

COMMITTEE ON THE HISTORY OF THE FEDERAL RESERVE SYSTEM

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With cooperation of
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722 JACKSON PLACE, N. W.
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May 1, 1956

Dear Mr. Rounds:

It is good of you to go over this transcript and fill in the holes. Had we been more experienced with the recorder, and with the relationship between the recorder and certain types of voices, had we had a more sensitive microphone able to carry that nice soft voice of yours, we would have done better.

If you can get this back to us with the spaces filled in before you go to Maine, we will be ever grateful.

Most sincerely yours,


Mildred Adams

Mr. Leslie Rounds
32 Washington Square West
New York City, N. Y.

Enc.

Confidential Interview with Leslie Hofnds - May 2, 1955
(Present - Dr. Lester Chandler, Mildred Adams)

C. I wonder if we might try and carry through an important episode beginning at the time of Strong's death. As I remember, immediately after Strong's death, Mr. McGarrah became acting governor of the bank.

R. Yes, that's right.

C. And then Harrison was selected to succeed him.

R. Yes, I think it was a foregone conclusion from the very beginning that Harrison would be elected. He had quite obviously been in training for this post for some time, but Strong's death came rather suddenly, and the directors have always felt that the post of governor or president, as it is now, should not be vacant for even one day, so that immediately when word came that Governor Strong had died, Mr. McGarrah was elected at once. The interim before Mr. Harrison's appointment was very brief. I don't recall now just what the period was, but I think it was only a week or two.

A. He had been chairman?

R. McGarrah had been chairman.

A. Yes, and then was moved in as acting governor?

R. That's right, and he continued in that duty as chairman also.

A. In both jobs?

R. Yes, but that was simply so that there would be a president of the bank here. Incidentally, I think that I told you the last time I was here in response to your question about McGarrah's having the by-laws changed, so that the chairman would be the executive head of the bank. When Mr. Jay resigned as chairman here to take the position as Deputy Reparations Commissioner, Mr. McGarrah was asked to become chairman. Mr. McGarrah was a member of the old school of bankers, a man well on in years when he came into the bank. He was understood as a condition of his acceptance to have demanded that the by-laws be changed to make the chairman the chief executive officer. He never really exercised that office. Strong

was a very strong-minded individual and Mr. McGarrah apparently felt the position of chairman should not be subordinated to the governorship. But it was really more a change pro forma than in fact.

C. Do you remember if Strong knew before the change was made that it was going to be made? In the by-laws?

R. I cannot answer positively, but I am reasonably certain that he did. I would put it 100 to 1 that he knew, but I haven't any positive information on the subject. I don't know, I guess that perhaps George Harrison would know. Herbert Case might possibly know.

C. I was under the impression that the directors were not disapproving of Strong in any way?

R. Oh no, by no means, and I'm very sure that if Strong had objected to that change being made, it would not have been made. The directors never would have made that change without his consent. I think I told you this the other day. That's why I say I'm quite sure Strong did know. I'm very sure that nothing would have been done that he was not thoroughly informed about and to which he had not agreed. He was far from a well man at that time, and nobody knew it better than he. He had to be absent a great deal, and I don't think he would have ever anticipated being overruled by McGarrah. Actually, there was never any conflict at all. McGarrah was a very mild administrator who had a faculty for getting along well with everybody. Of course, he was a strong man in many respects, and he could be very stubborn, but still, his natural bent was always towards harmony and getting along closely with his associates.

R. I think that the reason for that change in the by-laws was simply that McGarrah foresaw the possible occasions when that might be a necessary power to have, and even perhaps at times in the absence of Strong because the first deputy governor - (there was no first deputy governor at that time, but there was a ranking deputy governor) - could have been very much embarrassed at times when Strong would be

- 3 -

absent, as he was a great deal, and I think that that was a reason, just so that if McGarrah had the power he felt he needed, if he needed it, there wouldn't be any argument about it. The Reserve Bank organization is quite an unusual one and the position of the chairman is somewhat ambiguous. The position of Federal Reserve Agent which is the other half of the job, is clearly defined in the law. ... The by-laws had been pretty silent on any other authority that the chairman had. He was no more than a presiding officer. In actual practice, nobody noticed any change in procedure as a result of this change in the by-laws.

R. You have doubtless already run into the fact that there were some pretty serious squabbles over those two jobs at some of the banks. In one bank, a man took the position of chairman thinking in his own mind that he was going to be chief executive officer of the bank and then finding out he was not ... He and the president then swapped jobs ... At least three districts ran into that issue, San Francisco, Kansas City and Atlanta also. But here, Strong was the strong man from the beginning right through until the end as long as he lived.

C. It's often said that immediately after Strong's death, after Harrison came into office, that the Federal Reserve Board set about to make sure that the leadership would not longer be taken by the New York Bank.

