# Operation of the National and Federal Reserve Banking Systems

# HEARINGS

BEFORE THE

# COMMITTEE ON BANKING AND CURRENCY UNITED STATES SENATE

SEVENTY-SECOND CONGRESS

FIRST SESSION

ON

# S. 4115

A BILL TO PROVIDE FOR THE SAFER AND MORE EFFECTIVE USE OF THE ASSETS OF FEDERAL RESERVE BANKS AND OF NATIONAL BANKING ASSOCIATIONS, TO REGULATE INTERBANK CONTROL, TO PREVENT THE UNDUE DIVERSION OF FUNDS INTO SPECULATIVE OPERATIONS, AND FOR OTHER PURPOSES

**PART 1**

MARCH 23 TO 25, 1932

Printed for the use of the Committee on Banking and Currency

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# OPERATION OF THE NATIONAL AND FEDERAL RESERVE BANKING SYSTEMS

**WEDNESDAY, MARCH 23, 1932**

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

The committee met, pursuant to call at 10.30 o'clock a. m. in its committee room in the Senate Office Building, Senator Peter Norbeck, presiding.

Present: Senators Norbeck (chairman), Brookhart, Goldsborough, Townsend, Walcott, Couzens, Fletcher, Glass, Barkley, Bulkley, Gore, and Costigan.

The CHAIRMAN. The committee will come to order. We have met this morning for the purpose of a hearing on S. 4115, a bill introduced in the Senate on March 14 by Senator Glass, which bill will be made a part of the record:

[S. 4115, Seventy-second Congress, first session]

A BILL To provide for the safer and more effective use of the assets of Federal reserve banks and of national banking associations, to regulate interbank control, to prevent the undue diversion of funds into speculative operations, and for other purposes

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled*, That the short title of this act shall be the "Banking act of 1932."

SEC. 2. As used in this act—

(a) The terms "bank," "national bank," "national banking association," "member bank," "board," "district," and "reserve bank" shall have the meanings assigned to them in section 1 of the Federal reserve act, as amended.

(b) The term "affiliate" includes a trust company, a finance company, securities company, discount or acceptance company, investment trust, or other similar institution, or a corporation—

(1) Of which a national bank or member bank, directly or indirectly, owns or controls either a majority of the voting shares or more than 50 per centum of the number of shares voted for the election of its directors, trustees, or other managing officers at the preceding annual meeting, or controls in any manner the election of a majority of its directors, trustees, or other managing officers; or

(2) Of which control is held, directly or indirectly, through stock ownership or in any other manner, by the shareholders of a national bank or member bank who own or control either a majority of the shares of such bank or more than 50 per centum of the number of shares voted for the election of directors of such bank at the preceding annual meeting, or by trustees for the benefit of the shareholders of any such bank; or

(3) Of which either a majority of the members of its executive committee or a majority of its directors, trustees, or other managing officers are directors of a national bank or member bank; or

(4) Which owns or controls, directly or indirectly, either a majority of the shares of capital stock of a national bank or member bank or more than 50 per centum of the number of shares voted for the election of directors of such

bank at the preceding annual meeting, or controls in any manner the election of a majority of the directors of such bank; or

(5) For the benefit of whose shareholders or members all or substantially all the capital stock of a national bank or member bank is held by trustees.

SEC. 3. The fourth paragraph after paragraph "Eighth" of section 4 of the Federal reserve act, as amended, is amended by inserting before the period at the end thereof a comma and the following: "but only if such discounts, advancements, and accommodations are intended for the accommodation of commerce, industry, and agriculture. The Federal Reserve Board may prescribe regulations further defining and regulating the use of the credit facilities of the Federal reserve system within the limitations of this act. Such facilities shall not be extended to member banks for the purpose of making or carrying loans covering investments, or facilitating the carrying of, or trading in, stocks, bonds, or other investment securities other than obligations of the Government of the United States. Each Federal reserve bank shall keep itself informed of the loan and investment practices of its member banks and the uses made by them of the credit facilities of the Federal reserve system. The chairman of each Federal reserve bank shall report to the Federal Reserve Board any undue, unauthorized, or improper use of such credit facilities, together with his recommendation for remedial action in the matter. The Federal Reserve Board may, in its discretion, suspend for not more than one year from the use of the credit facilities of the Federal reserve system any member bank making undue, unauthorized, or improper use of such facilities."

SEC. 4. The twenty-fifth paragraph of section 4 of the Federal reserve act, as amended, is amended by inserting before the period at the end thereof a colon and the following: "*Provided*, That no such vote shall be cast by or on behalf of any member bank, if a majority of its stock shall be held or owned by any affiliate, or other corporation, which is in fact one of a chain, or of a jointly controlled group of banks, controlled by an individual, or if its stock is in the hands of a voting trust, or if in any other way such bank is prevented from acting subject to the uncontrolled decision of the general body of stockholders of such bank locally resident in the town or city in which such bank is established."

SEC. 5. The first paragraph of section 7 of the Federal reserve act, as amended, is amended to read as follows:

"After all necessary expenses of a Federal reserve bank shall have been paid or provided for, and provision shall have been made, when necessary, for restoring the surplus of the bank to its position as of December 31, 1931, the stockholders shall be entitled to receive an annual dividend of 6 per centum on the paid-in capital stock, which dividend shall be cumulative. After the aforesaid dividend claims have been fully met, the net earnings, beginning with the net earnings for the year ending December 31, 1932, shall be paid to the Federal Liquidating Corporation provided for in section 12B of this act and shall be used by the said corporation for carrying out the purposes of such section."

SEC. 6. Section 9 of the Federal reserve act, as amended, is further amended by inserting between the fifth and sixth paragraphs thereof the following new paragraph:

"Each affiliate of a bank admitted to membership under authority of this section shall make and furnish to the president of the bank, for transmission by him to the Federal Reserve Board, not less than three reports during each year. Such reports shall be in such form as the Federal Reserve Board may prescribe, shall be verified by the oath or affirmation of the president or such other officer as may be designated by the board of directors of such affiliate to verify such reports, and shall cover the condition of such affiliate on dates identical with those fixed by the Federal Reserve Board for reports of the condition of the member bank. Each such report of an affiliate shall be transmitted to the Federal Reserve Board at the same time as the corresponding report of the member bank, except that the Federal Reserve Board may, in its discretion, extend such time for good cause shown. Each such report shall exhibit in detail and under appropriate heads, the holdings of the affiliate in question, their cost and present value, the expenses of operation for the preceding year, and the balance sheet of the enterprise. It shall be the duty of the president of such member bank to satisfy himself as to the correctness of the report before transmitting the same to the Federal Reserve Board. Any affiliate which fails to make and furnish any report required of it under this section, and any member bank whose president fails to transmit, as required

by this section, any such report furnished to him, shall be subject to a penalty of $100 for each day during which such failure continues."

SEC. 7. (a) The first paragraph of section 10 of the Federal reserve act, as amended, is amended to read as follows:

"A Federal Reserve Board is hereby created which shall consist of seven members, including the Comptroller of the Currency, who shall be a member ex officio, and six members appointed by the President of the United States, by and with the advice and consent of the Senate. In selecting the six appointive members of the Federal Reserve Board, not more than one of whom shall be selected from any one Federal reserve district, the President shall have due regard to a fair representation of the financial, agricultural, industrial, and commercial interests, and geographical divisions of the country, and at least two of such members shall be persons of tested banking experience. The six members of the Federal Reserve Board appointed by the President and confirmed as aforesaid shall devote their entire time to the business of the Federal Reserve Board and shall each receive an annual salary of $12,000, payable monthly, together with actual necessary traveling expenses, and the Comptroller of the Currency, as ex officio member of the Federal Reserve Board, shall, in addition to the salary now paid him as Comptroller of the Currency, receive the sum of $7,000 annually for his services as a member of said board."

(b) The second paragraph of section 10 of the Federal reserve act, as amended, is amended to read as follows:

"The Comptroller of the Currency shall be ineligible during the time he is in office and for two years thereafter to hold any office, position, or employment in any member bank. The appointive members of the Federal Reserve Board shall be ineligible during the time they are in office and for two years thereafter to hold any office, position, or employment in any member bank, except that this restriction shall not apply to a member who has served the full term for which he was appointed. Upon the expiration of the term of any member of the Federal Reserve Board in office when this paragraph as amended takes effect, the President shall fix the term of the successor to such member at not to exceed twelve years, as designated by the President at the time of nomination, but in such manner as to provide for the expiration of the term of not more than one member in any two-year period, and thereafter each member shall hold office for a term of twelve years. Of the six persons thus appointed, one shall be designated by the President as governor and one as vice governor of the Federal Reserve Board. The governor of the Federal Reserve Board, subject to its supervision, shall be its active executive officer. Each member of the Federal Reserve Board shall within fifteen days after notice of appointment make and subscribe to the oath of office."

(c) The fourth paragraph of section 10 of the Federal reserve act, as amended, is amended to read as follows:

"No member of the Federal Reserve Board shall be an officer or director of any bank, banking institution, trust company, or Federal reserve bank or hold stock in any bank, banking institution, or trust company; and before entering upon his duties as a member of the Federal Reserve Board he shall certify under oath that he has complied with this requirement and such certification shall be filed with the secretary of the board. Whenever a vacancy shall occur, other than by expiration of term, among the six members of the Federal Reserve Board appointed by the President, as above provided, a successor shall be appointed by the President, with the advice and consent of the Senate, to fill such vacancy, and when appointed he shall hold office for the unexpired term of the member whose place he is selected to fill."

SEC. 8. Subsection (m) of section 11 of the Federal reserve act, as amended, is amended to read as follows:

"(m) Upon the affirmative vote of not less than six of its members the Federal Reserve Board shall have power to fix from time to time for any member bank the percentage of the capital and surplus of such bank which may be represented by loans protected by collateral security. Any percentage so fixed by the Federal Reserve Board shall be subject to change from time to time upon ten days' notice, and it shall be the duty of the board to establish such percentages with a view to preventing the undue use of bank loans for the speculative carrying of securities. The Federal Reserve Board shall have power to direct any member bank to refrain from further increase of its security loans for any period up to one year. Any violation of this subsection may be penalized by suspension of all rediscount privileges at Federal reserve banks."

SEC. 9. No national banking association and no member bank shall (1) make any loan or any extension of credit to any affiliate organized and existing for the purpose of buying and selling stocks, bonds, real estate, or real-estate mortgages, or for the purpose of holding title to any such property, or (2) invest any of its funds in the capital stock, bonds, or other obligations of any such affiliate, or (3) accept the capital stock, bonds, or other obligations of any such affiliate as collateral security to protect loans made to any person, partnership, or corporation, if the aggregate amount of such loans, extensions of credit, investments, and acceptances of collateral security in the case of any such affiliate, will exceed 10 per centum of the outstanding capital stock and surplus of such national banking association or member bank.

Each loan made to an affiliate within the foregoing limitations shall be secured by stocks or bonds listed on a stock exchange which have an ascertained market value at the time of making the loan of at least 20 per centum more than the amount of such loan, or shall be secured by notes, drafts, bills of exchange or acceptances, eligible for rediscount at Federal reserve banks, or by bonds or other obligations eligible for investment by savings banks in the State in which the association or member bank making the loan is located. A loan to a director, officer, clerk, or other employee of any such affiliate shall be deemed a loan to the affiliate to the extent that the proceeds of such loan are transferred to the affiliate.

SEC. 10. The Federal reserve act, as amended, is amended by inserting between sections 12 and 13 thereof the following new sections:

"SEC. 12A. (a) There is hereby created a Federal Open Market Committee (hereinafter referred to as the "committee"), which shall consist of the governor of the Federal Reserve Board and as many additional members as there are Federal reserve districts. Each Federal reserve bank by its board of directors shall annually select from among the officers of the said bank one member of said committee. The meetings of said committee shall be held at Washington, District of Columbia, at least four times each year. Additional meetings may be held elsewhere upon the call of the Federal Reserve Board, either upon the motion of the board or at the request of any three members of the committee. In the absence or inability of the governor of the Federal Reserve Board to act at such meetings the board shall designate the vice governor or some other member of the board to act in place of the governor.

"(b) No Federal reserve bank shall engage in open market operations described in section 14 of this act except after approval and authorization by the committee. The committee shall discuss, adopt, and transmit to the several Federal reserve banks resolutions relating to all matters affecting the open market transactions of such banks and to all matters affecting the relations of the Federal reserve system with foreign central or other banks. Every such resolution shall be reported within three days to the Federal Reserve Board and shall be subject to its approval. The board shall annually include in its report to the Speaker of the House of Representatives a review of the decisions of the committee for the preceding year and an explanation of the reasons for such decisions and the results thereof, so far as they may be ascertained.

"(c) The time, character, and volume of purchases and sales in the open market shall be governed with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country. Such purchases and sales shall include all paper described in section 14 of this act as eligible for open market operations.

"(d) The conclusions and recommendations of the committee when approved by the Federal Reserve Board shall be submitted to each Federal reserve bank for determination whether it will participate in any purchases or sales recommended. If any Federal reserve bank shall decide not to participate in the open market operations so recommended, it shall file with the chairman of the committee within thirty days a notice of its decision.

"SEC. 12B. (a) There is hereby created a Federal Liquidating Corporation (hereinafter referred to as the 'corporation'), whose duty it shall be to purchase, hold, and liquidate as hereinafter provided, the assets of banks which have been ordered closed by the Comptroller of the Currency or by vote of their directors, and the assets of member banks which have been ordered closed by the appropriate State authorities.

"(b) The Comptroller of the Currency and the members of the Federal Open Market Committee created by section 12A of this act shall constitute the directors of the corporation. The Comptroller of the Currency shall be the chairman of the board of directors of the corporation.

"(c) The capital stock of the corporation shall be divided into shares of $100 each. Certificates of stock of the corporation shall be of two classes, class A and class B. Class A stock shall be held by member banks only and shall be entitled to prior payment of dividends out of net earnings, to the extent of 30 per centum of such net earnings in any one year, after payment of all expenses of the corporation, but such stock shall have no vote at meetings of stockholders. Class B stock shall be held by Federal reserve banks only and shall not be entitled to the payment of dividends. Every Federal reserve bank shall subscribe to shares of class B stock in the corporation to an amount equal to one-fourth of the surplus of such bank on December 31, 1931, and its subscriptions shall be accompanied by a certified check payable to the Comptroller of the Currency in an amount equal to one-half of 1 per centum of such subscription. The remainder of such subscription shall be subject to call from time to time by the board of directors upon ninety days' notice and annual subscriptions to such stock shall be made by each such bank in an amount equal to one-fourth of the annual increase of such surplus.

"(d) Every member bank shall subscribe to the class A capital stock of the corporation in an amount equal to one-half of 1 per centum of its total net outstanding time and demand deposits on the last call date in the year 1931. One-half of such subscription shall be paid in full within ninety days after receipt of notice from the chairman of the board of directors of the corporation; and the remainder of such subscription shall be subject to call from time to time by the board of directors of the corporation.

"(e) The amount of the outstanding class A stock of the corporation held by member banks shall be annually adjusted as hereinafter provided as member banks increase their time and demand deposits or as additional banks become members, and such stock may be decreased in amount as member banks reduce their time and demand deposits or cease to be members. Shares of the capital stock of the corporation owned by member banks shall not be transferred or hypothecated. When a member bank increases its time and demand deposits, it shall at the beginning of each calendar year subscribe for an additional amount of capital stock of the corporation equal to one-half of 1 per centum of such increase in deposits. One-half of the amount of such additional stock shall be paid for at the time of the subscription therefor and the balance shall be subject to call by the board of directors of the corporation. A bank applying for stock in the corporation at any time after the organization thereof shall be required to subscribe for an amount of class A capital stock equal to one-half of 1 per centum of the time and demand deposits of the applicant bank, paying therefor its par value plus one-half of 1 per centum a month from the period of the last dividend on the class A stock of the corporation. When the capital stock of the corporation shall have been increased, either on account of the increase of the time and demand deposits of member banks or on account of the increase in the number of member banks, the board of directors of the corporation shall cause to be executed a certificate to the Comptroller of the Currency showing the increase in capital stock of the corporation, the amount paid in, and by whom paid. When a member bank reduces its time and demand deposits it shall surrender, not later than the 1st day of January thereafter, a proportionate amount of its holdings in the capital stock of the corporation, and when a member bank voluntarily liquidates it shall surrender all its holdings of the capital stock of the corporation and be released from its stock subscription not previously called. The shares so surrendered shall be canceled and the member bank shall receive in payment therefor, under regulations to be prescribed by the Federal Reserve Board, a sum equal to its cash-paid subscriptions on the shares surrendered and its proportionate share of earnings not to exceed one-half of 1 per centum a month, from the period of the last dividend on such stock, but not above the book value of such earnings, less any liability of such member bank to the corporation.

"(f) If any member bank shall be declared insolvent, the stock held by it in the corporation shall be canceled, without impairment of the liability of such bank, and all cash-paid subscriptions on such stock, with its proportionate share of earnings not to exceed one-half of 1 per centum per month from the period of last dividend on such stock but not above the book value of such earnings, shall be first applied to all debts of the insolvent bank to the corporation, and the balance, if any, shall be paid to the receiver of the insolvent bank. Whenever the capital stock of the corporation is reduced, either on account of a reduction in time and demand deposits of any member bank or on account of the liquidation or insolvency of such bank, the board of directors

shall cause to be executed a certificate to the Comptroller of the Currency showing such reduction of capital stock and the amount repaid to such bank.

"(g) When the minimum amount of class A and class B capital stock required by this act shall have been subscribed and paid for by such banks, the Comptroller shall designate five reserve banks to execute a certificate of organization, and thereupon the banks so designated shall, under their seals, make an organization certificate which shall specifically state the name of the corporation and the city and State in which the corporation is to be located, the amount of capital stock and the number of shares into which the same is divided, the name and place of doing business of each bank executing such certificate and of all banks which have subscribed to the capital stock of such corporation, the number of shares subscribed by each such bank, and the fact that the certificate is made to enable the banks executing the same and all banks which have subscribed or may thereafter subscribe to such capital stock to avail themselves of the advantages of this section.

"(h) Such organization certificate shall be acknowledged before a judge of a court of record or a notary public and shall, together with the acknowledgment thereof authenticated by the seal of such court or notary public, be transmitted to the Comptroller of the Currency, who shall file, record, and carefully preserve the same in his office.

"(i) Upon the filing of such certificate with the Comptroller of the Currency as aforesaid, the said corporation shall become a body corporate and as such shall have power—

"First. To adopt and use a corporate seal.

"Second. To have succession for a period of twenty years from its organization unless it is sooner dissolved by an act of Congress, or unless its franchise becomes forfeited by some violation of law.

"Third. To make contracts.

"Fourth. To sue and be sued, complain and defend, in any court of law or equity.

"Fifth. To appoint by its board of directors such officers and employees as are not otherwise provided for in this section, to define their duties, require bonds of them and fix the penalty thereof, and to dismiss at pleasure such officers or employees.

"Sixth. To prescribe by its board of directors, by-laws not inconsistent with law, regulating the manner in which its general business may be conducted, and the privileges granted to it by law may be exercised and enjoyed.

"Seventh. To exercise by its board of directors, or duly authorized officers or agents, all powers specifically granted by the provisions of this section and such incidental powers as shall be necessary to carry out the powers so granted.

"(j) The board of directors shall administer the affairs of the corporation fairly and impartially and without discrimination in favor of or against any member bank or banks and shall, subject to the provisions of law and the orders of the Federal Reserve Board, extend to each bank which is ordered closed by the Comptroller of the Currency, or by vote of its directors, and to each member bank which is ordered closed by the appropriate State authorities, such accommodations as may be safely and reasonably made with due regard for the claims and demands of other member banks.

"(k) Whenever any national bank shall be declared insolvent or placed in the hands of a receiver it shall be the duty of the Comptroller of the Currency to appoint a valuation committee of three members which shall include the receiver of such bank, a member to be named by the board of directors of such bank, and a person to be chosen by the receiver and the member named by the board of directors. The receiver shall be chairman of the committee, and the committee shall at once proceed to make a preliminary valuation of the assets of the bank. Thereupon the receiver shall notify the Comptroller of the Currency of the valuation agreed upon and the comptroller shall make a formal tender of such assets to the corporation which may purchase the same in whole or in part as its board of directors may determine. It shall be the duty of the corporation to proceed to realize as rapidly as possible, having due regard to the condition of credit in the district in which such bank is located, the assets so purchased, and if the amount realized from such assets exceeds the sum paid therefor, the corporation shall make an additional payment to the receiver of the bank equal to the amount of such excess, if any, after deducting a liquidation fee of 6 per centum of the sum thus realized. Money belonging to the corporation over and above such funds as may be required

for current operating expenses shall be kept invested in the assets of insolvent or closed banks or in securities of the Government of the United States.

"(l) The corporation may, in its discretion, purchase the assets of banks in the hands of receivers on the date of its organization, but on the same conditions and terms as are applicable in the case of assets of banks which may fail or be closed after such date. Nothing herein contained shall be construed to prevent the corporation from making loans to banks ordered closed by the Comptroller of the Currency or by vote of their directors, or to member banks ordered closed by the appropriate State authorities, or from entering into negotiations to secure the reopening of such banks.

"(m) Member banks organized under the law of any State which are now or may hereafter become insolvent or suspended shall be entitled to offer their assets for sale to the corporation upon receiving permission in accordance with law from the banking superintendent or commissioner of the State, under the same conditions as are applicable to the sale of assets of insolvent or suspended banks under the law of the State in which such member bank is located.

"(n) For a period of not to exceed two years after this section takes effect the corporation is authorized to purchase and for a period of five years thereafter to hold and liquidate the assets of closed State banks, to make loans to such banks, and to enter into negotiations to secure the reopening of such banks under the same terms and conditions as are applicable in the case of national banks and member banks; except that (1) no such purchase or loan shall be made and no such negotiations shall be entered into unless it is permitted under the laws of the State in which such State bank is located, and (2) the amount realized upon the sale of the assets of any such State bank in excess of the amount paid for such assets by the corporation shall, after deducting the amount of the liquidation fee authorized to be charged by the corporation under paragraph (k), be paid into the Treasury of the United States as miscellaneous receipts. For the purpose of carrying out the provisions of this paragraph, there is hereby authorized to be appropriated the sum of $200,000,000, which shall be paid by the Secretary of the Treasury to the corporation in such amounts and at such times as the board of directors thereof may require. The sums so paid to the corporation shall be used exclusively for such purposes. As used in this paragraph the term 'State bank' shall include any savings bank, trust company, or other banking institution, authorized to accept deposits, organized under the laws of any State, and which is not a member of the Federal reserve system.

"(o) The corporation is authorized and empowered to issue and to have outstanding at any one time in an amount aggregating not more than four times the amount of its capital, its notes, debentures, bonds, or other such obligations, to be redeemable at the option of the corporation before maturity in such manner as may be stipulated in such obligations, and to bear such rate or rates of interest, and to mature at such time or times as may be determined by the corporation: *Provided*, That the corporation may sell on a discount basis short-term obligations payable at maturity without interest. The notes, debentures, bonds, and other such obligations of the corporation may be secured by assets of the corporation in such manner as shall be prescribed by its board of directors. Such obligations may be offered for sale at such price or prices as the corporation may determine. The corporation is further authorized and empowered to dispose of any promissory note of any receiver evidencing loans made by the corporation, and to pledge such receivers' notes and any of the corporation's assets as collateral security to the corporation's promissory notes, under such terms and conditions as may be agreed upon by the corporation, provided that the obligations so incurred, together with all other outstanding obligations of the corporation, shall not be in excess of four times the amount of its capital.

"(p) All notes, debentures, bonds, or other such obligations issued by the corporation shall be exempt, both as to principal and interest, from all taxation (except estate and inheritance taxes) now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority. The corporation, including its franchise, its capital, reserves, and surplus, and its income, shall be exempt from all taxation now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority, except that any real property of the corporation shall be subject to State, Territorial, county, municipal, or local taxation to the same extent according to its value as other real property is taxed.

"(q) In order that the corporation may be supplied with such forms of notes, debentures, bonds, or other such obligations as it may need for issuance under this act, the Secretary of the Treasury is authorized to prepare such forms as shall be suitable and approved by the corporation, to be held in the Treasury subject to delivery upon order of the corporation. The engraved plates, dies, bed pieces, and other material executed in connection therewith shall remain in the custody of the Secretary of the Treasury. The corporation shall reimburse the Secretary of the Treasury for any expenses incurred in the preparation, custody, and delivery of such notes, debentures, bonds, or other obligations."

SEC. 11. The seventh paragraph of section 13 of the Federal reserve act, as amended, is amended to read as follows:

"Any Federal reserve bank may make advances to its member banks on their promissory notes for a period of not exceeding fifteen days at rates to be established by such Federal reserve bank, which rates shall in all cases be at least 1 per centum higher than the rediscount rate then in force at such reserve bank, subject to the review and determination of the Federal Reserve Board, provided such promissory notes are secured by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for rediscount or for purchase by Federal reserve banks under the provisions of this act, or by the deposit or pledge of bonds or notes of the United States. If any member bank to which any such advance has been made shall, during the life or continuance of such advance, and despite an official warning of the reserve bank of the district or of the Federal Reserve Board to the contrary, increase its outstanding loans made upon collateral security, or made to the members of any organized stock exchange, investment house, or dealer in securities, upon any obligation, note, or bill, secured or unsecured, for the purpose of purchasing and/or carrying investment securities (except obligations of the United States), such advance shall be immediately due and payable and such member bank shall be ineligible as a borrower at the reserve bank of the district upon fifteen-day paper for such period as the Federal Reserve Board shall determine. The Federal Reserve Board shall have power from time to time in its discretion by unanimous vote of its members to suspend the provisions of this paragraph in whole or in part, whenever in its opinion the public interest shall call for such action. Each such suspension shall be for a period of ninety days and may be renewed for one additional period of ninety days upon unanimous vote of the members of the board."

SEC. 12. Section 14 of the Federal reserve act, as amended, is amended by adding at the end thereof the following new paragraph:

"(g) Subject to the powers conveyed to and bestowed upon the Federal Open Market Committee by section 12A of this act, the Federal Reserve Board shall exercise special supervision and control over all relationships and transactions of any kind entered into by any Federal reserve bank with any foreign bank or banker, or with any group of foreign banks or bankers, and all such relationships and transactions shall be subject to such regulations, conditions, and limitations as the board may prescribe. No officer or other representative of any Federal reserve bank shall conduct negotiations of any kind with the officers or representatives of any foreign bank or banker without first obtaining the permission of the Federal Reserve Board. The Federal Reserve Board shall have the right, in its discretion, to be represented in any conference or negotiations by such representative or representatives as the board may designate. A full report of all conferences or negotiations, and all understandings or agreements arrived at or transactions agreed upon, and all other material facts appertaining to such conferences or negotiations, shall be filed with the Federal Reserve Board in writing and signed by all representatives of the Federal reserve bank attending such conferences or negotiations regardless of whether or not the Federal Reserve Board shall be represented at such conferences or negotiations."

SEC. 13. Section 19 of the Federal reserve act, as amended, is amended to read as follows:

"SEC. 19. (a) 'Demand deposits' within the meaning of this act shall comprise all deposits payable within 30 days, and 'time deposits' shall comprise all deposits payable after 30 days, all savings accounts and certificates of deposit which are subject to not less than 30 days' notice before payment, and all postal-savings deposits.

"(b) Every bank, banking association, or trust company which is or which becomes a member of any Federal reserve bank shall establish and maintain reserve balances with its Federal reserve bank as follows:

"(1) If not in a reserve or central reserve city as now or hereafter defined, it shall hold and maintain with the Federal reserve bank of its district an actual net balance equal to not less than 7 per centum of the aggregate amount of its demand and time deposits: *Provided*, That the said net balance maintained against time deposits shall be 3 per centum during the calendar year 1932, and shall be increased at the rate of four-fifths of 1 per centum on the 1st day of January in each calendar year thereafter until it shall equal 7 per centum as hereinbefore prescribed.

"(2) If in a reserve city as now or hereafter defined it shall hold and maintain with the Federal reserve bank of its district an actual net balance equal to not less than 10 per centum of the aggregate amount of its demand and time deposits: *Provided*, That the said net balance hereinbefore required to be maintained against time deposits shall be 3 per centum during the calendar year 1932, and shall be increased at the rate of 1½ per centum on the 1st day of January in each calendar year thereafter until it shall equal 10 per centum as hereinbefore prescribed: *Provided further*, That if located in the outlying districts of a reserve city or in territory added to such a city by the extension of its corporate charter it may, upon the affirmative vote of five members of the Federal Reserve Board, hold and maintain the reserve balances specified in paragraph (1) hereof.

"(3) If in a central reserve city as now or hereafter defined it shall hold and maintain with the Federal reserve bank of its district an actual net balance equal to not less than 13 per centum of the aggregate amount of its demand and time deposits: *Provided*, That the said net balance hereinbefore required to be maintained against time deposits shall be 3 per centum during the calendar year 1932, and shall be increased at the rate of 2 per centum on the 1st day of January in each calendar year thereafter until it shall equal 13 per centum as hereinbefore prescribed: *Provided further*, That if located in the outlying districts of a central reserve city or in territory added to such a city by the extension of its corporate charter it may, upon the affirmative vote of five members of the Federal Reserve Board, hold and maintain the reserve balances specified in paragraphs (1) and (2) hereof.

"(c) No member bank shall keep on deposit with any State bank or trust company which is not a member bank a sum in excess of 10 per centum of its own paid-up capital and surplus. No member bank shall act as the medium or agent of a nonmember bank in applying for or receiving discounts from a Federal reserve bank under the provisions of this act except by permission of the Federal Reserve Board.

"(d) No member bank shall act as the medium or agent of any nonbanking corporation or individual in making loans protected by collateral security; and no member bank shall make loans or discount paper for any corporation or individual if the proceeds of such transaction are to be used directly or indirectly for the purpose of making loans protected by collateral security in favor of any investment banker, broker, member of any stock exchange, or any dealer in securities. Every violation of this provision by any member bank shall be punishable by a fine of not less than $100 per day during the continuance of such violation, but it shall be a good defense that the borrower at the time of obtaining such loan or discount from a member bank made a sworn statement that the proceeds of the transaction would not be used for such purpose.

"(e) The required balance carried by a member bank with a Federal reserve bank may under the regulations, and subject to such penalties as may be prescribed by the Federal Reserve Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities: *Provided, however*, That no bank shall at any time make any new loans or shall pay any dividends unless and until the total balance required by law is fully restored.

"(f) No member bank shall sell or transfer to another member bank, or to a nonmember bank, private banking house, or banker, any balance standing to its credit upon the books of the Federal reserve bank of its district in excess of the balances required by this section unless the Federal Reserve Board shall have first authorized by general order the making of such sales or transfers within such district or between such district and another Federal reserve district, but no such sale or transfer shall be made by any such bank without first charging and reserving a fee to be fixed by the Federal Reserve Board on the basis of the rate of discount then charged upon ninety-day paper by the Federal reserve bank of the district in which the bank making such sale or transfer is located.

"(g) The Federal Reserve Board shall have power to suspend all dealings in reserve balances for such period as it may deem best. In estimating the reserve balances required by this act, the net difference of amounts due to and from other banks shall be taken as the basis for ascertaining the deposits against which required balances with Federal reserve banks shall be determined; and the liability created by every repurchase or other similar agreement entered into by a member bank shall be added to such net difference as ascertained under the provisions of this paragraph.

"(h) National banks, or banks organized under local laws, located in Alaska or in a dependency or insular possession or any part of the United States outside the continental United States may remain nonmember banks and shall in that event maintain reserves and comply with all the conditions now provided by law regulating them; or said banks may, with the consent of the board, become member banks of any one of the reserve districts and shall in that event take stock, maintain reserves, and be subject to all the other provisions of this act.

SEC. 14. Section 24 of the Federal reserve act, as amended, is amended to read as follows:

"SEC. 24. Any national banking association may make loans secured by first lien upon improved real estate, including improved farm land, situated within its Federal reserve district or within a radius of one hundred miles of the place in which such bank is located, irrespective of district lines. A loan secured by real estate within the meaning of this section shall be in the form of an obligation or obligations secured by mortgage, trust deed, or other such instrument upon real estate when the entire amount of such obligation or obligations is made or is sold to such association. The amount of any such loan shall not exceed 50 per centum of the actual value of the real estate offered for security, but no such loan upon such security shall be made for a longer term than five years. Such valuations shall be revised by the Comptroller of the Currency at the time of each examination of the bank making the loan and he shall have power to order changes therein and to require the adjustment of loans to such revised valuations. Any such bank may make such loans in an aggregate sum, including in such aggregate any such loans on which it is liable as indorser or guarantor or otherwise, equal to 15 per centum of the amount of the capital stock of such association actually paid in and unimpaired and 15 per centum of its unimpaired surplus fund, or to one-half of its time deposits, at the election of the association, subject to the general limitation contained in section 5200 of the Revised Statutes. Investments in bank premises and unsecured loans whose eventual safety depends upon the value of real estate shall be counted for the purposes of this section as real-estate loans. Every such bank may apply the moneys deposited therein as time deposits to the loans herein authorized and the balance of such time deposits shall be invested in property and securities in which savings banks may invest under the law of the State where such national bank is situated, or where there is no such law relating to investments by savings banks, in such property and securities as may be specified by the Comptroller of the Currency: *Provided*, That every member bank shall be required to report its investments in, or holdings of, any such property and securities at an aggregate valuation which shall not exceed the aggregate market value thereof at the time such reports to the comptroller or to the Federal Reserve Board are made: *Provided further*, That the reserve against time deposits required by section 19 of this act shall be counted as a corresponding part of such investments. All the property of any insolvent national bank acquired under this section shall be applied by the receiver thereof in the first place ratably and proportionately to the payment in full of its time deposits. Such banks may continue hereafter as heretofore to receive time deposits and to pay interest on the same, but the rate of interest which such banks may pay upon such time deposits or other deposits shall not exceed the maximum rate authorized by law to be paid upon such deposits by State banks or trust companies organized under the laws of the State wherein such national banking association is located.

"Every national banking association and every member bank which is in existence at the date this section as amended takes effect shall be required, within a period of two years from such date, to comply fully with the provisions of this section, and every national banking association hereafter organized and every State bank or trust company hereafter becoming a member of the Federal reserve system shall comply with the provisions of this sec-

tion from the date of its organization or admission to membership, as the case may be."

SEC. 15. Paragraph "Seventh" of section 5136 of the Revised Statutes, as amended, is amended to read as follows:

"Seventh. To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this title; and generally by engaging in all forms of banking business and undertaking all types of banking transactions that may, by the laws of the State in which such bank is situated, be permitted to banks of deposit and discount organized and incorporated under the laws of such State, except in so far as they may be forbidden by the provisions of the national bank act, as amended, the Federal reserve act, as amended, or any other laws of the United States. The business of purchasing and selling investment securities shall hereafter be limited to purchasing and selling such securities without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and no such association shall underwrite any issue of securities; except that any such association may purchase and hold for its own account investment securities to such an amount and of such kind as may be by regulation prescribed by the Comptroller of the Currency, but in no event shall the total amount of such investment securities of any one obligor or maker held by such association exceed 10 per centum of the total amount of such issue outstanding, nor shall the total amount of the securities so purchased and held for its own account at any time exceed 15 per centum of the amount of the capital stock of such association actually paid in and unimpaired and 25 per centum of its unimpaired surplus fund. Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase or holding of any shares of stock of any corporation by any such association. The limitations herein contained as to the purchasing and selling of investment securities shall not apply to obligations of the United States, or general obligations of any State or of any political subdivision thereof, or obligations issued under authority of the Federal farm loan act: *Provided*, That in carrying on the business commonly known as the safe deposit business no such association shall invest in the capital stock of a corporation organized under the law of any State to conduct a safe deposit business in an amount in excess of 15 per centum of the capital stock of such association actually paid in and unimpaired and 15 per centum of its unimpaired surplus."

SEC. 16. Section 5138 of the Revised Statutes, as amended, is amended to read as follows:

"SEC. 5138. After this section as amended takes effect, no national banking association shall be organized with a less capital than $100,000, except that such associations with a capital of not less than $50,000 may be organized in any place the population of which does not exceed six thousand inhabitants, and except that such associations formed for the purpose of succeeding to the business of an existing bank may, in the discretion of the Comptroller of the Currency, be organized with a less capital than $50,000, but in no event less than $25,000. No such association shall be organized in a city the population of which exceeds fifty thousand persons with a capital of less than $200,000, except that in the outlying districts of such a city where the State laws permit the organization of State banks with a capital of $100,000 or less, national banking associations now organized or hereafter organized may, with the approval of the Comptroller of the Currency, have a capital of not less than $100,000."

SEC. 17. Section 5139 of the Revised Statutes, as amended, is amended to read as follows:

"SEC. 5139. After this section as amended takes effect, the capital stock of each association shall be divided into shares of $100 each and be deemed personal property and transferable on the books of the association in such manner as may be prescribed in the by-laws or articles of association; and any such association which has certificates of stock outstanding on the date this section as amended takes effect which do not comply with the provisions of this section as amended shall, within two years after such date, issue new certificates in compliance with such provisions. No certificate representing the stock of any

such association shall represent the stock of any other corporation, nor shall the ownership, sale, or transfer of any certificate representing the stock of any such association be conditioned in any manner whatsoever upon the ownership, sale, or transfer of a certificate representing the stock of any other corporation. Every person becoming a shareholder by transfer as permitted by this section shall in proportion to his shares succeed to all the rights and liabilities of the prior holder of such shares, and no change shall be made in the articles of association by which the rights, remedies, or security of the existing creditors of the association shall be impaired."

SEC. 18. From and after January 1, 1933, no director, officer, or employee of any national bank or member bank shall be (a) an officer of any unincorporated association or corporation engaged primarily in the business of purchasing, selling, or negotiating securities, or (b) an employee of any such unincorporated association or corporation, or of any individual or partnership engaged in such business, or (c) a director, officer, or employee of a corporation organized for any purpose whatsoever which shall make loans secured by collateral to any corporation other than its own subsidiaries, or to any individual, association, or partnership; and no national bank or member bank shall perform the functions of a correspondent bank on behalf of any such individual, partnership, unincorporated association, or corporation; and no such individual, partnership, unincorporated association, or corporation shall perform the functions of a correspondent for any national bank or member bank or hold on deposit any funds on behalf of any national bank or member bank.

SEC. 19. Section 5144 of the Revised Statutes, as amended, is amended to read as follows:

"SEC. 5144. In all elections of directors and in deciding all questions at meetings of shareholders, each shareholder shall be entitled to one vote on each share of stock actually owned by him as the result of bona fide purchase, gift, or inheritance and no shareholder who shall become such through nominal transfer, or ownership on behalf of another, shall cast such vote. No corporation, association, or partnership which is the owner of more than 10 per centum of the stock of any such national bank and no officer, director, or employee of such corporation, association, or partnership, shall cast a ballot in such elections or meetings either on shares of stock owned by the corporation or by such officer, director, or employee. Shareholders may vote by proxies duly authorized in writing; but no officer, clerk, teller, or bookkeeper of such bank shall act as proxy; and no shareholder whose liability is past due and unpaid shall be allowed to vote."

SEC. 20. Notwithstanding the provisions of section 5144 of the Revised Statutes, as amended by this act, any affiliate, or any association, corporation, or partnership other than an affiliate, which owns or controls shares of stock in any national bank may make application to the Federal Reserve Board for a voting permit entitling it to cast one vote at all elections of directors of such national bank on each share of stock actually owned or controlled by it. The Federal Reserve Board may, in its discretion, grant or withhold such permit as the public interest may require but no such permit shall be granted except upon the following conditions:

(a) Every such affiliate, association, corporation, or partnership shall, at the time of making the application for such permit, enter into an agreement with the Comptroller of the Currency (1) to receive at such periodical intervals as shall be prescribed by the comptroller, on dates identical with those fixed for the examination of national banks, examiners representing and acting for the comptroller who shall make an examination of its financial condition with the same degree of care as in the case of an examination of a national bank, such examination to be at the expense of the affiliate, corporation, association, or partnership so examined; (2) that the report of the examiner shall set forth all the facts ascertained by the examination and shall include a statement of the name, location, capital, surplus, and undivided profits of each bank in which the applicant owns stock, the number of shares so owned, the par and book value of such shares, the number of shares of bank stock acquired and sold since the last examination, and other assets of such affiliate, corporation, association, or partnership (including under separate headings obligations of the United States, and the value and nature of other securities owned); and (3) that the comptroller may examine each national bank owned or controlled by such affiliate, association, corporation, or partnership, both individually and in conjunction with others so owned or controlled, and may

require publication periodically of individual or consolidated statements of condition of such bank;

(b) Every such affiliate, association, corporation, or partnership shall hold free of any lien or claim thereon obligations of the United States in an amount equal to 10 per centum of the total of capital stock owned by it in any national bank and shall agree (1) that in the event of failure of any national bank in which it shall hold stock the stockholders' liability accruing on account of such stock shall be a first lien upon the obligations so held, and (2) that any deficiency in such obligations due to their use in meeting claims under (1) above shall be made up within ninety days after such deficiency occurs;

(c) Every such affiliate, association, corporation, or partnership (1) shall possess at the time of the issuance of such voting permit, and shall continue to possess during the life of such permit, free and clear of any lien, pledge, or hypothecation of any nature, assets other than bank stock which, together with the amount of the obligations of the United States hereinbefore required to be held, shall not be less than 25 per centum of the aggregate par value of bank stocks held or owned by such affiliate, association, corporation, or partnership (but sums advanced during the years 1931 and 1932 for the replacement of capital in banks owned by such affiliate, association, corporation, or partnership, or for losses incurred or charge-offs made by it during those years, may be counted, up to 10 per centum of the aggregate par value of bank stocks held or owned by it, as a part of such assets); and (2) shall reinvest in assets other than bank stock all net earnings over and above 6 per centum per annum on the book value of its own shares outstanding until such assets shall equal the outstanding par value of bank shares owned by it: *Provided*, That from and after January 1, 1935, the 25 per centum requirement hereinbefore provided for shall be increased by not less than 2 per centum per annum, but at no time shall the assets held to meet any future stockholders' liability be less than the total assets held by such affiliate, association, corporation, or partnership on January 1, 1932;

(d) Every officer and employee of such affiliate, association, corporation, or partnership shall be subject to the same penalties for false statement as are applicable at the time of making such statement to the officers and employees of national banks; and

(e) Every such affiliate, association, corporation, or partnership shall, at the time of application for such voting permit, (1) file a statement with the Comptroller of the Currency that it does not own, control, or have any interest in, or is not participating in the management or direction of, any affiliate formed for the purpose of, or engaged in, the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities of any sort, and that during the period that the permit remains in force it will not acquire any ownership, control, or interest in any such affiliate or participate in the management or direction thereof, or (2) agree that if at the time of filing the application for such permit it owns, controls, or has an interest in, or is participating in the management or direction of, any such affiliate, it will, within two years after the filing of such application, divest itself of its ownership, control, and interest in such affiliate and will cease participating in the management or direction thereof, and will not thereafter, during the period that the permit remains in force, acquire any further ownership, control, or interest in any such affiliate or participate in the management or direction thereof, and (3) agree that thenceforth it will declare dividends only out of actual net earnings as indicated by the last preceding examination made by the comptroller.

The Federal Reserve Board may, in its discretion, revoke any such voting permit after giving sixty days' notice by registered mail of its intention to the affiliate, association, corporation, or partnership. Whenever the Federal Reserve Board shall have revoked any such voting permit, no national bank whose stock is owned in whole or in part by the affiliate, association, corporation, or partnership whose permit is so revoked shall receive deposits of United States moneys, nor shall any such national bank pay any further dividend to such affiliate, association, corporation, or partnership upon any shares of such bank owned or controlled by such affiliate, association, corporation, or partnership.

SEC. 21. Paragraph (c) of section 5155 of the Revised Statutes, as amended, is amended to read as follows:

"(c) A national banking association may, with the approval of the Federal Reserve Board, after the date this paragraph, as amended, takes effect, establish and operate new branches within the limits of the city, town, or village, or at any point within the State in which said association is situated, if such establishment and operation are at the time permitted to State banks by the law of the State in question: *Provided*, That, if by reason of the proximity of such an association to a State boundary line, the ordinary and usual business of such association is found to extend into an adjacent State, the Federal Reserve Board may permit the establishment of a branch or branches by such association in an adjacent State but not beyond a distance of fifty miles from the seat of the parent bank. No such association shall establish a branch outside of the city, town, or village in which it is situated unless it has a paid-in and unimpaired capital stock of not less than $500,000. The aggregate capital of every national banking association and its branches shall at no time be less than the aggregate minimum capital required by law for the establishment of an equal number of national banking associations situated in the various places where such association and its branches are situated."

SEC. 22. Sections 1 and 3 of the act entitled "An act to provide for the consolidation of national banking associations," approved November 7, 1918, as amended, are amended by striking out the words "county, city, town, or village" wherever they occur in each such section, and inserting in lieu thereof the words "State, county, city, town, or village."

SEC. 23. The first two sentences of section 5197 of the Revised Statutes are amended to read as follows:

"Any association may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory, or District where the bank is located, or at a rate of 1 per centum in excess of the discount rate of the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and no more, except that where, by the laws of any State, a different rate is limited for banks of issue organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this title. When no rate is fixed by the laws of the State, or Territory, or District, the bank may take, receive, reserve, or charge a rate not exceeding 7 per centum, or 1 per centum in excess of the discount rate of the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and such interest may be taken in advance, reckoning the days for which the note, bill, or other evidence of debt has to run."

SEC. 24. No national banking association or member bank shall promise or pay to its depositors as a consideration for the maintenance of deposit balances or accounts a rate of interest in excess of one-half the rate of interest specified in section 5197 of the Revised Statutes, as amended, and whenever such depositors are bankers who maintain balances with other banks, no such association or member bank shall promise or pay for the maintenance with it of such bankers' balances a rate of interest in excess of the current rate of discount of the Federal reserve bank of the district in which the depositary bank is located, or in excess of 2½ per centum per annum, whichever rate shall be the smaller.

SEC. 25. (a) The second sentence of the first paragraph of section 5200 of the Revised Statutes, as amended, is amended by inserting before the period at the end thereof the following: "and shall include in the case of obligations of a corporation all obligations of all subsidiaries thereof."

(b) Paragraph (8) of section 5200 of the Revised Statutes, as amended, is amended by inserting before the period at the end thereof a colon and the following: "*Provided*, That no obligation of a broker or member of any stock exchange or similar organization, or of any finance company, securities company, investment trust, or other similar institution, or of any affiliate, shall be entitled to the benefits of the foregoing exceptions, but such obligations shall in every case be subject to the limitations of 10 per centum hereinbefore set forth in this section; except that the total obligations of an affiliate shall in no case exceed the said 10 per centum limitations, or the amount of the capital stock of said affiliate actually paid in and unimpaired, whichever may be the smaller."

(c) Section 5200 of the Revised Statutes, as amended, is further amended by adding at the end thereof the following new paragraphs:

"The aggregate amount of the obligations (including repurchase agreements) of all the affiliates of a national banking association shall not at any time exceed 10 per centum of the capital stock of such association actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund: *Provided*, That loans collateraled by Government bonds, or by bonds issued by the State in which such bank is situated, or issued by any political subdivision of such State, shall not be included within the foregoing limitations if actually owned by the borrower from such bank.

"Within three years after this section as amended takes effect every affiliate shall be capitalized through the sale of its own stock, which shall be paid for in full in cash upon the same terms and conditions as provided in section 5140 of the Revised Statutes, as amended, in the case of national bank stock; and no national bank shall establish or capitalize an affiliate through cash or stock dividend declarations made from its surplus or from undivided profits. No affiliate shall at any time during such three-year period hold, or lend upon, more than 10 per centum of the shares of the capital stock of the parent institution."

SEC. 26. Nothing in section 5200 of the Revised Statutes, as amended, shall be construed to permit a member bank to lend to any individual or corporation upon collateral security an amount in excess of 10 per centum of its capital stock actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund, or an amount in excess of the percentage of such capital and surplus fund as shall from time to time be designated by the Federal Reserve Board in accordance with subsection (m) of section 13 of the Federal reserve act, as amended, whichever is the smaller.

SEC. 27. Section 5211 of the Revised Statutes, as amended, is amended by adding at the end thereof the following new paragraph:

"Each affiliate of a national banking association shall make and furnish to the president of the association, for transmission by him to the Comptroller of the Currency, not less than three reports during each year, in such form as the Comptroller may prescribe, verified by the oath or affirmation of the president of such other officer as may be designated by the board of directors of such affiliate to verify such reports, covering the condition of such affiliate on dates identical with those for which the comptroller shall during such year require the reports of the condition of the association. Each such report of an affiliate shall be transmitted to the comptroller at the same time as the corresponding report of the association; except that the comptroller may, in his discretion, extend such time for good cause shown. Each such report shall exhibit in detail and under appropriate heads, the holdings of the affiliate in question, their cost and present value, the expenses of operation for the preceding year, and the balance sheet of the enterprise. It shall be the duty of the president of such association to satisfy himself as to the correctness of the report before transmitting the same to the comptroller. The reports of its affiliates shall be published by the association under the same conditions as govern its own condition reports. The comptroller shall also have power to call for special reports with respect to any such affiliate whenever in his judgment the same are necessary in order to obtain a full and complete knowledge of the conditions of the association with which it is affiliated. Any affiliate which fails to make and furnish any report required of it under this section, and any association whose president fails to transmit as required by this section any such report furnished to him, shall be subject to a penalty of $100 for each day during which such failure continues: *Provided*, That every affiliate which shall be indebted to any bank or banks to an amount exceeding 5 per centum of the capital and surplus of its parent bank shall publish its entire portfolio at a date and in a manner to be prescribed by the Comptroller of the Currency but not oftener than once annually, and every affiliate which shall be so indebted to an amount in excess of 10 per centum of the capital and surplus of its parent bank shall be required to publish its portfolio in at least one daily newspaper issued in the place where such bank is located within ten days after receiving notice therefor from the comptroller, but such publication shall not be considered as a substitute for the annual publication hereinbefore required."

