

Supplementary Report

Experience of American Banks in Connection with Acceptance Credits Subject to Standstill Agreements

The following report deals with the experience of American accepting banks in connection with credits which have been subject to so-called standstill agreements and was not included in the main body of the report of the Federal Reserve Committee on Acceptance Practice.

The Committee excluded this standstill experience from its original report and made it the subject of this supplementary report for two reasons.

First, final liquidation of credits subject to the principal standstill agreements had not yet been completed, consequently the experience of accepting banks could not finally be judged.

Second, losses to date in liquidating standstill credits have been almost wholly due to the discount incident to conversion of foreign currencies into dollar exchange under existing exchange controls and in general are not traceable to faults in the individual credits themselves and therefore are not susceptible to the same methods of analysis as credits falling within the usual experience of accepting banks.

Principal Agreements

The three general standstill agreements to which American banks have adhered are those entered into with Germany, Austria, and Hungary. American banks to some extent have felt the influence of currency restrictions in certain other countries, notably Brazil, and the Argentine, but there the problem has been rather one of liquidating long term loans, and the effect on acceptance credits has been

practically negligible. Your committee's report is based largely on a study of the German Agreement since that is by far the most important of the three in respect of the amount involved and because basically it is similar to the other two. The Austrian Agreement originally covered acceptance credits aggregating about \$40,000,000. Approximately \$20,000,000 of these have been liquidated with a relatively small loss, the amount of which cannot be precisely estimated. The remaining \$20,000,000 was converted into other forms of indebtedness, and the ultimate value of which cannot now be determined. Acceptance credits subject to the Hungarian Agreement have been reduced from their original total of about \$24,000,000 to a present figure of about \$7,000,000, which is gradually being retired, albeit very slowly. The committee has not found it possible to arrive at an estimate of the losses which have been and may be incurred on these credits.

Events Leading to German Standstill Agreement

The inflation in Germany which eventually destroyed that country's entire working capital, came to an end in 1924 with the establishment of the Dawes Plan and the stabilization of the mark. German credit appeared to have been reestablished, and German industry with practically no fixed charges and with low wages presented an attractive prospect to the foreign investor. Long term capital, particularly from the United States, poured in and industrial revival began to take place on a huge scale.

States, municipalities and other public bodies, quickly aware of the ease with which they might borrow from the world's capital markets hastened to contract foreign loans not only for productive purposes but frequently for nonproductive, not to say extravagant ends. While there were some attempts to control the latter, loans of the former type were definitely encouraged.

Not until 1927, however, did short term borrowings of Germany reach noticeable proportions, but then, attracted by comparatively high interest rates, came a flood of funds in the form of bank deposits and credits. Ostensibly these funds were

used to finance German foreign trade as well as industrial undertakings and, to some extent, state and municipal expenditures.

Amount and Classification of German Short Term Foreign Debt

Germany's total foreign debt probably reached its peak about the middle of 1930 and has been estimated at perhaps 26 or 27 billion Reichsmarks* (6 to 7 billion dollars) of which at least 13 billion Reichsmarks, or about half, represented short term loans. There are no available records as to the distribution of the total foreign loans among lending countries at that time, but the following table published in the Economist of January 23, 1932, probably illustrates the relative proportions fairly accurately. It should be borne in mind that during the six months immediately prior to July 1931 a very substantial liquidation had taken place.

Table I

German Short Term Debts July 1931

(Dollars .000 omitted)
(Conversion rate Rm. = \$.23736)

<u>Country</u>	<u>Total Acceptance Credits and Other Short Term Loans</u>
U. S. A.	\$ 746
Great Britain	487
Holland	491
Switzerland	446
Other Countries	<u>671</u>
	<u>\$2,841**</u>

** Revised figures place this total at about \$3,100,000,000 but do not give a segregation. The higher figure is occasioned chiefly by including accounts up to Rm. 50,000 (\$12,000) which were not originally reported.

Probably the earliest and most nearly accurate classification of Germany's short term debt is shown in Table II. It was upon these figures that the first standstill agreement was based. They probably fairly represent the relative importance of the several categories.

* Note: Wiggin Committee report estimates Rm. 25.5 milliards
German estimate given to Young Plan Committee Rm. 28.5 milliards.

Table II

GERMAN SHORT TERM INDEBTEDNESS AS OF JULY 28, 1931

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(in millions of dollars)*

(Rate of Conversion Rm. 4.213 per dollar)

DEBTORS

	<u>Banks</u>	<u>Reichs- bank and Gold Discount Bank</u>	<u>Industry, Commerce, Transport, Agricul- ture</u>	<u>Other Debtors</u>	<u>Gov't Muni- cipal- ities</u>	<u>Total</u>
Total short term debts	1,316.6	235.9	1,182	33.9	72.4	2,840.1

Creditors

Banks	1,085.2	86.4	566.1		72.4	1,810.1
Other Creditors	231.4	149.5	615.7	33.9		1,030.