R. I think that is definitely so.

C. Can you think of any particular episodes that would indicate desire on the part of the Board to prevent the New York Bank from taking the initiative after October of '28?

R. Well, I don't know that I can exactly. I would say that it manifested itself more in many little things. The Board would hold up or block some of the Bank's recommendations, and it was quite obvious for a long time that the Board, or certain members of the Board, were just seeking opportunities to take control as far as relations with the New York Bank were concerned. Let's see, Strong died - ?

C. October 16, 1928.

R. That was just about it. I couldn't date that exactly, but I think we were already trying to change the discount rate before he died.

C. Well, the big controversy came around March, 1929.

R. Yes, a little bit later, and the discount rate was changed about every week.

C. There were those two letters that the Board wrote, remember, in January or February of '29? February 2, 1929 was the first of the letters where they asked you fellows to take direct action.

R. Those letters I think were written urging what we call direct action as against certain banks, and I think that one or two of those banks, there may have been others, in the judgement of the Board, were borrowing too much at the time. This was "moral suasion." They thought that those banks should be definitely told to reduce their loans or get out entirely. The Bank had already been trying to accomplish the purpose by raising the discount rate. Strong was a great believer in the theory that there was only one way to control credit, and that was by making it expensive. That was the traditional central bank policy the world over up to that time.

A. It was an extension of the free market theory really;

R. Yes. But the kind of control the Board was talking about before Strong died had no relationship whatever with the controls exercised by the free market. Miller of the Board was the strong advocate of control by moral suasion. At that time most bankers were members of the old school. Rate control was the only control they knew. Applying hindsight on all that, I think it was unfortunate that there were those differences of opinion ... both sides trying to get the same result ... there was something to be said for compromising between both methods. Perhaps the Bank was a little stubborn sticking to the idea that price was the controlling factor and also that the Board was very stubborn in not permitting use of the discount rate which was the generally accepted method for

controlling credit. Miller was a theory advocate completely. He was a man who had no practical experience in banking. He had been a college professor, and he thought you could talk the banks into taking desired action. We have found out that you can accomplish something by that method. Some banks are very responsive to suggestion; others have a very thick skin on that and resist it. The whole program of the Bank at that time had been opposed to that method. There is a place for the use of both methods.

C. In the spring of 1929 you fellows here at the Bank refused to send out a letter that the Board had sent to you to be sent to the member banks.

R. My best recollection at the moment is that that letter was a slightly different approach to the moral suasion idea. Just another way of getting at the thing, and the Bank took the position that it was not the right way to handle the thing. One of the great troubles is that if you try so-called selective controls to any considerable extent, you have to indicate to the individual banker how to exercise those controls, in effect how to run his bank. He doesn't like the medicine, he doesn't like what you're trying to tell him, and he is quite apt to, well I won't say rebel, exactly, but he is not at all adverse to pointing out to you where it didn't work.

We didn't have Regulations T and U in 1929. When they came, they demonstrated quite effectively that the use of those regulations was one way of restricting the use of credit. Direct action and moral suasion were about the same thing. The method was moral suasion, the application of it was direct action.

In those days the System had to be very circumspect in dealing with banks in order to be sure that no one bank would have, or appear to have, an advantage over another, and of course it was recognized at times that a bank might get an advantage over another just by its willingness to be less considerate of the interests of all than some other bank, but I think it would be fair to say that that was considered less objectionable than would have been direct action by the

Bank to try to force obedience. Those were very interesting days, and since central banking was a totally new experience in this country, many of these problems had never come up before, and there was some slowness in getting oriented to the effect of any real changes. Since then, of course, we've had, well, about the first attempts we have at selective control were Regulations T and U which attempted to control brokers' loans, loans to brokers and brokers' loans to their customers. That was the sort of thing that might have been more effective in 1928, if anyone had thought of it.

A. They didn't have any thought of it?

R. No. Well, I think frankly there was at that time great reluctance to think of such detailed control. I think that's not an overstatement of the case. The bank was committed to a different sort of policy, and nobody in the Board had thought of those things either, as far as that goes. There was no issue on those questions, they never came up. The Board had not gotten beyond the point of moral suasion and there were differences of opinion in the Board about that. Miller was the strong advocate for what he called direct action, which was putting moral suasion to work.

A. Miller?

R. Dr. Adolph Miller, yes, he certainly was a leader of that faction, and I doubt that without Miller there would ever have been any great difference of opinion. I don't think anybody else down there would have perhaps ever gotten to the point where they trusted their own judgement enough to take such a stand.

C. Would this be an accurate description of the attitude of New York Bank people at that time, that they thought they were doing all that was feasible in the way of direct action, but that that could not be effective by itself? It needed a rate increase in addition?