SEC. 28. The first paragraph of section 5240 of the Revised Statutes, as amended, is amended by inserting before the period at the end thereof a colon and the following proviso: "*Provided*, That during the period of three years after this section as amended takes effect, in making the examination of any national bank or of any other member bank, the examiner shall include

an examination of the affairs of all affiliates of such bank, and in the event of the refusal to give any information required in the course of the examination of any such affiliate, or in the event of the refusal to permit such examination, all the rights, privileges, and franchises of the bank shall be thereby forfeited, if a national bank, and if a bank or trust company organized under the law of any State, membership in the Federal reserve bank of its district shall be forfeited and no notice of the termination of such membership shall be required. The Comptroller of the Currency shall have power, and he is hereby authorized, to publish the report of his examination of any national banking association or affiliate which shall not within one hundred and twenty days after notification of the recommendations or suggestions of the comptroller, based on said examination, have complied with the same to his satisfaction. Ninety days' notice prior to such publicity shall be given to the bank or affiliate."

SEC. 29. Whenever, in the opinion of the Comptroller of the Currency, any director or officer of a national bank, or of a bank or trust company doing business in the District of Columbia, or whenever, in the opinion of a Federal reserve agent, any director or officer of a member bank of his district (other than a national bank) shall have persistently violated any law relating to such bank or trust company or shall have continued unsafe or unsound practices in conducting the business of such bank or trust company, the comptroller, or the Federal reserve agent, as the case may be, shall certify the facts to the governor of the Federal Reserve Board. Thereupon the governor of the Federal Reserve Board shall serve notice upon such director or officer to appear before a committee consisting of the governor, the Comptroller of the Currency, and the Federal reserve agent of the district in which such bank or trust company is located to show cause why he should not be removed from office. If upon such hearing the committee finds that such director or officer has persistently violated any such provision or has been responsible for the continuance of any such unsafe and unsound practices the committee may, in its discretion, by a majority vote order that he be removed from office. A copy of each such order shall be served upon such director or officer and upon the bank or trust company of which he is a director or officer. Any such director or officer upon whom any such order has been served as herein provided and who thereafter participates in any manner in the management of such bank or trust company shall be fined not more than $5,000 or imprisoned not more than five years, or both.

SEC. 30. The right to alter, amend, or repeal this act is hereby expressly reserved. If any clause, sentence, paragraph, or part of this act shall for any reason be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder of this act, but shall be confined in its operation to the clause, sentence, paragraph, or part thereof directly involved in the controversy in which such judgment shall have been rendered.

The CHAIRMAN. The first witness will be Mr. Pope, president of the Investment Bankers' Association of America. If Mr. Pope will come around to the committee table and take a seat opposite the committee reporter we will be glad to hear him.

## STATEMENT OF ALLAN M. POPE, PRESIDENT INVESTMENT BANKERS' ASSOCIATION OF AMERICA, BOSTON, MASS.

Mr. POPE. Shall I proceed, Mr. Chairman?

The CHAIRMAN. Just give your name, address, and business for the purpose of the record.

Mr. POPE. I am speaking as the president of the Investment Bankers' Association of America. My name is Allan M. Pope, and I am executive vice president of the First National-Old Colony Corporation of Boston.

The CHAIRMAN. Do any members of the committee desire to ask Mr. Pope any questions?

Senator GLASS. Were you heard at the prolonged hearings held by a subcommittee of the Committee on Banking and Currency last spring?

Mr. POPE. Yes, sir. I should like if possible to make a statement at this time.

Senator GORE. Might I suggest, Mr. Chairman, that the witness be permitted to first make his own statement in his own way, and then the members of the committee will ask him questions?

The CHAIRMAN. Very well. Proceed.

Mr. POPE. I should like to state in part that I am here as a representative of the Investment Bankers' Association of America. That association is composed of approximately 500 members engaged in the investment banking business of the country. The investment banking business of the country is the medium providing long-term credits to States, municipalities, public utilities, railways, and to industry in the same way that——

Senator BROOKHART (interposing). And how about agriculture?

Mr. POPE. To agriculture also.

The CHAIRMAN. You may continue.

Mr. POPE. In the same way that commercial bankers provide short-term credits.

The mechanism and organization of the Investment Bankers' Association was the same means by which at the time of the World War the Liberty loan bonds were sold. The success of the floating of those loans was in a measure provided by the members of this association placing at the disposal of the authorities their entire organization in most cases.

Investment bankers it should be understood are not primarily, and in fact very few of them are members of any stock exchange. Those that are members of a stock exchange have that part of their business separate and distinct from that classed as investment banking.

The investment banking business is not that of trading on an exchange, but is the distribution of securities, some of which, and in some cases many of which, are listed on an exchange, but the dealing is not on an exchange but off or over the counter.

I recently made a trip as president of the Investment Bankers' Association of America to 11 or 12 of the largest cities of the country, at which time I was privileged to talk to several hundred members of the Investment Bankers' Association, as senior executives and in some cases junior executives; and in the most of those cities with the presidents and other officials of commercial banks.

Because of the fact that the bill known as S. 3215, which was introduced by Senator Glass in January, was very much in the minds of investment bankers, it was discussed with all those whom I met. I am obliged to say that without a single exception each one of those gentlemen, numbering several hundred, was without question opposed to the bill at the present time, on the ground that we are at the moment engaged in an attempt to stem the tide of deflation, that we have emergency legislation enacted for that purpose, and that the results of that bill were diametrically opposed to such legislation because of the extreme deflationary character or the general character, I might say, of that bill.

Senator FLETCHER. How does that bill differ from S. 4115 which we now have before us?

Mr. POPE. The present bill is in its general character so like so far as it affects the situation, meaning the deflationary character of the bill, that the same attitude of investment bankers is directed toward this bill, S. 4115.

In addition to the fact of its extreme deflationary character, which makes it essential for the best interests of the country that the general principles of banking be not thus changed to-day, there is in the present bill, at least as we consider it, four sections and probably more in which there is such discrimination against national banks the we are of opinion it might be the natural result that such banks would be obliged to surrender their national charters and become State banks. This would so alter the character of the banking system of the country as to be considered decidedly dangerous.

Senator GLASS. In this connection in order that we may judge whether history will repeat itself, may I remind you that we were confronted with that threat by nearly all the national banks of the country when we adopted the Federal reserve act?

Mr. POPE. Investment bankers I should like to bring to your attention recognize very clearly, and have for some time, certain defects in the present banking system. Some of the executives of the Investment Bankers' Association of America testified at the hearings held by the subcommittee in relation to the bill S. 3215, and in their testimony they recommended an examination of bank affiliates, reports by bank affiliates, limitation of borrowing power of bank affiliates from parent institutions, both separately and in the aggregate; and they have also recommended that loans for the account of others be discontinued.

There are certain sections which affect the Investment Bankers' Association of America included in this bill which I should like now to recite by sections. There are many sections in the bill which either are of no importance to investment bankers as a whole or are technically commercial banking problems with which investment bankers do not feel capable of giving opinions.

In section 2 the definition of affiliates is too broad. It would require reports and examinations, for example, of any corporation of which stockholders of the bank hold 50 per cent of the stock.

That would mean that in many cities and in many towns of this country where influential citizens are stockholders of banks and who in the total as stockholders own more than 50 per cent of purely business corporations, those business corporations would have to be examined by the examiners of the Federal reserve system.

Also in this section in certain instances very large corporations are placed in the category of affiliates because of their ownership of a majority of the stock of small banks which they have taken over by force of circumstances to aid the industrial and banking situation. I know of at least one instance where one of these corporations, and one of the largest corporations in the United States I might say, would have to be examined and make reports as a banking affiliate for that reason.

Senator COUZENS. Right there let me ask you: Could you name that institution?

Mr. POPE. I prefer not to do so.

Senator COUZENS. I wish you would so that we might have the information.

Mr. POPE. I might recite this without any consultation or direct knowledge of the facts and only from information which I have received: I understand that in one instance, or more, the Bethlehem Steel Corporation for the purpose of protecting the interests and deposits of their employees were obliged to take over the stock of a bank. By owning the stock of that bank you would make the Bethlehem Steel Corporation a bank affiliate.

Senator BARKLEY. Right there let me ask you: If the majority of the stock is owned by the Bethlehem Steel Corporation and is controlled by it, why shouldn't it be considered an affiliate?

Mr. POPE. I am not questioning as to whether or not it is an affiliate, but I do question the fact as to whether it is necessary or practicable for the examiners of the Federal Reserve System to examine at stated intervals a corporation of the size of the Bethlehem Steel Corporation and should require them to make the same reports that are required to be made under this bill. I can not see how they would want it to be an affiliate.

Senator COUZENS. Does not that seem to be stretching the point when the stockholders of the Bethlehem Steel Corporation or the officers of the Bethlehem Steel Corporation could easily dispose of their bank stock to outside interests?

Mr. POPE. I am not prepared to state what the Bethlehem Steel Corporation could do.

Now, as to section 3 of the bill: If properly interpreted, we say it makes provision prohibiting the undue, unauthorized, or improper use of credit facilities by Federal reserve member banks, and as such investment bankers or anyone else I take it would agree. But investment bankers do not agree with the broad general statement, the intent of which is carried through this bill, and this bill is designed to carry out this statement and is a most deflationary measure, certainly to the detriment of the best interests of the country to-day. Invesment bankers do not agree with this statement, which is really he general purport of the bill as is understood by us, that credit facilities shall not be extended to member banks for the purpose of making or carrying loans for investment or facilitating the carrying of or trading in such securities other than Government obligations.

Senator BULKLEY. What are you reading from?

Mr. POPE. An extract from a paragraph in the bill, found on page 3 at line 19.

Senator GLASS. You, of course, are aware that that is the exact prohibition of section 13 of the Federal reserve act and has been for 18 years.

Mr. POPE. Yes, but it is not the question of what that statement is. I did not state that that was what was objected to. I said it was the method in this bill which corrected or carried out those statements, first, that was objected to.

Senator BULKLEY. Then you do not object to the statement itself?

Mr. POPE. No, sir; but this is what I say——

Senator BARKLEY (interposing). You do not mean to say that you object to the provision, but you do object to its enforcement?

Mr. POPE. The type of its enforcement.

Senator GLASS. And I might say for your encouragement that it has not been enforced but has been utterly ignored.

Mr. POPE. I do not say the type of enforcement as it stands to-day, or as it might be provided, but I say the type of enforcement as provided in the paragraphs and only the paragraphs which I shall later refer to. And perhaps I might better enlighten you as to our objection as I go along.

Senator FLETCHER. Does it provide for the imposition of penalties?

Mr. POPE. Not in every case. But I will explain that as I go along.

Senator BULKELY. I should like to get this clear: Do you really mean that you do not think this should be enforced?

Mr. POPE. No, sir; but I mean to say——

Senator BULKLEY (interposing). Then you think it should be enforced?

Mr. POPE. I think it is possible to enforce it, but I think the means taken at this time, and you will understand that I am saying at this time; that the means taken are such as to cause sudden deflation in the country and that this is not the time to undertake it.

Senator BULKLEY. I want to press my inquiry further in fairness to you, so that your views may be fairly on our record and we may know what you really have said: Are you or are you not opposed to the enforcement of this policy as stated at the point where you read?

Mr. POPE. I am not opposed to the statement as written in the bill, but——

Senator BULKLEY (interposing). Nor to the enforcement of it?

Mr. POPE. I am not opposed to the enforcement of it, but as to the enforcement of it as provided in this bill.

Senator BULKLEY. Which you are going to develop for us later.

Mr. POPE. Yes, sir.

Senator BULKLEY. All right.

Mr. POPE. We are not opposed to——

Senator BULKLEY (interposing). I want you to make that clear to us. I think it might now be in the record in a position to be unfair to you.

Mr. POPE. Certainly no one, or speaking more directly, no investment banker had any quarrel whatever with the statement prohibiting undue, unauthorized, or improper use of credit facilities.

Senator BARKLEY. That still does not cover the situation. You say unauthorized or undue use of credit facilities by a Federal reserve member.

Mr. POPE. Undue does cover it.

Senator BARKLEY. Where will you draw the line between authorized and unauthorized use, or due or undue use of credit facilities on the part of a member bank?

Mr. POPE. I think that is a matter of judgment in the particular case. I am going to go along with that further, and I think you will find that I will cover the most of the points.

Senator BARKLEY. All right.

Mr. POPE. This does not mean that investment bankers are in favor except in emergencies such as cited in the Glass-Steagall bill of Federal reserve credit being extended directly to borrowers from member banks. It is only an emergency measure.

Now, as to section 6 of the bill: Investment bankers approve of reports by bank affiliates. But on account of the broad definitions referred to above, these reports will undoubtedly be required of a very great number of industrial concerns, which appears not to be advisable or necessary and probably not practicable.

In section 8 of the bill——

Senator GORE (interposing). As to this investment by the Bethlehem Steel Corporation, would it put an end to its payment of such large bonuses as have been reported, made against the interests of its stockholders? Isn't that a good idea to stop that?

Mr. POPE. I haven't any ideas on that subject, sir.

Now, as to section 8 of the bill: This provides that members of the Federal Reserve Board can limit the percentage of capital and surplus which any member bank can loan if such loans are protected by collateral security. This may require an investment banker to pay off his loan on 10 days' notice, as provided in the provisions of this bill. And this might cause and probably would cause many bankruptcies, not only by investment bankers but other corporations and individuals.

This section also provides that the board can prevent a bank from making any security loans. This appears to me to place directly upon the Federal Reserve Board the responsibility for the conduct of all loaning officers of member banks.

As to section 9 of the bill: This section limits loans to national banks and member bank security and real-estate affiliates to 10 per cent of the capital and surplus of its parent bank. This eliminates the present provisions of the law permitting such affiliates to borrow in excess of such percentage in case of bankers' acceptances and Government bonds and certain other eligible securities, which is highly desirable in the development of the Government bond market and the bankers' acceptance market, for at times there is required a policy of large portfolios in order to properly conduct the business.

This section puts a premium on listed securities which, in the opinion of investment bankers, has in some instances been derogatory to their value. I will not go into the technical part of that, but I can show you that that has been the case.

It requires a 20 per cent margin—I mean it is required in this section—on all collateral loans, the collateral of which must be listed on a stock exchange. On certain classes of eligible paper, bonds legal for saving banks, no margin is specified.

Now, as to securities legal for savings banks, and it varies in practically every State, this provision makes it possible, for example, for a bank to be authorized in some States to borrow on foreign securities without any collateral at all. But it makes it impossible, absolutely impossible, to make a loan in many States, and New York State is one of them, with the exception of one of the Federal Land Banks, as I say makes it impossible to borrow on Federal Land Bank securities at all. It makes it impossible to borrow in some

States, in fact, in many States, on railroad equipment securities. And I think probably to-day there might be legislation passed making them legal, but to-day I do not believe in any State they could borrow on Reconstruction Finance Corporation bonds.

Senator GORE. Who do you mean could borrow?

Mr. POPE. No one; no bank could make collateral loans on those.

Senator FLETCHER. Did you say borrow on foreign securities?

Mr. POPE. As collateral.

Senator FLETCHER. Do you mean the securities of foreign governments?

Mr. POPE. Yes, sir; foreign countries securities can be borrowed on without margin under this provision in certain States, and Connecticut is one of them, and New Hampshire is one of them, and others. Now, might I correct that statement? I was too broad in it. That applies to affiliates of member and national banks and not to other dealers.

Now as to section 11 of the bill: This section raises the rate on 15-day advances to banks, on borrowings from the Federal reserve banks. This is a highly deflationary measure and therefore at this time is considered to be extremely dangerous. And it is particularly unwise at this time because of the necessity on the part of the Government of floating large loans. This section would depreciate the value of every Government security to-day.

Senator GLASS. Did it do it before it was put into the bill?

Mr. POPE. How was that?

Senator GLASS. The system operated for more than two years without that section.

Mr. POPE. I can not recall the market at that time, but I am talking about the change from one rate to another. If the carrying cost of a Government bond which would be under this provision to-day, 4 per cent in New York, which is the lowest of any discount rate, for it is 4½ per cent in most other cities, it is not possible certainly to make money. Certainly it is not possible to invest for the purpose of doing so, and it is not of interest to increase the investment in securities of the United States Government which are sold at the present time, the highest coupon rate being 3¾ per cent for 1-year loans.

Senator GLASS. Do you favor the immediate retirement of na- bank circulation?

Mr. POPE. I am not prepared to answer that question. That is a purely commercial banking matter which I have not given attention to.

Senator GLASS. But you are discussing the general problem of deflation. Would that result in deflation?

Mr. POPE. You would have to give me some time to answer that question because I am not prepared to do so offhand.

Senator GLASS. With the retirement of nearly $800,000,000 of national-bank circulation can't you say whether or not that would involve deflation or not?

Mr. POPE. As I say, you are asking me on certain technical points in that matter with which I am not familiar.

Senator GLASS. Well, it is not a technical but a very simple proposition.

Mr. POPE. I am not prepared to answer that question, sir.

Senator GLASS. Well, on this problem of deflation, what was the peak of loans for others during the riot of stock speculation?

Mr. POPE. I have not the figures before me, but I should say somewhere in the fall of 1929.

Senator GLASS. But what was the peak figure, approximately?

Mr. POPE. I have not the figures.

Senator GLASS. It was many billions of dollars?

Mr. POPE. Yes, sir; probably so.

Senator GLASS. Yet you are in favor of cutting those loans out. Would you regard that as deflationary?

Mr. POPE. Those loans are practically cut now.

Senator GLASS. I know, but they may be cut in again.

Mr. POPE. As long as they are out now that does not affect the present status. If they were in now and were to be taken out that would be one problem, but they are out now.

Senator GLASS. The purpose of this bill is to avert a repetition of the present status. You say you are in favor of cutting out loans for others, which reached a peak of some eight billions of dollars during the riot of stock speculation. You say you are in favor of cutting them out. Wouldn't you regard that as deflationary?

Mr. POPE. I would if they were in. But they are not in.

Senator GLASS. But they might come in again.

Mr. POPE. I do not think they will.

Senator GLASS. There isn't anything in this bill that deflates anything right now, except stock gambling which has abated tremendously. You are criticizing this bill as extremely deflationary, and yet as it seems to me you are advocating policies here before the committee that would be more deflationary than anything contained in this bill.

Mr. POPE. I do not think there is anything deflationary in continuing something that exists to-day. It would be if cutting out something that existed to-day.

Senator GLASS. They are out because nobody is loaning money for speculation in stocks, but they may come in again to-morrow if the people want to make loans.

Mr. POPE. The clearing-house regulations in New York prohibit those.

Senator GLASS. Yes; but they may be changed to-morrow if they are pleased to do so.

Mr. POPE. I am not able to say what they might do. I only say what they have done.

Senator BARKLEY. They only changed them because they wanted to, and they might change back again. There is no law that prevents it. It was a voluntary action on their part.

Mr. POPE. I think that is true. But on that I am in favor of legislation as I have stated.

Senator GLASS. Then, as I understand it, you are in favor of deflationary legislation in that respect.

Mr. POPE. The effect is not deflationary at the present time.

Senator GLASS. It is very restrictive, isn't it?

Mr. POPE. I do not know what you mean by restrictive in this case.

Senator GLASS. Oh, well. Never mind.

Senator BROOKHART. Your theory is that it is already deflated on that point and you just want to keep that part of it deflated.

Mr. POPE. Yes, sir. As I stated before, the question of stopping deflation was of no moment at that time. Investment bankers have no objection to the provisions of this section.

Senator FLETCHER. Do you mean section 10?

Mr. POPE. Section 11. It provides that a member bank shall not make any security loans while borrowing from the Federal reserve bank after warning. But the Investment Bankers' Association of America is opposed to the principle of this bill, which indicates that a member bank could not make any collateral loans while so operating, as a general principle.

Now, section 13: While the Glass-Steagall bill makes provision to permit adequate currency in circulation in spite of unusual gold withdrawals, this section, which increases the reserves on time deposits of banks, is particularly unfortunate at this time, as it has the equivalent effect of gold exports to an estimated figure of—and I am only giving this as a pure estimation—of something like over $100,000,000 a year for five years. This is particularly untimely as the measure is in addition highly deflationary.

Now, section 15——

Senator GORE (interposing). Will you explain that point a little more for me?

Mr. POPE. Well, when you take the reserves of time deposits and increase them so that an additional amount is not available for credit, it acts in the same way that a dollar does when it leaves the country.

Senator GLASS. Isn't it a fact, according to the testimony that we took last spring and according to our general information, that at least 80 per cent of the banks of the country have so manipulated their demand and time deposits as to reduce very much the general average of reserves behind deposits?

Mr. POPE. I understand, although I am not entirely certain because I am not familiar with the details, that that is correct. I want you to understand that in this case I am only saying why at this time it is particularly difficult, because it has the same effect as nullifying what was attempted to be done in the Glass-Steagall bill, in a certain degree at least.

Senator GLASS. Have you noted the fact that we expand this operation over a period of five years, that it does not immediately take effect?

Mr. POPE. I understood that it was to take effect at once to the extent of something like $100,000,000 a year for five years.

Senator GLASS. That depends on the basis of estimate. Some figures make it only $70,000,000 a year for five years. And you understand that that provision of the bill is intended to correct the illicit practices of bankers themselves.

Mr. POPE. I am only stating it as being unfortunate at this time.

Senator GLASS. Well, it was unfortunate that they should have been guilty of this manipulation at any time, wasn't it?

Mr. POPE. I am not prepared to agree with you on the exact phraseology, you see, because I don't know.

Senator GLASS. Well, I might call it by a politer name, but I am not noted for doing that, I am sorry to say.

Senator BULKLEY. You note that it does not have any effect until next January, do you not?

Mr. POPE. Yes, sir. Now I will take up section 15 of the bill: This section limits national banks to the business of buying and selling investment securities solely on order and for the account of others, and as such is discriminatory, as it is only directed toward national banks.

The effect of this section is also——

The CHAIRMAN (interposing). Might I ask you a question right there?

Mr. POPE. Certainly.

The CHAIRMAN. Have you any figures showing the amount of securities that have been sold by national banks during the last four or five years?

Mr. POPE. I have not.

The CHAIRMAN. The country has been flooded with them. I wish some one of the witnesses would be able to give us those figures during our present hearings.

Senator GLASS. We have from the State Department, have we not, in the recent investigation an approximate estimate of the foreign securities that have been sold, and I believe the sum was approximately $12,000,000,000.

The CHAIRMAN. Over how long a period?

Senator GLASS. Sold to and by national banks.

Mr. POPE. You mean distributed by national banks and others.

The CHAIRMAN. I meant both.

Mr. POPE. I can not give you the figures.

The CHAIRMAN. I have in mind that this country has been flooded with more of these securities than it has been able to absorb. Maybe that is a part of our trouble.

Mr. POPE. I can not give you those figures at the moment. The effect of this section 15 is also highly deflationary. That is, it would require the immediate sale of probably—and as to this, on account of lack of time which I had to prepare for this hearing is only an estimate—that it would require the sale of several billions of dollars of securities now held by national banks. Now, gentlemen of the committee, that would mean that the mere fact that they were obliged to sell would depress the market to an extent no one can foresee, thus decreasing the assets of national and member banks throughout the United States to a degree that would be certainly highly dangerous.

Senator COUZENS. Would you suggest any effective date for that provision to go into effect?

Mr. POPE. I should state that the date certainly should be—well, I am not stating anything as to the provision of the bill, either pro or con, in that respect—but I certainly would say the date ought to be set for any provisions that are deflationary as of a time when the bond market can stand it without ruining banks, individuals, or corporations.

Senator COUZENS. Could anything be written into this paragraph to make it effective at a date some time in the future?

Mr. POPE. Well, I do not know when the business of the country would be normal, or when this present economic situation will be corrected.

Senator BARKLEY. And who would be the judge of when that time arrives?

Mr. POPE. I think there are perhaps hundreds of investment and commercial bankers, and Members of Congress for that matter, who would recognize that time.

Senator BARKLEY. I know; but you can not submit it to a plebiscite. You must have some one in authority to handle it.

Mr. POPE. I do not think the objection from the standpoint of being purely deflationary would be raised by anyone at a time when the country is not in a state of deflation.

Senator COUZENS. Would you be agreeable to leaving the time to the Federal Reserve Board?

Mr. POPE. I should consider from what I know of the Federal Reserve Board that they are in touch with the investment and commercial banking interests of the country, and as such certainly should be able to determine when such a period arrives.

Senator COUZENS. Would you be willing to have written into the bill that the Federal Reserve Board might decide when this provision should become effective?

Mr. POPE. If this provision is to be a provision, and it is put on a deflationary status, I should think that might be a very helpful situation. But I am not certain, although I think it would.

Senator COUZENS. Well, we do not all admit your premise, but it might be desirable to let some one set the date in the future.

Mr. POPE. I can only say that it seems to me that the Federal Reserve Board, being in touch with banking and commercial and industrial interests of the country, should be able to determine that.

Senator FLETCHER. What is the process in that section which makes it so deflationary in your opinion?

Mr. POPE. It is the limitation of the percentage of holdings by national banks of securities, dividing them into two classes, general securities and Government securities.

Senator FLETCHER. But the limitations do not apply to Government obligations nor to obligations of any State or political subdivision or the farm land banks.

Mr. POPE. In the case of several billions of dollars it is based on the estimate that it does not apply to United States Government securities. But under that provision in that section, according to the actual interpretation of the section as I understand it, it does apply to Governments as well as other securities. Whether it was so intended or not I do not know.

Senator TOWNSEND. Where is that found in the bill?

Mr. POPE. On page 36, line 11, and continuing down to the foot of the page. It says certain provisions for buying and selling securities by national banks, and then it states certain provisions for purchasing and holding by national banks, meaning the securities they have in their own portfolios. Now, at the bottom, where the exemption is made, it again refers to buying and selling, and the same phrase as used in the preceding, to buying and selling for the account of others. A strict interpretation of that section means, in our opinion, that the restrictions or limitations would apply likewise to Government securities. It would mean millions and millions of dollars worth of Government securities sold to-day.

The CHAIRMAN. Would you be satisfied if the language were more clarified so as to put Government securities in a separate class?

Mr. POPE. This measure would be so deflationary, even if corrected as you suggest, that it would certainly be so highly detrimental to the investment market to-day as to unquestionably affect in a ruinous manner the banks throughout the country as well as investment bankers.

Senator BULKLEY. Are you referring to the restriction on page 36, line 15?

Mr. POPE. I am not sure of the line, as I have not the bill before me, but I understand it is on page 36, down to line 22.

Senator BULKLEY. It says [reading]:

**The limitations herein contained as to the purchasing and selling of investment securities shall not apply to obligations of the United States.**

Is that what you mean?

Mr. POPE. Yes, sir.

Senator BULKLEY. And you say that that would be interpreted so that it would apply to the holdings.

Mr. POPE. Yes, sir; because above there it says holdings of banks, and then refers to purchasing and holding of securities. And where it refers to buying for the account of others it says purchasing and selling. The exception of Government securities later on refers to purchasing and selling, which applies to doing business for the account of others. The phraseology there is the same.

Senator GLASS. Government and State securities, and securities of political subdivisions, are generally excepted as to that whole provision.

Mr. POPE. The point we were just speaking of here is that, and what the intent was I do not know, but our interpretation of the section is that the exemption you just spoke of applies to the purchasing and selling of securities, which is the phraseology used in purchasing and selling securities for the account of others, and not purchasing and holding for the account of the bank.

Senator BULKLEY. You are afraid that that exception does not apply to this limitation up here on line 14 [reading]:

**Nor shall the total amount of the securities so purchased and held for its own account at any time exceed 15 per centum of the amount of the capital stock.**

Mr. POPE. Yes, sir.

Senator BULKLEY. I see your point there. Now, I want to ask you about that restriction: Is that the restriction that you say is so deflationary?

Mr. POPE. The restriction, even though it were intended for the exception of holdings——

Senator BULKLEY (interposing). Assuming that we do except Government securities.

Mr. POPE. The amount of the securities, and this is purely an estimate, because I have not had time to get the facts, but it is an estimate made by a person in whom I have confidence as to his ability—the estimate that it would cause the sale of several billions of dollars of securities to-day, even though with the wording as you think it was intended.

Senator BULKLEY. About how many billions of dollars do you think?

Mr. POPE. I think it is probably safe to say a billion or two billion dollars.

Senator BULKLEY. A billion or two of dollars?

Mr. POPE. Possibly $2,000,000,000.

Senator BULKLEY. Or possibly from one to two billion dollars?

Mr. POPE. Yes, sir.

Senator BULKLEY. And you think it would probably be more than that?

Mr. POPE. Yes, sir.

Senator COUZENS. What would you say to putting a proviso in there that this does not affect securities already held by these banks?

Mr. POPE. That would nullify the deflationary part of the bill and correct the point I am trying to bring out, that this is not the time to enact anything that is deflationary.

Senator COUZENS. Wouldn't that proviso correct the deflationary part?

Mr. POPE. Yes, sir.

Senator BULKLEY. I want to be quite sure of what you have said, that this section would cause the immediate sale of securities now held by banks for their own account, to the extent at least of $1,000,000,000 and probably to more than $2,000,000,000. Is that your statement?

Mr. POPE. That is my estimate based on figures which I have not prepared myself.

The CHAIRMAN. You may proceed with your statement.

Mr. POPE. Now as to section 18 of the bill: This section prohibits, for example, men in the investment banking business becoming directors of member banks. It is considered that the Clayton Act sufficiently protects banks in such instances, and it would cause the removal from directorates of many men with investment and commercial banking experience, which would seriously hamper the activities of member banks.

This section prohibits interlocking officers between the parent bank and affiliates. The only particular objection that the investment banker would have to this section is in the case of smaller affiliates of banks. In that case there are many where the size of the affiliate is not great, but there is required a successful, careful, and shrewd man to operate the affiliates. On account of size it is not practical in the case of some of the smaller affiliates to hire a man and put him on a salary such as the man could demand. For that reason to give such a man the duty of performing the functions of an officer of the bank as well as of the affiliates would be highly beneficial, especially in the case of the smaller affiliates.

Senator GLASS. I might say that it is because some shrewd men have operated these affiliates and involved the parent national bank in great difficulties that we undertook to prevent interlocking directorates.

Mr. POPE. I think possibly I may have used the word "shrewd" without intending to give it the meaning which you perhaps apply to it.

Senator GLASS. It had a very pertinent application, I might say.

Mr. POPE. That was not the application, however, that I intended to impress you with, because I did not intend to do that.

Senator COUZENS. Would there be any great difficulty for these banks to get rid of their affiliates, which in many cases I think they should get rid of?

Mr. POPE. I should like to bring that up later.

Senator GLASS. What were the affiliates organized for? Weren't they organized to do a class of business that the resources of the parent national bank under the national bank act prohibited?

Mr. POPE. You ask me to make a statement in regard to bank affiliates in general, which would require on my part intimate knowledge with all bank affiliates. But if you should like to have me do so, I can explain the case of one with which I am entirely familiar.

Senator GLASS. All right.

Mr. POPE. In that case it is the First National-Old Colony Corporation of Boston. I should like to ask your indulgence in saying that as long as this has been brought up here I am stating this personally, that I am stating these as personal facts and not as the president of the Investment Bankers' Association of America. It is not my function to speak in that way as such officer, and I would ask the courtesy of the press not to embody these remarks on the First National-Old Colony Corporation as a part of my remarks as the president of the Investment Bankers' Association of America.

The First National-Old Colony Corporation was organized for the purpose of assisting in the missionary work necessary to sell bankers' acceptances, which were at that time comparatively new in this country. The country had no knowledge of them at all. We had to go to banks throughout the country and explain what they were.

Those banks, at a time when bankers' acceptance rates became prohibitive for them to satisfactorily invest in them, turned to this corporation and said, "Could you not sell us Government securities?" For that reason we were drawn into the Government-security business, supplying them to banks, corporations, and others.

When the situation arrived where Government securities were reaching a low point and banks demanded other securities, because of interest rates or for other reasons known to themselves, this corporation was drawn into the sales to institutions largely, the sale of securities to institutions other than governments and bankers' acceptances. It was entirely an evolution.

In order to continue the sale of securities which institutions wanted, it was necessary to take participation, and eventually in some cases, to originate new issues of securities. Otherwise we could not distribute them.

Senator COUZENS. What year did that begin?

Mr. POPE. In 1918. There was no motive then, such as Senator Glass referred to, in the case of this corporation. This corporation to-day has 21 offices in the United States. It has been expanding continuously each year since it was organized, including the present year. It has three offices in Europe, where it sells American dollar securities. It has an office in Buenos Aires, where it sells in South America these American securities.

Every one of the 21 offices of this corporation has made money every year, and is making money this year, in the three months of this quarter.

This corporation has a department called the investment-supervision department, in which there are security holdings of—well, it goes up each day, so I could not give you the last figures, but probably 600 banks of the country, many large corporations, and some insurance companies call on us, and we are asked by these corporations and banks to supervise their securities in order that they may act in their wisdom on the information which we, through our broad expanse of knowledge, are able to furnish.

We have had presidents of banks to come to this corporation and say that bank examiners have told them if they did not take our advice in security matters it would probably be necessary to close their banks.

We do probably the largest Government-security business in the country, our transactions in Government securities running into the billions of dollars a year. The total number of transactions in one day has reached $500,000,000, and one or two days it has run more than $300,000,000.

During time of stress of banks this corporation has been called upon and has functioned to the extent of taking as much in two instances I can recall of $40,000,000 from banks which had to have the cash immediately. And I can recall numbers of instances where we were called upon to take as much as $10,000,000 from these banks.

Senator FLETCHER. What are your charges?

Mr. POPE. We make no commission charges whatever. The basis on which we operate is the difference between the bid and asked prices of securities, which is in general regulated by the market itself.

Senator GLASS. Why might not your affiliate be operated in the same way as an independent corporation?

Mr. POPE. I think that without any question this corporation's activities, which now cover over a billion dollars, and $100,000,000 was bought in before I left—I say considerably more than a billion dollars of securities to supervise for banks to-day, that that was brought about by the fact that it was a bank affiliate. I do not think it could be done by any other private corporation in the same way that it was done by the First National-Old Colony Corporation. And I think it is unique in that respect so far as the particular matter of distribution is concerned.

However, there are many affiliates. The officer of one of the principal affiliates in the Middle West, Mr. Ferris, past president of the Investment Bankers' Association of America and president of the First National Co. of St. Louis, is present to-day. He can give you the type of national bank affiliate investment security, which does a different type of business, but is equally effective in the proper distribution of securities to small dealers, small individuals, as well as large investors.

Senator FLETCHER. Are those securities listed?

Mr. POPE. There are a great many securities which are listed, and many which are not. Farm-loan securities are not listed.

Senator FLETCHER. Securities only?

Mr. POPE. Many of them are listed. But I should like to explain that if you were to attempt to-day, and on many days, to sell securities on the board, meaning on the stock exchange, you are very apt, particularly now, to depress the market several points, even if a very few bonds. The off-the-board market provides a medium of finding buyer and seller, and therefore has not the effect in larger blocks of depressing the market. That is the purpose of this First National-Old Colony Corporation.

Senator GORE. I did not quite follow you there. Has not the effect of what?

Mr. POPE. On the stock exchange. The principle is that you have something to offer, for example, and there is to be found a buyer or bidder. In the case of over-the-counter business the principle under which we, for example, operate is this: We find a buyer when we know there is a seller.

Senator COUZENS. Using "shrewd" in the sense that you used it a while ago, isn't it a fact that shrewd lawyers have devised many of these affiliates of banking groups for the purpose of evading the inhibitions of the law?

Mr. POPE. I can not conceive that to be a fact, but I am not familiar with the details of any other affiliate. I have too much to do to run my own business.

Senator COUZENS. Speaking of it from the standpoint of wide experience, you must have observed that many of these affiliates have been, in banking groups, devised by shrewd lawyers to evade compliance with State and Federal laws. Isn't that a fact?

Mr. POPE. I would not say it was as the initial reason for their being. I do not say that there are no exceptions, and that there is not in the investment banking business as well as in other businesses, men who are not sound in their judgment or entirely honest. That is probably true of any business.

Senator COUZENS. I did not say they were dishonest. I was using the word "shrewd" in the sense that you used it a while ago.

Mr. POPE. I did not use it in that sense.

Senator COUZENS. Not in the sense that you suggested Senator Glass used it.

Senator GLASS. How does anybody know in what sense I used it?

Senator COUZENS. I was putting the interpretation on it that the witness did.

Senator GLASS. I conceive that Mr. Pope has perhaps described an ideal and virtuous affiliate. It might be a little distressing to describe here one of an utterly different type, which lost to its stockholders $57,000,000 in one year.

The CHAIRMAN. Yes; and they are now asking that we not interfere with them because of the condition of the times.

Senator GLASS. Just to get back to the proposition discussed a while ago. I should like to call Mr. Pope's attention to the fact that there is not a sentence in this section that requires the immediate disposal of any securities held by a bank. The section very distinctly provides that the business of purchasing and selling investment securities shall hereafter be limited, and so forth. It does not require any bank to immediately dispose of its holdings.

The CHAIRMAN. While you are going into your own business quite fully——

Mr. POPE (interposing). I think if I might say it, in response to Senator Glass's question, that our interpretation was the hereafter meant as soon as the law was put in force it would take effect.

Senator GLASS. Oh, no. It means purchasing and selling hereafter.

The CHAIRMAN. Under that interpretation Mr. Pope does not object to it. Is that it?

Mr. POPE. Yes, sir; I do.

Senator GLASS. For one I would be obliged to Mr. Pope if he could supply us with language that would make it clearer. But that is my interpretation of it.

The CHAIRMAN. Then you and Mr. Pope agree on what should be done on that?

Senator GLASS. As to what the intent is; yes.

Mr. POPE. I do not know just what you mean to say in regard to an agreement between us. My statement still stands, that this is not the time, on account of deflation, to sell securities, and therefore it is not the time to enact this legislation.

The CHAIRMAN. But Senator Glass says this bill does not compel the selling of securities. If that is correct in the matter of the interpretation of this section of the bill, then you have no objection to that provision of the bill?

Mr. POPE. If it does not require the sale of securities, they would have no objection from the standpoint of deflation.

Senator FLETCHER. That is in reference to section 15 of the bill?

Senator GLASS. Yes.

The CHAIRMAN. Mr. Pope, you went into your own business quite fully. These securities are recommended by you, or at least that is the impression carried to the public when they are sold by you, is it not?

Mr. POPE. Information regarding the value of securities is given, and then our customers have to make up their own minds on the information so given, as to whether the securities suit them for the purpose of purchase or not.

The CHAIRMAN. Your experience is that the buying public having confidence in you buy them very freely?

Mr. POPE. Naturally so, if people have confidence in us.

The CHAIRMAN. And you have been more careful in the sale of stocks. You have discriminated carefully, and to such an extent that bank examiners, as you have said, have recommended to banks that you are fully advised. Did I understand you on that point correctly?

Mr. POPE. In at least one or two instances.

The CHAIRMAN. Now, tell us something about the rise or fall of securities that you have sold?

Mr. POPE. Every security that I know of has depreciated in value. And it is impossible for securities in view of the universal drop in commodity values the world over, with the exception perhaps of very marked exceptions, to hold the values they had a year or two ago.

The CHAIRMAN. Have you sold foreign bonds?

Mr. POPE. Yes, sir.

The CHAIRMAN. What is the average value of those bonds now as compared to the time when you sold them, just in a general way, I mean?

Mr. POPE. I can not tell you. But I did see a compilation which was made by some one and which stated approximately that the average fall in commodity prices was virtually the same as the average fall in foreign securities.

The CHAIRMAN. What percentage was that, about?

Mr. POPE. I don't remember that.

The CHAIRMAN. Was it 30 or 40 per cent?

Mr. POPE. I should say yes. But I should also say——

The CHAIRMAN (interposing). Then people who bought from you lost somewhere near half the money they invested.

Mr. POPE. So far as I know in the case of anybody who has purchased almost anything, it is a fact that it has not the same value to-day as it had then.

The CHAIRMAN. But bank examiners have told banks that your advice was a good basis for the investment of their depositors' money.

Mr. POPE. It was a good basis, sir.

The CHAIRMAN. Of foreign securities?

Mr. POPE. Well, sir, to-day the purpose of any well-organized banking and investment house is to endeavor to place their customers, which in the case you are referring to is banks, in the best position under the circumstances. And the question as to whether they should hold this or buy that is a question of circumstances. It is not a question of previous value.

The CHAIRMAN. Oh, well, I will admit that. But the point seems to be that the advice they got was not the kind of advice they thought they were getting. In other words, the average buyer of securities has come to realize that the advice he paid for in the higher places was no better than his own judgment; and that if he had invested his money at home or in other places he would not have fared any worse than to take this valuable advice.

Mr. POPE. I do not agree with you, Mr. Chairman, but unless you want me to do so I will go on with the discussion of the bill. Or I can go ahead and give you what I think are perhaps practical ideas on this subject.

The CHAIRMAN. Oh, well. Never mind.

Senator COUZENS. Are any securities that your house sold now in default?

Mr. POPE. There is only one issue: I mean that this corporation issued as originating house, that is in default, of foreign securities. And that has sufficient money, and it has presented that amount of money to purchase the gold necessary to pay their interest, but when presented at the bank of the nation which had the gold it was finally refused on the ground that that particular locality should not be given an advantage over others that were unable to pay sufficient internal currency to purchase gold.

Senator COUZENS. Does that apply to both principal and interest, when you say that is the only default?

Mr. POPE. Well, to interest and principal, but I am not sure whether there is any case where a sinking fund is temporarily sus-

pended. But as to a case of bonds due or overdue it applies, that there is none.

Senator BARKLEY. Neither your house nor any other house that is reputable is willing to handle any bond, or suggest the purchase of any bond, that it does not think sound, is it?

Mr. POPE. It does not recommend the purchase of any bond that it thinks is not sound, is that your question?

Senator BARKLEY. Yes.

Mr. POPE. Certainly not.

Senator BARKLEY. You may not recommend a particular type of bond to a customer, but regardless of the type of bond any customer might want you certainly would not put your house in a position of handling it or recommending it unless you thought it was a sound maturity, would you?

Mr. POPE. Certainly not.

Senator BARKLEY. And in that sense the mere fact that you are handling a bond, being the president of a reputable investment bank, carries with it certainly the guarantee that it is sound, does it not?

Mr. POPE. It certainly does not carry any guarantee. But people have learned to respect our judgment because it has been proven to be correct over a period of 13 years.

Senator BARKLEY. I did not mean that you guaranteed the payment of anything.

Mr. POPE. No.

Senator BARKLEY. But you do put your reputation as an investment house against anything that you handle?

Mr. POPE. Yes, sir.

Senator BARKLEY. And the mere fact that you handle a type of bond is of itself a recommendation, is it not?

Mr. POPE. I think it has come to be so, but not merely because we are an affiliate of a bank, but because of our reputation plus the fact of the reputation of the parent institution.

Senator GLASS. Right on that point, Mr. Pope: You loan the name and prestige and tradition of your national bank to your affiliate. Is your national bank responsible for all losses that may occur in the operation of your affiliate?

Mr. POPE. Not at all.

Senator GLASS. Don't you think it ought to be?

Mr. POPE. I should not think so. We do not intend it to be so.

Senator GLASS. You loan to your affiliate, as I say, the prestige and tradition of your sound national banking institution. People buy its investment securities perhaps largely on that basis, and yet if a failure should come—and I am as gratified as you are perhaps that no failure has come except the one you said—it seems to me there ought to be some responsibility on the part of the bank. Evidently you did not write any of those letters in Scape Goats, did you?

Mr. POPE. I have never read the book.

Senator GLASS. Perhaps it would be of interest if you did read it.

Senator BROOKHART. When did you begin selling Government securities or handling them in your affiliate?

Mr. POPE. I think approximately two years after it was founded, I think in 1920 or 1921.

Senator BROOKHART. When did you begin handling securities of private corporations and institutions?

Mr. POPE. Probably a year or so after that.

Senator BROOKHART. Now, we will say that governments were at par when you began, were they not?

Mr. POPE. No, sir. Long-term governments were selling at 85.

Senator BROOKHART. That is, they had been deflated in 1920?

Mr. POPE. Yes, sir.

Senator BROOKHART. But when the Government handled them itself and sold them they all sold at par?

Mr. POPE. Yes, sir.

Senator BROOKHART. And then after your affiliate institution got charge of them they depreciated?

Mr. POPE. When our affiliate got charge of them they went up some 30 or 40 points.

Senator BROOKHART. When did they next depreciate?

Mr. POPE. Well, I can not recall the date of the present movement.

Senator BROOKHART. They did not go up or down, either one, as long as the Government itself handled them.

Mr. POPE. The Government, except incidentally, has nothing to do with the handling of Government securities after the initial distribution, except as the Federal reserve in the open market purchases them. It is all in the hands of investment bankers.

Senator BROOKHART. The big issues were Government sales and there was no gambling in them, but they were sold to the people of the country at par.

Mr. POPE. Yes, sir.

Senator BROOKHART. And after the banks and their affiliates got hold of them by calling loans of people who borrowed money to buy those securities, then they depreciated?

Mr. POPE. They did depreciate, but not because they were bought by those people, but because of the conditions in the country in 1920.

Senator BROOKHART. Now, let us see about the conditions of the country. I remember what happened to agriculture in 1920, but following that time for every other business there was a great revival generally, I mean in everything except agriculture.

Mr. POPE. No, sir; and the reason they went down was because of money rates. Money in 1921 caused the Government to pay 6 per cent for short-term credit because money rates of the country were so high. I can not recall exactly but the Federal reserve rates in New York were frequently 6 per cent, and money at times in New York reached 20 to 30 per cent on call.

Senator BROOKHART. Yes; I remember about that, too. You continued to sell these securities in 1926, 1927, and 1928?

Mr. POPE. Yes, sir.

Senator BROOKHART. And in 1929 up to October?

Mr. POPE. Yes, sir.

Senator BROOKHART. And you advised that they were sound and good investments, in the same way that you had given advice all the time?

Mr. POPE. Senator Brookhart, the task of taking securities from banks in that deflationary period you refer to was a stupendous problem. It takes the very best——

Senator BROOKHART (interposing). I am not talking about the deflationary period, but the inflationary period.

Mr. POPE. I thought you asked me if we still recommended them when they were going down.

Senator BROOKHART. No; while they were going up.

Mr. POPE. We did not have to recommend Government securities as a credit, and we never prophesy whether they are going up or down. We don't know.

Senator BROOKHART. In 1929, before the 24th of October, when this thing blew up, you continued to sell and to give your usual assurance of recommendation, whatever it was, up to that date, didn't you?

Mr. POPE. The usual assurance; yes, sir.

Senator BROOKHART. That is what I say.

Mr. POPE. But that is not——

Senator BROOKHART (interposing). You had not detected up to that time that things were inflated to the bursting point or anything of the kind, had you?

Mr. POPE. I can not recall what our attitude on Government bonds was at that time.

Senator BROOKHART. And as to other bonds you were still selling them up to October of 1929?

Mr. POPE. If you mean by your question that we did not know the date when the deflation would take place, I will answer no.

Senator BROOKHART. And you sold to your clients and to people generally just as though that highly inflated period was perfectly sound? You continued your business just the same as at any other time?

Mr. POPE. I can not recall exactly what our sales were at that time.

Senator BROOKHART. Well, anyhow they continued a good deal better than they are now?

Mr. POPE. Last year we had the largest volume of sales of any year in our history.

Senator BROOKHART. And you had a good volume of sales up to October of 1929?

Mr. POPE. Yes, sir.

Senator BROOKHART. Then your knowledge and your advice in the situation did not at all detect the enormous inflation of things that burst on the 24th of October, 1929?

Mr. POPE. I said we were not sufficient prophets to determine the date on which that would take place; no, sir.

Senator BROOKHART. Your sound judgment was not deep enough to see that or to understand it at all?

Mr. POPE. I object to the words "understand it at all" part of it, because I——

Senator BROOKHART (interposing). I am trying to find out the facts, whether you did detect it before it happened.

Mr. POPE. We were not cognizant of the date when deflation would take place, nor were we as cognizant of the extent of it as we are to-day.

Senator BROOKHART. You did know that deflation would take place at some time?

Mr. POPE. We thought it might be possible, but did not know.

Senator BROOKHART. And knowing that you still continued to advise the public and to sell to the public those inflated bonds and securities?

Mr. POPE. I think it is probable that we bought bonds from them rather than selling them, although I am not sure.

Senator COUZENS. What is the name of your bank affiliate?

Mr. POPE. The First National-Old Colony Corporation.

Senator COUZENS. What is the name of your institution that you have been referring to?

Mr. POPE. I am referring all the time to that same institution.

Senator COUZENS. What is your bank affiliate?

Mr. POPE. Our bank affiliate is the First National-Old Colony Corporation, and the parent is the First National Bank of Boston.

Senator COUZENS. I wondered why you made the name so much like the parent in organizing your corporation.

Mr. POPE. I do not know, sir. The name was originally the First National Corporation, before I joined it in 1919. And the reason it is the First National-Old Colony Corporation now is because the First National Corporation was merged with the Old Colony Corporation and the two names were linked together.

Senator COUZENS. Isn't it significant that many of these affiliates carry the same name as the parent national bank? For example, there is the National City Bank and the National City Co.

Mr. POPE. The significance of what?

Senator COUZENS. What is the purpose of having these names so alike?

Mr. POPE. I shouldn't think there was anything in it. At least it is nothing significant to me. I do not know what you mean by "significant."

Senator COUZENS. It seems to me the significance to the public would be that there was very close affiliation.

Mr. POPE. They are affiliates.

Senator COUZENS. And that the responsibility of both organizations was back of them.

Mr. POPE. Well, sir——

Senator COUZENS (continuing). I mention that because I think the public has ofttimes been misled, because even in my own city we did have the First National Bank and the First National Co., the inference being very plain to the public that they were so close to each other that the responsibility of each corporation was back of anything that either did.

Mr. POPE. Well, I think I now see what you mean. But I do not think the significance was anything that was to be concealed. Certainly it was not in our own instance, nor was there any intention to mislead anyone.

Senator FLETCHER. In the case of your own institution, do your national bank and your affiliate have the same directors?

Mr. POPE. No, sir. There are some that are, but there are others that are not on both boards.

Senator FLETCHER. There are some directors of the First National Bank of Boston who are directors of the affiliate?