Creditor Countries

United States	456.9	49.8	208.9	2.8	27.5	745.9
Great Britain	266.1	5.0	195.6	5.5	15.4	487.6
France	96.6	1.2	50.6	1.7	5.7	155.8
Holland	153.6	-	327.6	5.7	4.3	491.2
Switzerland	224.5	-	199.4	6.9	14.9	445.7
Other Countries	118.9	-	200.1	10.4	4.5	333.9
Bank for International Settlements	-	179.9	-	-	-	179.9

Type of Credit

Documentary Credits and other Bank Acceptances	631.9		176.5			808.4
Book Debts against commod- ity shipments			400.7			400.7
Acceptances and Single Name Paper			58.7			58.7
Loans			128.3	.2		128.5
Mortgages			3.6			3.6
Other Debts	684.8	235.9	414	33	72.4	1,440.1

* Source: "Germany's Foreign Indebtedness" published by German Registry Office for Foreign Debts.

It will be noted that approximately 26% \$746,000,000, of the total debt was owed in the United States, chiefly to banks. Nearly 30% \$808,000,000, of the indebtedness was in the form of acceptance credits, half of which \$396,000,000 were extended by American banks.

In the fall of 1929 began the world wide depression heralded by the collapse of the New York stock market boom. With the changed conditions in the United States, financial opinion became alarmed at the huge volume of Germany's foreign obligations and the flow of long term loans suddenly stopped. Borrowers, of necessity, turned to the only accommodation available: short term loans. Meanwhile, commodity prices began to fall and the volume of international trade was substantially reduced. In May 1931, the collapse of the Credit Anstalt in Austria drew world attention sharply to the precarious credit situation in central Europe. Withdrawals of foreign funds were accelerated and by the first week of June, Germany's loss of gold and foreign reserves had reached alarming proportions: flight from the mark was in full swing.

Inauguration of Standstill Arrangement

The Hoover moratorium at the end of June, 1931, proposing that all governments which were creditors of other governments should grant the latter a postponement of all principal and interest payments during one year from July 1, 1931, was followed, in July, by a banking moratorium in Germany. These measures prevented a complete collapse but withdrawal of foreign deposits was prohibited and it was evident to all that liquidation of foreign credits, both long and short term, must be indefinitely delayed.

A conference was held in London to consider possibilities of international assistance to Germany, the immediate problem being the arrangement of Germany's short term indebtedness in such a way as not to demoralize her foreign trade or destroy the stability of the mark. The London conference led to the appointment of a committee of banks who hastily arranged the first standstill agreement.

This agreement, which has been renewed annually with revisions and amendments, was limited to cash advances, time deposits and certain other indebtedness (all of which are generally referred to as cash advances) and acceptances, and was designed to maintain existing credit facilities by keeping acceptance lines open and

continuing cash advances and time deposits so that Germany's foreign trade would not be ruined and her currency rendered unstable. The types of credit, however, which came under the standstill, represented in the aggregate only a little over one-third of Germany's short term liabilities of some 13 billion Reichsmarks.

Table III shows the distribution of that part of Germany's short term indebtedness which was subject to standstill agreement compared with her total short term foreign debt.

Table III

German Short Term Debt
as of July 31, 1931

(Dollars .000 omitted)
(Conversion Rate Rm. = \$.23736)

	<u>Subject to Standstill*</u>			<u>Not Subject to Standstill</u>	<u>Total</u>
	<u>Accept- ances</u>	<u>Cash Advances</u>	<u>Total</u>		
U. S. A.	\$396	\$ 52	\$448	\$ 298	\$ 746
Great Britain	196	41	237	251	487
Holland	65	47	112	379	491
Switzerland	53	91	144	302	446
Others	<u>29</u>	<u>17</u>	<u>46</u>	<u>624</u>	<u>671</u>
	\$739	\$248	\$987	\$1,854	\$2,841

* Note: Except for the U. S. A., which is the July 31, 1931 figure reported by American banks, figures are converted into dollars from statistical material provided for the London conference by the Reichsbank and the Gold Discount Bank.

American Adherents

Eighty American banks adhered to the first German agreement in 1931.

