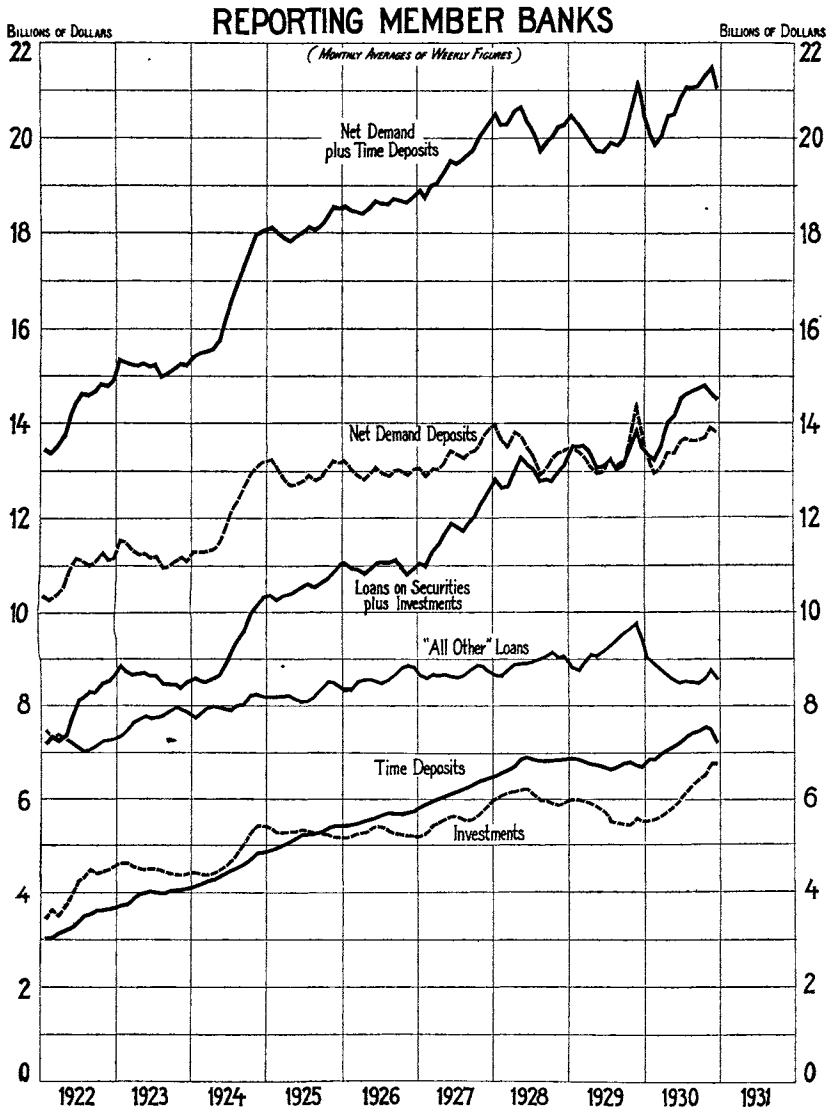
The increase throughout this period taken as a whole, might not be regarded as abnormal or highly abnormal, but the increases that took place in 1924 and in 1927 are to be regarded, I think, as abnormal and carry with them certain implications of a serious character concerning the credit condition of the country in this period.

It will be worth while, therefore, to inquire what it was that occasioned these sudden elevations brought out on the charts for member



banks' deposits and reserve balances, notably in the years 1924 and 1927. Increases in the reserves of member banks come primarily from two sources; one from increases in the gold stock of the country and the other, increases in the amount of reserve balances supplied to member banks by the Federal reserve banks, either through re-

CHART II



discount operations or, more importantly, through open market investments.

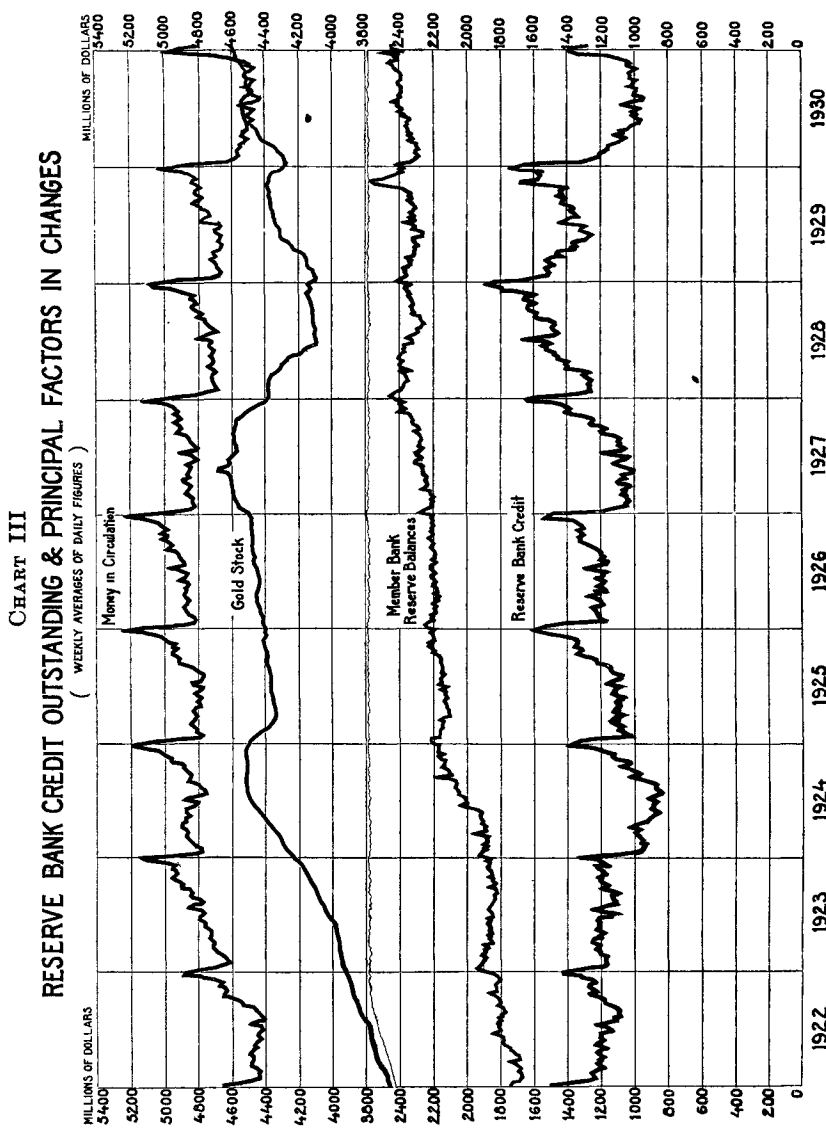
Taking the period 1922-1929 as a whole, the increases in the monetary gold stock of the country amounted to nearly \$700,000,000.

Senator WILCOTT. Do you recall the percentage? That would be about 10 per cent, would it not?

Mr. MILLER. Ten per cent of what?

Senator WALCOTT. Of the gold we have got.

Mr. MILLER. It is about 15 or 16 per cent.



Turning now to Chart III for a moment: The curve "Gold stock" represents what happened to our gold supply in these years. Starting from a level of about \$3,700,000,000 in 1922, it moved pretty rapidly up to about \$4,500,000,000 at the end of 1924, dropping a little in 1925, it then moved at a slight average incline into the year 1927. About mid year 1927 it began a rather precipitate fall until the middle of 1928. It then began, in an irregular movement, to go upwards.

We are now about where we were at the previous apex of the movement in May, 1927. I merely introduce this chart at this point for the purpose of showing that the principal basis of the enlargement of credit we experienced since the postwar deflation crisis, since the beginning of the year 1922, has been supplied by gold—mainly gold imports.

The CHAIRMAN. Doctor, how did the Federal reserve banks acquire that large stock of gold?

Mr. MILLER. By deposits from their member banks; that is, by an actual transfer of ownership of the gold to the reserve banks by the member banks which had imported it, that being the conventional phrase for describing the receipt of gold from abroad.

The CHAIRMAN. Did it acquire a large part of it by the exchange of Federal reserve notes for gold?

Mr. MILLER. The gold reaching the country? The curve does not represent gold in the Federal reserve banks, but gold in the country; gold which came into the country by way of imports. These imports, normally and almost with mathematical exactitude, come into the Federal reserve banks in the first instance. The latter determine from time to time what they will pursue in the way of a gold policy, and may pay out gold certificates in preference to issuing their own Federal reserve notes, in meeting demands for currency.

To go back, I repeat that, taking the movement of credit since 1922, the main basis of expansion was provided by gold imports and it probably will be the verdict of economic history that the volume of those imports was in excessive amounts; that is, in excess of what the credit system of the country could absorb without producing disturbances; in other words, without producing inflationary developments.

When we look at the pronounced jumps in the growth of member banks reserves in 1924 and 1927 (Chart I), we begin to tie the Federal reserve banks into the situation. These two great additions to the lending and investing power of the member banks trace back to the Federal reserve policy pursued in those years which expressed itself primarily through operations in the open market.

The CHAIRMAN. Right on that point, Doctor, I want, in this inquiry, to bring out as clearly as I may, just exactly how far, if at all, the Federal reserve system has been taken away from the original intent of the proponents of the act and of the Congress which passed the act, and I should like to ask you this question, if the open market operations of the system have not largely submerged the rediscount operations of the system which clearly were intended to be the major function of it?

Mr. MILLER. I think, Mr. Chairman, that is true. I would perhaps qualify by saying that the Federal reserve system has been a kind of alternating system as between open-market operations and rediscount operations. It eases or inflates through the open-market operation and then undertakes to firm or deflate (and usually fails) through the rediscount operation. That, in a nutshell, is the story of 1927 to 1929.

The CHAIRMAN. The system has established, as I understand it, what is called an open-market committee, has it not?

Mr. MILLER. Yes.

The CHAIRMAN. Has not that open-market committee—well, I will not say submerged in any sense the Federal reserve board—but has

not that open-market committee become a very powerful factor in the activities of the Federal reserve system?

Mr. MILLER. The open-market operation is the most powerful instrument the Federal reserve system ever uses to ease money conditions. The history of credit in the last 10 years can not be understood without paying the utmost attention to what has happened as regards the open-market operations of the system.

The CHAIRMAN. Is that committee under the scrutiny and complete authority of the Federal Reserve Board?

Mr. MILLER. Well, that committee, Mr. Chairman, under its present constitution, is a policy committee. It bears the name "The open-market policy conference." It has the authority to consider, prepare, and recommend plans for open-market operations.

The CHAIRMAN. To the board?

Mr. MILLER. To the banks and to the board. The recommendations do not become effective until approved by the Federal Reserve Board, so that, as a legal matter, all operations in the open market for what we call "system account"—that is, apart from occasional emergency operations that, for one reason or another, are engaged in by individual reserve banks—are actions in which the Federal Reserve Board is joined, under its general power of approval of purchases of securities in the open market.

The CHAIRMAN. So that anything of a critical nature that anybody might want to say about the activities of the open-market committee, would apply with equal force to the Federal Reserve Board, would it not?

Mr. MILLER. As a proposition of law; yes.

The CHAIRMAN. I mean of practice.

Mr. MILLER. That is a less simple question to answer.

The CHAIRMAN. What I am trying to determine is whether the major operations of the Federal reserve system have, in any measure—and, if so, to what extent—gotten away from the Federal Reserve Board, which is the central supervisory, controlling power.

Mr. MILLER. Well, I should say of open market operations, they never were until a year or two ago very adequately in the hands of the Federal Reserve Board.

The CHAIRMAN. Well, but should they not be?

Mr. MILLER. I think so. But I would say only to the extent that a satisfactory result can not be obtained without putting power of initiative into the hands of the board.

The CHAIRMAN. Well, if it is not clear, it ought to be made clear, should it not?

Mr. MILLER. Yes; but I am inclined to think that the situation is clarifying itself in a natural way and I look for further improvement. Though I have been in the system from the beginning, I have not grown cynical; I believe that, through errors, the banks are learning, and that the system, as a system, is coming into its own.

I am also inclined to think, Mr. Chairman, that events, especially in recent years, have demonstrated that the Federal Reserve Board is not altogether without knowledge and wisdom with respect to matters that concern good operation of the Federal reserve system.

Mr. WILLIS. You spoke, Mr. Miller, of the board as not having authority, or not having referred to it, the operations in the open

market transactions. Is it not a fact that the board can control, through the fixing of the acceptance rate?

Mr. MILLER. Yes.

Mr. WILLIS. At the present time—

Mr. MILLER. Let me interrupt. Only, of course, as to acceptance operations.

Mr. WILLIS. Yes.

Mr. MILLER. More important, I think, in explaining the actual operation of the open-market policy of the Federal reserve system are purchase and sale, on occasion, of United States Government securities.

Mr. WILLIS. But that is also under the control of the board, is it not?

Mr. MILLER. It has not been as simple and definite a control, until recently.

The CHAIRMAN. The act says that this may be done under regulations of the Federal Reserve Board.

Mr. MILLER. That is correct.

Mr. WILLIS. And you have made such regulations?

Mr. MILLER. We have set up a procedure, called, first, in 1923, the open market investment committee; later on—I think in 1929 or 1930—the open market policy conference, for the purpose of more definitely regularizing the procedure with regard to these operations that concern the whole country and that concern all of the Federal reserve banks in maintaining control in their respective districts.

Mr. WILLIS. And you have also issued instructions which have been printed, as to purchases in the open market of bonds?

Mr. MILLER. We have never issued printed instructions covering the purchase of Government securities.

Mr. WILLIS. But you can do it?

Mr. MILLER. Probably; but such a procedure would hardly be advisable.

Mr. WILLIS. You spoke of the acceptance rate. The board at present leaves that as a spread—leaves the reserve banks to fix any rate they choose between certain limits?

Mr. MILLER. Yes.

Mr. WILLIS. So, as a matter of fact, you are leaving it to them?

Mr. MILLER. Subject to the approval of the board. Acceptance rates are more intimately related to day to day or week to week market movements than are any other of the Federal reserve rates. The result is that the system has long followed the practice of having a so-called minimum buying rate and a so-called maximum buying rate, the difference between the maximum and the minimum rates having usually been about one-half of 1 per cent. Within those limits, the banks buy and sell acceptances, using their judgment, on any day or in any week, as to the rates at which they will buy and informing the board of what they are doing.

Mr. WILLIS. But that spread is so great that, under money market conditions, it leaves practically the full decision in their hands?

Mr. MILLER. It does as regards short-time periods.

The CHAIRMAN. Having been associated with the system from the beginning, I wonder if you recall the fact that there was the most intense hostility manifested by certain large bankers at the money centers to the open-market provision of the Federal reserve act, upon

the theory that it would bring the Federal reserve banks in sharp competition with the larger banks in the money centers, and that the answer which some of us made to that objection was that the open market provision of the act was intended directly or primarily for two purposes: One was to enable the Federal reserve banks to enforce, in some degree, its rediscount rate, and the other was—well, I would say three purposes, another being to enable the bank to use its idle funds for acquisitive purposes, in order to defray the expenses of the overhead charges of the bank, while the third was to safeguard its gold supply. It was never contended at that time that the open-market operations of the system would or ought to submerge the discount activities of the Federal reserve banks or to control the money rate on call loans and things of that sort. Do you recall that at the time it was suggested that it should be or might be used for that purpose?

Mr. MILLER. No; I do not.

The CHAIRMAN. In other words, to inflate or deflate?

Mr. MILLER. No; I do not. I think the original conception of the reserve system is pretty clearly indicated in its title, where it is described as an organization to provide rediscount facilities and for some time the system operated on that basis. Later on, under the stress or temptation of conditions, it changed.

You have referred to the fact that the open market clause of the act, among other things, was intended to give an opportunity to the banks to invest some of their resources to make some earnings. That was primarily responsible for the heavy purchase of United States Government obligations in the year 1922. That followed the deflation of 1921. Rediscounts were running off very rapidly and the reserve banks, or at any rate their governors, in many instances, began to worry a little as to what their earnings position would be, and so they began to buy Government securities, acting more or less independently, and it was because of the appreciation, after a short interval of time, that these operations were of vast importance in the money market, that the first steps were taken toward setting up some sort of a procedure.

The nucleus of that was a committee for centralized execution of purchases of Government securities in the open market. That committee was set-up, I think, in 1922, and, as I recall, the Treasury at that time felt that it was being embarrassed by reason of the fact that the rapid and considerable increase of purchases of United States securities by reserve banks was artificially affecting the market for United States securities.

The CHAIRMAN. Affected the rate?

Mr. MILLER. Yes. Now, we come to the year 1924. That presents a different condition from 1922. There we get the first real beginnings of something in the nature of open-market operations as a factor of great importance in Federal reserve policy and in the management of credit conditions.

No doubt officers of the Federal reserve banks who were in the system at that time would give different explanations of what lay back of the great purchase of Government obligations shown by the curve "Federal reserve holdings of United States securities" (Chart I). And I think it is fair to say that the Federal reserve system, as a system, was not fully conscious at that time of just what its objective was. There was some drifting. The policy was not entered upon

with a clear conception of what was the goal to be attained. I should say, among other things, that the year 1924 having been a year of industrial slackness—it was called a depression at the time, but it seems on the whole a rather moderate depression as compared with what we are experiencing at the present time—there was some thought on the part of the Federal reserve system at that time, as there has been since, that it could alter the psychology of business, as is said, and thus arrest the recession or lift business out of the depression, by the adoption of an avowed easy-money policy, the policy expressing itself most effectively through increased purchases of United States Government obligations.

I think there also filtered into the minds of the Federal reserve officials at that time the thought that perhaps the system could do something or ought to try to do something, to improve the international credit situation at least to the extent of not allowing the heavy imports of gold then coming into this country to become, as it was expressed, “sterilized,” by being used to take down rediscounts at the reserve banks.

The CHAIRMAN. Doctor, when you speak of something filtering into the minds of the Federal reserve system, do you mean that it entered the minds of the Federal Reserve Board or of a certain Federal reserve bank?

Mr. MILLER. Well, I should say that it entered the mind of the banks, and particularly of the largest bank in the system, which regards itself as being charged with primary responsibility to be quickly alert to what is going on or impending in the international situation, and more slowly, into the minds of the Federal Reserve Board. However, it was a factor, even though a dimly lighted factor in the councils of the Federal reserve system at the time.

I think there was also more or less of the illusion (that became more pronounced in 1927) that the Federal reserve system could do something to correct what was then described, and is still described, as the maldistribution of gold in the world. I am afraid that illusion still obtains in certain Federal reserve circles, and in certain parts of the country. It is one of the most misleading illusions that any body of men charged with the responsibility of administering the fundamental credit mechanism of the country could allow to enter its mind.

The CHAIRMAN. Is not the central supervisory authority charged with the responsibility of correcting illusions of that sort?

Mr. MILLER. Yes, if, when and as it can. That brings us pretty close, Mr. Chairman, to the human-equation factor.

I do not think you can ever overlook certain facts, that New York is the central money market of this country and that it has become, by virtue of all the vast changes that have swept over the economic and financial relationships of the major countries of the world, the most important money market in the world to-day.

The CHAIRMAN. Yes, but should it be big enough to control the action of the central supervisory authority in matters of vital importance?

Mr. MILLER. I should be disposed to say that it should be just as big, in the sense of just as strong, and able, as it possibly can be made, and that the central supervisory authority, as you describe it, should be just as strong and able as it can be made, in order that out of the

differences between them may come a broadly balanced judgment with respect to great problems of Federal reserve policy.

I have no objection to being confronted with strong opposition or a positive attitude on the part of any of the reserve bank officers, including those of the New York Federal Reserve Bank.

The CHAIRMAN. But the country should be able to venture the hope that the convictions of the central power should be just as well defined and as insistent as the convictions of those who are under the authority of the central power.

Mr. MILLER. The country has a right to expect it and to demand it; and as it gets it, I think the country will get a more competent performance from the Federal reserve system than it has had in recent years.

I have no hesitation in telling the committee that, in my judgment, the safety of the Federal reserve system for the country depends very largely upon the ability, the wisdom, the strength, and independence of the men who constitute the Federal Reserve Board. Without a strong board I see trouble ahead for the Federal reserve system.

Of necessity—almost inevitable necessity—because of the vast consequences to the world as well as to the country that depend upon the major decisions of the Federal reserve system in matters of policy, the system has taken on something of a centralized character. That means, in my judgment, that decisions on the larger matters of policy must be viewed from a very broad standpoint. They must be regarded as decisions of national economic policy.

Credit policy in the United States, of recent years, has become public policy in a very important sense, and I think it has been abundantly discovered by Federal reserve history, more particularly in recent years, as the system has come to fuller stature, that the contribution that has got to be made to the satisfactory determination of these problems of policy can only be made if an able, wise body, public in character, with a keen and high sense of its responsibilities brings to bear on their solution the deeper insights and larger understanding that may reasonably be expected from it.

I want to say, Mr. Chairman, that in the years I have been associated with the Federal reserve system, I have lived to see it pretty well demonstrated that somehow or other a group of conscientious men, of high character and good intelligence, sitting constantly with these problems, somewhat remote from the atmosphere of the great centers, is capable of an objective and detached view, such as the ablest of men are seldom capable of when they are right in the atmosphere of the large centers and engrossed in their own affairs.

The CHAIRMAN. If you will permit me to supply one adjective in your description of an ideal Federal Reserve Board, without offense, I would venture to do it.

Mr. MILLER. By all means, Mr. Chairman.

The CHAIRMAN. A courageous board, as well as an intelligent and wise board.

Mr. MILLER. Yes; you are quite correct. But I believe, gentlemen, that if we have a board of truly able men, they will probably have the courage to carry through. I think there is growing appreciation that the responsibilities that attach to membership in the Federal Reserve Board are of such mighty character, that no decent



man who might be appointed to the board will hesitate to discharge his responsibilities.

The CHAIRMAN. But sometimes there are decent men who are timid.

Mr. MILLER. Well, the board is no place for a timid or neutral man.

The CHAIRMAN. I did not mean to interrupt you. Go ahead with your statement, Doctor.

Mr. MILLER. I think in connection, Mr. Chairman, with one of your contemplated amendments to the Federal reserve act, drawn with the view of checking Federal reserve credit going into speculative uses—

The CHAIRMAN. Yes; I shall be glad to have you comment on any provision of that proposed bill.

Mr. MILLER. I should like first to call attention to some things that I think it is important be cleared up.

In the year 1927, if the committee will look at the curve (Chart I) which relates to Federal reserve holdings of United States securities, you will note the pronounced increase in these holdings in the second half of the year. Coupled with the heavy purchases of acceptances it was the greatest and boldest operation ever undertaken by the Federal reserve system, and, in my judgment, resulted in one of the most costly errors committed by it or any other banking system in the last 75 years. I am inclined to think that a different policy at that time would have left us with a different condition at this time. That is not an easy or a pleasant thing for me to say, but in the atmosphere of this committee, where you are undertaking to find out what can be done to control the use of Federal reserve credit for certain purposes, I feel it ought to be said.

You notice that as the volume of these securities voluntarily purchased by the Federal reserve banks increases; in other words, as the Federal reserve puts money into the market, not because member banks asked it by offering paper for rediscount, but in pursuance of an affirmative policy of its own, which in effect said,

We shall not wait to be asked to provide increased money through rediscounts; we will operate on our own responsibility and through our own instrumentality, to wit, the purchase of United States Government obligations—

there followed immediately an increase in the reserve balances of the member banks, as shown on the topmost curve (Chart I). That was a time of business recession. Business could not use and was not asking for increased money at that time. But the banks do not want to, and in fact do not, carry uninvested moneys or idle reserves. Here, then, in 1927 came an accession to their reserves for which they had to find a use.

The CHAIRMAN. And left them free to invest the funds—

Mr. MILLER. Not only left them free, but, from the point of view of the banker, put them under an obligation to go and invest—

The CHAIRMAN. Certainly under an invitation to do it?

Mr. MILLER. Yes. Now, let us see what the banks did. I draw your attention again to Chart II and its uppermost curve showing the increase of their deposits. If you will permit me to interrupt myself for a moment, I would like to note a distinction that is very important in the interpretation of banking deposits. There are two noteworthy methods by which bank deposits are created. One is the method which was in contemplation at the time the Federal

reserve act was drafted and which corresponded to the practice of banking at that time, to wit, a borrower, a merchant or manufacturer, takes his note, to his bank and has it discounted and is given a credit on the books of the bank. The credit is called a deposit. Deposits of that kind arise out of and are tied to loans and discounts. They keep in close correspondence with one another. The other method of creating a deposit is through the making of a deposit of cash or its equivalent by somebody in the bank. When that occurs deposit precedes investment or loan. Finding its reserves increased, the bank is obliged to go out and find some use for this new money. It rarely finds it immediately by increasing its commercial loans. It is, therefore, almost of necessity, compelled to buy investment securities or open-market paper or to make so-called open-market loans, of which the most familiar type is the call loan.

Now, that describes what happened in 1927. The deposits curve shows a great growth in deposits, not offset by commercial loans (Chart II.). The curve which bears the legend of "All other loans" is made up principally of commercial loans, loans to commercial and business men, who discount their unsecured notes at member banks. In 1927 no change occurred in the average volume of these commercial loans. "What then," one asks, "was the use made of the reserves which, so to speak, were handed to the banks by the Federal reserve banks, through open market purchases of securities"? Well, they bought investments in increasing amounts. There is a considerable increase in the volume of investments (shown by the curve "Investments," Chart II), corresponding to growth in deposits. But more important is the sudden and rapid upward flight of their loans on securities—collateral loans, as shown on the chart. These loans on securities include, of course, the so-called brokers' loans; in other words, the call loans made by the banks. The call loan is in ordinary times apt to be most sensitive in its response to an abundance of loan funds in the member banks—in other words to cheap and easy money. The call loan market will in ordinary times take all the money offered it at a price. Under the reserve system, or, rather since the reserve system was established, bankers endeavor to keep loaned up. They want no surplus reserves because they do not need them. Some of the things brought out in the testimony of Governor Harrison yesterday, I think, are due to that fact.

Mr. WILLIS. The Federal funds market would tend in that same direction.

Mr. MILLER. Yes; but not to any important degree.

Mr. WILLIS. So far as it had a tendency, it would be in that direction?

Mr. MILLER. So far as it had a tendency, it would be in that direction, in times when the call market or speculative security market, that lies back of it, has an appetite for funds.

Mr. WILLIS. In times when there is a delicate balance between demands?

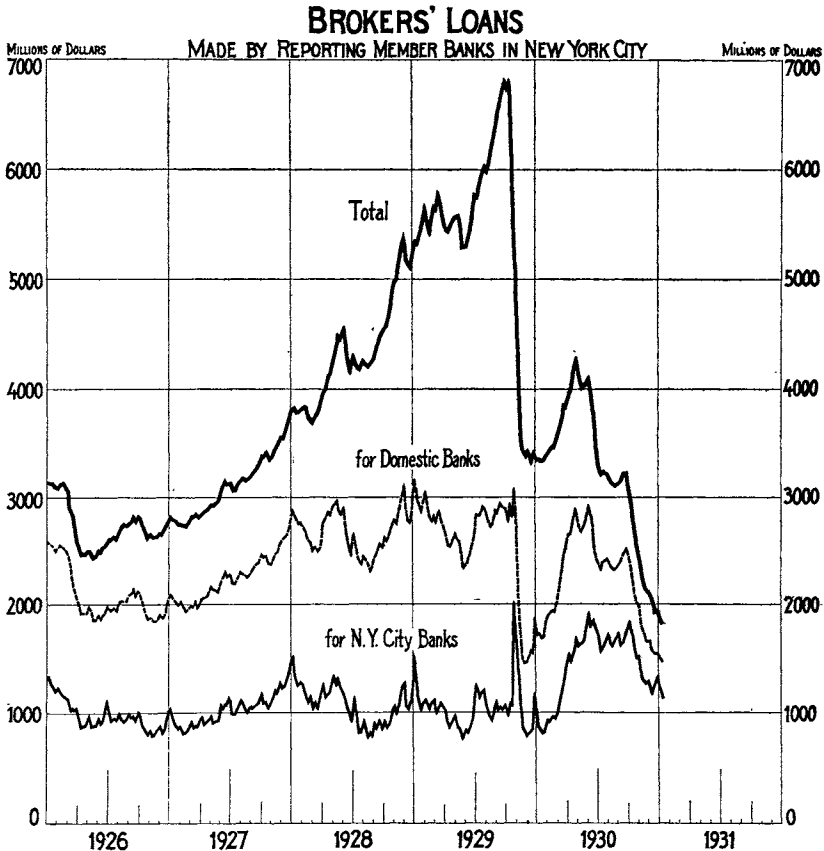
Mr. MILLER. Yes. The growth of security loans, which is marked on the chart "Loans on securities and investments," includes security loans of every character, customers' loans, the loans of financial houses, engaged in bringing out or distributing securities as a business—

The CHAIRMAN. Investments as distinguished from speculation?

Mr. MILLER. Yes. While that curve "Loans on securities" is rather pronounced in its upward movement, there is an even more pronounced movement in the brokers' loan curve (Chart IV) "For domestic banks." The curve marked "Total" includes loans made by nonbankers, the so-called bootleg loans.

A not inconsiderable part of the funds that came into the call-loan market, from 1927 on, as loans for account of others, loans of corporations, firms and individuals, also traces back to the impulse that the great creation of cheap credit in 1927 gave to company financing.

CHART IV



and refinancing. By issues of stock as well as bonds companies obtained funds in excess of immediate requirements which became available for loans in the call-loan market.

I do not know that the committee wants to be troubled at this time with facts and figures, but I will be happy to introduce into the revised record later, statistics showing the growth of new issues—stocks and bonds—during the period when the great growth in security loans and especially call loans took place. Many business concerns that formerly financed themselves through bank loans, when money became cheap and plentiful, began to put out debenture issues or stock issues and thus provided themselves with working

capital and, in most cases, with working capital in excess of what they actually needed to employ in their current business, and which was available, therefore, for loans or short investment.

The CHAIRMAN. And they proceeded to loan it on call?

Senator WALCOTT. It seems to me that would be a very interesting chart to supply this committee, particularly if you can segregate bonds and preferred stocks and equity stocks.

Mr. MILLER. We shall do the best we can. It will make an interesting footnote. (See table following.)

*Nominal capital issues* <sup>1</sup>

[In millions of dollars]

	Total foreign and domestic	Domestic issues			Total foreign <sup>3</sup>
		Total <sup>2</sup>	Bonds and notes	Stocks	
1922.....	4,395	3,631	3,061	570	764
1923.....	4,440	4,019	3,360	659	421
1924.....	5,557	4,588	3,759	829	969
1925.....	6,205	5,129	3,977	1,152	1,076
1926.....	6,282	5,157	4, 70	1,087	1,125
1927.....	7,489	6,152	4,692	1,460	1,337
1928.....	7,979	6,728	3,828	2,900	1,251
1929.....	10,005	9,334	3,466	5,868	671

<sup>1</sup> These figures exclude direct refunding issues but include issues such as investment trust issues, the proceeds of which may be reinvested in outstanding securities.

<sup>2</sup> Figures from Commercial and Financial Chronicle.

<sup>3</sup> Figures from Department of Commerce.

There is, then, I think what might well be described as a parallelism, a striking and significant parallelism, between the open-market operations of the Federal reserve, particularly in the years 1927-28, when it was entering the market to purchase Government securities, and, as on certain other occasions, acceptances, but particularly Government securities, and the growth of reserves and (consequent upon that) the growth of investments, loans on securities, and deposits. (See Chart V on page 138.)

The table presented in Chart V gives figures showing the growth of credit at all member banks. Total loans and investments over the period 1921 to 1929 grew by an amount of 48 per cent. "All other loans" which are identified by the Federal reserve as mainly commercial loans, showed a negligible growth, and remained practically constant through the period, notwithstanding the fact that money was abundant and cheap. Presumably this slow growth of commercial loans was not due to any inability to get accommodation, but to certain factors which may be broadly described as this, that business was able to finance itself by issuing securities and that it needed fewer dollars per unit of business; in other words, that the dollar was becoming more efficient; that it did more work; that business practices in the handling of inventories and the like were changing and business consequently needed less money relatively, judged by pre-war standards. The tendencies of prices to fall kept business alert not to be caught with large inventories on a falling market.

Senator BULKLEY. Would the amount of loans be affected, as was suggested in the statement made yesterday, by corporations being better financed to carry their own business?

Mr. MILLER. Very materially. I was trying to bring that out a moment ago.

The CHAIRMAN. If that situation is to persist, might not that suggest some alteration in the definition of eligible paper that banks might take?

Mr. MILLER. You mean in order to broaden the class of paper to be admitted to discount by the Federal reserve banks?

The CHAIRMAN. Yes.

Mr. MILLER. I can not conceive of any alteration, or I do not, at any rate, conceive of any that would improve conditions.

The CHAIRMAN. Nor I, either.

CHART V

LOANS AND INVESTMENTS—ALL MEMBER BANKS

in Millions of Dollars

JUNE 30	INVESTMENTS	LOANS ON SECURITIES	LOANS ON URBAN REAL ESTATE <sup>1/</sup>	ALL OTHER LOANS	TOTAL LOANS AND INVESTMENTS
1921	6002	<sup>1/</sup> 4,400	<sup>1/</sup> 875	12,844	24,121
1922	7,017	<sup>1/</sup> 4,500	<sup>1/</sup> 1,100	11,565	24,182
1923	7,757	<sup>1/</sup> 4,950	<sup>1/</sup> 1,350	12,450	26,507
1924	7,963	<sup>1/</sup> 5,350	<sup>1/</sup> 1,575	12,279	27,167
1925	8,863	6,718	<sup>1/</sup> 1,875	12,062	29,518
1926	9,123	7,321	2,161	12,579	31,184
1927	9,818	8,156	2,449	12,333	32,756
1928	10,758	9,068	2,624	12,611	35,061
1929	10,052	<sup>1/</sup> 10,095	2,750	12,814	35,711
Actual Increase 1921-1929	4,050	5,695	1,875	<sup>2/</sup> 30	11,590
Percentage Increase 1921-1929	67 %	129 %	214 %	—	48 %

<sup>1/</sup> Real Estate Loans other than Farm Lands

<sup>1/</sup> Partly Estimated

<sup>2/</sup> Decrease

Mr. MILLER. I should say that probably it might rather define the least objectionable method for preventing a too rapid growth of the country's credit.

The CHAIRMAN. If there are no rediscounts, what will the Federal reserve banks do with their accumulated funds?

Mr. MILLER. There will be rediscounts.

The CHAIRMAN. Except to use their resources in the open market as was disastrously done?

Mr. MILLER. There will be rediscounting the moment the Federal reserve banks reconvert themselves to institutions—

The CHAIRMAN. Of commerce?

Mr. MILLER. And rediscount.

The CHAIRMAN. Yes.

Mr. MILLER. I think it is reasonably clear, from the operations of the last few years, that the Federal reserve is tied into the credit

situation of the country in such a way that it will have to maintain outstanding about a billion of credit under ordinary conditions for the use of its member banks. Seldom, I think, will it drop much below that or need to increase much above that except to meet seasonal or exceptional conditions, if the banks are operated as rediscounting institutions.

Mr. WILLIS. In your report of three or four years ago, you brought out the statement that there was a large quantity of eligible paper in member banks which could have been rediscounted, did you not?

Mr. MILLER. Yes.

Mr. WILLIS. Yesterday it was estimated it was only about \$3,000,000,000.

Mr. MILLER. Yes.

Mr. WILLIS. Has the board changed its estimate on that?

Mr. MILLER. I think not; it depends a great deal on how rigid your criterion is as to what constitutes paper eligible for rediscount.

Mr. WILLIS. But at the time you had it estimated, three or four years ago, it was very much higher than that. It seems to me that you estimated it at seven and one-half billion.

Mr. MILLER. I do not recall. That figure includes what could be taken out on bills payable.

Mr. WILLIS. I merely wanted to bring out the fact that the board had said at that time there was an abundant amount of eligible paper in member banks that could be used for obtaining funds for commercial loaning if desirable.

Mr. MILLER. Yes. That might be used, at any rate, for the maintenance of member bank reserves.

Mr. Chairman, I think it might be well to state that this table brings out again in figure form the use made of the great increase in member bank reserve balances; loans on securities, first and most important; loans on urban real estate; and investments; in other words, it comes pretty nearly, I think, to this, that when the Federal reserve banks operate as investment banks, by buying investments, they force the member banks of the country also to operate as investment banks by buying investments or loaning against investments or by making loans of the kind here described as loans on real estate.

The CHAIRMAN. I have noted in the previous hearing that you offered the suggestion that these extensive open market operations of the system should require the sanction of at least five members of the Federal Reserve Board. You have not altered your view of that?

Mr. MILLER. I did not recall that I had ever expressed that opinion publicly before. Was that in hearings before the House committee?

The CHAIRMAN. I think so.

Mr. MILLER. I am still of that opinion, Mr. Chairman—more so than ever. I would say that the next step in the development of the Federal reserve system is to make it less easy to—

The CHAIRMAN. Could not you impose that obligation upon the open-market committee or would it be better to incorporate such provision in the act itself?

Mr. MILLER. I do not see how we could do it with the open-market committee. After all, that is merely a convenient working organization, not constituted or authorized by law, and I think would

be a pretty considerable step toward the conversion of the original reserve system into a central bank.

I want to call the attention of the committee to this, that whenever the Federal reserve system operates through the open-market committee, it operates, in effect, as a central bank, of necessity. It operates with the resources of the 12 banks as a system.

The CHAIRMAN. Which it was never intended to be.

Mr. MILLER. You strip your regional banks of their separate control of credit in their several districts when you operate with their resources in the central money market of the country.

The CHAIRMAN. I wonder how much the average Federal reserve bank in the country has to do with these operations or to what extent the boards of these respective banks influence the activities of the open-market committee?

Mr. MILLER. Well, interesting things, I think, are in process, are now going on in the Federal reserve system. I should say that until a comparatively recent date, the influence of—let us say, for short, the outside banks in the Federal reserve system—was trifling. But I think the miscarriage of the 1927 adventure of the system in its open-market operations—

The CHAIRMAN. Yes?

Mr. MILLER (continuing). Has served to make the other banks—the outside banks in the Federal reserve system—more solicitous, and it is largely due to their feeling that the open-market committee has changed its character and its size. It is now an open-market policy conference in which every reserve bank is represented.

Senator BULKLEY. Was that 1927 adventure in the nature of a central bank operation?

Mr. MILLER. Distinctly. It could hardly have been more so if we had had but one bank.

The CHAIRMAN. Have any of the Federal reserve banks ever declined to take their assignment of open-market paper?

Mr. MILLER. I think not on principle. I think they have never declined because of disapproval of the open-market policy, except, perhaps, on one or two occasions. There have been cases where some of the regional banks have been pretty well invested up and therefore had very little margin for participating in the system's open-market purchases, or having participated in the purchases subsequently sold their holdings in whole or in part to reserve banks in an easier position. But generally I think the policy, when adopted, has been participated in by all of the banks in a cooperative spirit.

The CHAIRMAN. If you have exhausted your very illuminating talk—that is, illuminating to me—about the open-market transactions, I should like for you to tell us a little something about the discount policies of the Federal reserve system.

It was developed in the hearing yesterday, that the Federal Reserve Bank of New York had—of course, with the assent of the Federal Reserve Board—advanced its rediscount rate on several occasions—three occasions as I recall it—in the early period of 1928 and that it had from time to time, and quite repeatedly, recommended an advance in the rate which the Federal Reserve Board declined to sanction. Could you tell us something about that?

Mr. MILLER. Yes. It declined to sanction the advance recommended in 1929; it approved all advances recommended in 1928.

The CHAIRMAN. To begin with, is it your theory that the rediscount rate was ever intended or might effectively be used, to repress activities in the stock market?

Mr. MILLER. Not per se. I would, however, think it a reasonable use of the discount rate to test out, or restrain incipient developments that might be in process—you can not be sure in such matters—and that first might be exhibiting themselves in the securities market.

You can never be sure, when securities are inflating, that it may not be preliminary to an inflation that will creep into the field of business later on and so I would not have much hesitation in approving increase in the discount rate from a comparatively low level in circumstances of that character.

The CHAIRMAN. Would you make the advance to the extent of penalizing the ordinary commercial transaction?

Mr. MILLER. No; I would not and particularly not when, under conditions such as obtained in 1929, there was no reason to believe that it would do anything but that.

Let me say, on your question, Mr. Chairman, the Federal reserve system began to go into the reverse, with its open-market policy, late in 1927. After its major operation in enlarging its portfolio of Government securities in the autumn of that year, the developments which are brought out on the charts began to give some concern, with the result that the system suspended further purchases and prepared to go into reverse and sell Government securities. That policy was definitely assumed as system policy, with the advent of the year 1928.

The system began to sell securities, and not getting the reaction it expected to get and believed it must get under a policy of sales, it began to reinforce its sales of Government securities by what I would describe as a hesitant increase of the discount rate. It entered the year 1928 with a discount rate of  $3\frac{1}{2}$  per cent. That was moved up in three steps, to a rate of 5 per cent by midsummer of 1928. I think that rate was fixed the 13th of July. In other words, it was then attempting to exert two forms of pressure; one to take money back from the market by securities sales and force the banks to rediscount or contract, and the other to raise the rate of rediscount from  $3\frac{1}{2}$  to 4,  $4\frac{1}{2}$ , and 5 per cent. But at that time the market had gotten such speed, the call rate was moving up so rapidly, that it was constantly ahead of the discount rate. In brief, the rates of 4,  $4\frac{1}{2}$ , and even 5 per cent, except momentarily, as a psychological influence, exercised, and could exercise, no adequate deterrent influence. I have no hesitation in saying that I would have voted for a 6 per cent rate in 1928 in the belief that conditions were developing in credit that could probably have been most effectively, and readily corrected by an energetic application of the discount rate. I think the thing might have been accomplished. I think that if, when the reserve banks raised their rates from  $3\frac{1}{2}$  to 4, they had raised it to 5 per cent, which is not an unreasonable rate—

The CHAIRMAN. At least that would have been a plain implication that the authorities of the Federal reserve system thought things were too much on the upward trend—

Mr. MILLER. Yes.

The CHAIRMAN. And it would have gone out that it was the purpose of the increase—

Mr. MILLER. Yes.



The CHAIRMAN. To put a stop to that sort of thing?

Mr. MILLER. Yes; I think it would have meant that there was a conviction behind the action, that it was a decision to accomplish something and that the Federal reserve had started out with the conviction that there was something that needed correction.

The CHAIRMAN. Then just exactly why, may I ask, did the Federal Reserve Board decline to sanction further advances in the rate at New York?

Mr. MILLER. The rate was raised by the New York bank to 5 per cent on the 13th of July, 1928. It was not until the 14th of February, 1929, or seven months later and one week after the board issued a public statement to the country with respect to credit conditions, in which was emphasized the dangers inherent in the extraordinary growth in the volume of speculative security credit, that the Federal Reserve bank moved. It was not until after the board issued that statement, that the first proposal to raise the rate to 6 per cent was made to the board.

In a letter sent to the Reserve banks under date of February 2, a part of which was incorporated in the statement to the public released on February 7, the Board said that it "realizes that there are elements in the situation which are not readily amenable to recognized methods of banking control."—Which meant that, in the judgment of the Federal Reserve Board, the time had gone by for useful rate action.

The CHAIRMAN. When you use the term "recognized methods" you mean ordinary methods?

Mr. MILLER. Conventional, traditional methods—discount rate changes and open-market operations.

Senator WALCOTT. What was the date of that?

Mr. MILLER. February 2, 1929.

Senator WALCOTT. Would it be proper to let us have that letter for insertion in the record?

Mr. MILLER. Yes. A part of the letter was contained in the public statement, but there were a few queries addressed to the Federal Reserve banks in this letter which might without impropriety become a part of this record.

The CHAIRMAN. We will be glad to have that.

LETTER SENT TO ALL FEDERAL RESERVE BANKS

FEBRUARY 2, 1929.

The firming tendencies of the money market which have been in evidence since the beginning of the year—contrary to the usual trend at this season—make it incumbent upon the Federal reserve banks to give constant and close attention to the situation in order that no influence adverse to the trade and industry of the country shall be exercised by the trend of money conditions, beyond what may develop as inevitable.

The extraordinary absorption of funds in speculative security loans which has characterized the credit movement during the past year or more, in the judgment of the Federal Reserve Board, deserves particular attention lest it become a decisive factor working toward a still further firming of money rates to the prejudice of the country's commercial interests.

The resources of the Federal reserve system are ample for meeting the growth of the country's commercial needs for credit, provided they are competently administered and protected against seepage into uses not contemplated by the Federal reserve act.

The Federal reserve act does not, in the opinion of the Federal Reserve Board, contemplate the use of the resources of the Federal reserve banks for the creation

or extension of speculative credit. A member bank is not within its reasonable claims for rediscount facilities at its Federal reserve bank when it borrows either for the purpose of making speculative loans or for the purpose of maintaining speculative loans.

The board has no disposition to assume authority to interfere with the loan practices of member banks so long as they do not involve the Federal reserve banks. It has, however, a grave responsibility whenever there is evidence that member banks are maintaining speculative security loans with the aid of Federal reserve credit. When such is the case the Federal reserve bank becomes either a contributing or a sustaining factor in the current volume of speculative security credit. This is not in harmony with the intent of the Federal reserve act nor is it conducive to the wholesome operation of the banking and credit system of the country.

You are desired to bring this letter to the attention of the directors of your bank in order that they may be advised of the attitude of the Federal Reserve Board with respect to this situation and the problem confronting the administration of Federal reserve banks. The board would like to have from them an expression as to (a) how they keep themselves fully informed of the use made of borrowings by their member banks, (b) what methods they employ to protect their institution against the improper use of its credit facilities by member banks, and (c) how effective these methods have been.

The board realizes that the problem of protecting the credit situation from strain because of excessive absorption of credit in speculative security loans is attended with difficulties. It also realizes that there are elements in the situation which are not readily amendable to recognized methods of banking control. The board, nevertheless, believes that, however difficult, the problem can be more completely met and that the existing situation admits of improvement.

The Federal Reserve Board awaits the reply of your directors to this letter and bespeaks their prompt attention in order that it may have their reply at an early date.

By direction of the Federal Reserve Board.

Mr. MILLER. It was my opinion, expressed several times in discussions at Federal reserve meetings, in the opening month of the year 1929, that the Federal reserve system was drifting; that it was in the midst of a perilous situation without a policy. It was also my opinion that the Federal Reserve Board was far more alive and aware of the terrific implications of the situation existing at the opening of the year 1929, than were the banks and that, in default of any program on the part of the Federal reserve banks for dealing with the situation, the Federal Reserve Board owed a responsibility to the country and to the future of the Federal reserve system, for which it must find a solution. That solution was found in a rejection of discount policy as a suitable expedient in the circumstances, as they had then developed, and the adoption of "direct pressure."

It was our belief that an increase to 6 per cent in February, 1929, would have been nothing but a futile gesture; that it would have been a practical declaration to the speculative markets of the country that the doors of the Federal reserve system were open to all comers with paper of the kinds eligible for rediscount provided they paid 6 per cent. With call rates mounting to 8, 9, 10, 15, and 20 per cent, a 6 per cent discount rate would have been an admission of defeat and given great relief to the speculating public.

An alternative use of discount policy would have been what you alluded to yesterday, Mr. Chairman—a drastic application of the policy, through successive increases to 6, 7, 8, or 9 per cent—in other words, a race between the call rate and the discount rate.

The CHAIRMAN. With legitimate commerce the victim.

Mr. MILLER. With legitimate commerce thrown into a state of bewilderment and the whole country thrown into a mental upheaval with only one thing certain as the outcome—the wrecking of the stock

market, the wrecking of business, and with imputation of responsibility for both wreckages to the Federal reserve system. It would have been an act of madness.

I want to add if I may here, Senator, that my own individual concern, at that time early in 1929 was as to what the board could do by appropriate intervention to save the good repute of the Federal reserve system. I had no misgivings as to the ultimate consequences of the speculative expansion at that time. It was clear to me that it had already gone beyond all the ordinary forms of control; that it would end in some sort of violent revulsion.

The CHAIRMAN. What different policy was recommended by the board or what different practice at that time other than the direct method of dissuading or remonstrating?