R. Yes, that is true. I think the attitude of the bank can perhaps best be expressed by saying there was a total unbelief in the theory of direct action or

attempts to control credit in the qualitative manner, although that again is a term that I don't think had ever come up at that time. It's a little difficult in talking about what's happened over a period of time to avoid using terms that came into being sometime later. There was no belief in moral suasion on the one hand, and there was a strong belief on the other that the Federal Reserve Banks must be impartial, that they couldn't spot out bad boys and spank them. Then of course all of this was colored by the very strong conventional belief based on long experience in other countries, that the only effective way to control credit was to control volume in total by controlling rates or cost. I heard Strong say many times that you just can't control the use of credit. Suppose we let a hundred million dollars of credit get out into the market. It starts in a half dozen banks that take the initial credit, but within 24 hours it's been transferred to a lot of other banks by normal banking transactions that would have taken place in a day, and you just can't control that at all. It's the way it goes. The bucket will only hold so much water, and when it's full it runs over and it goes in all directions. It goes in somebody else's bucket, and those are the arguments that were used at that time. Strong was a very firm believer in that.

Our economist here in the bank at that time was Carl Snyder, and nobody in the world ever believed in rate control on the volume of credit any more than Carl Snyder did. In fact I expect the great disappointment of his life was to have the very definite proof that this would not work when the tide was reversed in 1931, and we were trying our best to get credit into use by making it very cheap. I'm no economist, and I seldom presumed to match my wits against his in that area. But I came to have a rather definite theory of my own about all that, and I talked with Carl about it on many occasions, but I never could get him to admit it. I don't know whether before he died he ever changed his mind or not. My theory was that you could control the volume of credit by controlling the cost of it, but that to be successful by that method you had to maintain the variations

between two median points starting at a level that might be called normal. In other words, you can keep the boat on a level keel provided that you were level when you started and never permitted it to be very far off. If you never let the rate get above, well I used to say then 5%, in the light of what's happened since then, one might be tempted to put it lower, but 5% was considered a good rate at that time. Well, to use that illustration, to get over 5% and not to get under 3, you might be able to control the economy pretty well and have a fairly level picture operating on rates between those figures. But we certainly proved here in the bank in the depression years that you cannot induce the use of money by making it cheap. It is not a two-way road except as you can operate without creating any scare either way. A normal market is very sensitive to the cost of credit. The amount of credit that is being used can very substantially be influenced on the up side by the cost of it. One of the major problems of a controlled economy is that if everybody knows it's controlled, they also know any condition can be quickly reversed and therefore do not trust the existing condition.

I am willing to say that the experience in the last 25 years has pretty well demonstrated that there is a place for other controls as well as the discount rate. The most effective control today is open market operations. One reason why it is successful is because the thing is done before anybody knows it. In effect, it is already in and there is no resistance to it. There's no scare about it. It is a far more effective instrument than any of the others, but I would not say for a moment that it should be used exclusively. The other two principal instruments - the discount rate and reserve requirements - both have their place. Changing reserve requirements is a very drastic method of controlling credit. Some banks are in a much better position to handle it than others. I think the reserve requirements changes should only be made when the other methods have been used up to the point where you have gone as far as you can and you really need a major change in order to give a new start. It should be noted that all three of

these methods really depend upon the same end result for their effectiveness, namely, their effect upon the cost of credit.

C. Could I ask you about the policy there in the fall of 1929, starting around August? Although there was an increase in the discount rates there, you also bought quite a lot of acceptances, and so on, as I remember. Did you have the feeling that you were actually loosening credit at that time rather than tightening it?

R. Well, I would say that was the very rough first beginnings of what later became known as selective credit control.

A. That was the fall of '31?

C. No, '29.

R. We were trying to exert pressure against the stock market, and its absorption of credit, but we were also trying to make credit available for legitimate business, and of course the acceptance market then was regarded as prime business, nothing better known to exist. That was a direct use of credit to commerce, and there was much more certain application of it than you could get through commercial loans made by banks to their customers. They never did know whether the customer was manufacturing goods or buying stocks. Many, business men, thousands of them, were borrowing money at their banks, but not for manufacturing or trade purposes. It was being used to buy stocks. Many business men were head over heels in the stock market, and there were many cases where nobody could possibly tell whether the borrowing was to buy stocks or not. It could be covered up fairly well. Also, of course, there were many cases where the fellow really got himself way out on a limb and was borrowing not for legitimate business reasons but to protect his position on margin. He was trying to hang onto what he had. In other cases he may have been borrowing money for legitimate business purposes, but what he should have been doing was liquidating his already excessive stock position and financing his business that way. He was trying to carry two buckets instead of one.

A. Was that judgment a thing which the bank considered as a part of its responsibility?

R. You mean was it part of its function to try to make a distinction between the uses of credit? Is that what you have in mind?