Their distribution according to Federal Reserve districts was as follows:

New York	46	Philadelphia	3
Chicago	8	Dallas	2
San Francisco	8	Atlanta	2
Boston	6	St. Louis	1
Cleveland	3	Minneapolis	<u>1</u>
			<u>80</u>

At the end of 1935 there were but forty-four American adherents. The difference is accounted for in part by withdrawal of creditors whose original commitments have been entirely liquidated. A few adherents have sold their claims abroad. Others have failed to adhere to the current agreement in the belief that the nature of their particular credits was such as to make them easier to handle outside of the standstill. At least two in this category are banks which did not reopen after the banking holiday. Three original adherents subsequently merged with other adhering institutions. The present distribution of adherents by Federal Reserve districts is:

New York	24
San Francisco	6
Boston	3
Chicago	3
Cleveland	2
Philadelphia	1
Dallas	<u>1</u>
	<u>40</u>

Liquidation Experience

Table IV shows the progress of liquidation of Germany's short term debts which were subject to standstill agreement from July 1931 to December 31, 1935.

TABLE IV

GERMAN SHORT TERM DEBTS
SUBJECT TO STANDSTILL AGREEMENT

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(Total Lines - In million Reichsmarks)*

<u>Country</u>	<u>Basis for 1931 Agreement</u>	<u>As of December 31, 1935</u>	<u>Percentage of Reduction</u>
United States	1,886 (\$448 mill.)	425.4 (\$170.9)	61.8 (in creditor's currency)
Great Britain	997.1	611.5	26.5 "
Holland	473.3	166.8	65.8 "
Switzerland	606.4	324.6	49.3 "
France	173.3	42.8	75.1 "
All Others	23.1	32.6	Increase 41.1 (in Reichsmarks)

* Berlin middle rate of February 29, 1932 - Rm. 4.21 per dollar = 0.23736 ¢ per Rm.;
December 31, 1935 - Rm. 2.488 per dollar = 0.40192 ¢ per Rm.

1931 figures from "Statistisches Material fuer die Londoner Besprechungen," except U.S.A.; here is used the July 1931 figure reported by American banks. 1935 figures are taken from "Statistische Uebersichten."

It should be noted that while the expression of Germany's foreign debt in terms of the currencies of her creditor countries has been a constant, the depreciation of foreign currencies has resulted in a reduction of her indebtedness as expressed in Reichsmarks. Thus the net reduction shown in Table IV includes a gain to Germany on this account of approximately

Rm. 485.7 Million vs. U. S. A.

" 128.7	"	" Great Britain
" 27.5	"	" Holland
" 16.0	"	" Switzerland
" <u> </u>	"	" France

657.9

These amounts cover the period February 29, 1932 to December 31, 1935, inclusive. While there was no depreciation in the Dutch, Swiss or French currencies during the above period there was a gain to Germany in respect of Reichsmarks in the case of certain Dutch, Swiss and French credits which were effected in Sterling and dollars.

American Liquidation Experience

In order to establish the volume of credit which adhering banks should continue to extend to Germany in accordance with the first standstill agreement, effective September 1, 1931, the acceptance credits and cash advances actually in use on July 31, 1931 were used as a basis. Thus American banks entered the first agreement with credit lines aggregating \$448,000,000 of which \$396,000,000 were in use as acceptance credits and \$52,000,000 as other short term credits, generally referred to as "cash advances." By December 31, 1935, these lines had been reduced to an aggregate of \$170,900,000 of which \$149,800,000 were acceptance credits and \$21,100,000 were cash advances, an aggregate reduction of \$277,100,000, 90% of which has been in acceptance lines. Table V sets forth in more detail the classification and course of liquidation of the American commitments. It may be noted that since 1931 the volume of actual availments under these credits, although subject to fluctuation, has probably been used to very nearly the full extent of the lines extended.

TABLE V

GERMAN STANDSTILL AGREEMENT

Status of Acceptance Credits and Cash Advances
extended by American Banks as of July 31, 1931
and December 31, 1935

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(in millions of dollars)

ACCEPTANCES

	<u>Banks</u>		<u>Commercial and Industrial Debtors</u>	
	<u>Lines</u>	<u>Availments</u>	<u>Lines</u>	<u>Availments</u>
July 31, 1931	340	340	56	56
Dec. 31, 1935	<u>125.4</u>	<u>110.4</u>	<u>24.4</u>	<u>16.2</u>
Reduction	214.6	229.6	31.6	39.8

CASH ADVANCES

July 31, 1931	35	35	17.0	17.0
Dec. 31, 1935	<u>14.7</u>	<u>14.0</u>	<u>6.4</u>	<u>6.4</u>
Reduction	20.3	21.0	10.6	10.6

TOTAL

	<u>Lines</u>		<u>Availments</u>	
	<u>Acceptances</u>	<u>Cash Advances</u>	<u>Acceptances</u>	<u>Cash Advances</u>
July 31, 1931	396	52	396	52
Dec. 31, 1935	<u>149.8</u>	<u>21.1</u>	<u>126.6</u>	<u>20.4</u>
Reduction	246.2	30.9	269.4	31.6
Total Reduction of Lines		<u>277.1</u>	Total Reduction of Availments	<u>307.0</u>

December 1935 figures taken from Statistische Uebersichten February 1936; amounts converted at Berlin middle rate of December 31, 1935 - Rm. 2.488 per dollar = 0.40192 ¢ per Rm.