Mr. MILLER. Well, we undertook to remind the reserve banks in the letter of February 2 to them, that there was this great growth of credit that was occasioning concern—"Speculative security credit" was the term we used—that the use of Federal reserve credit for making loans of that character was not contemplated by the reserve act. We laid down what might be regarded in the nature of a principle or interpretation of the law when we said a member bank is not within its reasonable claims to the use of the rediscount facilities of the Federal reserve bank, when it borrows for the purpose of making or maintaining speculative loans; that when that occurs the Federal reserve banks become involved either as contributing factors or as sustaining factors in the existing volume of speculative credit. We stated in effect that we did not propose to have Federal reserve credit used for the purpose of increasing the volume of speculative security credit, on the two grounds, that the law did not recognize that as a legitimate use and that such use was not conducive to good functioning of the banking and credit system of the country.

Does that answer your inquiry?

The CHAIRMAN. Completely. Without any purpose to introduce anything of a disagreeable nature into these hearings, I may note, in the form of an inquiry, that it seems to me that a prominent director of an outstanding Federal reserve bank severely resented that admonition of the board and refused to conform his conduct to it, did he not?

Mr. MILLER. I would say, without answering your question directly or too immediately, that the procedure that the board saw fit to advise the reserve banks to follow in the conditions that existed at that time, did not commend itself to the judgments of all the reserve banks, notably the Federal Reserve Bank of New York, or to all of the bankers, notably some in New York. But there were banks in New York, among the very largest, that approved of the board's policy and gave it their support.

The CHAIRMAN. And gave it full cooperation?

Mr. MILLER. And gave it remarkable cooperation and were using, I think, the best judgment in mediating between what they regarded as good Federal reserve policy and conditions that might, on too severe an application of it, produce disaster in the stock market.

The CHAIRMAN. Was not that true of most of the important banks in New York?

Mr. MILLER. I think that is a pretty fair statement; yes. It is a fair statement, I think, as regards New York. It is a very fair statement as regards Chicago, where there was not only cooperation but

an approving cooperation. It was true of most of the banks in the other larger interior centers.

The CHAIRMAN. Doctor, what was the attitude at that time of the Federal Reserve Advisory Council?

Mr. MILLER. The attitude of the council, when the board put out its statement of February 7, 1921, was one of approval. My recollection is that the council met about six days after the board's statement was published. The board's statement was published on the 7th of February, 1929. The council assembled in Washington on February 13 or 14 and naturally having had before them in the press this most recent performance on the part of the Federal Reserve Board—this statement—their minds were filled with it. We did not refer the statement to them for expression of approval or disapproval. We purposely refrained from putting it on the usual program of the topics that we wanted them to consider. I would not want to speak for my colleagues, but I think that probably those, at any rate, that were behind the February 7 statement of the board were in very much the same state of mind that I was. They were afraid it might embarrass the council to be asked, because of the fact that these men, being representatives of the larger banks in their districts from all over the country, might look with disapproval upon a method of control of credit that was unorthodox and yet be reluctant to say so.

The CHAIRMAN. Why unorthodox, if explicitly authorized by law?

Mr. MILLER. Well, the banker, of course, has his own ideas of what is proper procedure and practice. "Direct pressure" was not among the recognized expedients. I think the bankers might well have been expected—especially the large city bankers—to take a cynical view or at least an unsympathetic view of this method of undertaking to improve a situation which they were as much concerned about, I think, as we of the Federal Reserve Board. They voluntarily raised the question when they met us in conference whether we would like to hear what they thought. I think the answer was that that was up to them. We did not know whether they would say they thought well of this method or poorly of it. My own expectation was that probably the large city banks represented in the conference would speak with doubt of the procedure, if not actually disapprove it. On the contrary, the council approved it and even went further than the board in its own recommendation. The board, in its statement always referred to "speculative security loans." The council, in its approval, referred to "security loans," which was much broader.

Here is their statement:

The Federal Advisory Council approves the action of the Federal Reserve Board in instructing the Federal reserve banks to prevent, as far as possible, the diversion of Federal reserve funds for the purpose of carrying loans based on securities. The Federal Advisory Council suggests that all the member banks in each district be asked directly by the Federal reserve bank of the district to cooperate in order to attain the end desired. The council believes beneficial results can be attained in this manner.

I recall very distinctly that when their recommendation was submitted, I asked whether the omission of the word "speculative" was inadvertent or intentional. The answer from the chairman of the council, who was then chairman of one of the largest banks in the country, was that it was not inadvertent.

The CHAIRMAN. Which made it more comprehensive?

Mr. MILLER. Which made it far more comprehensive; yes, sir, and they also indicated that they thought it would be a successful method of coping with the then existing conditions. They even went so far in a private memorandum to the board as to express themselves as believing "every effort should be made to correct the present situation in the speculative markets before resorting to an advance in rates."

The CHAIRMAN. This is getting to be a right entertaining hearing. Well, do you care to say anything further, Doctor?

Mr. MILLER. You have asked for suggestions as to how I think this matter of keeping within limits the growth of speculative credit can be accomplished. You referred to the suggestion made by me in the hearings of the House committee.

The CHAIRMAN. I did not catch that.

Mr. MILLER. You referred to a suggestion I made before the House Banking and Currency Committee that I thought might—

The CHAIRMAN. Affecting the open market transactions?

Mr. MILLER. Affecting open market purchases of securities, yes, and thereby occasioning those great bulges of credit shown on the charts, with the almost certain eruption of something in the stock market as a consequence when hopes are running high and business is in a forward movement. These problems need not concern us much, perhaps, when things are slack and flat as they now are. But we are going forward in this country again, and if we repeat the errors of 1927-28, we are going to have just about the same thing again as occurred in 1929 in about 7 years, and certainly in 10. Therefore, if I may repeat my recommendation, I would suggest for your very thorough consideration, the establishment of safeguards against a too easy entering upon these open market operations after the fashion the Federal reserve act itself has set a precedent for; to wit, by requiring not less than 5 affirmative votes on the board whenever the Federal Reserve Board is asked to approve something out of the ordinary.

The CHAIRMAN. It has done that with respect to requiring one Federal reserve bank to rediscount for another.

Mr. MILLER. Yes, and to suspend reserve requirements or to reduce the reserves of outlying banks. There are a number of those things.

The reason I suggest the requirement of an affirmative vote of 5 is this: As I look back upon the history of these open market operations, it has not infrequently happened that a decision of great consequence was made by a majority of a quorum of the board, but not a majority of the board.

The CHAIRMAN. Yes.

Mr. MILLER. I am reasonably satisfied that, even as things have been, that if there had been a requirement in the act of the kind I have suggested, to wit, that it shall take the affirmative votes of five members of the board in order to engage the Federal reserve system in open-market operations, purchase operations on such an extended scale as actually occurred might not and probably would not have happened in 1927.

Senator WALCOTT. Was not that the time to do it?

Mr. MILLER. Yes; and if it had been done—I do not want to be misunderstood. I do not think anything that the Federal reserve

system could have done, either by omission or commission in 1927 could have avoided a crisis of some sort eventually. The causes of the present crisis and depression go far deeper than the stock market. The stock-market crash was symptomatic of ruptures and dislocations running all through the financial and economic structure of the world which sooner or later would have exerted their effects. But if there had been greater awareness of what was involved in the economic disorganization left after the Great War, the Federal reserve would have pursued more temperate policies, with the result that when the crisis came, it would have been far less intense, severe, and devastating and the resulting depression less overwhelming and prolonged.

There is a lot of mopping up which has had to be done in the last year, a lot that would not have been necessary if we had pursued a more conservative policy in the system in 1927 and established a more vigorous control in 1928.

There, I think, is where a weakness has been revealed before in the open-market operations of the system. Men who enter boldly upon an operation are not infrequently apt to be slow to reverse when things don't turn out as expected. They are particularly apt to be slow to reverse when they are not acting alone and privately. When they are acting publicly and in seeming departure from their original policy, the tendency to wait becomes more pronounced, because it seems to involve them in confession of error. And so you get delay. I criticize the attitude of the leading banks of the system in the first half of the year 1928 as first slow and then hesitant.

I come back, therefore, to this, for your most earnest consideration—the advisability of the attempted separation of the system from too close contact with the speculative security credit market, of setting up certain safeguards right in the system itself and primarily in the Federal Reserve Board. I hope it will not be necessary, but if it is not necessary, it will not do any harm anyhow. I would myself, if I were at any time for an affirmative policy of buying Government securities—I would myself feel more comfortable in my position, if the law required at least four other of my colleagues to be joined to make that policy effective. You must not leave it too easy for the Federal reserve system to inflate. We have had too much inflation in the Federal reserve system, and its favorite instrument is the open-market purchase of Government securities.

We have had something of an obsession for easy money in the system, a feeling that it makes the atmosphere of business; that it can stop a recession of business and turn a period of depression into one of recovery.

The CHAIRMAN. In line with that, what is the meaning of the 2 per cent rediscount rate in New York now?

Mr. MILLER. I think the 2 per cent rediscount rate is intended to be notification to the people and to the world that credit conditions are very comfortable, sound and easy in our leading money markets and in the leading money markets of the world, and that no harm will result from a rate as low as 2 per cent at the leading reserve bank and that it might do something to release the business mind of the country from the grip of fear in which it is still held.

The CHAIRMAN. Doctor, would you care to comment on the question of affiliates, as to their prohibition or as to a requirement of examination and public report?

Mr. MILLER. Yes. I have not very much to add to what has already been said here, and what I think will be said better by others who are to follow. It is regrettable that there are so many of these investment affiliates of banks. If we had not had these affiliated institutions in 1928 and 1929, we should not have had as bad a situation, speculatively, as we have had, I am satisfied. Some of the banks of the country have not been operated strictly and only as banks of discount and deposit. Some of them have at times had a major interest in the operations of their affiliates. To speak frankly, some of these affiliates have been little more than market operators. By reason of their access to the credit facilities of the banks with which they are affiliated, and the access of the banks to the Federal reserve system, it has been made very easy for investment affiliates to spread into dangerous zones. If we had not a condition to deal with, I would think it a prudent safeguard of the law to absolutely discountenance these affiliated relationships. It is not, however, an easy thing to turn back and unscramble. Therefore, I suppose the development has got to be viewed in a more or less practical light, and find out what is the best thing to be done in the circumstances.

I should say a very rigid examination of these affiliates, regular examinations, some supervision and control over practices, is a necessity.

Senator WALCOTT. I should like, apropos of previous conversations as to suggestions, to ask you, Doctor Miller, whether you would not be willing to put into writing some suggestion by which we could establish these checks and controls—perhaps other than placing the minimum of votes necessary to approve at a higher point—at your convenience, I mean. Does that meet with your approval, Mr. Chairman.

The CHAIRMAN. Yes.

Mr. MILLER. I will be glad to do that if the committee will perhaps afford me the opportunity of presenting the memorandum later on.

The CHAIRMAN. We shall be glad to do that.

Mr. MILLER. I think, if you wish, I might comment upon one of the particular amendments here, which has been devised to control.

Mr. WILLIS. Which of the amendments is that?

Mr. MILLER. Amendment—

Senator WALCOTT. No. 11—

Mr. MILLER. The amendment that when a bank borrows on its bills payable, collateralized by Government securities, it may not increase its call loans.

The CHAIRMAN. The 15-day provision.

Mr. MILLER. I would say that the committee ought to have some competent person who is in sympathy with your purposes analyze the effects such a restriction as the amendment contemplates may have on the operation of the call-loan market.

I do not think it desirable to impose restrictions that are not absolutely necessary. I think it is very undesirable to do anything that will unnecessarily interfere with a free capital market or a free short-term money market in this country. I should be loath to see anything unnecessarily done that would say, in effect, to A "You shall not loan to B," when they are both private concerns.

The CHAIRMAN. Would you revert to a bond secured currency?

Mr. MILLER. No; I would not.

The CHAIRMAN. Are you not in danger of doing that, under that—

Mr. MILLER. I do not think so. I think under a wholesome operation of the Federal reserve system—that is, making these institutions function as banks of rediscount—

The CHAIRMAN. Yes, but the suggested alteration in the law is brought about by what some of us considered the very unwholesome operation of the system.

Mr. MILLER. Yes; I understand so.

The CHAIRMAN. We were told, when that provision was incorporated in the statute, that the purpose of it was to guard a bank against unexpected withdrawal of deposits or embarrassment in an emergency, and our information—not disclosed to you at this inquiry—my information has been that it has been used largely, if not principally, for stock speculative purposes.

Mr. MILLER. Well, I would say as to that, when we look at the whole sequence of circumstances and facts in the years before the crisis, that the member banks sinned less than they were sinned against. The inflation which caused bad banking came largely through gold imports and the open-market operations of the Federal reserve system. Then when the Federal reserve retired from the market and sold securities, it undertook to get back money from the member banks, and forced them to come in and rediscount.

The CHAIRMAN. Well, that is an emergency.

Mr. MILLER. Yes, they were caught, as it were.

The CHAIRMAN. The provision is not used simply and solely for that, by any means, if my information is at all accurate.

Mr. MILLER. I think that is true, Senator, but, Senator, let us not overlook this: There is nothing in the reserve act that implies any restriction upon the occasions or the purposes for which the credit that the Federal reserve banks release to the market through their open market purchases may be used by the member banks. When the reserve system puts money into the market by open market purchases, the money goes eventually to the highest bidder, and inasmuch as the open money market of the country is first and foremost in New York where the great call market is, that is the market to which the Federal reserve money tends to go. And where it first tends to go, it has a tendency to stay.

We talk much of the fluidity of money and credit. The fact is that it is sometimes very sluggish in its movement and tends to remain where it is first put out—that is the New York call-loan market. It will stick there if there is a good demand for it.

That states the case as to our open market operations. These great funds which have on occasion been released to the open market, as in 1927, by the Federal reserve, go into the pool of money and the member bank which gets some of it may not know where this new money is coming from—

The CHAIRMAN. But you are proposing to put a brake on that operation by requiring that five members of the Federal Reserve Board shall vote to authorize anything of the kind.

Mr. MILLER. Yes.

The CHAIRMAN. What this provision means is to put a brake on this thing of using the 15-day direct credit, for stock speculative purposes.



Mr. MILLER. I think what happens is this: When the banks come into—let us speak particularly of the New York banks—when they came, in 1928 and 1929, to rediscount their bills payable at the Federal reserve bank, it was not primarily for the purpose of making new brokers' loans. They were being subjected to pressure by some of their large depositors withdrawing their money and lending it directly to the call market. I do not believe that there will ordinarily be any considerable amount of rediscounting or borrowing on bills payable from the reserve banks for the purpose of making new speculative loans, except when a condition has been permitted to develop where the reserve bank is trying to contract credit through forcing the banks to rediscount and the situation does not readily admit of it, because of the speed of the call-loan market.

My thought, in the suggestion I have made, Mr. Chairman, is this: I believe that our troubles will be enormously minimized—in fact I think we will pretty nearly get rid of most of them—if the Federal reserve banks are operated as institutions of rediscount. The very reason they have not been primarily operated as institutions of rediscount is that the rediscount control is effective against voluntary inflation by the member banks. They do not like to borrow, they do not like to show indebtedness. I think you will find in some of the testimony before congressional committees the statement made by officers of some reserve banks that the trouble with the rediscount is not that it is not effective, but that it is ordinarily too effective against member bank borrowing to enable the system to use it when it wants to create "easy money" or an expansion of credit. But, almost by the same token, it has proved in its actual application an ineffective instrument for forcing a contraction of credit except by punitive and destructive rates.

The CHAIRMAN. Of course; and for that reason they have resorted to the open-market operations and the open-market operations have practically submergered the rediscount operations.

Mr. MILLER. That is true. But what I have in mind is not withdrawing the open-market operation from use, but restricting its use to rare occasions when resort to it may be truly necessary. It is in the nature of a surgical operation of great value and essential in circumstances.

The CHAIRMAN. It is not proposed here to withdraw the 15-day privilege. Frankly, it is my view that it ought to be repealed, but this is a proposed modification of it.

Mr. MILLER. Yes. I should regret to see it repealed; it would not, I think, be practicable to repeal it.

Senator BULKLEY. I do not yet see your objection to prohibiting the member bank from increasing security loans at the same time it has its secured bills with the Federal reserve banks.

Mr. MILLER. Well, let us look at Chart IV, "Brokers' loans." It will be noticed that funds, as witness 1927, pour into the call-loan market from all over the country, whenever there is an accumulation of banking reserves beyond what the banks can find good use for at home. The banks usually send the most considerable part of their surplus money to New York—usually for investment in call loans, especially when the rate on call loans is attractive. Bankers still use the phrase that was current in pre-Federal reserve days, and describe the call loan as "secondary reserve." Among the interior

banks it is so treated and used. The advantage of a good secondary reserve is that you can get it when you want it and in the meantime get a return on it. In other words, when you call your loan, you must be sure that you will get the money, otherwise it is a poor reliance as a secondary reserve.

Now, in practice, as loans are called in New York, in any considerable volume, by interior banks, there are going to be great gyrations in the call rate, perhaps at times flurries in the stock exchange and even panicky conditions, unless the banks of New York can stand under the situation and take over the loans called by the interior banks in whole or in part. The result is that the New York banks—I do not mean the reserve bank, but the large New York member banks—whether they like it or not, but simply because they are the leading banks in the leading money center of the country, are obliged to step into the breach and assume an obligation to the money market—even those who would prefer not to become thus involved.

The CHAIRMAN. Some of them do not seem to think they owe one whit of obligation to the Federal reserve banking system.

Mr. MILLER. I am the last who will deny that. That is, or rather was, only too true.

Mr. WILLIS. One point right there, Mr. Miller: You spoke of call loans as a secondary reserve. Yesterday I think it was stated that whenever pressure was brought on a bank the first thing it did was to call in its call loans. Is it not a fact that a large percentage of present call loans are frozen, that is, they are call loans only in name and only a small fraction, relatively, are call loans in fact?

Mr. MILLER. I would not admit that, Mr. Willis. I would say the call loan to-day is a highly liquid loan.

Mr. WILLIS. The statement of many people is that you can not call the loans without causing disaster.

Mr. MILLER. Why, \$5,000,000,000 have been called since September, 1929. Look at the "Brokers' loans" chart (Chart IV). No banking system in the world has ever been subjected to the pressure and the test that the New York banks were in the last part of 1929. Loans were called, they were met, they were liquidated; and the marvelous thing is that the banking situation in New York at that time had the strength it had. Of course it would not have had it if the Federal reserve bank had not been across the street with its vast resources to supplement—

Mr. WILLIS. You are speaking of an operation that occupied a number of months.

Mr. MILLER. It might be said to have been an operation that occurred within a short period of time, about \$3,500,000,000 were liquidated in two and a half months, so far as the heaviest withdrawals and the acute pressure were concerned.

The CHAIRMAN. What would have happened if the Federal reserve system had not been in existence?

Mr. MILLER. Pardon me, Mr. Chairman. I think it well worth while to put into the record at this point that a billion of call loans were taken over by the New York banks—

Mr. WILLIS. At the height of the panic?

Mr. MILLER. A billion of loans were taken over in a single week.

The CHAIRMAN. What would have happened to the country if it had not had the Federal reserve system?

Mr. MILLER. If we had had no Federal reserve system, Senator, I do not think we would have had as bad a speculative situation as we had, to begin with.

The CHAIRMAN. We have had ruinous speculative situations when we had no Federal reserve system.

Mr. MILLER. We have had, yes, but I doubt whether we would have had as bad a one as developed from 1927 to 1929.

The CHAIRMAN. Of course not. You have made that clear, that the Federal reserve system provided a terrific expansion by these open-market transactions.

Mr. MILLER. I do not want, however, to give an exaggerated sense of their importance. The importance of those open-market purchase operations is their timing. It is not what they contribute in the way of funds over a long period of time, but what they do at certain brief periods of time to create redundant and therefore unhealthy credit.

I was going to say, on the amendment, that anything which seriously threatens the liquidity of the call loan market in New York—well, would be a mistake. It can not be done. Therefore, if you should proceed with your amendment, with the purpose of which I am in the most complete accord—and by purpose I mean to restrict the use of Federal reserve credit in speculative loans—

The CHAIRMAN. To a reasonable percentage.

Mr. MILLER. Yes, I would think it advisable to add a proviso that would give the board the power, when the public interest required it—say, in a time of emergency—to suspend the restriction for limited periods of time—not over 10 days, perhaps, at a time; and, then only on affirmative vote of five members of the board.

The CHAIRMAN. The operation of the provision was only intended for an occasion of that sort.

Mr. MILLER. Yes. Well, as I understand the provision, it would estop any bank from borrowing on its bills payable at the Federal reserve bank when it increases its loans on call.

The CHAIRMAN. On its direct 15-day note?

Mr. MILLER. Yes. When money is withdrawn by an interior bank—say, in Cleveland—from New York, it exerts pressure on the money market in New York. Either you let that thing work out its effect or you try to ease the operation in some way so as to give it less of a disturbing character. For instance, when New York was in a near-panic condition in the last week of March, 1929—I think it was the 26th or the 27th of March, and I think it was in connection with that situation, Senator, that the statement was made by the gentlemen to whom you referred this morning—that condition was immediately due to the fact that a large interior bank had decided to readjust its position in accordance with the expressed desire of the Federal Reserve Board and began to call in its loans. It did not call loans in New York. It called them in another market. But even so, the pressure it put upon that other market forced those whose loans were called, to try to get accommodation elsewhere. For the moment they were between the devil and the deep blue sea. The only other market to which they could go was New York.

Now, I take it, it is not your purpose to tie up the Federal reserve system so tight that we may have these little panics from time to time which have no bearing upon an improvement in credit conditions, but which would come to what might be called an inelastic, rigid,

mechanical lockup of the money markets of the country at times. I do not conceive how we could operate in this manner, unless the country feels that there is virtue in the old-fashioned panic, and that when we have a panic, it had better be a quick and all-embracing one, a complete liquidation and clean-up, with tremendous mortality in the business and financial world, and yet, when——

The CHAIRMAN. Well, why not go back to the old system, and throw our reserve funds and the whole country into the maelstrom of stock speculation?

Mr. MILLER. Because I think we can operate our present machinery with results that, on the whole, will be much better than the old system and will, if competently handled, avoid both the excessive booms and the later disastrous breakdowns. That is the primary function of the reserve system. And it stands a failure unless it can meet that test.

The CHAIRMAN. It was never intended that our machinery should be operated so as to support speculative call market operations.

Mr. MILLER. Well, I am satisfied that if the reserve system has its hands tied against too easy a yielding to the seductive expedient of inflation through open market purchase operations, we need not worry so much about speculative abuses and excesses. The only nullifying influences against a prudent Federal reserve attitude that might happen would be uncontrollable imports of gold, which would put the member banks in an independent position. That, as you know, has been a large factor since the war.

The CHAIRMAN. It is half-past 1 now. Some of the members of the committee want to go to lunch, and I have no doubt you gentlemen do also——

Senator BULKLEY. I should like to take just one minute more to try to understand that thing. I do not just understand the force of this objection to section 11. Do I understand you to say that all of the banks would be likely to be struck at the same time with that same pressure, and just because you deny a single bank the right to carry on those operations under section 11, the whole structure would fall?

Mr. MILLER. No; I think we may be discussing different matters.

Senator BULKLEY. What I am discussing is the rule proposed in section 11, that the banks should not simultaneously borrow on a 15-day security note and at the same time increase their security loans.

Mr. MILLER. I think it would prove unworkable, except at the cost of occasional serious stringencies in the leading money market of the country.

Senator BULKLEY. You started to develop the proposition that there might be a pressure from some outside place, and New York might want to take over those loans called somewhere else.

Mr. MILLER. The "Brokers' loans" chart (Chart IV) gives a very good illustration of the matter in 1929. It is an exaggerated one, of course. But the curves make clear that the tremendous liquidation of loans which occurred in the call market was accomplished in part by the New York banks expanding theirs [indicating]. What would have happened if these loans could not have been liquidated? We might have been back on a clearing house basis. It was the liquidation of those loans that perhaps did more than any one single thing

to prevent the breakdown in the autumn of 1929 from becoming a crisis and prostration beyond anything ever before experienced.

Senator BULKLEY. Unquestionably that facility was necessary to be used in that emergency, but there having been no restriction before, the banks all felt they had that facility to rely upon. But what if they felt they could not do that?

Mr. MILLER. That is a different matter, a very different matter.

The CHAIRMAN. How did they operate before they could borrow on their 15-day paper?

Mr. MILLER. Let me have your question again, Senator.

Senator BULKLEY. I asked you why this restriction in here is not practical, and you assured me that it would have been very terrible at the time of the crash in 1929 if this facility had not existed. Now, I answer of course it would have been terrible to withdraw it at that moment and there would be no solution of it, but what if all the time, for all of 1929 and the years back of 1929, the banks had known in advance they would not have that facility to rely on? Would not they have steered a much better course?

Mr. MILLER. I doubt whether it would have made a big difference, though on that I do not feel sure. I doubt whether it would, because, as I have already said, the member banks were sinned against by having been inflated from the outside. It sounds a bit extravagant, perhaps, to hear that, but it nevertheless throws an essential light upon the facts. The Federal reserve by its open-market policy practically forced them to make the call loans complained of.

What was the object of Federal reserve policy in 1927? It was to bring down money rates, the call rate among them, because of the international importance the call rate had come to acquire. The purpose was to start an outflow of gold—to reverse the previous inflow of gold into this country. I am holding no brief for the New York banks, but I think if I had been the head of one of those banks, I should have been very much troubled in 1927 and 1928 as to what my duties were to my customers, to my stockholders, and to the situation. Frankly we must admit the fact, that under the reserve system there has, perhaps inevitably, taken place a relaxation of the sense of individual responsibility that the banker feels for his own safety and for the general situation. He swims with the tide and looks to the Federal reserve to regulate the tide.

The CHAIRMAN. That is the responsibility we are trying to impose upon him by this amendment.

Mr. MILLER. I think the responsibility for maintaining good credit and banking conditions belongs in the first instance, on the reserve banks, of which there are only 12. The member banks number thousands. The reserve banks should be the leaders. It is their business through sound policies and practices to control.

Senator, there was no great variation in the average amount of call loans made by the New York City banks during the years 1927 and 1928, except in the latter part of that year, until we come to the panic of 1929. They attained their quota back in 1924-25.

How was the situation met at the time of the crash in 1929? As far as the call loan market was concerned, it was met by a precipitate decline in the total volume of call loans, by a rapid decline of the volume of call loans of outside banks and a precipitate rise of the volume of loans of the New York City banks. The call-loan market was under

terrific pressure by reason of vast withdrawals of funds and the New York banks stepped into, and had to step into the breach to avoid an even worse catastrophe than actually occurred in those critical weeks of October and November, 1929.

The CHAIRMAN. This provision was intended to preclude the necessity of pressure.

Mr. MILLER. So I interpret it. But it must not be overlooked that we start now with an abnormal condition—that the New York banks have been holding the bag for a very large number of call loans that have been in liquidation ever since the panic of 1929. By force of circumstances, they have had to assume more call loans than they wanted. They could not I think, operate, if we experienced a considerable revival of business, without some difficulty, if they were denied access to the Federal reserve banks for funds, because of the contingent liability they have been forced to assume in connection with the call loan market.

Senator BULKLEY. I hope you do not feel we are doing this as a measure of discipline against the banks.

Mr. MILLER. No; sanitation.

Senator BULKLEY. That is it.

Mr. MILLER. I am with you, but want to point out some difficulties.

The CHAIRMAN. If it is agreeable to you, gentlemen, we will adjourn until 3 o'clock and try to conclude the hearing.

(Whereupon, at 1.45 o'clock p. m., the committee recessed until 3 o'clock p. m.)

#### AFTER RECESS

The subcommittee resumed its session at the conclusion of the recess at 3 o'clock p. m., Hon. Carter Glass, chairman, presiding.

The CHAIRMAN. The committee will come to order. Doctor, in order to save time, I am authorized to count some of my colleagues as present here, and Doctor Willis, the expert adviser of the committee, wants to ask you one or two questions. Would you mind excusing me?

Mr. MILLER. Certainly not.

The CHAIRMAN. And you may just proceed. Then I want to ask you one or two questions myself.

Mr. WILLIS. I just want to clear up a question or two, Doctor Miller, that I thought were left over from this morning.

Mr. MILLER. Yes, sir; that will be agreeable to me.

Mr. WILLIS. I have no new questions to speak of. In your testimony this morning with reference to the open market operations you spoke of the general effect of the open market sales, and I want to ask you this specific question: Do you think that a sale of the open market portfolio of the reserve banks brings about a real contraction of credit, or does it simply lead to increased borrowings on the part of member banks at reserve banks, perhaps on the very securities that have been sold?

Mr. MILLER. Yes, sir. It has, I think, never effected a noteworthy contraction of the general volume of credit.

Mr. WILLIS. Never?

Mr. MILLER. Never, except as to its own credit outstanding and the only important instance of that since 1922 occurred in 1929 in the first half year when "direct pressure" was being applied. Dis-

count policy has usually shifted the load of credit supplied by the Federal reserve banks from the open market portfolio to the portfolio of bills discounted, bills payable, and sometimes, notably at the end of 1928, to acceptances. What it does do, however, is to make money firmer, and to firm money conditions by reason of the fact that the member banks, generally speaking, have a rather salutary prejudice against borrowing unnecessarily. They are not, therefore, much disposed to extend themselves when they are in debt to the Federal reserve banks. And hence the familiar statement of the two leading working principles of the Federal reserve system; to ease money, buy securities from the open market; to firm money, sell securities to the open market and put the member banks under the necessity of rediscounting.

There is a view current in the reserve system that the mere fact that member banks are obliged to rediscount after a period of easy money in itself works a sufficient correction of the credit position; in other words, that the fact of rediscounting, rather than the actual rate of rediscount imposed by the Federal reserve system, is the important thing in working away from an easy money position. That theory, in my judgment, in the light of the actual experience of the Federal reserve system, needs very serious qualification. I should say that overconfidence in the validity of that principle is, in a very large measure, responsible for the ineffective discount policy pursued by the reserve bank of New York in the year 1928.

Mr. WILLIS. Have you found that where sales took place in the open market in the portfolio, I assume, of Government securities, they not infrequently resulted in increased borrowings on the basis of those very securities?

Mr. MILLER. On the basis of like securities; yes.

Mr. WILLIS. I do not mean upon the identical units. I mean, has that not increased frequently the borrowings on the same class of securities?

Mr. MILLER. On the basis of Government securities, I think that is undoubtedly true.

Mr. WILLIS. And what would be the effect then of such a circular transaction as that?

Mr. MILLER. Such as what?

Mr. WILLIS. Such a circular or repetitious operation as that.

Mr. MILLER. I tried to point out the effect. It puts the banks under pressure.

Mr. WILLIS. Yes, sir.

Mr. MILLER. And, if you please, in a time like the present it might tend to exercise an undesirable firming of money. The banks are extremely reluctant to show borrowings from Federal reserve banks. It is, on the whole, a very healthy and a very desirable feeling, but it sometimes deters resort to the Federal reserve banks under conditions that may make such resort desirable and legitimate. Such are present conditions.

Mr. WILLIS. Yes, sir.

Mr. MILLER. But in periods of expansion the mere fact of rediscounting is not an adequate deterrent. That is abundantly demonstrated by what took place in 1928. An effective discount control in a time of inflation requires teeth in the shape of rates—stiff rates.

Mr. WILLIS. I have a further question of theory that I would like to put merely by way of closing up something that I think you have very clearly stated. As a result of the experience of the past few years do you think that the reserve system can control the use to which the credit is put as distinct from its amount? Can it control the use to which credit is put at all?

Mr. MILLER. Yes, sir; I think so, within broad categories of credit.

Mr. WILLIS. Without qualification?

Mr. MILLER. Yes, sir; without qualification.

Mr. WILLIS. Now, may I ask you one question about the organization of the open-market committee of which you spoke this morning? Is that a successor to the governors' conference that was originally established?

Mr. MILLER. No. The governors' conference still continues.

Mr. WILLIS. Independent of this committee?

Mr. MILLER. Yes, sir. At times the two overlap in practice, because their membership is identical. The lines are not, therefore, drawn narrowly between them. At the present time, as I think I pointed out this morning—at any rate I meant to—the constitution of the open-market committee calls for a membership of all 12 Federal reserve banks.

Mr. WILLIS. Governors?

Mr. MILLER. Governors, yes, sir, have been designated by the banks as representatives.

Mr. WILLIS. So it has the same membership as the conference?

Mr. MILLER. It has the same membership as the conference.

Mr. WILLIS. But it has different meetings and is a different body entirely?

Mr. MILLER. It is the same body of men but in a different capacity.

The CHAIRMAN. I have understood, Doctor, that the governors' conference was practically defunct. I have understood that by action of the Federal Reserve Board itself the governors' conference is not permitted to function except upon request or suggestion of the board.

Mr. MILLER. That is correct. It is and has long been in effect a conference with the board.

The CHAIRMAN. Yes.

Mr. MILLER. And the call for the conference is issued by the board. And I think it is also a fair statement to say, not that it is defunct, but that its deliberations are mainly confined to technical matters.

The CHAIRMAN. What I mean is it seemed to many persons, and apparently to the board itself, that the so-called governors' conference bade fair to usurp the proper functions of the board itself, and there had to be restraint upon that situation.

Mr. MILLER. Yes, sir; I think that is true. I think it was in 1916 or 1917 that the board felt some concern in the matter, and it was then that it decided that these conferences should be held only when called by the Federal Reserve Board. And that meant that they be held in the board's offices in Washington, not elsewhere,

In actual operation, and I want to call your special attention to this, the reconstitution of the open market committee provides for 12 members, and those 12 members are by designation of the banks their governors. The Governors' conference consequently is relegated to a subordinate position, except as to this, that usually when the



governors meet in conference and on the call of the board in the spring of the year and in the autumn of the year they consider open-market matters. That is, they meet as a governors' conference and then as an open-market conference.

Mr. WILLIS. How often does the open market committee meet?

Mr. MILLER. It has no regular meeting, no regular meeting date.

Mr. WILLIS. But on the average it would meet about how often?

Mr. MILLER. It has met in the last year more frequently than ever before. I would be very glad to supply that for the record. I should say possibly, including two governors' conferences, which resolve themselves into open-market committee meetings, anywhere from five to seven times. (There were 11 meetings altogether held in 1929 and 1930.)

Mr. WILLIS. And does that committee in the interim have other meetings? The functions of that committee—are they exercised by a small subcommittee which is instructed at the general meeting?

Mr. MILLER. Senator, would you like to have a copy of the constitution of the open-market committee?

Here is the present procedure:

OPEN MARKET PROCEDURE AS ADOPTED BY THE FEDERAL RESERVE BOARD MARCH  
25, 1930

(1) The open market investment committee, as at present constituted, is hereby discontinued and a new committee, voluntary in character, to be known as the open market policy conference, is set up in its place.

(2) The open market policy conference shall consist of a representative from each Federal reserve bank, designated by the board of directors of the bank.

(3) The conference shall meet with the Federal Reserve Board upon the call of the governor of the Federal Reserve Board or the chairman of the executive committee, after consultation with the governor of the Federal Reserve Board.

(4) The function of the open market policy conference shall be to consider, develop and recommend policies and plans with regard to open market operations.

(5) The time, character, and volume of purchases and sales shall be governed with the view of accommodating commerce and business and with regard to their bearing upon the credit situation.

(6) The conclusions and/or recommendations of the open market policy conference, when approved by the Federal Reserve Board, shall be submitted to each Federal reserve bank for determination as to whether it will participate in any purchases or sales recommended; any Federal reserve bank dissenting from the proposed policy shall be expected to acquaint the Federal Reserve Board and the chairman of the executive committee with the reasons for its dissent.

(7) An executive committee of five shall be selected from and by the members of the conference for a term of one year, with full power to act in the execution of the policies adopted by the open market policy conference and approved by the Federal Reserve Board, and to hold meetings with the board as frequently as may be desirable.

(8) Each Federal reserve bank participating in the open market policy conference shall be considered as waiving none of its rights under the Federal reserve act; each Federal reserve bank shall have the right at its option to retire as a member of the open market policy conference, but each bank while a member of the conference shall respect its conference obligations.

The CHAIRMAN. It might be well to have it for the record.

Mr. MILLER. Yes, sir. There is an executive committee consisting of five reserve banks, those being the banks of New York, Boston, Philadelphia, Cleveland, and Chicago, the five largest reserve banks that are in the near-by territory. The San Francisco Bank by size would properly be a member of that committee, but it is too remote to make it practicable for the governor of that bank to be ready to

respond on short notice to calls for a meeting of the executive committee.

Mr. WILLIS. I have one more matter, and then I have finished. In regard to the foreign relations of the system, are those in any way brought now to the attention of the board regularly for consideration, approval and the like, or how are they managed?

Mr. MILLER. I should say that if you mean by foreign relations, operations that involve the Federal reserve banks, those operations being subject to the approval of the Federal Reserve Board, are necessarily brought before it. I think there are some matters affecting foreign relations or contacts that have not yet been settled, or at any rate settled satisfactorily, that still need adjustment. There is some difference of opinion, at any rate, among the members of the board, some feel a concern about the scope of some of these relations and these operations as they have sometimes been handled—particularly in the informal and preliminary stages. But it looks as though there is going to be improvement in this respect.

Mr. WILLIS. And do you think the board should authorize or share in conferences with the heads of other central banks or the foreign central banks?

Mr. MILLER. The board has no direct official contact with central banks. I think the central banks of Europe, following tradition and habit, regard a contact as a contact from bank to bank. So that the Federal Reserve Board, not being an operating board or a bank, not conducting a banking business, or itself in a position to open any accounts at the instance of a foreign central bank, is regarded as not immediately involved in an operating sense. The result is that the usual contacts are between the banks themselves or their representatives.

The CHAIRMAN. Has not that produced the impression abroad that we have a central bank in the United States, and that that central bank is the New York bank?

Mr. MILLER. I think that impression has existed to a certain extent, I would say to a considerable extent.

I was abroad last summer and I should say that it does not exist to the same extent it formerly did; and let me add, in a spirit of frankness, because of some diminution in the prestige of the American reserve system in the eyes of some European bankers, I think they are becoming disposed to inquire more into the constitution of the reserve system. It has puzzled them. It seems a bit complicated in its set-up, and they do not know exactly just what are the relative positions of the reserve banks and the Reserve Board in the functioning of the reserve system.

The CHAIRMAN. Would you say that anything that detracts from the dignity of the supervising board rather has a tendency to minimize the importance of the Federal reserve system?

Mr. MILLER. I am not sure of that, Mr. Chairman. I would say that in the long run the importance of the Federal Reserve Board as a factor in the Federal reserve system is going to depend upon what it does rather than upon what it seems. A fully competent board will be accorded the respect to which it is entitled and will not allow itself to be pushed aside where it has ultimate responsibility.

The CHAIRMAN. I confess I thought it an extraordinary situation at one time when the heads of foreign central banks found it desirable

to visit this country and discuss the relation of those banks to our banking system. The only contact that the Federal Reserve Board, which is the central and supreme authority of the system, had with these gentlemen, was through the courtesy of the governor of one of the Federal reserve banks.

Mr. MILLER. Yes, sir. You are perfectly right in that. That was a rather sorry and shabby episode. On the other hand, if the Federal Reserve Board had taken a position at that time, as it was its power and duty to do, on the matter which was the occasion of the visit to which you have referred, I think the contact, brief and informal though it was, would have sufficed to leave the visiting central bankers in no doubt where the ultimate responsibility and source of power in the matters which brought them to the United States resides—in the Federal reserve system.

The CHAIRMAN. Doctor, there is a question that I would like to ask. I have hesitated to ask it lest you might be reluctant to answer; and that is in relation to one of the reasons of this proposed bill of mine having reference to the organization of the Federal Reserve Board itself, particularly as to the ex-officio members. In short, the bill proposes that the Secretary of the Treasury shall no longer be a member of the Federal Reserve Board. Would it embarrass you at all to make some comment upon that?

Mr. MILLER. Not in the least.

The CHAIRMAN. I would be glad to have your view of it.

Mr. MILLER. In fact, I think that question was asked me two years ago, when I appeared before the Banking Committee of the House.

The CHAIRMAN. Yes, sir; but I had no memory of that.

Mr. MILLER. I think that the Secretary of the Treasury should be eliminated from membership in the Federal Reserve Board. If I may continue, I would state my view about the constitution of the board as follows: A membership of seven with no ex-officio members.

The CHAIRMAN. Not even the Comptroller of the Currency?

Mr. MILLER. Not even the Comptroller of the Currency. I have reached that conclusion after long years of experience. It is a very deliberate and a very firm conclusion.

I am satisfied that the Federal Reserve Board will never function nearly as well as it might and should as long as it is not an absolutely independent body, made up of men of strength, independence, ability, and leadership. Because it will become more and more difficult as we go along to induce men to come on to the board of the character and kind that must be on the Federal Reserve Board, if it is to do its job, unless they can feel that they are masters in their own house.

The CHAIRMAN. I was about to observe that while we greatly desired, and while we zealously sought to exclude what is commonly known as politics from the Federal reserve system, it was felt that in that larger and better sense there should be some way of having the public opinion and judgment of the country operate. That means to say, were we to have a board that seemed to be flagrantly derelict in its concern for the public interest, the proponents of the original bill felt that there ought to be some way of reaching a board, if we unhappily should have such a board, through changes of Government, and that, among other reasons, constrained those of us who had to do with the thing to put on these ex officio members.

Mr. MILLER. Of course, if the board is constituted as a really independent body, like the Interstate Commerce Commission, and a member is guilty of a flagrant violation of his responsibilities, or even an incompetent discharge of his duties, the corrective, I should say, would be the removal of such member of the board.

The CHAIRMAN. By the President?

Mr. MILLER. Yes, sir; by the President under power specifically mentioned in the Federal reserve act.

The CHAIRMAN. Of course, that, we felt, was another method of reaching the board.

Mr. MILLER. That, I think, is sufficient.

The CHAIRMAN. But I agree with you, and I have been very decidedly of the opinion ever since I happened to be, for a brief period, Secretary of the Treasury, that the Secretary of the Treasury ought not to be a member of the board for several very important reasons; in the first place, he has so many other duties of a complex nature that require his constant attention that he has not any time for the Federal Reserve Board. From past experience and observation I am led to doubt that the Secretary of the Treasury attends a meeting of the board half a dozen times in a period of 12 months.

Mr. MILLER. That has varied. Sometimes it has been more frequent but usually and for the most part very infrequent. But he may and frequently has been a factor even when not attending meetings.

The CHAIRMAN. Then, again, some of us felt, after the system had begun to operate, that the Secretary of the Treasury, whether intentionally or unintentionally, exercises an undue influence upon the activities of the board, and undertakes to draw it to the necessities of the Treasury rather than of the commerce of the country.

Mr. MILLER. The secretaries of the Treasury have not been much of a trouble in recent years. That has not been the trouble.

I would be inclined to suggest that if you are going to limit the ex officio membership to one, that I would prefer to see you eliminate the Comptroller of the Currency. There is at least this important consideration for that: The Secretary of the Treasury is usually, I would say regularly, a man of outstanding position and character. He is regarded by the country as one of its most important officers. He has a reputation. He may, by bad advice, involve the good reputation of the administration of which he is a member. He is exposed to criticism. Without disparaging in any way the men that have occupied the position of Comptroller of the Currency, the type must be admitted to be quite different, nor may we overlook the fact that the office of the comptroller is one that is subjected to great pressure, sometimes of a political nature and at times to pressure when not political, that comes pretty near the border line of the undesirable.

The CHAIRMAN. By the tenure of the comptroller he should be a more important official than the Secretary of the Treasury. He is required to report to Congress, and not to the Secretary of the Treasury. He has a term of six years that overlaps the changes of parties, or the changes of administration, rather.

Mr. MILLER. The position should be, I think, regarded as one of the most important in our whole executive mechanism. The comptroller's

office is certainly one of great difficulty and multiplicity of duties, particularly in times of banking strain.

The CHAIRMAN. You would not abolish then, I understand, the office of the Comptroller of the Currency?

Mr. MILLER. I am not prepared to say. I think that is one of the most difficult questions in the whole machinery of the Government's contact with the banking organizations of the country on which to reach a satisfactory decision. I have thought at times that it might be well to transfer the functions of the comptroller to the Federal Reserve Board. I am of the opinion now that that would be a mistake, that it would turn the Federal Reserve Board into a board of review of banking delinquencies. I have thought that if the appointment of the comptroller could be made subject to the approval of the Federal Reserve Board, that might be of value; also, if the comptroller were to have his contacts with the Federal Reserve Board, where he now has them with the Secretary of the Treasury. But I am not clear as to all this as yet. It presents a most difficult administrative problem. I may have something to suggest to the committee later on.

The CHAIRMAN. Doctor, unless you have some more observations that you desire to make we will excuse you.

Mr. MILLER. I would like to say just a word, on a matter on which I was interrupted this morning. It is with regard to the gold policy of the Federal reserve system.

There has been a vast amount of talk from time to time in the European press and in the American press, in speeches and essays, about the necessity of redistributing the gold of the world. And the enormous holdings that the United States possesses have frequently been alluded to as holdings that must be redistributed before the world can function properly. Something of that philosophy was involved, I think, in the determinations of the Federal reserve system in 1927 when it engaged in its great easing operation in the money market and brought money rates down to the point where an outward flow of gold was stimulated. This flow carried out almost six hundred millions of gold, a trifle less, by midsummer 1928. It was a gigantic operation—without a parallel in peace-time history.

As an economic proposition, among countries on the gold standard and maintaining a free gold market there can be no such thing as a maldistribution of gold of any great extent or duration. Nor can gold be redistributed on any large scale or for any length of time by the process of central bank control of money rates. You might as well talk about digging a hole in water as talk about rearranging the relative levels of gold in the different countries by an artificial maneuver.

And a rather notable thing is brought out on the gold chart, Senator, which you will be particularly interested in (Chart III). It is a notable phenomenon that much, if not most, of the gold that was shipped out in 1927 and 1928 is already back. The fact is sometimes overlooked that gold is the preeminent instance of a commodity in which there is the nearest approach to absolute free trade, and that therefore gold has an inevitable tendency to go where it is of the greatest value or enjoys the greatest security. The gold that went from the United States to South American countries in 1927 and 1928 in connection with their programs of monetary restoration is pretty nearly all here again. The flow of gold is a thing that is

governed by economic law, rather than by decrees or policies of central banks. They can operate within narrow limits, but when it comes to great changes, or redistribution—why, it is impossible. The maldistribution of gold so much complained of at the present time as a chief cause of world maladjustment is evidence and an effect of the maladjustment of the economic and trade relationships of the leading countries of the world, not the cause. As these maladjustments correct themselves, in time, the maldistribution of gold will also correct itself.

The CHAIRMAN. Speaking of your foreign relations, upon what statutory authority would the Federal reserve bank guarantee a loan of \$200,000,000 or \$250,000,000 to one of the foreign countries?

Mr. MILLER. It opened a credit.

The CHAIRMAN. Yes, sir; I mean a credit.

Mr. MILLER. It was and is my belief that there is no authority in law for it. I think the legal opinion under which it was undertaken was that the authority was implied in the powers of reserve banks to engage in the purchase and sale of gold.

The CHAIRMAN. Implied functions sometimes, if not often, vitiate the real purposes of a law. Is not that so?

Mr. MILLER. Yes, sir, Mr. Chairman. That is so.

The CHAIRMAN. That is all, Doctor, unless you have some further observations to make.

Mr. MILLER. I have nothing further to say at this time.

The CHAIRMAN. We are greatly indebted to you. It has been one of the most illuminating and educational hearings to-day that I have had the satisfaction of participating in, and we are greatly indebted to you.

Mr. MILLER. I thank you very much, and if there is anything more that I can do for the committee, I am ready to do it.

The CHAIRMAN. We thank you. We will be very glad to have any form of suggestion of modifying the existing laws, or anything of that sort.

Mr. MILLER. And in accordance with the request, I think made by you, or some of your colleagues this morning, I may submit a memorandum later on.

The CHAIRMAN. Yes, sir. We will be very glad to have you do that.

Mr. MILLER. And the documents, too.

The CHAIRMAN. Yes, sir. And if you care to, you may revise your remarks here.

Governor Hamlin, we would be very glad to hear any statement you care to make in respect to this.

#### STATEMENT OF HON. CHARLES S. HAMLIN, MEMBER OF THE FEDERAL RESERVE BOARD

Mr. HAMLIN. Mr. Chairman and gentlemen, I am very glad to appear here in response to the request of the committee, and I want so say in advance that I am going to express only my personal views, and not necessarily those of the Federal Reserve Board.

The CHAIRMAN. We do not understand that you are going to express any views of the board. We want your views as an original and continuous member of the board.