Mr. POPE. Yes, sir; some of them are.

Senator BROOKHART. Do you transact any of your business on the stock exchange?

Mr. POPE. We have to protect our customers if the market for a security is only on the stock exchange. But we make no profits from such transactions.

Senator BROOKHART. How do you mean, to protect your customers? Explain that.

Mr. POPE. Well, if we receive an order to sell securities at the market for a customer, if the market is both on the exchange and off the exchange, it is possible that a bid for the securities would be received first on the exchange. If so the customer should have the advantage of that. We pay a commission the same as any individual would pay for the transaction on the exchange. And we do not charge the customer for that service.

Senator BROOKHART. You sell it for him on the exchange, you mean by that?

Mr. POPE. Yes, sir.

Senator BROOKHART. Without charge, but you sell at what it is bid and not what is asked?

Mr. POPE. Well, whenever a transaction is quoted the highest bid is what receives the securities, if it is acceptable to the seller.

Senator BROOKHART. And a seller would sell at the asked price, I presume, and you would get the best you could for your customer?

Mr. POPE. Yes, sir; the best I can for the customer.

Senator BROOKHART. If you are buying you do it the other way; buy at what is bid?

Mr. POPE. Yes, sir. You become the bidder if you are buying, and you become the seller if you are selling.

Senator BROOKHART. What proportion of your business is that kind of business?

Mr. POPE. As little as possible on the stock exchange.

Senator BROOKHART. What I should like to know, if you can give us some idea of what proportion of it represents that "as little as possible" that you refer to?

Mr. POPE. I can not give you the percentages, but it is a very small proportion.

Senator BROOKHART. It is only occasionally that it happens?

Mr. POPE. It is every day, but with transactions of several billions of dollars a year you can see that several transactions a day might be a very small proportion of a day's business.

Senator FLETCHER. What amendment would you suggest to section 18 of the bill, or do you think it ought to be stricken out entirely?

Mr. POPE. I feel that the section should, as well as the others I have referred to, be deleted at the present time. I can not see how it is possible for this section, or the others, to be included in a bill carrying out the purposes of this bill without affecting detrimentally the present status of the country. Now, in going over it I will say further as to the section——

Senator BROOKHART (interposing). One other matter about deflation: About what was the average level of security values in 1929, before the deflation, as compared to present values?

Mr. POPE. I can not give you that. I suppose it has been determined, but I can not give it to you.

Senator BROOKHART. Is there any way to get that information?

Mr. POPE. I imagine the statistical services have it.

Senator BROOKHART. But you have no idea how much these securities have been deflated since the peak of 1929?

Mr. POPE. I can not give it to you definitely.

Senator BROOKHART. You do not handle stocks at all, but bonds?

Mr. POPE. We handle preferred stocks, and in some cases bank stocks buying and selling.

The CHAIRMAN. Has the shrinkage in bank stocks been greater than the shrinkage in other securities?

Mr. POPE. I am only hazarding a guess, but I shouldn't think there was much difference on the market.

The CHAIRMAN. Do you sell your own bank stock on the market?

Mr. POPE. If anybody asks us for it we try to obtain it.

The CHAIRMAN. What was the peak price of your bank stock?

Mr. POPE. I think something about $200.

The CHAIRMAN. And what is the present quotation on it, or is it a listed stock?

Mr. POPE. It is not listed; no, sir. I can not offhand tell you.

The CHAIRMAN. What are present sales on it?

Mr. POPE. Forty of fifty, I presume.

The CHAIRMAN. Other securities have not suffered as bad as that, have they?

Mr. POPE. Yes, sir; many securities have suffered much more.

Senator BROOKHART. But the average of them is a good deal more than that?

Mr. POPE. I would not attempt to say exactly how much more. There are many that are more.

Senator BROOKHART. Take the National City Bank of New York, and it has suffered a good deal more than yours.

Mr. POPE. I am not offhand familiar with their high or low.

Senator BROOKHART. And the Chase National Bank of New York the same way.

Mr. POPE. I would answer in the same way on that.

Senator GORE. Are you speaking of First National Bank stock?

Mr. POPE. Yes, sir; First National Bank of Boston.

Senator GORE. Is there any other stock that they hold, such as the First National-Old Colony concern, that is on the market?

Mr. POPE. No, sir.

Senator GORE. It is owned entirely by the First National Bank?

Mr. POPE. It is a part of the First National group, also the Old Colony Trust Co.

Senator GORE. Does the First National Bank own all the stock of the First National-Old Colony Corporation?

Mr. POPE. No, sir; it does not own any of it at the present time.

Senator GORE. Is the stock held in the company?

Mr. POPE. It is held by the same stockholders as the First National Bank of Boston.

Senator GORE. That was what I was getting at.

Senator GLASS. Your bank owns the entire capital stock of its affiliate, does it?

Mr. POPE. No, sir; it does not own any of it.

Senator GLASS. It does not own any of it?

Mr. POPE. No, sir.

Senator GLASS. Very well.

The CHAIRMAN. You may proceed with your statement.

Mr. POPE. Further as to section 18 of the bill: This section prevents any member bank from being a correspondent of any other bank or security dealer. That is the interpretation given to that paragraph. Such a provision would practically stop the security and industrial business of the country. It is possible that that is not the intention of the section, but——

Senator GLASS (interposing). What section is that?

Mr. POPE. Section 18. The word "correspondent" used in that section is not defined in law. I am quite naturally taking the general interpretation on the street of the meaning of the term. This appears to mean, however, that no bank could have deposits with any other bank or security dealer as it is worded. I do not know what the intention was. But I assume certainly that the probable intention was that securities could not be delivered in various parts of the country through any bank because security dealers could not have correspondents. Therefore dealers would be prohibited in the matter of using them and it would mean the mechanism of distributing securities throughout the country almost impracticable.

In the matter of section 21, the Investment Bankers Association of America did not feel they are familiar enough with the commercial banking business to pass on it, but they have no objection to the paragraph which permits branch banking. But, as I say, they are not qualified to discuss that subject.

Now, as to section 25: This section restricts the aggregate of all loans to all dealers to 10 per cent of the capital and surplus of banks, and in some cases less to bank affiliates. This reduces the present amount dealers can borrow against Government securities and bankers' acceptances, which would make it difficult for them to properly handle the business.

I will say that this whole section is highly discriminatory as it does not apply to State banks.

This section appears to be intended to divorce all affiliates of national banks within three years. It is not possible for us to determine the exact meaning of that section, but we judge it to mean as stated. If it does——

Senator GORE (interposing). Let me ask you a question right there: You stated that the stockholders in the First National Bank owned the stock in the First National-Old Colony Corporation.

Mr. POPE. No, sir; I said it did not own it.

Senator GLASS. You said the bank did not own it?

Mr. POPE. Yes, sir.

Senator GORE. But you said the stockholders did.

Mr. POPE. Yes, sir.

Senator GORE. Are they at liberty to sell or withdraw that stock?

Mr. POPE. The stock is trusteed for the benefit of the stockholders of the First National Bank.

Senator GORE. Then it is really bound up. If they sell their stock in the First National Bank of Boston they must dispose of their stock in the First National-Old Colony Corporation?

Mr. POPE. I should think you are correct.

Senator GLASS. You say this section would circumscribe the holdings of Government securities by banks 10 per cent.

Mr. POPE. Yes, sir.

Senator GLASS. Have you read this provision? [Reading:]

*Provided*, That loans, collateraled by Government bonds, or by bonds issued by the State in which such bank is situated, or issued by any political subdivision of such State, shall not be included within the foregoing limitations.

Mr. POPE. Without the bill in front of me, I will say that the exception is in the case of affiliates to which I refer.

Now, this section is intending also to divorce, as I have said, the affiliates of national banks within three years. This would mean, of course, the disintegration, probably, of such institutions at once. If it does, it eliminates some of the largest distributors of securities in the country to-day. And in some of the large cities of the country it reduces the distributing power in those cities to a very large extent, to a substantial extent.

Senator BROOKHART. If these large distributors, like yourself, in 1929 kept distributing this stuff at the inflated values, isn't it about time they ought to be eliminated?

Mr. POPE. Well, perhaps you will think I am not answering your questions, but I can only say that the people of the country in a general way buy whatever they want to buy, and if the demand is great for securities from dealers, members of stock exchanges, affiliates of member banks, they would sell such.

Senator BROOKHART. You think, then, that the salesmanship part of it has no effect? You put all of it on the board?

Mr. POPE. I do not think it is all on the board, but I say that is a fact. If they want the securities they will be purchased.

Senator BROOKHART. If these big distributors are not going to find out the honest and reliable course of values so the public can rely on them in the matter of making investments, they might better be abolished entirely than to be used in the way they were used in 1929.

Mr. POPE. Of course you are referring to affiliates as having done that. I can tell you only from the figures of the Investment Bankers' Association of America, but the affiliates are a little less than 25 per cent of the total number of investment banking members.

Senator BROOKHART. Then let us put only 25 per cent of them in it. Did they only handle 25 per cent of the business?

Mr. POPE. I can not tell you.

Senator BROOKHART. Let us only put on them the proportion of the business they handled. If they put out 25 per cent of it, then it is a big item, isn't it? And in being affiliated with the big banks probably they handled more than 25 per cent.

Mr. POPE. Possibly.

Senator TOWNSEND. What effect, if any, would this provision have upon national banks becoming State banks? Would there be a tendency toward a change from national to State banks?

Mr. POPE. Of course, I can not answer for any national bank, but it is the opinion of investment bankers that the important provisions of this bill are so discriminatory that it would certainly necessitate some change of national-bank charters into State-bank charters. But that is only an opinion.

Senator TOWNSEND. Consolidation or the reverse.

Mr. POPE. It would certainly not do the reverse in any circumstances.

Senator GLASS. Mr. Pope, you seem to be in disagreement with the vice chairman of the First National Bank of Boston, Mr. B. W. Trafford, whom we regarded as a man of such experience and good judgment that we called him down here before the subcommittee. I believe that he was in favor of complete separation of national banks and their affiliates.

Mr. POPE. Do you mean when you say complete, by not having interlocking directors?

Senator GLASS. Well, I do not know what he meant. I do not undertake to interpret what he meant.

Mr. POPE. That is what I think he meant.

Senator GLASS. Here is what he said. After agreeing with certain restrictions which we have embodied in this bill, that should be put upon affiliates, he was asked [reading]:

Would you place any further restrictions on them in order to get a more complete separation between the bank and the affiliate?

And then he answered [reading]:

Well, I would try completely to separate them. I would try to have the funds that support the security business segregated from the commercial bank.

Then he was asked [reading]:

How would you do that?

And he answered [reading]:

By putting the stock in the hands of trustees for the benefit of the stockholders of the bank and let the affiliate have its own capital and stand on its own feet.

That is what we have undertaken to do in this bill.

Mr. POPE. I have suggested exactly that, to the best of my ability. I have stated that they should trustee the stock and have the corporation stand on its own feet, and that is exactly what this corporation I have described does.

Senator GLASS. Well, but you not only do not want complete separation, but you want the officers of the bank to be the managers of the affiliate.

Mr. POPE. No, sir. The recommendation by many bank affiliate officers who appeared here I believe from the testimony, if I recall it as given before your subcommittee, recommended that the directors be different; and certainly as far as we are concerned and as far as many others I know of are concerned, the question of interlocking officers is of no degree of importance.

Senator GLASS. In order that it may be in the record and in order to show that the subcommittee had not acted in a whimsical way but has for weeks after weeks gone over these matters with the utmost care and sought the advice of experienced and tested bankers and experts, I want to read into the record what was said by Mr. Broderick, the superintendent of banks in New York, with respect to affiliates [reading]:

With reference to affiliate companies, we are recommending that no officer of any bank be permitted to be an officer of any affiliate or holding company; that the stock of the affiliate or holding company be represented by individual certificates and not coupled in any way with the certificates of the bank.

He recommends also a blanket provision as to the limiting to 10 per cent of the capital stock of a banking institution for all loans

made to a company of its affiliates, investments in stock, and the like, so that the aggregate of all shall not exceed 10 per cent of the capital and surplus of such institutions.

I also at this point want to put in the record the testimony of Mr. Owen D. Young, who I think is a director in the New York Federal Reserve Bank, who said [reading]:

I am clear that the ownership of the security companies and of the bank should be identical.

In other words, I take it that he meant that the bank should be responsible for the operations of the securities company, which is just the contrary to what you said in response to a question from me a while ago, that it had no responsibility in the matter. He said [reading]:

No other kind of affiliate should be permitted. If there is a divided interest then I think it would be better to prohibit affiliates altogether.

And further, Mr. Young insisted that there should be public statements of their condition by affiliates, to which I understand you to object, Mr. Pope.

Mr. POPE. No, sir.

Senator GLASS. Oh, yes.

Mr. POPE. Do you mean in the previous testimony?

Senator GLASS. Yes.

Mr. POPE. If I did, and I think I did say it at that time.

Senator GLASS. Well, that is what I am talking about.

Mr. POPE. I am not objecting to that now.

Senator GLASS. Well, you are making a sweeping objection to this provision, and it requires publicity and examination.

Mr. POPE. Not to-day, Senator. I have stated just the opposite to-day.

Senator GLASS. All right. And I hope to-morrow you will change your mind about some of the other provisions of the bill.

Mr. POPE. That was a technical situation in regard to a public statement or not, which made me change my mind.

Senator GORE. You stated that the officers of the First National Bank of Boston owned stock in the First National-Old Colony Corporation. Will you put in the record the exact reasons why the bank organized this alter ego or double instead of endeavoring to transact the same business itself? Was it because under the law affiliates could do some things a bank could not do, or that the bank could shift the responsibility to the affiliate? Or what was the reason?

Mr. POPE. I can not tell you. The question of the legal matters coming up on consolidations are very difficult to follow. And I was not even in Boston at the time it was done. But I can assure you it was not done for the purpose of evading any law or as a subterfuge. However, I can not tell you the technical legal reason why the exact method was employed.

Senator GORE. You admit it has been employed pretty generally over the country in late years, however?

Mr. POPE. I think there are a great many, not identical though. There are some small differences in each case, but such affiliates do exist.

Senator FLETCHER. What other section do you wish to speak on?

Mr. POPE. I will now come to section 26. This limits the borrowing of an individual or corporation on loans of collateral security to 10 per cent of a member bank's capital and surplus. It thus repeals all exceptions in section 5200 of the Revised Statutes, which section is particularly severe, and I only bring this to your attention, particularly severe on bankers' acceptances. Government bonds, and on industry and agriculture, to the extent that it restricts loans secured by shipping documents.

Section 27 provides for reports of national bank affiliates. In general this report is in accordance with recommendations made at hearings of the subcommittee and as such is in accordance with the opinion of investment bankers. However, the requirements that an affiliate publish its holdings if borrowing over 5 per cent of the parent bank's capital and surplus from any bank or banks is not only against the best interests of the affiliate but is derogatory to the investment market.

It discloses, for example, if the report occurred on the date of issue of securities, it would then undoubtedly show that the entire participation of the affiliate was held by the affiliate. The report going out a few days later would give to the public the impression that the affiliate had been unable to sell those securities; the impression would be that they were not satisfactorily taken by the public, and the public would start to sell them. This would hurt the affiliate and would hurt the bond market.

Senator BROOKHART. Upon that proposition let me ask you: If that is what would happen, isn't the public entitled to know it?

Mr. POPE. No, sir; because it is not a fact.

Senator BROOKHART. It would be if the securities did not move.

Mr. POPE. But I did not say that. I say when they are purchased it may take two or three days for them to be sold, but the payment on them frequently does not occur and usually does not occur for at least 10 days in the case of new issues.

Senator GLASS. After all the committee was not so much interested in the effect upon the public as in the effect upon the bank and the management itself. However, the fact that the bank would be required to do this would operate as a deterrent, wouldn't it, on reckless management?

Mr. POPE. Well, sir, the question would seem to me to be that the publication of a portfolio of an affiliate was no more important than the publication of a portfolio of the bank, the parent institution.

Senator GLASS. Well, that takes us back to the original inquiry, why the affiliate? Why not organize on its own basis and responsibility and conduct the business of investment banker rather than hooking up with a commercial bank, or rather than have a commercial bank institute an affiliate to do what the national bank act prohibited it from doing?

Mr. POPE. Now section 28: This section requires examination of all bank affiliates. This section is in general in conformity with the general feeling among all affiliate officials, and is highly recommended.

I have nothing further to say.

Senator BULKLEY. We have talked quite a little bit about deflation. I should like to inquire if you intend to imply that deflation is a bad thing in itself?

Mr. POPE. Well, sir, it depends upon when you apply deflation as to whether it is good or bad.

Senator BULKLEY. Very well. Will you elaborate a little to show just what you do mean?

Mr. POPE. I mean that I think deflation is bad as we see it to-day because it is excessive and has brought commodity, real estate, and security values to a point probably and in the opinion of myself far below intrinsic values. And when the spirit of the people gets to the point of thinking in terms of deflation, which means pessimism, the only thing to be said is that deflation in such cases is certainly bad. And a certain measure of inflation to stop the deflation appears from the standpoint of economics to be essential.

Senator BULKLEY. When you say that prices are below intrinsic values, what is your measure of intrinsic values?

Mr. POPE. There is no measure. The measure of intrinsic values is a question of judgment, which always makes it difficult.

Senator BULKLEY. When we say that prices are below intrinsic values we can only guess about them?

Mr. POPE. Yes, based on facts.

Senator BULKLEY. What would be your measure, then?

Mr. POPE. Applying the facts to the future.

Senator BULKLEY. Can you tell us just what you mean? How would you apply the facts to the future?

Mr. POPE. The value of anything is what to-morrow it can be sold for presumably. The only measure you have are the facts concerning values to-day. You have to guess what the result will be on those facts to-morrow.

Senator BULKLEY. You said something about intrinsic values, which I take it are distinguishable from market values.

Mr. POPE. Yes, sir.

Senator BULKLEY. And I was trying to get what you meant by intrinsic values.

Mr. POPE. For example, they are based upon this situation. The stock of a corporation might be selling at 10, we will say. The actual liquidating value of that corporation if completely wiped out and liquidated might be 20. Certainly the basis of intrinsic value then would be rather on the basis of liquidating value than on the basis of the market.

Senator BULKLEY. Liquidating value based upon present market for its shares, do you mean?

Mr. POPE. Well, based on your judgment as to what those assets could be sold for; yes, sir, if they are salable assets. It might be cash.

Senator BULKLEY. So that your measure of intrinsic value is the present market value of the sum of all the assets minus whatever liabilities the corporation has.

Mr. POPE. I do not quite follow you there. But I will say——

Senator BULKLEY (interposing). I am trying to trace out what intrinsic value means. I am trying to get your statement fairly into our record.

Mr. POPE. Perhaps I can explain it in this way: Intrinsic value to me means the real value, and not the value based on the market for securities.

Senator BULKLEY. Well then, I will have to ask you: What is the test of real value?

Mr. POPE. It is the real value, rather, based on the facts, which can be determined to prove the value in terms of to-day. If it is cash value it would be exactly the amount of cash.

Senator BULKLEY. Well, if it is something else you have to guess what real value is.

Mr. POPE. After all you might not have to guess because you might have a bid for the assets.

Senator BULKLEY. How is it as distinguished from market value?

Mr. POPE. Market value is entirely based upon the judgment of the public or other folks concerning the market, effected by such as pressure for sale of too great an amount of that security on the market, and other factors.

Senator BULKLEY. Well, Mr. Pope, I am very frank to say that you have not entirely satisfied me as to the distinction between intrinsic or real value and market value. But if we can not arrive at it any better than that I am ready to go on to the next question.

Senator GORE. You admit that there is such a thing as intrinsic value from an economic sense, do you not?

Mr. POPE. I would not dare say what economists would say in regard to that. But it is an expression frequently used and which means something to me.

Senator BARKLEY. If any individual is confronted with a proposition to buy anything at its market value or at its intrinsic value he buys it at the cheaper price, does he not?

Mr. POPE. If a man has information that the intrinsic value is greater than the market value he would presumably be interested in the security at the market value.

Senator BARKLEY. And he would go out and buy it on the market. But he would not pay more for it if he could get it for less.

Mr. POPE. No, sir.

Senator BARKLEY. So that really intrinsic value vanishes in the mind of the man going out to purchase?

Mr. POPE. It vanishes in the mind of the man who is thinking in terms of stock but not of the real value of the property represented by the stock.

Senator BARKLEY. I understand, but when he can get the same thing at two different prices, according to your theory, he is going to buy it at the cheaper price.

Mr. POPE. Intrinsic value has a very definite bearing upon the price of a stock, but it does not control it.

Senator BARKLEY. It probably ought to but it does not always do it, is that it?

Mr. POPE. No, sir.

Senator BULKLEY. Will you please define deflation in the sense that you used the word this morning?

Mr. POPE. Deflation is a pretty broad question to ask me for an answer at the moment.

Senator BULKLEY. I understand, but if you will explain it we will understand your testimony better.

Mr. POPE. It means to me a situation brought about by the selling of commodities, real estate, and securities in excess of demand, so much in excess of demand that it has recently brought about a very drastic drop in all such values.

Senator GLASS. With respect to what commodities? Do you mean a drop not in intrinsic values but a drop from the peak to which these various things were extended or inflated?

Mr. POPE. Any reduction in values I think would be deflation whether it came from a peak or anywhere else. That would be the degree of deflation.

Senator GLASS. Of course it has decreased in the matter of open market value. What I am trying to arrive at is the cause of the deflation. What do you mean by deflation at the present time? Whether it is deflation from the peak of the inflation, from the point of the exaggerated prices induced by the fever of gambling, or do you mean deflation from the more or less stable and normal prices of commodities and securities over a series of years?

Mr. POPE. I mean just in general, and I am not prepared to say that my answer is very carefully thought out. But my impression would be, or rather I mean when prices of things are below the cost of production, that then you have serious deflation. I am not referring to the drop from peak prices.

Senator GLASS. Is that true of anything except commodities?

Mr. POPE. I am not sure that it is, but by being true of commodities it affects all bonds practically.

Senator GLASS. Mr. Chairman, at this point I would ask leave to place in the record a table prepared by one of the outstanding business authorities of this country, whose name I am not right now at liberty to give, but he is associated with one of the greatest business corporations in the country and which statement (if accurate as I have no doubt the figures are) indicates that there has been no deflation whatsoever, but an advance in security prices, that there is to-day an advance over the years 1920 and 1921, and a very material advance, and that credit facilities are, relatively speaking, far greater now than then.

The CHAIRMAN. If there is no objection on the part of the committee, it will be printed in the record.

*Some aspects of growth of United States banking and business, 1920, 1921, and 1931*

[Value unit $1,000,000,000; most data as of June 30]

| | 1920 | 1921 | 1931 | Per cent increase | |
|---|---|---|---|---|---|
| | | | | 1931 from 1920 | 1931 from 1921 |
| Population (1,000,000) | 106.5 | 108.2 | 124.1 | 17 | 11 |
| Wholesale price level (U. S. B. L. S. average for year 1926—100), per cent | 154 | 98 | 71 | −54 | −28 |
| Physical production index (manufacturing and mining) average for year, per cent | 87 | 67 | 81 | −7 | 21 |
| Number of banks | 30,139 | 30,812 | 22,071 | 2 | −27 |
| Total banking resources | $53.1 | $49.7 | $70.2 | 32 | 41 |
| Per capita (dollars) | 499 | 459 | 566 | 13 | 23 |
| Per capita equivalent at 1920 price level | 499 | 721 | 1,228 | 146 | 70 |
| Total loans and discounts | 31.4 | 29.0 | 35.2 | 12 | 21 |
| Per capita (dollars) | 295 | 268 | 284 | −4 | 6 |
| Per capita equivalent at 1920 price level | 295 | 421 | 616 | 109 | 46 |
| Index of loans and discounts per unit of physical production, per cent | 100 | 120 | 121 | 21 | |
| Index equivalent at 1920 price level, per cent | 100 | 188 | 262 | 162 | 39 |
| Total loans and discounts and investments | $42.8 | $40.4 | $55.3 | 29 | 37 |
| Per capita (dollars) | 402 | 373 | 446 | 11 | 19 |
| Per capita at 1920 price level | 402 | 580 | 967 | 140 | 65 |
| Individual deposits | 37.9 | 35.5 | 51.6 | 36 | 45 |
| Per capita (dollars) | 355 | 328 | 416 | 17 | 27 |
| Per capita equivalent at 1920 price level | 355 | 515 | 902 | 154 | 75 |

Senator BROOKHART. In that connection I will say that I have similar information to what Senator Glass has just offered. I should like to insert some tables to show that commodity values are much below what they were.

Senator GLASS. This table shows that.

Senator BROOKHART. It shows commodities and securities, both of them.

Senator GLASS. Not commodities separately, but the commodity level is shown as 28 minus now as compared with 1920–21.

Senator BROOKHART. But securities are higher.

Senator GLASS. Very much.

Senator BROOKHART. Commodities are much lower and securities are much higher. On that proposition I should like to ask Mr. Pope this question: If that is true shouldn't there be some further deflation of these deflated securities? Doesn't that indicate that they are still enormously inflated?

Mr. POPE. No, sir. The cause of the difference is unquestionably due to the fact that in 1921 money was extremely tight and to-day it is extremely easy, and the difference is represented in the value of securities then and now.

The CHAIRMAN. And isn't the commodity market influenced by them?

Mr. POPE. Yes, sir. But the difference between these two prices can to a very large extent be accounted for, if not practically entirely, by the difference in the value of money to-day and then.

The CHAIRMAN. Do you mean that the value of money does not affect securities and commodities alike?

Mr. POPE. To a degree it does, but it is certainly more in the case of securities.

Senator BROOKHART. That is because securities are inflated and have been put on a false basis.

Mr. POPE. No, sir. It is because securities represent investment money, and money is invested according to demand and supply.

Senator BROOKHART. Yes; but let us get back to intrinsic values a little further. As long as there is a demand for a commodity its value is not at the intrinsic value.

Mr. POPE. It might not be.

Senator BROOKHART. Even though there is a demand for its use.

Mr. POPE. Yes, sir.

Senator BROOKHART. It might not have any value at all.

Mr. POPE. It might not.

Senator BROOKHART. Although I can not conceive of that.

Mr. POPE. I can not either, as a matter of judgment, but it is a fact.

Senator BROOKHART. The real intrinsic value that you hinted at a moment ago is cost of production and you would say plus a reasonable profit, or at least you would figure a reasonable profit in the cost of production.

Mr. POPE. I did not say that.

Senator BROOKHART. I know that you did not say that, but you mentioned cost of production in connection with the matter of values a moment ago.

Mr. POPE. I do not recall that, but I may have done it.

Senator BROOKHART. Wouldn't that be as near as you could figure out just the intrinsic value of things?

Mr. POPE. That is a pretty hard thing to say, because you are asking me, we will say, the intrinsic value of potatoes and the question of the value of potatoes is usually based on the question of price. Now, what is the intrinsic value of an article that is to be eaten?

Senator BROOKHART. You drew the distinction yourself between price and intrinsic value, and I think rightly.

Mr. POPE. When I am talking of intrinsic value I mean value not of a commodity but of an industrial concern, or a concern in which there are various parts which are tangible and which have a reason for value.

Senator BROOKHART. You would not call the inflated values of stocks and bonds in 1929 intrinsic values, would you?

Mr. POPE. Will you repeat that question?

Senator BROOKHART. You would not call the high prices, the inflated prices of 1929, before the panic, the intrinsic value of securities, would you?

Mr. POPE. I would say undoubtedly no in view of the results. But I think many people thought they had.

Senator BROOKHART. The fact of the matter is that the way our stock and bond markets are run now these values are just gambling values, what you can get somebody to gamble on, rather than intrinsic value?

Mr. POPE. No, sir; I think in the investment market there is very little gambling. You are confusing it with the trading market, and I am an investment banker.

Senator BROOKHART. Then you think the stock exchanges are mostly for gambling, and the investment bankers are mostly actual investors?

Mr. POPE. No, sir; I do not think so. I do not doubt that the stock exchange can be used as a medium for gambling, but I do say——

Senator BROOKHART (interposing). Are not the most of its transactions merely gambling?

Mr. POPE. I should say decidedly not.

Senator BROOKHART. Then if it sells the same thing over and over again that is not gambling?

Mr. POPE. Of course I would have to guess, because I can not give you figures of any value as to stock exchange transactions, but my impression is that there are thousands of issues of investment securities sold on the stock exchange that have values, and that parties purchasing them make their purchases as investments and are not gambling.

Senator BROOKHART. This gambling as I call it, or whatever you may call it, that takes place on the stock exchange, affects the investments in your investment business, does it not?

Mr. POPE. Yes, sir; very often it does.

Senator BROOKHART. It also affects the price of commodities, does it not?

Mr. POPE. It affects the prices of commodities very indirectly and sometimes directly.

Senator BROOKHART. It puts the prices of securities up and the prices of commodities down.

Mr. POPE. You are getting pretty deep into the reasons for the depression, Senator Brookhart, and I am not capable of answering the question offhand.

Senator GLASS. We have a great variety of opinion. By reference to the files of that New York paper which takes most pride in claiming it is the representative of the vested interests, it will be seen that in 1929 this journal stated textually that operations on the stock exchange for the preceding week had been as much in the nature of gambling as betting on the arrow of the roulette wheel, 90 per cent, it said. Ninety per cent of the operations for the preceding week on the stock exchange had been as much in the nature of gambling as betting on the arrow of a roulette wheel.

Senator BROOKHART. Have you the date of that issue?

Senator GLASS. I think it was around January or February of 1929. If it is desired, I can look up the record and have an extract from the paper put into our hearings.

Senator BROOKHART. If it was true in that week it was more true during all the rest of the weeks up to October of 1929.

The CHAIRMAN. Mr. Pope, or any other representative of the investment group present here in the room, our attention is called to the comparative value of securities, now and previously, and no one has so far in any of our hearings, or at least so far as I know, suggested what difference there may be in the physical value of properties. During the last 10 or 12 years listed stocks have accumulated earnings that have gone into properties, or the other way that earnings sometimes go. We can not get at the value of property by simply noting the market quotation. We have to go deeper into it. I am suggesting to Mr. Pope that before this hearing is over that he or some one of his group furnish us something along that line if he can. If a concern goes ahead and earns 25

per cent from 1920 on and puts it into surplus, they are entitled to a higher value to-day.

Senator BROOKHART. Unless they issued more stock, Mr. Chairman.

Senator GLASS. Again, Mr. Chairman, that it may not be imagined your subcommittee has dealt whimsically or inadequately with these problems, I want to put into the record the view of Mr. Davison, the president of the Central Hanover Bank & Trust Co. of New York, and one of the outstanding bankers of the country, as to the undesirability of commercial banks having affiliates. Mr. Davison at our previous hearing disagreed with the statements several times made here by Mr. Pope, that there should be no legislation in this respect, and he indicated that in his view there should be legislation and that national banks should not be permitted to have affiliates. He points out that they are the subject of very critical abuses and says [reading]:

The Bank of the United States shows what can happen when they are abused. It is a very glaring example, especially when dealing in their own securities.

Then he was asked [reading]:

And there are some other banks that at least might be placed under the same criticism, might they not?

And he answered [reading]:

It has possibilities of abuse and of danger.

It was then pointed out to him that we had in contemplation the requirement of examination and of publicity, to which Mr. Davison responded [reading]:

And a prohibition certainly of dealing in their own stocks.

And he went further. I quote these statements hurriedly taken here. There are many others that were made by experienced and practical bankers before our subcommittee, in order to show that we have not idly thrown together the provisions of this bill.

Senator BROOKHART. In view of that statement I should like to ask why it is, after Senator Glass's subcommittee gave such a thorough investigation of all this, that we are investigating it again now.

Senator GLASS. Well, some gentlemen desired to be heard.

The CHAIRMAN. Some changed their minds, and some disagreed with the amended bill, and some object to being restricted.

Senator GLASS. Mr. Pope, do I get an accurate view of your general criticism of the bill to the effect that you think now is an inopportune time to have any banking legislation at all?

Mr. POPE. I think now is an inopportune time to have any legislation which acts, as I am using the word again, in a manner to increase the present deflation; I mean at this time as this bill does.

Senator GLASS. You have spoken of section 11 of the bill dealing with 15-day paper as deflationary. I take it, then, you would not be willing to see a deflation in stock speculation on the exchange.

Mr. POPE. Do you mean at the moment?

Senator GLASS. There is no stock speculation at the moment to speak of, or at least I think not. We have frightened off the bears, temporarily, and the bulls do not seem to be quite active.

Mr. POPE. You are asking me a question now?

Senator GLASS. Yes.

Mr. POPE. What is it?

Senator GLASS. Isn't the real purpose of this bill, among other things, to avert a repetition of this situation by forbidding people to use the facilities of Federal reserve banks to inflate prices on the stock exchange to almost an inconceivable degree, and then have the whole business of the country collapse in consequence of that sort of speculation? I take it that you think now is an inopportune time to express the view of the Congress, if it should take that view, that we should not permit that sort of thing to occur.

Mr. POPE. It is an inopportune time now.

The CHAIRMAN. The Senator from Virginia (Mr. Glass) will recall that in the spring of 1928 this committee spent a great deal of time on that question, and that we were told then was an inopportune time, and that was a year and a half before this whole thing blew up.

Senator BROOKHART. Is it the purpose of these hearings to prevent any legislation on this subject?

The CHAIRMAN. These hearings were called at the request of leading bankers and business men, who felt that there were things in this bill adverse to their interest, or to the welfare of the country, and so they asked to be heard, and the request for a hearing was granted.

Senator BROOKHART. I take it, then, the primary purpose is to prevent any legislation.

Senator BULKLEY. Mr. Pope, do you mean to imply that prices are now deflated too much?

Mr. POPE. Well, that is a general statement. My impression is to that effect, and I am only conversant with security prices.

Senator BULKLEY. I refer to them.

Mr. POPE. My impression is that security prices are depressed too much, and it is bonds that I am talking about. I am not referring to stocks. I am in the investment banking business and am not interested from a stock standpoint.

Senator BULKLEY. A little while ago you expressed the view that the thing that might have been deflationary a while ago is not deflationary now on the ground that deflation has already happened. If deflation has happened, why can not we go ahead and do the sound thing?

Mr. POPE. Which would be what?

Senator BULKLEY. You were asked about stopping the practice of loans for others, and you said you were satisfied to stop it now because the deflation had already occurred.

Mr. POPE. All right.

Senator BULKLEY. Doesn't that argument apply all along the line?

Mr. POPE. The question of values is not brought out in the question reguarding loans for account of others; I mean so far as they are affected, because loans for account of others were some months ago given up, and therefore the fact——

Senator BULKLEY (interposing). We are free to fix that matter now and do the sound thing, aren't we?

Mr. POPE. Yes, sir.

Senator BULKLEY. Why does not that apply to other things?

Mr. POPE. Because you now, by applying sections of this act which continue to cause deflation, whereas stopping loans for account of others does not continue deflation.

Senator GLASS. How do we continue it any more than a law that has prevailed for 18 years which prohibits the use of Federal reserve bank facilities for investment and stock speculative activities?

Mr. POPE. Because in my opinion the method by which this section implies that would be done by way of punitive or other methods would necessitate the immediate sale of securities and it would cause excessive deflation, extremely dangerous deflation.

Senator GLASS. Of course, we disagree on that interpretation of the law. What you really mean to say is, and have said, as the record will show, that this provision of the law that has been in effect for 18 years has been a dead letter, and now because we propose to make it effective by a penalty you think it ought not to be done.

Mr. POPE. I did not say that either at the outset or since, but I brought out certain points regarding the measure which I disagreed with.

Senator GLASS. You said the law had been inoperative.

Mr. POPE. I said that this particular bill was inadvisable at this time.

Senator GLASS. No; but when I read to you the provision of the existing law, which has been a provision since the Federal reserve act was first enacted, you said it had been inoperative, and that we know.

Mr. POPE. I do not remember saying that.

Senator GLASS. Now, we want to make it operative. And you think it is an inopportune time to make it operative?

Mr. POPE. Yes, sir.

Senator GLASS. It is there but you do not think it should be obeyed, is that the idea?

Mr. POPE. No, sir.

Senator GLASS. Well, you do not think it should be obeyed if you object to our making it operative, do you?

Mr. POPE. If a law is a good law I can not see how anybody could say they would object to its being obeyed. I certainly do not.

Senator GLASS. You said it had been inoperative, and that we know.

Mr. POPE. I do not remember using that expression, saying it was inoperative. I think you said that.

Senator GLASS. Of course I said so, and that is the very purpose of our provision in this bill.

Mr. POPE. I do not know the extent it has been inoperative. That is a commercial banking matter, presumably.

Senator BROOKHART. If it has been inoperative it wouldn't hurt anything to have it enforced now. It would not change the law, but we would make it operative.

Mr. POPE. If it is in the law it is in operation.

Senator BROOKHART. If it is not enforced it would not be.

Mr. POPE. No, sir.

Senator GLASS. Would it hurt anything to provide a penalty?

Mr. POPE. At this time if the penalty would require an excessive sale of securities, to the extent of jeopardizing institutions and others in the market, I think, and have said, it is not a time to so legislate.

Senator GLASS. There is no sentence in that section of the bill that requires a sale of securities.

Mr. POPE. I think many provisions of the bill require the sale of securities.

Senator GLASS. I am talking about the 15-day paper provision.

Mr. POPE. That would, in my opinion, immediately drop the 3¾ per cent 1-year Treasury certificates that were issued a few weeks ago half a point certainly and probably more.

Senator GLASS. That provision of the bill has been suggested since June 17, 1930, and I have not observed that it caused a drop in any Government securities.

Mr. POPE. It is not the law.

Senator GLASS. No; it is not law now.

Senator BULKLEY. You are now referring to the penalty.

Mr. POPE. Yes, sir.

Senator BULKLEY. Would it be a good idea to reduce the rate so as to increase the price of securities?

Mr. POPE. If you reduce the discount rate; yes.

Senator BULKLEY. Then why not discount them free so that we would have a better market for Government securities?

Mr. POPE. Well, the present rates, and I am only familiar with the Federal reserve bank which operates in securities which we have and sell, although I presume it applies in other instances; but that rate, if it is set to-day, applies in the open-market purchase rate.

Senator BULKLEY. I just want to know how far Mr. Pope would go in supporting the market for governments. Would you like to increase the price of them, and instead of emphasizing penalty and rate together, have a premium against borrowing for Government securities; would that be a good way?

Mr. POPE. I wouldn't think the Government's market to-day needed assistance.

Senator BULKLEY. It may a little later on.

Mr. POPE. As far as the operations in governments to-day are concerned, of course nearly everyone who owns a Government bond has seen it depreciate in the last year. But if you mean with artificial means to stimulate supply and demand for bonds, I do not know exactly what provisions you would apply.

Senator BULKLEY. But what artificial means do you refer to?

Mr. POPE. I am not asking any change at all.

Senator BULKLEY. But we are contending with disobedience of the present law as the cause of an artificial situation.

Mr. POPE. Well, I do not think so.

Senator GLASS. Suppose we were to omit the peremptory requirement of 1 per cent increase in loans against Government securities, would you still object to that provision of the act which gives the Federal Reserve Board authority after due warning to suspend a bank from rediscount privileges if it persists in it.

Mr. POPE. It has been stated in the last hearings that it was not a question of preventing a bank from borrowing after due warning that we objected to.

Senator GLASS. Well, you agree to that provision, then, that the Federal Reserve Board may be authorized to suspend a bank from the privileges of the system after it has been warned that it is making excessive loans for stock speculation.

Mr. POPE. Do you know what section that is?

Senator GLASS. Section 11.

Mr. POPE. I said in regard to that that the Investment Bankers' Association of America has no objection to the provisions of this section, which provides that a member bank shall not make any security loans while borrowing from the Federal reserve bank after a warning, but it is opposed to the principle of this bill which indicates that a member bank could not make any collateral loan while so borrowing.

Senator GLASS. Of course, collateral loans there mean stock loans, speculative loans. You think, then, that a member bank should be permitted to extend its speculative loans to any extent it pleases and recoup itself by rediscounting with a Federal reserve bank?

Mr. POPE. Frankly, it seems to me that every time you mention loans you bring in a word that I do not mean to employ in there in my endeavor to answer your question. You employ the word "speculative" and we feel that these are not speculative——

Senator GLASS (interposing). There is not a sentence in this bill which the subcommittee has intended to apply to legitimate investment loans. The whole purpose of it where it relates to collateral loans is well understood and accepted to mean loans on the open stock exchanges. The whole purpose of it is to prevent a repetition of the thing that we witnessed in 1928 and 1929.

Mr. POPE. Well, of course in this term "collateral loans" there are billions of dollars of high-grade bonds which are also applicable to that general statement. It is the general statement that we object to. You include them all.

Senator GLASS. The law itself excludes investment loans from Federal reserve bank rediscounts, and it ought to because it is a commercial banking system we are setting up. It is not an investment banking system. People who want an investment banking system are at liberty to organize one and have organized one. The Federal reserve system is a commercial banking system. Its assets should be liquid. It should be amply able and cheerfully willing at any time to respond to the demands of agriculture, commerce, and industry, and that can not be if it is going into the investment banking business. You know that.

Mr. POPE. Well, sir, I can only say that if, for example, in times of tight money you restrict borrowing against a perfectly legitimate expansion of capital investments in industrial or public utility concerns, that require long-term credit, and if the receptivity of the market should happen at the time of issue to be nonreceptive, it would require the carrying over of the time of the loan of a bank, then as to the legitimate long-term borrowings of such public utility or corporation, you just keep them from borrowing.

Senator GLASS. Under the provisions of this bill, any national bank may gamble its head off if it wants to with its own assets, with the money of its depositors. It is not affected by this bill in doing that, but it is prevented in that circumstance from coming

and recouping itself at a Federal reserve bank in order to expand and exploit that sort of operation. Don't you think that ought to be done?

Mr. POPE. I think, of course, that is a commercial banking matter. I am presenting this situation to you on general terms as an investment banker.

Senator GLASS. But I am asking you now as to that specific provision of the bill. Do you think that a commercial bank, a member bank of the Federal reserve system, should be permitted—and it is not permitted by law now—to have access to the rediscount facilities of the Federal reserve bank for speculative purposes?

Mr. POPE. When you say "speculative purposes" I answer I am not enough familiar with the speculative interests to answer you. If you mean speculative from the pure sense of being bad, why, I think it is right if it is bad. I do not know exactly what speculation means.

Senator GLASS. Do you think we should distinguish in the law between bad and good speculation? Do you think we could do that?

Mr. POPE. If in the matter of investments it is the hope of having a fellow give up his speculation, then I think there is included in the provisions a blocking of the legitimate long-term borrowing of industry.

Senator GLASS. Do people invest for an hour? Do they invest for any period of time that requires them to stand at a ticker and ascertain the state of the market at any 15 or 20 minutes thereafter? Do you call that investing?

Mr. POPE. I wouldn't think that investing; no.

Senator GLASS. Well, I don't think so, either.

Senator BULKLEY. Did you tell us how many members of your association there are?

Mr. POPE. Approximately 500 members. That does not include the additional number of branch offices, but the principal offices.

Senator BULKLEY. The members are institutions and not individuals?

Mr. POPE. They are not individuals—yes, I think there are individuals. They may be either so long as they are qualified under the by-laws of the Investment Bankers' Association of America—partnerships, corporations, affiliates, or individuals.

Senator BULKLEY. They are units in the form that they do business.

Mr. POPE. In the form that they do business, and according to the character of their operations, and the personnel and size of their organization.

Senator BULKLEY. Can you tell us how many of these members are either commercial banks or affiliates of commercial banks?

Mr. POPE. Well, I can not tell you exactly.

Senator BULKLEY. Give it to us approximately.

Mr. POPE. Approximately 110 that are either bank affiliates or commercial or national or member banks or bond departments of banks.

Senator BULKLEY. That is what I mean. About a quarter of them.

Mr. POPE. Yes, sir.

Senator BULKLEY. Could you tell us what that proportion would be as relates to the importance of their business? Would the bank members be more than a quarter based on the amount of business they do?

Mr. POPE. I should think without having any compilation of it that it would be much more.

Senator BULKLEY. More nearly half?

Mr. POPE. I should think it might be possible, because the capitalization of bank affiliates is in many cases larger than others.

Senator BULKLEY. Exactness is not necessary. I only wanted an idea of it.

Mr. POPE. Possibly one-half.

Senator BROOKHART. Are there other institutions outside similar to your organization, or is everybody in your organization who is in this kind of business?

Mr. POPE. Everybody in the association is in the investment-banking business.

Senator BROOKHART. But I mean are there other companies outside that are not in your association?

Mr. POPE. Yes, sir.

Senator BROOKHART. Have you any idea how many of those there are?

Mr. POPE. No, sir; I have not.

Senator GORE. What is the capitalization of the First National Bank and its affiliate?

Mr. POPE. The First National Corporation is capitalized and has a surplus of $25,000,000.

Senator GORE. How much is it capital?

Mr. POPE. It is $16,000,000.

Senator GORE. What is the capitalization of its affiliate?

Mr. POPE. Which one? That is, the First National-Old Colony Corporation is the one I am talking about.

Senator GORE. What is the capitalization of the First National itself?

Senator TOWNSEND. Do you refer to the bank?

Senator GORE. Yes, sir.

Mr. POPE. It seems that I should know definitely, but I can not recall the exact figures. The capital and surplus of the First National Bank of Boston, I think, is approximately $70,000,000.

The CHAIRMAN. Is there any further statement you would like to make, Mr. Pope?

Mr. POPE. No, sir.

The CHAIRMAN. The committee will now stand in recess until 3 o'clock this afternoon, when it will reconvene in the hearing room of the Interstate Commerce Committee on the gallery floor of the Capitol. The first witness at that time will be Harry J. Haas, president of the American Bankers' Association. Is he here?

A VOICE. Yes, sir.

The CHAIRMAN. And we will try to hear Doctor Edwards if we can.

(Thereupon, at 1.10 p. m. Wednesday, March 23, 1932, the committee recessed until 3 o'clock p. m. of the same day.)

AFTERNOON SESSION

Pursuant to the expiration of the noon recess, the committee reconvened at 3 o'clock p. m.

The CHAIRMAN. The committee will come to order. The first witness will be Harry J. Haas, president of the American Bankers' Association.

## STATEMENT OF HARRY J. HAAS, PRESIDENT AMERICAN BANKERS' ASSOCIATION, AND VICE PRESIDENT FIRST NATIONAL BANK, PHILADELPHIA, PA.

The CHAIRMAN. Give your full name and address and official position, Mr. Haas.

Mr. HAAS. Mr. Chairman and gentlemen, I represent the American Bankers' Association, representing 16,000 banks. My name is Harry J. Haas, president of the American Bankers' Association, and vice president First National Bank, Philadelphia, Pa.

The CHAIRMAN. Do any members of the committee want to ask any questions, or let him go ahead and make his statement?

Senator TOWNSEND. Have you a prepared statement, Mr. Haas?

Mr. HAAS. Yes, sir; I have. If I may read just a short statement I have here, Senator.

The CHAIRMAN. You may proceed.

Senator TOWNSEND. You have read the bill?

Mr. HAAS. Yes.

Senator TOWNSEND. And you are familiar with it?

Mr. HAAS. Yes.

Senator TOWNSEND. Are you making comments on the bill, as to how it should be improved or changed?

Mr. HAAS. No, Senator; we have had an analysis made, an analysis has been completed, but we have not had it typed to this moment, but we expect to have it ready this evening.

Senator TOWNSEND. That will include both your criticisms and the constructive side of your argument as well?

Mr. HAAS. Yes; and with your permission we would like to have that put into the record before you finish these hearings, if that is agreeable to you.

The CHAIRMAN. How long a statement is it?

Mr. HAAS. That is a full analysis of the bill.

The CHAIRMAN. If there is no objection——

Senator GLASS (interposing). By whom is it made?

Mr. HAAS. We have all been working on it, Senator; we have all sat around with the interim committee of the American Bankers' Association. We have had some other people working on it.

Senator GLASS. Can you tell us who they are?

Mr. HAAS. We have Mr. Edwards. Mr. Edwards is here to testify this afternoon, from the College of the City of New York. And a Mr. Willard.

Senator COUZENS. Mr. Chairman, I do not think we ought to have that put in the record. I think it ought to be read before the committee, so we can ask questions. I hope that it will be arranged so that the criticism will be read before the committee.

Mr. HAAS. Whatever you wish, Senator.

Senator COUZENS. Is that agreeable, Mr. Chairman?

The CHAIRMAN. Certainly. It will not be printed unless it is unanimously agreed upon by the committee. I share with the Senator from Michigan the view that it had better be read, so that we will know what it is. But you say it is not ready yet; is that it?

Mr. HAAS. No; that is not ready yet, Senator.

The CHAIRMAN. We will be here next week. It can be presented by some members of your committee next week?

Mr. HAAS. Yes.

Senator GLASS. We should have as little duplication as possible. If Mr. Edwards is to appear in person, may he not state his views, and present facts here so that he may be interrogated upon it?

Mr. HAAS. All right, Senator. We thought you might like to have it.

Senator TOWNSEND. Mr. Haas, you are aware under the resolution that the hearings close on Thursday?

Mr. HAAS. Yes; we are aware of that, Senator.

Senator FLETCHER. Did you appear before the subcommittee, Mr. Haas?

Mr. HAAS. No; I have not.

Senator FLETCHER. None of these gentlemen you mentioned were heard by the subcommittee?

Mr. HAAS. They have not been heard.

Senator GLASS. Oh, the President of the American Bankers' Association at that time was heard, and the chairman of the legislative committee at that time was repeatedly invited to be heard. So that we do not want to get the impression in the record that we had a private conference over the matter, and did not give them opportunity to be heard.

Mr. HAAS. What the Senator says is correct, Mr. Chairman.

The CHAIRMAN. Seven volumes of testimony were taken.

Mr. HAAS. That was under a former administration of the American Bankers' Association. Our administration changes the first week in October.

Senator FLETCHER. When did you become president?

Mr. HAAS. The first week in October.

Senator FLETCHER. Of last year?

Mr. HAAS. Of last year; yes.

Senator FLETCHER. I think it would be all right for him to make his statement.

Mr. HAAS. The statement I have is very brief.

The CHAIRMAN. You may proceed.