It will be seen that most of the loans have taken the form of acceptance credits and that in the majority of cases American banks have dealt directly with German banks rather than with commercial or industrial concerns. While primarily liable for the credits which they received, German banks in turn placed the credits at the disposal of their commercial and industrial customers. As a consequence, there have been numerous substitutions of one debtor for another as well as changes in the types of transactions underlying the bills presented for acceptance. In addition not infrequently original acceptances have become overdrafts and have been replaced by bills which have again become overdrafts so that except in relatively few cases there has been no real continuity of individual credits. For these reasons it does not appear possible to apply the same methods of analysis to individual acceptances as were used in the main body of the report on acceptance practice.

Since in almost all cases acceptance credits of American banks were guaranteed by German banks, none of whom were permitted to fail, and since the standstill agreements have provided that drawers of good credit standing must be substituted for any who prove to be insolvent, the impossibility of applying the same methods of analysis as were used in the main report does not seriously affect the study of standstill experience. Practically no losses can be traced to failure of individual debtors to meet their obligations in their own currency.

Methods of Liquidation

Table VI sets forth in some detail the principal ways in which liquidation of American claims has been accomplished under the terms of the successive agreements.

TABLE VI

AMOUNTS AND METHODS OF FINAL SETTLEMENTS ON STANDSTILL CREDITS

(in millions of dollars - for Conversion Rates *)

<u>METHODS</u>	<u>1</u> Prior to Feb.29,1932	<u>2</u> March 1,1932 to Feb.28,1933	<u>3</u> March 1,1933 to Feb.28,1934	<u>4</u> March 1,1934 to Feb.28,1935	<u>5</u> March 1,1935 to Dec.31,1935	<u>6</u> Total Reduction
Cancellations (Cl.4)	39.5	-	20	-	9.5	69
Preferential Rights (Cl.4)	-	4.3	2.6	-	-	6.9
Conversions (Cl.10,1932)	-	1.0	.4	-	-	1.4
Repayment in Registered Marks (Cl.10,1933 et seq.)+	-	-	90.0	65.7	23.6	179.3
Gold Discount Bank Guaranties (Cl.23)	-	5.2**	5.2	2.4	1.4	14.2
Gold Discount Bk. Payments in place of postponements (Cl.23)	-	.8	1.1	1.2	1.0	4.1
Decreases for Other Reasons (Probably mainly sale of credits to foreign banks)	-	-	13.6	15.1	-	28.7
	39.5	11.3	132.9	84.4	35.5	303.6
On the other hand, there were increases for						
a) new adherences	-	8.6	11.6	6.4	-	-
b) other reasons	-	6.1	-	-	.2	32.9
	39.5	+ 3.4	121.3	78.0	35.3	<u>Net</u> <u>Total 270.7</u>

*Col. 1 at par = Rm.4.198 per \$
 " 2 and 3 at " 4.213 " "
 " 4 at " 2.510 " "
 " 5 at " 2.478 " "

** paid in foreign exchange

+Creditor received Reichsmark equivalent of his dollar credit in blocked account; if he utilizes his balance otherwise than for investment in Germany, he suffers a loss, the extent of which is determined by the discount at which registered marks are quoted.

Source: Various volumes of Statistische Uebersichten.

It will be seen that the greatest part of the liquidation of American claims has been through the payment of registered marks, and that this form of payment has been availed of to a decreasing extent since it came into effect in 1933.

The next most important item of reduction was cancelation of unused portions of open lines. Of course this represents no movement of actual funds at the time of cancelation although there was a prior movement at the time of actual repayment. Such cancelations have reduced the potential volume of credit which American banks had agreed to extend in Germany.

There follows a brief explanation of the methods of repayment mentioned in Table VI. The full text of the current agreement is attached to this report.

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1. Cancelations under Clause 4. During the negotiations preceding each renewal of the agreement a certain percentage of open lines which had not been used for a given time, was earmarked for cancelation, such cancelation to be effected in the early period of each agreement.

2. Preferential Rights under Clause 4. Whenever a creditor's right to cancelation was not fully satisfied, the amount still open on such cancelation took priority over other claims under the agreement.