Mr. HAMLIN. I shall state my views simply, and I want it understood that in stating them that if I differ with any policies undertaken by the system that I am not undertaking to criticise any one Federal reserve bank, and that for the purposes of what I have to say I am ready to assume that I am jointly responsible with any bank apparently criticised.

The testimony given yesterday indicating that a certain bank did not approve of the so-called direct pressure of our board, and did not approve our refusal to permit the increase in discount rates, and the statements made in connection with both, seem to me to make it incumbent upon me to tell the facts which governed my action to the Senate committee.

A great deal has been said in the press about this so-called controversy between the Federal Reserve Board and the Reserve Bank of New York in the matter of raising the discount rate. It is not proper to call that a controversy. The Federal Reserve Board has a distinct duty, the power to review a rate initiated by a Federal reserve bank. The fact that the board, in exercising its power of review may not approve the rate initiated by the bank should not be called a controversy any more than to call a decision of the Supreme Court of the United States a controversy when it overrules the decision of a lower United States court. Each party was acting under its lawful right, the bank to initiate the rate, and the Federal Reserve Board to review the rate.

There is another misapprehension that has formed the basis of a great deal of the criticism made of the Federal Reserve Board throughout this so-called difference of opinion. It seems to be almost universally assumed that the difference between the board and the New York bank began February 14, when that bank asked to increase its rate to 6 per cent, and continued until August 9, when the board, it is claimed, reversed itself, and agreed to the increased rate of 6 per cent. I think that is one of the fundamental errors that has been going around through the press and the minds of many bankers, and I want to say emphatically that this so-called policy of direct pressure began February 7, when the board issued its warning, and was suspended by the board early in June, and a formal note to that effect was sent to the Federal Reserve Bank of New York on June 12. But, as a matter of fact, it was practically suspended, or agreed to be suspended, the very latter part of May or, at the latest, very early in June, for on May 22, the governor and chairman of the Federal Reserve Bank of New York came before the board, and on May 31 the chairman, Mr. McGarragh, wrote the board a letter, in which he said that under the so-called direct pressure the banks were really afraid to borrow at all, and that there was coming a time very soon when there would be an absolute necessity for more Federal reserve credit—I think he intimated perhaps 100,000,000 more; and that as to the discount rate, while they still would like to have it advanced, yet that had become relatively unimportant as compared with reaching some understanding with the board toward easing our discount policy.

From that time on the discount rate divergence of policy practically went out of existence. As I have said, the board practically agreed then that it would suspend direct pressure for the purpose of enabling the banks to get the credit that they needed. That was not made public for obvious reasons. It, however, got into the public press

through an article by Mr. David Lawrence. I do not know how he got his facts, but his facts were essentially correct—that the board was satisfied with the result of direct pressure, and it determined that it would be wise for the present at least to suspend it. Now that is the real history. I shall come to that again in a minute.

And now, as to credit expansion. Comparing the years for the period covering 1922 to 1927, there was a very expanded condition; I won't say inflation, because I have never been able to define that term. I think to define Einstein's Theory of Relativity would be far easier, because every one has a different definition of inflation. So I am simply going to say there was, in my opinion, an undue expansion as between security loans and commercial loans covering the period of 1922 to 1927. In that period security loans increased three and nine-tenths billions for the reporting member banks, or over 100 per cent.

Commercial loans in the same period increased one and three-tenths billions, or merely 18 per cent.

In contrasting security with commercial loans I want to point out that the words "commercial loans" may be a little bit misleading. Of course, it includes all commercial loans. But the phrase we use in the Federal reserve, I think, is "other loans", because there are real estate and other loans in there. And, of course, on the other hand, under the title "security loans" there may be loans made for genuine agricultural or business purposes. But I merely draw that distinction in a general way knowing that the term "commercial loans" is not absolutely accurate.

In that same period, July, 1922 to 1927, the gold stock increased \$782,000,000 and the member bank reserves nearly \$500,000,000. The balanced that did not go into the member bank reserves went into the money in circulation. And on that increase of member banks' reserves during those years 1922 to 1927 the member banks expanded at a ratio of about 12 to 1, which seems to me to answer any claim that in any way we had "sterilized" this gold. If you take the annual averages for the years 1922 to 1928, you find that again it was largely the gold imports which formed the basis of this expansion, inflation, or whatever you want to call it, and only relatively the Federal reserve credit.

For example, in 1928, the average for the year of Federal reserve credit outstanding was \$79,000,000 less than it had been in the same period in 1922. So that it is fair to say in that period although the member bank reserves increased about \$500,000,000 yet gold stocks also increased about \$750,000,000, showing the expansion was primarily based on gold imports. But in that period there were three periods when the Federal reserve credit did increase, and that was when we were buying Government securities. From February to June 1922, the Government securities increased \$237,000,000, and the member bank reserves increased \$132,000,000.

From April to December, 1924, there was a similar increase in Government securities, and in 1927, the last quarter, another increase.

From the first two periods the increases caused by the purchase of Government securities went to the member banks and were used largely by them to take down their discounts. In 1927, however, there were not a large amount of discounts to be taken down, because the gold imports in the early part of the year had been used for this



purpose, and you had the expanded condition caused by buying Government securities without a material amount of discounts to be paid off. That was one of the reasons for the expansion explained by Doctor Miller.

You remember that it has been said that in 1927 on August 5, the rate was reduced to 3½ per cent, and I have heard a great deal about the disastrous result of that rate reduction, and that it produced easy money with all of its bad results. We must remember, however, that money was easy on August 5. When that rate reduction was made the discounts had fallen off. The Federal reserve bank was almost out of the market, as Governor Strong stated, and going down to the 3½ per cent merely recognized a condition that was actually existing. When the question came up of voting on that rate, I voted in favor of it, and I stated on the record that my reason primarily was because we had quite a severe depression over the country, and there was much unemployment; I thought at the time conditions were just beginning to turn. Agriculture, of course, had turned. I thought that if there ever was a time when a lower rate was wise it was when you had a depression just beginning to turn and which needed encouragement. I based it also, secondarily, upon the result it might have of sending gold over to Europe to help resume the gold standard, increasing purchasing power, and thus helping our manufacturing and agricultural exports.

Then we come to the 1928 firming policy, where in six months we sold \$400,000,000 of Government securities and made three increases of the discount rate up to July 13, 1928.

I agree with what was said yesterday that it might have been better if by July 13, 1928, we had raised discount rates to 6 per cent instead of 5 per cent, and I believe there might have been a chance that such a rate might have curbed speculation without injuring business. No such rate increase, however, was asked for by the Federal reserve bank. But whether that is true or not, even if we had gone to 6 per cent, by virtue of what happened during the latter part of the year I think it would have been useless.

In the middle of August, August 13, 1928, authority was given by the board to buy acceptances in the New York market, to take up any seasonal credit demand which might arise. And it is a surprising fact that while under this authority the seasonal credit was taken care of it was, in fact, much more than taken care of, by buying acceptances. About \$286,000,000 of acceptances were in fact bought, so that the Federal reserve banks finally held two-thirds of all the acceptances outstanding. So many were bought that the banks were able to take down \$193,000,000 of discounts with the proceeds. This was all during a time, as we supposed, of a steady, firming policy. These purchases, however, turned our policy from a policy of strict firmness into a policy of ease. And what was the result? Federal reserve credit in that period increased \$122,000,000; member bank reserves increased \$28,000,000; security loans of reporting banks increased \$127,000,000. Stock prices ran up from 150 to 192. Stock sales increased from 11.8 to 23 million average. Brokers' loans increased \$381,000,000, and the loans for others, of which we have heard so much, increased \$488,000,000. This was all between July 13, 1928, and January 1, 1929. One officer of a bank in a very able address delivered in New York in the middle of December stated that there was an excess

bought over the seasonal requirements, through acceptances of at least \$100,000,000. Such purchases do not necessarily increase Federal reserve credit outstanding, because you really exchange discounts for acceptances, but it produces a very decided easing effect. And these operations, taking out \$193,000,000 of discounts and putting in their place \$193,000,000 of acceptances, even though leaving the Federal reserve credit outstanding the same, had a distinctly easing effect, and it changed our policy from one of firmness into one of ease, and rates of customers began to fall.

To make a long matter short, personally, I believe that at that moment, January 1, 1929, the discount rate had ceased to be an effective instrument for curbing speculation which had developed into a perfect mania. While I would have been willing, looking back, to have voted for a 6 per cent rate in the middle of 1928, thinking that then it might have proved a curb, I felt that in January, 1929, it had absolutely gone by the board, and the discount rate would have been of no help to us whatsoever. I will take that up again in more detail in a minute.

On January 1, 1929, Federal reserve credit outstanding had increased \$226,000,000 over the amount outstanding on January 1, 1928.

For the year ending June 30, 1919, 1,114 banks were borrowing 80 per cent or more of the time, which we regarded a serious condition.

On February 2, as it has been stated, we sent a letter to the Federal reserve banks, not a public letter, but a letter to each bank, pointing out that Federal reserve funds had been seeping into speculative channels, and asking the Federal reserve banks what they had done to stop it, and how successful they had been in their efforts.

The CHAIRMAN. Did it just seep?

Mr. HAMLIN. I think "just seeped" describes the process, but perhaps you might say thrust at times. Certainly, there was always a seepage. At this time the acceptance rate was the same as the discount rate, 5 per cent. Now, I believed at that time that business and agriculture were entitled, had it not been for this speculative craze, to a lower rate than 5 per cent. And the majority of the board made up their minds that that was so, and that they must use some method, if possible, at least not to increase the rate to commerce and business, and use what we termed direct pressure.

The board, on February 7, issued a public warning that Federal reserve money had been going into use as the basis of speculative transactions, and calling on the banks to conserve, to cut down their unnecessary borrowings, and bring back the Federal reserve credit and put it back in its proper channels. Everybody speaks of that direct pressure as if the board approached the banks with a club. It was nothing of the kind. It was simply an appeal to the banks to cooperate with the Federal reserve banks, and to correct these conditions.

The board did not desire by that warning to bring about any radical deflation of speculative loans. It wanted gradually to attempt to put Federal reserve credit back where it belonged, and take it out as a basis of these excessive speculative loans.

The CHAIRMAN. Where it never should have been?

Mr. HAMLIN. Where in such quantities, at least, it never should have been. And in one statement which the board made it showed that fact. It has been said that we wanted to smash things, to smash

the stock market. There is nothing of the truth in that at all. This is fully disclosed in one sentence of the warning:

which, in the immediate situation, means to restrain the use, directly or indirectly, of Federal reserve credit facilities in aid of the *growth* of speculative credit.

And under that policy of gradual restraint we felt hopeful that we could bring back the Federal reserve credit without crashing or smashing any market or anything of the kind.

That board warning was issued February 7, 1929. On November 22, 1928, the Federal Advisory Council had met, and advised us to do this very thing. They did not call it direct pressure. They called it cooperation between the member banks and the Federal reserve banks, but they meant, of course, direct pressure. They made, however, one exception. They did not intend to intimate that there should be any restraint on customers' loans. I suppose they had in mind simply the brokers' loans.

On February 15, 1929, however, a week after our warning had been issued, the council came together again. The Reserve Bank of New York had initiated the rate of 6 per cent on the 14th, but when the council members met, they did not know what the New York Bank had done. They took up our warning entirely as an independent matter. And the council strongly endorsed the warning of the board, except they in effect said, "you men have not gone far enough. You have talked about speculative loans," meaning, they supposed, brokers' loans. "You have to go farther. You have got to bring about some way of restraining customers' speculative loans." As Doctor Miller said, there was no misunderstanding about that, because he put the question squarely to them. So the board's warning was approved. The council did something more, however—they filed a resolution with our board, which was never published, stating expressly that there should be no increase of discount rates until the efforts under direct pressure had been exhausted. That was very, very important. They not only indorsed what we had done, but they expressly said:

That we should not increase the discount rates until we had exhausted the efforts of direct pressure.

Now, what was the effect of that direct pressure? The table I have here shows that from February 9 to June 8, 1929—and that is about the period of direct pressure—security loans for all the reporting member banks decreased \$361,000,000; investments decreased \$262,000,000; acceptances decreased \$300,000,000, and the purchase of Government securities fell off \$44,000,000. On the other hand there was an increase in gold stock of \$173,000,000 and discounts increased \$140,000,000. But Federal reserve credit, however, decreased in that period \$193,000,000.

Of course the keeping of acceptances out of the Federal reserve banks by the high acceptance rates, threw an extra heavy strain on discounts. And in spite of that terrific strain we were able to keep the discount increase down to only \$140,000,000 and at the same time reduce the Federal reserve credit \$193,000,000. I think that those figures show that during the time in which direct pressure was in operation it was a distinct success in the Federal reserve system as a whole and also in the Federal Reserve District of New York, as opposed to the system, which latter figures I also will file.

Federal Reserve System

(The Federal reserve figures are weekly averages. The member bank figures are for weekly statement dates)

[In millions of dollars]

	Federal reserve credit	Dis-counts	Accept-ances	U. S. securi-ties	Mem-ber bank res-erves	Secur-ity loans	Com-mer-cial loans	In-vest-ment	Gold		
									Im-ports	Ex-ports	Cur-rency in cir-culation
1. January, 1928-January, 1929	+239	+503	+104	-364	-37	+796	+333	-24	-----	251	-19
2. February, 1928-February, 1929	+245	+391	+42	-208	-12	+924	+82	-45	-----	246	-33
3. Direct action, February 9, 1929-June 8, 1929	-193	+140	-300	-44	-68	-361	+444	-262	173	-----	+29
4. June 8, 1929-August 10, 1929	+62	+81	-24	+5	+31	+518	+189	-242	42	-----	+65
5. August, 1929-October, 1929	+41	-186	+234	-20	+10	-28	+253	-134	31	-----	+53

Federal Reserve Bank of New York

	Federal reserve bank credit	Bills dis-counted	Accept-ances	United States securi-ties	Mem-ber bank reserve bal-ances	Reporting member banks in New York City		
						Secur-ity loans	Com-mer-cial loans	Invest-ments
Period 1. Jan. 7, 1923-Jan. 5, 1929	+226	+243	+64	-80	-23	+344	+90	+37
Period 2. Feb. 11, 1928-Feb. 9, 1929	+39	+78	+10	-51	+2	+320	+16	+21
Period 3. Direct action, Feb. 9, 1929-June 8, 1929	-78	+1	-89	+2	-7	-179	+267	-78
Period 4. June 8, 1929-Aug. 10, 1929	+198	+168	+19	+12	-9	+283	+82	-90
Period 5. Aug. 10, 1929-Oct. 12, 1929	-161	-216	+60	-19	+15	-125	+108	-29

Another interesting fact is that, although the direct pressure was suspended in June, and a change was made in the discount rate, which I will explain in a minute, on August 9, yet even after that, right up to the time of the stock crash the Federal reserve credit outstanding increased for the system as a whole, comparatively little. It increased simply by the amount of the increased demand for currency in circulation.

The CHAIRMAN. Governor, what do you mean by saying that your warning was suspended? Do you mean that you thought that your warning was an inadvisable thing?

Mr. HAMLIN. Oh, no. The New York bank said that our direct pressure had affected the banks so that they did not dare to come to borrow at all, that there was going to arise a demand for more credit and that this might reach nearly a hundred million, and they said they did not want our board to keep that pressure on the member banks all the time to reduce their total borrowings when they have got to increase them to a certain extent.

The CHAIRMAN. They were only advised to reduce borrowings made on their speculative activities?

Mr. HAMLIN. Yes. And we never openly suspended anything. We simply said to the New York bank that those banks can go ahead and borrow where it is absolutely necessary for commercial purposes. As a matter of fact, we never questioned any bank's right to borrow for strictly commercial purposes. But to make things clear we made that statement. Now, as I have already said, the news got out.

The CHAIRMAN. But why terminate advice to banks not to use Federal reserve facilities either directly or indirectly for speculative purposes?

Mr. HAMLIN. We simply in the first instance, at least, brought pressure to bear on the total amount of borrowings they were making, no matter how they were produced, by speculation, or by other loans which could be cut down, or by investments which could be reduced.

The CHAIRMAN. That was not the text of your warning though.

Mr. HAMLIN. The text of our warning was that they must reduce their use of Federal reserve credit, they must reduce their participation in speculative loans. I think the warning covered all sorts of speculative loans, except, of course, commercial loans. But we never openly and publicly revoked that warning. We simply told the New York bank that on those banks, as they had to borrow for commercial purposes, we would not continue our pressure to reduce total borrowings. That was all of the suspension of the warning given out, and I merely used the word "suspension" because in our letter of June 12 explaining the position I think that phrase was, perhaps not advisedly, used.

To our letter of February 2, which we sent out, asking what they had done to stop Federal reserve credit going into speculative channels, Mr. McGarrah, on February 21, 1929, sent a letter to the board telling what they had done along the lines of so-called direct pressure. It is a very long letter and I am merely going to give this very brief synopsis. He said his board had special reports as to banks borrowing for profit or too much, or too continuously, in relation to other comparable banks, and banks which had a voluntary investment policy for profit rather than for loaning in response to demands of their customers. Then he added that the above had little effect as to controlling the total amount of credit outstanding. Then he took up the large New York City banks. He said that they had usually adjusted their position when advised that they are out of line, or acting contrary to our general policy. Apparently the direct action was confined largely to banks out of line, that is, banks which are borrowing more than other banks comparable with them as to size. But we thought that pressure should be applied just as much when all banks are engaged in encouraging speculation as when one bank gets out of line by borrowing a little more than other banks of its size. After describing the kind of pressure exerted, however, Mr. McGarrah said that the above has not been very effective in controlling the total amount of credit.

Governor Harrison stated the other day that the procedure outlined by Mr. McGarrah in his letter of February 21, 1929, together with discount rate increases, were the best ways of controlling credit, but as I have just stated, Mr. McGarrah in this letter stated that the procedure outlined was not very effective in controlling the total volume of credit. Thus, according to the views expressed by the governor, there would be little left in the way of control except the use of the discount rate.

On May 1, 1929, the board sent another letter to Mr. McGarrah which led to another issue. The board in that letter, sent a list of New York City banks which were borrowing continuously or frequently, and which were also carrying quite a large volume of security loans, including brokers' loans, and customers loans, and we requested him to take up the matter with those banks, and ask them why they had not adjusted their position in accordance with our warning, or what reason there was, why such adjustment was not in accordance with the public interest. Mr. McGarrah replied on May 10, in which letter he said that the board was laying down a new procedure to test the abuse of Federal reserve credit—carrying a considerable volume of security loans. He said that this was entirely a new test; that it implied that the right of a bank to borrow on eligible paper was prejudiced by the fact that that bank is loaning on securities; that the banks have a right to loan on securities; that it is not possible to determine whether security loans are or are not speculative, even by the member banks, and much less so by the Federal reserve banks. I should suppose that a member bank would know in a general way for what purpose a customer was borrowing large sums of money.

The CHAIRMAN. If not it is very poorly conducted.

Mr. HAMLIN. Mr. McGarrah replied further that to undertake what the board suggested as to individual banks would be to close its loan window with a view to rationing credit; that this would produce a condition that the bank can not afford to risk; that the most effective way, apart from the increase in discount rates, is to follow the procedure he had outlined in his letter of February 21; that any different procedure might entail serious consequences. In that letter, however, as I have said, he stated that this procedure had had little effect in controlling the total volume of credit.

I want to come now to the applications for increase in discount rates to 6 per cent.

The CHAIRMAN. Right there, governor, what response did the board make to that extraordinary letter?

Mr. HAMLIN. We wrote a great many letters. I do not have the precise letter in mind now. I think we pointed out to him that that was just what the board had a right to expect. I will take that up in a minute in considering our power to refuse discounts altogether.

The bank made the first application on February 14, 1929. It had made no application since July 13, 1928. No official reasons were given for that proposed increase in discount rates at that time. Of course, in a general way the governor talked it over, but the board felt that we wanted some official expression in writing. Right here let me go back and say that on October 5, 1928, our board requested the Federal reserve banks, when suggesting a change in discount rates, to give us very briefly the reasons prompting them to ask for the change, so that we, under our power of review, could determine the matter more satisfactorily.

The CHAIRMAN. I should think the information would be essential for review and determination.

Mr. HAMLIN. My recollection is that every bank in the system from that time forward, when initiating a rate change, gave the reasons, except the Federal reserve bank of New York. On October 26, 1928, Mr. McGarrah wrote that they would with pleasure give us all the statistics before their board, but it was not possible for

their board to give their reasons, because different members based their conclusion on different grounds. I am not now criticizing the bank; I am merely saying that this more or less did embarrass the board.

The board felt that when this application came in for an increase from 5 to 6 per cent, that a national question was involved, because if New York was permitted to go from 5 to 6 per cent we knew, or believed, that every Federal reserve bank east of the Mississippi River would have to do the same, and probably every Federal reserve bank in the system, and we feared that to add that 1 per cent at that time, which would mean an increase in the rates which agriculture and business were paying, would injure them.

The CHAIRMAN. I think that is true. But, Governor, why do you think the uniform interest rate, discount rate, should prevail throughout the United States.

Mr. HAMLIN. I do not.

The CHAIRMAN. But you say there you thought it would have been forced?

Mr. HAMLIN. No; I believe the rate at that time was practically uniform, 5 per cent, at the other Federal reserve banks, and I felt if New York went up to 6 per cent that every other bank would have to go up as high. I did not mean it as an approval of a uniform discount rate. We felt that this proposed increase involved a national question which we had to study, and we voted to take the application under review and consider it, but not to decide it on that day. This application, by the way, and I am not now criticizing the bank, was made over the telephone from New York. Governor Harrison, when advised of our decision, replied to Governor Young that he had not given us the full vote of the New York board, which contained a condition that our board should immediately decide it; and that his board of directors were waiting, and could not leave until we decided it. On that first application, the board was unanimous in rejecting it. I want to add in fairness to my associates that some who favored the application for increase, agreed that the condition imposed of an immediate decision could not be accepted by the board, and therefore joined in a unanimous rejection of the application.

There were other applications. There were in all 10 applications beginning February 14, and ending May 23.

On April 9, 1929, Governor Harrison for the first time sent us an official statement of reasons for desiring an increase in rates, and, of course, that letter should be in the possession of the committee. These reasons essentially were that speculation had injured business by increasing interest rates; that high interest rates prevented the flotation of foreign securities in the United States, that the purchasing power of Europe was thereby lowered, and that the high call loan rates were drawing gold from Europe.

The CHAIRMAN. You will furnish us a copy of that letter?

Mr. HAMLIN. Yes, Mr. Chairman.

Now, there were different reasons at different times for this increase. These applications for the 6 per cent rate lasted, I will say, from February 14 to May 23. At first the feeling of the New York bank was that discounts were increasing and the reserve ratio falling and that there was danger of a runaway market. But as time went on conditions changed very materially. Total bills and securities of the

New York Bank which on January 2, 1929, were \$709,000,000, by June 5 had fallen to \$253,000,000, and the reserve ratio had increased from about 70 to 79.1 per cent. In other words, conditions had arisen that normally give rise to lower rather than to higher rates.

The CHAIRMAN. I was going to ask what defense could a bank make of raising its discount rate with a reserve of nearly 80 per cent.

Mr. HAMLIN. The money that had been pouring into the country had really thrown out the reserve ratio as a test. But certainly if the total bills and securities are falling and the reserve ratio is rising, it would not speak very eloquently for an increase in discount rates. Then later the ground was changed and the argument was advanced as to the relation of rates, and we pointed out that it was not necessary to have 6 per cent, but that 5½ would have restored the old spread between Federal reserve and market rates. Finally it was claimed that the Federal reserve rate should be as high as or higher than the open-market rate. Of course, at that time the New York bank admitted the reserve ratio was rising rapidly. On May 31, as I have said, Mr. McGarrah stated that more credit would soon be needed, and while they still would like to go up to 6 per cent, at the same time that had ceased to be of such relative importance; that it was now much more important to consider how to ease the situation and permit member banks, perhaps even encourage them, to borrow. After that date I think it is fair to say that there was really no division or dispute, if you want to call it that, between our board and the Federal Reserve Bank of New York. We did encourage member banks to borrow, to accommodate business and agriculture.

On June 3 and again on July 16, 1929, Mr. Mitchell came down and favored a more liberal discount policy, the discount rate to remain at 5 per cent, barring excessive speculation.

On August 2 Governor Harrison came before the board. He favored an easing policy, because, as he said, there was need for more Federal reserve credit. He asked to have the discount rate increased to 6 per cent, and that was done, as you remember, three days later, on August 9, 1929. The increase was not made, however, to curb speculation. That increase was part of an easing policy. We determined to ease by lowering acceptance rates. The 6 per cent discount rate was suggested merely to encourage the banks to use acceptance money in paying off in part, at least, their discounts. It was not any new change of the policy of the Federal Reserve Board. Since the 10th or 12th day of June, the board has been in harmony with the policy of New York.

The Federal advisory council, after thoroughly approving our plan on February 15, 1929, changed its view and on April 19, and again on May 21 at their meeting stated they now thought the rate should be increased to 6 per cent. It is hardly necessary to spend much time on that. Their recommendation of May 21, was just 10 days before Mr. McGarrah wrote us that an easier money policy was necessary to help the banks. If the council had waited 10 days I do not think that recommendation of May 21 would ever have been made.

What was the real issue between the Federal Reserve Board and the Federal Reserve Bank of New York? The majority of the Federal Reserve Board felt that the 5 per cent rate should not be increased, but that pressure should be brought to bear on the banks to cut down unnecessary borrowings, reduce speculative loans and



investments, and adjust their position in accordance with our warning. That was the position of the majority of the board.

Most people apparently believe that the only issue before our board was whether the rate, which was then 5, be made 6. There never was a greater mistake than that. The position of the New York Bank was that, beginning at 6 per cent, we should start in on an affirmative rate policy of repeated increases of discount rates until the situation should be corrected.

The CHAIRMAN. What situation?

Mr. HAMLIN. I have been asked that a great many times. I think it meant until the stock market was liquidated.

The CHAIRMAN. Exactly.

Mr. HAMLIN. But I have no right to put myself in another person's shoes.

Governor Harrison, in an official letter dated April 9, 1929, to Governor Young, among other things, stated a reason for increasing discount rates as follows:

A rate increase would have the further result of giving definite public notice to the country that the reserve system is ready to supplement and support all its other efforts by an affirmative rate policy.

Public realization that the discount rate would be employed incisively and repeatedly, if necessary, would greatly strengthen the effectiveness of the system's policy, and in itself hasten the time when the system might lend its influence towards easier money conditions.

This states the issue between the Federal Reserve Board and the Federal Reserve Bank of New York. The Federal Reserve Board was asked to approve an increase to 6 per cent on the understanding that that was to be the first step, and then other increases were to follow, if necessary. As a matter of fact, rates as high as 7, 8, and 9 per cent were discussed at conferences in the board as being possible under such a drastic increased rate policy.

The CHAIRMAN. In short, as I understand it, then after permitting the facilities of the Federal reserve system to be issued in an inordinate degree for speculative purposes it was proposed to penalize legitimate commerce in a desperate effort to abate the very danger that had been thus created?

Mr. HAMLIN. Yes. And I believe that policy of drastic rate increases simply meant that the crash which came in October of 1929 would have been precipitated, by the action of the board, in perhaps May or June, 1929.

The CHAIRMAN. Perhaps that might have been better.

Mr. HAMLIN. While probably most or all of the board members and very many bankers and economists feared that a collapse was inevitable because of this mad speculative mania, yet there were not a few who took a decidedly different view. They seemed filled with the spirit of the "new era" philosophies. Even the committee on recent economic changes was very hopeful in its report, if not "bullish," as to the future.

The majority of the board members felt, that under the direct pressure instituted by them, speculative loans were being curbed; that Federal reserve credit was being gradually reduced, and that whatever improvement in the general situation by Federal reserve action might be hoped for, could best be accomplished by the method of continuous pressure.

Under these circumstances the Federal Reserve Board was asked to approve a new policy of drastic increases in discount rates which, in my opinion, would have almost immediately precipitated the crisis, with resultant injury to agriculture and business, which finally came in October, 1929.

I believe that no board, whatever the economic acuteness or courage of its individual members, would, under such circumstances, have undertaken, or have been justified in undertaking, such an experiment.

The CHAIRMAN. Suppose the board had done that, Governor, and the crash had come, who would have gotten all the blame for it?

Mr. HAMLIN. I think the Federal Reserve Board itself would.

The CHAIRMAN. Why, of course it would.

Mr. HAMLIN. Of course, you understand that we can not discount any paper secured by stock collateral. The only way we can discourage speculative loans through the discount rate is by putting up discount rates on commercial and agricultural paper, and we were asked to go into this system of drastic increases on such paper in order to stop speculation. I believe that would have produced a climax. I think business would have been prostrated. To ask us to increase drastically the rates on business and agricultural paper in order to stop speculation is to me like telling a father he must chastise his only son because a drunken man is carousing in the street. I admit that there have been times when we have increased discount rates to curb speculation, but that was where small increases at the beginning might curb speculation to the benefit of business. That is one thing, but to say to agriculture and business that we are going to raise the rate to 6, 7, 8, 9, or 10 per cent as our policy—what would happen during all of this time? I fear disaster would have followed.

The CHAIRMAN. Yes; you would have had a panic right then and there, and the Federal reserve would have been responsible for it.

Mr. HAMLIN. Now, I am not going to interpret what New York meant by favoring a drastic increase in rates. I am going, however, to quote what the English paper, The Manchester Guardian, said as to what such an increase meant. This paper did not approve our wish to keep the discount rate down to 5 per cent. I quote from its edition of March 4, 1929:

There appeared to be some slender hope that the Federal reserve authorities were meditating action drastic enough to precipitate the crisis in Wall Street, which, in the opinion of most monetary students, must come sooner or later.

That was the opinion of that journal as I understand it, of the effect of that drastic policy which the New York bank at that time favored. Our board, as I have said, did not want to precipitate any crisis. We wanted to get our Federal reserve credit back where it belonged. And, as I have said, had we yielded to a drastic series of increases in rates, I think we would have brought on the crash which even then I hoped could have been staved off. I think we would have simply precipitated the crash which came in October.

When a speculative mania is once under way you can not do anything with it by the use of higher discount rates; when speculation was beginning, higher rates might have been effective. But when you came to 1929, the period we were considering, it would have no effect whatsoever. The speculators, I believe, wanted us to approve the 6 per cent rate. Six per cent meant to those men easy money, because

it meant, as they hoped, a discontinuance of direct pressure and permission to borrow all the money they wanted if they would merely put up good collateral and pay the increased discount rate. A 6 per cent rate would have been to the speculator a relief.

The CHAIRMAN. The effect even at the beginning of an increased discount rate could only have been psychological merely.

Mr. HAMLIN. It might have been psychological.

The CHAIRMAN. I say it could have been only psychological.

Mr. HAMLIN. At the meeting of September 28, 1928, Mr. Alexander took the view that the discount rate was useless when a speculative mania had got under way.

One of the most distinguished British economists talked to me about that. He told me that to attempt to correct speculation by rate increases was useless.

Mr. H. A. Wheeler, a very prominent banker in Chicago, telegraphed us as to the same position, taking the same view.

The United States Chamber of Commerce took the view that we should not attempt to correct speculation by drastic rate increases.

The London Economist said on May 11, 1929, that when stock prices are rapidly rising, high money rates are only an inefficient deterrent which penalizes the innocent without troubling the guilty; that the only remedy against rampant speculation is to cut off funds altogether.

The New York Journal of Commerce on May 14, 1929, stated that the Federal reserve system has no right to try to curb speculation through drastic increases of discount rates. It said "drastic." It does not deny that there might have been some small increase. It also said:

All that has been required of it at any time has been that it should keep its own funds, the reserves of the deposit banks, out of the speculative market.

That is thoroughly in accord with the view that I take. I will not attempt to quote the other authorities. I will read, however, from the London Statist of May 25, 1929:

The banking authorities in the United States apparently want a business panic to curb speculation.

I have a suspicion that that refers to the policy of drastic increases of discount rates.

Now, as I have said, we believe that in those three or four months we succeeded in direct pressure, because we did reduce loans that were increased before it and greatly increased after it.

The London Economist said on May 11, 1929:

The events of the past year have seen the beginnings of a new technique, which, if maintained and developed, may succeed in rationing the speculator without injuring the trader.

And that was the feeling of certain members of the board, removing Federal reserve credit from the speculator without injuring the trader.

The principal success of our direct pressure was in lowering brokers' loans. They went down in New York City about \$600,000,000 from February 6 to June 5, 1929. The customers' loans increased about \$300,000,000, and the net decrease was about \$300,000,000. Now we had a difference with the New York bank over that. We called their attention to certain New York banks, which were borrowing heavily with a large assortment of security loans, and asked them to tell those banks to adjust their position. But, as I have before

said, the Federal reserve bank objected to looking into the internal management of any lending bank unless perhaps it was out of line with other banks. But we felt the Federal reserve bank had a right and duty to acquaint itself with the loaning practices of those banks, and that those banks ought to adjust their position as to their speculative loans.

One of the most prominent bankers in Chicago, whom you all know—I will not mention his name—said:

The people have lost their heads over stock gambling. The public has not profited by advice of the Federal Reserve Board. We have now reached a point where it is a matter for each individual bank to get into the game vigorously and do whatever is necessary to at least force a reduction in the amount of money that is borrowed against stock exchange collateral.

We felt that the Federal reserve bank had a right and duty to inquire into the loan practices of any member bank. They have that right under the power to refuse discounts. The law does not say they shall discount, it says they may discount. And our counsel advised us, and our special counsel, the Hon. Newton D. Baker, also advised us, that the Federal reserve bank has the power to refuse discounts. It is not my belief that that power will ever have to be used, but its merely being there is all that is necessary. We would not suddenly and unexpectedly refuse, but we would talk with that bank and advise it that in the future it must cut down its borrowings, or else we would have to exercise our power. That is the way the Federal reserve bank would operate. Governor Harrison said if we did refuse discounts altogether that the bank could still draw on what was left of its reserve, and all it would have to do would be to pay a sum of money as a penalty for its deficient reserves which would be only a little more than the discount rate. But the governor forgot that there is a provision of the national banking act forbidding any director to declare a dividend or make a loan when the bank is deficient in its reserves. This would mean the personal liability of every director. I do not think if that issue ever came up that it would trouble the Federal reserve bank very much in working out a solution. But I repeat, that issue is never likely to arise. We are going to cooperate with the banks, and the banks will cooperate with us.

The CHAIRMAN. It did arise.

Mr. HAMLIN. Certainly, it did arise. I am talking now about the future, because I feel that it will never arise again. I feel those banks appreciate to-day that they went too far, even with their favored customers. I have heard bankers say over and over again, "A good customer maintaining a satisfactory balance is entitled to any amount of money he wants if he gives collateral and is willing to pay the discount rate." In ordinary times that may be true. But when people have gone mad, in a wild, hysterical craze, I feel that it is the duty of a banker to the depositors to repress even his best customers. They say they would lose their accounts, they would go across the street to some other bank. That is undoubtedly true. The answer is, let the banks in New York and the larger cities get together and present a moderate statement to their customers, and I do not think that with the approval of the Federal Reserve Board that would be considered a restraint of trade under the Sherman Act. Unlimited customers loans is not the English practice. In England the customer can not go to any bank and get any amount that he can give collateral

for. As to this I want to quote what Governor Young said in an address delivered at Old Point Comfort, Va., on May 7, 1930. He said:

We bankers have a responsibility beyond our own balance sheets for the general course of events.

We must look beyond the safety of the collateral offered us for a loan to the safety of the aggregate volume of the collateral that we know is being offered for loans at all the banks.

When we see an unhealthy development getting under way, we must not only protect our own immediate institution, but we must take a broader view with reference to the interests of the entire community.

In other countries, where banking development has been longer and banking has proceeded farther, certain methods of control have been developed.

A customer in England is not granted unlimited credit on the basis of security offered as collateral; he is granted a line of credit in accordance with his credit standing and the requirements of his business, and he can not easily exceed that line, no matter how much collateral he may be able to offer.

Now, the whole question, as I have said, is one of cooperation. I have talked with a great many member bank officers during the 16 or 17 years that I have been on this board, and I do not think I have ever used the word "power." It is simply cooperation; let us get together. We want to cooperate. It can be accomplished. The banks are in a changed state of mind in this country to-day. I do not feel any fear whatsoever of any future recrudescence of this speculative craze. If it should come, I believe the member banks and the Federal reserve banks will come together and so cooperate, that we shall have no trouble whatever in adjusting any such situation.

The CHAIRMAN. I venture to interpose there my opinion that you won't have that unless the system itself asserts its superiority to any individual banker.

Mr. HAMLIN. I think the direct warning that we gave amounted to an assertion of power over the banks.

The board members have been criticized severely because they have been human, because they have allowed divergences and differences to appear. I remember, however, a good many cases where the Justices of the Supreme Court of the United States have not been unanimous, where they have published dissenting opinions. We have a board of individuals from all over the country, and while every effort should be made to reach unanimity, it is their duty to express their honest views. The claim that the board should always be unanimous is practically saying that there must always be some one on the board to tell the other members of that board what they are to agree to. I remember a mythical story which illustrates this perfectly. A judge in Massachusetts was trying a long case, and gave the case to the jury late in the afternoon, and he told the sheriff to let them go home if they reached an agreement during the night. He then went home, and, returning in the morning, he saw the foreman of the jury walking in the street. When he arrived at the courthouse he said to the sheriff, "I see that the jury agreed!" The sheriff said, "Oh, no, your honor, they are still out!" The judge said, "I saw the foreman walking in the street." The sheriff said, "Yes, your honor. You told me that if they agreed during the night, to let them go, and as fast as they agreed I let them out."

Now, who is to be the sheriff to let the board members out as fast as they agree? The law provides for no such contingency.

I have talked at very great length, much longer than I expected to talk. In what I have said in criticism of any operations or policies I am willing to assume joint responsibility for the errors of the system, but I feel it my duty to talk frankly to your committee when it asked me to do so. If there is anything in my testimony that you feel you should keep in executive session it is agreeable to me that you do that.

Our board has tried its best to protect the commerce, agriculture, and industry of this great country, and we have had to take many a hard blow because of that determined effort. We think that during the four months in which direct pressure was in force we succeeded in our efforts. Whether the general belief that it was the "Loans for Others" which practically stalled the system, I shall not undertake to consider now. That has been thoroughly gone into by others who have already testified.

The CHAIRMAN. Governor, I want to ask you as to one matter in my view, and I think I am perfectly accurate about it. The Federal Reserve Board has no authority whatsoever to initiate a rediscount rate. Do you think in any circumstances it would be desirable to give it that power?

Mr. HAMLIN. Assuming now that it has no power to initiate a discount rate, I think that it would be very desirable to give it that power. There might be some emergency where that would be a very useful power. You could conceive of a case where some bank maintained a very high rate, far above the level of other Federal reserve rates, to the great injury of business, where the board might have to step in. I think such a power should be circumscribed, however, by requiring five affirmative votes.

Of course, as you know, the Attorney General advised our board that we had the power, and that of course was used for the purposes of the board in initiating the rate in the Chicago rate decision, against which I personally voted.

The CHAIRMAN. You know it is very extraordinary legal advice. If they can find a sentence in the text, or a rational implication to justify any such opinion as that, I would be very much obliged to them to do it. It never was the intent. Anybody who can read the original report when the Federal reserve bill was presented to the House, or will examine the discussions, is obliged to see that it never was the intent that the board should initiate the discount rate. If it was intended, what idiocy for it to have been said that the rates of the bank should be subject to review and determination of the board. Why the two things are absolutely inconsistent.

Mr. HAMLIN. Assuming that we have not the power I think it would be wise to give it to us, requiring, however, five affirmative votes.

The CHAIRMAN. I do not assume it, I assert it.

Mr. HAMLIN. I say assuming that we have not the power I think it would be wise.

The CHAIRMAN. In the circumstances you mentioned.

Mr. HAMLIN. Yes, sir, with the five affirmative votes.

The CHAIRMAN. With limitations.

Mr. HAMLIN. Yes, sir.

Mr. WILLIS. Can you state for the committee any suggestions you have for legislation that have occurred to you, or any comment on the Glass bill which is now pending?

Mr. HAMLIN. I heard what Doctor Miller had to say about the 15-day collateral notes. I took that up some time ago and it is not fresh in my memory, but I will tell you how it struck me then. I would suggest increasing the maturity to 90 days when secured by eligible paper. I think that that would be a great convenience. But when notes are secured by Government bonds I should permit them only in an emergency to be determined by the Federal reserve bank or by the board, or any way you want, and at a higher rate. But I think there should be an extension in time to 90 days, when collateralized by eligible paper. That would be a great convenience to a great many small banks.

Mr. WILLIS. Governor, you are familiar with the situation in France, the Bank of France, are you not—its discount policy?

Mr. HAMLIN. Not as well as I perhaps ought to be.

Mr. WILLIS. It has a somewhat small unit of discount.

Mr. HAMLIN. Yes.

Mr. WILLIS. Is it not true that the Bank of France with this extremely small unit of discount has a great deal more work to do than any Federal reserve bank has ever had in the direct discounting of notes?

Mr. HAMLIN. Oh, yes.

Mr. WILLIS. So it is a perfectly practical and usable thing.

Mr. HAMLIN. Yes; it is a perfectly practicable and usable thing, so far as relates to the Federal reserve banks, but there are a great many small member banks scattered all over the country, and you see it would be a great convenience to them, and when secured by eligible paper I would favor it in this case.

Mr. WILLIS. You mean eligible commercial paper rather than Government bonds?

Mr. HAMLIN. Yes, sir; eligible commercial paper, and not Government bonds.

Mr. WILLIS. What is your comment on this bill?

Mr. HAMLIN. I would like to say that I think that such notes secured by Government bonds ought to be confined to an emergency when they should carry a higher rate.

Mr. WILLIS. Yes. Have you examined that part of the bill which relates to so-called chains, to the so-called chain system?

Mr. HAMLIN. No, I have not gone over that.

Mr. WILLIS. Have you any general suggestions for new legislation?

Mr. HAMLIN. No; I have not but I may have later on, if I may be permitted to submit them later.

The CHAIRMAN. We will be very glad to have you do that, particularly with reference to, if you have not already formed your judgment, this affiliate situation.

Mr. WILLIS. Also perhaps you have something in mind specifically with reference to the reserve situation. Do you consider the present reserve situation satisfactory?

Mr. HAMLIN. No. But we have been working on that for 10 or 12 years. We have a committee now that I earnestly hope is going to evolve something of great value.

The CHAIRMAN. I hope they do it quickly, because we can not wait 10 or 12 years now to do what we have in mind.

Mr. HAMLIN. No. We will do all we can.

Mr. WILLIS. You agree with the comptroller or with the governor of the New York Bank, or with Mr. Miller, as to the present savings reserves of 3 per cent?

Mr. HAMLIN. Yes. It has always been my hope that we could have one common reserve. Probably that means a little lower reserve than the reserve against demand deposits to-day. But that has always been my hope. But what the committee will report, I do not know.

The CHAIRMAN. Is it not a fact, Governor, that many of the banks have manipulated their reserve and transferred their demand deposits into savings deposits merely to get the advantage of that low rate?

Mr. HAMLIN. I can not prove that, but I have not a doubt of it.

Mr. WILLIS. Do you think the segregation of assets as behind savings deposits would be helpful or not?

Mr. HAMLIN. I think it would be helpful; I am inclined to think so. But I have not given that recently very much thought.

Mr. WILLIS. Would you be kind enough to do so?

Mr. HAMLIN. Yes; I will be glad to.

The CHAIRMAN. We would be glad to have any written suggestion of modification from you as to either the Federal reserve act or the national bank act.

Mr. WILLIS. Do you think savings banks like those of Massachusetts should be given any kind of access to reserve banks?

Mr. HAMLIN. I have always thought that; yes. Some one of the representatives from one of the other States came to me two or three months ago and said they were starting that up again. I gave them all encouragement about that.

Mr. WILLIS. What is your opinion about that? I would like to have it in concrete form.

Mr. HAMLIN. I can not give it in detail now. I was in favor of their joining the system. I considered the question of how much they should contribute.

Mr. WILLIS. On what basis would you allow them to get funds from the reserve bonds? Did you consider that?

Mr. HAMLIN. We have not gone into that. Of course, in Massachusetts they hold commercial paper. I do not know whether they do it in all States.

Mr. WILLIS. They hold liquid paper, and it was on that assumption that I asked whether they had commercial paper.

Mr. HAMLIN. Yes, commercial paper.

Mr. WILLIS. Of course, there is no evident reason why they should not be allowed to borrow on Government securities just as other banks, if you are going to allow the latter to continue as they have been doing. But what I had in mind is borrowing on liquid securities such as they may have.

Mr. HAMLIN. Yes.

The CHAIRMAN. Governor, we are greatly obliged to you for your statement, and we are consequently relying upon you to give us any assistance you can.

We will not hold a hearing to-morrow. The hearings will be resumed on Monday.

(Whereupon, at 5 o'clock p. m., an adjournment was taken until Monday, January 26, 1931, at 10 o'clock a. m.)





# OPERATION OF THE NATIONAL AND FEDERAL RESERVE BANKING SYSTEMS

MONDAY, JANUARY 26, 1931

UNITED STATES SENATE,  
COMMITTEE ON BANKING AND CURRENCY,  
*Washington, D. C.*

The subcommittee met, pursuant to adjournment, at 10.30 o'clock a. m., Hon. Frederic C. Walcott presiding.

The ACTING CHAIRMAN. Senator Glass, the chairman of the subcommittee, who is temporarily detained on account of illness, expects to attend later, and desires to be recorded as present, for the purpose of a quorum.

We will proceed now with Mr. Albert H. Wiggin.

## STATEMENT OF ALBERT H. WIGGIN, CHAIRMAN OF THE GOVERNING BOARD, CHASE NATIONAL BANK, NEW YORK CITY, N. Y.

The ACTING CHAIRMAN. The committee wishes to compliment you, Mr. Wiggin, on your replies to our questionnaire. Your replies were exceedingly full and very gratifying and, as you know, probably, the information contained in your replies will not be made public, of course.

There is a resolution here, unanimously adopted by the representatives of the member banks of the first Federal reserve district, which is rather interesting, and I think might properly be made a matter of record here. If it meets with your approval, Senator Norbeck, we will enter it in the record.

Mr. Wiggin, I am going to ask you to make your own statement, taking your own time, and I am going to put three or four questions. I think they have been asked of the other witnesses, all members of the Federal reserve.

1. From the banking standpoint, what do you regard as the causes of the collapse of 1929?
2. What specific evils in our banking system aided or contributed to bringing it on?
3. What legislation, if any, do you recommend against a repetition of such evils?

The purpose of this committee is a constructive one and if there is something that can be inserted in the banking act, applying to the Federal reserve, that will help them in the future, we should like to know it, and if there is not, we should like to know that.

If you will keep those questions in your mind, and make any statement you desire, the committee will appreciate it.

Mr. WIGGIN. I should rather reply to specific questions, if that is agreeable. Suppose you read the first one and see what I can do with it.

The ACTING CHAIRMAN. Would you rather make a general statement of your own first?

Mr. WIGGIN. I would not. I should prefer to answer specific questions.

The ACTING CHAIRMAN. Very well. From the banking standpoint, what do you regard as the causes of the collapse of 1929?

Mr. WIGGIN. The debauch of speculation reached its climax and stopped.

The ACTING CHAIRMAN. What specific evils in our banking system aided or contributed to bringing it on?

Mr. WIGGIN. I do not think it was an evil in the banking system. It was a participation by the public in a tremendous speculation.

The ACTING CHAIRMAN. Do you think that the policy of the Federal reserve with reference to their open-market operations, or the relation between the demand and time loans had anything to do with it?

Mr. WIGGIN. I think a stiffer policy on rates and a somewhat different open-market operation policy might have reduced the extremes to which the speculation went.

The ACTING CHAIRMAN. Now, that is in accord with the testimony that we have gotten from all the Federal reserve men that we have cross-questioned, and if that is true, is it or is it not advisable, in your opinion, that we put some kind of check, or is it not feasible, in a legislative way, to put some kind of check, on open-market operations?

Mr. WIGGIN. I think that is a question of management. I think your law is all right. I should like to see the Federal reserve rate higher than the market rate and, by the market rate, I do not mean necessarily the extreme rates on call money, but what we do consider the market rate for the best commercial paper.

The ACTING CHAIRMAN. Now, when you speak of the rate, you mean the rediscount rate?

Mr. WIGGIN. I would rather see the rediscount rate above the market rate, and I would not object to seeing a higher rate on borrowings on Government bonds—higher than the commercial rate.