Mr. HAAS. Thank you.

We have carefully analyzed the provisions of S. 4115, section by section, and after due deliberation the interim committee of the American Bankers' Association has, by resolution, registered its opposition to the bill.

We are of the opinion that it would be a serious mistake to pass a bill at this time, having so many provisions of a deflationary and regulatory nature which would, in our opinion, cause the withdrawal of a considerable number of members of the Federal reserve system. We believe that its effect would be injurious, not only to the member banks, but to the business interest of the country.

There are certain provisions of this bill which directly affect the interests of particular classes of bankers who are members of our association. These special matters will be presented later by representative bankers who will show how certain provisions of this bill affect them.

I wish in my presentation to indicate to you some of the broader aspects of the bill which affect all bankers and also the general public. I will therefore submit the effects of this bill on the following:

1. Federal reserve system.
2. The Treasury of the United States.
3. The member banks.
4. The securities markets.
5. General business.

### FEDERAL RESERVE SYSTEM

One of the fundamental principles of the Federal reserve act was the rejection of the European plan of central banking and the adoption of the American policy of regional or local banking. The act did not set up a single central bank, but, instead, 12 banks, and so gave full recognition to the principle of local independence and decentralization.

The proposed bill in various sections (see sec. 12–A, 11, 8 and 12–g), departs from this regional principle by centralizing powers in the Federal Reserve Board and by impairing the autonomy which each of the 12 Federal reserve banks have so far possessed.

### THE TREASURY OF THE UNITED STATES

The Federal reserve act wisely provided that the reserve system should act as fiscal agent for the Government, and should facilitate the marketing of United States obligations. In the coming years the volume of such Federal financing is bound to be heavy.

The proposed bill would seriously interfere with such Treasury financing, by checking the ready marketing of United States issues. In section 11 the proposed bill places a penalty on the holding of such securities by member banks which are the most important buyers of United States bonds.

### MEMBER BANKS

We, as bankers, fully realize that our business is quasi public in nature and therefore Government supervision is necessary. For this reason, Congress in the past has developed the national bank act and the Federal reserve act, with its numerous amendments, but all this legislation has accepted the fundamental principle that final responsibility for bank management and bank policy rests with the individual banker himself.

The proposed bill transfers some of this responsibility to the Federal Reserve Board at Washington. We are of the opinion that such banking powers were not intended, under the Federal reserve act, to be conferred on the Federal Reserve Board, but that the board was intended to be an organization to exercise supervisory powers and not to control banking operations.

SECURITIES MARKET

There have been four outstanding national movements inaugurated by a nonpartisan movement which were intended to arrest the progress of extreme deflation and to stabilize conditions. We refer to the organization of the National Credit Corporation and the citizens' reconstruction organization. Also the passage by Congress of the Reconstruction Finance Corporation bill, and the Glass-Steagall bill. We are fearful that the proposed bill will, to a large extent, nullify these efforts by causing a further liquidation of securities which would decrease their market value at a time when the owners are not able to withstand further losses.

Senator BLAINE. Mr. Chairman, is there any objection to interrupting there?

The CHAIRMAN. I would just ask—would you rather finish the statement first?

Mr. HAAS. As you please, Senator.

The CHAIRMAN. Go ahead and ask the question.

Senator BLAINE. What I was interested in was not an academic discussion of this whole field, because that has been covered by Senator Glass.

Mr. HAAS. Yes.

Senator BLAINE. But with respect to the specific thing you have just read, will you point out what is in the bill that you fear will do the thing that you fear will be done?

Mr. HAAS. This particular point I had in mind is section 15. I spoke to Doctor Willis about it, and he has corrected me on a matter here in section 15 on page 36, the ratio of " 15 per cent of the amount of the capital stock of such association actually paid in and unimpaired and 25 per cent of its unimpaired surplus fund."

I had in mind that it referred to the aggregate securities which a bank might hold in its portfolio, but the doctor corrected me on that—and I think the people generally believed that. That is the reason I quoted it, because I understood it in that way, and perhaps the wording of it might be more explicit if it referred to only one security, and I am now told that that is what it means.

Senator BROOKHART. The governments, you mean?

Mr. HAAS. No, outside of governments; other securities.

Senator GLASS. No; " governments " are expressly excluded.

Mr. HAAS. Are excluded; yes. [Reading:]

The business of purchasing and selling investment securities shall hereafter be limited to purchasing and selling such securities without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and no such association shall underwrite any issue of securities; except that any such association may purchase and hold for its own account investment securities to such an amount and of such kind as may be by regulation prescribed by the Comptroller of the Currency, but in no event shall the total amount of such investment securities of any one obligor or maker held by such association exceed 10 per centum of the total amount of such issue outstanding, nor shall the total amount of the securities so purchased and held for its own account at any time exceed 15 per centum of the amount of the capital stock of such association actually paid in and unimpaired and 25 per centum of its unimpaired surplus fund.

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I think people generally think that that means the total amount of securities which they hold.

Senator FLETCHER. It says distinctly.

Senator GLASS. "One obligor."

Senator FLETCHER. "Total amount of such investment securities of one obligor or maker."

Mr. HAAS. That referred to the 15 and 25 per cent.

Senator FLETCHER. I do not know if there is any other provision in there——

Senator GLASS (interposing). I may say to Mr. Haas that I was interrogated on that point by one of the New York newspapers immediately after the first print of the bill came out, and I gave out a statement in which I undertook to point out that it referred to any one obligator. I am rather surprised to be told that people generally think it means something different.

Mr. HAAS. I am expressing, Senator, the views that we had in our meeting, and I do not think any of us really got that point until I talked to Doctor Willis about it to-day.

Senator GLASS. That is not our fault.

Mr. HAAS. No; that is not your fault. I am perfectly willing to change that on the information which I have gotten here.

The Reconstruction Finance Corporation seeks to enable banks to carry investments which are sound but temporarily unmarketable except at a substantial loss.

Senator BULKLEY. That would not be applicable.

Mr. HAAS. That would not be applicable. I am very glad to have that straightened out, Senator.

Senator GLASS. You ought to be given an opportunity to rewrite that statement.

Mr. HAAS. I will be glad to eliminate that, Senator.

Recent national movements have recognized that business recovery can not come about through decreasing the value of investments and commodities, but rather by stabilizing the prices of investments and commodities at somewhere near their real value. This desired condition can not be brought about by reducing the volume of credit, but rather by increasing the amount of available credit.

The Glass-Steagall bill very wisely provided for the release of approximately seven hundred million in gold to secure Federal reserve notes. The enactment of this bill would have just the opposite effect and cause an increase of approximately $227,500,000 in gold reserve through the increase in reserve requirements against time deposits.

I am told that that figure—the sum is quite different, but I have quoted it. I took my figures from a statement which I saw of the amount of deposits affected, and figured 7 per cent on those deposits, and the 35 per cent gold reserve, and got this figure. Their figure is somewhat higher, I think over a hundred millions a year, one hundred and twenty-five millions a year for the year, I believe.

Senator GLASS. Our figures based on one set of estimates were seventy millions a year.

Senator BULKLEY. What did you say it should be?

Mr. HAAS. My figure was made up from the figures which I saw in a newspaper article, the effect of the deposits and the amount of

reserve that would be increased from the savings reserve to the commercial reserve, and figured the gold back of it, the gold back of the deposits with the Federal reserve bank. In other words, as you increase the reserve fund deposits, the only reserve we have now is the reserve carried at the Federal reserve bank, and if the Federal reserve banks deposits increase, their deposits increase, and they have to carry 35 per cent gold, and this 35 per cent gold is represented by my figures $227,500,000.

Senator GLASS. That is not necessarily gold. They can carry 35 per cent lawful money. It does not involve any intrenchment upon the free gold. The whole matter can be adjusted by rediscounts.

Mr. HAAS. But it does increase the deposits of the Federal reserve bank to that extent, that the member banks have to carry additional reserve, and the Federal reserve bank must carry its reserve against it.

Senator BROOKHART. Suppose of those reserves the surpluses were deposited in some other bank instead of the Federal reserve bank; would it not have the same effect?

Mr. HAAS. Well, you would be multiplying the deposits. You would carry reserve. If they deposit with another bank. That bank would have to carry the reserve.

Senator BROOKHART. You say they deposit in a Federal reserve, and that it increases their reserve they must carry. But if you redeposit in a New York bank, would that not have the same effect up there?

Mr. HAAS. Yes; just pass it on.

Senator BROOKHART. So that is just as broad as it is long.

Mr. HAAS. Yes; but if we carry——

Senator BROOKHART. If you kept it in your own bank, it would make your own reserve that much bigger, would it not?

Mr. HAAS. In case we pass it on to another bank, Senator, we would deduct it from our gross deposits before calculating reserves. You see, the net deposits is the figure that is calculated.

Senator BROOKHART. Yes; but if you deduct it, they add it in.

Mr. HAAS. They would have to add it to their deposits, but we could deduct it from our gross deposits before calculating our reserves. If the bank is a member of the Federal reserve bank system, they would have to carry a reserve on it. That is, the Federal reserve bank would have to carry gold or legal against it.

Senator GLASS. The very simple meaning of this reserve provision of the bill, as I stated this morning, is that every time we have undertaken to adjust reserve requirements of the banks we have been confronted with hostile comments, as my colleague, Senator Bulkley, will recall, because to him was confided the reserve section of the original Federal reserve act. We were told at that time that it was impossible to make the proposed readjustments within a 3-year period. As a matter of fact, the first adjustment was made, as I recall, in 11 months. We were told at the time that the banks had not the resources to comply with the law within three years, and they complied with it in much less time. We reduced the reserves from around 25 per cent to 18, and then to 13 per cent, releasing an immense amount of credit for investment banking purposes.

Then not so very long ago we reduced the reserves behind time deposits to 3 per cent, and the testimony and information secured by a subcommittee all is to the effect that at least 80 per cent of the banks of the country have engaged in the practice of so manipulating their demand and time deposit accounts as to take advantage of this low reserve until the average reserve at the banks is ridiculously too small.

Mr. HAAS. Senator, may I say—speaking for my own bank and my own experience in the bank, we have never——

Senator GLASS (interposing). Just let me finish that right there. Now, then, what we are proposing here is not anything of a revolutionary nature. We are simply proposing to restore——

Mr. HAAS (interposing). I know what you mean.

Senator GLASS. Behind time deposits the reserve that was required until very recently, in order that this manipulation of reserves shall not longer be resorted to. And we do not do it immediately; we do it over a period of five years. We give the banks five years in which gradually to readjust themselves to this situation.

Mr. HAAS. Senator, I have in mind a report of the committee appointed by the Federal Reserve Board to endeavor to find a scientific reserve on the activities of the account, and not on the amount of the balance, and I am just wondering whether you have given that any consideration.

Senator BULKLEY. Do you like that?

Mr. HAAS. I think it is all right, Senator. I think that the bank that has the active deposits and the bank that has the big turnover, certainly should carry a larger reserve than the bank that does not have the turnover. Doesn't that sound sensible and reasonable?

Senator BULKLEY. That is what I think; yes.

Senator GLASS. I think that, and our committee thought that.

Now, let me ask you one practical question: That proposition is revolutionary, is it not?

Mr. HAAS. Yes.

Senator GLASS. Suppose we were to undertake now to embody it in this bill. What do you think would happen?

Mr. HAAS. It would be a campaign of education.

Senator GLASS. There would be a campaign against this bill—isn't that a fact?

Mr. HAAS. I think it would be a campaign of education.

Senator GLASS. I say——

Mr. HAAS (interposing). I think you have an argument there. I think you can go right before the public and you can educate them to the activity of the account as a scientific means of carrying this reserve.

Senator GLASS. You do not require any education to follow this readjusting of the reserves here?

Mr. HAAS. No; they are accustomed to them.

Senator GLASS. We maintain the existing form, and we simply restore the reserve to avert a continuance of this manipulation, and there is not a country banker in the United States to-day that cannot understand this instantly.

Mr. HAAS. They understand this method; that is right.

Senator GLASS. Now, suppose we introduce into this bill this revolutionary theory of velocity reserves. Do you think it would be instantly and cheerfully accepted by the banks of the country? Already the New York banks have bitterly protested against it?

Mr. HAAS. Senator, I will answer your question in this way: I will remind you of something that happened a good many years ago, probably you remember when you were Secretary of the Treasury, when you were discussing the Liberty loans, and Mr. Crosby said, "I wonder if Tiffany would understand this. I wonder if Tiffany will understand this." Finally, Mr. Warburg said, "What has Tiffany got to do with this? He is a jeweler in New York." Mr. Crosby said, "No, not my Tiffany. My Tiffany is a country banker, and if he understood it, I am sure everybody on the committee would understand that." Do you remember that?

Senator GLASS. Yes. Don't you wonder whether the average country banker will understand your proposed velocity theory? I am not dissenting from it.

Mr. HAAS. Yes; I think it would be a campaign of education. This is the easiest thing to understand.

Senator GLASS. I know, but we haven't got time to carry on a campaign of legislation before Congress with a very short while of this session.

Mr. HAAS. Senator, it would be consistent with my position, because I am urging delay.

Senator GLASS. You do not want any legislation now, do you?

Mr. HAAS. It would be consistent with my position.

Senator GORE. I would like to ask a question there, because I want to get educated myself. Do some of the banks now favor this velocity theory?

Mr. HAAS. I think some of them do, some of the larger ones, except this one thing, Senator: I do not think it would be fair to figure in that velocity reserve disbursement checks. For instance, we have several large corporations, and probably the day before the close of the month they bring us a large check, and then they check out their dividend checks, and they come in straggling along, many of them come in in about two days, but some of them are outstanding a longer time.

If you exempt those disbursement checks, I think it is perfectly fair. I think it is right that a bank having a heavy turnover, should carry reserve according to the turnover. But I would not consider that a turnover.

Senator GORE. Just one other question: Would it be feasible to apply this theory to the bank who desired it, or is it necessary to have a uniform system?

Mr. HAAS. I think you would have to have a uniform system.

Senator GORE. I was going to ask whether you would not prefer the Federal Reserve Board or the Comptroller to have the power to use discretion there.

Mr. HAAS. Well, I think there is something in that, Senator. Surely there is an idea; yes. Certainly the city banks, having a large turnover, would be more familiar with that, but you would have to educate the country banks.

Senator GLASS. And yet the New York banks came out instantly against it as soon as it was proposed.

Mr. HAAS. If you made disbursements——

Senator GLASS (interposing). You know, we embodied it in one print of the bill. We embodied it in one print of the bill, and gave a period of five years to establish it, and we finally concluded that some of us need not bother with what is going to happen five years from now. Some of us will not be here then.

Mr. HAAS. I hope so. [Laughter.]

Senator GLASS. And therefore we struck it out.

Mr. HAAS. May I just correct a remark of Senator Bulkley through you?

The CHAIRMAN. Go ahead.

Mr. HAAS. You are quite familiar with this reserve. What would you think of eliminating disbursement checks if you should adopt the activity reserve?

Senator BULKLEY. I have not heard the suggestion before. It strikes me favorably. I would like to consider it a little more.

Mr. HAAS. It hardly seems fair.

Senator BULKLEY. I see your point.

Mr. HAAS. That is not a turnover; that is a temporary disbursement, and when those dividend checks are deposited by the customer and he checks against that, then it does represent a business transaction.

Senator BULKLEY. Yes; I see the distinction.

Senator GLASS. My reaction to that is just this: You note this point of objection in this intricate, technical proposition; some other banker will note another point, and some other banker still another, and interminably so. Therefore, it has seemed to the subcommittee that we had better adhere to the simple form and put a stop to this manipulation of deposits. Five years from now you may prevail. Go ahead, sir.

Mr. HAAS. It is quite possible that under the provisions of this bill, commercial business not entitled to bank credits on its single-named note might not be able to get accommodation on good marketable securities, if its depository bank had already reached the limit of Federal loans as provided by this bill.

I have in mind, Senator, in our city, a very large substantial bank or banks. They are members of the Federal reserve system really as a patriotic duty. They do not do a commercial business. They loan on collateral practically entirely, and if there is a limit fixed on their collateral loans by the Federal Reserve Board, and a customer of their bank comes in and wants some money on good marketable collateral and they are up to their limit as fixed by the board, they would be really subject to criticism from their board of directors and their officers about belonging to the Federal reserve system. They do not have commercial paper. I think one of them, with total deposits of around a hundred million dollars, has about $1,000,000 in paper. They do not separate their classification of loans, but I do know the nature of their business, and it is practically all collateral business.

Senator GLASS. That seems to be an exceptional case. Upon the official report of the extent of banking operations of the Federal

reserve system, I gave the figures for the whole country, showing that the member banks of the system at that time had eight and a half billion dollars of usable paper and were discounting to the extent of less than half a billion.

Mr. HAAS. Senator, probably the reason for that is that it is so much more convenient——

Senator GLASS (interposing). I am not talking about the reason for not rediscounting; I am saying that according to this official report there was an abundance of eligible paper, and in conversation with this very official night before last, he still insists that there is an abundance of eligible paper generally.

Mr. HAAS. Of course, there may be a bank here and there that is not supplied with eligible paper, and that deficiency may arise from various causes.

Senator FLETCHER. What percentage would you suggest, Mr. Haas?

Mr. HAAS. Beg pardon?

Senator FLETCHER. What percentage would you suggest?

Mr. HAAS. Senator, I do not know, really. I think the bank must govern its business according to its needs, as long as they are legitimate needs and they are legitimate customers. These banks that I have in mind, that is their legitimate business, and their customer wants to borrow and he has good collateral, and they are in shape to loan it to him; they certainly want to make him the loan.

Now, take our case, a commercial bank of our nature, our own securities and our own collateral loans will fluctuate with seasonal requirements. If business is active, we have more customers' notes in the making that can be used at the Federal reserve bank. If business is quiet, we do not have the making of those notes, and naturally we have to use our money some way in order to get a revenue out of it, and we make the investments that we can make at that time, but those investments go down——

Senator GLASS (interposing). Have you any reason to suppose that the Federal Reserve Board would not administer the provisions of the law with good banking judgment?

Mr. HAAS. I have no reason to think that they——

Senator GLASS (interposing). It is left within the discretion of the board to make these adjustments.

Mr. HAAS. Except that it does centralize authority. If it centralizes authority I think it would be more in keeping with your establishment of the Federal Reserve System with 12 banks in place of a central bank, without doing a central bank business.

Senator GLASS. The Federal Reserve Board was established here at Washington expressly for the purpose of supervisory control of the Federal reserve banking system. It is an altruistic board, no member of which is permitted to have any banking interest whatsoever, and the theory was that it would be a board composed of experienced, discerning, disinterested persons, who would administer the banking system in a practical and a fair way to all the member banks of the system, and what I am asking now is, if you have any reason to suppose, this matter being left to the discretion of the Federal Reserve Board, that it would not fix a percentage that would enable every bank within reason to operate in this particular matter?

Mr. HAAS. Senator, I have no reason, except this, that the Federal Reserve Board is an appointive board, and the boards of the 12 Federal reserve banks are largely elective. Somehow, I lean to an elective board, rather than to an appointive board for the regulation.

Now, I assume that when it says the Federal Reserve Board shall fix a percentage of the maximum loan on collateral they mean not in excess of a hundred per cent. I may be wrong. There is nothing in there to give me a cue about that. I may be wrong, but I am assuming that it is a hundred per cent that they may loan on collateral, and that in a number of banks that I know about, it would be a very unfortunate thing.

Senator GLASS. Would it not be a very unfortunate thing for the depositors in some banks if the hundred per cent should be exceeded?

Mr. HAAS. Well, I would not say any well-managed bank, Senator, that it would be——

Senator GLASS (interposing). Oh.

Mr. HAAS. Any difficulty.

Senator GLASS. Have you come to the conclusion that all banks are well managed?

Senator BULKLEY. I think it is perfectly clear that that is not limited to a hundred per cent. In fact, in one draft of the bill that we had, some words were in there that I think should have stayed to make that clear.

Mr. HAAS. What was it in there for?

Senator BULKLEY. Simply put in there whether a hundred per cent or more, whether more or less than than a hundred per cent.

Mr. HAAS. More or less?

Senator BULKLEY. Yes.

Mr. HAAS. Well, if it were more or less——

Senator GLASS (interposing). These words were stricken out because we assumed that is what was meant.

Senator BULKLEY. I think it is meant, but I think you wrote those words in there to make it clear. Mr. Haas has developed my thought for me by misunderstanding it again.

Mr. HAAS. It says a percentage of the capital or surplus. You naturally assume that it is restricted——

Senator BULKLEY (interposing). I find a good many do assume that, and that is the reason that those other words should be in there, but it certainly is not the intent of the language to confine it to a hundred per cent.

Mr. HAAS. I have but very little more, Mr. Chairman, if I may read it.

We believe that the ground work has been laid for an improvement in business.

Many large business concerns have mapped out plans for the expenditure of large sums in the employment of labor and the purchase of materials, but we sincerely believe that their plans will be interrupted or held in abeyance should they be fearful of legislation affecting their business adversely.

We believe that the enactment of this bill making sweeping changes in the National Bank act; the Federal reserve act; concentrating additional powers in the Federal Reserve Board; and in the Federal reserve banks, and the control provided for the adminis-

tration of member banks, would be most harmful to the Federal reserve system, member banks, and to business in general at this particular time.

The CHAIRMAN. Is that all?

Mr. HAAS. That is all

Senator BROOKHART. You mentioned something about some securities being restricted or reduced by this bill. Can you give us any specific lines?

Mr. HAAS. That is the part that we are going to delete, Senator, the 15 and 25 per cent. It refers, as I understand it now, to one issue, and not the entire holdings of the banks. I do not recall any other section.

Senator BROOKHART. You think that is a high enough percentage of any one issue?

Mr. HAAS. For one issue?

Senator BROOKHART. Yes.

Mr. HAAS. Well, in my banking experience I have not handled anything quite as large as that. We are rather modest.

Senator BROOKHART. What I meant is, notwithstanding that correction in the meaning of it, you have still said in conclusion that it is going to hamper certain business and employment of labor. You did not say anything about the price of farm products, whether it would reduce them any lower or not. I would like to know now what these lines are that it is going to interfere with.

Mr. HAAS. The lines of credit?

Senator BROOKHART. Yes.

Mr. HAAS. Senator, we tried to codify the Pennsylvania bank laws, and we tried to make restriction in the Pennsylvania bank laws, and we just could not get it over in Pennsylvania; we just could not do it. We had some institutions that handled whole issues, and they said they could not do it, and would not ride along.

Senator BROOKHART. Do you remember a particular line that was developed because of that situation?

Mr. HAAS. The line of business?

Senator BROOKHART. Yes .

Mr. HAAS. In these particular cases they did handle them. They handled them and sold them, and they are perfectly good securities. The one I had in mind was a very excellent steel company. No reason why they should not handle those securities. The public bought them.

Senator BROOKHART. And then they have depreciated like all other securities since?

Mr. HAAS. I suppose so.

Senator GLASS. Did you ever hear of a security that was not perfectly good, that somebody wanted to borrow money on it?

Mr. HAAS. Yes; technically, Senator, I have seen a lot of them, but we did not take them.

Senator GLASS. Practically you have seen more than you have seen technically; at least, some banks have.

Senator BROOKHART. We have had a good deal of evidence and testimony that there has been an overdevelopment, not only in railroad equipment, but in manufacturing and other lines. That means

that there have been a lot of issues put out that never ought to have been put out.

Mr. HAAS. Yes.

Senator BROOKHART. Don't you think that is the situation?

Mr. HAAS. Well, I can not imagine that any reputable house would knowingly and willingly put out anything that did not have fair prospects. Something might happen later on that would change the picture, as it does happen.

Senator BROOKHART. You as a banker advise your clients about buying stocks and bonds from time to time, do you not?

Mr. HAAS. Well, let me say this, Senator: Many times they come in and ask you for your opinion, and they do not want your opinion at all; they just want you to agree with them.

Senator BROOKHART. And you agree with them, do you, as a matter of course?

Mr. HAAS. I do not.

Senator GLASS. Unhappily, some bankers do.

Mr. HAAS. I do not.

Senator BROOKHART. In 1929 you would advise the buying of those stocks and bonds at those high prices, would you not, before the panic?

Mr. HAAS. Senator, I do not know anyone that I advised at that time to buy any securities.

Senator BROOKHART. Did you warn them that a panic was ahead and that they were overinflated?

Mr. HAAS. I did not say on such and such a day there was going to be a panic or anything of that sort.

Senator BROOKHART. Well, you did not say there would be at any time, did you?

Mr. HAAS. But there are a lot of people that we advised to lighten their loads.

Senator BROOKHART. You know that everything practically was overinflated at that time, do you not—or did you see that?

Mr. HAAS. There are enough statistical services that pointed that out, but you know the——

Senator BROOKHART (interposing). Most of the statistical services said that we had reached a new economic era, a new economic level, and most of the financial experts sized it up that way, did they not?

Mr. HAAS. Yes; they said with our Federal reserve system we were never going to allow a panic like we had before.

Senator GLASS. Well, you never have?

Mr. HAAS. No money panic.

Senator GLASS. Oh, well, then. The reserve system did not undertake to guarantee good bank management to prevent the failure of banks that engaged in wild speculation.

Senator BROOKHART. Wasn't this enormous inflation due to the advice of the banks and investment companies for the marketing of those inflated securities?

Mr. HAAS. I would not want to say, Senator. I would not want to go on record as making that statement.

Senator BROOKHART. You do not want the banks to take their share of the blame, then, for that?

Mr. HAAS. I think anybody who made a mistake ought to take a share of the blame, but I would not want to make a broad statement of that kind.

Senator BROOKHART. Further, are not those values still inflated? Are they not still too high?

Mr. HAAS. I do not want to be a prophet or the son of a prophet and say what is going to happen to these securities.

Senator BROOKHART. If they are some 40 per cent above 1914 and commodity prices are below, there is still something out of joint, is there not?

Mr. HAAS. There is quite an economic question there that is quite a difficult question to answer.

Senator COUZENS. Has that anything to do with this bill that we have before us, Senator?

Senator BROOKHART. I do not know whether it has or not, and I do not know whether any of these questions have.

Mr. HAAS. The suggestion has been made to me regarding page 43, section—oh, this is a different one. [After a pause:] Mr. Chairman, it has been suggested to me that on line 18, page 36, of the March reprint of the act, after the word "securities" there be added, "of any one obligor."

Senator GLASS. What section?

Mr. HAAS. This is section 15, Senator, on page 36 of the March issue, line 18.

The amount of the securities so purchased—the amount of the securities of any one obligor so purchased and held for its own account at any one time exceed 15 per cent of the amount of the capital.

The CHAIRMAN. Mr. Haas, it is possible you have the older print.

Mr. HAAS. I have; yes, sir. In the latest print, it is line 15, page 36.

Senator FLETCHER. Line 15, after the word "securities," "of any one obligor."

Mr. HAAS. That is line 15, "the amount of the securities of any one obligor so purchased and held for its own account." That is a little more enlightening.

Senator GLASS. Well, that is what it means.

Senator BROOKHART. If that is put in, do you still insist, as you did in the conclusion of the statement, that it is going to restrict business and injure the production and development?

Mr. HAAS. The amount of any one obligor?

Senator BROOKHART. Yes.

Mr. HAAS. I have not given enough consideration, Senator, to just how much they ought to loan. Personally, I want to keep pretty close to shore on the amount that I would want to loan to any one obligor.

Senator GLASS. How can it depress business, or have any effect upon existing holdings, when the bill states explicitly that hereafter this may happen?

Mr. HAAS. Speaking of the "one obligor"?

Senator GLASS. No; not of the one obligor.

Mr. HAAS. Or of the whole bill?

Senator GLASS. You say this thing would depress business and cause banks to unload their securities on the market at a loss. It does not require that at all. It says, "Hereafter."

Mr. HAAS. Where is that?

Senator GLASS. "The business of purchasing and selling investment securities shall hereafter be limited to purchasing and selling such securities."

Senator COUZENS. At the top of page 6, line 3.

Mr. HAAS. What I have in mind is this: It says "hereafter." But a business is growing, and how are they going to regulate the future volume of their business, by a new restriction, or by the old system? If they are just a stationary——

Senator GLASS (interposing). If that bill becomes a law, they regulate their banking activities by the requirements of this act.

Mr. HAAS. If their business was stationary, and they had this ratio all right, but their business probably is going to grow and develop; I am speaking of collateral loans, now, Senator.

Senator COUZENS. Is there any difficulty in dividing up the business between different banking interests, if what you say would be the case?

Mr. HAAS. No.

Senator COUZENS. Why is this such an obstacle?

Mr. HAAS. I do not say it is, Senator. I really haven't any definite percentage in mind.

Senator COUZENS. That is what I understood you said, that this bill was an obstacle. I do not see any objection, if business expands in the future, to dividing up the business between several banking institutions, and still live within the law.

Mr. HAAS. I probably did not make myself clear on that. My thought is this, that a bill of this kind that makes so many changes in the bank act and in the Federal reserve act and shifts additional powers to the Federal Reserve Board and additional powers to the Federal reserve bank and more detailed regulation of the Federal bank, would be most unfortunate at a time like this, when business is trying to get under way. There are certain plans, large plans, of large organizations that are willing to spend considerable money to endeavor to build up business, and start the wheels going.

Senator BULKLEY. Will you name some one plan as an example that you think will be interfered with by this bill?

Mr. HAAS. Well, I might say that certain lines would feel uncertain about the future.

Senator BULKLEY. What one would be?

Mr. HAAS. I might say the automotive business. I am just throwing that up in the air.

Senator COUZENS. That is where it is already.

Mr. HAAS. I saw an editorial this morning in a Washington paper which mentioned——

Senator COUZENS (interposing). Which said, "Kill the bill."

Mr. HAAS. That the automotive industry had certain plans to progress.

Senator COUZENS. Yes; but I think that they are well within their facilities, though.

Senator BLAINE. I might say that there is always danger of quoting an editorial from the Washington Post.

Mr. HAAS. Yes; well, I was not initiated.

Senator BULKLEY. Did that really make an impression on your mind, Mr. Haas?

Mr. HAAS. I read it, yes; but I had a report of the automotive industry before that.

Senator BULKLEY. Will you tell us just how this would disturb the automotive industry?

Mr. HAAS. I think any industry that contemplates spending a lot of money for development and trying to sell their product, would want to see stable conditions.

Senator BULKLEY. You do not think this bill tends toward stabilizing conditions?

Mr. HAAS. I would not think right now. I think it disturbs them. We have had a terrific wallop over this period of the mental attitude of people.

Senator BULKLEY. You think any effort to avoid a recurrence of it would be disheartening?

Mr. HAAS. No; I would not say any effort to avoid a repetition of it.

Senator COUZENS. What would you suggest to avoid it, then?

Mr. HAAS. A repetition of——

Senator COUZENS. A repetition of what Senator Bulkley is talking about. If you do not want this, what do you suggest?

Mr. HAAS. I would say if we were given a rest for a while, it would help a lot.

Senator GLASS. Do nothing?

Mr. HAAS. We have had the National Credit Corporation, which temporarily had a very fine effect on the banks. It stopped bank failures for a while, and then they started in again.

Senator GORE. Which do you refer to now, this voluntary——

Mr. HAAS (interposing). The National Credit Corporation. That was the 1st of October last.

Senator GORE. How long did it stop those suspensions?

Mr. HAAS. I do not just recall, but immediately there was a reduction in the number of bank failures. I do not have the figures.

Senator GLASS. I would be glad to have you point out any single, solitary provision of the Federal reserve act as it exists in this bill, that would discourage General Motors or any other industrial enterprise, or any other commercial or agricultural enterprise from doing business. I have had the conception that the Federal reserve act as it exists, and particularly under this bill, as an addendum to it, offers every safe, and almost every conceivable, opportunity to business. Business paper may be rediscounted without any limitation.

Mr. HAAS. Well, perhaps people in a different period, where their mind was more at ease and more at rest and had not gone through an experience like they have gone through in the last couple of years, might look at things more calmly.

Senator GLASS. We want to avoid a repetition of that experience. That is what we are trying to do.

Senator BARKLEY. When is the best time to treat a patient, when he is sick, or wait till he gets well again?

Mr. HAAS. It all depends on whether you want to operate, or give him medicine.

Senator BARKLEY. Regardless of whether it is an operation, or whether it is a medical treatment, you know that old couplet about "When the devil is sick he is a saint; and when the devil is well, he is a devil."

Mr. HAAS. No; I had forgotten about that.

Senator BARKLEY. If we wait until we get back to our prosperous times, we will forget all about this, and we will not want to do anything because it will put us back where we are now. So when do we want to operate?

Mr. HAAS. Well, I say it would be an ideal situation if we could level the peaks of prosperity and fill up the valleys of depression, but I do not know the saint that could do it.

Senator GLASS. We are extending increased opportunities to business here, and we authorize national banks to engage in all forms of banking business and undertake all types of banking transactions that under the laws of the State in which that bank is situated may be permitted, that are not contrary to the existing laws. and I would be obliged to you, Mr. Haas, before you conclude, if you would indicate what provisions of this bill specifically or incidentally restrict the operations of the Reconstruction Finance Corporation or of the banks under the so-called Glass-Steagall bill.

Mr. HAAS. What I have in mind, Senator, is this, that if there is anything to depress the values of the assets of banks under their present value we are going to have more trouble.

Senator GLASS. Do you think that anything could possibly happen that would disturb the situation any more than the things that have happened and which we are now seeking to prevent happening again?

Mr. HAAS. Well, I should hope that they would not be as bad as they have been, and with all the reconstruction propositions, and rehabilitation of this, that, and the other thing, it certainly has improved the situation, and we have not had the bank failures. But if something is going to depress the security market, the bonds of banks, and the investments of banks, they are going to have to have help again.

Senator BULKLEY. Do you suppose that it could be possible that there would be a bank depositor in the United States that thinks there is something wrong with banking practice and that something, perhaps, should be done to correct it?

Mr. HAAS. Well, you have 48 States—48 different State laws. You have the national bank act; Federal reserve act, for the national banking business. I think to a large extent you have to know each banker and the type of banker you are doing business with. If he is a good banker you will have a good bank. If he is not a good banker you will no have a good bank, no matter what your law is.

Senator BROOKHART. Do you think all of these banks that have failed, the failures were due to the fact that the bankers were not good bankers?

Mr. HAAS. Well, now, I would not want to go on record on that.

Senator BULKLEY. I certainly know lots of bankers that I regard as good bankers and I am very much afraid of the state of mind of their depositors to-day.

Mr. HAAS. I will say this, Senator, it is so much easier to run a good bank than it is to run a poor bank.

Senator BROOKHART. Is it not true that most of these banks have failed because of economic conditions that were forced on them?

Mr. HAAS. Many of them have in certain sections of the country where they have had unusual conditions, like drought and crop failures, and things of that kind.

Senator BROOKHART. In the agricultural States, they said to the bankers, "Lay off of farmers' loans. They are not sound. They are not liquid. Buy these long-time bonds." About 5,000 banks were closed with farmers' frozen paper. And then they loaded up with the long-time bonds, and then in 1929 they came along and they were deflated more than the farmers' paper, and now they are being closed because they have got the bonds.

Senator COUZENS. Are you going to have any more witnesses this afternoon, Mr. Chairman?

The CHAIRMAN. There will be another witness.

Senator FLETCHER. How do you account for the fact that there were only nine bank failures in Canada last year?

Senator GLASS. Last year?

Senator FLETCHER. Last year.

Senator GLASS. No; they have not had but one bank failure since 1914.

Senator FLETCHER. I understand there were nine.

Mr. HAAS. Their system is very flexible.

The CHAIRMAN. When one fails that means 500 fail, does it not, or a thousand, or two thousand?

Senator FLETCHER. Five of these paid the depositors in full, and only four did not.

Mr. HAAS. There have been no failures recently, Senator.

Senator BULKLEY. Mr. Haas, aside from the advisability of acting at this time, or the inadvisability of it, is there anything in this bill that is unsound in itself?

Mr. HAAS. Unsound theory?

Senator BULKLEY. Yes; is there anything in the bill that is affirmatively bad, leaving aside the question of whether it is wise to do it now or some other time?

Mr. HAAS. Well, I would say that there are certain provisions, as I have tried to outline here, in the bill that would be detrimental of the interest of some of the member banks, because of the character of their business.

Senator BULKLEY. You mean the instance where you have a hundred million dollar institution with a million dollars worth of rediscountable paper? Is that the sort of example you mean?

Mr. HAAS. I do not think that I understand you.

Senator BULKLEY. You gave an instance of a great institution.

Mr. HAAS. Yes.

Senator BULKLEY. Is that what you mean by your statement?

Mr. HAAS. Take the collateral loans in our bank, if we have a commercial demand for money, we are an active bank, we take care of our commercial demand. That is our first job.

Senator BULKLEY. Yes, sir.

Mr. HAAS. If we have money left over we have to use it in some way to produce an income for the bank.

During this easy-money period, we could have increased the deposits of our bank millions of dollars, but we would not take the money, because we could not do anything with it, they wanted a high rate of interest, and we refused to pay it, and if we had taken it and paid the rate of interest and put it into the kind of securities and investments that would have enabled us to pay that rate of interest, we would have lost a great deal of money.

Senator BULKLEY. What is there in this bill that makes that any worse?

Mr. HAAS. The collateral loans.

Senator BULKLEY. Do you mean the possibility that they might restrict your percentage of collateral loans? Is that what you mean?

Mr. HAAS. Yes.

Senator BULKLEY. The possibility that it might be restricted unwisely?

Mr. HAAS. Yes; that is right.

Senator COUZENS. What would you say to Congress fixing the amount instead of leaving it to the Federal Reserve Board?

Mr. HAAS. I do not know whether you can fix it, Senator, under any percentage or any yardstick. I think the bank has to regulate its loans according to its business needs at that time.

Senator COUZENS. What is your experience over these three kinds of periods that you just spoke of, bad times, fair times, and good times? What does your experience indicate that the percentage of deposits was invested in security loans?

Mr. HAAS. Well, they have gone up when the commercial demand was low, and there was an active demand for money on collateral. On brokers' loans we never lost a dollar.

Senator COUZENS. But what percentage of your loans?

Mr. HAAS. I do not recall, Senator.

Senator COUZENS. Don't you have an idea how far you went up at any time?

Mr. HAAS. Not just offhand.

Senator COUZENS. You haven't the slightest idea?

Mr. HAAS. Oh, I have an idea, yes; but whatever I would give you would simply be a guess.

Senator COUZENS. That is what I am asking you, to give us a guess so that we could get some light on it.

Mr. HAAS. I would say 10 per cent.

Senator COUZENS. Of your deposits?

Mr. HAAS. Of our gross deposits.

Senator COUZENS. Then during the demands for your customers, how low would you go down, or would you wipe that out entirely?

Mr. HAAS. No; we would not wipe them out entirely. It is necessary to have some money that you can call and get quickly as a secondary reserve in the shape of collateral loan, that you can immediately call, that you do not have to wait for the maturity of an obligation but can call immediately.

Senator GLASS. Do you know of a panic we have ever had in this country that did not result from the call system, call-loan system?

Mr. HAAS. You mean, Senator, that all of them have been caused by call loans?

Senator GLASS. Yes; in one way or another.

Mr. HAAS. Well, I have not analyzed all of them just to see whether that is the cause. I am wondering whether it is the cause or the effect, Senator. Now, you take——

Senator GLASS (interposing). Is it not a fixed system of the average bank to maintain what it calls its standard rate of discount, never giving to the commerce or industry of the community the advantage that ought to ensue from easy money and easy credit, but bundling it up—I think that was under the old system before the adoption of the Federal reserve act—bundling it up and sending it to the money centers to be loaned on call at a nominal rate of interest?

Mr. HAAS. Well, of course, the corporation business or the private business that has been sent to the money centers to be loaned on call has taken care of itself by the clearing houses that have passed their own particular rules.

Senator GLASS. I am not talking about loans now for others; I am talking about the banks themselves.

Mr. HAAS. The clearing houses have themselves passed rules prohibiting the members from making loans for account of others.

Senator GLASS. Oh, yes; and may rescind them day after to-morrow for that matter, if we do not put a provision in the statute. But I am not talking about loans for others; I am talking about the banking system itself. Generally, do not the banks of each community have what they call their standard rate of interest from which they are always reluctant to depart, no matter what the condition of the money market is?

Mr. HAAS. I will say that the customer of a bank gets a rate of interest commensurate with the type of account which he carries. Naturally, the customer that carries a very good balance in the bank and you analyze his account find it profitable. He would expect the very lowest rate which you could possibly give him.

Senator GLASS. But what I am asking is: Do many banks give a rate below their standard to the average borrower, no matter how easy money is?

Mr. HAAS. Well, Senator, many country banks, you know, have a standard rate, and that is 6 per cent.

Senator GLASS. That is what I am saying—or more, I say "or more."

Mr. HAAS. I am talking about Pennsylvania particularly. The country bankers get generally 6 per cent.

Senator FLETCHER. Is that the legal rate in Pennsylvania?

Mr. HAAS. Yes; except by contract.

Senator BROOKHART. How about city banks? Do they have a standard rate, too?

Mr. HAAS. No. What I meant, Senator, in explaining that, is that the rate is based on the character of the man's account, the amount of balance he carries, whether the account is profitable, how much work you do for him. Take, for instance, one with a large balance carried in a city bank. If you look at it and on the face of it you might think that it is profitable; you would think that

you could give that man a low rate for money; but when you analyze that account you find that the activity of the account does not give you any profit. You can not even pay him interest on his account.

Senator BROOKHART. There is a certain portion, though, of surplus credit that you send to New York particularly, even from Philadelphia, is there not?

Mr. HAAS. Yes, Senator.

Senator BROOKHART. From all over the country?

Mr. HAAS. We have not had a New York loan for ages. We happen to have one loan in Chicago, and that was simply because we had a customer there.

Senator BROOKHART. I mean to send to New York banks for redeposit.

Mr. HAAS. We would not do that, Senator, just to carry balances there and just to carry money there. We do that for the service which they render us. For instance, we have many thousands of coupons that are payable in New York, and we have to send them to some one in New York.

Senator BROOKHART. You maintain a balance there all the time?

Mr. HAAS. We maintain a balance there?

Senator BROOKHART. You get an interest on that?

Mr. HAAS. Yes; according to the clearing-house rule.

Senator BROOKHART. What is that rate now?

Mr. HAAS. One-half of 1 per cent.

Senator BROOKHART. The banks out in our country, when they have a surplus they charge a farmer 7 or 8 per cent and business 6 or 7 per cent. The eastern part of the State is lower than the rate in the western part, but they send surpluses down to New York for this one-half of 1 per cent in order to maintain that standard rate. Is that not the pretty general custom over the country?

Mr. HAAS. Well, I would hate to accuse them of doing that, Senator, just to get a half of 1 per cent. I think they send it down to have it available when they want it.

Senator BROOKHART. Most of the time they have got a higher rate than that, have they not?

Mr. HAAS. In New York?

Senator BROOKHART. Yes; since the Federal reserve act went into effect.

Mr. HAAS. Over a long period of time now we have had a very low rate. As a matter of fact, they were considering——

Senator GLASS (interposing). Yes; but prior to the adoption of the Federal reserve act the normal commercial rate was 2 per cent, was it not?

Mr. HAAS. Yes.

Senator GORE. Why do you pick on this one-half of 1 per cent in New York? You say they do not pay any attention to the Volstead Act there anyway.

Senator BROOKHART. I made a comparison of it once, and I found it was 1¾ per cent for quite a long time after the Federal reserve act, and I think it got up once to 2½, which was the highest, I believe, that they ever paid on that money.

Mr. HAAS. Yes; I would say that is right.

Senator BROOKHART. Since the panic it has gone back down to this one-half of 1 per cent.

Mr. HAAS. Senator, I would not like to say that a bank out in your State sends money to New York to get that half of 1 per cent.

Senator BROOKHART. Well, they had better get that than nothing, had they not?

Mr. HAAS. Oh, yes; rather than to—they would have to carry it somewhere. They either carry it in some bank or cash.

Senator BROOKHART. Would it not be better banking and better to them if they would lower their interest rate at home down to where people could afford to pay it and lend it at home?

Mr. HAAS. That is a matter for them to work out.

Senator BROOKHART. Would not the whole banking system be sounder if the interest rate were lowered all over the country so that business could afford to pay it?

Mr. HAAS. Senator, if you were starting with a clean slate, if we were trying to have an ideal banking situation and we started with a clean slate of no interest on any kind of deposits, then, of course, we could have saved 38 to 50 per cent of the banks' gross expense on interest on deposits. Now, if we start with a clean slate, no interest anywhere, neither State bank, national bank, or trust company pay no interest, why, of course, we could afford to do business all along the line on a lower basis of income.

Senator BROOKHART. You mean by that you start by paying too high an interest rate to a depositor and then you collect off of the public too high an interest rate to make it back?

Mr. HAAS. You have to govern the rate according to your business, your cost. What is your cost? The cost of the banking business is so much, and it takes from 38 to 50 per cent of your gross income to pay the interest which the banks pay on their deposits.

Senator BROOKHART. I do not know that that is particularly material to this bill, but I do think that interest rates charged by all the banks and all the other lending companies are higher than the American people can ever afford to pay, higher than American production can stand.

Mr. HAAS. Senator, I am just wondering——

Senator GLASS (interposing). I am just going to say we are not trying to restrict that in this bill.

Senator BROOKHART. No; that is outside the bill.

Mr. HAAS. Just on your point, Senator, I am just wondering whether you make a distinction between short-time money and long-time money?

Senator BROOKHART. I think it is all too high, short and long and the whole business, except these particular situations we have just described in the New York bank. They are low enough.

Senator BULKLEY. Mr. Haas, I would like to go back to something we were talking about a few minutes ago and see if we can understand it a little better. See if I understand you correctly. I think you said your bank was refusing considerable sums on deposit because you did not think it was wise to use the money on collateral loans at this time and did not have any other use for it; is that right?

Mr. HAAS. No. I would like to correct you on that. We did not think we could handle it satisfactorily at a profit. In other words, it was not permanent money.

Senator BULKLEY. Yes.

Mr. HAAS. We could not employ it satisfactorily at a profit. At that particular time call money was 1 per cent.

Senator GOLDSBOROUGH. That was the rate of interest required?

Mr. HAAS. It was higher than that. We would have to pay one-half of 1 per cent for the services of lending that money; therefore, we would have a loss. So why load yourself up with a lot of business that is going to give you trouble and make you lose money?

Senator BULKLEY. You are assuming you are paying interest on those deposits?

Mr. HAAS. Yes. That is what they wanted.

Senator GORE. Where is this?

Mr. HAAS. The First National Bank of Philadelphia. They were lending the money.

The CHAIRMAN. If we are through, I will call the next witness.

Senator GLASS. I would like to ask one more question and then I will desist: Why do you think there should be a discrimination against commercial loans which are restricted by the existing banking act and not authorize the Federal Reserve Board to determine the volume of loans to any one person or concern on collateral security? Why do you think collateral security should be favored as against commercial?

Mr. HAAS. Senator, I did not mean to convey the idea about the collateral security in regard to one loan. I meant in the aggregate; the aggregate amount of the banks' loans on collateral, not to any one person.

Senator GLASS. I understand. You did not mean that. You had a misinterpretation of the law.

The CHAIRMAN. The next witness is Doctor Edwards.

## STATEMENT OF GEORGE W. EDWARDS, NEW YORK CITY

The CHAIRMAN. How long a statement do you care to make? Have you a statement prepared?

Mr. EDWARDS. I have no statement prepared.

The CHAIRMAN. How long would you like to take to present what you have to present?

Mr. EDWARDS. Less than half an hour.

The CHAIRMAN. Are ther any questions to be asked by the members? You may proceed.

Mr. EDWARDS. Mr. Chairman, I just thought in order to same time I would like to express my opinion and answer some of the questions that were put this afternoon, with special reference to some of the provisions of the act and the possible regrouping of some of the provisions under certain special topics.

Senator BULKLEY. Excuse me. What is your banking connection?

Mr. EDWARDS. I have no banking connection. I am professor of economics at the College of the City of New York.

First, on the point mentioned by Mr. Haas—the trend toward centralization of control in the act in reference to both the Federal reserve banks and also the member banks—the bill provides that the open market operations of the reserve banks should be controlled by a committee of which each district appoints one member. That

is, section 10 on page 11, which really transfers the control from each Federal reserve bank to the committee. And then a second point, regarding the member banks already brought up to-day for consideration: Section 3 on page 3 and section 8 on page 9 take the investment credit operations of each bank, each individual member bank, and put it under the control of the Federal Reserve Board. The question was asked, Would the board be in a better position to know the investment credit operations or the extension of investment credit by individual banks? I would express my personal opinion. I doubt it. I believe the member banks are closer to the investment credit situation than the board. Of course, I am only expressing my own personal opinion on that point.

Senator GLASS. With respect to your first proposition there: What is your objection to the open-market committee established by this act?

Mr. EDWARDS. That this should rest really with the bank than with a separate committee, because certain districts have much larger open-market operations than others.

Senator BROOKHART. Would not that centralize the control more?

Mr. EDWARDS. I mean the committee brings about——

Senator BROOKHART. That comes from the banks. That decentralizes.

Mr. EDWARDS. At the present time each bank has its own open-market policy.

Senator GLASS. I am astonished at any such statement as that. There is an open-market committee.

Mr. EDWARDS. Yes; but I mean this really, in turn, gives each bank only one vote on the entire committee.

Senator GLASS. Why should it have any more?

Mr. EDWARDS. But should not each bank, Senator, if possible——

Senator GLASS. What different operation does this statutory provision for an open-market committee have from the regulation now in existence?

Mr. EDWARDS. Would it not transfer more control from the banks, from each individual bank, than at the present time, Senator?

Senator GLASS. Why, no; of course not.

Mr. EDWARDS. If that would not be the effect, I would not have any objection to it.

Senator GLASS. It is just enacting into statute law a regulation that the Federal reserve system has now.

Mr. EDWARDS. If it does not lead to more centralization, there would not be any objection to it, Senator.

Senator GLASS. You ought to be sure it does lead to more centralization before you criticize it. Have you read that [offering copy of Part I of the hearings]?