3. Conversion under Clause 10 - 1932. A creditor willing to accept payment of his claim in Reichsmarks was permitted to utilize such balances in long term investments of various types; such investments were blocked for a period of 5 years.

4. Conversion under Clause 10 - 1933 et seq. The 1933 and subsequent agreements provided for repayment of standstill claims in blocked (registered) marks and stipulated the various ways in which such balances may be used.

5. Clause 23. This clause covers the percentages of various debts for which the guaranty of the Gold Discount Bank may be requested by a creditor, and the manner in which settlement will be effected by the Gold Discount Bank.

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Losses Incurred in Course of Liquidation

American banks agree that in the great majority of cases their German debtors have been willing to meet their obligations in full at maturity but able to do so only in their own currency. Owing to the fact that Germany's gold and foreign exchange reserves had very nearly reached the vanishing point it was necessary to set up machinery to conserve and if possible augment what little remained. As a consequence an exceedingly complex and restrictive system of exchange controls was established. Thus foreign creditors, deprived of the normal means of repatriating their funds, have been able to effect the greater part of their liquidation of German credits only through the medium of registered or "blocked" marks. (See table VI.) These could only be converted into dollars at a discount and it is in such conversions that the only really important losses in connection with standstill credits have been incurred by American banks. Reduced to its simplest terms, the procedure of converting Reichsmarks into dollars is as follows: A German debtor desiring to repay a foreign obligation deposits the equivalent Reichsmarks calculated at the current Berlin middle rate for account of the foreign creditor. The latter may use these funds within Germany without incurring any loss other than that which may result from hazards which attend any credit or investment transaction. It is only when he elects to convert these Reichsmarks into foreign exchange, that he suffers a loss, for when he draws on his account for conversion purposes he is actually paid in registered marks, which he can only sell at a discount. Thus, for example, an American bank having a Reichsmark balance may sell registered marks at a discount to a customer about to travel in Germany. Likewise under certain conditions registered marks may be sold to importers of goods from Germany.

Since 1933, when the registered mark came into existence as a medium of exchange, an active market has developed, the principal movements in which are reflected in Table VII. From this table it is apparent that the United States accounts for more than a third of all the conversions of Reichsmarks into registered marks and has sold more and bought fewer registered marks than any other important

country adhering to the standstill arrangement. This confirms the general opinion that American banks were more desirous than others of liquidating their German commitments as rapidly and substantially as possible, in marked contrast to the British policy for example. This haste to liquidate appears to have been particularly true in the earlier years of the registered mark arrangement, and undoubtedly accounts in large measure for the increase in the rate of discount on registered marks.

This rate increased from the low of about 15% in 1933 to approximately 51 1/2% in the Fall of 1935. At the present time (August 13, 1936) it is about 42%. The average to date is about 33.5%.

It does not appear possible to calculate with absolute accuracy the losses sustained by all American banks in liquidating their acceptance credits through sale of registered marks. Inquiries among 24 banks whose original standstill acceptance lines amounted to 323 million dollars or about 85% of the total indicate that their aggregate losses on 235 million dollars liquidated up to January 1936 has been approximately 29 million dollars or 12 1/2 per cent. On this basis, it might reasonably be estimated that losses for all banks have been in the neighborhood of 32 million dollars. However, in view of the variations in accounting methods employed by banks, too much reliance cannot be placed on such an estimate. There are several reasons for this. Many banks have invested registered marks in various ways. Although such investments as a rule did not entail a loss at the time they were effected, since there is no discount involved in this use of registered marks, there may have been some loss attendant upon the subsequent disposition of the investments.

Furthermore, there is reason to believe that a few banks in reporting their losses applied income in the form of interest and commission against discounts incurred in the sale of registered marks, though this was not the practice at most of the big banks. Again, banks as a rule have not differentiated between cash advances and acceptances in recording their transactions in registered marks. Therefore it is difficult to separate exactly the amount involved in these two categories of credit.

Because of these weaknesses in this estimate, it seemed desirable to estimate the losses by another method. Fortunately the volume of liquidation through the sale of registered marks for consecutive periods from March 1933 through December 1935 is a matter of record, together with the rates of discount for these periods. By assuming that the amount of registered marks sold during each period was liquidated at the average rate of discount prevailing during the period it is possible to estimate a figure for total losses on acceptance credits and cash advances liquidated through sale of registered marks of about \$51,000,000. Since liquidation of cash advances has been about 11% of all credits liquidated, it may be fairly assumed that a similar relationship exists in respect to the losses sustained in these two categories. On this basis, the losses of all American accepting banks in liquidating their acceptance lines through sale of registered marks would be about \$45,000,000.