The ACTING CHAIRMAN. All right. Now, then, when you suggest that, you, of course, have in mind the difficulty of separating the banking business and the security business, or the commercial business, and how are you going to keep business going along normally? Supposing, for instance, as in 1928, business was reaching the peak in its gross operations, and that any advance in your rediscount rate would work a hardship on legitimate commercial business? Is it possible to differentiate? Are you not hurting that legitimate business that we all want to foster, by that theory?

Mr. WIGGIN. I do not think so. I think that the record shows that I am right. In these very extreme rates on stock exchange money, the commercial people always got their money at reasonable rates. There was no interference. The speculation did not interfere in any way with commercial borrowings.

The ACTING CHAIRMAN. You think that legitimate business had all the money it needed at reasonable rates even when the call money rate was as high as 18 per cent?

Mr. WIGGIN. Yes, sir.

The ACTING CHAIRMAN. That had no serious influence?

Mr. WIGGIN. I do not think so. I know in our own case it did not. Senator TOWNSEND. You mean the banks made different rates to legitimate business than those they made for speculative purposes?

Mr. WIGGIN. Oh, absolutely.

The ACTING CHAIRMAN. Now, what effect do you think the lending to member banks has? There is apparently a tendency to shift loans to cover stock operations and although the Federal reserve did not intend it so, that is the inevitable result. The member bank shifts to take care of its stock loans.

Mr. WIGGIN. You mean that a member bank borrows money from the Federal reserve in order to lend on the stock exchange?

The ACTING CHAIRMAN. Well, we believe that has been true to quite a large extent in the last two or three years.

Mr. WIGGIN. I do not see how you can prevent it. To use an old expression, you can not earmark the money.

The ACTING CHAIRMAN. You do not think there is any feasible way of getting around that?

Mr. WIGGIN. I do not think so.

Senator BULKLEY. Has Mr. Wiggin seen the provision of section 11? I would be glad to have his comment on that. Briefly, it is that during any period that a member bank is borrowing from the Federal reserve bank on its short-time notes, secured by Government securities, it shall not increase its loans on market securities.

Mr. WIGGIN. You can not tell when you lend money, always just for what purpose the money is to be used. If you lend money to a stockbroker, you have prima facie evidence it is for speculation.

Senator BULKLEY. I do not think you caught this. This does not presume to identify the purpose. It simply provides that while they are in debt to the Federal reserve bank, for their own notes, secured by Government securities, during that time they shall not increase their loans to their customers, based on collateral security.

Mr. WIGGIN. I think I understand. Suppose a bank in another city wants to borrow some money from the Chase National: Are we to investigate the purpose for which they are borrowing the money?

Senator BULKLEY. I did not mean to start that.

Mr. WIGGIN. But you are starting it.

Senator BULKLEY. It is only the form of the security that you are to take into consideration. It does not question the purpose of it.

Mr. WIGGIN. Well, wait a minute. We do business with a great many other banks, and when they borrow, they give us collateral. Now, should we stop lending those banks on collateral because we are borrowing from the Federal reserve bank?

Senator BULKLEY. That is precisely the question we are asking.

Mr. WIGGIN. I do not see any reason for it. I think you would interfere with the most legitimate business in the country. It may be abused in some instances, but by making it prohibitive, it might cause trouble unjustifiably. Do I make that clear?

Senator BULKLEY. Not entirely. I should like to hear that elaborated a little.

Mr. WIGGIN. Suppose the most important bank in some interior city wanted to borrow some money: Suppose they come to their New

York correspondent: Suppose they give us collateral, as is customary: Should we, because we happen to be borrowing money already from the Federal reserve bank, be obliged to refuse that accommodation?

Senatory BULKLEY. Now, you are simply turning around and asking me the question that I have asked you. I do not give any answer to it. I am trying to find the opinion of banking authorities on a proposal that is in the bill.

Mr. WIGGIN. My answer is, do not do it; it is a mistake.

Senator BULKLEY. That is a very fair expression of opinion, but I do not feel that you have made it very clear to us. I mean that very respectfully, of course.

Mr. WIGGIN. You asked for an opinion. That you have. Now, you asked me to explain. I have cited the case of an out of town bank borrowing money for legitimate purposes to take care of customers—borrowing from a New York bank on security. Now, if we say no, are we not causing trouble that is unwise to cause?

Senator BUCKLEY. That is just what I am not sure about. I think if you should arbitrarily say no, now, with the law in the state it is, that you would be causing trouble, but whether it would be desirable to make a new regulation to be embodied in the law, seems to me to be a different question.

Mr. WIGGIN. You see, I am representing a New York bank and, as you know, the business of the New York banks is somewhat different from the banks throughout the country and particularly in our case, where we have this enormous number of bank correspondents whom it was been our custom to serve for a number of years and loaning those banks is an important factor in the commercial business of the country and, therefore, it would appear to us, as we see it, as unwise to restrict our extending accommodation of that kind.

Senator BULKLEY. Just so long as they present any good security, no matter what the character of the security is, you would say you should go ahead and lend?

Mr. WIGGIN. Yes.

Mr. WILLIS. Some years ago I had the opportunity of getting information from a number of New York banks, including yours, regarding their relations with correspondents. Now, at that time, it appeared that the status of the correspondent was very carefully analyzed. You would not go on extending credit to the correspondent unless its statement of condition was about what you wanted?

Mr. WIGGIN. Oh, no. We do not pretend to make any bad loans and we would limit the loans to what seemed to us reasonable.

Mr. WILLIS. If they were borrowing money for the purpose of engaging in any kind of speculative activity, you would feel free to cut them out?

Mr. WIGGIN. If we knew it.

Mr. WILLIS. Yes.

Senator BULKLEY. You do not inquire too closely, do you?

Mr. WIGGIN. No.

Mr. WILLIS. Your constant analysis of the statements goes on from month to month and from quarter to quarter and, of course, the Federal reserve bank is provided not only with the statements of the examiners, but also its own examiners' statements. Is it not in good position to know that a bank is gradually increasing its discount line for the purpose of going into the market?

Mr. WIGGIN. Yes, we take all those matters into consideration.

Mr. WILLIS. So, while you can not earmark any one loan, you can tell when the current is setting in or against that direction?

Mr. WIGGIN. Yes.

The ACTING CHAIRMAN. Would it be wise, in your opinion, if we found some way of controlling the stock exchange loans, to interfere with local banking management or, in any way, put a check on that or an additional check other than what we have?

Mr. WIGGIN. I do not think so. I think your law is a good law and I do not think anything in the world will prevent bad banking occasionally.

The ACTING CHAIRMAN. Except bad bankers. If you have bad bankers, the law does not stop them?

Mr. WIGGIN. That is right.

The ACTING CHAIRMAN. You think the law, as far as the regulation of loans on the stock exchange collateral is concerned, is as far as we can go?

Mr. WIGGIN. My suggestions would be these: If we were going to change the law at all, I would liberalize it in one way. I will explain what my idea is if you would like to have me.

The ACTING CHAIRMAN. That is what we want.

Mr. WIGGIN. The rest of the law I consider good and I believe that a firmer policy on rates and a higher rate on bond borrowing and non-commercial borrowing, would be beneficial in its results.

The ACTING CHAIRMAN. Is that your specific recommendation, or have you others?

Mr. WIGGIN. In liberalizing the act—

The ACTING CHAIRMAN. What do you mean by "liberalizing the act"?

Mr. WIGGIN. We realize that commercial paper, in volume, is not adequate to-day. It is necessary for the banks to carry large holdings of Government bonds in order to have eligible collateral. I believe it would be beneficial to so amend the act that clearing-house certificates would be available as collateral to member banks. I would limit the clearing-house certificates to cities of a certain size, and to cities where the clearing-house associations had a certain minimum number of members.

Senator TOWNSEND. Why would you make that limit?

Mr. WIGGIN. Because you might get into a clearing house of two or three, in a small town. I would limit it to say—this is not as the result of careful thought but I would limit it to cities of say 500,000 people and to cities where the clearing-house membership is not less than 10, so that you would have a security back of the collateral.

Now, that is liberalizing the act and not curtailing it any.

The ACTING CHAIRMAN. What do you think the net result was of the large increase in Government securities starting in 1927? That curve goes up very rapidly. The reserves were very large. Was not that largely responsible for making money plenty and making it easy to lend on stock exchange collateral—in other words, bolstering up the speculative situation?

Mr. WIGGIN. You mean if they could not have borrowed on Government bonds, they would not have had it to lend?

The ACTING CHAIRMAN. Yes.

Mr. WIGGIN. I presume that is true. It increased the available collateral for borrowing from the Federal reserve bank.

The ACTING CHAIRMAN. It seems to have run along in the New York situation at about a billion dollars and that jumped up very quickly by another billion and a half—well, within a week—over a billion in a week, a little over a year ago.

Of course, the Federal reserve had been getting into a strong cash position.

Is it, in your opinion, desirable that the Federal reserve, the later policy of the Federal reserve in getting strong in the cash position as much as possible—have they overdone it recently?

Mr. WIGGIN. Oh, I do not think so.

The ACTING CHAIRMAN. Of course, you naturally want the banks in a strong position in times of this sort. Whether they have reached that position too quickly or whether they have been too drastic—

Mr. WIGGIN. I do not think they have been drastic.

The ACTING CHAIRMAN. There has been discussion on that more or less here, and I wanted your opinion on that. Do you think, Mr. Wiggin, that the abolition of loans for others would help the situation?

Mr. WIGGIN. Abolition of loans for others by members of the Federal reserve system?

The ACTING CHAIRMAN. Yes.

Mr. WIGGIN. Not a bit.

The ACTING CHAIRMAN. If a law were passed limiting the handling of such loans by commercial banks, would the increase in such loans be restrained to any extent?

Mr. WIGGIN. Not in my judgment.

Mr. WILLIS. What would become of them, in that instance?

Mr. WIGGIN. They would start their own firms. There is a vast amount of money loaned on the stock exchange not handled by the banks.

Mr. WILLIS. Through money brokers?

Mr. WIGGIN. Yes; and private banks.

Mr. WILLIS. Is it not possible for Congress to control that kind of banking, where the loans consist of funds obtained from large commercial enterprises—their owners are the stockholders and they have derived their business, in most cases, from all over the country. Ought not this business to be in the hands of the banks and go through them? Ought not the banks to be in full control of the situation and the others kept out of it?

Mr. WIGGIN. We should like to have full control of it, but it can not be done.

Mr. WILLIS. That is wholly out of the question?

Mr. WIGGIN. In my judgment, yes. I think your figures will show you that, during the period of large amount of loans on the stock exchange, there was something like \$1,400,000,000 loaned by firms—

Mr. WILLIS. You regard that loans for others, then, as a permanent phenomenon and one likely to recur at any time?

Mr. WIGGIN. I think so, just as long as those lenders think they are doing a safe business.

The ACTING CHAIRMAN. Do you regard security loans as one of the important causes of the recent bank failures? Statistics show there have been 6,000 bank failures in 10 years, and an abnormal number in 1930. What is the underlying trouble there, in your opinion?

Mr. WIGGIN. I think the nonliquid position of many banks was because of the larger proportion of their loans that were on securities.

The ACTING CHAIRMAN. That applies to the banks that have failed, you think?

Mr. WIGGIN. I think you must distinguish between liquid securities and unliquid securities, when you speak of slow loans or loans that are not slow.

Mr. WILLIS. Sometimes all of them are nonliquid, are they not, as in the autumn of 1929?

Mr. WIGGIN. Apparently not. The stock exchange loans were not frozen in 1929.

Mr. WILLIS. I mean for a short time during the panic.

Mr. WIGGIN. No; the only time they were frozen was in 1914. You remember that?

Mr. WILLIS. Yes. You think there was no substantial freezing at all in 1929.

Mr. WIGGIN. We saw none.

The ACTING CHAIRMAN. There was a market for the offerings?

Mr. WIGGIN. Yes.

Mr. WILLIS. But with great gaps and sudden perpendicular drops when the securities were offered?

Mr. WIGGIN. Yes; but there was no defaulting in stock exchange loans in 1929. Your slow loans throughout the country are not your stock exchange loans. They are your collateral loans. They are the loans on bank stocks and local manufacturing companies and real estate companies—

Mr. WILLIS. Unlisted things?

Mr. WIGGIN. Yes; unlisted things.

Mr. WILLIS. But there is always quite a proportion of call loans which can not be actually called in any immediate sense—that will not be called except in extreme cases?

Mr. WIGGIN. Are you speaking of loans to brokers or to individuals throughout the country?

Mr. WILLIS. I am speaking of loans to brokers.

Mr. WIGGIN. They can be called. It may be there will be a condition where the whole Street stops doing business, as in 1914.

Mr. WILLIS. That can happen but it will not happen in practice?

Mr. WIGGIN. Everybody has to stop at once to make them nonliquid.

Mr. WILLIS. As a matter of fact, a great many of them will not be called except in unusual conditions? Is not that so?

Mr. WIGGIN. Well, the only time we have seen Wall Street loans frozen was in 1914 when they closed the stock exchange.

The ACTING CHAIRMAN. Was there any concerted action on the part of the banks of New York, a little over a year ago, to support the situation?

Mr. WIGGIN. I do not know that it was concerted, but there was a general action of that kind.

The ACTING CHAIRMAN. Several banks came to the rescue?

Mr. WIGGIN. Yes. As you know, in our case, our loans increased overnight.

The ACTING CHAIRMAN. The tables show they increased very rapidly.

Mr. WIGGIN. Yes; a tremendous amount.



The ACTING CHAIRMAN. What do you regard as the likely future trend of the volume of security loans in this country?

Mr. WIGGIN. Why, as the country grows larger and its wealth accumulates, the tendency should be to increase those loans with not a steady increase, but with temporary shrinkages. The next move should be a temporary shrinkage and then a start up again.

Mr. WILLIS. From the present point?

Mr. WIGGIN. Yes.

Mr. WILLIS. What do you regard as the normal level of security loans for the country at the present time?

Mr. WIGGIN. I can not answer that. I have figures that show the increase and the shrinkage in commercial loans, but I would have to analyze them to give any estimate of what it should be.

Mr. WILLIS. To get back to satisfactory liquid conditions, do you think we should go back to the level of about 1926 or 1927?

Mr. WIGGIN. I should say so.

Mr. WILLIS. So that for the immediate future, the movement should be downward distinctly?

Mr. WIGGIN. Yes.

Mr. WILLIS. With a slow trend upwards as the country grows larger?

Mr. WIGGIN. Yes.

The ACTING CHAIRMAN. What are the figures now, Doctor Willis?

Mr. WILLIS. They are given for member banks—that is, reporting member banks—each week. I think the total, now, of security loans is in the neighborhood of \$7,500,000,000, if I am not mistaken.

The ACTING CHAIRMAN. Do you recall what those loans were in 1926 and 1927?

Mr. WILLIS. About five and one-half billion, as I recall.

Mr. WIGGIN. I think about 6,000,000,000.

Mr. WILLIS. About \$6,000,000,000?

Mr. WIGGINS. Yes, sir.

The ACTING CHAIRMAN. Would you advocate conservative steps looking toward the contraction of such loans over a period of time? Outline some such steps as you think advisable, in your opinion.

Mr. WIGGIN. Let it take care of itself. It will. The whole country is stock-minded. They are waiting for a rebound to-day. They will get over that.

Mr. WILLIS. How long will it take?

Mr. WIGGIN. You have read my report, have you not?

The ACTING CHAIRMAN. What measures would you suggest to check future market expansion of security loans during periods of popular widespread speculation?

Mr. WIGGIN. I would not take any steps. You can not question the purpose for which the bank borrows money without going into a tremendous amount of detail and they will always be able to convince you if it is for perfectly legitimate purposes.

The ACTING CHAIRMAN. You hear it frequently advocated that short sales be prohibited by law. Will you give us your idea of that, as a matter of record?

Mr. WIGGIN. I think it would be extremely unwise.

The ACTING CHAIRMAN. Why?

Mr. WIGGIN. I think the wider the market the less restriction there is on the marketing of securities, the more wholesome the market,

The ACTING CHAIRMAN. Is there any more reason for restricting short sales than long sales?

Mr. WIGGIN. At certain times; yes.

The ACTING CHAIRMAN. Are you not conscious, Mr. Wiggin, of a deliberate tendency, without making any specific charges, when we get a situation like the last 14 or 15 months, on the part, let us say, of professional bear raiders, to exaggerate depression, to exaggerate hard luck stories, and to put them out? In other words, is there not a pretty well systematized propaganda?

Mr. WIGGIN. That is what I had in mind when I said at certain times there is a reason.

The ACTING CHAIRMAN. You agree with me in that respect?

Mr. WIGGIN. I think anything—and this is entirely independent of short selling—anything that is scandalous; anything circulated to do harm, to injure people and injure securities, is a bad thing.

The ACTING CHAIRMAN. To depress—

Mr. WIGGIN. Entirely regardless of short selling.

The ACTING CHAIRMAN. The two may be easily connected?

Mr. WIGGIN. Correct.

The ACTING CHAIRMAN. Do you think that the Federal reserve banks in carrying out policies of credit control can exercise qualitative as well as quantitative restrictions in the use of member-bank credits?

Mr. WIGGIN. Well, I think they can.

The ACTING CHAIRMAN. It is their duty to, is it not?

Mr. WIGGIN. I think so.

Mr. WILLIS. Does not that imply, then, that it is possible for them to know what use is going to be made of the money?

Mr. WIGGIN. It implies giving the executives of the Federal reserve banks discretion.

Mr. WILLIS. It implies that he will be able to know or find out how the proceeds of a certain discount will be likely to be used?

Mr. WIGGIN. I think so.

Mr. WILLIS. From that, one would infer your opinion to be that a loan made to a bank for carrying securities, for example, would have a rather different immediate effect from the discount of eligible paper, on the general credit situation?

Mr. WIGGIN. Yes, sir.

The ACTING CHAIRMAN. I am anxious to bring out your idea on security affiliates. Do you think they have served a good purpose? Do you think some good has come from them? Do you think more good has come from them than harm?

Mr. WIGGIN. I think, if I may, I will read a paragraph I have prepared on that.

The ACTING CHAIRMAN. We will be glad to have it.

Mr. WIGGIN. The security affiliates of national banks should be continued and not abolished. These companies are required to render an essential banking service in financing the large corporations of the company and other clients of the banks. This is a service which can not, except within very narrow limits, be performed by the bank itself.

These companies in addition to providing long-term funds for customers of the bank, bring to the bank a great deal of banking business, such as trusteeships, fiscal agencies, transfer agencies, registrations, deposit accounts, and so forth.

State institutions, such as the New York State trust companies, can perform these services directly, and to place any restrictions on national banks which would prevent them from rendering the same service through affiliates, organized by the stockholders, would place them at a disadvantage in competition with State institutions and private bankers.

The method employed by the national banks of rendering this service through an affiliate, the capital of which is provided by the stockholders, permits a complete segregation of the capital funds used for the rendition of this service from the capital fund employed in the commercial and other general banking business.

I shall not take much longer on this. This may bore you.

The ACTING CHAIRMAN. No; it is interesting.

Mr. WIGGIN. As the service rendered by the security affiliate is rendered primarily to the bank's customers, the arrangements for the affiliation, as in the case of the Chase Securities Corporation and the Chase National Bank, should be such that the directors of the Securities Corporation and of the bank are always elected by the same stockholders, although the stockholders could and do elect different boards of directors for the securities company as against the bank. It is also essential that the affiliation arrangements should provide for an identity of stock-owning interests in the bank and in the Securities Corporation, so that the bank's stockholders will participate in any security business that might originate with the bank but be transferred to the Securities Corporation for consummation.

The bank examiners of the Comptroller of the Currency's office examine the Chase Securities Corporation at the same time they examine the bank. Of course, that examination is entirely agreeable to us. We believe that it is an advisable thing to have this done in connection with the examination of the bank.

The Chase Securities Corporation issues to its stockholders and to the public annually a balance sheet and statement of its income. Of course, since we do it ourselves, it is our belief that it is a sound policy. We believe that a stockholder and the public are entitled to that information. I do not mean by that to go so far as to say that I think it is advisable that the security affiliate should publish a statement as frequently as the bank does. I see no objection, if desired by the Federal Government, why the Comptroller of the Currency should not have reasonable supervisory powers with respect to any transactions between the banks and any of its affiliations.

I think that completes my answer to that question. I can go into detail as to the sort of examination that the Comptroller's office has made, if you would like me to do so.

The ACTING CHAIRMAN. It would be interesting. We have spent a great deal of time in the last week on this question of affiliates.

Mr. WIGGIN. At the time of the usual examination of the Chase National Bank by the bank examiners, one or two examiners are assigned to examine the Chase Bank's affiliates.

Senator BULKLEY. Do I understand they have an absolute right to do that?

Mr. WIGGIN. It is by courtesy.

Senator BULKLEY. Do you think that should be?

Mr. WIGGIN. Oh, I would go the whole distance and make it obligatory. This examination was first done at the time of our May,

1922, examination, and it has been followed regularly since that time. Schedules are furnished, giving the balance sheets and list of investments, showing the name of the security, the par value and the book value of everything on the list, the receivables and payables, the list of money balances in syndicate accounts, and list of securities held in syndicate accounts. The examiner is given access to our general ledgers and the security ledgers and subsidiary books covering both accounts. The securities held by the corporations, including syndicate securities held, have been verified by actual count by the examiners, not always, but up to the last two or three times they have always done that. They have never made any request for the books of the subsidiary companies nor for the records of the syndicate department other than those I have already mentioned. At times information on some specific company or investment has been requested and, in such cases, the examiner has been referred to a senior officer and his request always complied with.

The ACTING CHAIRMAN. Why was it omitted the last two or three times?

Mr. WIGGIN. I suppose under their pressure, and that was only in the examination of certain securities. They were all listed. They had all the information, but they simply did not examine them all. For example, in our last examination, in October, 1930, the balance sheet of the American Express Co. was requested. That is a subsidiary company and their last balance sheet was submitted.

I think I have covered the question.

Mr. WILLIS. If you make that obligatory, should the portfolio be published, in your opinion?

Mr. WIGGIN. I should not think so, any more than you would publish the loans of a bank.

Mr. WILLIS. Most investment companies publish it.

Mr. WIGGIN. Yes.

Mr. WILLIS. In this case you think it should not be done?

Mr. WIGGIN. I do not think so.

Mr. WILLIS. A statement of condition should be, however?

Mr. WIGGIN. Yes.

Mr. WILLIS. Along with the bank statement?

Mr. WIGGIN. Yes. I would make it once a year, because of the difference in the business.

Mr. WILLIS. What change would you make in the loans placed by the parent bank with the security company, or with all its security companies together?

Mr. WIGGINS. I would let it stand as the law is now. I would treat each company on its merits and let it stand on its own bottom.

Mr. WILLIS. At the present time, some of them get a large percentage of the capital and surplus of the parent bank.

Mr. WIGGIN. They are loaned by the bank simply within the limits placed by the banking act.

Mr. WILLIS. Yes; but suppose you have near 50 affiliates, as a certain defunct bank had in New York, I believe, and you applied that to each one: It might make a seriously dangerous situation, would it not?

Mr. WIGGINS. Well, but you will have to cover that the same way you cover this bad banking, by letting the Federal reserve have some discretion.

Mr. WILLIS. If I mistake not, Mr. Case said the Federal reserve knew nothing definite of this particular bank until last November. Suppose that an examination such as you spoke of were not called for by the State law but only by the national law, evidently then it would have to be undertaken by the Federal reserve system, would it not?

Mr. WIGGIN. Yes.

Mr. WILLIS. Unless they had a much larger examination staff than at present, it seems to me their hands would be strengthened a great deal if you had some positive prohibition in the law limiting the amount of loans by parent banks to security affiliates. I think the Comptroller of the Currency said last week he thought it would be very well to treat all security affiliates as if they were one; that is, to regard the whole group of them as a unit under the law, so that the existing law would apply to the aggregate and not separately to each and every affiliate.

Mr. WIGGIN. I think you had better let each concern stand on its own bottom, with its own figures and own capital, and consider it on its own merits, rather than that because of the fact someone has abused it—

Mr. WILLIS. You think, in spite of abuse, we should let each affiliate stand as an independent borrower, subject to the restrictions of the existing law and no other?

Mr. WIGGIN. I do. Take in our case, with the American Express Co., with \$18,000,000 of its own capital, with Harris-Forbes, with \$9,000,000 of its own capital, and Chase securities, with \$108,000,000 capital, it would be unfair to put those all into one class and say you could only lend all those great big concerns a certain amount of money.

Mr. WILLIS. Does not that mean you need an overhauling of the entire loaning provisions of the act, since these companies were not contemplated at the time the National banking act was framed?

Mr. WIGGIN. I do not think so. You can always have bad banking.

Mr. WILLIS. On that basis, you would never have any banking legislation at all, but simply work on the English system and leave it to public opinion to insure good banking?

Mr. WIGGIN. That would be ideal.

Mr. WILLIS. But we are not ready for such an ideal in this country, are we?

Mr. WIGGIN. No.

The ACTING CHAIRMAN. Do you consider the present status of the reserves entirely satisfactory?

Mr. WIGGIN. I think the reserve on time deposits is too low.

Mr. WILLIS. How much should it be? Should it be the same as on the demand deposits?

Mr. WIGGIN. I think so.

Mr. WILLIS. How long would you give them to get up to that, if you are going to legislate to make it the same as the demand deposits?

Mr. WIGGIN. I have not followed that.

Mr. WILLIS. Is not that an essential problem?

Mr. WIGGIN. It should go up three per cent a year.

The ACTING CHAIRMAN. Until it reached the level of the other reserves?

Mr. WIGGIN. Yes.

Mr. WILLIS. You think the level of the others is all right?

Mr. WIGGIN. I do.

Mr. WILLIS. What do you think of the proposal that some have made of either adding to the present reserve requirement a requirement that a certain proportion of unquestionably liquid securities be carried by the banks, or perhaps letting down the present cash requirements somewhat and adding a somewhat larger requirement for the carrying of liquid securities?

Mr. WIGGIN. Then you will get into the definition of liquid securities, which will always be very difficult.

Mr. WILLIS. You think you would then have a call for the good banking judgment you spoke of?

Mr. WIGGIN. Yes.

Mr. WILLIS. The present percentage, you think, is about as good as you can get?

Mr. WIGGIN. I think so. I think its results are as satisfactory as any determined percentage you could fix.

Mr. WILLIS. Has the market for Federal funds materially cut the reserve we have, or not?

Mr. WIGGIN. I do not believe I understand.

Mr. WILLIS. At the present time we have a market for Federal funds which results in sales by a bank that has an overage to the bank that is short, with the result that, on many occasions, surplus reserve which would otherwise exist, does not exist. Apparently that leads to a cutting down of the total percentage of the reserves a great deal.

Mr. WIGGIN. I think that custom does enable the banks to figure much closer the average than they would establish otherwise.

Mr. WILLIS. Have we not cut the amount of the reserves considerably more than before it was adopted, through this device?

Mr. WIGGIN. Possibly they can figure more closely.

Mr. WILLIS. Have you any idea how much closer they do figure?

Mr. WIGGIN. I have not.

Mr. WILLIS. It would seem to be considerably closer through that method.

The ACTING CHAIRMAN. Let us discuss, for a little while, this question of chain banking versus branch banking and see if we can clear up the minds of the public to some extent. There is a great deal of confusion to-day that exists between those two terms. You are, of course, familiar with the English system of branch banking. What do you think of extending that system to some extent in this country, gradually?

Mr. WIGGIN. Every community in this country that will support a bank is well cared for already. The communities that are not provided with banking facilities are communities that can not support a bank. We have had a very long experience in acting as correspondent of banks throughout the country, and we do not know of a case where a solvent bank has been permitted to fail from lack of accommodation from its correspondent.

Our own preference would be not to see any extension of branch banking. If the branch banking were limited to trade areas or to Federal reserve districts, it would cause, in the New York district,

a competition in the buying of other banks in other cities, which we would dislike to see.

You must also remember, with our present banking system as set up, there is just as much reason for a New York bank serving Nebraska as there is for serving the State of New York. We act as the correspondent of banks from all over the country and we lend those banks from all over the country and if there was any suggestion of branch banking to the extent of the whole country, we would consider it exceedingly inadvisable, because of the difficulty and impossibility of running branches at such a distance, in a satisfactory way. A lot of this you had when I appeared before the House committee and I do not want to repeat too much.

So in the suggestion of branch banking, whether it be country-wide or trade area or Federal reserve districts, I can see nothing that is going to supply a community that will not support a bank, with a bank, and that apparently is the one thing they are striving for.

The ACTING CHAIRMAN. Do you think there are too many banks now?

Mr. WIGGIN. Oh, I do not know. I think there was a mushroom growth of banks, especially in the larger cities in the last few years, that has been unhealthy, but that has been reduced somewhat in the last few months.

The ACTING CHAIRMAN. Most of them have been taken care of?

Mr. WIGGIN. Where that line should be drawn, I do not know.

The ACTING CHAIRMAN. Of course, it is a pretty nice point to say where any line should be drawn in a banking system. You are, of course, familiar with our Farm Loan Board and its ramifications and the system of banking set up. You are familiar with the system of joint-stock land banks. They have been having hard sledding. They are not, in any sense, guaranteed by the Government.

Have you an idea as to how that situation can be helped without too much paternalism?

Mr. WIGGIN. No; I think we have helped it too much. I think we have made the farm loans altogether too easily obtainable. I think that is one of the causes of the trouble.

The ACTING CHAIRMAN. Insufficient collateral?

Mr. WIGGIN. Well, the minute a farmer borrows money, he buys another farm. It was not kept liquid.

Mr. WILLIS. It is not the fault of the banks?

Mr. WIGGIN. In part.

The ACTING CHAIRMAN. The bank permits that?

Mr. WIGGIN. Yes.

The ACTING CHAIRMAN. It might be well to cover chain banking for the record.

Mr. WIGGIN. Well, I have no objection to chain banking. We simply do not want to do it ourselves.

Mr. WILLIS. Is it a sound system, Mr. Wiggin?

Mr. WIGGIN. Well, yes; I think it is sound. It is all a question of how far it goes and who does it.

Mr. WILLIS. Under past conditions, do you think it can continue to be carried on?

Mr. WIGGIN. Yes.

Mr. WILLIS. Does it not tend to exert a central control, without central responsibility?

Mr. WIGGIN. No; I think the responsibility is there just the same.

Mr. WILLIS. It largely nullifies or may nullify the double liability on bank stocks, for whatever it is worth, may it not?

Mr. WIGGIN. That is true.

Mr. WILLIS. What do you think of the provision in this bill with reference to chain banking—or have you examined that?

Mr. WIGGIN. I do not know the provisions of the bill and I will not try to answer that.

Mr. WILLIS. The provision, in brief, is simply to give the voting power solely to the local owners so that the outside owners lose their voting power on the shares they own.

Mr. WIGGIN. Is that constitutional?

Mr. WILLIS. I think it has been held that Congress can make the holding of national bank shares subject to whatever conditions it may see fit to impose, within specified limits. Suppose it were constitutional: Do you think it would have any beneficial effect, or the reverse?

Mr. WIGGIN. I do not think so. I think there are several groups of chain banks that have strengthened the local banks.

Mr. WILLIS. Strengthened the local control—

Mr. WIGGIN. Strengthened the institution.

Mr. WILLIS. Here is a question, as it seems to me: The people in the various towns where banks are bought up, for one reason or another—perhaps unwisely—object to that. They think they should have an institution locally controlled. Ought they not to be able to control that bank locally so that if an outsider comes in and buys it, he simply buys an investment, or ought they remain subject to the danger of losing their control of the local bank?

Mr. WIGGIN. All they have to do, if they sell it, is to start another bank.

Mr. WILLIS. But you have already said there were too many banks.

Mr. WIGGIN. No; I said I did not know whether there were too many banks.

Mr. WILLIS. I thought you said there had been a fortunate reduction of a lot of weak ones.

Mr. WIGGIN. Yes; I said that.

Mr. WILLIS. Then, the starting of another bank is not a satisfactory remedy for the existing situation, is it?

Mr. WIGGIN. It depends on the community and its particular needs.

Mr. WILLIS. Take the ordinary small community, that can support a small bank; it ought not to have more than one, should it?

Mr. WIGGIN. That is right.

Mr. WILLIS. It ought not to be necessary to start another bank to bring about a satisfactory conduct of that particular bank?

Mr. WIGGIN. No.

Mr. WILLIS. It is perfectly true that if the people who own the bank stock resolutely say: "We will not sell it"—if they feel that way—we need not discuss it, but they do not feel that way, and when they have a high price offered them, they frequently sell to the disadvantage of the welfare of the town. That has happened. Is it not well to have a limitation on that, if you are going to continue to have a system based on the idea of the unit bank? You yourself have spoken against branch banking.



Mr. WIGGIN. I think the people who put their money in the banks should have the right to run it.

Mr. WILLIS. Regardless of what they do?

Mr. WIGGIN. I do not mean to say they should have the right to abuse it.

Mr. WILLIS. We are assuming they are abusing it; that they are withdrawing funds from the community; using the local bank as a means of mopping up the funds of the community and sending them elsewhere, which undoubtedly has been done in many cases, so that local industries have not been given the loaning facilities they ought to have. I am speaking now purposely assuming sound banking, but that the local funds have been mopped up and sent somewhere else.

Mr. WIGGIN. Well, all they have to do is to start another bank.

Mr. WILLIS. But you are recommending as a remedy, the same thing that you have pointed out as a crying evil.

Mr. WIGGIN. There are two different purposes involved. The local purpose did not exist for starting the bank where there were too many before, but in the event this bank that has been sold is run in such a way that local industries feel they are suffering, then they can correct that by starting another bank.

Mr. WILLIS. But suppose the comptroller said they should not have a charter?

Mr. WIGGIN. He would not, if it was a respectable crowd.

Mr. WILLIS. Suppose he said he would prefer to give a charter to the local bank in a chain?

Mr. WIGGIN. You are going a little too far for me. I do not know what would happen.

Mr. WILLIS. It seems to me you would have to make some provision against that contingency.

The ACTING CHAIRMAN. Of course, we do not want to go into any unborn contingencies that may happen. I think we have briefly covered the ground we have covered with the various Federal reserve directors. Have you any questions, Senator Norbeck, you want to bring out?

Senator NORBECK. I have none.

The ACTING CHAIRMAN. Have you, Senator Townsend?

Senator TOWNSEND. No.

Mr. WILLIS. I wanted to ask you about the so-called pool that was established at the time of the panic, or just after the outbreak of the panic in 1929, to sustain the market. That is always spoken of as having been done by the banks. I suppose that was done through the securities companies?

Mr. WIGGIN. In our case we did not regard it as one to sustain the market, but as one so that there would be purchasing power at some fair price, and not let these shrinkages be too severe at one time. That may be the same thing. I do not know. In our case, it would be done by the Chase Securities Corporation.

Mr. WILLIS. And presumably in the same way by the others who participated?

Mr. WIGGIN. I think so.

Mr. WILLIS. Does that mean that the parent bank made a direct loan to the securities corporation for the purpose of enabling it to do this?

Mr. WIGGIN. I do not know whether the Chase securities affiliate borrowed any money at that time or not.

Mr. WILLIS. Did the reserve bank lend any money for that purpose, as far as you know?

Mr. WIGGIN. As I said, you can not ear-mark it.

Mr. WILLIS. Did it simultaneously, or about that time, lend money which might reasonably be supposed was used for that purpose?

Mr. WIGGIN. The Chase National Bank increased its loans very largely—very much over the amount used by the Chase securities pool.

Mr. WILLIS. Did it do that because of the existence of that pool?

Mr. WIGGIN. Possibly, but the borrowings by the bank were so much larger than the interest it had in that pool, you could not tell. The bank took over these loans for account of others which immediately put the money on deposit, which required a reserve and immediately made us borrow money, for a few weeks or a few days, our loans ran up enormously.

Mr. WILLIS. Was the pool really helpful and beneficial?

Mr. WIGGIN. I think so. I think it made people stop, look, and listen.

Mr. WILLIS. Did it exert its efforts over the whole field of the securities or only in certain cases?

Mr. WIGGIN. Only in what they call pivotal stocks. They could not do it in all. There were too many.

Mr. WILLIS. What was the definition of "pivotal stocks"?

Mr. WIGGIN. I do not know. What you would call active-market stocks I think is a good definition.

Mr. WILLIS. The support had no relation to the stocks that had been, as it is called, "sponsored" by different houses?

Mr. WIGGIN. I do not think so.

Mr. WILLIS. If you had not had security companies existing at that time, could that sort of market help have come equally easily?

Mr. WIGGIN. Not so easily. It may have come from individuals.

Mr. WILLIS. But the security companies were of distinct help in facilitating the prevention of something worse in the way of market deterioration?

Mr. WIGGIN. I think so.

Mr. WILLIS. How long did it take to liquidate the pool?

Mr. WIGGIN. I may be able to give you that exactly.

Mr. WILLIS. I mean only approximately.

Mr. WIGGIN. Well, it ran for several weeks. As I remember, I do not believe it was liquidated until after the turn of the year. It may have been five or six weeks. I am simply guessing on that.

Mr. WILLIS. Might that situation have been avoided by sufficiently prompt action on the part of the reserve bank? I understood you to say at the outset, Mr. Wiggin, you thought there should be a slightly stiffer policy in the rates and a different open-market policy. How far back would you carry that?

Mr. WIGGIN. I would have to look up my dates on that. I can not answer that.

Mr. WILLIS. That would be a criticism applying to some months before?

Mr. WIGGIN. A great many months.

Mr. WILLIS. I understood you also to say that legitimate business had all the money it needed at reasonable rates?

Mr. WIGGIN. Yes.

Mr. WILLIS. Do not the compilations of the banking authorities show that there was a steady upward movement of the commercial rates during the year or two before that in which the collapse took place, and that it took several months after that collapse before there was a distinct downward tendency noticed in the ordinary commercial rates?

Mr. WIGGIN. Let me glance at my papers and see what those rates were. I think I have it right here.

Mr. WILLIS. Suppose you add that to your testimony when it comes to you for examination?

Mr. WIGGIN. Give me one second and if I do not find it right away, I shall do that. I have a lot of figures on brokers' loans, if they are of any interest to the committee.

Mr. WILLIS. I suggest you file them with your testimony.

Mr. WIGGIN. No; I can not put my finger on that.

Mr. WILLIS. Will you insert that in your testimony?

Mr. WIGGIN. Very well.

The ACTING CHAIRMAN. Have you some figures you think would be interesting to us on brokers' loans?

Mr. WIGGIN. They may be of interest to you.

The ACTING CHAIRMAN. If you can spare them now, you might leave them with the clerk.

Mr. WIGGIN. All right; I shall do that.

The ACTING CHAIRMAN. And we will put them in the record.

Mr. WIGGIN. I shall do that.

The ACTING CHAIRMAN. Without objection, the figures asked for by Doctor Willis and these additional figures on broker's loans will be included in the record.

(The figures referred to are printed in full, as follows:)

TABLE 1.—*Brokers loans*

	High, Aug. 27, 1929	Low, Aug. 1, 1929	High, Sept. 27, 1929	Low, Sept. 4, 1929	High, Oct. 15, 1929	Low, Oct. 31, 1929	High, Nov. 1, 1929	Low, Nov. 27, 1929	High, Dec. 30, 1929	Low, Dec. 5, 1929	High, Jan. 31, 1930	Low, Jan. 3, 1930	Low, Jan. 4, 1930
Chase call.....	51,560	50,964	43,432	46,394	42,715	274,662	253,859	25,566	52,061	18,223	28,841	21,359	21,722
Chase time.....	510	560	750	510	525	625	625	1,410	2,540	1,710	1,508	2,490	2,490
Customers call.....	884,752	762,977	1,009,638	879,216	997,676	522,459	520,212	385,557	404,983	391,534	430,276	411,952	411,589
Customers time.....	21,069	13,129	21,709	20,519	29,274	29,524	29,024	17,606	13,316	14,631	12,426	13,066	13,066
Total.....	957,891	827,630	1,075,529	946,639	1,070,190	827,270	803,720	430,139	472,900	426,098	473,051	448,867	448,867

	High, Feb. 8, 1930	Low, Feb. 1, 1930	High, Mar. 27, 1930	Low, Mar. 5, 1930	High, Apr. 2, 1930	Low, Apr. 30, 1930	High, May 31, 1930	Low, May 21, 1930	High, June 5, 1930	Low, June 30, 1930	High, July 1, 1930	Low, July 23, 1930
Chase call.....	61,342	31,221	71,540	22,205	80,936	51,864	176,431	48,488	223,895	225,386	224,912	166,753
Chase time.....	1,473	1,508	11,563	1,543	11,778	11,797	42,645	11,695	42,545	28,945	28,945	7,745
Customers call.....	442,264	429,276	437,119	439,238	429,488	425,074	455,685	394,979	490,751	259,856	285,038	303,574
Customers time.....	13,072	12,426	25,605	11,925	25,330	35,661	91,755	25,480	88,005	72,405	73,905	63,975
Total.....	518,151	474,431	545,827	474,911	547,532	524,396	796,516	480,642	845,196	586,592	612,800	542,407

	High, Aug. 4, 1930	Low, Aug. 28, 1930	High, Sept. 25, 1930	Low, Sept. 4, 1930	High, Oct. 3, 1930	Low, Oct. 30, 1930	High, Nov. 1, 1930	Low, Nov. 26, 1930	High, Dec. 8, 1930	Low, Dec. 1, 1930
Chase call.....	257,995	153,114	250,191	155,875	261,362	163,299	167,762	104,578	160,722	99,750
Chase time.....	7,820	15,445	14,520	15,445	14,570	17,645	17,645	14,020	13,905	13,905
Customers call.....	273,635	286,678	283,979	277,183	223,223	197,662	195,829	166,886	168,021	166,576
Customers time.....	65,920	61,845	57,345	62,095	52,945	44,765	44,765	36,215	31,015	35,115
Total.....	605,370	517,082	606,035	510,598	552,100	423,371	426,001	321,699	373,663	315,346

TABLE 2.—*Brokers loans at close of business January 21, 1931*

Demand loans of this bank (strict call).....	\$93, 125, 000. 00
Other demand loans of this bank (main office).....	68, 482, 075. 00
Other demand loans of this bank (equitable branch).....	4, 254, 289. 00
Other demand loans of this bank (mercantile branch).....	3, 393, 800. 00
Time loans of this bank (main office).....	15, 085, 000. 00
Time loans of this bank (equitable branch).....	205, 571. 00
Call loans for account of domestic banks.....	83, 299, 010. 00
Time loans for account of domestic banks.....	8, 147, 283. 18
Time loans for account of London branch.....	32, 100, 000. 00
Call loans for account of firms, corporations and individuals.....	52, 234, 722. 22
Time loans for account of firms, corporations, and individuals.....	537, 691. 59
<b>The Chase National.....</b>	<b>360, 864, 441. 99</b>

TABLE 3.—*Shifting of loans*

The following figures show the shift of loans since the peak of \$1,075,000,000 was reached on September 27, 1929:

	Sept. 27, 1929	Nov. 6, 1929
Demand loans of this bank (strict call).....	\$3, 250, 000. 00	\$57, 500, 000. 00
Other demand loans of this bank.....	40, 182, 624. 84	109, 495, 244. 84
Time loans of this bank.....	750, 000. 00	625, 000. 00
Call loans for account domestic banks.....	380, 723, 900. 00	210, 409, 800. 00
Time loans for account domestic banks.....	15, 368, 883. 17	22, 400, 883. 17
Call loans for account foreign banks.....	8, 620, 000. 00	1, 923, 000. 00
Time loans for account foreign banks.....	250, 000. 00	.....
Call loans account firms, corporations and individuals.....	620, 294, 222. 22	303, 809, 222. 22
Time loans account firms, corporations, and individuals.....	6, 090, 297. 45	6, 473, 297. 45
	<b>1, 075, 529, 927. 68</b>	<b>712, 636, 447. 68</b>

This shows a reduction of \$363,000,000. Chase loans increased \$123,000,000 and customers' loans decreased \$468,000,000.

L. H. J.

NOVEMBER 6, 1929.

TABLE 4.—*Brokers' loans for the panic week*

	1929		Increase or decrease
	Close of business Oct. 23	Opening of business Oct. 31	
Demand loans of this bank <sup>1</sup> (strict call).....	\$245, 000. 00	\$188, 630, 000. 00	+\$188, 385, 000. 00
Other demand loans of this bank <sup>1</sup> .....	16, 495, 624. 84	109, 353, 244. 84	+92, 857, 620. 00
Time loans of this bank <sup>1</sup> .....	525, 000. 00	625, 000. 00	+100, 000. 00
<b>Total brokers' loans of this bank <sup>1</sup>.....</b>	<b>17, 265, 624. 84</b>	<b>298, 608, 244. 84</b>	<b>+281, 342, 620. 00</b>
Call loans for account of domestic banks.....	370, 274, 800. 00	216, 491, 300. 00	-153, 783, 500. 00
Time loans for account of domestic banks.....	23, 150, 883. 17	22, 850, 883. 17	-300, 000. 00
Call loans for account of foreign banks.....	8, 650, 000. 00	1, 773, 000. 00	-6, 877, 000. 00
Time loans for account of firms, corporations, and individuals.....	592, 219, 222. 22	311, 769, 222. 22	-280, 450, 000. 00
Time loans for account of firms, corporations, and individuals.....	4, 673, 297. 45	6, 473, 297. 45	+1, 800, 000. 00
<b>Total.....</b>	<b>1, 016, 233, 827. 68</b>	<b>857, 965, 947. 68</b>	<b>-158, 267, 880. 00</b>
<b>Total loans and discounts of Chase Bank—Demand, time loans, bills discounted, and overdue.....</b>	<b>690, 275, 000. 00</b>	<b>1, 062, 807, 000. 00</b>	<b>+372, 532, 000. 00</b>

<sup>1</sup> From officers' bulletin, Chase National Bank.

TABLE 5.—*Money rates*

	Commer- cial paper	Time money
1920:		
June.....	7.99	8.65
July.....	8.03	8.84
August.....	8.05	8.69
September.....	7.84	7.89
October.....	7.87	7.88
1929:		
June.....	6.19	8.70
July.....	6.13	8.11
August.....	6.23	8.87
September.....	6.12	8.61
October.....	6.09	7.31

Call rate higher still.

TABLE 6.—*Brokers' loans 1917 to 1931*

(Total, as reported by member banks in New York City—Record of highs and lows)

At start of records, October 5, 1917, total broker loans as reported by member banks in New York city were \$934,000,000. Major changes were as follows:

- Declined to 473 millions, January 25, 1918.
- Increased to 1,518 millions, November 7, 1919.
- Declined to 724 millions, July 6, 1921.
- Increased to 1,695 millions, May 2, 1923.
- Declined to 1,130 millions, November 7, 1923.
- Increased to 3,141 millions,<sup>1</sup> January 6, 1926.
- Declined to 2,409 millions,<sup>2</sup> May 19, 1926.
- Increased to 6,804 millions, October 2, 1929.
- Declined to 3,328 millions, December 24, 1929.
- Increased to 4,274 millions, April 30, 1930.
- Declined to 1,820 millions, January 14, 1931.

Source: Federal Reserve Bulletin, The Annalist, Annual Report of Federal Reserve Board and Standard Statistics.

TABLE 7.—*Brokers' loans 1926 to 1931*

(Total for account of others as reported by member banks in New York City—Record of highs and lows)

At start of records, January 6, 1926, total loans for account of others were \$564,000,000. Major changes were as follows:

- Increased to 3,907 millions October 2, 1929.
- Declined to 294 millions December 24, 1930.
- Increased to 344 millions January 14, 1931 (last available).
- Supplementary: Figure as of October 23, 1929, 3,823 millions; figure as of October 30, 1929, 2,443 millions.

Source: The Annalist, Federal Reserve Bulletin and Annual Report of Federal Reserve Bulletin.

TABLE 8.—*Brokers' loans 1918 to 1931*

(Total as reported by New York Stock Exchange—Record of highs and lows)

At start of records, October 1, 1918, total broker loans were \$1,009,000,000. Major changes were as follows:

- Declined to 970 millions February 1, 1919.
- Increased to 1,756 millions November 1, 1919.
- Declined to 948 millions September 1, 1921.
- Increased to 1,927 millions November 1, 1922.
- (Figures for years 1923–24–25 not available) 3,513 millions January 30, 1926.

<sup>1</sup> A slight change was made in method of reporting data at the beginning of 1926. (New figure contained about \$200,000,000 not previously included.)

<sup>2</sup> There were slight reverses in first and third quarters if 1928 and second quarter of 1929.