Mr. EDWARDS. I have seen the act; yes, Senator. That is not as important as the centralization of shifting investment credits from the individual banks to the board. I think that, really, is possibly more important. Answering your question before——

Senator GLASS. I did not address myself to that phase of your objection. I wanted to take the thing in order. You object to the open-market committee that we provide here, which is simply a trans-

fer to statutory requirement. Under the existing regulation of the board they have an open-market committee.

Mr. EDWARDS. Yes.

Senator GLASS. One member of which is selected by each Federal reserve bank.

Mr. EDWARDS. May I ask you a question, just for my own information? What is the purpose of the committee as compared with the present committee?

Senator GLASS. It is exactly the same. It is just simply to legalize the thing. In other words, we are putting into the statute here practically an existing process.

Mr. EDWARDS. Then, of course, there would not be any objection to that.

Senator GLASS. I did not think there would be any. I thought it would develop what objection you had. Now, as to the member bank proposition, of course, there is a disagreement about that.

Mr. EDWARDS. That point was raised this afternoon—the question of credit policy, and would it intensify deflation. I believe it would.

Senator GLASS. Why would it; for example, if the Federal Reserve Board would put no limitation upon the volume of security loans that a member bank might make?

Mr. EDWARDS. Because some of the security loans might be used for a productive purpose and not for speculation.

Senator GLASS. I say, suppose the Federal Reserve Board should put no limitation on it. That is a permissive provision of the bill. It says the Federal Reserve Board may do this. Suppose it should not do it. How would it be restricted? And suppose it would put the limitation at a point where it would never be abused. How would there be any deflation?

Mr. EDWARDS. There would not be with that interpretation. But there are certain sections that I believe, Senator, would lead to the deflation at the present time. I am referring to some of the individual provisions.

Senator GLASS. Just point them out and state whether they do or not.

Mr. EDWARDS. Section 11, page 25.

Senator GLASS. I am very familiar with that section. I have been dreaming about that for the last 10 years.

Mr. EDWARDS. I still believe, Senator, there is a distinction which could be drawn; but would not the effect of that, Senator—that section 11 be to check Federal financing?

Senator GLASS. Not the least bit in the world. Let me ask you right on that point, to show, as I conceive, the inconsistency of some of the critics of this bill: Are you in favor of retiring at one fell swoop all of the national bank speculation?

Mr. EDWARDS. No. You mean at one time?

Senator GLASS. Yes. Do you think that would have an adverse effect upon Government securities, upon United States bonds?

Mr. EDWARDS. That would not; no.

Senator GLASS. Why not?

Mr. EDWARDS. Because you would issue other notes in its place, probably.

Senator GLASS. You could issue an interminable number, just as many bonds as Congress authorizes or certificates of indebtedness as the Treasury may care to issue, despite anything in this bill. The point you are trying to make now is that if the brokers are denied the right to get unlimited access to the Federal reserve bank on 15-day paper for their uses, that that would impair United States securities. Is not that the point you are making?

Mr. EDWARDS. No; I would not make that point. That is not what I want to make.

Senator GLASS. How would it impair Federal financing?

Mr. EDWARDS. In the first place, on the question of brokers, I find myself in sympathy with any provision in that act.

Senator GLASS. Everybody is in sympathy with it, but nobody wants to do anything to stop it.

Mr. EDWARDS. I believe, though, certain provisions could possibly be changed. One way to attain your ideal, which certainly is necessary, is the checking of speculation.

Senator GLASS. I am interested to know right now, at this point, in what way will that section 11 interfere with Federal financing?

Mr. EDWARDS. I would say, Senator, in this way: That particular provision adds a penalty of 1 per cent on the advances supported by United States Government securities.

Senator GLASS. Not necessarily.

Mr. EDWARDS. Is that the intent of that clause, Senator?

Senator GLASS. Go ahead with that proposition.

Mr. EDWARDS. Therefore, the banks would be that much discouraged from buying securities, buying Government securities, because they can not use them as freely as they can at present, because of the high penalty.

Senator GLASS. Would not that be true in the case of the retirement of nearly $800,000,000 of national bank circulation? They could not use United States bonds for speculative purposes?

Mr. EDWARDS. Is that practical, though—the retiring of the national currency?

Senator GLASS. Let us ask the Secretary of the Treasury. He has five times recommended it to Congress.

Mr. EDWARDS. But your banks do not want to give up their rights.

Senator GLASS. What?

Mr. EDWARDS. The national banks would not give up the right.

Senator GLASS. They would have to give it up if the Secretary of the Treasury retires the national bank circulation. Why would not they?

Mr. EDWARDS. I mean without——

Senator GLASS. I am asking you if, as a matter of fact, we should withdraw national bank circulation based upon United States bonds, would that have any effect upon the market?

Mr. EDWARDS. For United States Government bonds? I believe it would.

Senator GLASS. That has been recommended by the very gentlemen who inspire this objection here to this proposition.

Mr. EDWARDS. I believe the retirements would have the very same effect. This particular clause would in that way by that much restrict the market for United States Government bonds.

Senator GLASS. Go ahead.

Mr. EDWARDS. Answering your question about the circulation privilege: That gives the Federal bonds that much more market.

Senator GLASS. Of course, I know that. That is the reason I am asking you if the withdrawal of the privilege would not affect Federal financing.

Mr. EDWARDS. My answer is yes, Senator; by all means. I also had down the section 15, which was reinterpreted.

Senator GLASS. Is that your only objection to section 11—the 1 per cent penalty?

Mr. EDWARDS. I have a second interpretation, Senator.

Senator GLASS. Right on that point, before you leave it, I want to call your attention to the fact that in the existing law the Federal reserve bank is authorized, subject to review by the Federal Reserve Board, to make that rate of discount anything it pleases. Would not that tremendous power rather impair Federal financing?

Mr. EDWARDS. I would not like to see the board have the power.

Senator GLASS. Well, it has it, and it has had it ever since that provision of the law was enacted. The Federal reserve bank, subject to review and determination of the Federal Reserve Board, has the right now, under existing law, and it has had it for 16 years, to determine the rate of rediscount for 15-day paper sustained by Federal reserve securities. That is a tremendous power, is it not?

Mr. EDWARDS. Yes. I did not understand first your statement. I will change my answer.

On section 15, page 36, that point was cleared up to-day. It does not refer to the total securities.

Senator GLASS. That is cleared up.

Mr. EDWARDS. Senator, if it does refer to individual security, I believe that percentage is far too high. I mean, if the interpretation of that particular clause means that a bank can put 15 per cent of its capital and 25 per cent of its surplus in one issue——

Senator GLASS. You think that ought to further deflate it?

Mr. EDWARDS. That is not deflation, Senator. I would not call it deflation. I am serious in that point. I would call that——

Senator GLASS. A safeguard?

Mr. EDWARDS. Allowing them to have——

Senator GLASS. You would call that a safeguard?

Mr. EDWARDS. I would call that permitting them to put too many of their eggs in one basket.

A third point: Section——

Senator BLAINE. You might elaborate that proposition that the percentage for these individual finances is too great.

Mr. EDWARDS. If it refers to the amount of securities, the amount of funds which a bank could put in one issue, that percentage would certainly be too high.

Senator GLASS. You think it is too high?

Mr. EDWARDS. If you could so interpret it as to refer to one particular issue.

Senator GLASS. Are you aware of this fact: That in the answers to our interrogatories, our questionnaires sent out, it developed that many of the banks are loaning immensely higher than this restrictive provision?

Mr. EDWARDS. That is certainly an error.

Senator GLASS. That you think is too high?

Mr. EDWARDS. It is certainly an error.

Senator GLASS. They are committing a lot of errors, and a lot of banks are committing them, too.

Mr. EDWARDS. If you take the restrictions laid down by some of the States and the amount which they can lend to any one borrower, the restrictions are far below even 50 or 25 per cent. That is merely a side comment. It was just the interpretation referring to the one issue.

Senator GLASS. We want it as one of your main comments, because it is peculiar. Everybody else says that we are too restrictive, and now you say we are not restrictive enough.

Mr. Edwards. Not if it refers to one issue, Senator.

Senator BROOKHART. Is not 10 per cent about the usual limit in one issue in the State laws?

Mr. EDWARDS. There are some exceptions in the case of local issues. That is, if it is the holding of a bond of a city within that State, they sometimes make an exception.

Senator BROOKHART. But this is about 15 per cent and even 25 per cent of the surplus. That is too high.

Mr. EDWARDS. Too high. That is it.

Senator BROOKHART. I am inclined to agree with you on that myself.

The CHAIRMAN. Proceed. We want to close here at about 5 o'clock.

Mr. EDWARDS. The third point is section 26, page 49, referring to national banks, repeals many of the exceptions to section 5200 of the national banks act.

Senator BLAINE. You have a different citation. I do not see any repealing provision in 49.

Mr. EDWARDS. Section 26, the bottom of page 49. That, I believe, might be interpreted by the Federal Reserve Board and a ruling made. It might discriminate against agricultural loans.

Senator BROOKHART. Are there any of those now? Can a farmer get a loan anywhere now that you know of?

Mr. EDWARDS. I believe under the exceptions of section 5200 at the present time he does.

Senator BARKLEY. Theoretically?

Mr. EDWARDS. I believe probably in practice he is receiving credit.

Senator BROOKHART. My understanding is he can not get any credit.

Senator GLASS. Do you think the national banks are loaning in large measure to farmers?

Mr. EDWARDS. Speaking of the banks themselves, Senator, fully and certainly they are not.

Senator GLASS. What is the section you are referring to?

Mr. EDWARDS. Section 26, Senator, page 49.

Senator BROOKHART. The bottom of page 49.

Senator BLAINE. There is nothing in section 5200 of the Revised Statutes that would permit you to construe it.

Mr. EDWARDS. I would say it may possibly. It would probably depend on the Federal Reserve Board. I mean, it is one of the possible trends for deflation.

Senator BROOKHART. I can not see where it restricts farmers' credit compared with what he is getting now, because he is not getting 10 per cent, or 1 per cent, or one hundredth.

Mr. EDWARDS. Section 510 exempts certain types of borrowing under the 10 per cent provision.

Senator BROOKHART. It says they may not lend in excess of 10 per centum of the capital.

Senator GLASS. That is the old question of collateral security. That does not relate to commodity supplies. It relates to collateral securities, which has a very definite meaning in banking parlance.

The CHAIRMAN. And which has been the practice for a long, long time.

Senator GLASS. Yes; certainly.

Mr. EDWARDS. Then, going back to section 13, page 28——

Senator BLAINE. Which paragraph? Paragraph A and (2) and (3) under B?

Senator GLASS. Is that the reserve section of your bill?

Mr. EDWARDS. Yes; the reserve section.

Senator GLASS. Very well.

Mr. EDWARDS. That raises the reserve question again. I just raise the thought whether or not that particular section would bear down heavily on the country banks because of their large amount of time deposits, and, possibly, true savings deposits as against the time deposits as it would in the case of city banks. My personal opinion is that the first draft of the act, which drew a distinction between time deposits and savings accounts, was one of the most important sections in the first draft.

Senator GLASS. But we are talking about this draft.

Mr. EDWARDS. Coming back, if you take this section, I believe that would hit the country banks and part of it would hit the city banks. Also, as an effect on deflation, you mention, Senator, that it would lead to the increase of nearly $70,000,000 a year.

Senator GLASS. Those were our figures, I think, were they not?

The CHAIRMAN. Let us get in the record the percentages gradually. We are talking about sums of money here. What is it the first year?

Mr. EDWARDS. Even at $70,000,000 a year it would.

Senator GLASS. The figure should be at the rate of four-fifths of 1 per cent.

The CHAIRMAN. Let us get this in the record. At the rate of four-fifths of 1 per cent the first year.

Mr. EDWARDS. Of course, the calculations may differ. The calculation that I made was a total of $650,000,000 over a 5-year period. Of course, I may have made a broad interpretation. I think it was $130,000,000 a year. That would, of course, result, that could only be attained by liquidation of both commercial and investment loans to meet those high requirements.

Senator GLASS. The increase would be met by the discounting, of course.

Mr. EDWARDS. May I make one last point and hurry along?

The CHAIRMAN. Go ahead.

Mr. EDWARDS. The act does legislate against investment credit in section 11, page 25, and in section 14, page 33.

There is one more point there I would like to bring out. In section 14, page 33, the investments of national banks are limited to legal investments. I do not like to express a doubt on the value of limiting investments to legal investments. There is no doubt that there must be protection for savings, but whether it is wise to limit it to legals, I doubt, because limiting investments to legals tends to create a nonofficial market for those particular bonds and tends to raise their price, at times, beyond their true value, as mentioned this morning.

Senator BROOKHART. What are the legals and what are nonlegals that you refer to? What do you mean by those terms?

Mr. EDWARDS. In most States the savings banks can put their funds only in certain types of investments.

Senator BROOKHART. That is, you do not want to limit this investment to what is authorized by State laws?

Mr. EDWARDS. Yes. I wonder if there could not be a better system; that that provision could not be improved.

Senator BROOKHART. You would have to define the limit according to State laws.

Mr. EDWARDS. Yes. Could not it be better defined?

Senator BROOKHART. The purpose of this, I take it, was to make the national bank system as liberal and equal with the State system as possible.

Mr. EDWARDS. That is framed in accordance with that policy. It may be a bad policy.

Senator GLASS. You want to make it more liberal?

Mr. EDWARDS. I think possibly sometimes less liberal.

Senator GLASS. Where would you lodge the discretion? Would you state it in the law or would you lodge it altogether in the individual bank?

Mr. EDWARDS. No. That discretion, of course, should be lodged in Congress, not in the board.

Just one last point, Senator: Many of the provisions of the act, as the Senator described this morning, legislate against investment credit. I would like to suggest the distinction should be drawn between investment credit used for speculation and investment credit used for productive purposes.

Senator GLASS. That is what we have tried to do.

Mr. EDWARDS. Would not you say that you could restrict the amount?

Senator GLASS. Investment credit, you know, is restricted and has been for 18 years, since the adoption of the Federal reserve act. The soundness of security is not the only thing about banking business, you know, particularly about commercial banking business.

Mr. EDWARDS. The soundness of commercial paper as well.

Senator GLASS. I say the soundness of it is not the only thing. The liquidity of it is a very vital consideration.

Mr. EDWARDS. Senator——

Senator GLASS. That being so, the original act provides that access to the Federal reserve system should be denied to investment secu-

rities. It has been there for 18 years, in section 13 of the act. [Reading:]

And the Federal Reserve Board may make advances to its member banks on paper defined as eligible by the Federal Reserve Board for collateral, commercial, and industrial purposes.

That is the affirmative statement. Then, the negative statement is that [reading]—

Such definition shall not include notes, drafts, or bills covering merely investments issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities except bonds of the United States.

That has been there for 18 years. Would you amend that? It is true we were told this morning that it had been practically a dead letter; it had not been in force. That is why we are here now, and that is why the country is in this condition now.

The CHAIRMAN. Are you through?

Mr. EDWARDS. Yes.

The CHAIRMAN. I think you said you felt the law would make investment credits difficult. Is not that the main trouble with this country to-day—there has been too much of the money that should be liquid that has gone into long-term investments?

Mr. EDWARDS. I make a distinction, Senator, between investment credit applied to speculative purposes and investment credit applied to productive needs.

The CHAIRMAN. But are we not limited in permanent investments to the earnings of our people throughout the year, and if we exceed that we get frozen assets?

Mr. EDWARDS. Yes.

The CHAIRMAN. And is not that the trouble with us, or one of the troubles with us?

Mr. EDWARDS. An excess of credit applied to speculative purposes.

The CHAIRMAN. But is there not also an excess of funds applied to long-term securities that have become frozen so that commercial credits and little loans that the average borrower could get are not available any more?

Mr. EDWARDS. Banking houses have gone into long-term bonds and the like of them.

Senator GLASS. Exactly. The claim that has been made to us most persistently is that stock exchange credits are infinitely more liquid than credits for productive purposes.

The CHAIRMAN. I want Doctor Edwards's view on that. He is appearing here as an expert, connected with and representing banks' credits.

Mr. EDWARDS. I am not representing a banking group.

The CHAIRMAN. You were brought here by them?

Mr. EDWARDS. Yes.

The CHAIRMAN. They testify you have been representing them.

Mr. EDWARDS. I have not.

Senator GLASS. I supposed he was representing the American Bankers Association.

Mr. EDWARDS. I would like to draw a distinction there. I deny the claim of being an expert and also representing the American Banking Association. I just would like to express, merely as a

student of banking, the one theory that I believe, that the act in that particular respect, of checking the amount of investment credit would, I believe, check business revival.

The CHAIRMAN. At the same time our difficulty is due to too much of it. But you think if we do not have some more of it, we will go still deeper?

Mr. EDWARDS. I want to draw a distinction there. Here is the difference I would like to make between long-term credit applied to a purely speculative purpose and that applied to a productive purpose: A speculative purpose is one trying to make a profit out of a rise in the value of some commodity or in the value of a security. Certainly Federal reserve credit should not be used for that purpose.

The CHAIRMAN. Certainly. We agree with you on that.

Senator GLASS. It was used chiefly for that purpose in 1928 and 1929.

The CHAIRMAN. That is what we are trying to prevent. But even going into the more legitimate lines of investment credit, leaving out speculation, can you even get too much of it, then—too much of your funds going into these long-term securities?

Mr. EDWARDS. Yes.

The CHAIRMAN. And bring on a frozen condition, bring on the very thing we have got now?

Mr. EDWARDS. It certainly can if you have too much of it.

The CHAIRMAN. You do not think we have too much of it?

Mr. EDWARDS. We have had too much of it, unquestionably.

The CHAIRMAN. You think we ought to have some more?

Mr. EDWARDS. For investment credit for productive purposes, I would say yes.

The CHAIRMAN. To produce what? More automobiles or more gasoline stations or more wheat?

Mr. EDWARDS. At the present time to produce more goods.

The CHAIRMAN. That can not be sold?

Mr. EDWARDS. That could be sold.

The CHAIRMAN. Name some of them.

Mr. EDWARDS. If the buying power were there.

The CHAIRMAN. Yes; but what goods?

Mr. EDWARDS. We need at the present time more credit.

The CHAIRMAN. Well, you say for the production of more goods?

Mr. EDWARDS. Yes.

The CHAIRMAN. What goods have you in mind?

Mr. EDWARDS. Those lines that have an insufficient supply.

The CHAIRMAN. There may be such lines. I have not found them.

Mr. EDWARDS. But there are such lines. May I make a little illustration just to prove it?

The CHAIRMAN. I wanted to get your opinion on that. We are anxious to get that. We admit there is room for many views here.

Mr. EDWARDS. May I illustrate that one point of investment credit?

The CHAIRMAN. Certainly.

Mr. EDWARDS. Here is a small business man that either can not get credit at the present time or not sufficient credit. He holds securities. He is dealing in a business that does not produce a commodity. He is dealing in service. He can use his securities to obtain a loan

for a business purpose, and I believe it would injure that type of lender.

The CHAIRMAN. You mean what would injure, what provision in this bill?

Mr. EDWARDS. The general trend of the act would check the amount of credit on investment securities.

The CHAIRMAN. There may be such an individual. I have been trying to get in touch with business men. I am wondering whether 1 per cent of the business men are carrying these securities.

Senator BULKLEY. What operation have you in mind that would have to be financed that way?

Mr. EDWARDS. Suppose you have a line that is not dealing in commodities or is not dealing in finished goods.

Senator BULKLEY. Dealing in what, for instance?

Mr. EDWARDS. Let us take a firm, an architectural firm, to give you one illustration, that does not deal in any commodity. It is, possibly, a surveying company. It wants to raise money. It can not get its own credit. It has to put up stocks and bonds to receive credit.

Senator BULKLEY. What is to prevent it?

Mr. EDWARDS. I would say the general trend of the act is to limit the amount of that credit which can be extended.

Senator BULKLEY. You mean that they want to borrow more than 10 per cent of the capital and surplus of the bank?

Mr. EDWARDS. No. The individual borrower would get no credit whatsoever if he could not offer an investment security.

Senator BULKLEY. I do not quite see what this bill does to him, how it makes it any worse.

Mr. EDWARDS. It tends to restrict the amount of credit which can be loaned on investment security.

Senator BLAINE. Let me see if I understand you. You maintain, Doctor Edwards, that before you can start business, start activities, you must have a rise in the value of stocks and bonds at low dividends? Is that your theory?

Mr. EDWARDS. That would be the result.

Senator BLAINE. And that you have to have that before business can start?

Mr. EDWARDS. It needs more credit.

Senator BLAINE. I just wanted to get that. That is your theory?

Mr. EDWARDS. Yes.

Senator BLAINE. There are a great many economists, of course, who hold to that proposition, and also that in developing new business it is essential to provide for credit. Is that your theory?

Mr. EDWARDS. Yes; and also do it through investment credit applied for a productive purpose—I mean the act really accepts the assumption that all classes of investment credit are bad. I believe there are——

Senator BULKLEY. Where did you find that all classes of investment are bad?

Mr. EDWARDS. Because the act tends to restrict the amount of investment credit that the banks would lend.

Senator BULKLEY. If it is bad, would not the act prohibit it?

Mr. EDWARDS. I do not believe all classes are bad.

Senator BULKLEY. The act does not presume it, either, and could only restrict the amount.

Mr. EDWARDS. It does not restrict the amount.

Senator BULKLEY. Certainly it does, no matter how good it may be.

Mr. EDWARDS. Are you not hitting both the production uses of investment credit and the purely speculative uses?

Senator BULKLEY. Aren't you going to refuse to distinguish between what is liquid and payable in a short term, sir, and what is frozen?

Mr. EDWARDS. I am distinguishing between investment credit used for speculative purposes, where no wealth is produced, where you simply are turning over commodity values and society does not gain from it, and investment credit which can be applied to productive uses. As a matter of fact, that is the system under which we live at the present time.

Senator BROOKHART. You are going to prohibit credit for speculative purposes?

Mr. EDWARDS. Absolutely.

Senator BROOKHART. And use it for productive purposes?

Mr. EDWARDS. Yes.

Senator GLASS. But if it is a class of credit you can not realize on, that is unliquid, if you choke up a Federal reserve bank with that nature of credit, you circumscribe, you curtail its ability to respond promptly and adequately to the current requirements of commerce. Is not that so?

Mr. EDWARDS. I would say that that depends on how you define liquidity. If you mean liquidity means marketability, I would say no.

Senator BROOKHART. You want to prohibit speculative liquidity as well as speculative freezing, do you?

Mr. EDWARDS. No; but I believe this: I believe that we have to regard actual fact to-day. I mean we are living in a banking system where the banks extend both investment and commercial credit. That is the situation which was developed especially in the last 10 years.

This morning the Senator mentioned the fact that the committee 10 years ago—I mean in 1920—was considering the fact of this trend. I believe had the Congress at that time taken action to prevent that trend—from 1913 until that time—they could have effected that result. Whether it was for good or bad, I do not know. I believe if the act was passed to-day, the checking of that trend of investment credit would intensify deflation.

Senator GLASS. There is no check upon investment credit. We have in this country an investment banking system, the president of which was before us this morning. Anybody is at liberty to organize all the investment banks that he wants to organize.

Mr. EDWARDS. But, Senator the investment dealer—I am not speaking of affiliates; I am speaking of the investment dealer who in the coming months must supply the country with investment credit. He needs a certain amount of assistance from the commercial banks at the present time.

Senator BLAINE. Well, reducing your propositions to terms which I may better understand than I do these other theories, you feel that

it is essential to have some element of inflation, whether in the credit system or in the monetary system?

Mr. EDWARDS. I would again draw a distinction between production and nonproduction inflation. Where you apply that money——

Senator BLAINE. I recognize the distinction you make.

Mr. EDWARDS. Where you apply that money for purely speculative needs, where you are simply giving credit for the purpose of raising security values, certainly, no. Where you apply credit to-day for production purposes, to get people back to work, I can not see any harm in it. I believe we need it.

Senator GLASS. Are not agricultural and commercial and industrial activities productive of anything?

Mr. EDWARDS. Yes.

Senator GLASS. They have free access to the Federal reserve banking system.

Mr. EDWARDS. But, Senator, those industries to-day need investment credit as well as commercial credit.

The CHAIRMAN. Do they need to enlarge their plants or do they need some money for operating expense, or do they need some customers to buy the goods?

Mr. EDWARDS. All three.

The CHAIRMAN. The testimony we have had in this hearing is that nearly every industry is overbuilt. The American milling industry is overbuilt so that only half of it operates; the railroads do not get enough business to keep going, and ships do not; hotels are not full; and apartment houses are not full. We produce all the agricultural products the country can use and then some. Where is it that we need to expand?

Mr. EDWARDS. We do not need to at the present time. As you know, in the banking situation, many of our corporations to-day need long-term and not short-term credit.

The CHAIRMAN. For expansive purposes, to enlarge their plants?

Mr. EDWARDS. No; to start industry. This is the point——

Senator BLAINE. Let me say in that connection that that is the complaint I received from industry respecting the Reconstruction Finance Corporation.

Mr. EDWARDS. May I just bring out one last point, sir? I think you have to realize that to-day our system of financing, especially in the last decade, has changed. Where even 10 years ago we financed through commercial credit, industry to-day finances through investment credit; and I do not believe the act recognizes that change.

Senator BROOKHART. Is it not a fact in this situation we have underconsumption quite as much as or more than overproduction? with seven or eight million men unemployed, they can not buy anything. Twelve million farmers are at the verge of bankruptcy, with not enough to pay their interest and taxes. They can not buy.

Senator GLASS. The Farm Loan Board are feeding them. They do not have to buy.

Senator BROOKHART. The Farm Loan Board is feeding I do not know who. They are not feeding any farmers; I know that. Is not the trouble that before we can increase this production we have got to increase the buying power of these people?

Mr. EDWARDS. Yes, sir.

Senator BROOKHART. So far as the farmers are concerned, they have got to have 8 or 10 years before they can buy what they ought to buy. Is not that true?

Mr. EDWARDS. That result may follow.

Senator BROOKHART. Yes; and so far as these laborers are concerned, they have got to have a job before they can buy anything, is not that true?

Mr. EDWARDS. That is the first consideration.

Senator BROOKHART. If private business can not start in enterprises to do that, has not public business got to do it?

Mr. EDWARDS. I believe private business could, Senator, if it received enough long-term credit.

Senator BROOKHART. But it had the full say-so and the full credit of the country and the control of it and everything else; and they led us into this and then they come down to Congress and ask for $2,000,000,000 to start it up again.

The CHAIRMAN. And enforce it.

Senator BROOKHART. Yes; and that does not appear to be enough to enforce it.

Senator BLAINE. I wanted to get to this proposition which the witness has suggested and it may be a very practical thing: Have you any suggestion by which the committee could distinguish between the two types of investments which you differentiate in, in a law—that is, a practical proposition?

Mr. EDWARDS. I would say this, without being considered inconsistent in my remarks by the Federal Reserve Board: I would say it could be put in the act and then so worded that the board can interpret that particular provision the same as it does by its rulings.

Senator GLASS. That would be centralization of power.

Mr. EDWARDS. I made the remark before that would be merely giving the board the powers it has at the present time to interpret the Federal reserve act.

Senator GLASS. You want the board to have that centralization power, but nobody else, is that the idea?

Mr. EDWARDS. No. It is giving the same power they have already.

Senator BLAINE. Would you be kind enough to draft a provision that would distinguish between the two types of investment?

Mr. EDWARDS. I would be glad to. I think it is important.

Senator BLAINE. I think it is a rather serious proposition.

The CHAIRMAN. If there are no further questions, we will adjourn until 10.30 to-morrow and meet in the Banking and Currency room in the Senate Office Building.

(Whereupon, at 5.10 o'clock p. m., an adjournment was taken until Thursday, March 24, 1932, at 10.30 o'clock a. m.)

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# OPERATION OF THE NATIONAL AND FEDERAL RESERVE BANKING SYSTEMS

THURSDAY, MARCH 24, 1932

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

The committee met at 10.30 o'clock a. m., pursuant to adjournment on yesterday, in its hearing room in the Senate Office Building, Senator Peter Norbeck presiding.

Present: Senators Norbeck (chairman), Brookhart, Goldsborough, Townsend, Walcott, Couzens, Fletcher, Glass, and Bulkley.

The CHAIRMAN. The committee will come to order. The first witness will be Mr. Mills. Come around to the committee table and take a seat opposite the committee reporter.

Mr. MILLS. All right, Mr. Chairman.

The CHAIRMAN. We understood that you and Mr. Lord are here from Detroit, and that you two together will have an hour. Is that right?

Mr. MILLS. That is correct, I believe.

The CHAIRMAN. Just go ahead and give your name, residence, and business connection for the purpose of the record.

## STATEMENT OF WILSON W. MILLS, DETROIT, MICH., CHAIRMAN OF THE BOARD OF DIRECTORS OF THE FIRST WAYNE NATIONAL BANK OF DETROIT

The CHAIRMAN. You may proceed if there are not any questions at this time by members of the committee.

Mr. MILLS. Mr. Chairman and gentlemen of the committee, I have not prepared a statement. I thought if it meets with your approval I should like to discuss generally a few sections of the bill, S. 4115, that do not to me at least appeal very much and which I think would be very disadvantageous to banks, to the community, to business, and in general to the country. What I shall have to say does not apply to the entire bill at all, but will apply to various portions of it.

I think in the first place if it meets with your approval I should like to discuss section 14, having to do with real estate and primarily with mortgages. And in that connection if you will forgive me I shall have to talk about our bank somewhat, because I think it is in a somewhat unique position in that respect, and incidentally I know more about it than I do about some others.

This bill would limit the amount of real-estate mortgages that a national bank or any member bank of the Federal reserve system may hold to, in effect, 50 per cent of the time deposits.

Our bank in Detroit is a consolidation of five or six banks which has taken place over a period of several years. Detroit is somewhat different from New York and other cities in that mortgages in Detroit, and in Michigan, I might add, are held by banks for the most part and not by outside companies. Insurance companies and others, for instance, do not have large Michigan real-estate mortgages, and the mortgage companies as a rule are rather small institutions.

Under the proposed bill our bank would be permitted to hold 50 per cent of its time deposits in mortgages, or $146,000,000, our time deposits being twice that amount. That would be the maximum amount we could hold.

In so far as our mortgages, generally speaking, are concerned, I am proud of them, because in Detroit some seven or eight years ago they instituted a system of requiring amortization of mortgages every year. Mortgages now are reduced by all Detroit banks; that is, they are required to be reduced at the rate of 10 per cent a year on the principal, or 2½ per cent quarterly.

I will say that our motgages, by and large, are in good shape. Of course, we have some foreclosures, there is no question about that; but when a man has paid down a substantial amount of his mortgage, of course, that mortgage as it stands is still good; and——

Senator BROOKHART (interposing). Are those mortgages that you hold on farm or city properties?

Mr. MILLS. We are a city bank and the mortgages that we hold are largely city mortgages, on homes and improvements.

To show you our volume, I will say that we have over 53,000 mortgages, and that the average amount of each mortgage is less than $3,000, or about $2,900. And I should say that around 95 per cent of our mortgages are on residence properties in which the people live.

Senator BROOKHART. Do you remember how much of those mortgages are on farms or agricultural properties?

Mr. MILLS. Very little. We are a city bank and operate in Detroit, and we have practically nothing on farms. In Michigan that kind of mortgage goes to the local banks located in the farming communities. We are in a manufacturing community and our mortgages are largely on homes.

Senator BROOKHART. Would you say that what you have said about your city mortgages would apply to farm mortgages too, that they are in about the same position?

Mr. MILLS. I should say that they have about the same percentage of farm mortgages throughout the State. But I think that all the banks in Michigan have not insisted upon similar amortization payments.

Senator BROOKHART. You mean as to farm mortgages?

Mr. MILLS. Yes, sir. But on residential mortgages they have. At the present time we have $155,000,000 of mortgages.

Senator FLETCHER (presiding). You may proceed.

Mr. MILLS. This bill goes on to provide that in addition to regular mortgages; that is, those classified as such, that all real estate of a bank is to be classified as mortgages; that is, not only its other real estate it may have acquired, but also its bank premises and offices.

Our bank has approximately 175 branches throughout the city of Detroit. Michigan does not have state-wide banking, and branches are limited to the city in which the bank is located. So, as I have said, we have about 175 branches, and those branches——

Senator TOWNSEND (interposing). Are they all in the city of Detroit?

Mr. MILLS. Yes, sir. The bill further goes on to provide that loans shall be counted as mortgages and so classified where the ultimate payment of the loan is predicated upon the value of real estate. In other words, as I read this bill it is intended to classify as mortgages any obligation founded upon or connected with real estate. It might have been originally a collateral obligation or any other kind of obligation, but if there is a guarantee signed by some individual whose worth is in real estate then immediately, as I read the bill, it would classify that particular loan as a mortgage.

Senator FLETCHER (presiding). What time do you generally allow on mortgages?

Mr. MILLS. Mortgages have been made over a period of three years, with the provision that 2½ per cent is to be paid quarterly on the principal. If those payments are made, then at the end of the 3-year period we just continue the mortgage so long as the mortgagor continues to make the same amortization payments upon the principal. In other words, I mean we do not require a new mortgage, because we think the old mortgage is better for all concerned.

Senator BROOKHART. Is that written into the terms of the mortgage, or is it merely a matter of policy?

Mr. MILLS. It has become a matter of custom. All banks in Detroit do the same thing after the 3-year period under the conditions I have described.

Senator BROOKHART. But you could require a new mortgage for any reasons you might think proper, and require it be given at any moment.

Mr. MILLS. Yes. But we have not done it so long as the payments are made, because we think the old mortgage better than to take a new mortgage. It cuts off the possibility of any subsequent liens on the property.

Senator TOWNSEND. Have you any suggestion to make to the committee that you think would meet your objection in this connection? I mean anything that might be written into the bill?

Mr. MILLS. Might I come to that after I have made one more statement?

Senator TOWNSEND. Certainly.

Mr. MILLS. The bill also provides that on each examination, and in practice there have been two examinations a year, although it is provided that there may be three, that every mortgage shall be appraised.

With 53,000 mortgages held by our bank, and with an examination to be made two or three times a year, you can see what it would mean. And I do not believe that the value of real estate or the condition of mortgages changes rapidly enough to warrant any such examination.

Coming down on the train this morning I was talking to Mr. J. Walter Drake, who is the receiver of a closed trust company in Detroit, and he told me that they had two men appraising mortgages, and they have some 300 of them, and that in order to make proper appraisals of the properties would require 70 days.

Senator TOWNSEND. In the case of something like 300 mortgages.

Mr. MILLS. Yes, sir. Under our present classification we have actually 53,000 mortgages, and, if you were to add to that number all of our bank premises, together with all loans the payment of which is predicated eventually upon real estate, it would mean about 80 per cent of our loans that would have to be examined at least twice a year, which would mean an endless job.

My own view of this proposition, for what it may be worth, is this: That it would be better in view of the bill permitting national banks in general to make mortgages, to put them to some extent under State laws with a clause simply permitting national banks to make mortgages under the same conditions as if they were State banks in that particular State. It seems to me that would meet the situation.

Senator BROOKHART. To have State laws apply as to mortgages in this connection.

Mr. MILLS. Yes, sir. It seems to me that would meet the situation, plus the fact that I do not believe it possible to appraise the vast volume of mortgages such as exist in our case, as is proposed in this bill. I will admit that our bank is somewhat unique along that line, and it has probably more mortgages than any other bank in the country, some 53,000 mortgages without including the other classifications that seem to be provided here.

I think it would be wise to permit State law to govern as to investments in mortgages. That is particularly true in our case. We have this large amount of mortgages which have come along under State law, and our bank is a system of consolidations of six or seven different banks only one of which was a national bank, the others being State banks.

The next item that I should hold forth on, with your permission, is paragraph 13 on reserves.

Senator FLETCHER. Section 13 of the bill, you mean?

Mr. MILLS. Yes, sir. Under the present law members of the Federal reserve system have to keep on deposit with Federal reserve banks in the case of country banks 3 per cent of their time deposits and 7 per cent of commercial deposits.

Senator TOWNSEND. You mean under the present law?

Mr. MILLS. Yes, sir. In the case of reserve city banks still 3 per cent of its time deposits and 10 per cent of its demand deposits; and in case of central reserve city banks 3 per cent of their time deposits and 13 per cent of their other deposits shall be held and maintained with the Federal reserve bank of its district. No interest of course is paid on these deposits to the member banks by the Federal reserve bank in which the deposit is kept.

This proposed bill leaves reserves on demand deposits where they are, but it increases the reserves in the matter of deposits with the Federal reserve bank of the district, in case of time deposits, from 3 per cent and 7 per cent to 10 per cent. There is the flat reserve requirement of 10 per cent on all deposits which is to be required under the terms of this bill to be kept on deposit with the Federal reserve bank.

Senator TOWNSEND. You are referring to city banks?

Mr. MILLS. No; I am referring to all banks. They have to keep on deposit under the proposed bill over a period of time, and they are given a short period of five years to step it up, but they are required to keep 10 per cent of demand and time deposits with the Federal reserve bank of the district.

Senator TOWNSEND. It says 7 per cent here in the bill.

Mr. MILLS. I owe you an apology. It is 7, 10, and 13 per cent, all based on the same classification, without differentiation between time and demand deposits. I personally do not follow the theory back of that. I happen to have studied a report, which I presume has been presented here, but if not I should like to present it for the record, if it may be done—the report on bank reserves of the Federal reserve system.

Senator GLASS. I will simply say to you that we sat up with that for a month.

Mr. MILLS. Well, to me at least, Senator Glass, the provision which they suggest is very sound, because when you take time deposits you must remember that activity in time deposits is very small and not general. It is nothing like as large as it is in the matter of ordinary commercial deposits.

Senator GLASS. But when you transfer demand deposits to time deposits and use them indiscriminately, as banks have been doing ever since we reduced the reserve behind time deposits, you have a situation in which the average reserves of a bank are drawn down tremendously.

Mr. MILLS. The average of reserves have gone down, but the Federal Reserve Board has said that the present reserves are ample to do all business they wish to do. This report sets forth that they have no complaint against the total reserves on deposit; that they give them ample working capital in order to conduct their operations.

This provision of the bill would not only increase—and this is only an estimate, Senator Glass, because I have not been able to get the figures on the three classes of reserve banks, country, reserve city, and central reserve city—well, I do believe it would increase the total reserves under the proposed bill by some 30 or 35 per cent, which under the report of the committee on reserve banks of the Federal reserve system is not at all necessary, because they have said they have ample resources to conduct the business they wish to conduct and in the way they wish to conduct it.

To answer your observation, Senator Glass, to the effect that banks transferred certain deposits which are really commercial or demand deposits into time deposits in order to obtain the benefit of lower reserves, if there is any activity in those accounts, and if the activity approximates—or whatever it may be—the reserves would still be computed on the daily charges to individual accounts.

To me that is an automatic way of handling it, a simple way of handling it, and does not penalize time deposits.

If you will take the case of our bank, we had on deposit with the Federal reserve bank, on which we had no interest at all, something over $22,000,000. That was our reserve deposit. In the case of the proposed bill, that would be increased to $45,000,000. And again I will say that I think we are in a somewhat unique position, because we are primarily a savings bank, but our reserve deposits would be increased to $45,000,000—something over 100 per cent.

Senator GLASS. You understand that we are simply returning here to the requirements of the law before this recent change was made in the matter of reserves.

Mr. MILLS. As I read the report of the committee on reserves, Senator Glass, that is not the case, because prior to 1917 and prior to the enactment of the present reserve act, there was still a differentiation in favor of time deposits as against time deposits in the way of reserves.

Senator GLASS. But when banks manipulate their time and demand deposits so as to take advantage of the lower reserves, what are you going to do?

Mr. MILLS. My answer about reserves is based on activity in the main.

Senator GLASS. You are in favor of the velocity method of reserves. Do you think the banking community generally, and particularly country banks, would want that done?

Mr. MILLS. I think they would.

Senator GLASS. Which is revolutionary.

Mr. MILLS. I will grant you that it is very different.

Senator GLASS. We have been told by those who have already appeared before us that we ought not to do anything to disturb existing conditions, not even this simple method of returning to the former reserve requirements under the existing form of counting reserves. Now if we were to adopt this revolutionary proposition, do you think the banking community would not be disturbed by it at all?

Mr. MILLS. No. Taking all of the banks in the country the result would be——

Senator GLASS (interposing). Not the result but the reaction on the minds of the bankers of the country in general.

Mr. MILLS. That is why I have to speak of the result. The result for the country at large would be about the same reserves that they have now. I should say there would be no difference. Some banks that have a very large turnover in their accounts would not like it. But I think the very fact that there is that heavy turnover in accounts is a reason which points to having the reserves computed in that way.

If you will take a savings account that has no activity in it at all to speak of, two or three entries a year, I can see no justification in the case of a reserve city bank of requiring a reserve of 10 per cent to be kept on that account. In other words, increasing those reserves, as against that particular account, some 233 per cent. This proposed bill does increase the reserve on time deposits from 133 per cent to 333 per cent depending upon the location of the bank.

Senator GLASS. It simply restores the reserve to what it was before the banks manipulated deposit accounts to such an extent as to reduce the general average of reserves.

Mr. MILLS. The purpose of the reserve, in addition to enabling a bank to have some control over its liquidity, is to furnish the Federal reserve with ample capital, and they say the present method does give them ample capital.

Senator TOWNSEND. You mean ample resources or reserves and not capital?

Mr. MILLS. Yes; ample resources, in order to conduct their credit operations. And this would increase the reserve of the Federal Reserve System by a very substantial amount.

Senator BROOKHART. Would you suggest some appropriate definition or division of deposits so as to indicate what would be called time deposits and what active deposits, in order to meet this situation?

Mr. MILLS. If you would call them active, I think the answer would be, what is the actual activity in the account by the depositor? If a depositor continues his account right along and checks it out an average of once a week, that is an active account, and a high reserve should be set up. But——

Senator BROOKHART (interposing). Suppose he were to make a deposit for six months and then were to check it out at the end of four months.

Mr. MILLS. You have your activity based on your past record.

Senator BROOKHART. In other words, if the depositor checks it out before it is due you would call it an active account.

Mr. MILLS. Well, I don't know that you could say that. It would be based upon the previous experience over a period of three months. You would have that experience to guide you on what your reserves should be.

Senator COUZENS. Is there any way, when a depositor makes a deposit, to tell whether it is a time deposit or demand deposit?

Mr. MILLS. Every deposit is made either as a time or a demand deposit.

Senator BROOKHART. And if it is a time deposit he can not draw it out until the time is up unless the bank consents to it.

Mr. MILLS. That is true, but a bank in nine cases out of ten will consent to his withdrawing it ahead of time, and the only penalty that that man pays is a reduction in the interest rate he would have got for the longer period of time.

If you will permit me to again cite the case of our own institution, if a man makes a deposit for three months it is a time deposit, and he is entitled to 3 per cent. If he takes that money out within the three months' period he does not get interest at the rate of 3 per cent, but the deposit is considered a demand deposit upon which he gets interest at the rate of one and a half per cent.

Senator BROOKHART. Why not figure it from that time on as an active account?

Mr. MILLS. I think it would be figured as an active account. If you should apply that rule it would cover the situation, and activity of account is, I believe, the only fair one to be applied.

But if you take the method in the bill it would increase our reserve to the Federal reserve bank by approximately $25,000,000, upon

which we are to get no interest from the Federal reserve system. In order to make up for the loss of interest on $25,000,000 of funds so held, I can see only three things we could do: We would have to increase the rate we charge borrowers because of the fact that we would be losing interest on an additional $25,000,000, and then we would have to——

Senator BROOKHART (interposing). You would say that if a depositor put money in as a time deposit and then proceeded to check against it, the classification of that account ought to be corrected.

Mr. MILLS. I think it should be, and I think it would be fully corrected under this proposed velocity method.

Senator BULKLEY. If we adopted the velocity system of computation, then you agree that a distinction between time and demand deposits could be fairly eliminated.

Mr. MILLS. Yes; because I think velocity is the total test of reserves. The only purpose in having a reserve is to have the money when you want it, and the velocity test should be applied.

Senator TOWNSEND. Will you now go ahead and finish your three thoughts that you started on?

Senator BLAINE. Mr. Mills, you were interrupted by a question before you completed your statement. You said there were three things that might happen. Will you now go ahead and state them?

Mr. MILLS. There are three things I will say that could be done in order to compensate us for having to keep the extra sum of $25,000,000 on deposit with the Federal reserve system without interest. Of course we would have to make up the revenue lost on it, and the only methods I can see by which that might be done would be: First, to increase the rate that we are now charging borrowers on present and future loans. It would have to be raised from 6 to 7 per cent, or some other rate; and 7 per cent is our maximum rate in Michigan.

Second. We would have to——

Senator COUZENS (interposing). Of course you could decrease the amount of interest paid by you.

Mr. MILLS. Yes; and that would include the other two things that we might do. The other results that might be obtained would be: To decrease the rate that we pay on commercial accounts; and, next, to decrease the rate that we pay on time deposits.

If we wanted to put the burden where it would fall under this bill, it would have to go to reducing the rate paid on savings deposits, because it is on them that we would have to keep the larger reserve under the proposed bill. This would be unfortunate.

Senator TOWNSEND. What do you pay on savings accounts?

Mr. MILLS. Three per cent.

Senator FLETCHER. How do your deposits compare as between time and savings accounts, or whatever your classifications may be?

Mr. MILLS. We consider all deposits of over 30 days as time deposits, which are usually savings accounts. On straight savings deposits—and we have also demand deposits as distinguished from time deposits—we have $143,000,000 of demand deposits, and $276,000,000 time deposits. So, as I have said, we are hit very strongly by this proposed increase in the matter of reserve, which must ultimately fall on somebody, and would be of no benefit to us

certainly, and so far as I can see, would be of no benefit to the country.

I will say that the method I have suggested is not my own suggestion, as to the velocity system. It would increase our reserves very considerably, but it would not increase them anything like 100 per cent.

Senator FLETCHER. It was testified here by one witness that we would have to undergo a process of education in order to get that plan accepted. What have you to say about that?

Mr. MILLS. Well, it is a perfectly simple matter of operation. The Federal reserve system has the figures and all they would have to do would be notify the banks of the basis, and that would be based on experience, as to what their reserve requirements are. I think it is the most simple method of computing reserves I have ever seen.

Senator GLASS. But certainly it is not as familiar to the banking community throughout the country as the reserve system that has been in existence for 50 years.

Mr. MILLS. It is not as familiar as that; no. But, after all, the banks ought to know a good deal about collateral loans now that the bill proposes to stop some of that which has been done.

Senator GLASS. What we are proposing is simply over a period of five years, which is a good long time, to add an almost inappreciable percentage in order to restore the reserves to what they were formerly and not so many years back.

Mr. MILLS. There has always been a differentiation between time and demand deposits:

Senator GLASS. Yes.

Mr. MILLS. And this bill wipes out that differentiation entirely.

Senator GLASS. And who is to blame for that? The manipulation by bankers in the matter of their time and demand deposits. It never was intended that those deposits should be manipulated in that way in order to give a bank the advantage of the reserve behind time deposits.

Mr. MILLS. I do not know what the experience has been in other parts of the country, but I do not know that in Michigan there has been very little of that sort of manipulation. That is, so as to call an account a time deposit when it is actually a demand deposit. Take the case of our time deposits and they have been very constant. They have gone off a little, it is true, but are quite constant. Our demand deposits change. They are volatile accounts, upon which there should be to my mind a much higher reserve than as against time deposits. In the very nature of things there should be a much higher reserve against demand deposits as distinguished from time deposits.

Senator FLETCHER (presiding). You have a few minutes more, Mr. Mills. Suppose you proceed with your suggestions.

Senator GLASS. Mr. Willis, the technician of the committee, would like to ask Mr. Mills some questions.

Senator FLETCHER (presiding). Doctor Willis may proceed.

Mr. WILLIS. I want to ask a question or two about the working of this valuation matter you spoke of. You did not intend to express the thought that the Comptroller of the Currency would have to examine each of these mortgages if this bill were enacted into law for the purpose of changing its worth, did you?

Mr. MILLS. The way I read the bill it provides that he shall examine them.

Mr. WILLIS. I see you are looking at the bill. Glance at page 33.

Mr. MILLS. On page 33, beginning on line 4, it says (reading):

Such valuations shall be revised by the Comptroller of the Currency at the time of each examination of the bank making the loan and he shall have power to order changes therein and to require the adjustment of loans to such revised valuations.

Mr. WILLIS. Yes; but that does not mean that he has to order a bank to dispose of the loan unless he chooses in an individual case.

Mr. MILLS. No. But in order for the Comptroller of the Currency to do that he would have to examine all mortgage loans.

Mr. WILLIS. Yes; but he would not have to have them examined individually through a physical valuation obtained by visiting all of the properties. From the answer you gave it occurred to me perhaps you had that thought in mind.

Mr. MILLS. Well, if an examiner under the Comptroller of the Currency is simply to take the valuations that are on the books of the bank, that is one thing. But certainly the wording of the statute is wide enough and broad enough to require, in fact, I should say that it does require, an examiner to make revised valuations.

Mr. WILLIS. It is left to the discretion of the Comptroller of the Currency. He is to revise valuations as may be proper and necessary according to his judgment, and will use his own judgment in that matter, and then will decide whether he will require a change to be made.

Mr. MILLS. Yes. But if he is to revise valuations I should say that he can not do it unless he makes examinations of the properties.

Mr. WILLIS. Of course, he would do that as often as necessary. But in a good many cities of the country, and in many farming sections also, isn't it true that notable changes have occurred in real estate values, perhaps because of some local condition that has brought them down?

Mr. MILLS. Oh, yes. Like every other commodity the value of real estate has come down.

Mr. WILLIS. Suppose that fact is well known in a given community, say, in Minnesota, so that it has become a recognized fact that there has been a general decline in all land values as indicated by recent sales, amounting to 10, 15, or 20 per cent. It would not be necessary for the Comptroller of the Currency to visit every individual property covered by a mortgage in order to make sure of that, would it?

Mr. MILLS. He would not have to do it if they are all off in value. But we find in addition to general conditions that there are many considerations entering into any consideration of mortgages, such as a change in a particular neighborhood. Values in that particular neighborhood may be going down, and it may be true of only two or three blocks in a city, and if a real-estate valuation is to be of any benefit at all an examination would have to be made of those properties.