A. Yes.

R. Well, the bank was, I think it fair to say, very slow in coming to the conclusion that it had to exercise that judgment, or perhaps that it had the power, to make those distinctions. I think there's probably a considerably greater realization of the possibilities of that today than there was at that time. In 1929 and 1930 that was an entirely new idea which was being tried out very modestly for the first time.

C. Did this idea of raising the discount rate and at the same time encouraging purchase of acceptances by the Reserve Banks originate with the New York Bank or with the Federal Reserve Board? As you say, it was in fact selective control in a sense, but did it originate here or in Washington?

R. Well, I'm not sure that I can answer that question. I think it originated here probably as a compromise measure, but I don't know what the record would show on that, if it shows anything. You better check up on that.

C. I made an attempt to check up on it, but apparently negotiations were mostly off the record.

R. Yes, of course the telephone has always been a major instrument of negotiation between here and Washington.

A. And no recorder was put on the telephone.

R. No. In many cases memoranda were written following conversations. In many instances also, it was not done. The idea seemed important at the time, and I would guess that it originated here, but it could easily have resulted from arguments back and forth with the Board, or discussions as to what would happen if you put up the rate and refused to make loans generally, who was going to be hurt, and so on. Of course, the Board has always been very sensitive to credit damage to any business. I wouldn't

be at all surprised if you might find it utterly impossible to be able to make a clear statement as to where that idea did originate. The man who handled the open market operations and bankers' acceptances at that time was Kenzel. He died in 1933, I think. It used to be said that when Kenzel went to lunch the bill market closed.

C. After the market break and it came time to loosen up on whatever restriction was there, where did the movement toward easier money come from first, the New York Bank or the Board? Or were they pretty much in agreement?

R. Oh, I don't believe there was any great disagreement at that point. The havoc of a rapidly falling stock market became so great that nearly everybody had experiences of people in great distress. I remember one day I had a woman on the phone, I don't know how she happened to get to me, except that the telephone operator didn't know what else to do with her, and she was just about half crazy and asked, "Why didn't the Federal Reserve Bank do something about this condition?" I tried to quiet her, and she said, "Well, if you don't do something about it, I'm going right over and jump out the window." That sort of thing was not unusual at that time.

A. Mr. Rounds, may we ask specifically what you remember of happenings here within the bank after, it was the 29th of October, wasn't it? Wasn't that the fatal day?

R. There were no bank failures of any consequence as an immediate result of all this. That came much later, and the first impressions were that this was entirely a stock market crash, nearly everybody believed prices were too high and they ought to come down, and this was it. I don't think it was realized then how many people were involved in the market, or what it would look like after the pieces were picked up. How many people were going to be wiped out, that sort of thing.

A. Well, it must have been a great shock to the whole credit mechanism.

R. Oh, yes, it was tremendous. The margin clerks in brokers' offices were working overtime, and of course by and large they are a pretty astute crowd. When prices are high they watch margins much more closely than they do when prices are low, and most people had been required to keep pretty well margined up during that period, but even

so, of course, when the break came, the losses were so much greater than anything they'd ever seen before that margins were wiped out very quickly.

A. How was this felt here in the bank?

R. In the Reserve Bank this was regarded entirely as a stock market crash; and while there were many, many more people in the stock market than had been customary in the past or have been since for that matter, in terms of percentage of population, it was still pretty small. I think most people didn't realize that it was a more than average reversal.

A. Well now then, how about the banking reaction.

R. Well, the banking reaction was this. There had been a tremendous increase in stock market operations, both in volume and in prices, and it involved more people than any similar operation had before, and it involved more banks. I would say there were not a large number of banks that were importantly involved from the solvency point of view, but here and there around the country there were quite a few banks that had loaned more on stocks than they should have and faced the possibility of substantial losses as a result.

Quite a few officers of commercial banks were themselves involved in the stock market and faced serious personal losses, in some cases so great as to almost, if not completely, destroy their prospective and their ability to make loans, a sort of shell shock, temporarily at least. In not a few instances this contributed greatly to the difficulty smaller business men had in securing credit.

Another area seriously affected was the building industry. There were a good many building projects that were still uncompleted, and very often the money was not available to complete them, partly because the people who might provide that money had been caught in the stock market, partly because credit had suddenly dried up.

A. I have heard it argued that if Governor Strong had lived there would have been no stock market crash. Do you think there is anything in that idea?

R. Well, it is an interesting speculation. I do know this - Mr. McGarrah was not a

fighter. A man of very strong principle and very strong ideas and generally right, but altogether conventional. He would insist on keeping the record straight, and it was partly at his insistence that this bank's board week after week voted an increase in the discount rate, all of which appear in the minutes. He wanted the record to show the bank had been on the job and had done what it could, but perhaps he did not sense how great a calamity was building up.