Declined to 2,767 millions May 29, 1926.  
 Increased to 3,549 millions September 30, 1929.  
 Declined to 3,985 millions January 31, 1930.  
 Increased to 5,063 millions April 30, 1930.  
 Declined to 1,894 millions January 1, 1931.

Source: Annual Report of Federal Reserve Board, Stock Exchange Bulletin, and Standard Statistics.

TABLE 9.—*Brokers' loans 1918 to 1931*

Total loans from private banks, brokers, foreign banking agencies, etc., as reported by New York Stock Exchange—Record of highs and lows

At start of records, October 1, 1918, total loans from private banks, brokers, foreign banking agencies, etc., were \$198,000,000. Major changes were as follows:  
 Increased to 212 millions December 1, 1918.  
 Declined to 177 millions May 1, 1919.  
 Increased to 292 millions July 1, 1920.  
 Declined to 155 millions August 1, 1921.  
 Increased to 266 millions July 1, 1922.  
 (Figures for years 1923–24–25 not available) 470 millions January 30, 1926.  
 Declined to 367 millions April 30, 1926.  
 Increased to 1,472 millions September 30, 1929.  
 Declined to 585 millions November 30, 1929.  
 Increased to 654 millions April 30, 1930.  
 Declined to 233 millions November 30, 1930 (last available).  
 Source: Annual Report of Federal Reserve Board, Stock Exchange Bulletin, and Standard Statistics.

TABLE 10.—*Bills payable at the Federal Reserve Bank*

On October 30, 1929, we borrowed \$95,000,000, which on November 1 was increased to \$100,000,000, which was the peak. From then on we made reductions and on the following dates we owed balances as listed below:

November 4, \$76,000,000; November 6, \$60,000,000; November 7, \$25,000,000; November 8, \$5,000,000; November 9, \$10,000,000; November 11, payment in full.

TABLE 11.—*Number of shares of the stocks held as collateral to brokers' loans at the opening of business January 26 as compared with January 22*

Name	In loans Jan. 26	In loans Jan. 22
United States Steel.....	38,256	36,960
General Motors.....	326,727	321,375
Chrysler Corporation.....	186,175	178,183
Packard Motors.....	58,570	69,250
Anaconda Copper.....	109,586	16,302
Kennebec Copper.....	115,483	122,618
International Nickel.....	284,542	232,900
Sinclair Consolidated Oil.....	100,175	105,900
Standard Oil of New Jersey.....	104,527	106,773
Barnsdall Corporation "A".....	61,100	84,700
Standard Oil of New York.....	74,005	81,230
Standard Oil of Indiana.....	58,296	48,429
Texas Corporation.....	62,307	67,662
Continental Oil of Delaware.....	82,887	94,221
Phillips Petroleum.....	127,202	113,547
Atlantic Refining.....	47,857	59,975
American Can.....	24,819	25,250
American Radiator Standard San.....	64,150	75,915
General Electric.....	93,496	96,052
Consolidated Gas Co.....	66,255	77,080
American Telegraph & Telephone.....	45,996	46,511
International Telegraph & Telephone.....	97,085	92,480
Columbia Gas & Electric.....	69,360	83,534
Commonwealth & Southern.....	105,630	121,300
Adams Express.....	33,331	38,295
United Corporation.....	275,038	270,412
Electric Bond and Share.....	124,030	125,465
American Superpower.....	77,140	86,415
United Gas & Improvement.....	82,274	96,212
Kreuger & Toll.....	53,297	43,797

TABLE 11.—Number of shares of the stocks held as collateral to brokers' loans at the opening of business January 26 as compared with January 22—Continued

Name	In loans Jan. 26	In loans Jan. 22
Radio Corporation	166,664	156,466
Montgomery Ward & Co.	119,778	125,415
F. W. Woolworth	55,209	58,149
Columbia Graphophone	46,700	48,100
Reynolds Tobacco "B"	108,324	99,128
Union Carbide & Carbon	55,250	52,824
Gold Dust	62,453	47,578
Commercial Solvents	78,887	86,245
General Foods Corporation	63,764	70,113
National Dairy Products	108,616	110,048
Standard Brands (Inc.)	185,464	174,257
Texas Gulf Sulphur	42,160	45,772
Warner Bros.	158,918	144,990
Paramount Publix	98,245	98,535
Radio Keith	110,214	116,231
General Theatre Equipment, Common	276,995	199,647
General Theatre Equipment, preferred	87,792	59,637

Mr. WILLIS. The other day, when one of the officers of a Federal reserve bank was here, the question was raised by Chairman Glass whether the chairman of the bank in New York at the present time is regarded as the superior officer of the bank, as compared with the president, who corresponds to the governor. Would you mind stating your view of the practice on that?

Mr. WIGGINS. I think it depends entirely on the institution, or the individual.

Mr. WILLIS. But, in general, the prevailing view in New York.

Mr. WIGGIN. I think you have got to take each case.

Mr. WILLIS. You can not state any general rule?

Mr. WIGGIN. When you think of a bank, you think of a certain man. I would have to look over the list to see what title that man held to answer that.

Mr. WILLIS. You could not think of that individual, say, in the Federal reserve system? What is desired now is to find out the interpretation of the provision of the National banking act and the Federal reserve law which referred to the usual custom of the banks in that regard. That was the purpose of my question.

Mr. WIGGIN. I do not think you can say what the usual custom is.

Mr. WILLIS. It is not sufficiently defined to say one way or the other?

Mr. WIGGIN. No. My title is probably unique, and it was a title that was invented for the occasion. When we found it necessary to have another officer in the bank and we wanted him as president, and we wanted to recognize the previous president by making him chairman of the board, I made room by taking whatever title they wanted to invent.

Mr. WILLIS. Now, taking the half a dozen banks that compare with, or rank next to, yours in size, is there any rule or custom?

Mr. WIGGIN. I suppose in most cases the chairman of the board is probably regarded as the senior executive officer.

Mr. WILLIS. One other question and then I have finished: You spoke of having the Federal reserve rate higher than the market rate ordinarily. You mean the market rate for commercial paper? You



mean commercial paper in the ordinary sense of the word, or customers' loans?

Mr. WIGGIN. I mean the market rate for the best commercial paper that has an open market.

Mr. WILLIS. I think you said also that the rate on Government borrowings, secured by Government obligations, should be higher than the commercial paper rate? Did I understand that correctly?

Mr. WIGGIN. I think so.

Mr. WILLIS. What should be the relationship of that rate, then, to this general Federal reserve rate? I am assuming that you mean the rate of the Federal reserve bank on borrowings on Government securities.

Mr. WIGGIN. Yes.

Mr. WILLIS. Speaking of the two rates, one the general discount rate and the other the special rate based on special Government obligations—

Mr. WIGGIN. Yes.

Mr. WILLIS. Of those, which would you make the higher?

Mr. WIGGIN. The rate on Government obligations slightly higher than the general discount rate.

Senator NORBECK. May I ask for what reason?

Mr. WIGGIN. So that the purpose of the bill; namely, as the bulkwark of commercial business, should be carried out.

Mr. WILLIS. Do you think the Bank of England practice, on the whole, should be used here; that is, the practice established by the Bank of England for the past generation, in reference to open-market rates—you think that is substantially applicable here?

Mr. WIGGIN. I am not sufficiently familiar with their operations, but I understand they have two rates, and a higher rate on the non-commercial paper.

Mr. WILLIS. Have you any view about the rates at the Federal reserve bank, and rates at interior reserve banks? That is a question that has been given some consideration here, but nothing very conclusive has been reached, and I should like to know if you have any thought on that.

Mr. WIGGIN. Whether they should be the same?

Mr. WILLIS. Whether there should be a uniform discount rate or a system of differentials, or rates based on district conditions.

Mr. WIGGIN. I think the rate fixed on district conditions should be the right rate.

Mr. WILLIS. It should have no relationship to the New York and Chicago rates?

Mr. WIGGIN. In time it would probably adjust itself, but I would make it on the district's needs.

Mr. WILLIS. Have you been familiar with the existing rate structure in the Federal reserve banks as compared with the old type of rates fixed in the local districts, and resulting in a considerable variety of rates in the different districts? Which of those do you think is the better?

Mr. WIGGIN. I have not studied them.

Mr. WILLIS. Do you see any harm in practical uniformity of reserve rates throughout the country at the present time?

Mr. WIGGIN. I think the rates are all too low.

Mr. WILLIS. I am speaking of the relative feature.

Mr. WIGGIN. I see no harm.

Mr. WILLIS. What is the effect of having them so low as now?

Mr. WIGGIN. It does not force the liquidation of lones as much as I would like to see it.

Senator BULKLEY. I should like to return to that question of branch banks. I think you said the only purpose of permitting branch banks would be to provide banks for small communities that are possibly not in shape to sustain banks. As I understood Comptroller Pole's recommendation, it had a further purpose than that. I think his theory was that many small communities that have already banks would have stronger and better managed banks if they were taken over as branches of larger institutions. Would you care to comment on that?

Mr. WIGGIN. Now, let me see if I understand. You are asking about the small bank in the small place?

Senator BULKLEY. I am asking about the desirability of permitting branch banks, and one element of that is what effect it would have on the banks in the small communities. Now, as I understand it, Comptroller Pole believes that by permitting the larger banks in centers to buy up existing banks, or establish branches in communities that can well support branches, those communities would be better served in that they would have banks of greater responsibility and better management represented in their communities.

Mr. WIGGIN. Well, where the community will support a bank, I think that community is just as well served by one locally owned, as one owned outside.

Senator BULKLEY. Then, you do not think there is much merit in Mr. Pole's suggestion?

Mr. WIGGIN. Don't ask me that. [Laughter.]

Mr. WILLIS. You recommended that clearing-house certificates should be accepted as eligible paper. You think that would mean it would be desirable to have any form of local organization to handle them?

Mr. WIGGIN. I do not think so. I think the limit on the size of the city and the number of members would be sufficient safeguard.

Mr. WILLIS. Leave it to the bankers to decide what a clearing house shall be?

Mr. WIGGIN. I would leave it with the limitation as to the size.

Mr. WILLIS. Those clearing-house certificates would be certificates issued against any assets?

Mr. WIGGIN. What you would have then is the entire strength of the banking community against what the clearing-house issues. What you would have also is a security that automatically retires itself the minute the conditions warrant it; in other words, it is not used for expansion, but simply for an emergency.

The ACTING CHAIRMAN. If the other members of the committee have no other questions, I should like to keep you a few minutes on this matter:

In the report of the chairman of the board the other day—the Chase National Bank—you made this statement:

From the middle of 1924 to the middle of 1929, we delayed the adverse effect of our high tariffs upon our exports, by heavy buying of foreign bonds. The effect of this was to increase, year by year, the interest and amortization charges the foreign countries have to meet, and to bring about a congestion in our foreign bond market. Our alternative to-day is, therefore, either a reduction of our tariffs, or readjustment to our greatly reduced volume of exports. The burden

of this readjustment, now under way, falls with particular weight upon agriculture and farms are being abandoned.

Do you care to expand a little more in detail, that point of view?  
Mr. WIGGIN. No; I think that is fairly complete.

The ACTING CHAIRMAN. That is, you think unless we reduce our tariff schedules—some of them—our export market will shrink?

Mr. WIGGIN. I think it has.

The ACTING CHAIRMAN. Well, the figures that we have here, recently compiled, within two or three weeks, indicate this, that the imports on the dutiable list have not increased as rapidly as the articles on the free list. Of course, the volume of the first is not nearly as great as the second, but we have not any specific evidence to prove that point.

Senator BULKLEY. Are you not talking about imports, and Mr. Wiggin is talking about exports?

The ACTING CHAIRMAN. He is talking about both.

Mr. WIGGIN. Well, I do not think there is anything to add to that.

The ACTING CHAIRMAN. Is it not conceivable that, irrespective of our tariff, the situation abroad—the buying power abroad—has been reduced just as our own domestic buying power has been?

Mr. WIGGIN. Undoubtedly.

The ACTING CHAIRMAN. Therefore that statement, it seems to me, is not necessarily true.

Mr. WIGGIN. Of course, there is a great deal of irritation in certain countries. We find it particularly true in Switzerland—their watch and lace trade—and find it true in other countries, which probably adds to the situation.

The ACTING CHAIRMAN. Now, a little further along in that next paragraph you state:

Cancellation or reduction of the interallied debts has been increasingly discussed throughout the world. This question has an importance far beyond the dollar magnitude of the debts involved. Without commenting on the many arguments on both sides of the controversy, and aside from the question of the justice of the cancellation, I am firmly convinced it would be good business for our Government to initiate the reduction in these debts at this time.

Had you any reduction figure in mind?

Mr. WIGGIN. Well, I would rather not get into figures on that. That has caused us a great deal of trouble as it stands. The minute I—

The ACTING CHAIRMAN. Are you influenced in that opinion in that respect by certain agitations in Germany looking to the possible cancellation of the so-called Young plan?

Mr. WIGGIN. Oh, I think that is one thing that may have had an influence.

The ACTING CHAIRMAN. That is a very large factor, is it not?

Mr. WIGGIN. My statement was based on this, that anything of that kind would so improve the good feeling, would so improve the willingness to buy, that it would be a wonderful thing for the trade and manufacturers of this country.

The ACTING CHAIRMAN. More than offset the disadvantage in dollars and cents?

Mr. WIGGIN. I think so.

The ACTING CHAIRMAN. That is all, Mr. Wiggin, and we are very much obliged to you. Mr. Wiggin we would like to have you take

back this impression that this committee is anxious to really help the banking situation and not at all desirous to unearth anything showing weakness excepting for the purpose of eliminating the weakness as far as possible and strengthening the situation.

Mr. WIGGIN. I came here distinctly with that feeling, and I go away distinctly with that feeling.

The ACTING CHAIRMAN. We appreciate your coming down.

#### STATEMENT OF EDMUND PLATT, VICE PRESIDENT MARINE MIDLAND CORPORATION

The ACTING CHAIRMAN. Mr. Platt, will you please give us your full name for the record and your official position in connection with the Federal reserve system?

Mr. PLATT. I am not now connected with the Federal reserve.

The ACTING CHAIRMAN. Well, your previous connection.

Mr. PLATT. Edmund Platt. I was a member of the Federal Reserve Board from June, 1920, to September 15, 1930, and was vice governor from August, 1920, I think.

At the present time I am a vice president of the Marine Midland Corporation and also of an operating corporation known as the Marine Midland group, of which I am also a director.

The ACTING CHAIRMAN. The purpose or business of that being—

Mr. PLATT. The Marine Midland group?

The ACTING CHAIRMAN. Yes.

Mr. PLATT. The Marine Midland Corporation is simply a holding company, holding the stocks of the 16 banks of the group, maintaining a reserve for double liability.

The Marine Midland group is a corporation with a comparatively small capital, which does the actual operating, supervising the banks, and so forth.

Senator TOWNSEND. Sixteen banks in the group?

Mr. PLATT. Sixteen banks in the group, yes; several of them rather small banks around Buffalo, but they include the Fidelity Trust Co., now called the Midland Trust Co., the Union Trust Co. of Rochester, the Manufacturers' National Bank of Troy, and the Peoples' Trust Co. of Binghamton, N. Y. The largest bank in the group is the Marine Trust Co. of Buffalo.

The ACTING CHAIRMAN. You have been present during the questioning of Mr. Wiggin and you are familiar with the general trend of our questioning?

Mr. PLATT. Yes.

The ACTING CHAIRMAN. What we would like to develop from you is, first, have you any general statement to make? Do you care to make any statement?

Mr. PLATT. With relation to Federal reserve policy?

The ACTING CHAIRMAN. Yes; the Federal reserve policy.

Mr. PLATT. I may say that it was my impression during most of the time I was a member of the Federal Reserve Board, that the rate policy was too low. I became a member of the Federal Reserve Board in 1920, just after the rates had been raised in the eastern Federal reserve banks, in New York, Boston, and so forth, to 7 per cent.

The ACTING CHAIRMAN. You are speaking of your rediscount rate?

MR. PLATT. Yes. Gradually some of the other rates were raised to 7 per cent, and some others had a progressive rate based on 6 per cent and went higher to banks that were borrowing more than a certain percentage of what was called the basic line. A few of the banks, I think, did not raise their rates above 6 per cent during all that time.

The depression came on in 1920. There was no restriction of credit. We went on loaning money. The high rates were fixed before I became a member of the board, practically. There was very little change after I became a member. They had to be raised, in my opinion, because the Federal reserve system was right at the lowest reserve percentage allowed by law; in fact, if we had calculated the percentage as we do now, it would have been a little bit under, or much closer than shown at the time. The only reason why the Federal reserve banks could go on making loans in increasing amounts during the rest of 1920, was due to the fact of the gold imports. We had been exporting gold down to April, 1920, and later in the year we began to import gold and we imported enough gold to keep the reserve percentages up above the requirements in spite of the fact we kept on increasing loans until about December.

There was so much criticism of the system and of the board when prices began to fall and the depression began that it always seemed to me that it more or less influenced the whole policy of the Federal reserve system.

SENATOR TOWNSEND. You are speaking of the depression of 1920?

MR. PLATT. 1920 and 1921; yes. Of course the country picked on the Federal Reserve Board and the system as having caused the depression, which, of course, was not true. Personally I think it had very little, if anything, to do with it. But at any rate the rates had to be raised enough to prevent too rapid further expansion of credit at the time when they were raised.

MR. WILLIS. When was that?

MR. PLATT. In May, as I remember it, or early June.

MR. WILLIS. May, 1920?

MR. PLATT. Yes, sir. That was when the reserve percentage was the lowest—May 10, or about that. I am speaking from memory.

I do not know that the criticism at that time had very much effect on the older members of the board who had been members since the beginning, like Mr. Hamlin and Mr. Miller, but in 1921 a new administration came in and a year or two later new men were appointed, and they were more or less of the idea that the depression had been caused by the Federal reserve rates and were all a little resistant to increasing the rates. So it always seemed to me that we easily reduced rates and bought Government securities for the purpose of easing the market but were slow in going into reverse, and we went into reverse in a piecayune fashion—on the basis of half a per cent at a time.

It seems to me the public has been taught to regard Federal reserve rates as of a great deal more importance than they really are. An increase of 1 per cent spread over all the loans of a member bank borrowing all of its reserves means only about one-tenth of 1 per cent. There is very little out-of-pocket expense to a member bank from an increase of the rate which requires that it get anything from its borrowing customers to amount to anything.

Mr. WILLIS. Does not that overlook the effect that the increased rate has on so-called marginal loans?

Mr. PLATT. That is true. It can not be spread over the investments, and it can be spread only over a part of the loans. But even at that, in many banks, it would be only one-tenth of one per cent, supposing the banks were borrowing their whole reserves, but in New York City and other commercial centers, no bank ever does borrow its whole reserve except on very rare occasions. Country banks sometimes do. If the bank is not borrowing an increase of the rediscount rate makes no out-of-pocket expense to it at all. If it is borrowing only a small percentage of its reserves, it makes very little difference. So, the effect of an increase of rates, it seems to me, is mostly psychological, unless the increases were to go further than they have ever gone. It does not have much effect unless the rates are above 5 or 6 per cent.

Mr. WILLIS. Does not that largely ignore the experience of other central banks?

Mr. PLATT. I do not think so. The central banks of Europe run their rate up to as high as 7 and 8 per cent.

Mr. WILLIS. Yes; since the war.

Mr. PLATT. In England, the joint stock bank rates are all tied up to the Bank of England rates by custom. If the Bank of England raises its rate 1 per cent, that raises the rates on the deposits and rates charged customers. It is not a law, but an invariable custom. Nothing like that happens here; with relation to a great many of our banks there is no change at all.

In New York State the country banks were loaning money at 6 per cent when they were paying the Federal reserve bank 7 per cent. I do not suppose they lost any money by doing it.

Mr. WILLIS. But they did not borrow as sharply as before.

Mr. PLATT. Probably not.

Mr. WILLIS. Was not that the effect of the high rate? Did it not keep them from borrowing?

Mr. PLATT. Doubtless to some extent, but a bank would not turn away substantial business at a 6 per cent rate simply because it had to borrow money for a few days at 7 per cent.

Mr. WILLIS. But it would turn away the marginal business.

Mr. PLATT. Yes; it would turn away the marginal business. It seems to me that the law should be amended possibly—and this is rather a horseback opinion—to allow the Federal reserve rates to be minimum rates so that reserve banks could charge more under certain conditions.

Mr. WILLIS. So that the reserve banks could charge more?

Mr. PLATT. Yes. Every reserve bank in the commercial centers does two classes of business. The New York reserve bank does a central banking business with the city banks, but with the country banks it does a correspondent banking business.

Mr. WILLIS. You mean you would allow the Federal reserve bank to charge one rate to some banks, and some other rate to other banks, or allow the Federal reserve banks to raise the rates to all, or make the same rate to all?

Mr. PLATT. Where things are regulated by law and not by custom, as in England, it is going to be difficult to allow the Federal reserve

banks to exercise discretion between banks. I think it would be a wholesome thing if you could do it.

Mr. WILLIS. In this country?

Mr. PLATT. Yes.

Mr. WILLIS. Is that practicable?

Mr. PLATT. I am not sure that it is not. There is a great deal of difference in what banks borrow for. In the western towns, Governor Young used to say a bank never borrowed money unless it was losing deposits, which generally meant that funds were being transferred to the East or at least out of the neighborhood. In such cases I do not think that the reserve rate should be above the best market rate, or when banks are borrowing for currency, as in the late affair in New York City.

Mr. WILLIS. If borrowing in the open market, you would advocate the same rate as Mr. Wiggin—the rate for good open market paper?

Mr. PLATT. That is a definition I would give in the big cities. I do not know what you could take as the lowest open market rate in western cities. Perhaps in those districts, you could say the lowest rate to first-class customers—the competitive rate. For instance, Minneapolis and Kansas City and St. Louis all lend some money to big customers in competition with the New York customers' rates.

Mr. WILLIS. At the present time a differential exists through the use of the open market position and the fixing of rates on acceptances at times when the discount rate is raising.

Mr. PLATT. I did not quite catch that.

Mr. WILLIS. Through the use of the acceptance power or the present method of dealing in acceptances, there is, at the present time a practical way by which some groups of banks may get funds from the reserve bank materially lower than is true of other banks. Is not that so?

Mr. PLATT. Yes, if they own acceptances; but banks are not big buyers of acceptances. Banks that have bought acceptances can turn them into the Federal reserve at a much lower rate. I wish we could get them to buy more than they do. I am preaching that to them all the time. They seem to think Government securities are much better, though recently some large banks have purchased acceptances.

Mr. WILLIS. Many of the acceptances are frozen, are they not?

Mr. PLATT. That is something——

Mr. WILLIS. Especially when made against stored goods abroad.

Mr. PLATT. I suppose the acceptances that are based on the Farm Board's wheat are frozen, in a sense.

Mr. WILLIS. And also cotton and copper in Germany.

Mr. PLATT. I think some are renewed from time to time.

Mr. WILLIS. They are not very liquid, are they?

Mr. PLATT. Except in the sense they can be sold from hand to hand, the same as call loans are liquid, unless everybody discriminates against them at the same time. They are well secured.

The ACTING CHAIRMAN. There is pretty apt to be a discount on the unliquid loans if you are trying to sell them.

Mr. PLATT. If there are too many people trying to sell them at once, probably, although, if you have a broad enough market, the market takes care of the acceptances pretty well. Acceptances of

banks like the Bank of the United States, ought to have been discriminated against more than they were.

There is a power that possibly you might give to the Federal reserve banks or to the board on the recommendation of the comptroller—the power to take away from a bank that is not carrying on a sound banking business, its right to accept. It gives our American acceptances a bad name when an accepting bank fails and its bills go “sour.”

Mr. WILLIS. That was never suggested with reference to the Bank of the United States?

Mr. PLATT. I do not know positively but think not.

Mr. WILLIS. How many acceptances did they have out?

Mr. PLATT. Their bills I understand were not regarded as prime but nevertheless the dealers shoved in a few with the other prime acceptances and passed them along.

Mr. WILLIS. They were held in other banks?

Mr. PLATT. I think a few were. Do you want me to speak further on the Federal reserve policies?

The ACTING CHAIRMAN. Yes.

Mr. PLATT. I should like to differ with Doctor Miller a little with relation to 1927. I think he overemphasizes the events of that year somewhat and it seems to me it was the whole easy money policy of the last half of 1927 rather than the open market policy that deserves criticism.

We started in the summer of 1927 by forcing down the rediscount rates. The Chicago rate was forced down by vote of the Federal Reserve Board and other western reserve banks were practically told that their rates should come down too. All 12 reserve banks went down to a 3½ per cent rate.

Mr. WILLIS. What was the reason for doing that?

Mr. PLATT. Business seemed to be slipping a little bit and we had been importing too much gold.

Mr. WILLIS. You needed less credit to carry the business?

Mr. PLATT. Yes, but we had been importing gold and we wanted to turn the gold current.

The ACTING CHAIRMAN. Were you alarmed at that gold influx?

Mr. PLATT. Alarmed is perhaps too strong a word, but we were concerned about it. It seemed to me that the low rate policy at the time was all right with relation to the New York reserve bank and the eastern reserve banks, but there was no necessity for forcing the western and southern reserve banks down to a uniform 3½ per cent rediscount rate. If the rates are uniform throughout the country, the New York rates are higher in practical effect, and will tend to draw money from all over the country; in other words, the interior banks should have a little pull on New York. Whether it should be 1 per cent or one-half of a per cent higher, I do not know. But they ought to be a little higher, as a rule.

That year they were all forced down and then we began to buy securities in order to support the low rates. Then the gold current turned and gold began to be exported and then we continued to buy securities until about December to offset that. We did not go into reverse fast enough in my opinion.

Personally I do not see any reason why the reserve banks can not go into reverse more promptly and more effectively.



Mr. WILLIS. From what source did the impetus come for forcing down the rate?

Mr. PLATT. I do not know that I can testify to that. There was a great deal in the newspapers about a meeting of the Federal reserve and the foreign central bank men. I happened to be in Europe at the time and got back late in July and found it all set up.

Mr. WILLIS. Did you find that this meeting of the central bankers had reached an agreement to force down the rate?

Mr. PLATT. I do not think there was an agreement. Governor Strong was in favor of lowering rates, but I do not think he wanted the whole country to go down. I think there was a great deal of camouflage used about that time—having the Kansas City bank start the reduction.

Mr. WILLIS. He wanted lower rates for the purpose of driving gold away from this country, did he not?

Mr. PLATT. That was one motive, undoubtedly.

Mr. WILLIS. Has there ever been, as far as you know, an agreement with the Bank of England as to the rates to be made by any reserve bank in this country?

Mr. PLATT. I do not think there has been any agreement at any time. It seems to me it is important to know what the other central banks are doing and to cooperate with them. I believe in international cooperation when possible. I believe it will be a serious matter if it is not carried on in the future.

Mr. WILLIS. But discussions have never culminated in an agreement?

Mr. PLATT. No, sir.

Mr. WILLIS. This policy you mention was designed to improve business—stimulate business internally—and drive gold back abroad, was it not?

Mr. PLATT. And help create a market for our goods abroad. I think that is a good policy when our crops are going abroad in the fall.

Mr. WILLIS. I understood Mr. Miller the other day to say the rate was too low at the start and he would have gladly raised it, and it was only later on when it became a penalty rate for business, that the raising of the rate was opposed.

Mr. PLATT. That was in 1929.

Mr. WILLIS. And the latter part of 1928.

Mr. PLATT. Yes. There was considerable resistance to the raising of the rate from  $4\frac{1}{2}$  to 5 per cent in June and July, 1928. Chicago first established the 5 per cent rate and it was difficult to get it approved by the Federal Reserve Board. Some members happened to be away. I happened to be in charge, as acting governor, and I could not get the rate approved at once. There was a delay of two or three weeks.

I think Governor Harrison said the other day instead of changing the rate from  $4\frac{1}{2}$  to 5, it might well have been changed to  $5\frac{1}{2}$ . I think it would have been a more effective check on speculation. Speculation did slacken considerably in July, 1928, following the 5 per cent rates and did not start up until the fall, when the Federal reserve began to ease money by buying acceptances. That was the time of harvest and crop movement and it was believed that the situation had to be eased. I think there was perhaps more money put into the market than necessary.

The ACTING CHAIRMAN. You think it would have helped the situation to-day if we had started sooner in 1927, when we were pretty conscious of a big speculative fever?

Mr. PLATT. It did not get rampant until 1928. Then we tried to correct it by selling Government securities and raising the rates. We did it a little at a time, and as we sold Government securities, we put the member banks in debt to the reserve banks.

The New York banks, having money on the stock exchange could not greatly reduce their street loans and had to go to the Federal reserve to replenish their reserves to take the place of the reserve funds taken out by the sale of securities by the reserve banks, and it always seemed to me a little unfair——

Mr. WILLIS. Unfair to whom?

Mr. PLATT. To the bankers lending on stock-exchange collateral. We first furnished the reserve funds with which to make those loans and then took the funds away from them and forced them to borrow.

Mr. WILLIS. I think that was Doctor Miller's statement the other day. His chart showed that.

Mr. PLATT. I was in favor of increasing the New York rate to 6 per cent.

Mr. WILLIS. At what time?

Mr. PLATT. In February.

Mr. WILLIS. 1929?

Mr. PLATT. Yes. I think it could have been done earlier. I think my file shows I wrote some letters suggesting it a month or two earlier.

Mr. WILLIS. Was that consistent with the open-market policy then being pursued?

Mr. PLATT. Yes. We were selling securities and making money dearer. We forced the commercial rates up by selling securities—the rate people paid for borrowing money for commercial purposes; as well as for speculation.

Mr. WILLIS. Up to what time did that condition prevail?

Mr. PLATT. The New York increase to 6 per cent was approved in August—August 8, or something like that—and shortly after that the Federal reserve began buying acceptances and the acceptance rates were put down when the Federal reserve rate went up, so that the market was eased a little.

Mr. WILLIS. At the same time it was officially being tightened?

Mr. PLATT. It turned out beautifully for the Federal reserve system and the board, because the panic came along and the board was not blamed.

Mr. WILLIS. That was a political rather than an economic situation?

Mr. PLATT. I would not say that exactly. I suppose if the panic had been precipitated in the spring of 1929, the Federal Reserve Board would have been blamed if they had approved the 6 per cent rate. My own feeling was, when they talk about having one rate for business and another rate for—or rather, when they talk about penalizing business by putting the rate up—business at that time ought to have been penalized. Business was speculating as well as the stock market, and the whole price level was high as well as the price of stocks. The fact that commodity price levels had not risen and were not rising, does not mean that those price levels were not too high. I think the

fact they have gone down so drastically since shows they were too high. They were kept up by the speculative situation, and they had to break when the stock market situation broke. Of course we had no statistics to show that at that time. There was not much evidence of accumulating inventories except perhaps in copper and price levels had not gone up. It did not look as if they were too high, but subsequent events show they were too high.

Mr. WILLIS. Was it not high for this reason, that the policy of the Federal Reserve Board had produced a mild deflation and thereby deferred a sharp deflation that occurred at a later date?

Mr. PLATT. Of course, you can not be sure of anything in the economic situation.

Mr. WILLIS. What you had was an inflation in the form of a negative deflation?

Mr. PLATT. I think that is a fair statement of the case. I should like to say a word or two with reference to branch banking and group banking, if you care to have me.

The ACTING CHAIRMAN. Yes; and also discuss the affiliates—the policy of affiliates. We are interested in that.

Mr. PLATT. I do not fully understand these things. I have been connected with practical banking so short a time that I can not talk alongside Mr. Wiggin on things of that sort, but if I grasp the idea of the affiliates at all, these affiliates are doing something like what the German banks do directly.

The German banks go directly into investments in industry and sometimes even own them. That business is not wrong. It is useful if properly done, and the segregation in affiliated corporations has its advantages. They are doing a useful business and I do not see why it should not be done in connection with the large banks.

After all, a very prominent English authority on banking has said that good banking is made by good bankers and not by law. If you have good bankers you can give them a little leeway.

Mr. WILLIS. That is particularly true of the English system.

Mr. PLATT. Yes, sir; and it would be a great deal better if we did not have so many laws binding in the Federal reserve and the member bank. If we could be sure of having larger banks to insure good management—

Mr. WILLIS. Do I understand you to say that large banks are better managed than the smaller ones?

Mr. PLATT. On the whole, I think they are.

Mr. WILLIS. A comparison of the losses in the last year would interfere with that generalization.

Mr. PLATT. Yes; there was one failure of a big bank that militates against that statement.

Mr. WILLIS. It is a fact that you have an abundance of well managed, able, and profitable small banks all over the country?

Mr. PLATT. A considerable number of them, but we have also had a tremendous number of failures of small banks—running about 1,300 this past year.

Mr. WILLIS. According to the Federal reserve figures, it is much larger than that. It is 6,000, as stated by the comptroller, for the past 10 years is it not?

Mr. PLATT. I am speaking about 1930. It is not much over 6,000, during the past 10 years, is it?

Mr. WILLIS. Six thousand in the comptroller's figure. The board's figures are generally higher. The figures we have do not include November.

Mr. PLATT. Then it must be 7,000 if it does not include November, with total liabilities of something over \$2,000,000,000. It seems to me that not enough attention has been paid to that in discussing the causes of the present depression. I think bank failures are an important cause of depression. Nothing restricts credit like bank failure. You can not imagine putting the Federal reserve rates up to a figure that would check credit like a bank failure.

The Federal reserve can not manage these little country banks. It does undertake, when it lends money—well, sometimes, they pretty nearly run the banks, but these little banks in some sections of the country have not a Chinaman's chance. Their system is wrong.

Mr. WILLIS. If they are well managed—

Mr. PLATT. Not even if well managed.

Mr. WILLIS. I have read, in your writings, the statement that well-managed country banks may helpfully establish sound branch banks.

Mr. PLATT. Well, the word "country" is applied to banks as a technical expression. As used by the comptroller, it includes some rather large banks. It does not mean ten or twenty five thousand dollar capitalized banks. It may be banks of four or five hundred thousand dollars or a million capital.

The ACTING CHAIRMAN. Suppose you go ahead and develop your suggested remedy for this.

Mr. PLATT. I think the banking laws should be amended so that country banks can consolidate just as the city banks do. I think the McFadden Act discriminates against the country banks. Under that act, you can combine the banks in four or five counties if you cover them with brick and mortar, as in New York, but you can not combine them even in one county if it contains several small cities or towns. I do not see why they should not be allowed to merge.

The thing that is important is that the country bank should be given an opportunity to do a diversified business. It should not be confined to one crop or to one class of business—agriculture or anything else. Most of the country banks in this country, are, outside of New England and the East, where they generally have a sufficient diversification, so that those country banks can lend on a lot of different things. Outside of the New England and eastern country banks, the country banks are often located in neighborhoods where they have no chance to do a diversified business.

The Chase National Bank, the National City Bank, and other large banks in New York do business all over the country. It is not only business done with correspondent banks, but with big business. Pretty nearly every town of any size has individuals and corporations that carry accounts in New York. Generally speaking, the local bank is not large enough to handle their business. Some of those local banks could be increased to handle the business by consolidations. That is one of the things the comptroller speaks about as decentralization of credit. I do not know how much that will amount to. I think big business will always carry accounts to a large extent with New York and Chicago. They are our financial centers.

However, when certain banks were consolidated in Detroit they held certain of the business there that was previously forced to New York. The same thing happened in Buffalo and in Cleveland.

I have said, in my speeches on branch banking, that I thought the Blaine law, permitting branches in groups of counties, was about right. If you can start with that and allow branches further away, through consolidation, where necessary for diversification, as it would be in the Dakotas and much of the West, where you would have to go much farther away in order to get enough diversification—if you can start in that way, you can begin to build up a system that will stand up.

I think our banking system, for the purpose of serving small agricultural communities—I think it serves the cities excellently, as a rule—but for the purpose of serving safely and adequately the small agricultural communities, we have the worst banking system in the world. We practically deny access to the strong banks to the small man.

Mr. WILLIS. Just following that up: You talk about the consolidation of the small banks or isolated country banks. How are you going to get diversification? Let us take a group of small banks in South Carolina or North Dakota or Wyoming, where they are mostly all farmers, and in South Carolina where they raise cotton, and so forth, where you have a one-crop situation: How are you going to do it, unless you have a contact with some large center outside of that area?

Mr. PLATT. In many places I think you would have to do that. But there is in South Carolina, since you have mentioned that, a bank called, I believe, the South Carolina National Bank, with its headquarters in Charleston and a branch in Columbia and a branch over in the Piedmont at Greenville, and Mr. Small, president of that bank, in getting out his circular with relation to it, stated that when Charleston has a surplus of money and is lending it in New York, Greenville has a demand for money and, conversely, when Greenville was lending in Wall Street, Charleston had a demand for money. So, by connecting the banks across the country, they could keep the money in the State and more fully employed at home. In other words, Greenville is a manufacturing center, and the Columbia section has diversified fruit growing and cotton, mostly, while Charleston has some shipping and largely garden truck, so that the peak demands do not come at exactly the same time. On a smaller scale it is very much what happens in California.

I used to say that branch banking within city limits was of no consequence, economically; that it was all a matter of accommodation, like branch post offices, but since I have been getting some actual experience I find that our little group of five branches of the Marine Midland Trust in New York handle quite a diversified line of business. For instance, the branch at Chambers Street they call the butter and eggs branch, the branch at West and Liberty Streets does business with the railroads, so there is some diversification through branches in the big cities. The uptown branches handle a business differing considerably from that of the down-town offices.

Mr. WILLIS. The group in South Carolina was a group of small banks picked up because they had gotten so weak they could not carry on?

Mr. PLATT. You are speaking of a different group. This group of banks, consolidated into a branch banking system by Mr. Small, was organized in January, 1926. There has been a group, perhaps more than one, organized since. The recent systems took a number of banks out of the Federal reserve system. The Federal reserve law as amended by the McFadden Act, does not allow branch banks outside of city limits.

Mr. WILLIS. Would you apply the English development of branch-banking business to this country? Would that help?

Mr. PLATT. I should agree with Mr. Wiggin, that I should hate to see our banks have to compete with each other for branches all over the country. You may come to that in the long run, but it seems to me it will be a long time coming and I do not believe there is any reason for authorizing it at the present time. All we need to do is to give the country banks a chance to group themselves together for diversification. No one would insure a house with an insurance company that had all of its risks in one town. But that is what depositors in some of the small banks are doing. Some of these banks are not really failing, but just drying up.

Senator NORBECK. To what do you attribute so many failures in the last 10 years, as compared with the previous 10 years?

Mr. PLATT. I think it goes back more or less in history. We had one major panic in this country without many bank failures. That was the panic of 1873. There were then very few State banks of any kind, and the smallest national bank was capitalized at \$50,000.

In the early nineties and late eighties, the Western States began to charter banks of \$5,000 and \$10,000, and some Eastern States \$25,000. A lot of them went down in 1893. Two Comptrollers in succession, Mr. Eckels and Mr. Charles G. Dawes, recommended branch banking as a remedy. Mr. Dawes recommended it in towns of 2,000 or less.

Senator NORBECK. Is it not a fact that most failures took place in the section of the country where there was a deflation in the commodity prices of the country?

Mr. PLATT. Yes; but there were no failures just over the line in Canada.

Senator NORBECK. But did not the United States Tariff Commission find that it costs just 42 cents a bushel more to raise a bushel of wheat in the United States than in Canada? If we had had the price advantage of Canada we would not have had an agricultural depression.

Mr. PLATT. I do not know about that.

Senator NORBECK. The conditions are not similar.

Mr. PLATT. We had similar conditions and price reductions in 1920 and 1921 and that also obtained in Canada, but there were no bank failures in Canada or only one (1922). There are no bank failures now in Canada and there were 1,300 in 1930 in this country.

Senator NORBECK. We had our big drop about 1920 and the bank failures came later.

Mr. PLATT. The prices dropped in 1920 and 1921.

Senator NORBECK. But our failures have been more recent.

Mr. PLATT. They came not long afterwards. Just about the time the farmer was getting on his feet again his bank failed and tied him up.

I have seen some letters written about these bank failures that are heart-rending. I remember one from a Presbyterian minister telling about the situation in Arkansas, about the hard times the farmers had experienced and then after that and on top of all that, the banks failed.

Senator NORBECK. I quite agree with you, Governor Platt, that the bank failures have contributed greatly to the distress, but I think you will agree with me that the inability of the farmers to pay their notes really brought the bank failures.

Mr. PLATT. Yes, but if your banks had had a certain diversification, the failure of the crops or the drop in prices affecting a staple crop in one neighborhood would not cause the bank to fail. It would be absorbed somewhere else, just as a fire burning up a big building in one town does not cause everything to fail in that town, because the insurance company has its risks in hundreds of towns.

Senator NORBECK. That is a beautiful theory, but the answer is we did not have the failures in those countries until we had the deflation.

Mr. PLATT. That is true, but to go back a little bit, after the panic in 1907, California passed a new banking law that provided for branch banking. They had just the same drop in prices in California, but very few branch bank failures.

Senator NORBECK. Is it not a fact that the deflation hit California long after the depression hit the Mississippi Valley?

Mr. PLATT. I do not know—

Senator NORBECK. I think the agricultural deflation hit the Northwest the hardest. I think it is well set out in the industrial report of the commission of which Mr. Young is a member, showing that it was the Northwestern States and not the West coast or the East coast that was hard hit, showing that the farmer in Nebraska, for instance, has to suffer a deflation of 80 per cent and in Pennsylvania the farmers suffered only about an 8 or 10 per cent deflation.

Mr. PLATT. If we had had a proper banking system, the banks need not have failed.

Senator NORBECK. But if you lend money secured on something worth \$80 and it goes down to \$30, how can you prevent a failure?

Mr. PLATT. Because you have a bank in another neighborhood that is making a profit that can absorb that loss. We have some rather small branch banks in this country that have been running for over 30 years, like The Tennessee Valley Bank of Decatur, Ala. The president of that small branch bank system told me that, operating individually, some of his branches would have been closed absolutely long ago. He has only 15 branches and all operated practically within the Cotton Belt, but he has just enough diversification and a sufficiently broad outlook so that he can keep going. They started in the late nineties. They should be spread over a larger territory, but they managed to get along. So, branch banking does help.

Senator NORBECK. Do you think that any banking situation that covered the agricultural States would prove an advantage?

Mr. PLATT. A combination of groups as they have in St. Paul and Minneapolis would help.

Senator NORBECK. But if the commodity prices fall in the territory served by any of these branches who will absorb the losses?

Mr. PLATT. There have been very few failures in your territory this last year since the big groups came in.

Senator NORBECK. Surely; we had some hard-shell banks that had not lost much money and by playing a conservative game they were able to stand up and enjoy the confidence of the community and then the group came in and bought some of them and said, "See what we have done for your community." I want to ask you to name two banks in the Northwest that have been helped or put on their feet by these group banks.

Mr. PLATT. I do not know the northwestern groups closely enough to answer that question, but I know some banks have been helped and there have been very few failures in the Northwest since the groups were organized.

Senator NORBECK. They waited to see which banks would stand the test and then they started to acquire them. After acquiring those good banks they said, "Look at us; see how strong we are."

Mr. PLATT. That is one objection to group banking as compared with branch banking. It is not quite as economical and it is more likely to take strong banks rather than the weak ones. However, they have helped the situation because they have strengthened the strong banks, and at least some of the weaker ones also.

Senator NORBECK. I have never found anybody living outside of our State that was charitably enough inclined to come in and give us money and help us. I admit they can do it, but whether they will is another question.

Mr. PLATT. You have had chain banks in your territory since about 1900.

Senator NORBECK. No; we have not had chain banks.

Mr. PLATT. I have a study of chain banking made in the Northwest, made by Miss Hartrough for the University of Minnesota in 1924.

Senator NORBECK. In the Northwest, but not in South Dakota.

The ACTING CHAIRMAN. Mr. Platt, suppose you give us a definition that will distinguish between chain, group, and branch banking.

Mr. PLATT. The Federal Reserve Board, in its bulletin reporting on chain banking and group banking, does not make a distinction, but I think there is a distinction. I think chain banking began in the 1890's, in response more or less to the recommendation of two Comptrollers of the Currency, Mr. Eckels and Mr. Dawes. They recommended branch banking in the small towns, and these strings of banks were purchased, without any central organization, and along a little after 1900 there began to be holding companies organized, mostly in the Northwest territory, around Minneapolis and St. Paul.

The ACTING CHAIRMAN. To hold the stocks?

Mr. PLATT. Yes; and those chain banks, on the whole, have stood up pretty well. Some have failed but they have stood up better than the unit banks. They were built up, I believe, in response to a real economic need. Probably the idea of a great many of their originators, when they started them, was that they would convert them into branches if they were allowed to, but they were not allowed to.

The ACTING CHAIRMAN. Most of them are not member banks?

Mr. PLATT. Most of them are not. There is a man named Petersen, who has a chain of six or eight banks in North Dakota. I do not think any of his banks have failed. I know he wrote me about 1923



asking if there was any way by which he could convert his banks into branches.

Senator NORBECK. I hope Mr. Platt did not understand me to say that the group bank was necessarily wicked because it was a group. I am not saying that. I am simply questioning what the benefits will be of the group banking system.

Mr. PLATT. It gives a chance for diversification as much as you can do it through separately incorporated institutions. Converting them into branches you would have the strength and greater diversification of the big institutions.

Senator NORBECK. Give us a fair price for our products and we will build up good banks. I believe there was a statement that there were less failures in Iowa for 50 years than in Massachusetts. So, if the products of labor are sold at lower prices, then the banks are hurt too—that is, if they have any loans out.

Mr. PLATT. If the banks go down that makes the situation worse.

Senator NORBECK. I want to say that Governor Platt has been very helpful while on the board and I do not want to be too critical. I have no doubt Mr. Platt has the welfare of the whole country at heart, and I think his testimony shows that. He and I just do not share the same view as to the cause of bank failures in the Northwest. We had the same system in the previous decade as in the past, but it was in the last decade we had the failures.

Mr. PLATT. I think Doctor Willis's compilation for a Senate committee made in 1926 for the 25 preceding years shows that we had 40 bank failures in the best of those years. That was the minimum number, and there were few years when the failures didn't go over 100.

Senator NORBECK. But there are at least 40 people go wrong every year. You can not prevent that in the banking business or any other business.

Mr. PLATT. We could to some extent, if we had larger units. I think bank failures are due to two fundamental things. Back of the whole thing is the free banking idea, which, carried to the extreme limit, means you can give a bank charter to a bunch of crooks and have a good bank if you keep them under strict enough supervision.

Senator NORBECK. What law can you pass that will prevent honest men selling a bank to crooks?

Mr. PLATT. We can not prevent that?

Senator NORBECK. Is not that what is happening time and time again?

Mr. PLATT. Not with the large banks, I think.

Senator NORBECK. Will not a banker sell his bank to the highest bidder, if it is for sale—generally?

Mr. PLATT. I do not know about that. I was never much of an owner of bank stocks myself, having come on the Federal Reserve Board before I had a chance to acquire a great deal for myself, but I know there are bankers who won't sell. The free banking idea, carried too far, means that you must not question a group of men too much if they want a charter and have the capital required. In former times Comptrollers of the Currency used to indicate that they had no authority to inquire into the character of the applicants for a charter, provided they had sufficient financial responsibility.

Mr. WILLIS. But they do invariably now, do they not?

Mr. PLATT. Yes, and they are also now giving attention to the need for a new bank. The other point is that you can multiply banks under the free banking idea carried to an extreme and put them down in capital as low as 5, 10, or 20 thousand dollars. No such banks were created until in the late eighties and a lot went down in the panic of 1893. A lot have gone down in every panic since. There are a few bank failures always, but even the rather small Weyburn Security Bank in Canada, with all its branches in Saskatchewan, did not fail.

Senator NORBECK. As long as they can keep that 42 cents a bushel advantage in the cost of producing wheat, that advantage will keep them open. The United States Tariff Commission is my authority for that differential advantage. President Coolidge acted on their advice. He admitted the principle of the findings, and he said that the American farmer is at a disadvantage of 42 cents on each bushel of wheat he raises.

Mr. PLATT. That may be true. I am not a wheat grower myself and can not dispute that. However, I know that in a growing community a little bank can be started with \$5,000 or \$10,000 capital or nothing at all and, of course, if nothing happens and prosperity prevails that bank can grow and come up. I remember when I was a member of the Federal Reserve Board we had submitted to us the application of a bank for admission into the system in Texas, which had started only a few years before with \$10,000 capital, and it had increased its capital to \$50,000, all out of earnings. If everything goes well they will grow up with the community, but if the community does not grow, and things go wrong, they have nothing to fall back on. The trouble is that their eggs are all in one basket.