Mr. WILLIS. That might be your judgment as to whether the valuation would be of any benefit or not. But I was trying to bring out what is described here in this bill, which is, that the Comptroller

of the Currency shall look over the situation and revise values when it seems to him wise to do so. Isn't that true?

Mr. MILLS. No. While it is true that he has to revise values and change values if he sees fit, at the same time if he is to make any definite revision of values he must sufficiently inform himself to do so.

Mr. WILLIS. Quite so. He has to have general information that will enable him to revise valuations.

Mr. MILLS. Yes.

Mr. WILLIS. Now, in that event he will simply be doing what he does in reference to ordinary collateral loans.

Mr. MILLS. But there he has statements both as to the market for the collateral and the financial responsibility and so on of the borrower.

Mr. WILLIS. Precisely. So that this provision of the bill would merely ask him to do for real-estate loans what he now has to do for collateral loans.

Mr. MILLS. But there is quite a distinct difference in the methods by which each may be done. In the one case an examiner will come into the office and will be furnished with the necessary statements and data upon which to base a judgment. While the other requires, if it is to be done at all properly, and I will assume, of course, that the Comptroller of the Currency would do it in a proper way, he would have to appraise the properties.

Mr. WILLIS. We must assume that if he does it at all he will do it in the proper way, or will at least do it as in the past.

Mr. MILLS. But in the past there has been no statute requiring him to make revised valuations.

Mr. WILLIS. But he has had to do many other things in the past without specific order.

Mr. MILLS. Yes, sir.

Mr. WILLIS. He does not go into the field in order to make a valuation of United States Steel or Bethlehem Steel.

Mr. MILLS. No, sir; for he knows the market value.

Mr. WILLIS. You mean the quoted value?

Mr. MILLS. Yes, sir; he knows the market value.

Mr. WILLIS. The provision is intended to establish some kind of control over real-estate loans and of land values as security for loans.

Mr. MILLS. The difference is simply this, that in the matter of security loans you have a well-known place where you can go to find market values.

Mr. WILLIS. Is it any more difficult in the one case than in the other?

Mr. MILLS. Yes, sir. The only way to find out in the case of real-estate loans is to make an examination.

Mr. WILLIS. But the object is the same in both cases?

Mr. MILLS. Yes, sir.

Mr. WILLIS. Isn't it a fact that a great many banks at the present time have a vast body of overvalued real-estate loans due to the slump?

Mr. MILLS. Yes; doubtless many are overvalued at this time in that they are over 50 per cent of value.

Mr. WILLIS. Isn't it desirable to bring them down as soon as we can by recognizing the fact that there is a necessary write-off there

although not by forcing it to be done in an uncomfortable or difficult way?

Mr. MILLS. Yes. But under the figures that I have cited to the committee in our own case, the maximum amount that we could have under the proposed bill would be $146,000,000.

Mr. WILLIS. You mean $146,000,000 of what?

Mr. MILLS. Of mortgages.

Mr. WILLIS. To be held by your bank—based on what?

Mr. MILLS. Based on our time deposits, under that provision of this bill. It gives us $228,000,000.

Mr. WILLIS. In making loans is there anything to prevent a bank from making them on the amortization plan so that the lender has the power to reduce them?

Mr. MILLS. We always do that.

Mr. WILLIS. You have the power to compel a regular paying off if you want to?

Mr. MILLS. Yes; and we have always done that.

Mr. WILLIS. Now, about the time deposit situation: You are familiar with the reserve plan that you spoke of.

Mr. MILLS. Yes.

Mr. WILLIS. That fixes a maximum limitation.

Mr. MILLS. It does, 15 per cent.

Mr. WILLIS. Do you think that a good plan? Would you keep that in the bill?

Mr. MILLS. In reading that report I referred to I have understood that only two banks would be affected; that of all member banks only two would obtain any benefit by keeping the maximum of 15 per cent in.

Senator BULKLEY. Why should there be a maximum in the bill?

Mr. MILLS. I do not know what two banks are referred to in the report, but I presume those two banks have some unusual circumstances whereby they know that funds are coming in. For instance, I can understand it in the case of a bank that has only one or two factories in the community. For instance, we have a town in Michigan—Marysville—where there are on or two factories, and I would presume that a bank in that location, having nothing to support it but the workmen and those one or two factories, would have an exceedingly high turnover of accounts.

Mr. WILLIS. You say——

Senator BULKLEY (interposing). Mr. Haas suggested on yesterday that we might put an exemption in this provision in favor of disbursements for pay rolls or dividends.

Mr. MILLS. Well, that would mean a deduction, but you would still be penalizing, and that is the vice of the thing to my mind, the time deposits——

Senator BULKLEY (interposing). Wait a minute. What are we talking about now? I am talking about a system that would not penalize them.

Mr. MILLS. Then I beg pardon. I thought you said that what you had done was not what the bill proposes but would be a thing that does not penalize savings deposits.

Senator BULKLEY. I am talking about the velocity system that you are advocating.

Mr. MILLS. The velocity system does not penalize regular time deposits.

Senator BULKLEY. I did not see what you meant. I told you that Mr. Haas suggested to us on yesterday that we make an exemption in favor of disbursements for pay rolls.

Mr. MILLS. All right.

Senator BULKLEY. Can you give us your reaction to that? That is an answer to the proposition you presented a minute ago about how there might be exceptional circumstances.

Mr. MILLS. I think it might be proper to use that, and remove the 15 per cent maximum limitation that is proposed.

Senator BULKLEY. I will say that I do not like the 15 per cent maximum limitation.

Mr. MILLS. I think that might do it. That is the only case where I can see there might be a necessity for having a maximum limitation. Probably if dividends and pay rolls were exempted they would relieve any necessity for a maximum.

Mr. WILLIS. If that plan were to be adopted I understand you would eliminate the maximum entirely.

Mr. MILLS. If pay rolls and dividends and that type of activity were exempted we escape the situation which you suggested.

Mr. WILLIS. In other words, if we were to revise the whole thing all the way through that would cover it.

Mr. MILLS. Yes, sir.

Mr. WILLIS. But if you had to take it as it stands, would you leave the maximum in or not?

Mr. MILLS. Yes; and the reason I say that is that I have confidence in the gentlemen who made the report, of only two banks being affected. And I have complete confidence in those gentlemen.

Mr. WILLIS. Then you take it on faith.

Mr. MILLS. As to these two cases, yes.

Mr. WILLIS. And if you had a maximum you would have no objection to having a minimum, would you?

Mr. MILLS. If the minimum is very small. I think that would almost follow from the turnover in the accounts.

Mr. WILLIS. There is a minimum in the bill.

Mr. MILLS. You mean in the report?

Mr. WILLIS. You would be perfectly willing to add also a minimum figure, say, representing the present level of reserves now held, wouldn't you?

Mr. MILLS. I would if that were applied with a differentiation of time and demand deposits.

Mr. WILLIS. Quite so.

Mr. MILLS. Yes.

Mr. WILLIS. You noticed in the reserve statement that there is a provision for counting Federal reserve notes in vaults as a part of the reserve.

Mr. MILLS. Yes.

Mr. WILLIS. Do you favor that or not?

Mr. MILLS. Under the present law there is counted as reserve only money in Federal reserve banks. I personally think money in vaults should be counted the same as money in reserve.

Mr. WILLIS. For long years national bank notes have not been counted that way.

Mr. MILLS. No, sir.

Mr. WILLIS. Would you differentiate between them?

Mr. MILLS. No, sir.

Mr. WILLIS. You would not count reserve notes in vaults as a part of it?

Mr. MILLS. No, sir.

Mr. WILLIS. That would make a pretty material alteration in the working out of this provision.

Mr. MILLS. Yes, sir; and I think properly.

Mr. WILLIS. At the present time isn't it a fact that our reserves have fallen to a very low level?

Mr. MILLS. How do you mean?

Mr. WILLIS. I give this merely from memory and subject to correction—I do not think I had better give the name of the bank. But I recall in a bank circular a couple of years ago the reserve was figured at about 6 per cent, computing cash held as a percentage of the entire outstanding deposit liabilities of the country.

Taking this as a basis on which to figure reserves, say, 6 per cent represents the real reserve power of the country as a whole. Would you think that about right?

Mr. MILLS. My only answer to that is that this report to which I have referred shows the average for the country as 8 per cent.

Mr. WILLIS. Do you mean figuring it in that way or in some other way?

Mr. MILLS. Under the present law the average for the country is 8 per cent.

Mr. WILLIS. But if you take it the other way, which is intended to represent a real relationship between outstanding deposits and cash on hand, it gets down lower than that. I gave the figure from memory, but I think it is 6 per cent. Figuring it the same way for later dates you would get a still further reduction. Are not reserves at the present time too low for safety?

Mr. MILLS. I think not. I do not know of any bank that has failed on account of improper reserves. I know banks that have failed for lack of liquidity, and so forth, but not on account of improper reserves. I do not believe there is any longer any real relationship between reserves and liquidity.

Mr. WILLIS. Do you think the banks at the present time have plenty of rediscountable material?

Mr. MILLS. Well, I know that they have not got plenty on account of the debates I have seen in the Senate.

Mr. WILLIS. I should rather have your experience as a banker.

Mr. MILLS. If you exclude, as I assume you do, securities which may be eligible under the Glass-Steagall bill, and if by eligible securities you mean those which in the ordinary and natural course may now go to a Federal reserve bank, according to reports of the last two call dates, I know the banks have not very much eligible paper left to go to the Federal reserve system with.

This condition is due to two causes: First, corporations that have ordinarily made that paper and borrow have liquidated their inventories into cash and they are not now borrowing. That paper is

nonexistent. Take practically all of the motor companies around Detroit, and we have not any of that paper on account of the low state of industrial activity.

Senator BULKLEY. You say there is not very much eligible paper left. How much is there?

Mr. MILLS. Of course, it varies with the different banks.

Senator BULKLEY. I mean in the aggregate what does it amount to as to paper that is eligible?

Mr. MILLS. I think that report which was given to the Senate—and if you will bear with me one moment I will look it up for you.

Senator BULKLEY. All right.

Mr. MILLS. On September 29, 1931, and I am now quoting from page 4341 of the Congressional Record, it appeared that there were only 91 banks which at that date had exhausted their eligible reserves at the Federal reserve banks from eligible paper. Twenty per cent of those banks had less than $10 of eligible assets for $100 of total loans. Two hundred and thirty-one banks on that date reported that they were using 70 per cent or more of their eligible assets to borrow. They were in the danger zone.

Now, since that time deposits have declined. And here in this debate, which was in early February of this year, it is shown to be $2,250,000,000 or 11 per cent. So that in the period between September 29, 1931, and February of this year there has developed a very much tenser situation. I have not the present figures but I know in our own bank we perhaps have less than 5 per cent of our paper eligible for rediscount.

Mr. WILLIS. Would your situation be exceptional?

Mr. MILLS. I do not believe that is exceptional in Michigan.

Senator GLASS. Let me say that in an interview I had with him as late as last Saturday evening, the chief of banking operations in the Federal reserve system stated to me that the banks had ample eligible paper.

Mr. MILLS. Then I do not know where they get it?

Senator BULKLEY. Did he say how much they have?

Senator GLASS. No. He simply made that statement.

Mr. MILLS. We were discussing the 15-day loan proposition. At the call date in September the banks were all asked to include an estimate of what their eligible paper was. We made such an estimate. Likewise we were asked to do the same thing on the last day of December, and we did it. In our own case we found it had dropped very much. And I have been told by the State bank commissioner of Michigan that that situation is true throughout Michigan.

Senator BULKLEY. As I recall the situation it developed that there was about three billions of dollars of eligible paper held by banks and not rediscounted. That seemed quite inconsistent to my mind with your statement that there was only a small amount. I would call it a substantial amount.

Mr. MILLS. You are referring now to the country as a whole?

Senator BULKLEY. Yes.

Mr. MILLS. I do not know what that amount would be for the country as a whole. But I can give you my belief that in Michigan there is not more than 5 per cent of the paper eligible.

Senator GLASS. The figures used in that debate were based upon official reports, were they not?

Mr. MILLS. Yes, sir. There has been, of course, a great deal of water over the dam since September. Deposits have gone off and industrial activity has been curtailed, and there is less borrowing by industrial concerns whose paper is eligible than there was in September.

Senator BULKLEY. I think it would be fair to expect an estimate up to date to show less eligible paper at this time.

Mr. MILLS. Yes, sir.

Senator GLASS. Very likely, and also a greater volume of rediscounts. But, as to that, I do not know. I have not had any official figures.

Senator BULKLEY. Rediscounts are going down.

Mr. MILLS. Mr. Chairman, my time is going down, and if I might make one or two more statements I should like to do so.

Senator FLETCHER (presiding). The average reserve you have given is now 8 per cent. Suppose this bill became a law, how would that be affected, what would be the increase?

Mr. MILLS. It would be very considerably higher, because the country bank reserve would be 7 per cent. Reserve city banks would be 10 per cent. Central reserve city banks, which are the largest banks of the country, would be 13 per cent.

Senator GLASS. They are now behind demand deposits.

Mr. MILLS. Yes; but I was speaking of all deposits. That meant that all deposits would be raised probably close to 10 per cent on an average. I would think it would be probably over 10 per cent, because the large amount of deposits are in the larger cities where the reserve would be raised to the higher point.

Senator FLETCHER. You think that unnecessary for protection?

Mr. MILLS. I think it is unnecessary for the purpose of protection, and that the results by way of increase of interest charges to borrowers, and decreased amounts by way of interest to deposits both savings and time, would be disastrous.

Senator GLASS. That would not be the immediate effect, but would be over a period of five years.

Mr. MILLS. Yes. But to follow that up I will say, as these increased reserves were required to come into the Federal reserve bank the only way member banks have of making up the loss on the increased reserves would be through the three methods I have mentioned. If I know human nature, and I think I do, I will say that just as sure as the sun will rise the banks will try to equalize that loss in earning power.

Senator GLASS. Banks certainly have their share of human nature because whenever they have appeared here they have wanted us to reduce the reserves and we have done it. We have reduced the central bank reserves from 25 per cent to 13 per cent, and we have reduced the country bank reserve from 12 to 7 per cent.

Mr. MILLS. Do you think it is fair, Senator Glass—and I realize you are not a witness, but I am—still do you think it fair to go back to reserve requirements prior to the Federal reserve act? There was a reason then for a larger reserve, because there was no central body to which banks could go for borrowings.

Senator GLASS. Of course I have not suggested that or I would not have agreed to reduce them.

Mr. MILLS. That is my point.

Mr. WILLIS. You have noted the valuable provisions for profit making given to member banks. Wouldn't those offset any expense?

Mr. MILLS. Do you mean the liquidating corporation?

Mr. WILLIS. Yes. And the fact that national banks have the power of doing business on the same basis as State banks unless specifically prohibited.

Mr. MILLS. Take the liquidating corporation, and I think opportunities for profit are questionable.

Mr. WILLIS. It depends on how they are managed.

Mr. MILLS. Yes; but that also requires an additional investment being made in the corporation by banks, and profits on that are fixed at 30 per cent of the profits in one year. As I read the bill there is no guaranteed return in anywise from there. Profits are not cumulative.

Mr. WILLIS. If a bank gives up the stock it gets the benefit.

Mr. MILLS. It gets the benefit to its assets. But there is a question whether there would be any benefit therefrom.

Mr. WILLIS. It also receives future earnings or balance of surplus.

Mr. MILLS. I think this is the way to answer that question: That, if the bill should give an option to member banks to subscribe to stock of a liquidating corporation, I doubt if any bank would exercise the option to subscribe, for the reason that the chances of profit are speculative.

Mr. WILLIS. I suppose we have all refused to take advantage of opportunities we ought to have taken advantage of.

Mr. MILLS. Yes; and likewise often have taken advantage of what we thought were opportunities of which we should not have taken advantage.

Senator GLASS. Your dividend under the law as it exists is specific. That is, an opportunity to earn an increased dividend, is it not?

Mr. MILLS. Well, our dividend under the present law is 6 per cent.

Senator GLASS. That is what I say.

Mr. MILLS. But we do not get, as I read the proposed bill, any 6 per cent on anything else which is guaranteed.

Senator GLASS. You get whatever dividend is made.

Mr. MILLS. We get whatever is made on the operation of liquidating closing banks.

Senator GLASS. I say, this is an additional opportunity for an increased dividend.

Mr. MILLS. It is an additional chance. I would not use the word "opportunity," because I do not think it resolves itself into that, Senator.

Senator GLASS. Do you think the proposed stock assessment there would be a great hardship on the banks?

Mr. MILLS. No; I think after all the banks have to be somewhat in the position of helping out each other, and I haven't any particular fault to find with the liquidating corporation.

Senator GLASS. You have got more sense than some of the witnesses we had.

Mr. MILLS. Well, that may be something against me, Senator.

Senator GLASS. We have had witnesses to object to an assessment of one quarter of 1 per cent on the individual banks to help themselves, and they had no criticism to make, apparently, of the larger assessment made by this National Credit Corporation in New York.

Mr. MILLS. We all joined in the National Credit Corporation. Speaking of the activities of the National Credit Corporation in Michigan, with which I have been rather actively connected, that is one reason that leads me to believe there will not be a great deal of profit in this opportunity, as Doctor Willis has designated it, of joining in this liquidating corporation. I do not believe there will be a profit in that operation at all. I do believe, however, and the National Credit Corporation has convinced me, that banks to a certain extent have to and should help out each other. I think that refers to anyone that is connected with the Federal reserve system. I haven't any fault to find with it.

Senator GLASS. That is the real purpose of that, and then it is protection to the depositors in member banks. It is an assurance to them that they will get whatever money is coming to them within a reasonable length of time and not be delayed by receiverships that extend over very protracted periods.

Mr. MILLS. I think that is true. I do not want to get into a lot of details in the wording of this, but I must say that in the subscription to the class B stock by the Federal reserve bank the total amount subscribed by the Federal reserve bank, a quarter of the surplus, I think, is generous. I haven't any complaint to find on that. I do think that the amount that the Federal reserve banks have to pay in at the moment is rather small, and that amount should be increased. In other words, the burden that the member banks pay is far greater at the moment than the Federal reserve banks pay. Eventually the Federal reserve banks pay a very substantial amount, which I think is probably proper enough.

I think, for instance, that the banks—I am not speaking of the Federal reserve banks but the member banks—should be given a similar opportunity to pay their subscription and not to pay their one-half of 1 per cent within 90 days and the balance when called for. That may be a little strong. Certainly, it is not right to have the whole Federal reserve system only put up, as it stands here, the figures I have, $136,000,000, when they can put up a great deal more without really feeling the burden. I think that process is not rapid enough; it hasn't enough velocity to get the funds from the Federal reserve system.

Senator BULKLEY. I am particularly interested in your statement that you do not believe the liquidating corporation will make any money. Is it that you presume they will pay too high a price for the assets of the closed banks?

Mr. MILLS. It all depends on the management.

Senator BULKLEY. Well, it does depend on the management, but what is your presumption? Do you think that they would buy them for reckless prices?

Mr. MILLS. No; I would not think that they would buy them for reckless prices.

Senator BULKLEY. Then how can they fail to make money?

Mr. MILLS. It is a question of carrying the items for a very long period of time. Some of these items will have to be carried 20 years, and I think as a banker I would prefer to have the profit that a bank makes from its interest account than I would in making a long-term investment.

Senator BULKLEY. Are you really sincere in your statement that you would have to carry an asset 20 years?

Mr. MILLS. I think some of these assets will be absolutely unsalable. For instance, on some mortgages the real estate will have to be carried, because it is unsalable for any kind of a price.

Senator BULKLEY. Why should they pay a higher price than anybody else who is buying the same thing?

Mr. MILLS. It gets back to the human judgment. Isn't that correct? If it did not, we would not be in the position we are in now.

Senator BULKLEY. Then you do assume that they will pay excessive prices?

Mr. MILLS. I do in some cases. They will exercise good judgment, but it will be mistaken judgment. No bank, Senator, as you know, would make a bad loan if they thought it was bad at the time that they made it. That would be precisely the case with this liquidating corporation.

Senator BULKLEY. I think liquidators are a little different from a going bank.

Mr. MILLS. Yes; they are different, but they also make mistakes—I am not saying anything else but honest mistakes; mistakes in judgment.

Senator GLASS. We do not understand that you are particularly opposed to the liquidating corporation.

Mr. MILLS. No; like everybody else, I think I can improve a little bit on it, but I haven't any real objections to it. I think that the amount to be contributed by the Federal reserve bank as such should be stepped up more initially and the amounts to be computed by the member banks should initially be decreased. I have no objection whatsoever with their total amounts.

Senator GLASS. It is one-quarter of 1 per cent. Do you think it ought to be made less than that?

Mr. MILLS. No; I haven't any objection to that, provided that you increase the amount from one-half of 1 per cent of one quarter of the surplus to be put up by the Federal reserve bank. That, I think, is altogether too low.

Senator GLASS. When we hear from the Federal reserve banks we will probably be told that it is altogether too high.

Mr. MILLS. Very likely. That, again, is human nature.

Senator BULKLEY. Is it not true that whatever is contributed by the Federal reserve banks is an asset of the liquidating corporation and presumably an earning asset, and the class B stockholders get all the benefit of it without any dividend to the Federal reserve banks?

Mr. MILLS. That is true, except that the dividends are not made cumulative in any respect. They get up to 30 per cent of the earnings in any one year. It is not cumulative.

Senator BULKLEY. But the amount of surplus is cumulative, so that there is more and more paid in surplus?

Mr. MILLS. That is true. That accumulates.

Senator BULKLEY. And that becomes an earning asset?

Mr. MILLS. That presumably becomes an earning asset over a period of time.

Senator GLASS. If they have the same number of bank failures within the next few years that they had in the last few years that corporation will be pretty active, will it not?

Mr. MILLS. They will be active, and you will not have anybody to run it on that basis, Senator.

Senator FLETCHER. Is there anything else that you want to mention?

Mr. MILLS. I do; but I do not want to take Mr. Lord's time.

Senator FLETCHER. State the points rapidly that you want to make. We had better go on and finish.

Mr. MILLS. Now, I realize I am getting on some pretty debatable ground with you gentlemen, particularly Senator Glass. Our bank happens to be a member of a holding company group, no other banks of any large consequence in it except a trust company. We have one state bank outside Wayne County that is owned by the holding company. That is all that we have. Mr. Lord, who will follow me, is also in the holding company.

In Michigan at least there are no banks which have been members of holding companies that have closed their doors or had any moratoriums or anything else, except paid their depositors when they wanted it. In Michigan we have had 112 banks closed during 1931. Michigan does not permit its State banks to engage in banking beyond corporate limits.

My own view is that the drafters of this bill obviously believe in wider than present banking limits. That is, the banking limits should be wider than they now are. It even goes so far as, in certain circumstances, to permit banking to be done in two different States.

Senator GLASS. Only to a very, very limited extent in extraordinary circumstances.

Mr. MILLS. Yes; in proper circumstances, but it at least generally contemplates that banking will go to an extent of state-wide banking.

Senator GLASS. Yes.

Mr. MILLS. In our case in Michigan I can see no reason, if the drafters of this bill are in favor of state-wide banking for not going sled length and saying: "All right, every national bank can go sled length." Certainly, the results in Michigan have been perfectly splendid. There have been no failures of any banks in Michigan that have been members of the group. There have been no moratoriums of any of those banks. Those banks have met their customers' demands when they have been made, as against the 112 banks that have been closed.

Senator GLASS. You would say that regardless of State laws on the subject?

Mr. MILLS. I would, regardless of State laws, because if there is strength, that would solve fully in Michigan, in my judgment, Senator, all objection to group banking. There would not be any group banks left. They will just go out of business.

Senator GLASS. I understood the committee would say that too, and cheerfully, if they could get the bill through Congress.

Mr. MILLS. That is a matter that I can not judge.

Senator GLASS. Well, you may judge the future by the past. It took us 16 months to get the limited branch banking facilities that are granted in the McFadden bill.

Senator BROOKHART. Some of us think that was too quick.

Senator GLASS. Exactly.

Mr. MILLS. I wanted to make that statement. Now, the holding companies—I know they have been damned up one street and down the other, but all the holding companies in Michigan provide for double liability on the shares of stock of the holding company.

Senator GLASS. If that is true, there is no reason why the holding companies in other States should not be required to have that, is there?

Mr. MILLS. I do not know of any reason. We have done it voluntarily. Both holding companies in Michigan have done that voluntarily, and there is double liability on holders of stock of holding companies.

Senator BROOKHART. The fact that your holding companies have done well in Michigan does not mean that they have throughout the United States?

Mr. MILLS. No; they have not. So I will say, Senator, I will grant you that in some places they have not.

Senator BROOKHART. I was out in Louisville and waked up in the morning and a group bank went down and also carried with it 100 or 150 banks.

Mr. MILLS. If the Congress of the United States had passed a law to the effect that you could have had branch banking and branch banking in the future, the provisions as set out by this bill, by a national bank, irrespective of the State, I do not think that you would have had many holding companies in existence at all. The necessity for them would not have been there.

Senator BROOKHART. Of course, a holding company may have been a little worse than a branch, but not much.

Senator GLASS. Oh, yes.

Mr. MILLS. They are open to certain abuses in certain cases that others are not. Before I leave, I just want to make three statements——

The CHAIRMAN. There have been some inglorious failures of branch banks, too.

Mr. MILLS. There have been, but I think if you look over the history of the failures you will find an infinitesimally small number of failures of branch banks.

Senator BROOKHART. How many branches did the Bank of the United States have up in New York?

Mr. MILLS. I can not answer that, but I would be surprised if they had more than three or four branches in New York City. I do not know. I would be surprised if there were more than that.

The CHAIRMAN. Our committee was informed some 50 or 60.

Mr. MILLS. I did not know that. I am not familiar. But I would doubt if they had that number of branches.

The CHAIRMAN. One fact was brought out rather strongly: The money involved in bank failures in the State of South Dakota was not much over $50,000,000, and we have been thoroughly advertised for the large number of bank failures. Here is this big branch bank in New York that went down with over two hundred millions, one single bank, dragged down four times as much as all the failures in my State did. And still we are told we have a poor system out there because we have so many bank failures.

Mr. MILLS. Well, taking your own statement, Senator, do you think if the banks there had united so that the strength of each would have been the strength of the other—of course you would have had the weaknesses also—there would have been the same number of failures?

Senator BROOKHART. Yes; with the price of corn and hogs and wheat and oats the way they are.

Mr. MILLS. You would have had the failures anyway, it didn't make any difference, is that it, Senator?

Senator BROOKHART. You are going to have failures of your combinations in Michigan, because they will quit buying Fords pretty soon.

Mr. MILLS. The failures there had no relation to groups.

Senator TOWNSEND. Are there other provisions in the bill that you oppose that you have not referred to?

Mr. MILLS. Yes; just two or three, if I may state them. I would like to have them on the record, if I may.

I personally feel, and I feel strongly, that the Secretary of the Treasury should be a member ex officio of the Federal Reserve Board. I also believe that the open-market operations had rather be conducted by the banks than by the board. I also feel—I do not understand the reason for a higher interest rate on borrowings from the Federal reserve bank where those notes are secured by Government obligations than where they are secured by eligible paper.

Senator GLASS. There is no difference except on 15-day notes.

Mr. MILLS. That is on the 15-day note, and there is a difference of the differential of the interest rate of 1 per cent on that, although those notes are backed by the obligations of the Government of the United States, and, of course, the paper that is issued on it is backed by an obligation as a whole of the 12 Federal reserve banks.

Senator GLASS. There is no difference between commercial paper and Government securities, but on 15-day paper it is a special privilege.

Mr. MILLS. Yes; but if a bank comes in and simply rediscounts eligible paper it has a preference rate of 1 per cent, rather than if it comes in and borrows on Government paper.

Senator GLASS. For 15 days?

Mr. MILLS. Yes.

Senator GLASS. Oh, no; not at all.

Mr. MILLS. I think so, Senator.

Senator GLASS. Well, look and see.

Mr. WILLIS. Page 25:

Any Federal reserve bank may make advances to its member banks on their promissory notes for a period of not exceeding 15 days at rates to be established by such Federal reserve bank, which rates shall in all cases be at least 1 per

cent higher than the rediscount rate then in force at such reserve bank, subject to the review and determination of the Federal Reserve Board, provided such promissory notes are secured by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for rediscount or for purchase by Federal reserve banks under the provisions of this act, or by the deposit or pledge of bonds or notes of the United States.

Senator GLASS. Well, what is the difference? That is a 1 per cent higher charge upon 15-day notes of banks where those notes are backed at least by obligations of the United States. Or eligible paper.

Mr. MILLS. Or eligible paper, but in either case if the note itself is increased by the 1 per cent there is a higher charge than if they simply rediscount commercial paper.

Senator GLASS. On all 15-day paper?

Mr. MILLS. On all 15-day paper.

Senator GLASS. Direct promissory notes?

Mr. MILLS. Yes; direct promissory notes.

Senator GLASS. And yet there is no difference between the security?

Mr. MILLS. No; but why should a bank be penalized in borrowing for 15 days, you say on Government paper, when it could obtain those funds by taking in and rediscounting customers' paper?

Senator GLASS. It is not under that section.

Mr. MILLS. I do not read it that way, Senator.

Senator BULKLEY. I think the answer to Mr. Mills' question is that fundamentally they ought not to have the right to borrow on Government securities at all.

Mr. MILLS. If that is the case, then you reach the point where, in my judgment, the operation of the Treasury Department of the United States would be hampered. It would just raise the devil—pardon my language—with everything.

Senator BULKLEY. That is the question of the Treasury leaning on the Federal reserve again.

Mr. MILLS. Yes; exactly, and I think it will have to lean on it.

Senator BULKLEY. We simply do not believe it. We believe the Government is pretty good, whether there is a Federal reserve system or not.

Mr. WILLIS. In some instances it is their practice to make Lombard loans.

Mr. MILLS. Yes; Lombard loans at higher rates. These are not Lombard loans. The Glass-Steagall bill is the Lombard feature.

Mr. WILLIS. It is often contended that they are Lombard loans, but in reality those of which we are speaking are much nearer the true Lombard loan.

Senator GLASS. The question is putting into use Federal reserve facilities for stock-gambling purposes. That is the real purpose.

Mr. MILLS. Senator, I know that is the purpose. I think it goes much further than that, and while I have no desire to use the Federal reserve funds for stock-gambling, I think the medicine here is going to cause another serious disease, Government financing. I feel that very strongly.

Senator GLASS. Do you feel that the rediscounting provisions of the Federal reserve act, which were intended to be the major provisions of the act, have simply been submerged by the open-market

operations of the Federal reserve banks, dominated by the New York bank and by the stock-gambling use, with the 15-day paper for stock-gambling purposes?

Mr. MILLS. They use the 15-day paper for many, many other things, Senator.

Senator GLASS. Not for many other things.

Mr. MILLS. We have used that for the purpose of the 15-day period to help the city of Detroit in its operations in order to lend money to the city of Detroit to enable it to meet payrolls, and all that kind of things. We have had to use the 15-day paper on account of the shortage of the other paper. We have had to use it. And I think it is next to impossible to use the eligible paper, anyway. They have a bunch of clerks over there that if the "t" is not crossed they will throw it back at you. It is so much easier to use the Government paper.

Senator GLASS. Would you object to that provision if we should eliminate the 1 per cent penalty?

Mr. MILLS. I think that would help it very much, with this proviso—I read in the morning paper——

Senator GLASS (interposing). Before you leave that particular point; you will note, of course, that under existing law the Federal reserve bank has unqualified right to put any penalty there it pleases.

Mr. MILLS. Yes.

Senator GLASS. Subject to review and determination of the Federal Reserve Board.

Mr. MILLS. Yes, it has.

Senator GLASS. So that we give a stated percentage, but the Federal Reserve Board, under existing law, can not only name that minimum percentage but they can name a higher percentage.

Mr. MILLS. That is true.

Senator GLASS. That has been true for 16 years, has it not?

Mr. MILLS. That is true. No question about that.

The only other thing I would like to state, Mr. Chairman, is this: I saw in the morning paper—as I read this act there is this clause, the investment clause. 15 per cent of investment capital from 25 per cent of surplus. The newspaper at least quoted, I think it was Senator Glass and Doctor Willis, as stating that the intent was only to have those provisions apply to the future and not the present. The law as it reads clearly, in my mind at least, provides that the excess securities would have to be disposed of. That is in section 15, I think, page 36. If the paper was correctly quoting, that this statute was not intended to provide that any bank should have to dispose of these tremendous quantities of securities of the reserve accounts——

Senator BULKLEY. It does not really mean any such thing.

Mr. MILLS. It says that, I believe.

Senator BULKLEY. I know it. I think the language is very unfortunate myself.

Mr. WILLIS. What language is there there that indicates the necessity of a sale, please? We might stick to that point and get your view on that.

Mr. MILLS. "But in no event shall the total amount of such investment securities of any one obligor or maker held"—the words are "and held."

Senator BULKLEY. That means the one obligor, although I would not have read it that way myself.

Mr. WILLIS. You see, Mr. Mills, the provision in lines 2 and 3 states that "The business of purchasing and selling investment securities shall hereafter be limited," and so forth. That qualifying clause runs on down to the end of the sentence.

Mr. MILLS. We discussed this at a meeting we held in Detroit, and that question was raised. I think the language is exceedingly blind on it.

Senator BULKLEY. Yes; it ought to be changed.

Mr. MILLS. The language should be changed so as to make that intent clear. Because, if that should stand, the results would be terrible to the liquidations that the banks would have to make. If it means only as to the future, I would like to ask this question: If this change is to be made what is to happen to future purchases until the portfolio gets in this new required shape? In other words, the banks are holding in excess of the amounts permitted under this particular section. I then take it that it is understood that they are not required to immediately divest themselves of such holdings, but in the future they can not go over——

Mr. WILLIS (interposing). They are not to enter into any new contract or make any new loan.

Mr. MILLS. And those provisos are limited and they are not to make investments on the total portfolio of the bank but on the total obligations that any one bank holds. Thank you, gentlemen. I am sorry to take so much longer than I intended.

The CHAIRMAN. The next witness is Mr. Lord.

## STATEMENT OF ROBERT O. LORD, PRESIDENT GUARDIAN DETROIT UNION GROUP AND GUARDIAN NATIONAL BANK OF COMMERCE, DETROIT, MICH.

The CHAIRMAN. Give your full name and address and business connections to the reporter.

Mr. LORD. Robert O. Lord, president of the Guardian Detroit Union Group and also of the Guardian National Bank of Commerce, Detroit.

Senator, Mr. Mills has covered in a general way the Detroit situation. I might, to get the picture in the minds of this committee, state that the Detroit Bankers Group, of which his institution is a part, confines its activities to Wayne County. Our own group of banks covers the industrial section of Michigan in the lower peninsula.

If I may be privileged to do so, I think it might simplify the matter, on account of lack of time, if I read the statement that I have and answer any questions that might be put.

Senator COUZENS. Have you had any experience, Mr. Lord, as a bank examiner?

Mr. LORD. No, sir. I have had 26 years' experience in a bank.

Senator COUZENS. Yes; I was just wondering what your experience was.

Mr. LORD. The Guardian Detroit Union Group (Inc.) is a corporation organized under the laws of the State of Michigan. Its

principal assets consist of all or practically all of the capital stock, except directors' qualifying shares, of the following banks and trust companies:

Guardian National Bank of Commerce of Detroit.
Union Guardian Trust Co., Detroit.
Michigan Industrial Bank, Detroit.
Highland Park State Bank, Highland Park.
Highland Park Trust Co., Highland Park.
Bank of Hamtramck, Hamtramck.
Guardian Bank of Grosse Pointe.
Guardian Bank of Dearborn.
Guardian Bank of Royal Oak.
Guardian Bank of Trenton.
City National Bank & Trust Co., Battle Creek.
Union Industrial Trust & Savings Bank, Flint.
Grand Rapids National Bank.
Grand Rapids Trust Co.
National Bank of Ionia.
Union & Peoples National Bank, Jackson.
First National Bank & Trust Co., Kalamazoo.
Capital National Bank, Lansing.
City National Bank & Trust Co., Niles.
First National Trust & Savings Bank, Port Huron.
Second National Bank & Trust Co., Saginaw.

All of these institutions are located in the lower peninsula of the State of Michigan. The banks of this group serve more than 400,000 depositors, offering them the complete protection that is demanded in these times when large resources, liquidity, and directorates composed of men whose names are synonymous with honesty, integrity, and high principles are necessary to convince depositors of complete security. In spite of the fact that during the year 1931 112 banks were compelled to close their doors in the State of Michigan alone, all of our institutions successfully weathered the storm and no depositor in these institutions suffered any loss.

The group company does not own or control any banks, trust companies, or financial institutions located outside of the State of Michigan. The stock of the group company, consisting of 1,544,844 shares of $20 par value, is held by upwards of 8,000 shareholders, and more than 92 per cent of the shares outstanding is owned by residents of the State of Michigan. Aggregate deposits of the institutions named above totaled on December 31, 1931, $349,398,000, with total customers exceeding 400,000, as I have stated.

Senator GORE. How many different institutions? Pardon me.

Mr. LORD. Twenty-one banks and trust companies, Senator.

These banks and trust companies became a part of the guardian group through the exchange of stock on an appraised book-value basis. None of the institutions were bought for cash. The group or holding company was organized in accordance with law and with the full knowledge and approval of the State authorities.

In order to give to each local community management which has a primary interest in the welfare of that community and in the prosperity of industry and of the individual there located, there was included in the by-laws of the holding corporation the following Article VI:

Whenever at any meeting of the stockholders of a bank or trust company of which this corporation shall at the time own 75 per cent or more of the outstanding stock, an election of a board of directors is held, the shares of such

bank or trust company owned by this company shall be voted in favor of the election of a board of directors of which at least 75 per cent shall consist of directors residing in the municipality where said bank or trust company is located or within a radius of 50 miles thereof.

As a matter of fact, with the exception of 2 or 3 of the 21 institutions, or rather of the dozen or more institutions outside of the limits of Detroit, we do not have representation of these boards. Their own boards govern the banks entirely. Where we have members it has been at the invitation of the local institution.

While the lower peninsula of Michigan has excellent diversification of agriculture, this district, and Detroit especially, is best known throughout the world for the manufacture and distribution of motor cars and automobile accessories, an industry which affects directly or indirectly the welfare of more than 10 per cent of the population of the United States.

Any legislation which adversely affects the banks in Michigan will, in turn, affect the motor industry and will thus indirectly affect a vast number of individuals throughout the entire nation.

As indicating the importance of the motor industry to this country and to its other industries as well as to the farmer, might I remind the committee that 10 per cent of all cotton, 14 per cent of all tin, 15 per cent of all finished steel, 15 per cent of all copper, 17 per cent of all aluminum, 18 per cent of all hardwood lining, 30 per cent of all nickel, 51 per cent of all upholstery leather, 68 per cent of all polished glass, and 82 per cent of all crude rubber goes into the manufacture of motor cars and their accessories.

More than 58 per cent of the aggregate banking resources of Michigan are included in the two banking groups—Guardian Detroit Union Group and Detroit Bankers Co. These two groups on December 31, 1931, showed aggregate resources of their banks and trust companies amounting to more than $1,090,000,000 of which about $888,000,000 was in national banks, representing 83¼ per cent of the national bank resources of the entire State of Michigan, more than $84,000,000 was in State banks, and more than $118,000,000 in trust companies.

Incidentally, these two groups, out of total subscriptions to the National Credit Corporation from Michigan banks amounting to $13,410,912.30, subscribed $7,752,553, or nearly 58 per cent——

Senator GORE (interposing). How much did they pay?

Mr. LORD. Thirty per cent assessment, I think.

Senator GORE. That was paid——

Mr. LORD. That was paid by all of the banks subscribing. I think that is correct—the balance being subscribed by 293 other banks in Michigan. Furthermore, neither of these groups nor any banks——

Senator FLETCHER (interposing). May I ask you there what became of this National Credit Corporation?

Mr. LORD. Still in operation.

Senator FLETCHER. Going ahead?

Mr. LORD. They are making no new loans at the present time in Michigan. I can not answer for the other districts.

Senator FLETCHER. They are unloading it onto the Reconstruction Finance Corporation?

Mr. LORD. They are making no new loans but are renewing present loans as they mature.

Furthermore, neither of these groups nor any banks in these groups found it necessary to avail themselves of loans through the National Credit Corporation. In other words, their resources were contributed in substantial amounts for the protection of other Michigan institutions as well as other institutions throughout the country making use of the facilities of the National Credit Corporation.

These two groups have been a bulwark of strength during the financial hurricane of the past two and a half years. Speaking only for the guardian group, our institutions alone, or jointly with others, have been instrumental in protecting deposits in other banks in aggregate amount of more than $65,000,000, with depositors numbering more than 150,000, located throughout the State. Without such strength and such help there must inevitably have been tremendous losses to business and individuals.

The State of Michigan is just now beginning to show signs of returning confidence in its banks and in its industries. Funds are starting to come from safe deposit boxes and other places of hiding. This may be attributed in large measure to the effective help, both practical and psychological, of the national legislation by which there was created the National Credit Corporation, the Reconstruction Finance Corporation, and also the Glass-Steagall bill. All of these measures have been designed wisely to permit the proper expansion of credit, and to aid existing agencies in taking care of the financial requirements of industry, commerce, and of the individual.

Unquestionably, during the years preceding 1929, many unsound practices developed in certain phases of the banking business, as in all business and industry, principally in respect to securities companies affiliated with banks. Such abuses can be eliminated or prevented without disturbances to the banking business, to the entire industrial structure of the country, or to public confidence. Those who are proposing remedies for past or present ills should bear in mind that the patient, at least as we see it, is only now starting to recover and that a major operation in the present state of financial health of the patient may result in a relapse or even in the death of the patient. Perfect rest and quiet with an occasional stimulant may bring about the quickest and surest recovery.

Commenting generally upon this Senate bill 4115, many of the provisions are sound and constructive, especially the establishment of an agency for the liquidation of the assets of closed banks.

The provisions of the bill covering affiliates are presumably aimed at securities companies. In the case of unit banks, there is no sound reason why such banks, whether operating under national or State charters, should not have as affiliates a trust company, a building company owning the property in which the banking quarters are located, or a safe-deposit company. In the latter case it is especially desirable, as the liability of a safe-deposit company is impossible to ascertain or to fully cover by insurance. Such affiliates have demonstrated in years past their usefulness and desirability.

If it is wise to eliminate security company affiliates, this can undoubtedly be done within a reasonable period of time. To attempt to force them out of business immediately would result in further liquidation at sacrifice prices that would affect the general public even more than the securities companies themselves.

In that connection I might state that in our own group many months ago we commenced liquidation and dismemberment of our securities companies. The institutions at the present time are not in the security business.

If branch banking is to be preferred to group ownership of banks and trust companies, then the bill should either permit branch banking within State limits or other approved areas, regardless of the laws of the State or States in question; or the bill should permit the existing groups to consolidate their member banks into a single institution and operate such banks which are now members of a group as branches, regardless of the law or the State or States in question, with a further restriction if deemed wise that no new branches shall be permitted except as the State laws may permit.

Presumably, the purpose of section 20, subsections (b) and (c), is to prevent the evasion of the double liability on bank stocks through the ownership by a holding company of such bank stocks. In the case of the Guardian Detroit Union Group, we recognized at the time of our incorporation nearly four years ago that the double liability protection to depositors should be preserved. Our charter, and in fact our stock certificate itself includes the following provisions—I would like for the information of this committee to have you see how that is worded [passing specimen stock certificates to members of the committee]. There are some stock certificates, and on the back is that provision, which is a part of the certificate. That provision is as follows:

> The holders of stock of this corporation shall be individually and severally liable (in proportion to the number of shares of its stock held by them respectively) for any statutory liability imposed upon this corporation by reason of its ownership of shares of the capital stock of any bank or trust company, and the stockholders of this corporation by the acceptance of their certificates of stock of this corporation severally agree that such liability may be enforced in the same manner as statutory liability may now or hereafter be enforceable against stockholders of banks or trust companies under the laws of the United States or the State of Michigan. A list of the stockholders of this corporation shall be filed with the banking commissioner of Michigan and the Comptroller of the Currency whenever requested by either of those officers.

So long as this double liability is carried through to the holders of the stock of the group company, there is no more reason for a group company to be compelled to carry a reserve to protect that double liability than there is for the national or State banking departments to require the individual holder of stock in a unit bank to deposit cash or securities to cover his own personal double liability in case his bank should become insolvent.

I am in hearty accord in permitting the proper authorities full power to examine each and every corporation owned by a holding company—and the holding company itself; and there should be no objection to furnishing the authorities periodically with a complete list of the portfolio of securities owned.

The bill includes restrictions against group banking which seem to me to be both unnecessary and unfair, in view of the record and standing of the group-banking institutions. None have failed to my knowledge where they have been honestly and conscientiously run. Dishonesty is just as responsible for the failure of unit banks as it is for group banks or branch banks.

The existing groups have probably contributed vastly more to the stability and safety of the smaller communities throughout this country than have the unit banks, due to their financial strength and to the confidence in which they are held by the public. According to the testimony of Governor Young of the Federal Reserve Bank before the Banking and Currency Committee of the House on March 19, 1930, group banking at that time included 2103 banks, or one-twelfth of the total number of banks in the country with total loans and investments of about $11,200,000,000, or nearly one-fifth of the aggregate loans and investments of all banks in the United States.

It seems to me especially dangerous at this time to either destroy or impair, by legislation, banking institutions representing so great a percentage of the entire banking resources of this country. The repercussion upon industry and the public would be far more serious than the effect upon the banks themselves. The present is far too critical a period in the financial and industrial life of this Nation to enact legislation which does not have the fully approval of the Treasury Department, the Federal Reserve experts, the department of the Comptroller of the Currency, and the approval of the ablest and soundest banking minds of the United States, as well as the approval of this committee.

To refer to the bill itself and the specific provisions, I have a few comments on some of the provisions.

Section 2 contains a definition of "affiliates" which seems to be so broad as to include industrial corporations, the officers and directors of which might happen also to be either directors or officers of local banks. That undoubtedly can be clarified either by ruling or by change in the wording.

Section 3, I think, is in the main constructive. The argument has been made that it will force a vast amount of securities out of the banks and onto a market which can not absorb them.

Senator FLETCHER. What do you think about having the Secretary of the Treasury as a member of the board?

Mr. LORD. I see no reason why he should not be on the board, Senator.

Section 3, as I read it, is so drawn that there are possibilities of circumstances where a correspondent bank could not lend to its country correspondent, which might be a savings bank or a small country institution, even though such security as was presented was entirely satisfactory, and even though the bank applying for the loan might be having a serious time in the way of withdrawals. I think that section could undoubtedly be clarified so as to prevent such a situation. Section 4 prevents in our own case the institutions which are members of the Federal Reserve Bank from voting for a director of the Federal Reserve, of our own Federal Reserve Bank. That is not to us particularly important, except as a matter of principle. Section 5 seems to me satisfactory. Section 6 satisfactory. I have no comment on section 7. Section 8 I believe has been clarified already by the testimony of yesterday with regard to this percentage which a bank may loan of its capital and surplus. Section 9 is satisfactory and conforms to the practice which our own institutions have been following ever since we started.

Section 10 has been discussed by Mr. Mills and he spoke of the figures. It does seem to me that a good many institutions have done their part in contributing to the liquidation of closed banks already. In the case of the American State Bank of Detroit, which was taken over by all of the other banks in Detroit, the cost of that is a great deal more than we would have to contribute already. It is a great deal more than our subscription to this new liquidating corporation. Our own group will have to stand the expense of about two and a half million dollars to save the deposits of 150,000 depositors. We are glad to do it.

Senator BROOKHART. Does that mean the rate of contributions is too low in this bill?

Mr. LORD. No, sir; I think the rate of contribution of the Federal reserve bank is too low. The proportion, as I figure it out, the member banks would subscribe in round figures is $127,000,000, and they would be asked to pay at once half of that, or $68,500,000. The Federal reserve banks would subscribe $260,000,000, with $1,300,000 to pay in with their subscription, and the balance called for on 90 days' notice. They pay in a quarter of one per cent of their subscription, if I remember correctly, and the balance of their subscription, which is one-quarter of their surplus, is subject to call on 90 days' notice.

Section 11: You gentlemen have heard a great deal of discussion as to the effect of the market value of the United States Government bonds, and possible difficulties of the Government handling its financing if that penalty rate of 1 per cent on 15-day loans on governments is included.

Personally, I think it would be wise if Government securities were eliminated from that, because, unquestionably, there must be a substantial amount of Government financing within the next two or three years, either to meet maturities or to cover the deficit.

Then section 11 does not in any way increase the amount of eligible paper. It does put a premium on eligible paper from the standpoint of borrowing purposes if the paper is discounted rather than used as collateral. In our own largest institution, the Guardian National Bank of Commerce, located in a highly industrial city, with total deposits of about 150,000,000, I do not believe that we could pick out of our loans $5,000,000 of eligible paper. The primary industries in that community are not borrowers at any time.

Section 12 I have no comment on.

Section 13, which Mr. Mills discussed in full detail on the question of the reserve situation, I think does impose a hardship, and a considerable hardship, on banks throughout the country which have a preponderance of savings deposits. In our own institutions, particularly the Guardian National Bank of Commerce of Detroit, we have the smallest percentage of time deposits of any institution in town. It would not seriously affect us, but with institutions which have a vast amount of savings as compared with their commercial deposits or demand deposits, it would increase the reserve requirements very substantially and at considerable sacrifice. In our own group our time deposits average only about one-third of our total deposits.

Mr. WILLIS. Do you recall the average amount of the time deposits per depositor?

Mr. LORD. Excuse me?

Mr. WILLIS. Do you recall what the amount per depositor is—the average amount?

Mr. LORD. I think our time deposits would be about 125,000,000, and I can not tell you the number of our savings depositors; I should say perhaps 325,000. So that you can figure it out that way.

Senator GORE. You have not figured out the average per depositor?

Mr. LORD. No; I have not, Senator.

Mr. Mills spoke also of section 14.

Senator GORE. Just one minute, please, sir. You say one-third of your time deposits?

Mr. LORD. One-third time and two-thirds demand deposits.