Strong was a pretty farseeing gentleman and somewhere along the line between 1927 and 1929, the chances are that at some point Strong would have said that this thing had gone far enough and would have tried to settle it. I suspect that he would have presented arguments that would have resulted in something being done. He could compromise when he had to and very effectively too, but he was a very powerful advocate ... and knew what he wanted. It could have made a powerful lot of difference. McGarrah could present a case quite effectively, but when it got to the arguments, he was through. He had no patience to argue. Strong did not have much patience either, but he would keep at it nevertheless. McGarrah just wasn't built on a plan to permit him to argue and win. Strong loved it. He thoroughly enjoyed getting into a fight and coming out on top, as he always did. Strong sensed the importance of things that were going on, and he also always felt a keen responsibility to solve these problems. McGarrah never went that far. McGarrah took the position that final responsibility rested with the Board of Governors, perhaps partly because he thought they wanted it that way.

C. There were no important bank failures as a result of the crash?

R. Not immediately. You remember the Bank of United States closed. I think it was in December of '31. Now the main reason why that bank closed was because almost nobody had any confidence in the management that was running it. Actually, when the pieces were cleared away, it was found that most of the loans in that bank were generally sound, and particularly the loans in which the bank was primarily engaged, that's the needle trade, cloak and suit business. They had relatively small losses

on those loans, but they had gotten involved in quite a number of large and speculative real estate operations, and the bulk of the losses that were finally taken were from those real estate loans and not loans in their regular business.

A. Did I understand that Mr. Harrison was leading a group that tried hard to effect a merger with the Bank of the United States and other banks that would have saved it?

R. Where did you get that opinion?

A. I think from Mr. Case.

R. I would hesitate to contradict anything Mr. Case said about it, but it is my impression that George Harrison had gone on a trip to Europe that fall and was away when the situation came to a head. Case was here in the Bank and realized very quickly that the top man in the bank had to take hold. We had in the city at that time several definitely Jewish banks, and every one of them was on the hot coals. The U.S., Public and Manufacturers' were the three largest Jewish banks in town. They all three had very definitely Jewish top management, and the general public just put them all in one basket, and that's all there was to it. And they were beginning to experience a great many runs. The chief counsel for the Bank of U. S., and Marcus who was the son of the old man Marcus who founded the bank, and Saul Singer were the top officers in that bank. Everybody thought the bank was much too big for the management, and it probably was, but at the same time, as I said a minute ago, when the chips were all gathered up, I think there was general agreement that they had done not too bad a job (except for their real estate operations).

Joe Broderick was superintendent of banks in New York State, and the Manufacturers' and the Bank of the United States were state institutions, not national banks. We were holding sessions here every night, and a good part of the night during the last two weeks before the bank closed in trying to work out a solution of the thing. The Clearing House banks were very much concerned; they were right in the middle of it, but I think it would be fair to say they were more concerned with figuring out how they could stay out of it than figuring out any way they could be helpful by staying in.

They were pretty badly shell shocked crowd. Mortimer Buckner, who was head of the New York Trust Company was chairman of the Clearing House committee. He's dead now, but he was head of the New York Trust Company for quite a few years and a pretty able fellow. He was quite a friend of George Harrison. The top man in the New York Clearing House is the chairman of the clearing committee, and the incumbent changes every year. The job is passed around among the banks, so a man may hold that office several times, but not continuously.

George Harrison was away, and Case was in effect taking his place. And these meetings went on every night, discussing what to do about the Bank of the United States, and finally somebody came up with the idea, why not solve this whole problem in one fell swoop, and merge the Bank of the United States and the Public into the Manufacturers' Trust Company? That program was finally agreed to, including even the basis upon which it could be done. The Public was in fine shape, the Manufacturers' was in good shape, and the Bank of the United States was generally supposed to be in pretty poor shape, although nobody trusted the figures. They finally got to the point of deciding who was going to head this merger and make a real success out of it. The bankers agreed to back the plan provided Herbert Case would take the job as chairman of the board of the combined bank. He wasn't eager to do it, but finally agreed, and it was just a question of working out the details. As I told you, George Harrison was in Europe and came back at just about this point. He came back very late in the discussions.

A. He wasn't informed?

R. He wasn't informed, and of course, his whole attitude was very cautious. There were a lot of unwilling participants in this program. The Manufacturers' insisted that the Clearing House banks put up a certain amount to guarantee the goodness of the Bank of the United States. We had worked day and night on this merger. As a matter of fact, the particular night I'm talking about we had a team of people in the larger branch of the Bank of the United States. Along about midnight we had gone over

the records and sized it up and decided that they were good enough to justify us in keeping the bank open, provided this agreement would go through. Nobody could foresee that it wouldn't. We were prepared to make any amount of money available to see them through. And we'd have done that, but then there began to be bickerings over details of the program and specially over the guarantee that the Clearing House banks should assume. They had been badly stung when the Harriman Bank got in trouble earlier. And quite a few of those representing the Clearing House banks cooled off and George was not disposed to warm them up any, so it all fell through; at about 5:30 that morning it was decided to close the bank. (Actual closing was of course decided by the State Superintendent of Banking, and he was unwilling to permit the bank to remain open without some guarantee of its ability to continue.)