Senator NORBECK. Is it not a fact that in every State of the Union that that is the way that big business has grown up—out of these little things? Realizing they are in a weak position, they strive to get away from it and manage to build up. Most businesses build up out of earnings and most banks also build up out of earnings. A \$5,000 bank is, of course, a joke to our minds now, but it supplied a necessity at one time and became a larger bank.

Mr. PLATT. A great many of them that survived did, but a great many did not survive. We should have established a different system. We should have served those places by branches and most of them would have stood up, and we would not have had nearly as many failures.

The ACTING CHAIRMAN. You approve, in a general way, in certain cases, of branch banks; in certain other cases you approve of group banks, where you have an economic and geographical situation that favors it?

Mr. PLATT. Yes. I think a proper definition of group banking is the one the comptroller gave; a group of banks, the stock of which is controlled by a holding company and more or less integrated in management with a rather large central institution.

The ACTING CHAIRMAN. Located in some proximity to the general area?

Mr. PLATT. Yes. In the old chain banks there was never, as a rule, any big bank or parent bank, so-called. They were simply a string of small banks of about the same size. I think in Iowa there

was a chain of banks with what they called a parent bank not much larger, however, than the others.

The ACTING CHAIRMAN. But a Chicago bank could not have a small cluster of banks in North Dakota and call that a group banking system? It would be much nearer branch banking?

Mr. PLATT. I do not know that I understood the question.

The ACTING CHAIRMAN. It is a zonal thing or a regional thing?

Mr. PLATT. Yes; the central institution should be contiguous to the rest of the group. All these nationally known groups have a large bank in the same general region with which the other banks are more or less integrated in management. They advise them on buying bonds, and so forth, and supervise their loaning policies, and it seems to me there is a great deal of advantage in the system. It is not as economical as branch banking, but it is the best that can be done in the circumstances. When the stock of the holding company has been exchanged for the stock of the banks, it seems to me you still have the neighborhood bank idea. The people still have a stock interest in the local bank as well as the group.

Senator BULKLEY. Are you in accord with the comptroller's recommendation in that respect?

Mr. PLATT. I think so. I think he has given us the right recommendation. It will give us the strongest branch banking systems. If I understand him correctly, he considers trade areas as rather large areas, and I am not quite sure that they need to be very large. You can have a trade area around a town of 50,000 inhabitants or even 25,000 inhabitants that would include two or three counties.

Senator BULKLEY. We have had some difficulty in defining trade areas. What would you suggest as the limit, if not trade areas?

Mr. PLATT. I think "trade areas" is perhaps as good a term as you could use, but I would not say that the trade area can exist only outside of a city of 500,000. I think that cities of 50,000 inhabitants or smaller also have trade areas that would compete with each other. I think all we need is an area large enough to permit diversification so that the banks will not have too many eggs in one basket.

The ACTING CHAIRMAN. Then, obviously, you can not limit a trade area to any radius, in miles; you must get diversification no matter how far you reach out for it?

Mr. PLATT. Yes. Still, there is some diversification even in agricultural products. There is some advantage in loaning some money on wheat and some on corn and some on flax, and so forth. Crops do not all go down at once.

Senator NORBECK. I think Mr. Platt is laboring under a great deal of misapprehension as to the products of our State. For instance, our income from butter and eggs is larger than our revenue from wheat; our income from tourists is greater than the income from wheat, and we lead in gold production.

Mr. PLATT. Yes; that is right—out in the Black Hills. I got you for the moment mixed up with North Dakota.

Senator NORBECK. North Dakota is a wonderful wheat State, and Canada is even better. There they have conditions which permit them to raise wheat at an advantage of 42 cents a bushel over the American farmer.

Senator TOWNSEND. Is it not a fact that there is a great competition between the State and Federal banks?

Mr. PLATT. I think there is a great deal of unfortunate competition.

Senator TOWNSEND. Have you a remedy for that?

Mr. PLATT. I would relax the national laws and allow the national banks to do a certain amount of branch banking business as Mr. Pole suggests. I would not go into any unsound propositions. I rather doubt whether it is very wise to let national banks do as much real-estate business as some do.

Senator TOWNSEND. You think a great deal could be accomplished by liberalizing the national banking law?

Mr. PLATT. I think if you allowed the small banks to consolidate, making larger institutions, with branches, they would perhaps become national banks; at least they would be large enough to become members of the Federal reserve system. That would bring the thing more nearly to uniformity. I would not do away arbitrarily with the State systems. The State banks do most of the experimenting and some of the State laws are excellent. I have always believed the California law was superior to the national banking act.

The ACTING CHAIRMAN. The comptroller has sent me his final figures in reference to bank suspensions, and they show 6,968 banks suspended between the years 1921 and 1930, inclusive, of which 797 banks reopened, or a total closed of 6,171.

Senator TOWNSEND. Does he give the proportion with respect to State and Federal?

The ACTING CHAIRMAN. During those same years, 1921 to 1930, inclusive, national banks suspended, 925; State member banks, 257; and State nonmember banks, 5,786.

Now, of those reopened there were, national banks, 98; State member banks, 27; and State nonmembers, 672, leaving a net total closed of all banks, 6,171, or, national banks, 827; State member banks, 230; and State nonmember banks, 5,114.

Senator NORBECK. The diversification advice given our farmers so freely by the eastern press, eastern business men and eastern bankers simply proves their ignorance of our economic conditions. It was such fool advice that led to such an overproduction of butter that it broke the American market.

Mr. PLATT. May I say one thing with reference to present efforts at diversification in the Western banks? How do they do it? They do it by engaging in open-market purchases, by loaning in Wall Street, and in the purchase of bonds.

Mr. WILLIS. Mr. Wiggin, will you give us your rough approximate idea on this point: What proportion of total call loans, when they were at the highest point, came from outside the city and what proportion came from the city banks?

Mr. WIGGIN. I do not think I can give it to you. In our own case practically all our loans were for outsiders.

Mr. WILLIS. Outside of New York?

Mr. WIGGIN. You mean separated from the accounts of others that lived in the same city?

Senator BULKLEY. The question is between the country banks and the city banks.

The ACTING CHAIRMAN. The rural banks.

Mr. WIGGIN. I can speak for the Chase National Bank and that may be a criterion.

On September 27, 1929, the demand loans of the Chase National Bank, street call loans, \$3,250,000.

Other demand loans of the Chase National Bank subject to call, but not quick call—that we make a distinction on—\$40,182,000.

Time loans of the Chase National Bank, street loans, less than a million—\$750,000.

Call loans and time loans—I put the two together—for account of domestic banks—probably those were mostly out-of-town banks but they may have included some in New York City—\$396,000,000.

Call and time loans for account of foreign banks, \$9,000,000.

Call loans and time loans for account of firms, corporations, and individuals—whether out of town or in town we do not distinguish—\$626,000,000.

Senator BULKLEY. Do you think that is fairly typical?

Mr. WIGGIN. I think we probably did more for others than most banks. If you would like to see the changes between that and the November figures, it might interest you. I think that would be very interesting.

November 20—this is after the break in the latter part of October—demand loans for brokers, practically nil—\$225,000.

Loans to others on demand, \$41,000,000.

Time loans on the street, practically the same as the demand loans on the street, \$690,000.

Call loans for account of domestic banks, \$151,000,000, against \$396,000,000.

Call and time loans, account of foreign banks, \$1,700,000.

Call loans for individuals, \$245,000,000 as against \$626,000,000.

Mr. WILLIS. They were all paid up, I think, without difficulty, in cash?

Mr. WIGGIN. Yes. Our trouble came in loans on securities and not the brokers' loans.

Mr. WILLIS. The country banks had no difficulty in recovering all they had placed with the banks?

Mr. WIGGIN. Not a bit.

As to any possible improvements in the banking act, I would call your attention to the fact that the minimum capital, the point that Mr. Platt raised, is pretty small for the size of the community. It used to be \$50,000 but it has been reduced to \$25,000 in certain territories.

I would also call attention to the liberality of the loaning limit on certain commodities. On certain commodities a bank can loan 50 per cent of its capital and surplus. It provides for a certain margin, but it might not be there shortly after the loan is made. It is a pretty large percentage of the capital and the surplus to permit to loan.

The ACTING CHAIRMAN. It is now 1 o'clock and this hearing is adjourned until 10.30 on Thursday morning.

(Whereupon, at 1 o'clock p. m. the committee adjourned until Thursday, January 29, 1931, at 10.30 o'clock a. m.)

# OPERATION OF THE NATIONAL AND FEDERAL RESERVE BANKING SYSTEMS

THURSDAY, JANUARY 29, 1931

UNITED STATES SENATE,  
COMMITTEE ON BANKING AND CURRENCY,  
*Washington, D. C.*

The subcommittee met, pursuant to adjournment, at 10.30 o'clock a. m., Hon. Frederic C. Walcott presiding.

The ACTING CHAIRMAN. The committee will come to order.

## STATEMENT OF B. W. TRAFFORD, VICE CHAIRMAN OF THE FIRST NATIONAL BANK OF BOSTON

The ACTING CHAIRMAN. Mr. Trafford, you have given your name and occupation?

Mr. TRAFFORD. Yes.

The ACTING CHAIRMAN. You are vice chairman of the First National Bank of Boston?

Mr. TRAFFORD. Yes, sir.

The ACTING CHAIRMAN. The purpose of this hearing is, we hope, entirely constructive. Our hearings are informal. If there is anything you think ought to be kept off the record, state it frankly, and we will keep it off the record, or if there is any question you feel you do not care to answer in a public hearing, just say so. We do not want to have anything appear in this record that is of a confidential nature; I mean by that, personal accounts, and so forth. We are not asking, as far as we know, any embarrassing questions. What we are trying to do is to find out the cause and a partial or complete cure for these depressions. We are analyzing them to see if there is anything in the Federal reserve act that we can tighten up, if it is wise, to avoid certain types of loans or whatever may be a dangerous feature, and we feel that the time to engage the physician to cure the disease is when the patient is sick, and we want to do it with the least embarrassment to the patient.

I have a list of questions similar to those asked members of the Federal Reserve Board, and, with you, we want to apply the questions more particularly to New England. We want to get into the cotton-manufacturing business a little—into the textiles—to see what relation they have to the financial situation. I will ask you a few of these questions, and then we will get into something more general, unless you have a statement you would like to give us first.

Mr. TRAFFORD. No; this is simply a digest of the bill that I have in my hand.

The ACTING CHAIRMAN. First, what, in your opinion, was the cause of the securities collapse of 1929 and the banking difficulties accompanying and following it?

I shall read four questions to you now. The second question is, what remedies have you to suggest against the recurrence of another such episode; third, have you examined the bill pending before this committee, and have you any criticism thereof; fourth, what other suggestions for legislation can you make?

That is a pretty broad order and you can handle it any way you please.

Mr. TRAFFORD. I think the cause of the collapse was that people believed we were entering a new era and that stocks would increase and continue to increase. It was simply an orgy of speculation and it collapsed. I do not think it was due to any defect in the banking law. It was just the collapse of an orgy of speculation.

The ACTING CHAIRMAN. You think the new generation coming along imagined that earnings did not count, perhaps? That thought was thrown at me a number of times—a new era with a new way of thinking.

Mr. TRAFFORD. I do not know what all thought, but some seemed to think we were going to enter into an era of easy money, and that in this machine age, immense profits were going to be made, and that earnings would increase indefinitely. We have simply gone back to the old yardstick.

Mr. WILLIS. But they would not have succeeded very well in their speculations, without the aid of the banks? Did not the banks aid in bringing on the collapse?

Mr. TRAFFORD. I think the money would have gone into speculation, banks or no banks, banking laws or no banking laws.

The ACTING CHAIRMAN. We have developed in the hearings in the past 10 days the fact that there was an enormous accumulation of reserves and eligible paper and United States securities in 1927 and 1928, and the member banks were in a position then to borrow large sums of money, which they did, and probably diverted a great deal of that legitimate borrowing over into brokers' loans.

Mr. TRAFFORD. Well, I do not think they diverted it really. I think they satisfied all commercial needs. I never heard of anybody not getting money for their commercial needs then or now.

The ACTING CHAIRMAN. You think the commercial borrowings were kept on a lower level of rates than the brokers' loans?

Mr. TRAFFORD. They were with us, and I think that was true generally.

Senator TOWNSEND. Your rate of interest did not exceed 6 per cent for the regular business?

Mr. TRAFFORD. I think no commercial business was higher than six. I do not know what the call loans went to—20 per cent, possibly.

Mr. WILLIS. Did not the high rates for call money tend to affect the commercial rates?

Mr. TRAFFORD. I think they did have the effect of pulling them up a little bit, but they were given favorable treatment.

Mr. WILLIS. The figures of the Federal reserve system seem to indicate a general average increase over the country—perhaps 1½ to 2 per cent—during that period. Was not that the direct result of the diversion of funds into speculative channels?

Mr. TRAFFORD. I think it must have had an effect of that kind.

Mr. WILLIS. You think in New England the increase was not over 1 per cent?

Mr. TRAFFORD. Six per cent was our maximum, and I was thinking of what it might have been if we had not had the condition you mention.

Mr. WILLIS. You never went above 6 per cent?

Mr. TRAFFORD. I do not think our bank went above 6, and I do not think banks generally did. I really do not know and I would not want to be quoted. I think our bank stayed entirely at 6 per cent or less.

Mr. WILLIS. There was never any shortage of funds due to the throwing in of the money into the call market?

Mr. TRAFFORD. No; I do not think I ever heard of a commercial customer who could not get money if he deserved it, at a reasonable rate.

Mr. WILLIS. Was there much increase in borrowing at the reserve bank of Boston as the result of this speculative episode?

Mr. TRAFFORD. I think there was.

Mr. WILLIS. I mean directly as the result of speculation.

Mr. TRAFFORD. I do not know; I am not sure.

The ACTING CHAIRMAN. That was true in New York to a large extent, was it not?

Mr. TRAFFORD. Yes; I think it was. That brings one thing to my mind. I do not know whether it is an appropriate time to discuss it.

The ACTING CHAIRMAN. Just go right ahead, Mr. Trafford.

Mr. TRAFFORD. The Federal reserve rediscount rates, as a rule, are lower than the commercial rates and, in times just as you have spoken of, it is a temptation, certainly, to lend on collateral with the stock exchange houses and borrow at the Federal reserve bank at a lower rate. It is a scalping operation.

Mr. WILLIS. Was there much of that in the Federal reserve district around Boston?

Mr. TRAFFORD. I think there was some. It seemed to me poor banking to do that. That leads me to think that if the rediscount rate were a bit higher than the commercial rate, it would perhaps keep that situation more normal; there would not be the temptation to borrow in order to scalp.

Senator TOWNSEND. Do you think an increase in the Federal reserve rates would have obviated this condition?

Mr. TRAFFORD. What condition?

Senator TOWNSEND. This scalping condition in borrowing.

Mr. TRAFFORD. Even if the Federal reserve rates had been put up, even higher than they were, I doubt if they would have prevented the collapse. But there was a period when it was to the advantage of the banks to lend money to the stock exchange on securities and borrow from the Federal reserve banks. It seemed to me to be poor banking.

Mr. WILLIS. Did the Boston banks loan chiefly to members of the Boston Stock Exchange or also to the New York Stock Exchange?

Mr. TRAFFORD. I do not know.

Mr. WILLIS. You made no use of your funds in that way?

Mr. TRAFFORD. No; we felt that whenever we had to go to the reserve bank, we should get out as quickly as possible and not be a



steady boarder. We did not think it was right. That leads to the suggestion that the Federal reserve rates should be higher than the commercial rates, to discourage that thing.

Mr. WILLIS. What was the effect of having them lower in New England? Have you a distinct local money market there or not?

Mr. TRAFFORD. What do you mean—a brokers' loan market?

Mr. WILLIS. I mean a definite organization—a money market such as you have in New York, but on a smaller scale; for instance, do you have a market for acceptances there or a call-loan market?

Mr. TRAFFORD. We call it a call-loan market. It is small.

Mr. WILLIS. Is that regulated solely with reference to the New York market, or do you fix the rates independently?

Mr. TRAFFORD. As a rule, the Boston rate is slightly above the New York rate and the reason is that the collateral offered is less well known and stocks and securities that are perhaps well known in the Boston market are unknown in New York. Probably the banks do not accept them there. I think, as a rule, the Boston rate is just slightly above the New York rate—probably a quarter or half of 1 per cent. I think now it is about the same.

Mr. WILLIS. Have the banks in Boston developed any definite business in local brokers' loans, or what have they done?

Mr. TRAFFORD. All of the Boston brokers borrow from the Boston banks and some of them borrow from New York banks.

Mr. WILLIS. So you have a regular brokers' loan market there?

Mr. TRAFFORD. Yes, sir.

Mr. WILLIS. That is not merely a branch of the New York market, but an independent, separate thing?

Mr. TRAFFORD. An independent separate thing for what it is—small.

Mr. WILLIS. Does that market devote itself chiefly to the locally listed stocks or is the money used in the New York market on stocks listed there?

Mr. TRAFFORD. Both. I think the real difference is that the Boston banks will accept some collateral known in Boston which the New York banks would not. Some of our loans by Boston banks are purely New York Stock Exchange collateral and some are made with Boston collateral.

Mr. WILLIS. To what extent do you think the New York call market was in the habit of drawing from the reserve resources at Boston?

Mr. TRAFFORD. I do not quite see what you mean.

Mr. WILLIS. As you know, the New York Stock Exchange publishes a compilation of brokers' loans made from time to time. Now, those come both from local banks and also from other banks. The question that seems to me interesting here is how far they come from Boston banks, if you have any information on that.

Mr. TRAFFORD. I have no figures, but it must have been a considerable item.

Mr. WILLIS. So that the Boston banks really were, in a certain sense, a part of the New York call-loan market?

Mr. TRAFFORD. I think so; I mean our own banks loan considerable money in the New York market, in addition to lending on the local market.

The ACTING CHAIRMAN. We want to pay some attention to affiliates. You do not have them as extensively in connection with your banks in Boston as they have them in New York.

Mr. TRAFFORD. Four Boston banks have them. That may be as large a percentage as in New York.

The ACTING CHAIRMAN. The First National has an affiliate?

Mr. TRAFFORD. Yes.

The ACTING CHAIRMAN. Do you think they are useful?

Mr. TRAFFORD. Yes.

The ACTING CHAIRMAN. You think they do more good than harm? There are all kinds of abuses possible. Do you think they are indulged in?

Mr. TRAFFORD. No; I do not.

The ACTING CHAIRMAN. You do not think there is a temptation? Of course, you know the New York situation, and some of those situations have been pretty disastrous in the last two years. Would that situation have been better if there had been no affiliates at all in the last 10 years?

Mr. TRAFFORD. No; I do not think so. I think they have done their work well.

The ACTING CHAIRMAN. Well, in some cases—

Mr. TRAFFORD. And fulfilled the needs. I think you started to ask if there was a temptation on the part of the management to do some crooked things. I think there is that temptation on the part of bad management.

The ACTING CHAIRMAN. Of course, there is always that temptation whether they have affiliates or anything else.

Mr. TRAFFORD. Yes, sir; exactly.

The ACTING CHAIRMAN. Would you place any further restrictions on them in order to get a more complete separation between the bank and the affiliate?

Mr. TRAFFORD. Well, I would try completely to separate them. I would try to have the funds that support the security business segregated from the commercial bank.

Mr. WILLIS. How would you do that?

Mr. TRAFFORD. By putting the stock in the hands of trustees for the benefit of the stockholders of the bank and let the affiliate have its own capital and stand on its own feet.

Mr. WILLIS. That is the same plan followed by the First National of New York.

Mr. TRAFFORD. I think so. I am not sure whether all the affiliates are the same.

Mr. WILLIS. Substantially the same.

Mr. TRAFFORD. Yes; I think it is substantially the same.

The ACTING CHAIRMAN. It is different, I think, with the Chase and the National City.

Senator TOWNSEND. You have the affiliate examined by the bank examiners at the same time the bank is examined?

Mr. TRAFFORD. No. However, I ought to qualify that. Our affiliate did not start as a securities company. It started under the Edge Act to do a foreign business, and we were examined by the Federal Reserve Board examiners every year simultaneously with the examination of the bank, which is a very good plan, up to last year. Then we ceased to be an Edge Act organization and our stock was

segregated. We asked the Boston reserve bank if we could be examined by them and they referred us to the New York reserve bank, who declined. We then asked the Federal Reserve Board and they said that inasmuch as we were not an Edge Act corporation they did not feel like going outside of their field. However, I think it is very desirable to examine them.

Mr. WILLIS. When that Edge Act corporation existed, was its stock owned by the same stockholders?

Mr. TRAFFORD. It was owned by the bank itself. The law gave, as I recall it, the right to invest a certain percentage in Edge Act companies. It was a small amount. That is the way we started in. We did an acceptance business at first.

Mr. WILLIS. When you changed over the stock was transferred?

Mr. TRAFFORD. It was segregated from the bank and put into the hands of trustees for the beneficial interest of the stockholders of the bank.

Mr. WILLIS. Of the First National Bank?

Mr. TRAFFORD. Yes, sir.

The ACTING CHAIRMAN. Do you have a separate board of directors?

Mr. TRAFFORD. Yes, sir.

The ACTING CHAIRMAN. The trustees holding the stock—they do not overlap?

Mr. TRAFFORD. No, sir. What do you mean by "overlap"?

The ACTING CHAIRMAN. No director of the bank is a trustee of the affiliate?

Mr. TRAFFORD. Yes, the three trustees are directors of the bank.

Mr. WILLIS. Are the officers the same?

Mr. TRAFFORD. Yes; they are.

Mr. WILLIS. They are all the same?

Mr. TRAFFORD. No; the active operating officers are not the same. For instance, I am chairman of the board of the corporation and vice chairman of the bank. Mr. Stockton is president of the bank and president of the corporation. The active operating officers, however, are entirely different.

Mr. WILLIS. Why did you give up the Edge Act function?

Mr. TRAFFORD. There were two reasons. May I take a little time on this?

The ACTING CHAIRMAN. Certainly.

Mr. TRAFFORD. It is complicated and I am not sure I can trace it now. We started under the Edge Act, when the war came along and a tremendous foreign business was thrown on this country. Our bank had been largely in the foreign business doing an acceptance business. Foreign trade increased at such a rate that there were not enough banking facilities to handle it, that is, banks organized to do it. So, the Federal Reserve Board gave us permission to accept, up to 100 per cent of our capital and surplus, but that was not sufficient and then we founded this Edge Act corporation and did quite an acceptance business, the Reserve Board giving us rather wide power to make these acceptances.

Then the foreign trade subsided, and it left the corporation with little to do. Then it was urged that we build up a market for acceptances, which we have done, and have been very large dealers in bankers' acceptances and United States Government bonds, which were based on foreign Government loans. As our business grew the

capital limitation in the Edge Act—I have forgotten what it was—was really too small for the volume of business we were doing. We were in a sort of strait-jacket. That was the major reason. The second reason was that this business was not so foreign as it had been in the beginning. Our acceptance business brought us into touch with a great many of the banks throughout the country. They wanted some domestic loans and we began to do a little of that business.

Then we did not know whether our business would develop into a domestic business or be entirely foreign or mixed, and so we thought we would have no question about it and be free to go either way. First, on account of the restriction of capital and second to be able to do a foreign or domestic business, we withdrew from the Edge Act, increased the capital, and became a Massachusetts corporation.

Mr. WILLIS. There are no corporations remaining now under the Edge Act?

Mr. TRAFFORD. I do not know.

Mr. MEYER. Yes; there is one.

Mr. WILLIS. Has not that just arranged to alter its business?

Mr. MEYER. I do not know about that.

Mr. WILLIS. Do you think it would be well to repeal the Edge Act provisions or recast it so there will be organizations under it?

Mr. TRAFFORD. I do not know much about the Edge Act except we were allowed to qualify under it.

Mr. WILLIS. You seem to have had more experience with it than others.

The ACTING CHAIRMAN. Did your business under it produce profits?

Mr. TRAFFORD. Yes, sir.

Mr. WILLIS. But you found it not suitable to your requirements?

Mr. TRAFFORD. We were invited to go into it under the Edge Act.

Mr. WILLIS. But has it not proved to be ill-adapted to anybody's needs, as proved by the fact that nobody that has gone into it has remained in it?

Mr. TRAFFORD. I do not know what the Edge act is, except in the one particular in which we qualified. We had to get out of it. It really did not suit our needs.

Mr. WILLIS. I think that was the general experience.

The ACTING CHAIRMAN. You speak of "acceptances," in the American sense, and not the English sense? You have no English acceptances, have you?

Mr. TRAFFORD. I do not know the difference between the American and English.

The ACTING CHAIRMAN. How do you handle yours? It is commercial paper: What is the guarantee?

Mr. TRAFFORD. Our acceptance business is mostly based on the exportation and importation of goods.

Mr. WILLIS. You do not handle domestic acceptances?

Mr. TRAFFORD. We have a very small proportion.

Mr. WILLIS. Why is that?

Mr. TRAFFORD. I do not know. We have been in the foreign business with a foreign atmosphere for 30 or 40 years. It has gradually grown and grown so that we are able to get plenty of foreign acceptance business.

Mr. WILLIS. Do you regard the domestic acceptance business as unsound?

Mr. TRAFFORD. I do not suppose it is unsound. We do not do much of it. But I guess it is sound enough.

The ACTING CHAIRMAN. It is practically all commodity paper?

Mr. TRAFFORD. The acceptances?

The ACTING CHAIRMAN. Yes.

Mr. TRAFFORD. Well, it is all commodity paper in some form or other. The type that we use mostly, is on goods from one country to another.

Mr. WILLIS. Do you regard the making of acceptances against commodities in warehouses an undesirable practice?

Mr. TRAFFORD. I do not think it is.

The ACTING CHAIRMAN. When you speak of——

Mr. TRAFFORD. That is, if you get the right warehouse.

The ACTING CHAIRMAN. You have to get that kind of warehouse?

Mr. TRAFFORD. Yes.

Mr. WILLIS. It is very easy to mistake the character of the warehouse?

Mr. TRAFFORD. Very.

The ACTING CHAIRMAN. You are handling commodities in transit, as a rule?

Mr. TRAFFORD. Yes. We bring leather from the Argentine or hides or wool and ship automobiles to Australia and these are covered by these acceptances—usually 90 days.

Mr. WILLIS. Does the First National Bank hold many acceptances in its portfolio, usually?

Mr. TRAFFORD. We have now. As a rule, we do not, I am sorry to say.

Mr. WILLIS. Why is that?

Mr. TRAFFORD. Because we make more money in other directions.

Mr. WILLIS. Why should others take acceptances then if you do not?

Mr. TRAFFORD. They do not.

Mr. WILLIS. Where do they go?

Mr. TRAFFORD. The Federal reserve bank.

Mr. WILLIS. The Federal Reserve Bank of Boston is the sole repository, practically?

Mr. TRAFFORD. The reserve banks are.

Mr. WILLIS. Is that a healthy situation?

Mr. TRAFFORD. I do not think so.

Mr. WILLIS. What can be done to remedy that and put the acceptances on their feet?

Mr. TRAFFORD. I do not think you can do it by any law. We have been over 10 years trying to develop it. It is a very slow-growing plant.

Mr. WILLIS. What is the reason?

Mr. TRAFFORD. Because banks can make more money somewhere else.

Mr. WILLIS. Where is that somewhere else?

Mr. TRAFFORD. We make commercial loans if we can get them.

Mr. WILLIS. And when you can not——

Mr. TRAFFORD. We can make more on Government bonds.

Mr. WILLIS. When those are deficient?

Mr. TRAFFORD. Then we have to go to acceptances. That is what we are doing now.

Mr. WILLIS. You go into the call market as an alternative?

Mr. TRAFFORD. Oh, yes.

Mr. WILLIS. Is not that the reason why the acceptance market is depressed?

Mr. TRAFFORD. I think that is one.

Mr. WILLIS. If the call market were not quite as active and all-embracing as it is, there might be more business in acceptances?

Mr. TRAFFORD. There might. I know how that worked out when the call market was active. Now, when it is less active there is more buying of acceptances.

The ACTING CHAIRMAN. The call market now is pretty dead?

Mr. TRAFFORD. Yes; and the rates are very low.

The ACTING CHAIRMAN. Your rate, of course, is the dominant factor?

Mr. TRAFFORD. Yes; it is the rate.

The ACTING CHAIRMAN. If you get a high rate on your call loans, of course your acceptance business must dwindle—no one wants it.

Mr. TRAFFORD. That is right. I think we have between 60 and 70 millions of acceptances now in our portfolio.

Mr. WILLIS. That is, the portfolio of the First National Bank?

Mr. TRAFFORD. Yes. A year ago we did not have many.

Mr. WILLIS. Do many of your acceptances base themselves upon commodities in storage warehouses abroad, particularly in Germany?

Mr. TRAFFORD. No; I think not.

Mr. WILLIS. There has been a great increase in such acceptances elsewhere. I did not know whether it was true in the Boston district or not.

Mr. TRAFFORD. I can not speak accurately on that. I do not know. There may be some.

Mr. WILLIS. Such increases as have taken place in that regard, I take it, indicates a substitution for the longer-term bonds that Germany had been in the habit of floating here?

Mr. TRAFFORD. I think so.

Mr. WILLIS. That results in freezing the acceptances, does it not?

Mr. TRAFFORD. I think so.

Mr. WILLIS. How can that be prevented?

Mr. TRAFFORD. I do not know. I think it would be well to strike this all off the record. It is very casual.

The ACTING CHAIRMAN. It might be slightly inaccurate, but it is useful to us in what we are trying to get at. Your attitude toward the security affiliate is interesting and instructive. You think there must be a complete separation there.

Mr. TRAFFORD. I think there ought to be a complete separation. I think there ought to be an examination and it ought to be simultaneous with the bank examination. I think you have got to have—

The ACTING CHAIRMAN. Is there any reason that you know of why the bank examiners have suddenly stopped within the last three years, from regular examinations of security affiliates? It is an unusual coincidence that they stopped with you and New York.

Mr. TRAFFORD. Ours only stopped in 1930.

The ACTING CHAIRMAN. Well, in 1929 and 1930 they apparently stopped in New York. It is a curious coincidence.

Mr. TRAFFORD. I think I have explained why ours stopped.

The ACTING CHAIRMAN. You say they did not have any adequate machinery for doing it, but they had been doing it regularly.

Mr. TRAFFORD. When we were under the Edge Act they considered that we were under the regulations of the Federal Reserve Board and were under their jurisdiction and they went about it and examined it, and they always examined it simultaneously with the bank, and they made very good examinations, and after a year or two they knew how to make them and we valued them very highly. When we went out from the Edge Act, as I told you, we requested the two reserve banks and finally the Reserve Board, and they replied that we were no longer under the Edge Act and they felt it was outside their province to do it. I do not know whether the labor of making it influenced their decision or not.

The ACTING CHAIRMAN. Whom would you make responsible for the examination of the affiliates of the banks? Would you put it up to the Federal reserve or whom would you have do the bank examining, the State bank examiner or the Federal examiner?

Mr. TRAFFORD. We would rather have the Federal examiner.

The ACTING CHAIRMAN. Under the direction of the comptroller or the Federal reserve? How would you work it out; what is the practical solution of it?

Mr. TRAFFORD. The practical way, it would seem to me, would be to have the comptroller do it. He examines the banks, and he could also examine the affiliates simultaneously. I imagine in practice, if the Federal Reserve Board did it, they would borrow some examiners, and you really would not know who was really supervising it. It would probably be the same people. I think the same examiners would be better. I think it is quite important they be the same examiners and that the examination be made at the same time.

Mr. WILLIS. You have only the one affiliate?

Mr. TRAFFORD. Only one, under your definition. We have the Old Colony Trust Co., which is, in a sense, an affiliate.

Mr. WILLIS. The other Boston banks; have they more than one affiliate, as a rule? You spoke of the four largest ones having an affiliate? Have they each one or many?

Mr. TRAFFORD. We have more than one. We have the Old Colony Trust Co., which is, in a sense, an affiliate, and then the First National Old Colony Corporation, which is an affiliate. Then there is the Old Colony Associates. I do not know whether you call that an affiliate or not. That is a Massachusetts association in which our corporation owns 10 per cent of the stock. I do not know whether you would call that an affiliate.

Mr. WILLIS. How much do you own of the other corporations—the Old Colony Trust Co., for example? Who owns the stock of that?

Mr. TRAFFORD. The Old Colony Trust Co., which is a trust company doing a fiduciary business almost exclusively—that stock is in the hands of trustees for the benefit of the shareholders of the First National Bank.

Mr. WILLIS. Just the same as a security company?

Mr. TRAFFORD. Yes.

Mr. WILLIS. The same method exactly?

Mr. TRAFFORD. Exactly; so, a shareholder in the First National Bank of Boston, has an interest in the affiliates.

Mr. WILLIS. There has been some feeling that when you had that arrangement, that—in the hands of a bank officer who was not of the highest standards—there was some danger of the exercise of the fiduciary function in that the security affiliate from time to time unloaded or dumped securities upon the trust company. Have you seen any development of that in New England?

Mr. TRAFFORD. I should say generally not. In our case we are forbidden. We do not do it. Our trust company does not buy from the security affiliate, and we advertise that we do not do that.

Mr. WILLIS. But others do that.

Mr. TRAFFORD. I do not think many of them do.

Mr. WILLIS. Then, there would be no harm in forbidding such a transaction by law?

Mr. TRAFFORD. I would see no objection to it. I do not think they ought to do it. Whether you want to put it into the law or not I do not know.

Mr. WILLIS. Still, if it is very rarely practiced and everyone disapproves of it, a law to that effect would do no harm.

Mr. TRAFFORD. I should not think so. If I could strike my answer off the record, I should say I would be very glad to have it done.

Mr. WILLIS. We have had some inquiry here as to the question of loans of affiliates, and I think the Comptroller of the Currency has favored the limitation of the total amount of loans to be made by the banks to all of its security affiliates to the same amount that any one of them would be able to get. What would you think of that?

Mr. TRAFFORD. That is where they have more than one affiliate?

Mr. WILLIS. Yes; for instance, the Bank of the United States in New York is said to have had 48 of them, and various of the larger New York banks have several. You have, yourself, several.

Mr. TRAFFORD. We have one security affiliate.

Mr. WILLIS. Others have had real estate affiliates, and so forth. Now at the present time, as we understand from the Comptroller of the Currency, it is possible for each one of those affiliates to borrow, under section 5,200 and other restrictions. The comptroller thinks it might be well to treat all of the affiliates as one borrower, so that the restrictions that would apply to each individually, would apply in the aggregate, to all. What do you think of that?

Mr. TRAFFORD. I do not think well of that suggestion. I think that that would be unfair.

Mr. WILLIS. For what reason?

Mr. TRAFFORD. I do not know why they have all of these affiliates, but supposing they had two affiliates, to simplify it, and each one adequately capitalized and entitled to credit. I think each one ought to be treated on its own merits and given what it should be given. I do not see why you add them all together if they are segregated, one from another.

Mr. WILLIS. The investigation we have been making shows a very high development of loans to security affiliates, and the question, it seems to me, is whether the practice should be permitted to increase, so that the affiliate becomes a brokers' department of the bank, making



its loans primarily to brokers and dealers and borrowing from the parent bank for that purpose to the full extent that the legal requirements would permit. If you do that and you go on with another affiliate dealing in real estate, which makes equally generous real estate loans to dealers in real estate, and then you have another affiliate making some other kind of loans, you have a situation which a banks' whole loaning power may be diverted to and engaged in frozen loans. Is not that a danger?

Mr. TRAFFORD. Yes. I have not thought that there was that chain of arrangements. In other words, a bank might have 10 affiliates?

Mr. WILLIS. Concededly.

Mr. TRAFFORD. And would lend 10 per cent of its capital and surplus to each one?

Mr. WILLIS. Yes. That would not be a good situation?

Mr. TRAFFORD. Well, I should think it might be abused very much, if all those 10 were bad. If they are all good, of course there would not be any harm done. You would treat them as any other customer.

Mr. WILLIS. Of course if all loans of banks were good, it would not make very much difference how they were made. They would be 100 per cent good in that case.

The ACTING CHAIRMAN. Let us get on to the security loans.

Mr. TRAFFORD. May I say one thing more? Are we leaving the affiliate question?

The ACTING CHAIRMAN. Unless you have something to add.

Mr. TRAFFORD. You asked whether I thought they were doing good work and should be continued. I said I did. The main reason why I think they have to continue is this, that if they do not the national banks will be at a tremendous disadvantage with the State banks and private banks, and it is pretty hard now in New England to keep the people in the system. They are all the time coming to us asking why they should stay in. There is quite an exodus, and if those added penalties were put on I do not know what would happen.

Mr. WILLIS. You mean by "added penalties," not allowing them to have affiliates?

Mr. TRAFFORD. Yes. The State banks do. It would lose the system an important part of the banks that I think you want.

(Discussion off the record.)

The ACTING CHAIRMAN. Now, let us go to the matter of security loans. What method do you think is safer—loaning directly to a customer on a security basis or through a broker? Which, in the average, over a period of time, would be the sounder business, do you think, and what is your practice, generally speaking?

Mr. TRAFFORD. Of course we loan both ways. We loan to brokers and to customers who want to borrow on securities.

The ACTING CHAIRMAN. You probably loan more through brokers?

Mr. TRAFFORD. I think we are loaning more direct. I know we are now. I think we are probably loaning three times as much now and I imagine, at the height of the inflation we were loaning about equally. I would not like to be quoted on that, but it is about right.

The ACTING CHAIRMAN. In other words, you look to the security—you watch the security rather than the personal obligation?

Mr. TRAFFORD. Yes. I know we made some losses on individual collateral loans, and I am not sure, but I doubt if we have ever lost any on New York Stock Exchange loans in all the years. I doubt it.

The ACTING CHAIRMAN. Would your tendency, in making the loans, be more conservative than the average broker? Of course it would be. Your margin would be higher?

Mr. TRAFFORD. It was in 1928 and 1929.

The ACTING CHAIRMAN. You jacked your margin up?

Mr. TRAFFORD. Yes.

(Discussion off the record.)

The ACTING CHAIRMAN. In your opinion, is any substantial proportion of bank security loans at the present time backed by securities the market value of which is less than 110 per cent of the amount of the loan? That is tantamount to asking you whether you think the margin on securities at the present time is adequate.

Mr. TRAFFORD. I think there are some.

The ACTING CHAIRMAN. When the collateral is insufficient, is there a tendency to shift over to other loans and discounts?

Mr. TRAFFORD. I did not get that.

The ACTING CHAIRMAN. When your collateral is insufficient and impaired—you have an account “other loans and discounts”—do you shift over?

Mr. TRAFFORD. I still do not get that.

Mr. WILLIS. Is there any tendency to transfer loans that are undermargined?

The ACTING CHAIRMAN. You must have that heading “Other loans and discounts.”

Mr. TRAFFORD. I do not know that we have.

The ACTING CHAIRMAN. Most banks have. It is the cats and dogs column.

Mr. WILLIS. Is there any such practice in New England that you know of?

Mr. TRAFFORD. No; we have our collateral men who deal with these people right along and sweat and strain with them.

Mr. WILLIS. There is no tendency in New England to use this as a wastebasket provision for the purpose of cleaning up the security loans accounts?

Mr. TRAFFORD. Not that I know of.

The ACTING CHAIRMAN. Would you suggest any remedy or any legal method for restricting brokers' loans in the future, in the event of the leading bankers in the country being pretty well agreed on a period of inflation in sight—warnings sent out? Is there any way other than good banking; good bankers? Would you leave that flexible, as it is now?

Mr. TRAFFORD. I would leave it as it is now. I would not know what to put into the law. Most anything I would think of would be really damaging. I do not see how we can differentiate.

The ACTING CHAIRMAN. You believe in leaving the system and the laws pretty flexible and getting good bankers in?

Mr. TRAFFORD. Yes; and keeping them in.

Mr. WILLIS. How do you do that?

Mr. TRAFFORD. I think on that point you speak of there is a radical improvement in the last few years in the number of young men coming in.

The ACTING CHAIRMAN. You think the personnel in improving?

Mr. TRAFFORD. I think so.

The ACTING CHAIRMAN. Under the head of "bank investments" there are a few questions we desire to ask you. Do you regard the great increase in the volume of bondholdings by banks in recent years as tending to impair the liquidity of commercial banks?

Mr. TRAFFORD. I do not know how to answer that.

The ACTING CHAIRMAN. You are having the same experience now as in New York—you have not been as liquid in years?

Mr. TRAFFORD. No, sir.

Mr. WILLIS. The country banks are not quite as liquid?

Mr. TRAFFORD. I do not think New England country banks are too liquid, but sound.

Senator TOWNSEND. Is there a keen competition between the national banking system and the State banking system in your State?

Mr. TRAFFORD. There certainly is.

Senator TOWNSEND. Was the organization of your affiliates brought about by this keen competition?

Mr. TRAFFORD. No.

Senator TOWNSEND. It was not brought on by that competition?

Mr. TRAFFORD. No, sir. It came on as I described, from the big war-time needs. The Government really asked us to do it. I dare say that our being in it led others to do it.

Senator TOWNSEND. Have you any remedy for taking this keen competition out between the Federal and State systems?

Mr. TRAFFORD. No, I have not. If the reserve system could be made attractive enough, so they would all come in, I think that would be the best solution.

The ACTING CHAIRMAN. We will come to that in a few minutes. That is a large question itself, in which we are very much interested. Will you put any further restrictions on the question of bond purchases, perhaps through the office of the comptroller?

Mr. TRAFFORD. No; I would not.

Mr. WILLIS. You are familiar with the confidential instructions issued to the banks governing the buying of bonds, issued by the comptroller?

Mr. TRAFFORD. I am not sure that I know what that is. Is it a recent one?

Mr. WILLIS. The circular the comptroller sent out, issued under the McFadden Act, stating what bonds banks can buy. Is that thoroughly satisfactory?

Mr. TRAFFORD. I know what you mean. I read it, and at the time I thought it was.

Mr. WILLIS. You do not think the banks now are in danger of becoming water-logged with bonds and, of course, having to dispose of them, as they are doing now, at a loss?

Mr. TRAFFORD. Of course that is always so.

Mr. WILLIS. Under the McFadden Act, is there not a special danger there of banks doing that?

Mr. TRAFFORD. Well, there is a chance to make a loss, but I do not see how we can avoid that.

Mr. WILLIS. Take the securities section of the McFadden law, three years ago: Do you think that is a good thing to have in the law, or do you regard it as advisable to repeal it?

Mr. TRAFFORD. Will you digest that?

Mr. WILLIS. It provides that banks may become investors in securities subject to the rules of the comptroller. Of course they have always been able to buy bonds under rather loose regulations of the comptroller. However, this seems to authorize their going into the investment business.

Mr. TRAFFORD. I think that is a good thing if it is as far as you are going. I would like to see the security business segregated.

Mr. WILLIS. You would not like to see it used for issue purposes?

Mr. TRAFFORD. Yes.

Mr. WILLIS. You think it is quite all right for the banks to become issue houses?

Mr. TRAFFORD. Yes.

Mr. WILLIS. You already have them in the brokerage business with the security affiliates?

Mr. TRAFFORD. I was thinking of the banker without an affiliate, whether he should be allowed to do a security business. I think he should. The State banks can do it.

Mr. WILLIS. I think they can.

Mr. TRAFFORD. I would not do anything that would put us at a disadvantage with the State banks. I would get the State banks into the system if I could.

The ACTING CHAIRMAN. If you had any modification, you would tend to check up the State banks rather than restrict the National banks; that is, you would bring the State banks to conform to the national system rather than impair the activities of the national banks? Is that what you mean?

Mr. TRAFFORD. I would not place the national banks at a disadvantage with the State banks unless I thought a bad practice was involved. If the States had an obviously bad practice I would not do that.

Mr. WILLIS. This boils down to the provision that national banks should be allowed to exercise all powers unless prohibited by the national bank act, exercised by State banks in the locality in which they are situated. What do you think of that?

Mr. TRAFFORD. It sounds all right to me. We have had some very serious droppings out of the Federal reserve system in New England.

Mr. WILLIS. Is it not a good thing to get the Federal reserve system down to a compact body of banks that want to stay?

Mr. TRAFFORD. If I understand you, I do not think that at all. I do not see why a select group should pay the expenses of the system for the general benefit of everyone else. I think we ought to have the system and I think we all ought to go in and support it and pay our pro rata share.

The ACTING CHAIRMAN. In other words, they should be encouraged to come into the system?

Mr. TRAFFORD. I do not think a bank should say "I can save so many thousand dollars a year by dropping out of the system."

The ACTING CHAIRMAN. In other words, you ought to give something for your fee—it ought to be a privilege?

Mr. TRAFFORD. Yes.

Senator TOWNSEND. Have there been a number of national banks in your State that have surrendered their charters and accepted State charters?

Mr. TRAFFORD. There have been quite a few. I do not think there is a national bank in Maine. I do not like that. What happens is that we act as their reserve agent.

The ACTING CHAIRMAN. In other words, you are holding the bag?

Mr. TRAFFORD. Yes.

Senator TOWNSEND. Is that for the reason they feel the State charters are more liberal?

Mr. TRAFFORD. Yes; and they save money by doing that. We take 10 per cent of our deposits and put it into the Federal reserve bank and get no interest on it. I do not know what they do with it—perhaps invest it in Government bonds. They say that that is so much a year and why should they forego that profit.

Senator TOWNSEND. Have you any suggestion to make to remedy this situation?

Mr. TRAFFORD. No. I notice in this bill one thing—in this digest of it—and that is the dividends provision; that the banks should get a larger proportion. I do not see why that should not be so. That might help. I do not know whether you can do anything, under the currency acts, to compel State banks to keep non-interest-bearing reserves of some kind. That seems to be the thing they do not like—the non-interest-bearing reserve.

Mr. WILLIS. They ought to maintain some such reserve, should they not?

Mr. TRAFFORD. Yes; but they maintain it with us at 1 or 2 per cent and in Government bonds at 4 per cent, and they do not see the sense of maintaining the reserve in the Federal reserve system at zero.

Senator TOWNSEND. Do you think it is possible to liberalize the Federal reserve act so as to attract State banks?

Mr. TRAFFORD. Is there any legal way in which you can regulate the reserves of a State bank?

Mr. WILLIS. There is a difference of opinion about that. There is a question whether Congress could do it under the currency or interstate commerce powers.

Mr. TRAFFORD. If they could do that—one of those two things—it would very likely bring them back.

The ACTING CHAIRMAN. When the price of your securities you hold in the bank falls below your cost price, how do you care for that on the books? Do you mark them down? Do you maintain the cost price on your books always, or do you follow the market down?

Mr. TRAFFORD. What we do really is see that our total portfolio is at market.

Senator TOWNSEND. You set up a reserve for depreciation?

Mr. TRAFFORD. Yes; we have marked down some securities at times.

(Discussion off the record.)

The ACTING CHAIRMAN. Would you advocate a legal provision that banks must either write down—you can not write off a loan; it has got to show as a reserve—

Senator TOWNSEND. The transaction must be closed before they can write off a loan.

The ACTING CHAIRMAN. It is not obligatory now that they set up a reserve?

Mr. TRAFFORD. No.

Mr. WILLIS. I think the chairman wants to know whether you think it would be well to have any legislation at all on the revision of book values of securities held by banks that have changed in market value—either appreciated or depreciated?

Mr. TRAFFORD. I would leave that to the bank.

Mr. WILLIS. You would not have any requirement whatever as to the valuation of bonds on the books of the bank?

Mr. TRAFFORD. I would say not.

Mr. WILLIS. Even when they have deteriorated very markedly?

Mr. TRAFFORD. I think the examiners would speak about it.

Mr. WILLIS. You would leave it to the discretion of the examiners?

Mr. TRAFFORD. The examiners and the management.

The ACTING CHAIRMAN. Do you think those investments have been a significant cause of bank suspensions in the Northeast or in other parts of the country?

Mr. TRAFFORD. Those investments?

The ACTING CHAIRMAN. Yes. You know there have been a great many bank failures?

Mr. TRAFFORD. There have been very few in New England.

The ACTING CHAIRMAN. Something like 1,300 last year and 6,000 in 10 years.

Mr. TRAFFORD. There have been very few in New England—very few I do not know this last year how many, but not over a half a dozen, possibly.

Mr. WILLIS. What have been the causes of the failures there?