As regards section 14, Mr. Mills spoke of the requirement, which we both, I think, understood the same way, as to the appraisal by the comptroller of property securing real estate mortgages, when the comptroller makes his examination three times a year. In Detroit it would almost be a physical impossibility. Our own institution, that is the Guardian National Bank, our biggest institution, has about 5,000 mortgages, and I think the First Wayne National Bank has 53,000, and for anybody to attempt to appraise those properties would be a continuous job and an impossible job.

Mr. WILLIS. You mean there it would be impossible to value if the valuations were made by repeated visits of expert people to the properties themselves?

Mr. LORD. Yes.

Mr. WILLIS. But it would be entirely possible to give a comparative estimate of the average reduction in value which had taken place, would it not, without any such elaborate visitation?

Mr. LORD. I think it would if you classified the properties, Mr. Willis.

Mr. WILLIS. And there is nothing here, seriously, that would prevent the comptroller from requiring that, is there?

Mr. LORD. I think there is nothing to require an inspection of the mortgage loans by the comptroller; no.

Mr. WILLIS. It would be feasible if it were done in that manner, with that flexibility; that is, it would not have to be done three or four times a year? There is nothing here to indicate he must do that. He may revise the valuations in any way he may choose—isn't that true?

Mr. LORD. I think it is. Of course, the banks in Detroit, I think very generally, have the amortization provision in all of their mortgages, so that every three months or every six months, as the case may be, there is a payment on the principal as well as the payment of interest.

Mr. WILLIS. It seems to me, from what both you and Mr. Mills have said, in an institution managed as yours are, this would be peculiarly easy to apply.

Senator GLASS. Would it help any to exempt the smaller mortgages from the operation of the law?

Mr. LORD. Senator, I do not know, because our average mortgage in our own institution runs under $3,000, which shows how they have been paid down.

Senator GLASS. Well, I say——

Mr. LORD (interposing). You could pick out mortgages over $5,000 or over $10,000 and have the comptroller check those or spot check them. That could be done. I think it would make it simpler at least; yes, sir.

Mr. WILLIS. Is it not true, Mr. Lord, that in a great many cases where the banks have loaned on collateral security the examiners have been rather severe in penalizing them, compelling them to mark down bonds they held. It is taken for granted constantly that the real estate stays right at the original loan value, so that those institutions maintain a considerably inflated asset value?

Mr. LORD. I think that is true to some extent, Doctor Willis, but the requirement that the mortgage when made should not exceed 50 per cent of the valuation of the property I think was designed to cover the fluctuation of property values. There is not any question that real estate values in Detroit and in every section of the country have dropped. Nobody can deny that.

Senator GORE. In about the same proportion as securities and commodities, would you say?

Mr. LORD. I should say that security values have dropped more drastically and commodity values also.

Mr. WILLIS. But the banking authorities are now engaged in having the security values marked off on a reasonable basis of adjustment?

Mr. LORD. That is true. Of course, it is a very difficult thing to judge what the market value is of real estate. You or I may have an opinion as to the value of real estate and our appraisal may be perfectly sound, but to try to sell it at that price under conditions existing to-day may be impossible.

Mr. WILLIS. There is nothing here, according to your reading of it, is there, that would enable the comptroller to require the immediate disposal of a loan; merely that he is allowed to revise the valuation in order to bring out the fact that a given loan is undermargined?

Mr. LORD. Well, it was not clear in my mind, Doctor Willis, what the comptroller might require; whether he would require you to write a $5,000 mortgage down to $3,000 or $4,000, or whatever was in his opinion a fair amount on the valuation, or how it was done. I think it would certainly be a help to have it clarified.

Senator COUZENS. Isn't the language too broad as it is in the bill?

Mr. LORD. It is broad.

Senator COUZENS. That is my view. It is too broad, because, obviously, these small borrowers can not put up additional securities to make the loans good if they are deficient and found by the examiner to be so.

Mr. LORD. I think that would be almost impossible to carry out, Senator, to go back to the man to whom you had made a mortgage and ask him to put up $500 more or $1,000 more, especially if the mortgage is in good standing, because you have a contract with him; he agrees to pay interest and a certain amount of principal.

Mr. WILLIS. You see, the point is this: In connection with the other provisions of the bill the object is to arrive at what is the

valuation, and in order to get a correct valuation of the present assets, the statements of the banks of the country at the present time do not present a correct asset value of the holdings of the bank.

Mr. LORD. Don't you think, Doctor Willis, that the borrower on a mortgage—we will say that the mortgage is in pretty good standing.

Mr. WILLIS. Yes.

Mr. LORD. At the time it was made it may have been a 40 or 50 per cent mortgage, and to-day it might be a 75 or 80 per cent mortgage.

Mr. WILLIS. Yes.

Mr. LORD. Don't you think that some weight, some credence, should be given to the personal, moral risk?

Mr. WILLIS. Absolutely.

Mr. LORD. And to the financial responsibility of the maker of the mortgage, as well as on any loan?

Mr. WILLIS. Unquestionably it should be. It is merely the question, I think, to be decided, and it is always desirable to know what collateral or supporting property there is there in the case of real estate just as you want it in the case of a collateral loan, in order that the bank itself may be apprised of its weaknesses and then left to correct them in so far as they can be corrected.

Mr. LORD. I think, unquestionably, Mr. Willis, that the intention of that provision is a good idea, and could be followed out perhaps by changing the wording of that section and making it a little more workable from the standpoint of the banks, either by banks setting up reserves, as they do, to take care of losses, whether they are real-estate mortgages, or bonds, or commercial paper, with spot check by the comptroller to know what condition they are in.

Mr. WILLIS. It is revaluations that are called for here, and it is true that, according to the information available on the subject, such work is now very much neglected in examinations of banks throughout the country.

Mr. LORD. The examiners do, however, Mr. Willis, point out to the banks and list the mortgages that are in default.

Mr. WILLIS. Yes.

Mr. LORD. Which immediately calls it to the attention of the board of any bank.

Mr. WILLIS. Certainly.

Senator GLASS. Is the average bank examiner equipped with the essential knowledge to determine the value of real-estate mortgages?

Mr. LORD. No: I would say not. I think you would find it very difficult to get men qualified to appraise real estate.

Senator FLETCHER. Does the law of Michigan require that you should not loan over 50 per cent of the value?

Senator GLASS. Sixty per cent of the value.

Mr. LORD. We only loan 50 per cent.

Senator GLASS. The State law permits 60 per cent.

Senator FLETCHER. But your practice is to limit it to 50?

Mr. LORD. Yes, sir. I venture to say that we have many mortgages that are over 50 per cent of the present valuation, that are in perfectly good standing.

Senator FLETCHER. Yes; and you can have a bunch of real-estate agents in your town or community examine a piece of property and one of them may put a value of $50,000 and another a hundred thousand.

Mr. LORD. Correct. Appraisal is a matter of opinion.

Senator FLETCHER. Yes. I do not see how a bank examiner can tell much about that, no matter how good an inspection he made of it.

Senator GLASS. We have had that illustrated in my own town in the last few months. A half a dozen real-estate agents were summoned before a commission or court to estimate the value of certain properties to be condemned by the Government, and not a one of them agreed with another.

Senator BROOKHART. I think the bank examiners have agreed to beat down the value of farm real estate everywhere.

Mr. LORD. It would apply just as much to farm mortgages as it would to city mortgages. As that provision now stands in the bill, so far as our own institutions are concerned, I would not dare make another mortgage, because I do not want the responsibility of going out to a man to whom we have loaned money on the mortgage and saying, "You must give us $5,000 more to protect the mortgage and keep it satisfactory for the comptroller." We could not do it.

Mr. WILLIS. May I bring out the point again—there is nothing here to require you to do that, is there?

Mr. LORD. It is by inference.

Senator COUZENS. I would like to ask Mr. Willis what this language means, then, on page 33, where it says:

> Such valuations shall be revised by the Comptroller of the Currency at the time of each examination of the bank making the loan, and he shall have power to order changes therein and to require the adjustment of loans to such revised valuations.

Mr. WILLIS. He has the power to do that in cases where the situation is such that it undoubtedly needs it.

Senator COUZENS. That is unreasonable power in the case of real-estate loans.

The CHAIRMAN. Does he not have that now?

Mr. LORD. I doubt if he has if the mortgage is in good standing, Senator. That provision would frighten me so that I would not make any more real-estate loans in our bank, with that power on the part of the comptroller.

The CHAIRMAN. The examiner can order you to charge off any part, no matter how good a standing it is in, if in their opinion it is not——

Mr. LORD (interposing). But if it is in good standing you have a pretty good argument, Senator.

The CHAIRMAN. Oh, yes: you might have a good argument, but paper could be kept in good standing that would not be good paper.

Mr. LORD. I do not think the comptroller ever does that.

The CHAIRMAN. No: I do not say he does it, but he could do it?

Mr. LORD. Yes; he could do it.

The CHAIRMAN. Yes; in other words, he could now.

Senator BULKLEY. In other words, you would not fear anything that he would do under existing law, but you do fear some rash action that might be taken if the law were changed?

Mr. LORD. I do. I fear it under the situation.

Senator COUZENS. May I ask Mr. Lord to look at page 32, beginning with line 21? It says:

A loan secured by real estate within the meaning of this section shall be in the form of an obligation or obligations secured by mortgage, trust deed, or other such instrument, upon real estate, when the entire amount of such obligation or obligations is made or is sold to such association.

Would that prohibit any participation in a loan based upon real estate?

Mr. LORD. It is not clear to me, Senator.

Senator COUZENS. I would like to ask Mr. Willis if he would not so interpret it.

Mr. WILLIS. I beg pardon, Senator; I do not think I quite got the question.

Senator COUZENS. With respect to that provision beginning on line 21 of page 32, would that prohibit the participation of a bank in a loan because it says the whole loan must be sold to the association?

Mr. WILLIS. I should not think so; no, sir. Not necessarily, no. What it says is:

A loan secured by real estate within the meaning of this section shall be in the form of an obligation or obligations secured by mortgage, trust deed, or other such instrument upon real estate when the entire amount of such obligation or obligations is made or is sold to such association.

That is to say, if the association is the only holder there it is to be protected in that particular way. Now if it is a part holder, along with, say, three or four other banks, in a large mortgage, the meaning I should think is that it might be protected in some other way. That is to say, that a different kind of protection could be used.

Senator COUZENS. That would have to be modified, because I could not interpret it in any other way than I would have to buy the whole obligation if I was buying one of those mortgages.

Mr. WILLIS. I do not think so, sir.

Senator COUZENS. It certainly would have to have a clearer interpretation if I were to follow it.

Mr. LORD. Is it not intended to mean that the total obligation or obligations outstanding, and that whether you own a part of it or own only a fraction, it shall not exceed 50 per cent?

Senator COUZENS. But that limits the amount of the loan on the property.

Mr. LORD. Yes.

Senator COUZENS. Under any circumstances. But this provision requires you to take the whole obligation, as I understand it, if I read English correctly.

Mr. WILLIS. I think the provision requires the banker who has the obligation to have it secured in that way, but if he is lending with others he can secure it in another way.

Senator COUZENS. There is no provision for that. It can not possibly be construed that way, if I read English correctly. However——

The CHAIRMAN. I would like to ask the witness a few questions, but if you desire to complete your statement you may go ahead with it.

Mr. LORD. I think I am practically through. We were discussing section 14.

In section 15, as I understand it, the bank's portfolio is not limited, except to the extent of 15 per cent of the capital and 25 per cent of surplus to any one borrower or obligor. Sections 16, 17, 18, and 19 are satisfactory.

Section 20 I have already spoken about, and particularly paragraphs (b) and (c), which are very difficult from the standpoint of our own group, and I think of most banking groups. We think we have protected the depositor due to the double liability, which was our own thought, not the thought of the banking department in Michigan nor the attorney general.

Section 21 refers also to group and branch banking, and I have already stated our position.

Senator COUZENS. In other words, you object to that whole provision limiting the voting power of the group; is that it?

Mr. LORD. Section 21, Senator, is in regard to branches, is it not?

Senator COUZENS. I mean there is a provision there regulating the voting power of the group bank.

Mr. LORD. Senator Couzens, if the banks are permitted to vote under certain provisions and subject to good behavior, I am not a bit afraid of that. We will behave.

Senator GLASS. The purpose of that, as you know, was to prevent the holding company from controlling completely the Federal reserve bank itself.

Mr. LORD. I understand that. I think that is perfectly proper, that there should be a division so that they could not. In our own district neither of our groups could control it, because there are plenty of independent banks—I do feel, however, that if groups are to be limited in any way as to their power to do a banking business separately, according to the units, we have got to have some place to go. My suggestion, as made in this memorandum, was that branch banking should be permitted regardless of the State laws, for national banks, or that the groups be allowed to take their present units and organize them as branches with no powers of extension, if it is thought wise, unless the State law permitted it.

Mr. WILLIS. As national banks?

Mr. LORD. As national banks; yes, sir.

Senator GLASS. I think you would not experience any difficulty in convincing the subcommittee on that point if the subcommittee could feel that it is possible to get such provisions through Congress.

Senator COUZENS. Would you be willing to abandon group banking if branch banking was permitted throughout the State?

Mr. LORD. Yes, sir; and we would put our banks into one institution, a national bank. Of our institutions the larger ones are all national banks, but the Highland Park State Bank and the bank in Flint and two or three small banks are State institutions. Most of them are national institutions.

The CHAIRMAN. I am not sure that I understood what you meant there. Of course, each bank is operating under its own charter?

Mr. LORD. Each bank is operating under its own charter. Each bank, under the group company's by-laws, must have at least 75 per cent of their directors local men.

The CHAIRMAN. And how much of the stock is held by the holding company in each instance?

Mr. LORD. Except for one case, we own all or practically all—in most cases we own all except the directors' shares.

The CHAIRMAN. You protest against the suggested provision in this bill of building up a reserve to protect stockholders' liability; is that your feeling, that your stockholders are legally bound for double liability at the present time?

Mr. LORD. Absolutely.

The CHAIRMAN. Has this form of agreement that they signed been submitted to the attorneys at the Comptroller's office to its binding effect?

Mr. LORD. I believe they have seen it, although the holding company is a State corporation. It was submitted to the attorney general of the State of Michigan and the banking department there, both of whom approved it.

The CHAIRMAN. Both of whom held that they could hold them the same as though they were stockholders in the bank?

Mr. LORD. Yes, sir.

The CHAIRMAN. But your banks are not all in one State?

Mr. LORD. They are; all in Michigan.

The CHAIRMAN. They are all in Michigan?

Mr. LORD. We have no institution of any kind outside of the State.

The CHAIRMAN. The liability of national banks would be enforced in the Federal court, and the others is the State courts, of course?

Mr. LORD. Correct.

The CHAIRMAN. Should this not be a matter to be submitted to the comptroller's office for their consideration?

Mr. LORD. Yes, sir. I think they do know about it, Senator.

Senator FLETCHER. As a matter of fact, as stockholders in your institution you own all the stock practically in all of those?

Mr. LORD. Yes; but the owners of the stock of the company that owns these banks have that double liability through the provision in our stock certificate. In other words, you not only have the individual double liability passed on the holders of stock in the holding company, but in addition you have whatever other assets the holding company may have as protection. You have a greater protection than merely the double liability of a unit bank.

Senator FLETCHER. The double liability attaches to the stockholders of the holding company?

Mr. LORD. Of the holding company; yes, sir.

The CHAIRMAN. Under a form of agreement that they sign and that is indorsed on the certificate.

Senator GLASS. There is double liability in many of the unit banks but it does not amount to much, does it?

Mr. LORD. That is very true these days, Senator Glass.

The CHAIRMAN. May I ask—there are a dozen or so large groups throughout the country, are there not?

Mr. LORD. Yes, sir; I think there are more than that.

The CHAIRMAN. There is a larger number of large groups than a dozen?

Mr. LORD. I do not think as large as we are. In our own State there are the two principal groups, and I understand there are others

covering the northwest section, and there are the groups in Utah and adjacent States, and there is the group in New York and also other groups in the Southeast.

The CHAIRMAN. Do you know whether any other groups use this form of certificate, bringing the stockholders in the holding company under the double liability?

Mr. LORD. The Detroit Bankers, which is in Michigan also, and I believe Wisconsin Bank Shares Corporation. I do not know whether others do or not, Senator.

The CHAIRMAN. In other words, so far as you know, there are just a few of them that follow that.

Mr. LORD. I know that some do. Whether they all do, I can not say.

The CHAIRMAN. You realize, of course, the effort of the committee to protect was due to the fact that the committee did not believe that it was a general rule to hold the stockholders in the holding company to double liability. In fact, some members of the committee believed the whole purpose of the organization was to evade a good law that provided for stockholders' liability.

Mr. LORD. That was not ours, because we put it in the charter when we organized.

The CHAIRMAN. No; I see, because you stuck to it and carried it through.

Senator FLETCHER. Do you object to these three reports a year?

Mr. LORD. It means a little more work, but we do not object to anything along that line.

The CHAIRMAN. Do I understand that you feel it is absolutely necessary for the affiliate corporation to own the bank building, the safety deposit boxes, and other parts of the banking institution?

Mr. LORD. Institutions that are tied into the banking and trust business pure and simple.

Senator GORE. Where it effects an economy in the operation of the bank?

Mr. LORD. Yes, sir.

The CHAIRMAN. Do you feel that the measure as drawn is too drastic in that respect?

Mr. LORD. Yes; I do.

The CHAIRMAN. Could you suggest some wording that would avoid that part of it and still accomplish the purpose aimed at by the subcommittee?

Mr. LORD. I think I could if I were given a little time and I knew the exact purpose of the subcommittee.

The CHAIRMAN. Will you confer with Doctor Willis about that?

Mr. LORD. I will be glad to.

Mr. WILLIS. You are aware there that in section 24. I think it is, the bank is allowed expressly to hold stock; that is to say, the prohibition against their holding stock is limited by the statement that those institutions that are specially provided for by law are not included? You noticed that, did you not?

Mr. LORD. Yes.

Mr. WILLIS. Of course, that covers the safe-deposit company?

Mr. LORD. Yes, sir. But the definition in section 2 is too broad to pick it out.

Mr. WILLIS. Here you have a specific exemption, and with the statement in section 4, I think——

Senator GORE (interposing). Would it be permitted, Doctor, for the banks in the corporation to own the stock of the members who owned the buildings?

Mr. WILLIS. The law permits that now under our regulations.

Senator GORE. Yes; would that be permissible under this law?

Mr. WILLIS. I said that in connection with the testimony yesterday, and then somebody suggested that we add the words "or regulation."

Senator GORE. There was an example of that in my State, where there has been a large 32-story building constructed there recently by the First National Bank. The man who wrote me about it thought that the bill as drawn would permit the bank to own the stock.

Mr. WILLIS. If we were to add the words "or regulation" where the word "law" is used in the section relating to that, I think there would be no danger that anything of the kind might be inferred.

Senator COUZENS. Just what is the necessity of organizing an affiliate to hold safe-deposit stock and building stock? What is the necessity for that?

The CHAIRMAN. The witness suggested something about that.

Mr. LORD. There may be $1,000,000 in securities in the safe-deposit boxes or $500,000,000, and there is no way that you can tell what your liability is, because you do not know what is in those boxes. We all carry tremendous blanket insurance. We carry, and every institution in our group, the big ones, up to $2,500,000.

Two and a half million dollars would not be a drop in the bucket to the amount of securities that might be in your safety vaults, and you have no way of knowing how much is in there. I do not believe it is sound, from the standpoint of bank depositors or trust company depositors, to tie that liability on an institution which has depositors' funds in it. The man who puts his money in the safe-deposit box realizes that liability. The depositor should not be asked to take that risk.

Senator FLETCHER. Did you state how many stockholders you have?

Mr. LORD. Over 8,000, Senator.

Senator GORE. The point made in this letter I had was that the bank building was largely devoted to offices, used as an office building, and the relationship between the bank and its tenants or occupants, if the bank owned the building outright, might give rise to irritation or friction that might be obviated if a different concern owned the building.

Mr. LORD. I think that is true, Senator, from the standpoint of operations.

Senator GORE. Yes; that was the point.

The CHAIRMAN. This 15-day provision has been the subject of much controversy, and there is a wide difference of opinion on it, and an honest one, I am sure of that. Have you thought of making the use of that provision subject to the approval of the Federal Reserve Board and only using it for emergency purposes?

Mr. LORD. The 15-day loan?

The CHAIRMAN. Yes.

Mr. LORD. If I understand your question correctly, we use the 15-day loan for borrowing from time to time, and use Government bonds rather than put up eligible paper, because of the difficulty of——

The CHAIRMAN. The only difficulty that comes from it is from some abuse, I think not from the provision itself. but it lends itself so easily to certain abuses, such as the Wall Street boom, and I was wondering whether this might be made more practical if we should provide that it should only be used upon the approval of the Federal Reserve Board and then could be used in every legitimate emergency.

Mr. LORD. May I answer your question by telling you how the Federal Reserve Bank of Chicago handled just that situation during a time of very high call money—and when other money rates were high also. The banks in Detroit very generally were borrowing substantial sums of money, and they were using their Government bonds and their eligible paper and anything they had. Mr. McDougall, of the Federal Reserve Bank of Chicago, came to Detroit and warned the banks there that they were not under any circumstances to borrow money to loan on call in New York, regardless of the profit they might make. In other words, the Federal reserve bank has in the past brought pressure to see that it was not abused, and they can step in to-day, under their powers, their broad powers, and tell a bank that "We will not loan you on Government securities so long as you are lending money on call in New York."

Senator GLASS. But you will recall the fact that when the Federal Reserve Board, in an exceedingly mild or general way undertook to admonish the member banks in New York in 1929 against excessive use of the Federal reserve facilities for investment purposes, perhaps the outstanding banker in New York City practically told the Federal Reserve Board to go to hell?

Mr. LORD. I did hear something about it.

Senator GLASS. That he intended to rediscount to the extent of $25,000,000 the next day and to loan it for stock investment purposes, and that his obligation was to the market rather than to the bank of which he was a sworn director; you recall that, don't you?

Now, with respect to that provision, if I have not already said for the record, and maybe it can not too often be said, it has a history. When the Federal reserve system had been in existence two and a half years without that provision, and when it was incorporated in the act as a war measure, avowedly, its purpose being to prevent a bank from being suddenly embarrased overnight by any extraordinary thing that might happen in war times, Europe then being in the World War, and when it was incorporated in the act over bitter opposition, it was done with a gentleman's agreement that after the war it should be eliminated.

And this significant fact attaches to the history of that act. At that time the indebtedness of the United States, the bonded indebtedness of the United States, was less than a billion dollars, of which amount the national banks owned $748,000,000 for circulation purposes, it was computed that fiduciary funds, estates and individuals owned at the very least $150,000,000 of United States bonds.

So that at the time of the incorporation of this provision of the bill in the act there were perhaps, it is fair to say, less than a

hundred millions of dollars of United States bonds available for this purpose. And yet, over a given brief period during this riot of stock gambling in New York, 10 of the New York banks alone borrowed from the Federal reserve bank approximately a billion dollars on 15-day paper.

So that you may see from that statement, I think——

Mr. LORD (interposing). I see what you intend.

Senator GLASS. I should discern from that statement that the original purpose of that provision has been frightfully perverted to an evil use.

Mr. LORD. Would it be possible, Senator Glass, to make that penalty subject to the discretion of the Federal reserve bank, if in their opinion the borrowing facilities of the bank were being abused? That would make it compulsory.

Senator GLASS. It was made so for 16 years, and somebody, I do not undertake to say who, had not courage enough to exercise the power that the act gave him, even when the abuses were so frightful as to have brought on the very situation that the country finds itself in now.

Senator GORE. Mr. Lord, you did not quite finish your statement as to why you used Government securities instead of commercial paper.

Mr. LORD. When you rediscount eligible paper at the Federal reserve bank you must furnish statements. Our experience with the bank is that they are supertechnical, and that it is a very difficult thing to get eligible paper through the bank and get it approved without going through a great deal of work, in our opinion unnecessary. Our credit files are available to them if they want them. It is so much simpler, when you are running short a million dollars, or $5,000,000, or whatever the amount is, to leave your Government securities there and borrow against them. It may be only a question of one day borrowing. It may have nothing to do with the lending of money on securities.

Take our own institutions with these motor companies.

Senator GORE. It is just a question of the mechanics of it?

Mr. LORD. Senator, let me give you an example in connection with the motor companies: The Ford Motor Co. carries accounts with most of the banks in Detroit. We have one of their very active accounts. The Ford Motor Co. pays its bills on the 20th of the month. There have been times when they would draw $35,000,000 in one day to pay their bills. The only way you can handle an account of that kind is to carry a tremendous amount of Government securities or call loans. There are just two ways you can meet a 35,000,000 withdrawal in one day and meet it properly, and we find that the most satisfactory way to do it is to carry an extensive amount of Government securities, so that if the Ford Motor Co., instead of drawing twenty or twenty-five million, as we might expect, draws 35,000,000, we take our Government bonds to the Federal reserve bank and borrow for a day, or two days, or a week, until the balance is normal again.

Senator GORE. It is the mechanical facility of using it more conveniently, one kind of paper against the other?

Mr. LORD. It is the mechanics that makes it simpler to use Government bonds.

Senator GLASS. Undoubtedly it is a question of that description, and if it were used only for that purpose, why, perhaps there would not be many valid objections to it.

Mr. LORD. Senator, supposing that you put a provision in that so long as that bank was lending money on call in New York they should be penalized 1 per cent? Don't you think that would cover your point?

Senator GLASS. It might be so. We might modify that 1 per cent penalty, though you understand that the Federal reserve bank, subject to review and determination of the Federal Reserve Board, has that power now—but it is not exercised.

Mr. LORD. Can't they be persuaded to exercise it? Mr. McDougall exercised it in the Chicago district.

Senator GLASS. We were actuated by the knowledge that they had never exercised it, and therefore we put the penalty in there.

Senator FLETCHER. What does that amount to to these people that are making 20 per cent, a 1 per cent penalty?

Mr. LORD. It is not that, Senator; it is the penalty of 1 per cent against the people who are borrowing for legitimate purposes not for the bank which is getting a big percentage on call.

Senator FLETCHER. I mean these people who use this for speculation.

Mr. LORD. If you mean that 1 per cent penalty to the banks when they are lending on call to New York, I will agree to that. It would, however, penalize the legitimate transaction.

Senator GLASS. You would have no objection, then, to that provision if we were to modify or eliminate that 1 per cent penalty? You would have no objection to the requirement of the provision that if, upon due notice and warning by the Federal Reserve Bank and Board, a bank persists in extending its loans on stock as collateral it should be penalized by suspension?

Mr. LORD. I would be perfectly willing to have that provision.

Senator GLASS. You think that is all right?

Mr. LORD. Absolutely, so far as our institutions are concerned.

Senator GLASS. Have you any knowledge of any Federal reserve bank ever buying a dollar of commercial paper in open-market transaction?

Mr. LORD. Ever buying a dollar?

Senator GLASS. Yes; of commercial paper. Has there ever been any attempt since the institution of the system to create a market for legitimate commercial paper?

Mr. LORD. Senator, I think since the organization of the Federal reserve bank there has been such a tremendous amount of financing done by corporations which has taken them out of the commercial paper market that it is difficult to answer your question. Our own institutions in times past, not in the last two or three years, have been substantial buyers of commercial paper.

Mr. WILLIS. But the reserve banks?

Senator GLASS. I mean the reserve banks.

Mr. LORD. I think not.

Senator GLASS. In its open-market transactions?

Mr. LORD. No. I do not know. I never heard of their doing it.

Senator GLASS. It has confined itself to purchasing collateral securities rather than making a market such as the European market for commercial paper?

Mr. LORD. If you are speaking of the Federal reserve banks themselves——

Senator GLASS. Yes.

Mr. LORD. They have confined themselves, as I understand it, to the purchase of Government securities, notes, Treasury certificates, bankers' acceptances, and the acceptance and rediscount of commercial or eligible paper that the bank might have.

Senator GLASS. But they have never undertaken to make a market for current commercial transactions?

Mr. LORD. Not to my knowledge; no, sir.

Senator GORE. Mr. Lord, you stated that two-thirds of all of your deposits were demand deposits. Could you state or estimate what proportion of your demand deposits represent deposits of actual cash or cash items distinguished from credit, so to speak, resulting from your loan-discount operations?

Mr. LORD. I think that would be a very difficult thing to judge, Senator, because——

Senator GORE (interposing). You could not approximate it?

Mr. LORD. I might answer the question by saying that we do not like to take new accounts that open with a loan, as a matter of policy. We prefer that the deposit be made in cash or checks rather than by credit on a loan, even though the depositor is entitled to have credit granted.

Senator GORE. Less than half would probably represent actual cash. The other is——

Mr. LORD (interposing). No: I should think a good deal more than half would represent actual cash deposits, because, while I am sure we have a good many small depositors who might not represent deposits in cash, the larger amounts, the deposits of the big corporations, are in cash rather than by credit. It is not a question of credit with them.

Mr. WILLIS. By cash there you mean cash or by check?

Mr. LORD. Yes.

Senator GORE. Cash or equivalent of cash?

Mr. LORD. Yes.

Mr. WILLIS. May I ask you one further question, Mr. Lord?

Mr. LORD. Yes.

Mr. WILLIS. You notice in the latter part of this bill a plan for removal of officers of banks who in any way are responsible for unsafe or unsound practices.

Mr. LORD. I am also in favor of it.

Mr. WILLIS. In favor of it?

Mr. LORD. If you do not remove them we will.

Mr. WILLIS. But, in general, do you think there is any unfairness or hardship?

Mr. LORD. No objection at all.

The CHAIRMAN. Your suggestion as to the groups would be this, that they would be regulated but not extended? Is that your thought?

Mr. LORD. Unless the State laws permit it. I think the provision you have in as to that territorial provision is excellent. I think that is fine. The objection I have to the bill as it stands to-day is that there is no branch banking permitted except in States where the laws of those States permit it.

The CHAIRMAN. Would you override the sovereignty of the State in a matter of this kind? Is there not a great deal of danger in doing that?

Mr. LORD. Perhaps.

The CHAIRMAN. Are you not getting centralized too much now and taking this power and that power away from the States?

Mr. LORD. I am in favor of doing it for the national banks. The States have no control over national banks now.

Senator GLASS. Now that the exceedingly conservative chairman of this committee suggests an objection of that sort, just what sort of objections may we encounter from the radical members? [Laughter.]

Senator GORE. When the reds get after it?

Mr. LORD. Senator, the question of branch banking is a very interesting one, and I think that, frankly, it is the ultimate solution of our banking troubles. If it can be handled in such a way as to prevent a centralization of power in one place I believe it would be the solution.

The CHAIRMAN. Well, I think your "if" is the main part of your statement.

Mr. LORD. All right; supposing that the directors of a bank permitted to have branch banking within the limits of the State must be 90 per cent residents of that State?

The CHAIRMAN. Well, I certainly share your view that it should not be located outside the State but should be owned by the people of the State, if you want to avoid centralization.

Mr. LORD. Of course, you can not prevent ownership of stock passing from one locality to another, but you can prevent a directorate living in New York or San Francisco and attempting to operate a corporation elsewhere.

The CHAIRMAN. We all know that directors are sometimes just dummies. They are just representatives of some one who lives at a distance.

Senator GORE. Would it be feasible to prevent stockholders who live outside of the State from voting? You know that that was done in United States banks.

Mr. LORD. I think it would. That is a legal question. But that would answer your question as to the directors being dummies.

Senator GLASS. The subcommittee would not go into mourning altogether if you were to prevail upon Congress to take that view of it. I would not.

Mr. LORD. Can you prevail upon Congress to take that view, Senator?

Senator GLASS. I do not know. It seems that I can not prevail upon the Banking Committee to let us pass a reform banking bill.

The CHAIRMAN. If that is all, we will close the hearings for to-day and there will be no further hearings until to-morrow at 10.30 in this room. We had two other witnesses on for to-day but they are not here.

(Whereupon, at 1.05 o'clock p. m., the committee adjourned to meet again at 10.30 o'clock a. m. of the next day, Friday, March 25, 1932.)

# OPERATION OF THE NATIONAL AND FEDERAL RESERVE BANKING SYSTEMS

FRIDAY, MARCH 25, 1932

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

The committee met, pursuant to adjournment on the previous day, in the committee room, 303 Senate Office Building, at 10.30 o'clock a. m., Senator John G. Townsend presiding, in the absence of the chairman.

Present: Senators Townsend (presiding), Walcott, Carey, Watson, Fletcher, Glass, Wagner, Bulkley, Morrison, Gore, and Hull.

Senator TOWNSEND (presiding). The committee will be in order. Senator Norbeck has requested that I preside for a moment. The first witness will be Mr. Percy H. Johnston, New York.

## STATEMENT OF PERCY H. JOHNSTON, PRESIDENT CHEMICAL BANK & TRUST CO., CHAIRMAN BANKING AND CURRENCY COMMITTEE OF MERCHANTS ASSOCIATION OF NEW YORK, NEW YORK, N. Y.

Senator TOWNSEND (presiding). Mr. Johnston, will you take a seat there and give your name and address to the reporter?

Mr. JOHNSTON. Percy H. Johnston, president of the Chemical Bank & Trust Co., New York, an institution owned by 14,000 stockholders, domiciled in every State in the Union. Also as representing the Merchants Association of New York, as chairman of their banking and currency committee, which is the largest business organization in any city in America, with some seven or eight thousand business memberships.

Senator TOWNSEND (presiding). Mr. Johnston, have you a written statement?

Mr. JOHNSTON. Yes, sir; I have.

Senator TOWNSEND (presiding). You may proceed.

Mr. JOHNSTON. Mr. Chairman and gentlemen, I should like to say first that I have much sympathy in any measure that is propounded to strengthen the general banking situation. I spent I think six of the best years of my life in the Treasury Department as a national-bank examiner and national-bank examiner at large, trying to bring those conditions about over the country. I am somewhat familiar with many of the weaknesses that the Government has been confronted with and that the various supervising boards and superintendents of banks have met with.

Speaking now of the proposed Senate bill 4115, the passage of this bill at this time would destroy all effect of the remedial measure looking to an ending of deflation. It would bring about a large deflation for the following reasons:

The security business is made outlaw and credit can not come from banks to carry on this business. The bill is aimed to break up the distribution of long-term securities, through its limitation on the extension of bank credit against collateral. This would prevent refunding of municipal, railroad, or industrial loans.

Banks may not use the Federal reserve to facilitate carrying bonds. So practically banks could not borrow from the Federal reserve at all and have a bond account.

This would force further liquidation of all bonds except United State Government.

The penalization of 15-day borrowings would make United States bonds less desirable, would handicap the United States Treasury in its necessary financing, and would increase the rate on Governments, and thereby the interest rate on all classes of securities, and depreciate the market price of all existing securities. The 15-day borrowing is essential in periods of depression where eligible paper is not available for rediscount.

The requirement for revaluation of all real estate owned by banks and real estate loans to market value would render many banks insolvent and compel their closing. Has real estate any "market value" to-day?

The prohibition against banks owning more than 10 per cent of any particular issue of securities would compel the dumping of large holdings of inactive bonds on the market.

The provision segregating the best assets of a bank for its time deposits would, in the case of many banks having a large proportion of time deposits, likely frighten demand depositors in those banks and bring on large withdrawals of demand deposits. This would be particularly felt by the country banks.

Authority of Federal Reserve Board to fix from time to time for any member bank the percentage of the capital and surplus of such bank which may be represented by loans protected by collateral security is a power that should not be vested in any governmental body. It destroys the free functioning of the banks and robs directors and owners of their rightful privileges.

The compulsory requirement of member banks to supply capital for the Federal Liquidating Corporation is essentially unfair. It forces member banks to supply capital and take risks with no hope of gain other than receiving 6 per cent interest, if the corporation should earn it. There will be heavy losses, which in the last analysis are forced on member banks. It is just as logical to require good industrials, insurance companies, and other lines of business to bail out the failed ones in their respective fields, as it is to ask the member banks to do so.

Restricting the sale or purchase of Federal funds would seriously interfere with free operation of member banks, would decrease their earnings, and would accomplish no good purpose.

It is too much to hope that good banking can be brought about by legislation. After 35 years of banking experience, six years as national-bank examiner, I am convinced more laws will not effect a

cure. Strict rules and careful discrimination in the granting of charters will go a long way. We have had too many banks and too few bankers.

Better standards of supervision and examination will be helpful in bringing about better conditions.

Now, if I may have the privilege of speaking on one or two of these paragraphs that I have mentioned.

Senator TOWNSEND (presiding). You may proceed.

Mr. JOHNSTON. I should like to say that in making these remarks very little of it is applicable to my own institution of which I am the president. As far as 15-day borrowing is concerned I do not know that we ever made a 15-day loan. We used the Federal reserve bank in the year 1931 three days; in the year 1932 we have not used it a day, and in 1930 we used it seven days, and during the boom, when money was 15 and 20 per cent, we made no use of the Federal reserve to borrow money to reloan on stock-exchange collateral.

Senator GLASS. If you could exist in such a solid state without the use of the 15-day paper, why would it destroy the balance of the banking community?

Mr. JOHNSTON. Many banks, Senator, haven't other paper that is eligible for rediscount. They are forced to borrow on their Government bonds. As you probably know, most of the banks carry large amounts of Government bonds at the Federal reserve bank. I think the real reason that most banks prefer to borrow on Government bonds is in convenience. It is very easy to send over their note and ask them to attach so many Government bonds or set them aside for the protection of their note.

Second, notwithstanding that we have tried in the Federal reserve to make borrowing more popular in member banks, or rediscounting, there has always existed a prejudice among banks from having to borrow on bills payable or rediscounts. Most bankers do not want to take their customers' paper out of their files, indorse it over to the Federal reserve bank, and then take it up later and take it back to the bank, and when the customer has paid off his notes he discovers that he has had his paper pledged to the Federal reserve bank.

Senator GLASS. Then do you think the Federal reserve system is totally inacceptable or undesirable?

Mr. JOHNSTON. No, Senator; I think it is a very desirable set-up.

Senator GLASS. That is what it was meant for, to rediscount paper of a customer of an individual bank?

Mr. JOHNSTON. Yes; but you can not overcome prejudice, Senator.

Senator GLASS. Well, if prejudice exists to such an extent that rediscounting gets to be an inappreciable function of the bank, what is the use of the Federal reserve system at all?

Mr. JOHNSTON. I think its principal use is in the time like we had in the war: I mean in a time of great stress.

Senator GLASS. Then, you want us to have another war in order to make it available?

Mr. JOHNSTON. No; I would not say that. The thing I am saying is this, that banks as a class—I think over 90 per cent of them—would prefer to borrow on their Government bonds than to take their paper out and rediscount it, due to the fact that there has always been a prejudice among bankers against rediscounting paper.

Senator GLASS. But you know very well, Mr. Johnston, that at the time of the adoption of the Federal reserve act there were not any United States bonds to borrow on?

Mr. JOHNSTON. That is true.

Senator GLASS. Then, you think it was futile to set up the Federal reserve system because you did not have United States bonds to borrow on?

Mr. JOHNSTON. Not at all.

Senator GLASS. Well, I just do not get your logic.

Mr. JOHNSTON. I just do not get yours, sir, if you will pardon me.

Senator GLASS. Mine is that we set up a system to enable member banks of that system to rediscount their eligible paper when they had exhausted their ability to respond to the demands of commerce and of agriculture, so that they might continue to respond.

Mr. JOHNSTON. They do that now, Senator, but they use their Governments first.

Senator GLASS. But I say, at the time the Federal reserve act was enacted, there were not any Governments for this use.

Mr. JOHNSTON. That is true.

Senator GLASS. Then, do you think it was futile to have set up the Federal reserve act?

Mr. JOHNSTON. Not at all; but we live in a changing world, and we have issued a large amount of Government bonds in this country, and we have made them eligible for borrowing at the Federal reserve banks, and the banks would rather borrow on the Government bonds than on the eligible paper.

Senator GLASS. At the time we instituted the Federal reserve bank there were less than a hundred million dollars of United States bonds available for this 15-day provision of the bill, which was not in the original act. What is the significance of the fact that over a very limited period in 1929 10 banks in New York alone borrowed nearly a billion dollars in United States bonds under the 15-day provision?

Mr. JOHNSTON. It is very easy to explain. There was a large amount of money loaned in New York over the country, and when the panic came they became frightened and they all asked to have the money called within 48 hours.

Senator GLASS. It had no relation to the stock exchange transactions, you think?

Mr. JOHNSTON. The money had been loaned to Wall Street brokers.

Senator GLASS. Yes.

Mr. JOHNSTON. And the banks called it over the country. The New York banks stepped in and took it all up and borrowed enormous amounts, as you know, of the Federal reserve, which were very quickly wiped out in a few days, because the people that called the money left it to their credit in banks in New York as a rule.

Senator GLASS. But these borrowings were not overnight; they extended over a period of six months, when we had the riot of stock speculation in New York.

Mr. JOHNSTON. Not those loans that you refer to as having been a billion dollars made overnight.

Senator GLASS. Yes; just those loans. That represented the transactions of the first six months of 1929.

Mr. JOHNSTON. I do not think the record would bear that out, Senator.

Senator GLASS. I have the record right here.

Mr. JOHNSTON. All right, sir. I served on the New York Clearing House committee, and 90 per cent of those loans were washed out within 30 days.

Senator GLASS. In January, 1929, $270,000,000 were borrowed under the 15-day provision.

Mr. JOHNSTON. Yes, sir.

Senator GLASS. In February, seventy-nine million.

Mr. JOHNSTON. We are speaking, though, Senator, of after the panic.

Senator GLASS. In March, one hundred forty-eight million. In April, one hundred five million. In May, ninety million. In June, eighty-two million.

Mr. JOHNSTON. Yes.

Senator GLASS. That was not overnight; that was over——

Mr. JOHNSTON (interposing). I do not believe we are talking about the same thing.

Senator GLASS. Well, I can not help that. I know what I am talking about.

Mr. JOHNSTON. Yes, sir. I credit you with that fully. But I understood you to say that banks in New York borrowed a billion dollars.

Senator GLASS. Approximately that.

Mr. JOHNSTON. And carried it for six months.

Senator GLASS. No; I did not say they carried it for six months; I said over a period of six months.

Mr. JOHNSTON. And the answer I made was that 90 per cent of it was paid off in less than 30 days.

Senator GLASS. What would have happened in circumstances of that sort if there had been no United States bonds, as there were not when we adopted the Federal reserve act?

Mr. JOHNSTON. Why, the stock exchange would probably have closed and there would have been a moratorium.

Senator GLASS. Then you do think the Federal reserve system is of some account?

Mr. JOHNSTON. I do not see how you draw any contrary conclusions from any remarks I made, Senator.

Senator GLASS. Well, then, unhappily, I do.

Senator BULKLEY. Mr. Johnston, apart from the prejudices of the bankers as to what collateral they would prefer to offer, which, as you say, is merely a matter of prejudice, what is the sound thing to be rediscounted at the Federal reserve banks? What is the sound thing on which to judge it?

Mr. JOHNSTON. I think commercial paper, without a question. That is what the law was based on.

Senator BULKLEY. Certainly it was. Why shouldn't we restrict borrowings on bonds or any other capital asset as distinguished from commercial paper? How are you going to keep your system pure and right if you do not maintain the principles it is based on?

Mr. JOHNSTON. Well, you know it is pretty hard to purify a household when it is on fire.

Senator BULKLEY. The fire has pretty well died down now.

Senator GLASS. You do not want it to burn up twice, do you?

Mr. JOHNSTON. I hope not.

Senator BULKLEY. I can not think of any better time to purify. Have you any suggestion about what would be a better time to purify than right now, and why?

Mr. JOHNSTON. I think any major changes in the Federal reserve would be much better if they can be made in some normal time. I do not think the country is entirely over its fright. I think any important changes we make—I am speaking of the 15-day provision; I am not speaking at all because I haven't any personal interest whether you have that 15-day or not—but I know the situation in many banks. Many of them have not the eligible paper to any extent.

Senator BULKLEY. How many?

Mr. JOHNSTON. A very large amount. I should like to say this——

Senator BULKLEY (interposing). How many do you think are out of eligible paper in the New York district, say?

Mr. JOHNSTON. Well, they have very little. I could not say they were entirely out. I should like to give you an illustration of our own institution.

Senator GLASS. The chief of the banking operations of the Federal reserve system on last Saturday evening told me they had ample eligible paper.

Mr. JOHNSTON. You mean in the whole system?

Senator GLASS. Yes; in the whole system. He had particular reference to New York. And the official figures were put in the record when I made my speech on the so-called Glass-Steagall bill, showing that they had nearly $3,000,000,000 of eligible paper and were discounting only about a half billion—five hundred million.

Mr. JOHNSTON. Fifteen years ago 90 per cent of the business of the bank of which I am president was commercial business and 90 per cent of our income came from those accounts. We have always been a commercial bank. We are not a Wall Street bank and never have been a Wall Street bank. The trend of business in the last 12 or 15 years has been commercial business down, down, down, and last year only 22 per cent of our income came from the commercial business; 28 per cent came from loans on securities, bonds, and stocks—I do not mean speculative loans; 21 per cent came from investments, municipal, State bonds, and things like that; 49 per cent of our revenue came from a class of income that is going to be largely prohibited under this act.

Senator GLASS. Is not the reason of that that the Federal reserve system has been transformed from a commercial banking system largely into an investment banking system?

Mr. JOHNSTON. I do not think so.

Senator GLASS. And has favored bonds and securities rather than commercial paper?

Mr. JOHNSTON. I do not think so. I think it is just the nature of what is happening in the country; that the big corporations that used to borrow money from us do not borrow. They are lending money.

Senator GLASS. Well, ought they be permitted to lend money?

Mr. JOHNSTON. No; I am——

Senator GLASS (interposing). They are not chartered for that purpose, are they?

Mr. JOHNSTON. No; I am glad they are not permitted. You probably, of course, know that the associated banks in New York have declined to do it for them by resolution.

Senator GLASS. Yes; I know they did, after I embodied in a proposed bill here a prohibition against it—and the day after to-morrow when this bill is beaten, if it is beaten, they may change their regulation, may they not?

Mr. JOHNSTON. I do not think so.

Senator GLASS. You do not think they may do that?

Mr. JOHNSTON. I do not think there is any likelihood of it. I do not think they did that for any fear of anybody, Senator.

Senator GLASS. Oh, I do not apprehend they are afraid of me.

Mr. JOHNSTON. I spent six years——

Senator GLASS (interposing). And I hope I am not afraid of them.

Mr. JOHNSTON. No, sir; they do not give you——

Senator GLASS (interposing). Never have been yet.

Mr. JOHNSTON. The majority of these banks—they are honorable men. I examined 1,180 of them, in over half of the States in this Union, and I came out firmly convinced that the men in the banks are men of honesty and their integrity is as high as anyone, not even barring the pulpit.

Senator GLASS. Yes; but their judgment is not infallible?

Mr. JOHNSTON. No.

Senator GLASS. Because the last man of them, almost, opposed the enactment of the Federal reserve act. I have letters here, just picked out from my correspondence this morning hurriedly, five or six of them; one from a country banker, a bank that has $200,000 capital, calling attention to the fact that he attended the October meeting in 1913 in Boston, which almost unanimously denounced the enactment of the Federal reserve bill and came near to throwing out bodily one of the members of the association that ventured to speak a word on behalf of it, howled him down, would not let him speak.

Senator BULKLEY. You recall that, Mr. Johnston, do you not?

Mr. JOHNSTON. Yes, sir.

Senator BULKLEY. And there is no question but that the majority of the banks were opposed to it?

Mr. JOHNSTON. Yes, sir; they were, because they did not like the compulsory feature. That was the principal reason—like they do not like the compulsory feature in this Federal liquidation proposition.

Senator GLASS. No; but they voluntarily subscribed 10 per cent of their capital and surplus to your Federal Finance Corporation——

Mr. JOHNSTON. National Credit Corporation.

Senator GLASS. In New York, and this is one-quarter of 1 per cent.

Mr. JOHNSTON. I would not just exactly say, Senator, that they voluntarily did it, because I happened to be in the conference over at Mr. Mellon's home that night when the President of the United States asked us to do it. He said they talked to the leaders on both sides of the Congress and that, as soon as the Congress reassembled,

they would form the reconstruction corporation and take us out of this position.

And then not only that; even assuming that we did voluntarily form it, we elected the board and we supplied the management.

Senator GLASS. Yes.

Mr. JOHNSTON. And that is what we think stockholders ought to have the right to do. We believe that is inherent in our Constitution, that the people that own the property ought to have some say so in the running of the business.

Senator GLASS. Do not the member banks have some say so in running the Federal reserve system? They elect six of the nine directors of each Federal reserve bank.

Mr. JOHNSTON. I do not see that we have very much voice when we furnish the capital and we are limited to 6 per cent interest, with no hope of anything else, and when we have to furnish the capital, whether we want to or not, and that is what we have to furnish in this.

I do not say that maybe some of these measures are not good, but I say just do not pick on one class of people to furnish the sinews of war.

Senator GLASS. The sinews of war are to be devoted to the service of that particular class of people. They are given 30 per cent of the profits of the liquidating corporation. The point I am making is that there was no outcry in the banking community against furnishing subscriptions of 10 per cent of their capital and surplus to your Federal Credit Corporation in New York.

Mr. JOHNSTON. Half the banks of the country did not subscribe.

Senator GORE. Those that did paid how much?

Senator GLASS. Well, I think much more than half of the banks of the country subscribed. I grant you they were coerced, but they subscribed. You note the difference between one-quarter of 1 per cent subscription of half of the banks and the requirements of the corporations.

Mr. JOHNSTON. I think it was 2 per cent of our deposits that we subscribed to the national credit.

Senator GORE. And how much did you pay in?

Mr. JOHNSTON. We were called for, I think it was 60 per cent of the subscription, Senator.

Senator GORE. Do you know how much that was?

Mr. JOHNSTON. About one hundred eighty-five or ninety million dollars.

Senator GORE. I mean your bank.

Senator GLASS. You only subscribed that, I understand you to say, because you were assured by high authority that the whole thing would be taken over by a new organization?

Mr. JOHNSTON. We were asked to do it on that basis, as a quick stop-gap, and we did it.

Senator GORE. How much did your bank put up?

Mr. JOHNSTON. Five millions.