A. In other words, there was no positive move that could keep it open?

R. The superintendent of banks at that time had reached the point where he said that something would have to be done or he would close the bank. He would not permit them to keep on doing business with depositors continually withdrawing their funds. The withdrawals had become very heavy, and of course every depositor who was taking his money out was weakening the bank that much. I remember one very interesting incident of that night. We had been watching the whole situation pretty closely; we knew that in the clearings that day were something over \$100,000 in checks on the Bank of the United States signed by Max Stauer.

A. Oh-h-h!!!!

R. Does that name mean anything to you?

A. He was the attorney that prosecuted.

R. That's the reason he prosecuted, because those checks were never paid.

A. Oh-h-h, I see. They stopped payment?

R. They were not cleared, and Stauer was mad about it. There was nothing irregular about their not being paid, quite the other way around. But even so, / Stauer thought he had influence enough so those checks should have been paid, and he was so worked up

about it that he went after Joe and got him indicted.

C. Was you estimate that the Bank of the United States was insolvent as of the time of closing?

R. No, we thought they were solvent. We had been over their records with a fine-toothed comb, and we had discounted the doubtful items very heavily. They had a pretty good bond account, they had \$35 or \$40 million of capital to be exhausted before they became insolvent.

C. Well, it strikes me then that Broderick was not showing great courage in closing them so soon.

R. Oh, well, yes, I think he was. We were at a point in that particular situation where decision was difficult. The Clearing House would not support this merger, and it left Joe in a position where I don't think he could have done anything else, and we (at the Federal Reserve Bank) were in somewhat the same boat because while we were prepared to make available any amount of money necessary to pay off depositors, we had to have some limit in mind, because if you're going to pay off say 75% of the depositors and then finally have to close, the other 25% are going to have a pretty crummy prospect. There wouldn't be much left of the assets for them to work on to get their money out. We took the position that the bank was solvent and that we could see it through provided it had Clearing House support and those mergers would be permitted to go through, or even without the merger if it had Clearing House support, but the Clearing House couldn't see it that way, and the bank closed.

C. Well, may I ask you a hypothetical question here. Suppose that you had gone ahead, left them open and made loans to them so that they paid off say 75% of their depositors, and then finally had to be closed with only 25% of deposits unpaid. Do you think it would have been likely that the 25% of deposits would not have been covered eventually in the liquidation?

R. I think they paid out either 99 or 98 and a fraction % of the deposits, showing that the degree of insolvency was less than 2%, say. Now any bank that could do that

in liquidation is worth a good margin over its liabilities as a going concern, because the sacrifices that were taken in that liquidation were terrific. There were many very large losses. However, I think if we had kept them open, shall I say a month or even two months longer, and they had paid out 75%, I think the effect of liquidation would have been substantially the same, because the people who withdrew would have gotten 100%, and as for the 25% who were left, the loss on that would have been 4% or 5%, instead of 1%, but in dollars and cents the result would have been just about the same.

A. Is it the job of the Superintendent of Banks to see that everybody gets his fair share?

R. That is certainly part of his job. He can be very severely criticised, in fact he was criticised very severely for letting it stay open as long as it did, but there's always the hope that something could or would be done, and we were giving him every possible support.

C. Well, did the other clearing house banks indicate any fear that the closing of the Bank of the United States would have an adverse effect on them by weakening confidence in the rest of the banks?

R. Well, yes, I think that everyone of them was thinking of himself and his own situation, and of course by that time liquidation had reached the point where lots of people who shouldn't have been scared were. The great trouble was that the management of the Bank of U.S. was so poorly regarded by almost everybody there was a complete lack of confidence. Therefore, the feeling was that the situation ~~XXXX~~ was probably very much worse than it appeared. I am convinced that the whole situation dealt with wisely and with courage at that time could have been prevented. The old Public Bank, recently merged into the Bankers, was always a very conservative outfit ... They never had any idea of taking any losses and never took any, relatively speaking. The Manufacturers' was sort of in between. They had been a pretty shrewd bunch but weren't thought too well of at that time. Actually the management of that bank was good.