In all probability, the true loss from the sale of registered marks lies somewhere between the estimate of \$32,000,000 based on reports of certain accepting banks and the \$45,000,000 figure. In computing the net effect of these operations by American banks, it should be noted that this loss has been offset by approximately \$36,000,000 which American banks have received

as interest and commission on their acceptance credits during the same period.

According to statements of a number of bank examiners, the majority of American accepting banks have set up ample reserves against their standstill commitments. In some cases the latter have been written off entirely.

TABLE VII

REGISTERED MARK TRANSFERS AMONG REGISTERED HOLDERS

since March 1, 1933

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Status as of December 31, 1935*

(in million Reichsmarks)

<u>Country</u>	Reichsmark balances Converted into Registered Marks	<u>Registered Marks</u>		
		<u>Sold</u>	<u>Bought</u>	<u>Balance</u>
United States	501.0	363.8	105.1	242.3
Great Britain	96.5	141.8	213.9	168.6
Holland	315.6	301.4	357.5	371.7
Switzerland	353.1	309.8	324.7	368.0
France	125.2	34.9	80.2	170.5
Others (standstill)	<u>24.6</u>	<u>19.1</u>	<u>89.4</u>	<u>94.9</u>
	1,416.0	1,170.8	1,170.8	1,416.0

The "Balance held" was invested as follows:

<u>Country</u>	<u>Travel Marks</u>	<u>Surplus Exports</u>	<u>Other Investments**</u>	<u>Total</u>
United States	130.4	69.4	42.5	242.3
Great Britain	144.4	7.1	17.1	168.6
Holland	256.3	35.8	79.6	371.7
Switzerland	246.4	30.1	91.5	368.0
France	37.6	109.5	23.4	170.5
Others (standstill)	<u>81.9</u>	<u>9.3</u>	<u>3.7</u>	<u>94.9</u>
	897.0	261.2	257.8	1,416.0

* Statistische Übersichten, January 1936.

** Contain the small amounts carried in registered account, which in the case of the United States and Switzerland amount to approximately 11 million Reichsmarks each, but are insignificant for the other countries.

Possible Future Losses

It is impossible to estimate what loss, if any, may yet be incurred in connection with acceptance credits which American banks are still extending in Germany. As noted in Table VI, liquidation through recourse to registered marks has shown a constant and substantial decrease which would appear to confirm the statements of many accepting banks that early anxiety to liquidate German commitments at any cost has largely disappeared, that the weaker and less desirable debtors have been for the most part eliminated and that the remaining accounts may be continued with a reasonable assumption that they largely represent profitable and desirable business. It is the expressed opinion of those bankers who have followed the market for registered marks most closely that the increasing rate of discount had little to do with the decrease in volume of liquidation. This belief would appear to be supported by the fact that earlier this year when the rate of discount was less than at some previous times, sales of registered marks by American banks continued to diminish.

The volume of current acceptance lines, scattered as they are among forty banks, has ceased to be an important problem in American banking. Indeed, as some bankers have remarked, the entire amount of German Standstill debt owed to American accepting banks today is less than the entire former dollar accommodation granted to say the Deutsche und Disconto Bank alone.

Character of Paper Drawn Under Standstill Agreements

The acceptance credits extended to Germany were intended primarily to finance self-liquidating transactions in the export or import trade or the storage of commodities. From time to time charges have been made as, for example, in the Senate report which was quoted at the beginning of the full report to which this is an appendix, that a considerable volume of acceptance credits granted in Germany and other countries did not represent bona fide commercial transactions, but in some instances represented the financing of internal trade and not infrequently was

nothing more or less than finance paper used to provide working capital.

The Committee has made a considerable effort to secure evidence on this question. The first important conclusion arising from competent testimony and the examination of available records, is that a clear distinction should be drawn between the condition of affairs before the period when the standstill agreements became necessary and the developments since that time.

American banks generally are of the opinion, and German authorities maintain, that until shortly before the standstill agreements came into effect, the majority of acceptances drawn represented bona fide commercial transactions, though we have the testimony quoted in the main body of the report that there were undoubtedly some cases where banks had been lax in assuring themselves in detail as to the nature of the underlying transaction. At this date there is no way of demonstrating statistically the extent to which laxity of this sort may have existed. The figures collected for the main body of this report do, however, offer evidence as to the quality of bills drawn prior to the standstill agreements. Table VIII which follows shows all the individual acceptance credits extended in Germany, Austria, and Hungary, in the period from 1920 to 1931 inclusive, which were involved in difficulties prior to the standstill agreements. This table indicates that so far as these three countries were concerned the total number of cases of individual credits which encountered difficulty in this eleven year period totaled only 7 as against a total of 72 cases for all countries. Thus, as far as goodness is concerned the credits extended in these countries prior to the standstill agreements appear to have been at least as good as like credits extended elsewhere. These data do not, of course, carry any necessary implications as to the extent to which credits in these countries conform to the standards of technical eligibility. On that point our only present reliance is the opinion of competent bankers here and abroad which has been cited earlier.

