



THE SECRETARY OF THE TREASURY  
WASHINGTON



March 15, 1923.

Dear Mr. Platt:

I received your letter of March 10, 1923, in reply to my letter of that date as to the open market operations of the Federal Reserve Banks, with particular reference to their purchases of Government securities. I am glad to note that you find yourself in general agreement with my letter and that the Federal Reserve Board has sent out to the Chairmen of the Federal Reserve Banks a letter stating that it is strongly of the opinion that certificates maturing March 15th which have been held in their portfolios should be allowed to run off without reinvestment. I am interested also to note that the Board has now designated a committee to prepare regulations governing the open market operations of the Federal Reserve Banks, and hope that in so far as these regulations may affect Government securities the Treasury will be permitted an opportunity to examine them before they are issued. The question of the legal authority of the Federal Reserve Board to prescribe regulations governing these operations, and even prohibiting purchases under certain conditions, has been raised before, and I have understood from Governor Harding's letter of April 14, 1922, to the Governor of the Federal Reserve Bank of Philadelphia, a copy of which was sent to the Treasury at the time, that the General Counsel of the Board had rendered an opinion that

under the authority given by subdivision (b) of section 14 of the Federal Reserve Act, to prescribe rules and regulations governing the purchase of bonds and notes of the United States, and the authority given by subdivision (j) of section 11 of the Act, to exercise general supervision over the Federal Reserve Banks, the Federal Reserve Board may at any time impose such restrictions or limitations as it deems advisable upon the exercise by Federal Reserve Banks of their power to make such purchases. Certainly the question as to what policy the Federal Reserve Banks shall follow with respect to earning assets, as related to expenditures and dividends, is a question within the authority of the Federal Reserve Board to determine by virtue of the powers granted by the Federal Reserve Act, and particularly the power to exercise general supervision over the Federal Reserve Banks. Generally speaking, the Federal Reserve Banks in buying Government securities have been moved by a desire to maintain their earning assets at some assumed figure sufficient to cover their expenses and dividends, and entirely apart from its power, which I believe to be ample, to regulate purchases of Government securities by the Federal Reserve Banks and under some circumstances to prohibit them, the Federal Reserve Board clearly has full power to shape these operations through its general supervision of the management and administration of the several Federal Reserve Banks. There are, of course, many legitimate transactions in connection with which the Federal Reserve Banks may buy or sell Government securities,

on repurchase agreements or otherwise, and these transactions should not, of course, be hampered by regulations any more than is absolutely necessary. I should say, however, that it would be a relatively simple matter to separate these business transactions from the purely investment transactions under which Federal Reserve Banks have bought Government securities in the past simply for the sake of maintaining their earning assets, and that having in mind this distinction it would be entirely appropriate for the Board to prescribe general regulations governing the investment transactions of the Federal Reserve Banks and even, in some circumstances, to prohibit purchases simply for investment. The Board, for example, could quite properly promulgate regulations, it seems to me, under which Federal Reserve Banks intending to buy Government securities simply for investment would first have to submit the matter to the Federal Reserve Board and get its express approval.

Very truly yours,

*A. C. Mellon*

Secretary of the Treasury.

Hon. Edmund Platt,  
Vice Governor,  
Federal Reserve Board,  
Washington, D. C.

*Circulate*  
AT BOARD MEETING

MAR 20 1923

*W. W. Abaton*  
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