I don't think the merger program would have resulted in a dollar loss to anybody, but you could not convince anybody of that at that time. The fellow then really running the Manufacturers' Trust Company (Von Elm) was a very able banker. Manufacturers' really, upon analysis, made, in my judgement, the best record of any of the large banks in New York City between say 1930 and 1950 and were often right in their policies. Almost 100% scare psychology took hold. The clearing house banks did not like the idea of backing the merger. I don't think the anti-Jewish feeling was too important so far as the clearing house banks were concerned. Of course, it contributed to the feeling that they all had of doubt about how bad the situation was. There had been a lot of Jewish banks that had been started during the '20's and quite a number of them had been merged to save them, and a number of them had been taken over, some under distress conditions. There was a definite feeling in the minds of the public regarding banks that was anti-Jewish. As far as the clearing house banks were concerned, I don't think they thought in terms of race. The first consideration is self-preservation and any line that will work in that direction is good - Jewish or otherwise. There was a certain amount of feeling about the Jewish banks but I don't think it was based on race. I do think that in the public mind there was a strong aversion to Jewish banks and that many of the Jewish bankers felt that the public had made that decision.

When the break started in '29, for about a year nobody heard about much of anything except the stock market. Then suddenly it became apparent that the bond market was weakening a great deal. Actually there had been sold during the '20's a tremendous volume of bonds, particularly the bonds of public utility holding companies; also large amounts of foreign bonds, and the losses that were taken on many of those bonds were simply terrific. Second grade railroad bonds were also very weak, and very frankly, almost all railroad bonds came to be regarded as undesirable, even those of good grade. If a bank had 10,000 that they wanted to sell and they offered them, there wouldn't be a single taker for 10,000. Even small sales would drop the

market so much that it became almost impossible to dispose of these poorer quality bonds except at great loss. There were just no buyers for that sort of bond. And that sort of thing was pretty deadly to banks. In this district the banks, particularly the country banks, most of which are also savings banks, that is they have a savings department, and the rule used to be and still is that the funds representing the savings deposits ought to be invested in bonds. A great many small banks in the country area just don't have enough demand for loans; they can't even lend out their commercial deposits locally to take up the money they have on hand to lend, and therefore there was a great disposition to go into bonds.

The first two national banks that closed in the Second Federal Reserve District were the First National Bank of Rouses Point, and the First National Bank of Champlain, New York. The president of one was the cashier of the other. They were both small banks. The national bank examiner always made it a practice to examine the two banks simultaneously. The assets of these banks were largely in bonds. It was something of a shock when news came through that the banks had been closed for depreciation of the bond account.

Not long before that we had been working on a rating system for getting a quick judgement of the bond list of a bank. Briefly, the system was this: Based on ratings, triple A and double A bonds were rated 100; single A bonds were rated 90, triple B bonds were rated 80, bonds below B or certainly below three C's had no value at all in the rating. These ratings were averaged on a dollar value basis.

If I recall correctly, the bond lists of these two banks when subjected to the rating scale (after the closing) showed quality ratings of 18 and either 21 or 23 on a scale where anything under 80 was regarded as definitely unsatisfactory. Now, as a matter of fact, a bank officer has no business buying bonds for a bank when he doesn't know a thing about bonds. The average small banker knows his customers and can generally make sound loans, but unless he is the exception and really knows something about it, or gets very competent advice, he is lost in the bond market.

C. Well, may I ask you two questions about the Bank of the United States. The first one, you have indicated that rumors flew all around about these three banks, at least two or which were really quite sound in your thinking, but what they had in common was that they were all Jewish. Is there any indication of any sort of concerted rumor mongering about them?

R. Oh, I don't think so.

C. Because at that time, you know, there were charges of Communist inspired rumors and that kind of thing. I wonder if there was any ...

R. Well, I would doubt that. Of course, we had in the late twenties a tremendous number of bank mergers, quite a few of which had been forced by poor banking, not all, but quite a few, and the Manufacturers' Trust Company was a bank which had taken over a large number of these smaller banks, some of which were in trouble or likely to be. And the Manufacturers' had been growing at a very rapid rate.

The thing that I didn't mention, I should have I think, to complete the story, before the night closed when the decision to close the Bank of the United States was made, the Clearing House also agreed to admit the Manufacturers' Trust Company and the Public Bank to the Clearing House.

A. So they had not been clearing house members?

R. Neither one of them had been members of the clearing house, and the announcement was made that these two banks were being admitted into the clearing house at the same time that the announcement was made that the Bank of the United States was closing. At the same time there was a change in control of the Manufacturers' Trust Company. Harvey Gibson became president, and he acquired a large block of stock from the Jonas family.

There were two Jonases. Nathan Jonas was the banker, his brother, a lawyer, was a big stockholder and generally understood to be quite a figure in the bank. By and large people thought more of Nathan than they did of his brother. Nathan was a typical east side Jew. He happened to be from Brooklyn, he was really a pretty good fellow.

He was a man of sound principles and always ran a good bank. But the feeling of the Clearing House was that the bank could not survive as a Jewish bank and that Harvey Gibson was a leading citizen. He was Red Cross Commissioner in Europe during the war, both wars in fact, and was regarded very highly; Mr. Gibson's election as president evidenced a complete and definite change in management. As far as I know, however, Harvey Gibson was the only important change in the management. The man who really ran the bank many years before that and after up to about a year ago was a man that Harvey Gibson later said was the ablest banker he ever saw. His name was Henry von Elm. He had a nervous breakdown a year or two ago, but he was the man that really managed the Manufacturers' Trust Company for the last 25 years or more, a very able fellow.