Mr. TRAFFORD. The two that I know about were just crooked management; I think perhaps a couple more were unintelligent. But there were only five or six altogether.

Mr. WILLIS. The security movement has had nothing to do with the bank failures in your part of the country at all?

Mr. TRAFFORD. Not this last year. I think no national bank failed in New England last year. I think not.

The ACTING CHAIRMAN. Mr. Trafford, we want to consider the branch-banking question a little, also groups and chains. Of course, there is some modification between them. Have you given much thought to branch banking and would you advise an extension of some form of branch banking for New England or the Northeastern group?

Mr. TRAFFORD. Speaking just of New England?

The ACTING CHAIRMAN. Well, yes.

Mr. TRAFFORD. I do not see any need for branch banking in New England.

The ACTING CHAIRMAN. Are you familiar with the point of view of the present Comptroller of the Currency on branch banking? He speaks of trade areas which, of course, is a pretty indefinite term. It might be a radius of 100 miles in the East and a thousand miles in the West. But whatever that might mean, branch banking, somewhat along the English line, perhaps.

Mr. TRAFFORD. We would like that.

The ACTING CHAIRMAN. You would like that?

Mr. TRAFFORD. Yes, in trade areas.

The ACTING CHAIRMAN. You would like to go out and establish branches—say, commercial banks along sound lines in any particular field?

Mr. TRAFFORD. Buy them.

The ACTING CHAIRMAN. Buy up existing banks?

Mr. TRAFFORD. Our bank would, because Boston, as you know, is a little island with 30 municipalities around it. Municipal Boston is really a small thing. We think we would like to have banks not only in this municipality but in this entire area, which is simply metropolitan Boston.

Mr. WILLIS. Would that need be relieved by allowing branches to be established in counties—adjacent counties?

Mr. TRAFFORD. Yes; but we would have to take in four or five counties. The city itself is one.

Mr. WILLIS. That has been suggested here.

Mr. TRAFFORD. Certain adjoining counties.

Mr. WILLIS. Any county adjoining the one in which you are located?

Mr. TRAFFORD. That might fit our case. I do not know what kind of arrangement you would have for the country over, to put that into effect. My own feeling is that the slower you go in branch banking at present, the better. Personally, I would go to as limited an extent and area as possible.

Mr. WILLIS. You think branch banking would give rise to unsoundness in banking or bad management in banking? One witness from New York has said that the effect of branch banking on a large scale would be to produce a race for the purchase of banks, with the result of embarking upon perhaps a feverish speculation in the stock of those banks. Is that your thought?

Mr. TRAFFORD. Yes; I think they are all right on the line ready to go. I do not know how many would go. I think it would have that effect. I do not think it would do much good.

Mr. WILLIS. If you had it in your Federal reserve district, as proposed by others, do you think the same effect would be produced?

Mr. TRAFFORD. Yes; on a much smaller scale. There would be a few banks in New England bidding against each other.

The ACTING CHAIRMAN. And you would bid those values up probably out of all reason?

Mr. TRAFFORD. That is quite true.

The ACTING CHAIRMAN. Then, there is not anything in the suggestion unless it is done very quietly and without competition, and that is pretty difficult to regulate.

Mr. TRAFFORD. If you raise the bars, that would allow a certain amount of competition. If you raise the bars for the county, there would be some; in the State it would be a little more, in the district it would be still more, but if you made it the whole country, there would be a great stampede. I do not think it would do any particular good. The larger banks do not need to be larger. The large business can be taken care of as it is now.

Mr. WILLIS. Have you many out of town correspondents?

Mr. TRAFFORD. A great many in New England and elsewhere.

Mr. WILLIS. Is it not a fact that the banks with a large well-established line of correspondents are usually opposed to branch banking?

Mr. TRAFFORD. I think they have that tendency; yes. They have built up the correspondent system.

Mr. WILLIS. You think the branch-banking system would damage your correspondent relationships considerably—tend to cut them off and drive them away?

Mr. TRAFFORD. Yes; it would chop that system to pieces, but if it were permitted by law, I do not think the communities would resent it as much as if it were done indirectly.

The ACTING CHAIRMAN. What we are feeling around for is some way of improvement—not particularly in New England, because the situation is sounder there than in other sections, like the Southeast. There you have a 1-crop situation and have long lean periods through each year, and you have your grocery-store competition where the trader is practically the banker in one of those villages, and often a very bad load factor. Now, whether the group system would relieve the situation, with perhaps one large bank in the group to steer the group—

Mr. TRAFFORD. I suppose it would if it was a good group.

The ACTING CHAIRMAN. The problem is very serious in the Southeast and the Northwest. Can you not imagine weak units being strengthened through a single controlling bank in that group which could diversify their loans and their business?

Mr. TRAFFORD. Yes; I can.

The ACTING CHAIRMAN. There is no parallel in New England for that situation, is there?

Mr. TRAFFORD. No; there is not; because farming is a small percentage of the business there and even the country banks are pretty well diversified and locally we do not have the depression quite as hard, and I think the management is pretty good as a rule, and so we have not the dire consequences they have had in other sections of the country. That is the only end that really needs any help. The big bank does not need it and the middle-sized bank does not. I think it is only the little bank. I do not know what the answer is. I suppose they would have made the same losses if they had been the branches of some near-by bank. If they had the money in mortgages, the losses would have been there, but it might not have affected the depositors of that bank.

The ACTING CHAIRMAN. Is it not conceivable that if they had close affiliation with a so-called master bank, their banking would have been a little sounder and more conservative?

Mr. TRAFFORD. It might have been more sound. I do not know what you can do in a 1-crop district. Whether it is owned by a big bank or a small bank, there is a loss. In the case of the small banks, perhaps the depositors lose the money. Probably if you could get some small branch banking rather than group banking in small areas, that might help the situation. I do not think it is opportune to open the country to branch banking on a large scale, at the present time. I would rather see an improvement in the management and supervision of what we have got, which is pretty good. We would be trying an experiment which might or might not fit. Personally I do not know what would fit.

The ACTING CHAIRMAN. Of course, branch banking is a very extensive system in England—Lloyds, London City Midland. I think the London City Midland has a vast number of branches.

Mr. TRAFFORD. Two thousand two hundred branches.



The ACTING CHAIRMAN. In England alone, which is a very small area.

Mr. TRAFFORD. Yes. If you put England down on this map [indicating] it would not look very large. I do not know whether it works well.

The ACTING CHAIRMAN. They think so.

Mr. TRAFFORD. Perhaps it does. It might work better than ours, but it is not entirely clear to me.

The ACTING CHAIRMAN. Have you any questions that occur to you, Doctor Willis?

Mr. WILLIS. Yes; one or two. Have you any development of chain banking in New England to any important extent?

Mr. TRAFFORD. It is not growing. We have, I think, the largest chain.

Mr. WILLIS. Including how many members?

Mr. TRAFFORD. We call it a group. We have what we call the Old Colony Associates, in which our corporation owns 10 per cent of the stock. The "Associates" which is a holding group banking system, owns a certain amount of stock of, I think it is, 20 of these suburban banks around Boston.

Mr. WILLIS. What function does it perform in reference to them? What is its relation to the banks?

Mr. TRAFFORD. They help the management. They have a management committee and they try to introduce the best methods of one into all others—really run them.

Mr. WILLIS. Do they pass on loans and discounts in the Old Colony Associates, or in each of the banks?

Mr. TRAFFORD. They have a central loan committee which, I think, passes on loans over a certain size.

Mr. WILLIS. Do you have a local board of directors in each case?

Mr. TRAFFORD. Yes.

Senator TOWNSEND. Is the local board permitted to make loans?

Mr. TRAFFORD. Up to a certain figure, and above that the central committee.

Mr. WILLIS. How many such chains are there in New England?

Mr. TRAFFORD. We have about 20 in that group which may represent \$100,000,000 deposits. In case of branch banking of the type which has been suggested, they would likely become branches.

I think there are three other chains, or two others, in Boston. Then there is a chain in Worcester County. I am not sure whether there are any more.

Mr. WILLIS. Are these chains pretty successful?

Mr. TRAFFORD. They have done very well.

Mr. WILLIS. The central management has been a good thing; it has been shown to be a practical way of managing?

Mr. TRAFFORD. Our management committee tell us so.

Mr. WILLIS. I am speaking of it in general terms and questioning you about it as a method of banking, and not merely as handled by one of the best banks, or under its auspices, but handled generally—

Mr. TRAFFORD. I, personally, would prefer the branch-banking method. It seems to me the responsibility is more centralized.

Mr. WILLIS. I had the impression awhile ago you did not think highly of branch banking.

Mr. TRAFFORD. I think it is a mistake to do it now. Whether, 20 years from now, we will have it, I do not know.

Mr. WILLIS. It is preferable to a chain.

Mr. TRAFFORD. Yes; you have it all under one head and there is no shifting around.

Mr. WILLIS. Who owns the other 90 per cent of the old Colony Associates stock?

Mr. TRAFFORD. The public.

The ACTING CHAIRMAN. Where is your chief saving in a chain banking system? Are you saving in the overhead?

Mr. TRAFFORD. Yes; we are saving a bit in the overhead, but not much.

The ACTING CHAIRMAN. You think you could do better where you have central control—

Mr. TRAFFORD. They think they do it better. They think now that bank No. 20 is run just as well as bank No. 1, which had a spectacular record.

The ACTING CHAIRMAN. That is by comparison of details of management?

Mr. TRAFFORD. Yes, and watching the security lists, watching general trends, and so forth, and they think they have generally good results, and I think they have myself.

Mr. WILLIS. Do they give out to the public the information that they are in a chain system?

Mr. TRAFFORD. I think they all do it—issue elaborate pamphlets.

The ACTING CHAIRMAN. There is nothing hidden about it?

Mr. TRAFFORD. No.

The ACTING CHAIRMAN. Does the State take any cognizance of it?

Mr. TRAFFORD. No.

The ACTING CHAIRMAN. There is no recognition legally?

Mr. TRAFFORD. No.

The ACTING CHAIRMAN. No interference with it?

Mr. TRAFFORD. No.

Mr. WILLIS. They simply examine the banks each as an independent unit?

Mr. TRAFFORD. Yes.

The ACTING CHAIRMAN. Can a national bank take into its chain both a State bank and/or National bank and carry them in the same chain?

Mr. TRAFFORD. Well, the chain is done through a vehicle which can do it.

The ACTING CHAIRMAN. I mean such a vehicle.

Mr. TRAFFORD. Yes.

The ACTING CHAIRMAN. And that vehicle may be entirely owned by a national bank?

Mr. TRAFFORD. It can not be held by a national bank, can it?

Mr. WILLIS. By the stockholders.

Mr. TRAFFORD. By a holding company; yes.

Senator TOWNSEND. Your published statements—are they published separately for each bank in a chain or altogether?

Mr. TRAFFORD. In the legal statements they are each published separately and then the associates get out a group consolidated statement.

Mr. WILLIS. How many of these are members of the Federal reserve system—this chain of banks?

Mr. TRAFFORD. I do not know.

Mr. WILLIS. A considerable number?

Mr. TRAFFORD. I think so.

Mr. WILLIS. So that you really get, in that way, a pretty large voting power in managing the Federal reserve bank, do you not?

Mr. TRAFFORD. I have never thought of that.

Mr. WILLIS. In some of the western districts I have understood that the chain banks really control the Federal reserve banks because they have so many members in a small number of chains that the control of the reserve bank is in the control of a few hands.

Mr. TRAFFORD. That is not true with us.

Mr. WILLIS. But that would be perfectly possible, would it not?

Mr. TRAFFORD. I suppose it would.

The ACTING CHAIRMAN. Mr. Trafford, what is your opinion with reference to our legislation? Would you be opposed to any legislation, or have you studied this bill far enough to know whether there is anything in this that appeals to you?

Mr. TRAFFORD. I have not read the bill, but this is a digest [exhibiting] which was given me.

The ACTING CHAIRMAN. Are you at liberty to read that?

Mr. TRAFFORD. This is just a digest of the bill. I guess I had better begin at the end. There are twelve points. Most of them I do not see any objection to, or not much reason for. This says that member banks when borrowing, roughly, shall not make any further collateral loans. I do not think that is good at all. I think it is very bad.

The ACTING CHAIRMAN. That is section 11?

Mr. TRAFFORD. Yes. I mean we have to be helpful to banks in New England and we should hate to tell a correspondent bank, "We are very sorry, but we happen to be borrowing in the Federal reserve bank to-day, and although you may fail to-morrow, we can not help you." I do not think, simply because we are borrowing for a day or for a week from the Federal reserve bank, we should not be permitted to loan.

Mr. WILLIS. I think your digest does not quite represent section 11. I merely call that to your attention for further reading. It only has reference to speculative loans.

Senator BULKLEY. Is there any part way measure on this? You say it would be too strict as there proposed. Is there any limitation along that line that would be reasonable or desirable?

Mr. TRAFFORD. I do not know of any, and I would hesitate to put anything in that might be more embarrassing and might not be helpful.

Senator BULKLEY. Is your answer that you can not think of a remedy, for you think there is nothing there to be remedied?

Mr. TRAFFORD. Well, I think that the thing will work itself out about as well without legislation as with. I think you will get these waves of speculation and an artificial rule here or there on this will not stop it. I think it had better be left to the management of the bank as to where the money they are borrowing is going. I can not think of anything that will fit the situation.

Now, here is one—the last one—which I do not understand. It requires national banks to invest time and savings deposits, and so

forth. If a national bank becomes insolvent all the property in this connection shall be applied ratably. It limits them in one group.

Mr. WILLIS. It is merely to bring about segregation of assets, so that savings deposits shall be protected, as in savings banks, by a special list of assets that are designated for that purpose.

Mr. TRAFFORD. What bothered me at first was there is a great difference in New England between time and savings deposits. They should not be classified together. I do not think the time deposits need protection and neither do the savings deposits.

The ACTING CHAIRMAN. You have had very little opportunity to study the bill?

Mr. TRAFFORD. I have had none. This is simply a digest of the bill.

The ACTING CHAIRMAN. We would like to have your mature opinion on it, and will you not take the bill back with you and submit something in writing later, after you have had a chance to consult with some one on the bill?

Mr. TRAFFORD. I shall be very glad to do that.

The ACTING CHAIRMAN. Do you favor a restriction on the placing of loans for the account of others? Would you put in any restrictions as to what would go into that column?

Mr. TRAFFORD. I would not. I do not know what you aim to accomplish by that.

The ACTING CHAIRMAN. I suppose that account is a sort of dumping ground.

Mr. TRAFFORD. I did not get you. I thought you meant loans for the account of others.

Mr. WILLIS. The question has been asked of almost all witnesses, and discussed by most of them, as to whether the so-called "loans for others" in stock-exchange transactions—whether those have not been an injurious thing. Most have testified they have been an injurious thing and would like to see the case remedied if they could.

Mr. TRAFFORD. I do not know whether you can do that. I suppose it is a bad thing. I am not so dead sure it is. Even if it is, I do not see what you can do about it. We had cases a year ago of corporations who wanted to lend and who told us that if we did not want to do it others would.

Mr. WILLIS. Were those mostly corporations who had financed themselves in the market recently and had separate capital on hand, or old established corporations?

Mr. TRAFFORD. I think it was both those types and also individuals. They said, "We have so much money, and the rate is so much and we want to put it out."

The ACTING CHAIRMAN. Do you think corporations borrowed much money for use for that purpose?

Mr. TRAFFORD. I do not believe so.

The ACTING CHAIRMAN. Or sold securities in order to get money to lend at that high interest?

Mr. TRAFFORD. I do not know.

Senator TOWNSEND. Do you think individuals did that? In other words, you think they sold stock in their own companies to get money to lend at the higher rate?

Mr. TRAFFORD. They did not come to my attention, but it did come to my attention that individuals said, "If you do not lend it

for us, we will get other banks, and if other banks will not lend it, we will get it through other sources that will or loan it direct, ourselves.”

The ACTING CHAIRMAN. Mr. Trafford, we are very much obliged to you for coming down and giving us your views.

Mr. TRAFFORD. I have enjoyed it very much.

The ACTING CHAIRMAN. That is very high praise. We will adjourn now until 10.30 o'clock tomorrow morning, when we will have another open hearing.

(Adjourned at 12.15 p. m. until Friday, January 30, 1931, at 10.30 o'clock a. m.).

# OPERATION OF THE NATIONAL AND FEDERAL RESERVE BANKING SYSTEMS

FRIDAY, JANUARY 30, 1930

UNITED STATES SENATE,  
COMMITTEE ON BANKING AND CURRENCY,  
*Washington, D. C.*

The subcommittee met, pursuant to adjournment, at 11 o'clock a. m. Hon. Carter Glass (chairman) presiding.

The CHAIRMAN. The committee will come to order. Senators Walcott and Townsend will be here in a few minutes, and they have authorized me to announce them as present, for a quorum.

## STATEMENT OF GEORGE W. DAVISON, PRESIDENT OF THE CENTRAL HANOVER BANK AND TRUST CO. OF NEW YORK

The CHAIRMAN. Mr. Davison, we are obliged to you for coming down. We have in process a general inquiry into the banking situation of the country with the expectation and hope of being able to do something to prevent a recurrence of such a situation as we now have. I believe you appeared before the House Committee on the 5th of last June?

Mr. DAVISON. Yes.

The CHAIRMAN. And practically confined your statement to a discussion of the question of branch banks?

Mr. DAVISON. Yes.

The CHAIRMAN. So that that hearing is available to the committee and the likelihood is that we shall not ask you to talk, certainly in an extended way, about branch banking, except that some members of the committee might have occasion to ask you some question about that.

What we should like you to do is to give us a general statement of the situation as you see it, and of proposed legislation or any legislation that may commend itself to your favorable consideration; in other words, state to us what is the situation and what you think may be done to prevent a recurrence of it, if it is bad.

Mr. DAVISON. That is a very large order, Mr. Chairman.

The CHAIRMAN. Yes, but that is what we are making the inquiry about.

Mr. DAVISON. I do not believe that you could make good banking by legislation. I do not know of any good banks that have failed. I think one—

The CHAIRMAN. What we want to do is to prevent bad banking, as far as we may by legislation.

Mr. DAVISON. I think the great trouble has been the too liberal chartering of banks. There have been banks with too small capital, and certainly in the past there has been a sort of rivalry between the State and National systems. Where one bank was operating successfully in a small community, another would be started under a different aegis. The result of two banks attempting to operate in a community that will support but one is bad. The tendency is for the new bank to take accounts from the old bank, and it may be that the old bank will do things it ordinarily would not do, in order to keep accounts.

Coupled with that you have had a change in economic conditions. The larger centers, with good roads, etc., have been brought very much nearer to the small communities, and business tends to the centers. That probably has been helped by the absorption of small businesses into chains or groups where a clerk, instead of a business man is running the business, and the business of the group has been done in some larger center.

I think those two things have contributed very largely to the failure of banks, coupled with the further fact that banks have been formed in communities where there was not enough business to furnish a bank with opportunities for a proper use of its money and, having deposits, it has had to go and buy bonds and with the tremendous swings that we have had in interest rates, beginning in 1914, good bonds have had a wide variety of prices which would seriously affect the capital and surplus structure of a small institution.

The CHAIRMAN. Mr. Davison, have you given any consideration at all to the question of how we may, by legislation, readjust the competition between the National and State systems?

Mr. DAVISON. No; I have not. I think it is a real handicap that we labor under, having 49 different systems.

The CHAIRMAN. And you can not tell us any way of correcting that situation?

Mr. DAVISON. Except by more cooperation.

The CHAIRMAN. You say no well-managed banks failed in 1928 and 1929?

Mr. DAVISON. Nor in 1930.

The CHAIRMAN. Well, is there no way of correcting banking mismanagement by legislation?

Mr. DAVISON. Not by legislation. You have now examinations which should disclose the condition of banks.

The CHAIRMAN. Well, do they?

Mr. DAVISON. Well, I can not say that they do not. The examinations that have been made by our State superintendent and your Federal reserve system and our clearing house have been very helpful to us and I think they are searching examinations. The great difficulty, of course, with the superintending authority is how to correct the abuses that he finds. If he talks about them, he endangers the bank. He does not want to close a bank that may, by any probability be solvent, and it becomes a difficult question of administration.

The CHAIRMAN. The Comptroller of the Currency ventured to suggest, as to the national system, that either the comptroller or the Federal Reserve Board might well be given authority to suspend bank officials, and, if necessary, to dismiss them when they might be found to be mismanaging a bank.

Mr. DAVISON. Of course, that is a notice to the public that there is something wrong in the bank. I should think that it would disturb the public and create a run that might result in the closing of the bank. I can not conceive of a situation where a board of directors, on the proper statement from the examining authority, would not take things into their hands. I think that we have been very careless in chartering too many banks, and especially banks with small capital.

The CHAIRMAN. I talked not more than half an hour ago—at least, I terminated a talk—with a high official, having in large measure supervisory control of the national banking system, and he told me that over and over and over again, an innumerable number of times, they have undertaken to remonstrate with boards of directors of banks, pointing out to them the unsafe processes prevailing at the bank, without making any impression on them at all.

Mr. DAVISON. He has now the authority to close the bank. I think suspension is practically the same thing.

The CHAIRMAN. I called his attention to that, but he thought that was a dreadful remedy.

Mr. DAVISON. I think suspension is practically the same thing.

The CHAIRMAN. Well, would it not be better to close a bank doing a business of that sort, than to permit it to continue in a business of that sort?

Mr. DAVISON. I am inclined to think it would.

The CHAIRMAN. And involve its patrons—its depositors and stockholders—in a greater degree?

Mr. DAVISON. In my judgment the best thing is to do it right away and not temporize.

The CHAIRMAN. It is not being done.

Mr. DAVISON. That is a matter of administration.

The CHAIRMAN. Do you think the situation in 1929 was brought about by bad banking management?

Mr. DAVISON. Yes.

The CHAIRMAN. Well, what different type of management would you suggest to us?

Mr. DAVISON. Well, I could not suggest any different type of management. I will give you, in support of my opinion, the statement of the man who, in my office, has closest touch with the correspondents, who made the remark to me that no good bank had failed. He is in touch with a great many banks throughout the country.

The CHAIRMAN. Have no banks failed—

Senator NORBECK. May I ask a question? Isn't it a fact that all banks in New York failed at one time?

Mr. DAVISON. That they all failed at one time?

Senator NORBECK. Yes.

Mr. DAVISON. Not that I know of.

Senator WALCOTT. Is the converse of that true, that all banks which have failed, have failed necessarily because they are badly run banks?

The CHAIRMAN. I was going to ask a kindred question to that; that is to say, have not many good banks failed because of bad management?

Mr. DAVISON. There is no doubt some banks that would have been fundamentally sound, but for dishonesty or bad management, have failed—yes.



The CHAIRMAN. Do you think the management of the Federal reserve system had anything to do with the situation in 1929?

Mr. DAVISON. I think the Federal reserve system has been a tremendous contribution of benefit to the banking situation in the United States.

The CHAIRMAN. Yes, we all think that, Mr. Davison, but what I am asking is, Did its policy or its lack of policy or its courageous supervision or lack of courageous supervision, contribute, in any measure, to the situation we had in 1929?

Mr. DAVISON. Possibly. There are a tremendous number of reasons I think that led to the situation in 1929. I think the primary cause of the tremendous rise in prices was the capital gains tax.

The CHAIRMAN. You mean the taxpayers or holders of securities were unwilling to take profits and realize on them because they were taxed?

Mr. DAVISON. It is not because they are taxed, but people who had securities which they had held for a long while and which they wished to continue to hold at the same prices, figured that if they sold and paid the taxes they would have to reinvest their money and might not be in a position to do so advantageously and did not know how long they would have to wait. So they decided to hold on, and this did result in a corner in a great many stocks; in other words, the supply of securities of that type was limited and it left a situation where the small floating supply was marked up to high prices. That is one of the causes.

The CHAIRMAN. In what degree were adventures in the stock market the cause of the situation?

Mr. DAVISON. I do not think there is any question that the participation in the stock market by the whole country also was a large contributing factor. Waves of that kind do come at different times, based on prosperity and based to some extent on the high prices of securities which had a real investment value and had been marked up to unprecedented prices. It is not improbable that the easy money of 1927, which made a real contribution to our agricultural business and our other business may have been continued too long. It is quite probable that if Federal reserve rediscount rates had been raised a little faster and with less talk about it, it might have checked much speculation but that is a matter of judgment and it is much easier to judge now than then.

The CHAIRMAN. Do you think it was ever intended that the rediscount provisions of the Federal reserve act should be used to control stock speculation or influence it in any way?

Mr. DAVIDSON. Well, it is expressly provided that the Federal reserve banks shall not rediscount on securities.

The CHAIRMAN. I know that is the provision, and that being so, would it not seem to indicate what was in the minds of the proponents of the system; namely, that the rediscount processes of the Federal reserve banking system should not be used to affect the stock market?

Mr. DAVISON. It is very hard to earmark any particular kind of money. All banks did not use the Federal reserve system, so that they could have money to loan on stocks—

The CHAIRMAN. Should any banks have been permitted to do it?

Mr. DAVISON. I think, from the nature of the business which banks do, that it would be impossible that they should not occasion-

ally have to borrow because of loans that they had made that were collateralized by securities. As a matter of fact, in ordinary times, with the daily settlements on the New York Stock Exchange, call loans furnish as good a secondary reserve as any bank could have.

The CHAIRMAN. That I understand. I understand there were comparatively few losses on call loans, but what I am trying to arrive at is: What is the meaning of section 13 of the Federal reserve act if it does not mean to preclude that sort of business from the operations of the Federal reserve bank.

Mr. DAVISON. The Federal reserve provisions mean that if I have securities which can be rediscounted, I can use them. If you can find some way that I can not use them so that I can lend money in improper channels, that is all right. As a matter of fact, my bank did not do it.

The CHAIRMAN. I am not suggesting that it did, but other banks did, did they not?

Mr. DAVISON. I do not think so, generally. I had not supposed that banks took advantage of that situation to secure money to loan on securities.

The CHAIRMAN. Then, if they do not do that, what could be the objection to the proposed amendment to the act contained in the bill introduced in the Senate recently expressly to prohibit the rediscounting of any bank which does make loans of that description beyond a certain limit?

Mr. DAVISON. Well, I think that any restrictions that you put on banking are apt to work a hardship. My experience has been that legislation remedies drafted for a particular malady that you suffered once have usually, sooner or later, been repealed.

The CHAIRMAN. Could it work any greater hardship than the country had to endure recently?

Mr. DAVISON. Yes; the situation might have been very much worse than it was.

The CHAIRMAN. Well, it takes a lively imagination to come to that conclusion, it seems to me. My contention has been that, in the Federal reserve system, we set up a commercial reserve banking system to respond readily to the demands of commerce.

Mr. DAVISON. And I do not believe that business suffered in any way or any bank was not able, during all that time, to make loans to its commercial customers, or did not make them, or that they made them at as high a rate as the loans on securities in the Street.

The CHAIRMAN. But I understood you to advocate the use of the commercial rediscount rate of the Federal reserve system to abate the violence of stock speculation.

Mr. DAVISON. I did not understand that I had said that. I said that my practice had been otherwise.

The CHAIRMAN. Well, I am not talking about the practice of your particular bank, Mr. Davison. I understood you to say—

Mr. DAVISON. I said I did not think the situation called for any legislation.

The CHAIRMAN. I understood you to say, however, that had there been an increase in the rediscount rate in the Federal reserve system sooner, and more persistent, that that would have had the effect of—

Mr. DAVISON. I said it might have—that such a regulatory step as any step—proven effective.

The CHAIRMAN. Some of us think that legitimate commerce should not be penalized in the matter of rediscount rates at the Federal reserve banks for the express purpose of abating the violence of stock speculations.

Mr. DAVISON. That means that commerce should have a different rate on its money than loans on stocks. Is that right?

The CHAIRMAN. It means that none of the facilities of the Federal reserve banking system should be used for stock speculative purposes or any investment purposes.

Mr. DAVISON. Well, I think that would be a great hardship. I think that the investment of the people's money in this country is a very important part of the business of this country.

The CHAIRMAN. But it is not an important part of the business of a reserve banking system, set up to respond readily to the needs of commerce.

Mr. DAVISON. It is a necessary part of our banking system.

The CHAIRMAN. Then, why did we preclude from the definition of eligible paper, investment securities?

Mr. DAVISON. To make more advantageous to the bank loans on commercial paper.

The CHAIRMAN. Well, did we not textually preclude loans for stock speculative purposes?

Mr. DAVISON. You have just proved that you did not.

The CHAIRMAN. Well, we intended to, if the English language can do anything of the sort. It says so.

Mr. DAVISON. All loans on securities are not speculative.

The CHAIRMAN. The statute does not employ the term "speculative." It says for the purchase or carrying of investment loans. Is not that the fact?

Mr. DAVISON. I assume that you have quoted the language correctly. I do not know.

The CHAIRMAN. But you think had the Federal Reserve Bank of New York, for example, been permitted, by the Federal Reserve Board at Washington, to raise its commercial rediscount rate—I might say indefinitely—it would have been the correct method of using the facilities of the Federal reserve bank?

Mr. DAVISON. Yes.

The CHAIRMAN. For the sole purpose of abating the violence of stock speculation?

Mr. DAVISON. I did not say that.

The CHAIRMAN. Well, for what other purpose?

Mr. DAVISON. For the purpose of trying to stop the inordinate rise of all prices, including securities.

The CHAIRMAN. You think a Federal reserve bank, with an 80 per cent reserve, could justify itself in raising its commercial rediscount rate?

Mr. DAVISON. I do. Of course you realize that we are permitted to rediscount against Government securities?

The CHAIRMAN. Yes; I am coming to that.

Mr. DAVISON. Otherwise, we could probably not have floated the loans during the war.

The CHAIRMAN. We did float loans during the war before that provision was inserted in the bill.

Mr. DAVISON. A very small amount, compared to what we finally did.

The CHAIRMAN. Do you think that provision of the act has been abused at all, and used for stock speculative purposes?

Mr. DAVISON. No.

The CHAIRMAN. Then, you differ with other authorities who have testified before us.

Mr. DAVISON. I am not an authority.

The CHAIRMAN. You differ with other authorities who have testified before the committee. Then I take it, Mr. Davison, that you think the Federal reserve banks were established to affect the stock market rather than respond to the demands of commerce?

Mr. DAVISON. I do not think so, nor do I think I have said so.

The CHAIRMAN. Well, as it seems to me, that is your conclusion.

Mr. DAVISON. Then I have not correctly conveyed my opinion.

The CHAIRMAN. Well, let us see whether I am mistaken or you are mistaken. You think a Federal reserve bank, regardless of its plethora of reserves, should increase its rediscount rate upon legitimate commercial transactions?

Mr. DAVISON. I have said that I thought if this had been done, it was quite possible that it would have served to halt the speculation that was then going on.

The CHAIRMAN. What I am trying to arrive at, Mr. Davison, if you please, is whether a Federal reserve bank had any justification, in fact, under the statute to penalize ordinary commerce, in order to abate the violence of speculation in the stock market.

Mr. DAVISON. Well, I thought, under our system as it was being administered, and under all the facts, that you could not earmark certain kinds of money, and that it was not improbable that that might have accomplished a very good purpose. I presume you know there has been a very great decrease in the amount of commercial paper available for banks in the last eight or nine years.

The CHAIRMAN. Yes; I know that. Do you favor permitting Federal reserve banks to rediscount outright on investment loans on the stock exchange?

Mr. DAVISON. No.

The CHAIRMAN. Well, if you would not have us do it by law, why should the Federal reserve banks be permitted to do it, when the statute itself textually says they can not?

Mr. DAVISON. If they legally can not do it, of course, they can not do it.

The CHAIRMAN. But do they not do it?

Mr. DAVISON. I do not think they rediscount to make loans on securities. That was not my experience.

The CHAIRMAN. You speak of the difficulty of earmarking loans. Do you think any soundly conducted bank is in ignorance of the use of its credits?

Mr. DAVISON. No; we know to whom the loans go.

The CHAIRMAN. What is that?

Mr. DAVISON. We know who borrows the money, of course.

The CHAIRMAN. Do you not know for what purpose it is borrowed?

Mr. DAVISON. Generally.

The CHAIRMAN. Should you not know?

Mr. DAVISON. As a rule.

The CHAIRMAN. Therefore, if any member of the Federal reserve system is overextended in its loans for investment purposes, should not the Federal reserve bank authorities know that?

Mr. DAVISON. I do not know.

The CHAIRMAN. And you think the 15-day loan—direct loans to banks—on Government securities, has not been abused at all?

Mr. DAVISON. I do not know of any abuse.

The CHAIRMAN. As I recall, both Doctor Miller and former Governor Hamlin of the Federal Reserve Board, and very likely—although I am not certain—the Comptroller of the Currency, thought that had been the case.

Mr. DAVISON. They would be much more familiar with the facts than I, since they have a broader field to cover.

The CHAIRMAN. It may be that since your bank is conducted in such a sound and orthodox way, you find it difficult to imagine that any other banks are conducted in any other way. Well, of course, that does not require a specific answer.

Do you believe in the affiliate banking system, Mr. Davison? Do you think a national bank should be permitted to have affiliates?

Mr. DAVISON. That is a very difficult question. We have no affiliate. You have got them in the national banks. I think it may work a hardship to take them away. I do not know. They are capable of abuse. The Bank of United States shows what can happen when they are abused. It is a very glaring example—especially when dealing in their own securities.

The CHAIRMAN. And some other banks with affiliates might be placed under the same criticism, might they not?

Mr. DAVISON. It has possibilities of abuse and danger.

The CHAIRMAN. If experience has shown that they have not only possibilities, but that flagrant abuses have occurred, should there not be some legislation?

Mr. DAVISON. I should think there should be.

The CHAIRMAN. You would help us tremendously if you would suggest what might be done to correct that situation.

Mr. DAVISON. Well, I think examinations—

Senator WALCOTT. Coincidental with the bank?

Mr. DAVISON. Absolutely—and possibly a publication of their statements?

The CHAIRMAN. We have a provision in the legislation now proposed, requiring examination and publicity.

Mr. DAVISON. And a prohibition, certainly, of dealing in their own stocks.

The CHAIRMAN. Yes. You think that should be done, then?

Mr. DAVISON. Yes, sir. I hesitate, Mr. Chairman, to express any opinion on it because it may appear I am suggesting something about someone's else's business. However, I think those things would be helpful.

The CHAIRMAN. I think the fact that you have not done it yourself is convincing evidence you do not believe in that system of banking.

Mr. DAVISON. That is right.

The CHAIRMAN. Do you think the trust or fiduciary powers now bestowed on member banks is open to any criticism at all?

Mr. DAVISON. No. Of course I deplore the fact you have ever given them the power, but having given it to them, I do not see how you can change it.

The CHAIRMAN. Well, if I may ask you without offense, you deplore the fact—

Mr. DAVISON. Because we did a very large trust business and I got just that many more competitors?

The CHAIRMAN. Yes.

Mr. WILLIS. But your objection is based on something more extensive than that, is it not?

Mr. DAVISON. Well, since it has been done, and they have been exercising these powers and acquiring experience, whatever primary objection I might have had, I can not press to-day, without being subjected to criticism that I was doing it in self-interest.

Mr. WILLIS. I do not think anyone would suggest that. I think it is very desirable, for the sake of proposed legislation, to get your view.

Mr. DAVISON. I do not think you could take away the power, having given it, without working a hardship.

The CHAIRMAN. You do not think we could take a power away, if we find it is being dangerously abused?

Mr. DAVISON. I would not say it is being dangerously abused.

Mr. WILLIS. If trust powers are granted to banks such as have been mentioned—that is, undesirable banks—there is grave danger there, is there not?

Mr. DAVISON. Very.

Mr. WILLIS. Trust powers are being granted at the present time very freely to small banks, among others?

Mr. DAVISON. Yes.

Mr. WILLIS. And to banks that are not especially high grade?

Mr. DAVISON. It might very easily be that a bank should not have trust powers if it did not have substantial capital.

Mr. WILLIS. Meaning by that how much?

Mr. DAVISON. Not less than \$100,000.

Mr. WILLIS. Preferably a great deal more than that?

Mr. DAVISON. Preferably a great deal more than that; yes.

The CHAIRMAN. Mr. Davison, I believe it has been generally agreed by those who have done us the honor to appear here and testify, that this system of loans for others, on the New York Stock Exchange, has been a source of rather alarming abuse and was largely responsible for the excessive speculation which resulted in the collapse of 1929. Do you know how that may be measurably controlled?

Mr. DAVISON. I do not. I wish I did.

The CHAIRMAN. You think it should be, if it can be?

Mr. DAVISON. I think it is very bad. It has been a slow growth, but it did get to very big figures. Of course it has naturally gone down now with the rates for money. It came about probably from the fact that many of our corporations learned a lesson in 1919 or 1920, and having the opportunity to raise sufficient capital, had large sums and they loaned them. We refused to do it for a long while until I was losing business to competitors and we had to do it.

But I wish there were some way of stopping it. I do not know how. We had to make "loans for others." It would be very easy, if the banks did not do it, for the lenders to arrange otherwise. I really do not know how you could stop it.

The CHAIRMAN. Mr. Davison, according to the fact—

Mr. DAVISON. There were some corporations which refused to join in making these loans and deserve a great deal of credit for standing on a high moral and business ground.

The CHAIRMAN. I think they should be commended in a very unqualified way for refusing to do it.

Mr. DAVISON. I mean corporations that had money.

The CHAIRMAN. I think there ought to be—and I am very much in hope there may be—some way legislatively to prevent or penalize that sort of thing.

Mr. DAVISON. It can not be done through the banking end of it. I think it would have to go back to the lending end. If the banks will not do it, there are other agencies they could and did use.

The CHAIRMAN. Your bank is a member of the Federal reserve system?

Mr. DAVISON. We are.

The CHAIRMAN. And of course you value its services.

Mr. DAVISON. We do.

The CHAIRMAN. And I imagine you are entirely familiar with its operations.

Mr. DAVISON. Generally.

The CHAIRMAN. Do you think it wise to have the open market operations of the Federal reserve banking system practically submerge the rediscount feature of the system?

Mr. DAVISON. Well, I think they work together. I do not believe you could separate them.

The CHAIRMAN. The original purpose of the open market provision of the act was, as I have stated, here, threefold. I think I have some familiarity with it.

Mr. DAVISON. No one greater.

The CHAIRMAN. It was to enable the Federal reserve bank to compel largely an observance of its commercial rate; it was likewise to enable it to use any surplus funds it might have on hand—idle funds—to insure the overhead charges of the bank itself and, in the third place, to enable it to safeguard its gold supply. It never was intended—it never was remotely suggested—when we had the act in preparation and in process of passage, that the open market provision of the bill would authorize a Federal reserve bank to go extensively into the open market in order to control the money rate. We had supposed, some of us, that the discount rate of a Federal reserve bank would very largely, if not completely, depend upon the bank's resources—upon the amount of its reserve—in responding to the demands of commerce, but it seems that the open market provision of the act has been used in an attempt to control the market rate both in the purchase of Government securities and the sale of Government securities.

Had you understood that that was the intent of that provision?

Mr. DAVISON. I do not know just what the intent was, but there is no question in my mind you could not separate commercial money by putting it into one pocket from the other money of the United States in the other pocket. It is money and it is like two streams of water meeting. They become one. I do not think that you can separate them at all. It is a natural corollary.

The CHAIRMAN. That would mean to me, in the last analysis, that either the Federal reserve bank would control the money market or the money market would control the bank.

Mr. DAVISON. That it has a relation to the money market is beyond question.

The CHAIRMAN. Well, that it has been given a relation to the money market—

Mr. DAVISON. That it must have.

The CHAIRMAN. We tried our best to prevent it.

Mr. DAVISON. I do not think you can.

The CHAIRMAN. Well, we have not.

Mr. DAVISON. You can not. It is impossible.

The CHAIRMAN. Then the only thing we have done, by setting up the Federal reserve system, is to prevent a currency famine?

Mr. DAVISON. That is one great thing you have accomplished.

The CHAIRMAN. Is not that about the only thing we have accomplished?

Mr. DAVISON. I do not think so. That is one great thing you did do.

The CHAIRMAN. Yes; and we are about to be taken away from that.

Mr. DAVISON. They—the Federal Reserve Banks—have given a liquidity to the assets of banks that never existed before and made a wonderful contribution to the banking welfare of the country.

The CHAIRMAN. I know; but if it is going to be perverted and take us back practically to the old system, we want to prevent such a result.

Mr. DAVISON. Well, I do not think you are back at the old system.

The CHAIRMAN. It seems to me under the 15-day-loan provision of the bill, as it has been operated, we are back to the point where we have a bond secured currency largely, and that is the one thing above all others that we tried to get away from.

Mr. DAVISON. Of course there were a number of things happened after you drew the bill that we did not contemplate and one was that the Government would issue \$20,000,000,000 of securities.

The CHAIRMAN. Yes; we had a war that compelled the Government to issue billions of dollars of securities. If we had had a contemplation of that sort, we would not have included Government securities.

Mr. DAVISON. If you had not, you would have put them in during the war; otherwise you could not have sold them.

The CHAIRMAN. Of course, as a war measure, we would have put them in, but what I mean to say is that we would not have permitted them as a basis of rediscount at the Federal reserve banks.

Mr. DAVISON. During normal times?

The CHAIRMAN. Yes; had we not been faced with a situation wherein the Government had less than a billion dollars of outstanding securities, \$748,000,000 of which were being used by national banks for circulation purposes; and the fact we did have a war and the act authorized United States securities as a basis of loans, does not seem to me to mean necessarily that we may not now guard against that abuse of that situation.

Mr. DAVISON. I do not believe it is being abused. That is a matter of opinion, of course.

The CHAIRMAN. Those who are in intimate contact with the situation think it has been very much abused.

Have you any questions, Senator?



Senator WALCOTT. I have nothing particularly in mind. We have covered most of this ground with others. I am particularly interested, of course, in trying to find something that we can do here that is constructive that will put some kind of a check on a recurrence of this stock market panic, if you can call it that—and that is the purpose of our inquiry—so that naturally I am very much interested in all phases of the question of the taxing of the sale of securities. If it did not exist, the market would be a great deal longer on securities than it is now. If it were cut in two, or reduced to any extent, it would tend to increase the number of securities for sale.

The CHAIRMAN. You mean the capital tax?

Senator WALCOTT. Yes—the profit on the sale of securities—and I should like to be pretty sure about the way Mr. Davison feels about that. It did not seem to me you were very specific.

Mr. DAVISON. The idea is to do away with it altogether—certainly a reduction if reduction will help. I am not guessing on that. I have talked with certain people who came in and told me and said to me, “If I pay the tax, will I get the money back if the stock goes down? I like this thing and want to live with it; I think it has a great future; but what is my situation if I do not have an opportunity to buy it back?”

The opportunity came, as it usually does. It is like another man who boasted that he had sold his holdings at a high price, and he was asked what he bought with the money he received.

The CHAIRMAN. Is not that a matter, Senator, that has to be dealt with in the revenue bill?

Senator WALCOTT. Yes; I think it does not pertain to this bill.

Mr. DAVISON. I think it has a large influence on the situation.

The CHAIRMAN. What I am particularly interested in, Mr. Davison, speaking for myself alone, is to do something more effectively to prevent the use of Federal reserve banking assets and Federal reserve banking facilities, in stock speculation. We tried to, and thought at the time we had, removed the system as far as possible from the influence of the stock market.

Mr. DAVISON. All loans on securities are not for the purpose of speculation. Most of the real-estate operations and homes in this country, are held on margin. I have in mind particularly now an elderly man who told me whenever he bought anything, he bought more than he could pay for, because when he owed money, he kept saving money and paid off his debts. That was good business. He was not speculating but making an investment.

The CHAIRMAN. But as I have intimated before, to make sure of what we were doing, we did not use the term “speculation.” We used the term “securities.”

Mr. DAVISON. I want to emphasize one other thing, and that is I think that investments form a very large part of our banking business and a very essential part.

The CHAIRMAN. Undoubtedly that is true, but they were not intended to form a part of the reserve banking system.

Mr. DAVISON. There is one other thing I want to say, and that is, with the rates very high on call money, the rates on commercial loans were very much lower.

The CHAIRMAN. That is because we have the Federal reserve banking system, is it not?

Mr. DAVISON. Possibly; but it is a uniform practice of banks always.

The CHAIRMAN. Before we had the Federal reserve banking system, the call-loan market practically controlled the commercial rates, as well as all other rates.

Mr. DAVISON. No; I think the determination of a commercial rate, as a rule, is a different matter from fixing the rate for a loan that you can call for payment in an emergency, and that you make when you have temporarily too much money. You know you can call one loan and get it paid the next day, whereas the other loan is running for a given period of time.

The CHAIRMAN. The time came when you could not get it the next day and could not get it at all.

Mr. DAVISON. There have been very few times when that happened.

The CHAIRMAN. Every decennial period we have had a situation of that sort—pretty nearly.

Mr. DAVISON. I do not think I quite agree with that.

The CHAIRMAN. You mean we never had any currency panics in the country when banks could not call loans?

Mr. DAVISON. We had a panic in 1907. There is no doubt about that. We did not have a currency panic in 1914 when the exchange was closed.

The CHAIRMAN. Well, did you not have a currency panic? We had to issue many hundred of millions of dollars under the Vreeland-Aldrich bill, after radically amending the original measure. That came just before the opening of the Federal reserve banking system. The act had been passed—

Mr. DAVISON. That was 1913.

The CHAIRMAN. The act was passed and approved in December, 1913. The banks were opened later in 1914.

Mr. DAVISON. Yes.

The CHAIRMAN. And the only reason we did not have a very decided currency panic was, that under the Vreeland-Aldrich Act as amended, we put out about \$300,000,000 of emergency currency.

I believe—in fact, I know, having read your testimony—you are opposed to branch banking.

Mr. DAVISON. No; I am not opposed to branch banking within definite limits. I think I am opposed to chain banking of any kind.

The CHAIRMAN. And group banking?

Mr. DAVISON. I think it is bad and irresponsible. Branch banking within definite limits, where your head office can know the needs of a community and where the branch is in close touch with the head office, has proven to be a satisfactory form of banking.

The CHAIRMAN. Would state-wide branch banking appeal to your judgment?

Mr. DAVISON. It would not. It would be very unfortunate. I think it would mean a remote control, which is entirely foreign to all our ideas and the theory and practice upon which this country has been built up. You would have clerks running the branch office, whose prime purpose would be safety, and loans made on personal character would not be made.

The CHAIRMAN. Why would they not be made?

Mr. DAVISON. Well, the record of branch management is going to be, as far as the manager can make it, that he makes no losses. He will play safe always.

The CHAIRMAN. Would not the parent bank be somewhat guided by the recommendation of its local representatives?

Mr. DAVISON. It could not have the touch and knowledge that is necessary in making some kinds of loans—loans that people would be entitled to.

Senator WALCOTT. Would you be willing to extend branch banking somewhat as under the English system?

Mr. DAVISON. I do not think our people would like it at all, and after I made some remarks about this out in San Francisco, I got one or two letters, particularly from a man who had been in touch with Canada, and he said that the people in outlying sections there were just dried up; that the branches were deposit places, but they could not get loans.

Senator WALCOTT. They have practically the English method?

Mr. DAVISON. They have; but it is a different nature of people.

The CHAIRMAN. Well, is not the unit banking system carried to an undesirable, if not a disastrous, extreme when you have banks chartered all over the country with a capital anywhere from \$15,000 up to \$50,000?

Mr. DAVISON. I am very sure that it is.

The CHAIRMAN. And they break all to pieces. Could statewide branch banking do any worse than that?

Mr. DAVISON. I do not think it would help it at all, because in all the groups that have been formed, you can not find the people, forming them, buying the little country banks. They buy the big, well-established country banks.

The CHAIRMAN. Of course they would not buy these little country banks. They are simply pawnshops. They are not banks.

Mr. DAVISON. You will not have branches going out there.

The CHAIRMAN. No community should have any banking facilities if it be not able to support a bank.

Mr. DAVISON. That is right.

The CHAIRMAN. A unit bank that will stand, I mean.

Mr. DAVISON. You should not have more than the community can support.

Senator TOWNSEND. Have you a suggestion looking toward the helping of the condition that seems to exist—the very keen competition between State and national banks?

Mr. DAVISON. No; I have no suggestion. I wish we could have a uniform banking law, if possible, throughout the country. I think it would be a grand thing.

Senator TOWNSEND. For both State and national systems?

Mr. DAVISON. Yes. You have tried to reach it by permitting national banks to do whatever State banks do in any particular State?

Senator TOWNSEND. What influence would you say the State banks have had on the organization of affiliates by national banks?