Table VIII

Acceptance credits in difficulties 1920 to 1931 inclusive,
in Germany, Austria, and Hungary prior to standstill arrangements.

(000 omitted)

Type of credit	No. of cases in difficulty	Dollar amount involved
<u>GERMANY</u>		
Export	-	-
Shipment between foreign countries	5	\$517
Foreign storage	-	-
<u>HUNGARY</u> - nothing		
<u>AUSTRIA</u>		
Export	2	\$312
Shipment between foreign countries	-	-
Foreign storage	-	-
Totals	7	\$829
<u>ALL COUNTRIES</u>		
Export	19	\$ 3,692
Shipment between foreign countries	43	7,009
Foreign storage	10	3,817
Totals	72	\$14,518

When we turn from the experience prior to the standstill agreements to the experience with individual credits under those agreements, we encounter a quite different situation. As the period of falling prices and the contraction of foreign trade set in, at that time a number of German concerns suffered a decrease in the type of business which would permit of their creating eligible commercial bills. At the same time they found themselves in need of working capital and, therefore, continued to draw on American banks under existing credit lines. It may be asked why if the bills drawn before the decline in business represented bona fide commercial transactions they did not provide self-liquidation through the exchanges. The answer lies in the fact that the German Government took over for its own use such exchange as was available rather than permit it to follow its customary

channels in trade. Accordingly, foreign creditors were compelled to a large extent to countenance a use of credit with which they were not altogether in accord in order not to jeopardize claims which they held against German debtors. American banks became increasingly aware of the deterioration of the character of the paper offered for acceptance as many of their more punctilious German debtors volunteered that they were no longer in a position to create eligible bills. From the closer scrutiny to which all foreign credits began to be subjected, it was noted that not infrequently statements as to the character of the underlying transaction became increasingly general and lacking in specific detail. Investigation of such cases usually revealed that there was no actual current merchandise transaction directly matching the individual bill offered for acceptance. In some instances the drawer offered his bills in anticipation of transactions which were to take place at some time in the future or which had been completed prior to the drawings. In other words, being engaged in a type of business ordinarily financed by acceptance credits, the drawer drew his bills as he needed funds rather than as a specific current transaction was effected. In some other cases there was evidence that the use of the proceeds of certain credits had no connection with the transactions from which the acceptances purported to arise.

In negotiating the German Standstill Agreements, it was the desire of American banks to be sure that they would not be called upon to accept ineligible renewal bills and that the bills which would be offered to them for acceptance would be self-liquidating in character and of an eligible kind. These conditions the Germans agreed to so far as possible, and the right is reserved, where it is not possible, to carry the resulting debt in the form of cash advances or overdraft, of course at higher rate of interest.

It appears impossible to ascertain exactly the proportion of drawings which, measured by the standard of rules and regulations of the Board of Governors of the Federal Reserve System, should be classed as not self-liquidating. Table IX

based upon inquiries among 100 American accepting banks indicates the character of German standstill bills as of October 31, 1931, as regards self-liquidation.

Table IX

Character of German Standstill Acceptances as regards self-liquidation
based on reports of 100 American Banks as of October 31, 1931.

(000 Omitted)

	(1)	(2)	(3)	(4)
		Proof of	Self-liquidating	
		shipment	bills without	
		other than	documents or proof	
		documents	which could	Definitely not
	Shipping documents		probably be brought	self-liquidating;
	passed through		under Col. (1)	no documents
	acceptors' hands		or (2)	or proof
Total Outstanding*				
\$288,000	\$33,000	\$80,000	\$88,000	\$87,000
		39%	31%	30%

* Of this amount \$49 million represents total amount of acceptances outstanding issued against imports or exports to or from the U. S. A.

From this it would appear that at that time 39% of the paper was definitely self-liquidating as evidenced by shipping documents or other similar proof, 31% was in all probability self-liquidating although not substantiated by documents or other proof, and 30% was definitely not self-liquidating.

Replies to inquiries among 25 American banks adhering to the 1935 standstill agreement indicated that at the end of 1935 an average of 74% of the bills outstanding was eligible while 26% was ineligible or pure finance paper.