C. The other question was this. A great number of people, at least implied if they didn't state it specifically, that if the Bank of the United States had not been closed, the whole history of the thirties with regard to bank failures and even credit conditions might have been quite different. Do you agree with that?

R. Well, that's an easy statement to make, it's pretty difficult to prove it. I'll go this far. I'll say I think it might have been, I don't know any way to prove it. But I think it might well have been a totally different situation. Of course, the closing of the Bank of the United States was followed very quickly by bank closures pretty much all over the country, and coming to a climax in Detroit where three large banks all closed, probably no one of which should have closed. There was no reason to close those banks out there. At that point the fear complex had taken over. Everyone of them paid off its depositors in full.

A. What about the Bank of Kentucky? Wasn't that another one in that same category?

R. Yes, but that was a relatively small outfit. Oh, there were various banks all over the country. Of course, there was a tremendous amount of talk about the Bank of America in California at that same time. But they weathered pretty much on their own, getting little help from anybody.

C. Did there seem to be, following the talk about the Bank of America, a definite change in attitude toward banks and confidence in them?

R. Well, some change unquestionably. I think it fair to say, in the minds of, shall I say, of the uninformed, the man on the street, there was certainly a conviction that there was something rotten in Denmark in the banking system. Of course, every bank that closed added to his conviction on that subject and made him more anxious to get his money out. I'm amazed even now every once in a while when I hear of a case where somebody's safe deposit box is opened and \$100,000 or \$200,000 is found. Of course, that thing was very common in the early thirties, but it shouldn't still continue, and I know it does.

A. Can we go back to open market operations for a minute? I think they began in the individual banks about 1922.

R. My recollection is this. In this bank before the time of any Open Market Committee ... this bank began open market operations. Some of the other banks also bought securities for the purpose of increasing their earnings. Some of the banks were not making their expenses. The obvious answer was to go out and buy some government bonds and get the income from those bonds. A situation developed where some of the banks would be out in the market buying governments solely for the earnings at a time when it was considered to be very undesirable to be putting money into the market. The result was that different parts of the System were not only competing against each other, but actually working at cross purposes.

A. Who was it that realized that this purchasing was influencing the market in quite a different way?

R. Benjamin Strong. He could not get the Board in Washington to support him on it. The Presidents' Conference of the System finally took hold of the thing upon Strong's insistence and adopted rules and got the Board to support them in their contention that no bank by itself should buy government bonds. For some time the Presidents' Conference handled the whole thing with little or no help or guidance from the Board.

It did stop the buying of government bonds for revenue only. The next step from there on was that when the changes came in the Board and new faces appeared down there, there developed a strong feeling that the Board should take that all over. We then got the Open Market Committee, but it all started with the Presidents' Conference committee which was initially designed to prevent competing and cross purpose activities on the part of the banks.

At that time (1921-22) we were running into a mildly inflationary situation. From 1921-29 there was an increasing use of credit almost continuously. At times that trend was so marked that it needed some checking. The initial favorite method was through the bankers' acceptance market. The bankers' acceptance market was then being built up and this Bank did a great deal to foster that development. The bankers' acceptance was a very popular secondary reserve instrument ... up until the time that interest rates began to get terribly cheap (1931). Less than a 3% rate prior to 1931 was almost unheard of in this market and in rates above that there was a good field for bankers' acceptances. A banker's acceptance is probably the nearest thing there is to a riskless credit instrument. A banker's acceptance relies on the acceptance of a bank to make the credit absolutely good or as nearly riskless as you can get.

The customary fee for accepting is 1% per annum on the face of the obligation. When the going interest rate gets down to 2%, there is 1% or less left for the use of the money and under that the business dies. It died in the early '30's. This bank at times has held close to \$1 billion in bankers' acceptances... Nearly all purchases were made in New York, after which holdings were distributed to all Reserve Banks in proportion to the indicated deficit, i.e. the difference between the total of all other earnings and the expense account.

Strong insisted that they should never buy for income but he was perfectly willing to concede that if they were going to buy, the holdings should be in proportion to each bank's need for earnings. The banks were not too satisfied with it. It

did not give all of them what they thought they needed. It took into account normal loans to member banks. Whatever the holdings were in bankers acceptances and government bonds was distributed pro rata. Some banks would have liked to have gone out and bought much more... At that time the other banks were somewhat provincial, knowing little about the money market as such. They were not required to know much about that. Most of the directors who understood banking were the product of commercial banking. Except for Strong at that time, there was no such thing as a real "central banker."

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