Mr. DAVISON. I think they were undoubtedly started because the national banks could not do certain things the State banks could do. That was the beginning.

Senator TOWNSEND. Exactly. Then, you have no specific suggestions for relieving this competition other than what you have just stated?

Mr. DAVISON. No. I think that latterly there has been some relief, because I think both State and National Governments have been more chary of chartering banks.

Senator TOWNSEND. They have increased the capital stock, probably.

Mr. DAVISON. Yes; but I remember a good while ago, in a vicinity that I was very familiar with, there were a number of State banks along through a section of the country, and a group of people came out and formed a national bank in every one of its communities. They have all prospered because the communities grew rapidly, but that sort of thing, in a community that does not grow, or starts to go back at all, works out disastrously.

Senator TOWNSEND. Does not the reverse condition obtain in a great many cases; so that where a national bank has been organized in a community, it has shifted to State charter?

Mr. DAVISON. It has been both ways. There is no doubt about that.

Senator TOWNSEND. Then another condition exists, too. For instance, a national bank is in a community where they have probably a liberal State charter. The examiner has insisted on the national bank's doing certain things and it begins to get worried. It immediately takes out a State charter which gives it a little longer lease of life. I think that may weaken the State banking structure very much, too.

The CHAIRMAN. The dual system of banking has seemed to me to be an almost insuperable obstacle in the way of sound banking legislation. If we undertake to make certain prescriptions for the conduct or management of national banks—

Mr. DAVISON. They take out State charters.

The CHAIRMAN. Yes; if any number of them do not like it, they take out State charters.

Mr. DAVISON. That is a very unfortunate situation.

Senator TOWNSEND. Have you any suggestion looking toward liberalizing the Federal reserve system that would make it more attractive for banks outside of the system to enter it?

Mr. DAVISON. I do not know of any; no.

The CHAIRMAN. Are there not very few banks outside of the system which would contribute to the strength of the system—worthy to come in?

Mr. DAVISON. I think that is pretty nearly true. There are some, though, that should be in it, but I think they are rather exceptional.

The CHAIRMAN. The banking business, in that respect, is somewhat like religion. The soundness of it does not consist in numbers, but in the integrity and soundness of those who are in it.

Mr. DAVISON. Correct.

The CHAIRMAN. This thing of getting religion by holding up your hand does not appeal to me.

Senator TOWNSEND. As a matter of fact, though, are there not a great many sound institutions outside of the Federal reserve system?

Mr. DAVISON. I do not know that there are a great many. I am not familiar with the exact figures anyhow, I am sorry to say.

Mr. WILLIS. Mr. Davison, may I ask you a little further about the exercise of the trust powers? I followed what you said about your general attitude on the exercise of these powers by commercial banks.

Now, before the full exercise of trust powers was given to national banks, in the original reserve act, we had it limited to the exercise of corporate trusts but not personal trusts. Was not that a better situation than the one existing now?

Mr. DAVISON. As I say, I am not free to talk about that, because my interests may prejudice my judgment.

Mr. WILLIS. You do not feel you can give any answer at all?

Mr. DAVISON. No. I say, having given the powers which have been exercised so long, there is a certain responsibility to the capital structure of an institution. I do not know how you can take that away.

Mr. WILLIS. There are a few things that need comment by way of making the situation a little clearer. Do you think banks should be prohibited from purchasing for trust account securities issued by themselves or through security affiliates?

Mr. DAVISON. I do.

Mr. WILLIS. If you think that should be done, should it be absolute or in a modified form?

Mr. DAVISON. I think it should be absolute. It is a well-known principle of law, they tell me, that a trustee can not profit from the execution of his trust. So, if it were ever questioned, I do not believe you could do it now.

Mr. WILLIS. As things stand?

Mr. DAVISON. If anybody questions it.

Mr. WILLIS. Well, now, if one were to do that, would not a considerable part of the profit derived from the present situation disappear—that is, if we absolutely prohibited that?

Mr. DAVISON. I do not know. I am not going to say they make a practice of it now.

Mr. WILLIS. Suppose you go on with the situation as it stands now. Have you any view as to whether such affiliates should be allowed to trade in the stock of the parent bank and make loans on that?

Mr. DAVISON. That is one thing that helped break the Bank of United States. I think that is an abuse of power.

Mr. WILLIS. Should that be absolutely prohibited?

Mr. DAVISON. In my opinion, yes.

Mr. WILLIS. Are there any other functions or practices currently engaged in which should be similarly prohibited, so far as you know, if you maintain the system of security affiliates?

Mr. DAVISON. Not that I know of.

Mr. WILLIS. Those strike you as outstanding?

Mr. DAVISON. You have the suggested examination and publication.

Mr. WILLIS. Those are the outstanding evils at the present time that could be touched by law?

Mr. DAVISON. I think so.

Mr. WILLIS. About the question of earmarking the proceeds of loans: Did I understand you correctly to say that you thought that that could not be done; that you could not tell sufficiently accurately for practical purposes, what a loan was intended for?

Mr. DAVISON. Yes.

Mr. WILLIS. In the questionnaires that the committee has sent out to security affiliates and banks, I note there is a question asking for the percentage of loans that are made for commercial, industrial,

and agricultural purposes. I find that the loaning officers who made these replies up were apparently able to tell, down to two decimal places, for what purposes the loans were made.

Mr. DAVISON. That is shown by the character of the loans. Of course, you can do that.

Mr. WILLIS. Does not that mean you can, in effect, find out—

Mr. DAVISON. I think I told the chairman a bank knows where its money is loaned and, generally, for what it is used. Yet I might loan money to someone on a commercial account and they may not make that use of it.

Mr. WILLIS. Does not that amount to the same thing as earmarking the money?

Mr. DAVISON. To the extent of that loan; yes.

Mr. WILLIS. In the case of trust companies, has your experience shown that they were more deeply engaged in loans on securities than the banks were before the panic of 1929 or not, or were they in about the same position?

Mr. DAVISON. Well, I would not know any distinction.

Mr. WILLIS. You have no impression about that?

Mr. DAVISON. No.

Mr. WILLIS. As far as you know, were they continuing in about the same way and same proportion, in the security loans, during the years 1928 and 1929, as before that, or were they increasing such loans?

Mr. DAVISON. I know it happened with us that our Street loans to brokers were lower in 1929 than they normally are.

Mr. WILLIS. Did I understand you to say this morning that your discounts were also lower at the Federal reserve bank?

Mr. DAVISON. I did not say they were lower. I said during the period of higher money we borrowed only twice—both for one day. One was caused by the fact of our banking merger; and our exchanges happened to be big at the settling date. We borrowed a large amount one day, and the 1st of August we made another borrowing.

Mr. WILLIS. I understood you to say you kept out of the loans for others as long as you could.

Mr. DAVISON. Yes; and when we did go in, we had to do it.

Mr. WILLIS. It is your judgment, evidently, that it is not a good thing to do in the proportions in which it was going on at that time?

Mr. DAVISON. I think it is very unfortunate.

Mr. WILLIS. If that is the case, is it not practical to get the same point of view that you have suggested, as the head of one of the large banks of the country, enforced in the other banks.

Mr. DAVISON. I think the corporations and other depositors would lend their money through other channels and accomplish the same result. I think in order to remedy the situation, you have to go to people who have the money to lend.

Mr. WILLIS. That is, you have to legislate against the corporations using it in that way?

Mr. DAVISON. Yes.

Mr. WILLIS. Do you think that is a practical thing?

Mr. DAVISON. I do not know. I think not. I had no remedy when I started to speak. I know you can not accomplish it the other way. The lenders have shown me what they will do if I do not do it.

Mr. WILLIS. Could you accomplish it by a joint effort of the stock exchange and the clearing-house banks?

Mr. DAVISON. I do not think so.

Mr. WILLIS. Nothing we could do would materially prevent it?

Mr. DAVISON. I do not think so.

The CHAIRMAN. They would then make loans through institutions not controlled by the stock-exchange banks and clearing-house banks?

Mr. DAVISON. Absolutely.

The CHAIRMAN. Might it not be reached through the famous interstate commerce clause of the Constitution? Legislators reach everything they want to reach through that clause.

Mr. DAVISON. It is possible.

Mr. WILLIS. Do you think that the present savings deposit situation is in serious danger?

Mr. DAVISON. It probably has no dangers to-day, but it has been shown to have dangerous possibilities. To my mind it is very difficult to have a commercial bank act as a savings bank. The two kinds of funds are different. The rates of interest are different and, in order to earn the rate of interest they have been paying on savings, they have to make different kinds of investments, which make them less liquid.

The CHAIRMAN. Do you not think there should be some readjustment of the reserve requirements?

Mr. DAVISON. I certainly do.

The CHAIRMAN. You think the 3 per cent is entirely too low?

Mr. DAVISON. I think the 3 per cent on thrift accounts is entirely too low, because they are practically demand deposits.

Mr. WILLIS. You would make it the same as demand deposits?

Mr. DAVISON. When we discussed it last year in the commission Governor Roosevelt appointed, we were willing to stop somewhere in between. I suggested another remedy which I thought was more efficacious than either—that an ordinary bank pay no interest on accounts under \$1,000.

Mr. WILLIS. To anybody?

Mr. DAVISON. That would mean the money would go into the savings account where it should be. It is an impossible situation where a banker like myself, a commercial banker, has to pay a higher rate of interest on thrift money, which is the first to go out, necessitating the use of liquid assets on the theoretically slow thrift money.

Mr. WILLIS. Do you believe in the segregation of assets?

Mr. DAVISON. For the reasons I have suggested, it is unthinkable to me, but it has worked in some States. They tell me in California where you segregate your assets in savings accounts and commercial accounts, that where there has been a failure, the savings depositors got a little more money back than the commercial accounts.

I do not see how a man can be two or three minded in running a financial institution. I really think that eliminating the interest on deposits under a thousand dollars would be a very efficacious way of handling the situation.

The CHAIRMAN. How would it be if you put a limitation upon all deposits of banks with other banks?

Mr. DAVISON. Why?

The CHAIRMAN. To prevent the drawing of money from the interior banks to the money centers.

Mr. DAVISON. Well, I do not think that happens—not at the instance of the money center, at any rate.

The CHAIRMAN. Yes; I knew that was your view.

Mr. DAVISON. That is my experience.

The CHAIRMAN. Do we not have this situation, Mr. Davison, that local industries and local commerce never get the benefit of easy credit and easy money? Do they not have a standard rate of discount from which they never depart, and do they not bundle up their excess supplies of credit and money and send them up to the money centers at a nominal rate of interest and never give their local people the advantage?

Mr. DAVISON. I think they are apt to have a uniform rate. I do not think they bundle up their money and send it to the money centers and not lend it locally.

The CHAIRMAN. They prefer to send it up to their correspondent bank at a nominal interest rather than reduce the rate of discount to the local people.

Mr. DAVISON. That could not be the practice of a successful local bank. As a matter of fact, we find they call on us in moments of stress for loans.

The CHAIRMAN. That is the reason they have you as a correspondent.

Mr. DAVISON. And we are able to serve a useful purpose.

The CHAIRMAN. But they send the money to you rather than reduce the rate of discount locally?

Mr. DAVISON. If they have a use for it, they use it in the community. They do not send it to us unless it is necessary for a reserve or liquidity.

The CHAIRMAN. They lend it in the community at their standard rate of discount from which they never depart. They would rather loan it through you at one and a half of 1 per cent, at call, than reduce their rate of discount to people in their own locality.

Mr. DAVISON. I should like to find some community where I can make loans on that basis.

The CHAIRMAN. It is my general information that it is the practice and my observation is that it is the practice. No matter what the condition of the money market is, I am never able to borrow from my bank at less than 6 per cent.

Mr. DAVISON. You ought to change banks.

The CHAIRMAN. I could not, unless I got out of my community, and if I got into any other community I would be confronted with the same situation.

Senator TOWNSEND. Mr. Davison, you said you favored branch banking, but not on State lines. How would you define the limit?

Mr. DAVISON. The limit would be where the head office could be thoroughly familiar with the situation of the branch banks and where the branch could be in constant touch with the head office, so that the whole situation would be before them.

Senator TOWNSEND. And you would define it by county lines or trade areas?

Mr. DAVISON. No. Trade areas might be very wide and too wide.

The CHAIRMAN. Mr. Davison, is not the correspondent bank system of the country now practically nation-wide branch banking?

Mr. DAVISON. No; it is not practically nation-wide branch banking. I think it is very much better than branch banking in that in each community you have a responsible body or bank that knows the



needs of that community and, as a rule, commands the respect of the community and knows all about it. It does its business independent of any direction whatever from the correspondent bank, but it does know that when it has made good loans and has pressure for money, it can always go and get money from the correspondent bank, but the initiative and responsibility are in the locality where they should be.

Senator TOWNSEND. Would that be true with a well established and soundly-conducted parent bank with an agency in the community?

Mr. DAVISON. I do not think it would. If you would go into one of the English banks, you would find they would receive your money, but when you wanted to talk about a loan, you would find it was a matter of long negotiation. The local management, as a rule, has no authority. I think an extensive branch banking system would be simply using the remote community as a source of contributing, in a sense—simply draining money out of that community to the money center.

The CHAIRMAN. There is one thing in connection with this discussion of branch banking that has always appeared to be outstanding to me, Mr. Davison. I have been in Congress about 30 years, on the Banking and Currency Committee of the House for 18 years and on this committee for 12 years, and I have never known a borrower to object to branch banking. The only objections that have ever come have come from the bankers themselves, and there seems to be some change of attitude among bankers, as indicated by the more recent action of the American Bankers Association.

Mr. DAVISON. That was very limited, and that was a rather equivocal resolution that they passed. Certainly when I saw the American Bankers Association a year ago, in October, in San Francisco, they were whole-heartedly opposed to branch banking to any extent, and the way bankers talk to me, they feel that way still.

The CHAIRMAN. Two years ago the American Bankers Association, was it not, at Los Angeles—

Mr. DAVISON. They were at San Francisco a year ago in October.

The CHAIRMAN. Well, were they not at Los Angeles two years ago when they had the McFadden Bill under discussion, with its very meagre, limited grant of branch banking?

Mr. DAVISON. I do not know.

Mr. WILLIS. It was four years ago.

The CHAIRMAN. Time goes by fast with me now.

Mr. DAVISON. It certainly does.

The CHAIRMAN. I know the American Bankers Association then reversed its attitude and I have never known a man or an association of men who wanted credit to object to a branch banking system.

Under the 10 per cent limitation, Mr. Davison, on loans to individuals, concerns or corporations, would a branch banking system overcome the many objections to that restriction?

Mr. DAVISON. I do not believe that it works a hardship. If a man is entitled to further credit, the correspondent bank is usually glad to take the excess of it.

The CHAIRMAN. Is not that an aspect of branch banking?

Mr. DAVISON. It is an aspect of cooperation which helps to overcome what you might call an objection to a local bank.

The CHAIRMAN. It helps if it is always available.

Mr. DAVISON. It is going to be just as available as the loan is going to be available if it is the branch of some bank, because we are going to have the same knowledge and going to have a man with experience and whose money is at stake in the community, rather than some one we hire.

The CHAIRMAN. You think you have carried the spirit of independent banking to an excess when we charter a lot of little banks all over the country that can not stand up?

Mr. DAVISON. I think beyond question.

The CHAIRMAN. Well, sir, we are greatly indebted to you for coming down here.

#### STATEMENT OF JOHN A. BRODERICK, SUPERINTENDENT OF BANKS, STATE OF NEW YORK

The CHAIRMAN. Mr. Broderick, it is very good of you to come down here at this time because you have a situation of your own in New York, have you not?

Mr. BRODERICK. I have not very much trouble in keeping busy, Mr. Glass.

The CHAIRMAN. Would you mind telling us what, in your judgment, brought about the situation in New York in 1929?

Mr. BRODERICK. In 1929?

The CHAIRMAN. Yes.

Mr. BRODERICK. That is a pretty large order. But I would say that the situation was brought about by two years of unbridled speculation, nation-wide, which affected every branch of business, including banking.

Senator TOWNSEND. Unbridled speculation?

Mr. BRODERICK. Yes.

Senator TOWNSEND. Have you any suggestion of a way to bridle speculation?

Mr. BRODERICK. The man who can do that is not living at the present time. The speculative fever is in the blood of the American people and it will break out again.

The CHAIRMAN. Knowing that, those of us who had to do with the construction of the Federal reserve act, at least, tried to guard the Federal reserve system from influences and practices of that sort.

Were not the Federal reserve facilities used in New York to contribute to that sort of thing?

Mr. BRODERICK. Senator, there are some questions which I do not think it would be proper for me to answer.

The CHAIRMAN. I know that.

Mr. BRODERICK. Of course, I am interested in the Federal reserve system. As you know, I was in it at its birth, too. But I would hesitate to express an opinion about some things because of the fact I occupy an official position myself. In private I would not hesitate to do it.

The CHAIRMAN. I understand the delicacy of the situation. Let me just ask you this: You were at one time Secretary of the board when that position meant very much more than it has meant since. Was it or was it not your judgment that the purpose of the act was to

preclude the use of Federal reserve facilities for stock speculative purposes?

Mr. BRODERICK. Yes; it was, to stabilize the banking situation.

Senator TOWNSEND. I was going to ask, Mr. Broderick, what percentage of your State banks were in the Federal reserve system in New York?

Mr. BRODERICK. I could not answer that offhand, but I might say that the principal banks in the State are members of the Federal reserve system. The smaller ones are not. That refers to banks and trust companies. Of course our savings banks, which are very large, have deposits of between four and four and three-quarters billions of dollars, and they have depositors that number over 5,300,000; they, of course, are not members of the Federal reserve system, although I should like to see them members.

Senator TOWNSEND. Would you say 50 per cent of the State banks in New York State are members?

Mr. BRODERICK. No; not as much as that.

The CHAIRMAN. Would you not say that much more than 50 per cent of the banking resources of the State belong to members of the Federal reserve system?

Mr. BRODERICK. Yes; I would go higher, 75 to 80 per cent.

Senator TOWNSEND. Have you any suggestion to make whereby banks not in the system might be induced to come into it?

Mr. BRODERICK. I think it could only be done, Senator, through missionary work. I think there is great room to "sell" the Federal reserve system from the standpoint of insurance. It can be done. They think they are losing money by not belonging to the system.

Senator TOWNSEND. They think they are losing money by not belonging to it?

Mr. BRODERICK. By belonging to it. Pardon me.

Senator TOWNSEND. Yes; I find that sentiment.

The CHAIRMAN. How do they imagine they are losing money? Simply by failure to get interest on their reserve deposits?

Mr. BRODERICK. Yes; which is quite a big item to the small banks.

The CHAIRMAN. But is it a bigger item to the small bank than the prospect of a collapse of the money market and an occurrence of famine, such as we had before the establishment of the Federal reserve system?

Mr. BRODERICK. No; it is not, but they can not see that. They say, "We will be pretty well taken care of by the New York correspondents."

The CHAIRMAN. But they were not, in some periods of panics, were they?

Mr. BRODERICK. Not in 1907. They could not get currency in any circumstances.

The CHAIRMAN. Yes; they had to issue clearing-house certificates.

Senator TOWNSEND. There has been some criticism here on affiliates; and one banker has stated that probably the liberality of the State law had compelled the national banks to go into affiliates because the State law permitted it.

Mr. BRODERICK. The only section of the State law to which that reference can be made is in connection with trust companies which have the right to invest in stocks. That, practically, is the only power which the State trust companies have which the national

banks have not. They may be referring to that. But that does not even justify them. That is the only difference between the State and national banks.

The CHAIRMAN. Under the system of examinations, national, State, and Federal reserve, is it ever difficult for an important bank to know what uses are made of its credits?

Mr. BRODERICK. Usually they know what the uses are.

The CHAIRMAN. Ought they not always to know?

Mr. BRODERICK. I believe they try to, but a customer may borrow and tell you the reason why he is borrowing, and tell you also what his basis of repayment is, and then turn around and use the money for other purposes.

The CHAIRMAN. Oh, I know you can not prevent people from lying or changing their minds, either. Is it not easy enough, under the system of examination—is not inevitable, under the system of examination—that the Federal reserve bank of any given district should know whether or not its facilities are being used for stock speculative purposes?

Mr. BRODERICK. That is a difficult question to answer, Senator. The Federal reserve banks loan on commercial paper or lend against United States bonds. Those are simply temporary loans. But where they rediscount, they have every reason to believe, from the rediscounted paper, that the reason for the rediscount is to take care of those people and not speculation.

The CHAIRMAN. Have they not reason to believe that if they know a particular bank is largely engaged in brokers' loans and is over-extended for speculative purposes—they know that if that bank is extending its commercial paper and using the facilities of the Federal reserve bank, and is it reasonable to suppose that the Federal reserve bank management does not know that that is being done?

Mr. BRODERICK. It might not know, but I believe it could find out.

The CHAIRMAN. Ought it not to know?

Mr. BRODERICK. They would have to send in people especially to ascertain that, and if they did that, it might look as if they had some doubt of the correctness of the statements of the bank officers as to the purpose of the loans.

The CHAIRMAN. If they have not correctly stated the case, should it not be found out?

Mr. BRODERICK. You are going quite a distance when you doubt a bank officer's statement. I do not believe that some bank officers can always tell.

The CHAIRMAN. But is it not easy enough for a Federal reserve bank—the Federal Reserve Bank of New York—to know whether a given member bank is using its facilities for speculative purposes rather than for ordinary commercial purposes?

Mr. BRODERICK. Well, I think I will have to ask you to excuse me on that question, because my knowledge of the Federal reserve bank goes back 10 years—

The CHAIRMAN. Do you not know whether a State bank is using its facilities for speculative rather than commercial purposes?

Mr. BRODERICK. Yes.

The CHAIRMAN. If you know that as to State banks, which may be members of the Federal reserve system, should not the Federal reserve bank know that?

Mr. BRODERICK. Yes, but in each case of that kind, the bank was not borrowing from the Federal reserve bank.

The CHAIRMAN. If it is not borrowing from the Federal reserve bank, there is no reason for the Federal reserve bank to inquire into its specific activities.

Mr. BRODERICK. Most of the borrowings Senator—I am speaking of the State institutions—most of the borrowings from the Federal reserve bank in New York are from the smaller institutions, and when the larger banks borrow it is simply for a day or two to readjust their position. It is not customary for them to borrow steadily.

The CHAIRMAN. Why does a bank have to readjust its position?

Mr. BRODERICK. Withdrawals may be heavier than anticipated.

The CHAIRMAN. I know, but are there not other reasons why they have to readjust their reserve situation?

Mr. BRODERICK. What have you in mind, Senator?

The CHAIRMAN. Well, if they were overextended in their brokers' loans.

Mr. BRODERICK. Well, if they are overextended in brokers' loans. all they have to do is call the brokers' loans and correct it immediately.

The CHAIRMAN. But they do not call them; they increase them.

Mr. BRODERICK. No, Senator. They do call them when they need the money that way. The only exception to that is where the particular brokers have accounts with them—their own customers' loans. They have no compunction at all about calling the average brokers' loans.

The CHAIRMAN. Mr. Broderick, have you made any concrete suggestions for amendment of the banking laws of New York State, in order to avert the situation such as confronts you now?

Mr. BRODERICK. Quite a few. We have made 60 of them to the Legislature of the State of New York, some of which my good banking friends consider quite radical.

The CHAIRMAN. Would you mind letting us have a list of them?

Mr. BRODERICK. I am glad to give you this copy.

The CHAIRMAN. I am greatly obliged to you. We will put this in the record.

(The recommendations referred to are printed in full, as follows:)

MEMORANDUM PROPOSALS FOR AMENDMENTS TO THE BANKING LAW MADE BY THE SUPERINTENDENT OF BANKS IN HIS PRELIMINARY REPORT FILED WITH THE GOVERNOR AND THE LEGISLATURE JANUARY 7, 1931

GENERAL

1. To amend the banking law in order to permit prompt mergers of banking institutions in case of emergency or when necessary to protect the interests of depositors and shareholders, by providing that with the approval of the superintendent of banks, the boards of directors of any two or more banking institutions may merge such institutions under an agreement which will protect and preserve the equities of the respective stockholders. Such amendment might also provide that such agreement shall be subject to the approval of a justice of the Supreme Court of New York.

Under the existing law when a banking institution, because of lack of liquidity or depreciation in the value of assets, can no longer safely be permitted to continue in the conduct of its business, the superintendent of banks is placed in the position of being obliged to either close such institution or urge that it merge with some institution having a sound financial standing. The latter remedy, providing the merger is a proper one, is much to be preferred to the first, for the reason that the closing of an institution undermines public confidence

generally and often leads to heavy withdrawals from other institutions. Furthermore, the closing of a banking institution may result in loss to depositors for no other reason than the fact that the closing operates to depreciate the value of certain classes of assets, not easily liquidated, though of substantial value to a going institution.

Why not mergers then in all cases where the condition of an institution will not justify permitting it to continue in business? Under the present law, mergers to become effective must be approved by stockholders. To procure such approval it may be necessary to inform them of the facts necessitating the merger, which is likely to lead to uncertainty and rumors, resulting in runs which may cause the institution's closing before the merger can be effected. Furthermore, because of rumors which may originate suddenly, it becomes necessary in some instances to accomplish mergers over night if institutions are to be saved, which under the present law is impossible since approval by stockholders must be obtained at a meeting held on two weeks' notice.

For these reasons, and because it is a matter of great public interest that banking institutions be closed only in cases where there is no other alternative, it is urged that the legislature, which is about to meet, adopt legislation permitting, in cases where an emergency exists, the merger of banking institutions by action of the respective boards of directors without the approval of stockholders. The proposed statute, which is now in the process of being drafted, will permit such a merger only in cases where the superintendent of banks declares that such action is necessary in order to avoid closing one of the institutions. It also makes ample provision for the protection of the interest of stockholders of the merging institutions.

Had the present law contained such a provision, the Bank of United States would have been merged with one of our strongest institutions and its closing avoided.

2. To permit the superintendent to remove from office, officers or directors of banking institutions who have been guilty of persistent violations of the banking law, or of a continuance of unsafe and unsound policies.

3. To permit the superintendent, to insist upon charge offs as directed by the department, within 60 days after receipt of notification, permitting reserves to be established in lieu of charge offs.

4. To provide that the stock of all banks and trust companies and other corporations subject to the supervision of the banking department be evidenced by individual certificates of stock, which shall not be coupled with the stock of any other corporation. All such arrangements existing at the present time shall terminate within two years.

5. To limit the extension of credit and investment of funds in stock and obligations of affiliated corporations as defined in section 39 of the banking law, by providing that the aggregate investment in capital shares or obligations of, or direct or indirect loans to or loans secured by the shares or obligations of, any corporation affiliated with a banking institution and/or any subsidiary corporation of such affiliated corporation, shall not exceed in the aggregate 10 per cent of the capital and surplus of any banking institution.

6. To prohibit any officer, clerk, or other employee of a bank or trust company from borrowing from the institution of which he is an officer, clerk, or other employee, and from becoming obligated directly or indirectly, conditionally or otherwise, to such institution.

7. To provide that an officer of a banking institution shall not be permitted to become an officer of any company engaged primarily in the business of the purchase and sale of securities.

8. To provide that every director of any banking institution who is directly, indirectly, conditionally, or otherwise obligated on any loan or other extension of credit made by such institution to such director or other individual, partnership, unincorporated association, or corporation shall file with such institution once in each year, and at such other times as the superintendent may require, a statement of his financial condition.

9. To change the period within which directors' examinations are to be made to provide for such examinations at least once in each six months period. The scope of such examinations to include a complete review by each director of all loans and investments in excess of one-tenth of 1 per cent of the capital and surplus of such institution (exceeding a minimum of \$1,000, however), including all extensions of credit to affiliated or subsidiary companies. At least once in two successive years such examination is to include a complete verification of deposit liabilities.

10. To require that banks and trust companies shall, at the end of each year, render to stockholders a report showing the attendance of directors at meetings held during that year.

11. To provide for the segregation of thrift accounts in commercial banking institutions located in cities having a population of 75,000 or over, and to place restrictions on the investment of such thrift funds. This provision is to be applicable to all funds received after June 30, 1931; deposits made prior to that date to be invested in such manner as prescribed at the rate of one-fifth of the total of such deposits yearly for a period of five years.

12. To limit the amount of the funds of any banking institution that may be deposited with any other banking institution, giving effect to the varying exigencies attaching to the depositing of funds with (a) designated reserve depositories; (b) domestic banking institutions not acting as reserve agents; (c) foreign banking institutions.

13. To require banks and trust companies to maintain reserves against time deposits.

14. To omit foreign exchange balances credited to a banking institution from the items that may be deducted from the total deposits of such banking institution in arriving at the aggregate demand deposits thereof against which reserves are required to be maintained.

15. To permit any agency of a foreign institution, with the approval of the superintendent, to change the location of its place of business in the same state.

16. To coordinate the provisions of the banking law relating to the change of national banks to State banks, and the change of State banks to trust companies, with the provisions of the banking law relating to the organization of banks and trust companies respectively.

17. To limit the aggregate amount of funds which a banking institution may invest in the stock, convertible bonds, or other obligations of other corporations.

18. To modify the provision of the banking law which now required that each director of a trust company be a citizen of the United States, to provide some elasticity in the case of trust companies which at the time such provision became law had on their boards of directors, persons who were not citizens of the United States, by permitting one noncitizen to become a director.

19. To provide that any holding company which owns stock of a banking institution shall be required to maintain reserves or surety bonds to protect the statutory double liability which attaches to such stock.

20. To make applicable to trust companies the provisions of the banking law relating to adverse claims to bank deposits as now provided for banks in section 149 subdivision (b) of the banking law.

21. To provide that pass books used as receipts by any individual, copartnership, unincorporated association or corporation authorized to engage in business under the provisions of any laws other than the banking or insurance laws, and used in connection with the sale of securities shall bear the statement "Not under the supervision of the banking department."

22. To provide that no office or place of business of any corporation association or private banker authorized to engage in business under the banking law shall be open to the public for the transaction of banking business on Sunday.

23. To permit the superintendent to order, at the expense of a bank or trust company, appraisals of real estate properties owned by or mortgaged to such institutions, by independent, impartial appraisers of recognized standing.

#### PRIVATE BANKERS

1. To require that the deposit liabilities of private bankers shall be audited periodically by an outside independent auditor.

2. To modify the present provisions requiring that a certain portion of reserves maintained against deposits shall be kept on hand and to permit a larger proportion to be deposited with the designated reserve depository.

3. To provide for the continuation of the business of an individual engaged in the business of a private banker during any interim between the death of such private banker and the appointment of his executor, administrator or legal representative.

4. To permit any person engaged in the business of transmission of funds to others pursuant to the provisions of section 150, subdivision 4 of the banking law, to deposit with the superintendent, stocks, bonds, or interest bearing obligations of the United States or of this State or of any city, county, town, village, or free school district in this State instead of only interest bearing stock or bonds of such obligors.

5. To provide restrictions on loans, purchases of securities, and total liabilities to a private banker of any one person to conform with similar restrictions now imposed on banks and trust companies.

6. To provide that all licensed private bankers in cities of this State shall be required to discontinue accepting deposits by June 30, 1931, and be required to liquidate their deposit liabilities by December 31, 1931.

#### SAVINGS BANKS

1. To permit savings banks with the approval of the superintendent to establish and maintain deposit and withdrawal stations limiting the locations thereof to the county in which the principal office is located.

2. To amend section 239, subdivision 9 of the banking law relating to the liability of the trustees of a savings bank with reference to the investment of the deposits and guaranty fund thereof to bring it into conformity with the contents of section 239.

3. To amend section 239, subdivision 8, subparagraph (c) of the banking law relating to the investment of deposits and guaranty fund of savings banks in promissory notes secured by the assignment and pledge to the savings bank of first mortgages on real estate in order to bring the restrictions placed upon that class of investment as compared with the deposits and the guaranty fund of a savings bank into conformity with the restrictions placed upon the investment of a savings bank in bonds and mortgages as compared with the total assets of such savings bank.

4. To broaden the provisions of section 239, subdivision 12, of the banking law relating to the investment of deposits and guaranty fund of savings banks in bonds of public utility companies to include bonds of companies that purchase natural gas as a substitute for artificial gas.

5. To permit a savings bank to change the location of a place of business occupied and maintained by it as a branch office as a result of prior merger with another savings bank to another place in the same county.

6. To permit the superintendent of banks to order at the expense of the savings bank, appraisals of real estate property owned by or mortgaged to such institution, by independent, impartial appraisers of recognized standing.

7. To permit the payment of extra dividends above a basic rate when earnings permit.

#### INVESTMENT COMPANIES

To amend the banking law to provide as follows:

(a) That industrial banking companies and domestic corporations engaged in the business of foreign banking shall be the only classes of institutions permitted to be organized under the investment article of the banking law. In this connection, provision will be made for the reincorporation of mortgage companies and finance companies under the stock corporation law.

(b) That the business of industrial-loan companies and domestic corporations engaged in the business of foreign banking shall be limited to general powers which will be clearly defined in the statute.

(c) That industrial-loan companies shall be required to maintain a specified ratio of capital funds to outstanding unencumbered bonds or notes issued by them, now known as investment certificates.

(d) That industrial-loan companies shall be required to maintain reserves against outstanding unencumbered bonds or notes issued by them now known as investment certificates.

(e) That domestic corporations engaged in the business of foreign banking be permitted to accept deposits only under definite conditions.

(f) That the statutory total liability attaching to the capital stock of moneyed corporations be extended to industrial-loan companies and domestic corporations engaged in the business of foreign banking.

(g) That it shall be the duty of the board of directors of every industrial-loan company and domestic corporation engaged in the business of foreign banking to examine fully the affairs of the company of which they are directors.

(h) That directors of every industrial-loan company and domestic corporation engaged in the business of foreign banking be required to meet the qualifications similar to those set up for directors of banks and trust companies.

(i) That restrictions be placed upon the investment of industrial-loan companies in the capital stock of similar companies.



Provisions relating to the organization and operation of domestic corporations engaged in the business of foreign banking will follow closely the provisions of the Federal reserve act relating to companies organized under that act to engage in business of a similar type.

#### SAVINGS AND LOAN ASSOCIATIONS

1. To require the segregation of funds received by a savings and loan association on account of the issuance of savings shares and to restrict the investment of these funds to the class of securities in which savings banks are required by the provisions of section 239 to invest deposits and guaranty fund.
2. To provide for the transfer each year to guaranty fund of a larger portion of the earnings of a savings and loan association and to require a more adequate guaranty fund.
3. To require that vacancies in the board of directors of a savings and loan association occasioned by resignation, death, or other cause shall be reported to the superintendent within 10 days of the event and that the savings and loan association shall likewise report each election by the board to fill such vacancy.

#### CREDIT UNIONS

1. To amend generally the credit union article of the banking law to provide as follows:
  - (a) That the qualifications for membership shall be limited strictly so that open membership credit unions may not be authorized henceforth.
  - (b) That credit unions shall not have the power to accept deposits.
  - (c) That the power of credit unions to borrow money shall be further limited, and subject to the approval of the superintendent of banks.
  - (d) That credit unions be required to set up reserves at the end of each fiscal year against bad debts.

#### DEPARTMENTAL

1. To permit a deputy, clerk, or other employee to obtain a mortgage loan upon his own home from a savings bank or savings and loan association and to permit him to open an account with or subscribe to the shares of such institutions.
2. To permit the department to charge a fee to an applicant for a new charter in order to defray expense of investigation so that such expenses do not become a charge upon existing banking institutions.
3. To permit the superintendent, in his discretion, to reinstate any bank examiner who has left the department, provided he had served as a bank examiner for three successive years but who had been separated from the service through no delinquency or misconduct on his part.
4. To permit the superintendent to transfer to the State treasurer, interest now in his possession which accrued on unclaimed deposits prior to 1914.
5. To permit the superintendent, in his discretion, to omit one examination in any year of a bank or trust company which is a member of the New York Clearing House Association and to accept in lieu thereof a report of examination made by such association during that year.
6. To permit the superintendent to examine any corporation which owns 10 per cent or more of the capital stock of any corporation organized under the banking law.
7. To provide for the establishment within the department of a special bureau for investigations of illegal banking concerns, general complaints against banking institutions, illegal banking operations of individuals, firms and corporations providing further for the appointment under classified service, of six accountant; and investigators including also one practicing attorney; the expenses of this bureau to be borne directly by the State and not assessed on banking institutions.

Mr. WILLIS. How many of those recommendations are applicable to the national system, do you think? How many would be helpful if taken over into the national system?

Mr. BRODERICK. I think there are least five or six. However, I would not have it appear that I am making any suggestions to you. There are a number of them, however, of general application which we would consider very good for either national or State systems.

Mr. WILLIS. Which are those?

Mr. BRODERICK. The merger provision, which would permit two institutions to merge overnight, without the consent of the stockholders; second, the right of the supervising authority to remove from office and directors for persistent violation of the banking law or for the continuation of unsafe or unsound practices.

The CHAIRMAN. I might interject that that is a very important one.

Mr. BRODERICK. Most important, Senator.

The CHAIRMAN. The Comptroller of the Currency hesitates long—and sometimes too long—to adopt the radical action of closing a bank.

Mr. BRODERICK. I am 100 per cent with the comptroller in that, Senator, because a bank should be closed only as a last resort.

The CHAIRMAN. But this would be an intermediate remedy?

Mr. BRODERICK. Yes; and prevent quite a few things. The fact that that law would be on the statute books—in itself would mean it would never have to be used. It would be a sort of big stick to force out some of these people. We have been years trying to force out some of our people in New York. Peaceful means are not always successful. Any authority will hesitate a long while before putting the burden on depositors of closing a bank when there is any chance of saving it at all.

However, some people object to this and say it is radical and drastic and is an authority that should not be given a public official.

Senator TOWNSEND. The bankers object to it?

Mr. BRODERICK. Yes. They are wrong, because if a man is to be a proper supervisory authority, he must be an autocrat, and must be above influence of any kind, and must do what he thinks is right without assistance or suggestion from the outside, and he must have some means whereby he can enforce what he believes is right.

The CHAIRMAN. It does no good, as a high banking authority told me to-day, to assemble a board of directors and admonish them. The admonishment is laughed at in the end, because you have no authority except to close the bank and you are reluctant to do that.

Mr. BRODERICK. Mr. Pole will undoubtedly back me up in this, I think, that the moment you close a bank, automatically you close out one-third of its assets—the difference between a going and a closed institution.

Mr. WILLIS. What are the rest of them?

Mr. BRODERICK. With reference to affiliate companies, we are recommending that no officer of any bank be permitted to be an officer of any affiliate company or holding company; that the stock of the affiliate or holding company be represented by individual certificates and not coupled in any way with the certificates of the bank.

Third, a blanket provision as to the limiting to 10 per cent of the capital stock of a banking institution, all loans made to a company or its affiliates, investments in stock, investments in bonds of any kind, so that the aggregate of all shall not exceed 10 per cent of the capital and surplus of such institution.

The affiliated company is defined in section 39 of our law and I might say that that was one of the fine recommendations made by Mr. Davison's committee last year. We have the right to investigate, for information only, any company affiliated with the bank. We did not have that right last year, but we have investigated affiliated companies ever since April, 1929, when I took office, without any

legal right, until April of this year. That is why we know how things stand. That is the reason we have corrected a large number of instances, although I am sorry to say we were not in a position to correct past mistakes which happened before I took office.

Those are the three suggestions there in regard to affiliated companies. We have recommended too, segregation of thrift accounts in cities having a population of 75,000 or more.

Senator TOWNSEND. Have you reason to believe that the legislature will pass your recommendations?

Mr. BRODERICK. I am never discouraged, Senator. I had experience last year in a great deal of legislation. It requires very patient—I am not saying labor—but very patient missionary work. I believe the legislature can be sold on this. It does not take in the country districts. The principle is correct. It takes in cities only. The reason why we are not recommending at this time the country districts is because practically every bank and trust company, whether it be a national bank, State bank, or trust company or savings bank, outside of the cities of New York and Buffalo are, in reality, savings banks. Do I make that clear?

Senator TOWNSEND. Yes; that prevails in a great many States.

Mr. BRODERICK. And the segregation of such a large amount at any one time would not be possible or advisable. It is possible in the cities. A thrift account, I would define as an account not exceeding \$7,500 in amount, not subject to check, but possible of withdrawal only on presentation of pass books and also subject to 30 or 60 days' notice.

Senator TOWNSEND. You may have had that thought back in your mind; but you thought you had opposition enough in the cities without taking in the country banks?

Mr. BRODERICK. I am never discouraged at all. I am optimist enough to fight it.

There may be some others in the list there, Senator, which might be probably good for national banks, too.

The merger provision is subject to a great deal of opposition on the ground of its constitutionality. I believe it is constitutional.

Senator TOWNSEND. Suppose a national bank in your district decides to give up its charter and take a State charter: What are the provisions of law with reference to taking it over?

Mr. BRODERICK. A very thorough examination to find out if their condition is such as to permit them to be taken over.

Senator TOWNSEND. It is absolutely under your authority?

Mr. BRODERICK. Yes.

Senator TOWNSEND. In some States they get a charter from the legislature and then the bank examiner or bank commissioner has no choice in the matter except to take them over and give them a charter.

Mr. BRODERICK. I think the bank commissioner in our State has unlimited discretionary power.

Senator TOWNSEND. I think he should have—or some authority.

Mr. BRODERICK. He has it in connection with bank charters, bank mergers, and bank branches.

The CHAIRMAN. Do you have any suggestions to make, Mr. Broderick, as to improving the effectiveness of bank examinations?

Mr. BRODERICK. I think the bank examination system, Senator, is still in its infancy. It is possible to do too much and possible to do

too little. Success depends on the men. You can not hire bank examiners. You must develop them. Our department and, I think, the other departments, have to take young men and train them. It takes time to build up a force of that kind.

The CHAIRMAN. Of what great service is an effective examination of a bank, if your only recourse, after ascertaining a condition is to admonish the officials of a bank against pursuing an illicit course?

Mr. BRODERICK. Senator, in effect, bank examinations are very effective because I would say with 90 to 95 per cent of the banks, moral suasion is still a potent influence, and sometimes the big stick can still be used to force things. It is only in the extreme cases where we have to have means of firing some people. However, with 90 to 95 per cent of the cases moral suasion is effective.

Now, with both National and State banks in our State—the nationals are probably the first in this line—after the examination, the directors receive a complete copy of the report of the examinations and quite often conferences are held and if the conditions are unsatisfactory, every effort is made to force correction where possible.

The bank examination also has a great effect from an advisory standpoint. No bank examination is successful, nor is any system effective, unless a means is found to detect and correct unsound tendencies; in other words, policies that might lead to unsound and unsafe conditions. Until the bank examinations get to a point where it is possible to detect unsound tendencies and stop them before conditions become dangerous, the bank examination will not be successful.

The CHAIRMAN. There is a difficulty we encounter in any proposed legislation. The 90 per cent of the banking community which is amenable to advice and remonstrance and which wants to do right, does not want to be subjected to a statutory regulation which is meant for only to 10 per cent of the banking community which wants to do the wrong thing or does wrong.

Mr. BRODERICK. Yes, that is correct. They will all say that, but I think, Senator, if I may say so, that the bankers as a rule do not give enough attention to the public aspect of banking but consider mainly the private aspects of it and in a democracy such as we have, in law you have to be guided by the greatest good for the greatest number. It is unfortunate that our better bankers have got to be inconvenienced because of the acts of those who are less experienced and less skillful than themselves, but there is no other way to handle it.

The CHAIRMAN. I do not think so. What do you think, Mr. Broderick, of branch banking?

Mr. BRODERICK. Well, first off, I think there is no power on the globe that can stop the development of branch banking. Whether it is the best thing or not for the country is something that experience alone will show. It is coming. It is the only thing for cities. The day of the small bank in the cities has gone. It is hard for a small bank to find the type of management that is necessary to properly run the bank. The small banks get the extra hazardous credit risks, and not the big banks.

The CHAIRMAN. What is your exact definition of a city?

Mr. BRODERICK. Well—

The CHAIRMAN. A city in which a small bank may not exist?

Mr. BRODERICK. I would say 100,000 or more. I find a tendency in every city of that size. A small bank will be chartered and it will

be run about a year and then sold out. So with the national bank. A national bank will be chartered and will run about a year and will then sell out.

Senator TOWNSEND. They convert them into branches?

Mr. BRODERICK. We have killed that by giving branches direct.

The CHAIRMAN. Is there a distinct analogy between a correspondent bank and a branch bank?

Mr. BRODERICK. Somewhat, except the correspondent banks that take in the whole country.

The CHAIRMAN. It is nation-wide, if the bank is large enough?

Mr. BRODERICK. I do not think we will ever have a nation-wide branch banking system that will run successfully.

The CHAIRMAN. But we have a correspondent banking system that is nation-wide.

Mr. BRODERICK. That is true, but that has been built up over a period of years. In most cases, you will find there is a generation of experience with the particular banks. There is only a small number of banks in New York that have that system.

The CHAIRMAN. If there is objection to branch banking, even to a limited extent, such as State wide branch banking, would not the same objection apply with equal force to the correspondent banking—nation-wide correspondent banking?

Mr. BRODERICK. It is a case where we have one and have not the other.

The CHAIRMAN. Well, have you not to some extent the other?

Mr. BRODERICK. The New York City banks and Chicago banks that have a large number of correspondents are really banks of rediscount. They are doing a large rediscount business for their correspondent banks, performing the same function for their correspondents, as the Federal reserve banks do for their members.

The CHAIRMAN. Which is never intended they should do.

Mr. BRODERICK. May I go on and answer the question about branch banking?

The CHAIRMAN. Yes.

Mr. BRODERICK. I think there are two or three things that will bring about branch banking within limited areas. One is the difficulty in replacing the present managers of small unit banks and one sub-reason for that is the expense of running these small banks is growing each year and the income is not sufficient, and the second big reason is that in a community like New York or New England, where most of the banks have excess funds on deposit—that is, deposits in excess of the borrowing demand in that particular community—are having difficulty in properly and safely investing their surplus funds. The average banker at the present time has not the skill that is necessary to invest those funds in the proper way.

The CHAIRMAN. Is there any greater incentive for a small bank, locally organized, to do business than there is for the established agency of a branch bank in the same community?

Mr. BRODERICK. I do not think I am clear on that question, Senator.

The CHAIRMAN. What I mean is——

Mr. BRODERICK. What is the advantage?

The CHAIRMAN. Is there more incentive to a bank locally organized and conducted by officers and the board of directors, to do business

in the community than there would be for a branch bank of a large parent bank, doing business through an agency?

Mr. BRODERICK. No; except the prestige which generally comes to a man who is president or a director in a bank. Objection is raised by the opponents of branch banking that the communities would not receive as much consideration from the branch of an existing bank as they would from an independent institution.

The CHAIRMAN. Why not? That is what I am trying to reach.

Mr. BRODERICK. I can not answer that. I think that idea is a fallacy.

The CHAIRMAN. The parent bank is in business to do a banking business and I should think it would to the fullest extent respond to the demands of the local community just as readily and as completely as a locally organized bank.

Mr. BRODERICK. For all the legitimate needs of the community. What they really mean is that they want a local bank there because they will have an easier credit policy than they would get from a larger institution.

The CHAIRMAN. Would that be true if the overhead of the local bank exceeds considerably the charge of an agency there?

Mr. BRODERICK. It would exceed it.

The CHAIRMAN. Well, I say it would exceed it, and if it would exceed it to any considerable extent, could not the branch agency of a parent bank be just as liberal as a local bank with its credit accommodations?

Mr. BRODERICK. Yes; except a local bank will be probably more liberal to its own officers and directors than an outside institution.

The CHAIRMAN. And that has been an abuse, has it not?

Mr. BRODERICK. Yes; and I think you will find one of the recommendations I have here is an attempt to curb quite a few abuses, Senator, which I would not dare mention in times like this.

Mr. WILLIS. Mr. Broderick, suppose nothing is done on the question of security affiliates, but that we simply go ahead as at present. Suppose you are not able to obtain the passage of your reform and nothing is done legislatively. Do you think the security affiliate system is likely to grow pretty rapidly and become even more of an abuse than it has been or what is its future?

Mr. BRODERICK. Frankly, I do not think it is apt to grow.

(Discussion off the record.)

The CHAIRMAN. That is all, Mr. Broderick, and we are greatly indebted to you. We know what a busy man you are and we know what a delicate situation you are in.

(Whereupon at 1.15 o'clock p. m. the subcommittee adjourned until Monday, February 2, 1931, at 10.30 o'clock a. m.)