Figures compiled by German authorities show that from March 1932 to December 1935, 90% of the bills accepted by American banks for which the Reichsbank authorized payment in foreign exchange represented self-liquidating transactions while 10% was finance paper. The difference between the American and German percentages is probably in large part due to the fact that as regards the question of self-liquidation American banks have applied the standard of our own eligibility requirements while the Germans have followed the more liberal standards of European

practice. It is probably safe to say that from seventy to seventy-five per cent of German drawings under American credits represent self-liquidating transactions hence eligible paper from our standpoint.

Some observers, including some accepting institutions, believe that many American acceptors had left the way open for abuses by laxness in depending on general statements made to them by German banks and in not requiring more detailed information regarding the transactions underlying the bills which they accepted. It is probably safe to say that American banks generally exercised what they thought was reasonable care to assure themselves that the underlying transactions were such as to make the bills eligible for acceptance. Following the spirit of then current banking practice, however, many acceptors placed more dependence on what they believed was strong credit and ample guaranty than on specific self-liquidating underlying merchandise transactions. In this procedure they were perhaps influenced by the example of London. It is said that London accepting houses generally were less concerned that the transactions financed by them should be self-liquidating than that the acceptances should bear names regarded as good. It may be that a somewhat stricter acceptance practice would have restricted the volume of credits extended and so reduced the later losses. The principal assured ground for criticism is that too large a volume of credits of all sorts was extended to these countries under all the circumstances.

Although accepting banks were pledged, under the agreements, to continue to extend credit, sudden withdrawal of which in large volume would have had disastrous effects not only on German debtors but on foreign creditors as well, they were under no obligation to treat as eligible, credit transactions which were definitely ineligible. Accordingly, most American banks transferred into the category of cash advances those bills which did not clearly represent self-liquidating transactions and held such paper in their own portfolios, charging the debtor the higher rates applicable under the agreements to cash advances.

In considering the question of so-called "eligible paper" versus "finance paper," it may be borne in mind that under the standstill agreement the fact that a bill covers a self-liquidating commercial transaction does not necessarily mean that the American acceptor will be paid any more promptly than if the bill were a pure finance bill. In the latter case, however, payment is more apt to be from the proceeds of a renewal bill. In either event, so long as the credit taker is solvent, final payment in foreign currency can only be obtained subject to existing exchange restrictions. In either case if the credit has been arranged through a German bank and if the credit standing of the ultimate taker of credit becomes seriously impaired, the German bank must at the request of the creditor bank substitute a drawer of good standing. In case of bankruptcy of a German bank debtor's client, all obligations covered by letter of guaranty become due without notice.

CONCLUSIONS

About midsummer of 1931 standstill agreements were arranged with respect to American credits in Germany, Austria, and Hungary.

The Austrian agreement covered originally acceptance credits of about \$40,000,000 of which \$20,000,000 has been liquidated with a relatively small but not precisely calculable loss. The remaining \$20,000,000 has been converted into other forms of indebtedness.

Hungarian credits have been reduced from about \$24,000,000 to about \$7,000,000, and the loss in liquidation or on the remaining balance is not now calculable.

In July 1931 the first German Standstill Agreement was established. At that time acceptance credit commitments of American banks totaled about \$396,000,000. At the end of 1935 this figure had been reduced to approximately \$150,000,000, a decrease of 62%. In the course of this liquidation of \$246,000,000 the only loss of consequence incurred by American banks has been through the discount involved in

dollar exchange conversion. This loss probably lies between \$32,000,000 and \$45,000,000. During the same period American banks have received approximately \$36,000,000 in interest and commissions.

Present commitments are being extended by forty American banks in the majority of cases to German banks rather than to commerce or industry direct. It appears that the least desirable debtors have been largely eliminated and that the problem with respect to these remaining credits concerns the transfer of funds rather than its goodness of individual credits.

In general difficulties encountered and losses incurred with respect to standstill credits in Germany, Austria, and Hungary, were not so much the result of unwise acceptance practice, as of a world wide economic upheaval which interrupted the normal relations of debtor and creditor and cut off the normal flow of funds between countries. It may fairly be said that in view of the general economic position too large credits of all sorts were extended to the central European countries. While it is difficult to present any detailed statistical evidence it seems clear that acceptance credits have suffered far less from these world economic disorders than have credits of other sorts, such as long term bond issues or direct advances by banks. By their nature acceptance credits should of course suffer less than other forms of credits.

The study of standstill credits, like the more general study of all credits covered in the main body of this report, has brought to light evidence of some amount of unsatisfactory acceptance practice, particularly with respect to acceptors obtaining evidence of the nature of the underlying transactions behind credits extended for the shipment of goods between foreign countries or the storage of goods in those countries. This study thus supplements the main report in pointing to the desirability of improving acceptance practice in this respect.

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Ira Clerk

November 6, 1936,