Senator GORE. You mean you subscribed that much or paid in that much?

Mr. JOHNSTON. We subscribed five millions and paid in I think it was three millions, Senator. Now they are going to pay back 15 per cent of the amount on this coming Monday.

Senator GORE. Did it render very much service?

Mr. JOHNSTON. Oh, I think it did, without any question. Yes, sir; I think it did fine work. Part of it was psychological.

Senator GORE. It saved two or three pretty important banks?

Mr. JOHNSTON. It did, yes, sir; more than that.

Senator GLASS. We have made three efforts, psychologically, to save the country. Now I want to make one, practically, to save it.

Mr. JOHNSTON. Senator everybody believes that. I do not believe there is a man in the banking business that does not believe that about you. The thing is, we differ with you.

Senator GLASS. Yes.

Mr. JOHNSTON. Of course, that being the case, one of us has got to be wrong, one side.

Senator GLASS. That is right. I was right once and I hope I am right again.

Mr. JOHNSTON. Yes, sir.

I haven't anything more to say, Senator, unless you want to ask questions.

Senator TOWNSEND (presiding). Are there any further questions the Senators would like to propound to Mr. Johnston?

Mr. JOHNSTON. I would like to say this further thing: We are not interested in time deposits, the saving business. I am not speaking of that on my own account.

Senator GLASS. I would like to ask you, Mr. Johnston, do you favor the affiliate banking system?

Mr. JOHNSTON. Probably the best thing I could say to you, Senator, is that we had one of those institutions and we voted in January to turn it into the bank. It has never been really active. That is, we never offer securities to the public other than Government bonds and municipals, and it was not serving any purpose, and it looked like it was out of style, and for many reasons we turned it in. I do think there is a place for it. Some of the institutions have built up very large ramifications, and it would be very disturbing in these ramifications to unscramble.

There is another thing I would like to say: I wish very much that your measure about $100 par bank stocks had been passed 15 years ago.

Senator GLASS. I wish all of it had been passed 15 years ago.

Mr. JOHNSTON. We were one of those foolish virgins that split our stock up. But now we have got 14,000 stockholders, and how are we going to get units of $10 back into the whole? How are we going to force the stockholders to bring it in? I believe if that was passed, not to be retroactive but to become active with the passing of any measure, I think all of the big banks would just as soon as they could unscramble the situation, because we have got to. Now it is just impossible, because you have a whole multitude of people who are not interested in your bank but they have got stock in half a dozen banks. We thought it was going to bring more customers. We were wrong about it: it did not bring more customers.

But I think it would be a great hardship on us if we are going to try to unscramble this stockholding proposition, because I do not see how you can force a man to turn in his multiple shares of stock so that he can get the less number. I just do not see how you can force him to come in and buy another share or do something with it.

Senator GORE. You can not arrange to buy his nine shares, for example, that he has?

Mr. JOHNSTON. Suppose he does not want to sell it?

Senator GORE. You could not make him do that?

Mr. JOHNSTON. No, sir. We have in our bank 9,000 stockholders that own less than 100 shares. We have over 3,000 that own less than 10. I do not know how I am going to get those 3,000 to bring that stock in and put it all in the pot. I wish I could.

Senator GLASS. Is it not being done by the large corporations of the country to a considerable extent?

Mr. JOHNSTON. Some of them are doing it in capital adjustments where they are wiping out losses.

Senator GLASS. To get back to the affiliate question, Mr. Johnston, if the affiliate system is to persist do you think it ought to go unrestricted as at present?

Mr. JOHNSTON. I think it ought to have the same supervision that the parent institution would have, same examination and supervision.

Senator GLASS. And no limitations upon the character of its business?

Mr. JOHNSTON. I do not think it should be entitled to borrow from the parent institution any more than any other customer could, on any different basis from any other customer. In other words, I do not think the parent institution should furnish its capital or its capital assets to its affiliate. I do not think that is sound. Of course, in the period that we have been through, a period of seven or eight years boom, you might say, many abuses have crept in. That is human nature.

The thing I want to point out is, after my long experience of governmental service—I have examined banks in more States, I think, than any other examiner ever examined, because I was young and could take more punishment—I say the majority of the banks are honest; that they are honest at heart; they want to do right.

Senator GLASS. Nobody doubts that.

Mr. JOHNSTON. And I am just fearful this bill, Senator, is going to make it very difficult for them to operate. I do not know what our bank is going to do with 49 per cent of its investments already in a class, in a field, that this bill practically outlaws.

Senator GORE. Most of that is Government bond investments?

Mr. JOHNSTON. In loans on bonds and stocks and securities.

Senator BULKLEY. Will you develop what you mean by saying it "outlaws" them?

Mr. JOHNSTON. Well, we can not loan on those and borrow at the Federal reserve bank if the Federal reserve's agent says we should not, unless it is in some emergency. This bill practically outlaws it.

Senator GLASS. You can not borrow on them at the Federal reserve bank under existing law, and could not for the last 18 years. It outlaws, if you call it that, investment loans for rediscount purposes.

Mr. JOHNSTON. We do not borrow on them, Senator; never have; do not want to.

Senator GLASS. Yes; but you say we are outlawing them here, and that has been the provision of the Federal reserve act for 18 years, Mr. Johnston.

Mr. JOHNSTON. Yes; but in this bill here, as I read it, we just can not do any security business or loan them money, people who are doing security businesses.

Senator GLASS. I think you will have to read the bill again. Let me call your attention——

Senator BULKLEY (interposing). Where do you find that, Mr. Johnston?

Mr. JOHNSTON. Well, now, here is one, section 8:

> Upon affirmative vote of not less than six of its members the Federal Reserve Board shall have power to fix from time to time for any member bank the percentage of the capital and surplus of such bank which may be represented by loans protected by collateral security.

Senator GLASS. Why would you say that that outlaws your collateral now? You say the bankers are honest. Do you think the members of the Federal Reserve Board are honest?

Mr. JOHNSTON. We do, but we do not want to give that power to anyone. We do not want to give any more power—I do not think any corporation would want to give any more power to anybody but to the people who run their business. We might have a set of men at one time that are very favorable, and we might have another set of men at another time later on that are unfavorable.

Senator GLASS. Do you think the banking business of the country ought to be left wide open to do as it pleases without legislative restriction?

Mr. JOHNSTON. I think it would be a lot better. It is in England practically without any restriction, and they have had no failures.

Senator GLASS. There are a good many things here that are not in England.

Mr. JOHNSTON. And the same in the Canadian system; it is pretty much the same way. I am sure that no restriction whatever would be much better than too much restriction. We ran 93 years at the Chemical Bank and did not have a set of by-laws and accidentally found it out, although every examiner had said in his report in answer to the question "By-laws satisfactory."

Senator GLASS. Would you like to introduce the English system here of periodical settlements on the stock exchange?

Mr. JOHNSTON. I do not know that that would be a very bad thing. I have often thought it probably would be a good thing to have the periodical settlements.

Senator GLASS. We would not have a repetition, then, of such riots of stock gambling as we had in 1928 and 1929, would we?

Mr. JOHNSTON. I think it would help lessen that.

Senator MORRISON. Mr. Johnston, what control under the present law has the Federal Reserve Board of the loans and securities that the banks in the system may accept?

Mr. JOHNSTON. I do not think they have any. I do not think they should.

Senator MORRISON. I agree with you very heartily.

Mr. JOHNSTON. I do not think they should. I was this way when I was in the Government service: I wanted more power to administer these banks, although I was in the supervising service. That is the history and trend of our Government.

Senator MORRISON. Under the present law and for some time the Federal reserve bank, until this 15-day provision was put in it, discounted notes of a character described in the act?

Mr. JOHNSTON. Yes, sir.

Senator MORRISON. And that is about all they did, was it not?

Mr. JOHNSTON. Yes, sir.

Senator MORRISON. And the purpose for which the note was discounted controlled its eligibility?

Mr. JOHNSTON. That is right.

Senator MORRISON. And as to the rest of the bank's funds, why, they were administered under the laws of the States when they were State banks who had become members of the system, or under Federal law that controlled the banking system, and they had no right to dictate to the bank how it should invest its funds at all.

Now you think under this law that they would have such power?

Mr. JOHNSTON. Why, certainly. I do not know how we can operate under it.

Senator MORRISON. You are acquainted with the banking conditions in the States where there are not big cities, are you not?

Mr. JOHNSTON. Yes, sir.

Senator MORRISON. For instance, North Carolina?

Mr. JOHNSTON. I grew up in one of them, on a farm.

Senator MORRISON. I know you do lots of business down in my State, your bank does.

Mr. JOHNSTON. Yes, sir.

Senator MORRISON. Do you think these new provisions giving this control would be helpful or hurtful to the type of banking done in a State like North Carolina?

Mr. JOHNSTON. I think it would hurt it.

Senator MORRISON. The banks in such areas of the country as that, the percentage of their business, generally speaking, is nothing like so large in the character of paper eligible for discount as in the larger cities, is it?

Mr. JOHNSTON. That is true.

Senator MORRISON. Do you think they could run a bank in a State like North Carolina with the towns and cities and the general type of business there purely upon commercial paper?

Mr. JOHNSTON. They would starve to death.

Senator MORRISON. They do not do it, do they?

Mr. JOHNSTON. No, sir.

Senator MORRISON. And in your opinion it would perish them if they undertook it? And this law seeks to regulate not only what they will discount but that they will not discount eligible paper unless the bank is run according to the provisions of this act, or may not do it?

Mr. JOHNSTON. That is right.

Senator MORRISON. And you do not think that would help us?

Mr. JOHNSTON. No, sir; I do not think it would help anyone. I do not think it is right or fair. These banks belong to their shareholders. I assume that they have been classified as a semi or quasi institution receiving deposits. It is no more than any other large company in a semi condition. But I think there are inherent, under our law and our Constitution, property rights. I do not think there

should be any more systems set up in Washington or any other place that are going to have the right to dictate to the boards who are elected by the shareholders of a bank as to the type of business that they should do.

Senator MORRISON. You do not imply by that that they should not have laws regulating honesty and preventing rascality and all that, when you say they should not be allowed to control the business part of the bank?

Mr. JOHNSTON. Unfortunately, you can not prevent rascality.

Senator MORRISON. Well, you can pass law condemning it.

Mr. JOHNSTON. Yes, you can, but we have got to remember that banking is like life—it is the law of averages. Among the 12 Apostles there was one Judas, and you find them creeping into the banks, and now we should not punish the bankers who want to run their banks honestly, who believe that they know how to run them. They do not want to be punished by having to ask somebody in Washington just what they can do.

Senator MORRISON. Well, I think I agree with you; with what I think you mean. But you do not mean that you do not think there ought to be laws regulating the integrity of officials of banks?

Mr. JOHNSTON. Yes: there should be—just as few as we can have.

Senator MORRISON. But you mean that as to how they——

Mr. JOHNSTON (interposing). Invest their money.

Senator MORRISON. Administer their funds.

Senator GLASS. Do you think that the national bank act should be repealed? It undertakes to do that. It undertakes to determine what classes of loans national banks should make. Do you think that should be repealed?

Senator MORRISON. Senator, would you just let me get through with him, please, sir? It is disagreeable to you. May I?

Senator GLASS. Oh, you have the same privilege here that I have. I ventured to ask a question, but you can go ahead.

Senator MORRISON. What I mean by that, I was asking him some and just about through with what I wanted to ask him.

There is no law now regulating the right of a member of the Federal reserve bank to make any loan which it deems wise to make, except such criminal laws as regulate the dishonesty of it, is there?

Mr. Johnston. There are limitations.

Senator Morrison. A Federal bank can not loan money on real estate?

Mr. JOHNSTON. Yes, sir.

Senator MORRISON. They had that, which they wisely changed. But they can and have been administering their assets subject to criminal laws?

Mr. JOHNSTON. Yes, sir.

Senator MORRISON. Demanding honesty and integrity and so on, with a free hand, have they not?

Mr. JOHNSTON. Yes, sir.

Senator MORRISON. Do you think it would serve any good purpose to clothe a lot of officers here in the country with the right to say to these banks that "If you run your banks in such and such a manner then we will not discount your otherwise perfectly eligible notes"?

Mr. JOHNSTON. I do not think it would. We have clothed a lot of officers in a certain branch of supervising in connection with what is known as the eighteenth amendment, and I am very sorry to say that it certainly has not been effective. I do not believe it would be very much more effective. I am afraid not, in the banking business. I just do not believe we can have six or eight men prescribe how twenty-five or thirty thousand banks are going to run over the country.

Senator MORRISON. Do you think if they exercised the power in that act on a bank in North Carolina it could profitably transact the banking business?

Mr. JOHNSTON. It could not.

Senator MORRISON. It could kill it if they wanted to, absolutely, could it not?

Mr. JOHNSTON. Yes, sir.

Senator MORRISON. That is all.

Senator WATSON. Do you want to abolish the Federal reserve system?

Mr. JOHNSTON. No.

Senator WATSON. Do you want to amend it?

Mr. JOHNSTON. No.

Senator WATSON. Do you want to let the thing run along just as it is?

Mr. JOHNSTON. At present.

Senator WATSON. You would not abolish the system of Government inspection?

Mr. JOHNSTON. No. I could not say that even if I wanted to, because I spent six years doing it.

Senator WATSON. I know, but maybe you found out something about it in six years. Do you want to?

Mr. JOHNSTON. No; I think it is a good system of inspection. Really, it should be better fortified.

Senator WATSON. Is it helpful or harmful?

Mr. JOHNSTON. It is helpful, of course. All those are.

Senator WATSON. How far would you go with governmental supervision?

Mr. JOHNSTON. Give them plenty of authority to examine; see that they live within the statutes under which they operate. I would give them no power whatever of operation. It is dangerous when you put the power of operating in the hands of governments.

Senator MORRISON. That is the point exactly.

Senator WATSON. Are there any features of this bill that you would pass if you had your way about it?

Mr. JOHNSTON. There probably are; yes, sir.

Senator WATSON. What are they?

Mr. JOHNSTON. I have to go over it. I have only pointed out—I did not aim to come here to pick this bill to pieces. I have only aimed to take out some of the essential things, and I hope Senator Glass will realize that I have not done that. Senator, I have a very high regard for you.

Senator GLASS. And I have for you, Mr. Johnston.

Mr. JOHNSTON. And I am not actuated by any selfish motive in this.

Senator GLASS. I have always judged you as a banker of great ability. The fact that you have dispensed with your affiliates answered my objection to the affiliate, for that matter. But I do not exactly bring myself to agree with you on the contention that there should be no restrictions upon the operations of the individual banks. You, then, would repeal that provision of the national bank act which prescribes that not more than 10 per cent of the capital of a bank should be loaned to one individual borrower?

Mr. JOHNSTON. You refer to the provision that says no more than 10 per cent of the capital and surplus shall be loaned to any one institution?

Senator GLASS. Yes.

Mr. JOHNSTON. I think that is a sound provision.

Senator BULKLEY. But it ought not to be a matter of law?

Senator GLASS. No.

Senator BULKLEY. Is that what you mean—it ought not to be a matter of law? It is already there, I know; but you would like to repeal it, would you not?

Mr. JOHNSTON. No.

Senator BULKLEY. It is inconsistent with your theory that there should be no regulation.

Mr. JOHNSTON. No.

Senator MORRISON. I do not think it is, the police regulations.

Senator GLASS. If I may, with the permission of the Senator from North Carolina, I would like to continue my inquiry.

Senator MORRISON. If the Senator from Ohio will let you, I am willing.

Senator GLASS. Then you would repeal that provision of the law that undertakes to put a limitation upon real estate loans by a national bank?

Mr. JOHNSTON. I think all those provisions are sound.

Senator GLASS. Well, but not according to your theory. A bank should be left to do as it pleases; it ought not to be subject to any supervisory power, Mr. Johnston—that is the record that you have made here.

Mr. JOHNSTON. There is quite a difference between supervising and administration.

Senator BULKLEY. What do you mean by that? What is in the bill that makes that distinction?

Mr. JOHNSTON. That some board in Washington can tell us just what we can do with our funds.

Senator GLASS. They do not undertake to tell you just what you can do with your funds. Would you repeal this provision of the Federal reserve act which confides to the Federal Reserve Board here at Washington the exclusive right to define eligible paper, and says, "but such definition shall not include notes, drafts, or bills covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except United States bonds?" Would you repeal that?

Mr. JOHNSTON. I do not think so. It is quite different when you——

Senator GLASS (interposing). You said so.

Mr. JOHNSTON. It is quite different when you propose to say to us, "Because you happen to have a certain per cent of your capital

funds or your depositors' funds loaned on a certain class of securities that may not suit us, you can not use the Federal reserve bank of which you are a member unless you regulate that amount to just what we think is proper and right." That is the difference. That is administration; that is not supervision.

Senator GLASS. In other words, then, do you think a member bank may loan if it pleases every dollar of its depositors' money on speculative securities, and then go, as of right, to the Federal reserve bank and recoup itself out of the resources of the Federal reserve bank, and that nobody in control should have the right to say you can not do that?

Mr. JOHNSTON. Of course, that is a pretty broad statement.

Senator GLASS. That is stating it.

Mr. JOHNSTON. To say a bank would take all its money and loan it on speculative securities and then go to the Federal reserve to recoup.

Senator GLASS. Well, but you said the bank should be permitted to operate without any restraint at all.

Mr. JOHNSTON. I say I think it would probably be just as well if it had less restraint, because good banks are going to run right whether you have any laws or not, and poor banks, you can not get enough policemen to make them; badly managed banks, you can not get enough policemen to make them run right.

Senator GLASS. That is what I say; you think the banking business of the country should be left to the judgment of those who have money invested——

Mr. JOHNSTON (interposing). In the main I would say yes. I would say that the stockholders elect board of directors, and they should manage it within the laws that we have in the various States and the Federal reserve system.

Senator GLASS. Why any laws in the States at all? If there are to be no Federal laws to put limitations upon national banking, why any laws in the States to put limitations upon State banks?

Mr. JOHNSTON. We already have limitations of laws.

Senator GLASS. I know, but why have them?

Mr. JOHNSTON. It is a question of degree. It is a question how far you want to go.

Senator GLASS. We do not think we have gone very far in this bill.

Senator WATSON. Has governmental inspection and supervision up to the present time done more harm than good?

Mr. JOHNSTON. Oh, it has done more good.

Senator WATSON. More good?

Mr. JOHNSTON. Why, certainly.

Senator MORRISON. Mr. Johnston, don't you think there are other types of credit that ought to be recognized in our banking system besides these particular types mentioned in the Federal reserve act and made eligible for discount?

Mr. JOHNSTON. Of course, that is a question that many people have given serious thought to. Many people think that municipal securities or State securities should. I think that the theory of the Federal reserve system was that the paper should be self-liquidating.

Senator MORRISON. Exactly, but there was no effort in it to dictate to banks what they should do about individual credits.

Mr. JOHNSTON. No, sir.

Senator MORRISON. Or other types of credit; but as to that particular type of credit that that reservoir was put up and to be always open and ready to furnish currency on such paper as that, but there was not any provision then to dictate what the banks should do with other funds, was there?

Mr. JOHNSON. No; not that I know of.

Senator GLASS. You will concede that in section 5200 of the Revised Statutes there is an attempt to dictate to the national banks the classes of credit that they may accord, will you not?

Mr. JOHNSTON. That is ever increasing in governments and in central banking. The history of central banking——

Senator GLASS (interposing). Well, but there are provisions in the Revised Statutes that undertake to restrain the operations of national banks, are there not?

Mr. JOHNSTON. They limit them under the law as to the tpyes and amount of investments and certain things that they may do.

Senator GLASS. That is what I am saying.

Mr. JOHNSTON. Yes, sir; it is in the national bank law.

Senator GLASS. You think they ought to be repealed, do you?

Mr. JOHNSTON. I would not say so, but I would not want to give the power to the Comptroller of the Currency to say just how much any national bank would have, or any other body in Washington, or anywhere else.

Senator GORE. Mr. Johnston, there was a good deal of opposition on the part of the banks to the Federal reserve act when it was pending, was there not?

Mr. JOHNSTON. Yes, sir; there was.

Senator GORE. A good deal of that opposition was unjustified, as events have proven?

Mr. JOHNSTON. I think that is true, Senator.

Senator GORE. Don't you think a good deal of the opposition was due just to the instinct of conservatism and the fear of change, and not to any well-grounded opposition to the bill itself?

Mr. JOHNSTON. I was strongly in favor of the Federal reserve system. In fact, I wrote the first book that came out on it, most copies of which I have withdrawn from circulation that I could get my hands on.

Senator GLASS. You mean after it was adopted?

Mr. JOHNSTON. No, sir; just about simultaneously with it. I followed the legislation. I was here and I was very strong for it.

Senator GORE. Did you retire those books from circulation?

Mr. JOHNSTON. Yes; as fast as I could get my hands on them.

Senator GLASS. I would like to have discovered you at that particular time.

Senator WATSON. Perhaps he will send you one of his books.

Mr. JOHNSTON. Senator, I do not want to be construed as saying that I wrote an explanation of what the Federal Reserve might do.

Senator GLASS. I understand what you want to say.

Mr. JOHNSTON. I do not mean that I had anything to do with the act. I think the banks' prejudice against the measure was largely one that they were compelled to do this. You know, we American people are independent people. We do not like to be told we just have to do things.

Senator GORE. Oh, I get your reaction on that. You do not like to be made to do what you have to do.

Mr. JOHNSTON. Yes; they would probably have come in, Senator, if there had been a free-will affair, if they had the choice.

Senator GLASS. Yes; like the Aldrich bill that was unanimously approved at New Orleans before it had ever been read, and that was very much more compulsory in its provisions than the Federal reserve act ever was. The Federal reserve act was not compulsory. It did not compel a national bank to come in. It might surrender its charter and transform into a State bank if it wanted to.

Mr. JOHNSTON. You would not call that compelling them?

Senator GLASS. No. Just as the Aldrich bill provided that if they did not come in under the Aldrich system, which was to be controlled absolutely by the banking community, practically their holdings of United States bonds would be dreadfully depreciated.

Mr. JOHNSTON. Senator, I would say, just as a different point of view, that is very much like a farmer that says to his son, "Unless you plow that field up over there you have got to move out of here and go somewhere else to live."

Senator GORE. That is what I think.

Senator GLASS. Yes; and under the Aldrich bill, "If you do not plow that field out there, we will take your horses and plow away from you." That is what the Aldrich bill provided, and you swallowed that without a grimace. Yet you opposed the Federal reserve act.

Mr. JOHNSTON. When you say we swallowed——

Senator GLASS (interposing). Not you, but the American Bankers' Association.

Mr. JOHNSTON. The American Bankers' Association; yes.

Senator GLASS. Yes.

Senator GORE. What I was trying to get at is how much of your present condition is due to the instinct of conservatism and how much to the fear or fact that this might aggravate the deflation.

Mr. JOHNSTON. I am sure it is going to make conditions much worse in the bond market than the deflation. If I am prejudiced, I do not know it. I do not suppose anyone knows when he is prejudiced, anyway. So I may be wrong on that.

Senator MORRISON. Mr. Johnston, is not the effect of the Federal reserve system, as they are administering it and as they interpret it, to depreciate the desirability of all other types of credit except those enumerated in that act? I want you to get this: I am not so much concerned about whether you all are in favor of it or not or how it will affect you, although I would not want to do you any harm, any injustice. But upon the whole country, and especially the section of country that I in part represent here, will not this law, these amendments that we are proposing to make to it, further tend to depreciate the desirability of all other types of credit except those short-term, business-in-process credits therein enumerated?

Mr. JOHNSTON. That is my belief

Senator MORRISON. Of every type?

Mr. JOHNSTON. Yes, sir.

Senator MORRISON. And your opinion about that is based on an actual business contact with the banking life of the whole country, is it? Your bank is doing business in most of the States?

Mr. JOHNSTON. In every State.

Senator MORRISON. And your opinion is that it would further depreciate all other types of credit except those few types enumerated in there?

Mr. JOHNSTON. I think so. I do not know how——

Senator MORRISON. And do you think that it would be a good thing for the whole country to do that?

Mr. JOHNSTON. I think it would be a bad thing.

Senator MORRISON. I agree with you most heartily.

Senator GLASS. What additional classes of paper does this bill exclude from rediscounting operations more than the existing law?

Mr. JOHNSTON. I do not think it makes any change in the classification of paper to be rediscounted.

Senator GLASS. Of course not, but you have just said——

Senator MORRISON (interposing). But it does make a difference in the power given these people to dictate to the banks what they shall do on the other credits?

Mr. JOHNSTON. Yes.

Senator MORRISON. That is the big thing in the whole business, is it not, in the new law, that it gives them authority to say to banks, "If you make these other loans then you can not have the benefit of discounting the paper which otherwise would be eligible?"

Mr. JOHNSTON. That is true.

Senator MORRISON. And indirectly control the administration of the whole aspects of the banks that belong to it; and in the small towns and cities of the country I believe you have stated that you thought if that power was exercised they could perish the bank to death, or make it impossible to profitably do business?

Mr. JOHNSTON. I think that is true, and I think it would have a very disastrous effect on the Federal reserve system.

Senator MORRISON. And on the whole country?

Mr. JOHNSTON. I sincerely say that. I think it would have a very disastrous effect on the entire system.

Senator GORE. Now, Mr. Johnston, I want to get back to your theory and philosophy of this business. You say that your stockholders have invested their capital in the bank and you think they ought to be allowed to run it?

Mr. JOHNSON. Yes. They ought to be allowed to elect their board of directors who select the officials to operate the bank. I think that is inherent.

Senator GORE. What is the ratio between your capital and surplus and your total deposits?

Mr. JOHNSTON. Our capital and surplus are sixty-five millions and our total deposits two hundred and seventy-five or three hundred million.

Senator GORE. And you make most of your money out of your depositors' money, do you not?

Mr. JOHNSTON. No, sir; we do not.

Senator GORE. A considerable portion of it?

Mr. JOHNSTON. We make some of it; we make about 1 per cent on our depositors' money. Our income last year averaged on all our funds 3.73 per cent.

Senator GORE. One per cent on deposits?

Mr. JOHNSTON. About 1 per cent was made on deposits.

Senator GORE. What I was trying to get at, since your stockholders derive their profits largely from the deposits, money put in your bank by your depositors——

Mr. JOHNSTON (interposing). Partly, Senator, if I may interrupt. I think it is about 50-50 from all capital funds and from our profits on our depositors.

Senator GORE. Of course, the interest from your depositors represents quite as much as the capital invested by your stockholders?

Mr. JOHNSTON. Their deposits, of course, is their money, that we have to stand ready to give back to them at any time. That is an entirely different relation from the stockholders' relation.

Senator GORE. Of course, when they deposit it, it becomes yours instead of theirs?

Mr. JOHNSTON. I do not think so. We are only holding it for them. If you put wheat in the warehouse, I do not think it belongs to the warehouse man.

Senator GORE. I think the deposits, when they are placed in the bank, become the property of the bank. They have a right to draw it out, but you have a right to spend it and use it.

Mr. JOHNSTON. I could not agree with you on that, Senator.

Senator GORE. Yes; well, that is immaterial anyway.

Mr. JOHNSTON. Yes, sir.

Senator GORE. It makes the point I am getting at even stronger. You say the money is still the depositors' money. What additional guaranty do you think ought to be erected to protect that depositor and see that he gets his money out of your bank, if it is his property and not yours?

Mr. JOHNSTON. I do not see why he should have any guaranty at all, because he still retains title to it.

Senator GORE. You think the stockholders, though, having the property interest, ought to be allowed to run the bank in which his property is, and yet you think the depositors who put their money in your hands in trust, according to your theory, ought not to have any right at all.

Mr. JOHNSTON. He has the right, because he can draw his money out if he wants to.

Senator GORE. Yes; but suppose it fails?

Mr. JOHNSTON. If he puts it in a bad bank and it fails he will not get his money out.

Senator GORE. No; but ought there not be some guarantee that he will?

Mr. JOHNSTON. I do not think so, unless we are going to guarantee all elements of society against misfortunes and evils of all kind. Of course, if we are going to have socialistic government, then we ought to guarantee everybody against all manner of things.

Senator GORE. But you are making your point now that stockholders, having invested their capital in your bank, ought to have a property right and it ought not to be interfered with.

Mr. JOHNSTON. I did not say that.

Senator GORE. That is your general theory.

Mr. JOHNSTON. I say they ought not to ask any Government board in Washington——

Senator GORE (interposing). You said that it ought to be like in England.

Mr. JOHNSTON. I think it would be better if it was like that. I did not say I thought it ought to be.

Senator GORE. You mean you think the stockholders ought not to be regulated in the use and administration of their property and property rights, and yet you think a depositor, who puts his property in your keeping, ought not to have any particular guarantee further than you state?

Mr. JOHNSTON. I could not say that I do, Senator. We have been doing that for 108 years successfully, and if we had had to pay for the fellow that has not been doing it successfully these 108 years, we would have had to pay a very large sum.

Senator GORE. I agree with that. I think the banks ought not to guarantee everybody's debts. I think that is what it amounts to. But what about the depositors being required to put up a sort of an insurance on the stock—they are the ones that take out the policy?

Mr. JOHNSTON. Of course, some of them do that now, you know. The Ford Motor Co. operates that way in many of its banks and pays that premium itself. Other companies do that, I am told. We have no business of that nature. We have never had anyone who wanted to put money with us on that basis; only on our long record of honesty and integrity. We do not want it.

Senator GORE. Do you pay interest on commercial deposits?

Mr. JOHNSTON. Yes; we pay interest of 1 per cent.

Senator GORE. What proportion of your deposits are demand deposits?

Mr. JOHNSTON. Practically all of them: 90 per cent.

Senator GORE. And could you make an estimate of what proportion of demand deposits result from the actual deposit of cash and cash items and what results from loans and discounts, credit transactions?

Mr. JOHNSTON. Oh, the great bulk of deposits come from the deposit of checks and cash.

Senator GORE. No cash items?

Mr. JOHNSTON. There is practically no borrowing. Our borrowing is down to 20 per cent. It has just disappeared. They are not borrowing. We want more business. We would like to take on $50,000,000 of it to-day if we could find it over the country.

Senator WAGNER. Is it that there is no borrowing because there are no loans being sought or because loans are being sought but are being refused by the banks?

Mr. JOHNSTON. No, sir; they are just not borrowing.

Senator WAGNER. That question has been the center of much controversy in the Senate.

Mr. JOHNSTON. These companies all raised their capital during our hectic days.

Senator GORE. How is that?

Mr. JOHNSTON. The companies during the boom period from 1922 on up to 1929, many of them, increased their capital and took in so

much money on capital funds that they do not have to use the banks.

Senator GLASS. And loaned a good deal of it on the stock exchange?

Mr. JOHNSTON. Many of them did; yes, sir; took it out of the banks and did that, and they got frightened in '29 and asked us to pay it back to them, and that is when we went to the Federal reserve and borrowed that huge sum of money for a very short time.

Senator MORRISON. Now, Mr. Johnston, if this law were passed like it is would it not be necessary for most of the banks in the South and the agricultural sections of the country, where there are not large cities, to collect largely their present credits and reinvest them or lose their right to discounts under the Federal reserve system?

Mr. JOHNSTON. Unless the big banks in the centers would supply them.

Senator GLASS. What provision of the bill requires that?

Senator MORRISON. The provisions in which——

Senator GLASS (interposing). I am asking Mr. Johnston what provision of the bill requires that.

Mr. JOHNSTON. Well, it is in the limitation of the type of business that they can do.

Senator GLASS. What is the limitation on their rediscounts in this bill? What limitations are different from the existing law?

Mr. JOHNSTON. I do not know that there is any limitation, but there is a threatened limitation that you can not borrow at all unless you do to suit some board here in Washington.

Senator GLASS. I am asking you to point to that provision of the bill that requires the country banks to dispose of all of their loans and collateral before they can get accommodations at the Federal reserve bank.

Mr. JOHNSTON. Well, under this correspondent bank provision in this bill where it says that you can not have a correspondent if you do not do certain things, I take it to come under there.

Senator GLASS. You think that that provision of the bill requires all of the banks throughout the country to dispose of all of their collateral loans before they can get accommodation at the Federal reserve bank?

Mr. JOHNSTON. I think many of them. As I read it and study it, it would seem to me that we are going to have to abandon a great deal of our business in many of the States. Many of our customers, for example, many mortgage bond companies, that we have been doing business with, many agencies that we have supplied credit during two or three months while they were collecting these loans, the large life insurance companies—all those are going to be classes of securities that are going to be taboo here for us to have.

Senator MORRISON. What I am driving at is that if the bank is now in that condition, if they are, and then apply for discounts of notes, then they can refuse to discount it, if the bank is in the condition condemned by that act. And I ask you if it is not a fact in your opinion that most of them are now in that very condition.

Senator BULKLEY. What provision? I would like to know what it is.

Senator MORRISON. That they have got loans other than eligible paper, real-estate mortgages, individual loans secured by stock or

good notes without any security at all. There are lots of them in that condition all over the country.

Mr. JOHNSTON. They are usually the best, in my estimation.

Senator MORRISON. Yes; all those types of loans. If the bank had such an assortment of that sort of credit as was condemned by this new law, then it would be necessary for it to collect those credits and change them into the uncondemned character. Don't you think that that would tear the South all to pieces, if that were undertaken at this time?

Mr. JOHNSTON. I am afraid it would. I hope it does not happen. We are very large lenders of money in the South, as you know, Senator.

Senator GLASS. Mr. Johnston, do you think that is true? Do you think there is any provision of this bill that requires that?

Senator MORRISON. I do.

Senator GLASS. I did not ask the Senator from North Carolina.

Senator MORRISON. I answered you, though.

Senator GLASS. I asked the witness on the stand. Again, I would like you to point to the provision that requires that.

Mr. JOHNSTON. I am fearful that is a tendency of the legislation, Senator.

Senator BULKLEY. In what provision, Mr. Johnston?

Mr. JOHNSTON. Well, let me get the section here. Of course, I am not quite as familiar with these sections, as to the numbers, as you are.

Senator BULKLEY. We would like to know where you got that impression.

Senator GLASS. While you are looking it up you might incidentally answer this question, Mr. Johnston: Do you not know that power is lodged in the Federal reserve bank now to refuse all rediscounts?

Mr. JOHNSTON. Yes, sir. I think, Senator——

Senator GLASS (interposing). Tremendous power, is it not?

Mr. JOHNSTON. If you will permit me to say, I think you have all the power now. I think you had it in precise terms.

Senator GLASS. That is an immense power, is it not?

Mr. JOHNSTON. I say I think you had the power that you are really seeking to correct this stock and bond matter——

Senator GLASS (interposing). It has not destroyed the banking system, though, has it?

Mr. JOHNSTON. Oh, no; but I think the Federal reserve could have cured it by raising the discount rate, which the Federal Reserve Board did not do. They did it finally, after the horse had gotten out of the barn.

Senator GLASS. Do you think the board has had this power all along?

Mr. JOHNSTON. I think the power to raise the discount rate——

Senator GLASS (interposing). Do you think it has the power to cure this situation?

Mr. JOHNSTON. To cure the speculative situation by raising the discount rate.

Senator GLASS. It did not destroy the banking situation because of that?

Mr. JOHNSON. No.

Senator GLASS. Well, I say, to cure the situation——

Mr. JOHNSTON (interposing). I think that is a power that belongs to the board, in the Federal reserve bank. I really think it belongs to the Federal reserve banks.

Senator GLASS. The Federal reserve banks have complete power to decline any loan that they please; isn't that true?

Mr. JOHNSTON. Yes, sir.

Senator GLASS. Exactly. Courts have decided that.

Senator BULKLEY. I would like to see that language that you think is going to "ruin the South."

Mr. JOHNSTON. Senator, you are speaking from it. You have asked me a question.

Senator MORRISON. Section 8, it says:

Subsection (m) of section 11 of the Federal reserve act, as amended, is amended to read as follows:

"Upon the affirmative vote of not less than six of its members the Federal Reserve Board shall have power to fix from time to time for any member bank the percentage of the capital and surplus of such bank which may be represented by loans protected by"—

Not stock exchange collateral or speculative collateral but "collateral security."

And the spirit behind this bill and all of it makes it very clear to me that the whole purpose of it is to see to it that these banks do not invest extensively except in the character of the paper favored by the gentleman behind the legislation. It will give them that power, and there it is, and if they should condemn the types of credit come to be called "frozen" and all that simply because it is not payable in 90 days or 6 months and commercial business-in-process, they could make every bank in the country reform the investment of its securities to meet with their demands, and under it, if they carry it out, the spirit that they have radiated from there all the while, all over this country, why, the banks could not loan on anything but those types of security that the gentleman behind this bill seems to have exalted into the only important credit in this country. That power would give them the power to practically break up banking in my section of the country and make it worthless to the people.

Now, why couldn't they do it under that?

Senator BULKLEY. I do not want to argue the question at this time. I am trying to find out the witness's views about this.

Senator MORRISON. Neither do I wish to argue it, but you and Senator Glass seem to wipe the face of those of us that do not agree with you about this, with your ideas on it and all that, and I simply give you my retort.

Senator BULKLEY. I am sorry the Senator construed it that way. I surely did not address any remarks to him.

Senator MORRISON. I heard them.

Senator GORE. Do you think it is wise to change the provision prohibiting the national banks making loans on real estate?

Senator MORRISON. Let us get his answer to that.

Senator BULKLEY. Yes; I want to get his answer to it.

Senator MORRISON. Why can't they under that power regulate the collateral security, say how they shall invest all of their funds where they had collateral?

Mr. JOHNSTON. That is a question that many people differ about. Everyone knows that real-estate loans in periods of depression are slow loans, the most difficult to dispose of. Part of our great trouble now that is going on over this Nation is our real-estate situation.

Senator GLASS. Everybody knows that existing law put the limitation upon real-estate loans.

Mr. JOHNSTON. Yes. And I am not certain that it was a wise provision, Senator, to permit national banks—we should not overlook the fact——

Senator MORRISON (interposing). Mr. Johnston, I asked you a question: Why under that law—it is not a question of the wisdom of doing it or not doing it—would not they have the power to make a bank reform its loans according to——

Mr. JOHNSTON (interposing). To what they thought was——

Senator MORRISON (interposing). Wise? Now, the question of what is wise or not you and I might disagree about, or the rest of us, but that does give them that clear-cut power, does it not?

Mr. JOHNSTON. I think so.

Senator MORRISON. And under it they could absolutely control what percentage would be loaned on any kind of collateral.

Mr. JOHNSTON. I do not want to give anybody that power.

Senator MORRISON. I do not either.

Mr. JOHNSTON. I would rather go back to farming in Kentucky than to operate a bank under that.

Senator GLASS. Mr. Johnston, has not the board of directors of every individual bank that power?

Mr. JOHNSTON. Yes; they should.

Senator GLASS. You do not want to give it to anybody.

Mr. JOHNSTON. They should. They are the owners of the bank—the stockholders—and the directors are selected by the stockholders. That is quite different from giving it to some Government official. I do not think the banks need policemen. That is the thing. I just don't think they need policemen.

Senator GLASS. I say you think the banking business ought to be done without restraint?

Mr. JOHNSTON. No; I would not say without any restraint.

Senator GLASS. Without legislative restraint?

Mr. JOHNSTON. There should be limitations on everything, but I think most of the bankers are going to continue this business honestly, whether there is ever any reserve act or any Federal reserve bill or not, and there are going to be great periods of depression and great periods of deflation of values. I do not think we are going to find any cure in any legislative action for those things.

Senator CAREY. Don't you think there is danger that this is going to drive a lot of them out of the Federal reserve system that are now members?

Mr. JOHNSTON. Yes; there is no question about that.

Senator GLASS. Oh, yes; there is a question about it. We think it will bring many in. So there is a question about it.

Mr. JOHNSTON. No question in my mind.

Senator CAREY. Mr. Johnston, don't you think the present restrictions have had the effect of keeping a good many out?

Mr. JOHNSTON. I think it prejudices the Federal reserve system. I think that prejudice exists to-day.

Senator GORE. What is the amount of your deposits?

Mr. JOHNSTON. About $300,000,000.

Senator GORE. I mean the average deposit is how much? How many depositors have you?

Mr. JOHNSTON. About 35,000.

Senator GORE. I was wondering what you would think about a small tax on depositors to guarantee small deposits, say deposits of less than $2,500; not a tax on the bank but a tax on the depositors.

Mr. JOHNSTON. Voluntary or involuntary?

Senator GORE. Well, I have been considering both. At least one bank, say, in every community mandatory, but others come in or not. If it is true—and I may be wrong—that the runs on banks are generally started by the rather small depositors who put actual cash in the bank, put money in the bank——

Mr. JOHNSTON (interposing). That is not true, Senator.

Senator GORE. Isn't it?

Mr. JOHNSTON. The smart fellow gets out first and he is the big depositor. What we call the national money, the big chain stores and tobacco companies and that type of people, they get out first, long before the little fellow ever hears of it.

Senator GORE. Are they the ones that take—it is the psychology I was trying to get at. The man who understands the situation is not disposed to take to panic; it is the little fellow that does not know much about it that kind of gets stampeded and rushes to the bank and demands his money. Am I wrong about that?

Mr. JOHNSTON. Yes; I think you are. You see him walk in the door to get his money. You do not see the large depositor that checks his out that goes through the clearing house.

Senator GORE. But most of these banks that I have in mind are not in these cities like New York and these five or six big cities. I think there was only one big one that failed in New York. But take it out over the country and these four or five thousand banks, of course they have not all been preceded by runs, but there have been runs. Were those runs not generally started by small depositors who did not know much about the situation?

Mr. JOHNSTON. Well, now, in the smaller banks, of course, that would be true, because they have not any large depositors.

Senator GORE. Yes.

Mr. JOHNSTON. And these people hear rumors and they get uneasy and a bank has failed over in some neighboring town.

Senator GORE. And some friend has lost money.

Mr. JOHNSTON. And some fellow has lost money, and they think they had better take theirs out and put it in a safe place.

Senator GORE. Now, the depositor who does that is the man who has put money in the bank, is it not?

Mr. JOHNSTON. Yes, sir.

Senator GORE. Not the man who has deposited under a loan. What I was trying to get at, this proposition would prevent him from starting a stampede in the first instance. I think the depositor ought to pay for it just like any policyholder ought to pay his premium.

Mr. JOHNSTON. I think that theory is sound. If a man is asking for protection he ought to pay the premium.

Senator GORE. I think, just like life insurance companies, the policyholder ought to be made to pay the premiums.

Mr. JOHNSON. I do not think the good banks ought to be assessed to pay for the bad ones.

Senator GORE. I do not think any of the banks ought to be assessed. I think the depositors who have the advantage of the insurance ought to pay for it.

Mr. JOHNSTON. You speak of the people becoming frightened. There was a woman that had a cook, and she sent her on a little trip somewhere and while she was gone she concluded she would fix the room up, she had been there so long, and when she threw the mattress out she found $3,000 under the mattress, so when the cook came back she made her go and put it in a bank, and a week later that bank failed and the woman went in and told the cook how sorry she was that she had lost her money, and she said, "You needn't to worry. I went down the next day and took it out."

So that is the psychology of a lot of people. They are just frightened in times like this and they take out their money.

Senator GORE. I think about a hundred banks failed down in Mississippi, and it probably started in a garage where some man said that such and such a bank was going to fail and he was going to take his money out, and his neighbor told it to somebody else, and they went and took their money out, and so did everybody else, and broke the bank.

Mr. JOHNSTON. The reason that banks failed was their lack of liquidity. We could not have kept the banks of this country liquid and built this great Nation. It just can not be done. The banks have served a wonderful place in this Nation. I grew up in one of them. I know the good they are doing in the community. Those banks can not be liquid. The man that is loaned the money can not pay it back until he has an income somewhere from farm products or something else, and most of those loans are not liquid loans, and when the time comes that depositors want to take their money out the only place they have to go is to their Federal reserve bank or to their correspondent bank.

Senator MORRISON. Now, Mr. Johnston, generally speaking—and I suppose we could get the figures—what percentage of the credits of the member banks of the Federal reserve system are in eligible paper, eligible for discount?

Mr. JOHNSTON. Of course, I do not know. Senator Glass has the figures here, the amount. I do not believe the banks of the country have an average of over 15 per cent of paper that is eligible for rediscount.

Senator MORRISON. And in the small towns and smaller cities and agricultural sections of the country the percentage is much less?

Mr. JOHNSTON. As a rule they have less.

Senator MORRISON. And there is not enough of that paper to run the bank on, is there?

Mr. JOHNSTON. No. There is if people would just be steady, would not come in and get frightened. In the old days, normal times, you take when I was an examiner, 1907, 1908, 1909, 1910, 1911, 1912, why, a bank would run on 15 per cent reserve very comfortably and nobody was frightened. But——

Senator MORRISON (interposing). I mean they could not run a bank on that type of credit alone?

Mr. JOHNSTON. Oh, no. Of course, the banks closed down—take these big failures, sometimes with 50 per cent liquidity.

Senator MORRISON. Don't you think some consideration should be given in the law to the type of credits in which the banks under the law, and even those members of the Federal reserve system, invest the larger part of their capital?

Senator GLASS. Mr. Johnston, would you say there is less restraint upon State banks than upon national banks?

Mr. JOHNSTON. I think so.

Senator GLASS. In matters of discretion of that sort?

Mr. JOHNSTON. Yes, sir; I think there is less restraint upon the State banks than on the national.

Senator GLASS. Has that anything to do with the fact that of the 4,000 banks which have failed within the last two years five to one are State banks?

Mr. JOHNSTON. I do not think so much, Senator. I think the fact that the State banks are so much smaller, I mean smaller per unit average, that they have not been able to get the management.

Senator GLASS. You do not think the character of their portfolios has anything to do with their failure at all?

Mr. JOHNSTON. I think that is responsible for the failure, but then the character of the portfolio is due to the management.

Senator GLASS. Why, of course.

Mr. JOHNSTON. The small banks can not get the management. They can not pay for the type of management. It takes just as much intelligence to manage a $500,000 bank as a $500,000,000 bank, and I know what I am speaking of.

Senator GLASS. I understand; and not having that wise type of management, they prefer to fill their portfolios with unliquid assets and when the trouble comes, they crash—isn't that true?

Mr. JOHNSTON. Too late, you mean—yes, sir; that is correct.

Senator FLETCHER. Isn't that bank failure proposition largely due to lack of confidence in banks? Haven't we got to do something to build up confidence in the banks?

Mr. JOHNSTON. Yes, sir.

Senator FLETCHER. To get rid of this fear and apprehension. That is the thing to do. You do not think it ought to be done by any system of guaranty, but something must be done to restore confidence in the banks—isn't that true?

Mr. JOHNSTON. Yes. I just do not know exactly what is the best thing to do, either.

Senator FLETCHER. Yes.

Mr. JOHNSTON. Of course, the Reconstruction Corporation and the National Credit have done a great deal of good.

Senator FLETCHER. If you can throw around the banking system, not so far as the laws are concerned, as we are trying to do here, but to establish confidence in the banks, assure the people that banks will be safely conducted—that is what they want; they want safety?

Mr. JOHNSTON. Yes; but I do not think this will do it. I think it will make it worse.

Senator MORRISON. Now, Mr. Johnston, when these larger banks have broken, they have usually carried down a string of little ones with them, have they not, and one reason there were so many more little ones was because one, when it broke, would break and topple over about 10 of its connections?

Mr. JOHNSTON. Yes.

Senator MORRISON. Don't you think if we had had the Glass-Steagall bill that we have recently passed, giving the Federal reserve system larger instead of less rediscount power, many of those banks that did break would have been saved?

Mr. JOHNSTON. I think that is true.

Senator MORRISON. And they would have not only been saved themselves but would have saved dozens of little ones that went down with them?

Mr. JOHNSTON. Yes.

Senator MORRISON. And that the banking trouble was due not to loose laws so much as the lack of rediscount power anywhere for the character of securities which the banks had?

Mr. JOHNSTON. Due to that and the banks were not liquid. There have been lots of good, perfectly solid, banks that have had to close their doors, in my opinion, any number of them.

Senator MORRISON. They were not liquid because they did not have enough paper eligible for rediscount?

Mr. JOHNSTON. That is right.

Senator MORRISON. And yet their paper was good and if they could have found some rediscount power, as the Glass-Steagall bill now gives——

Mr. JOHNSTON (interposing). It would have saved many of them.

Senator MORRISON. Many of them?

Mr. JOHNSTON. Yes, sir.

Senator MORRISON. Your National Credit Association saved a great many of them that would have gone, did it not?

Mr. JOHNSTON. Yes, sir.

Senator MORRISON. I know down in my State you kept them from absolutely being wrecked.

Mr. JOHNSTON. We are familiar with what you did there.

Senator MORRISON. Yes; you put about $11,000,000 in there, with all the fun being made of it.

Mr. JOHNSTON. Yes.

Senator MORRISON. And saved bank after bank that is now on its feet and going.

Mr. JOHNSTON. Not only the National Credit but the large banks that joined with them. You know that. They were fifty-fifty.

Senator MORRISON. So our trouble was not less rediscount power but a lack of adequate rediscount power, was it not?

Senator TOWNSEND (presiding). Are there other questions from Senators?

Senator BULKLEY. Yes; I still want to know whether Mr. Johnston says that it is this section 8 that is likely to "ruin the South."

Mr. JOHNSTON. I would not put it that strong.

Senator BULKLEY. I thought you did put it that strong.

Senator GLASS. If Virginia is classified as a southern State, I have renounced that proposition altogether.

Senator BULKLEY. Just a minute. If that was not Mr. Johnston's statement I certainly misunderstood him. I thought he made a very alarming statement.

Mr. JOHNSTON. The Senator asked me a question if I thought this was going to seriously interfere with the operation of those banks in North Carolina and I said, "Yes; I do."

Senator BULKLEY. And I think you said it would ruin the banks in North Carolina.

Mr. JOHNSTON. I could not make a statement that anything would ruin the banks.

Senator BULKLEY. You do not mean that?

Mr. JOHNSTON. I did not mean that. If I made it I should like to correct it.

Senator CAREY. You feel that the way it would be administered, not the act itself, if the Federal Reserve Board would classify such paper——

Mr. JOHNSTON (interposing). I would not want to take that chance with such a board.

Senator GLASS. You know it requires six members of the board to take that action?

Mr. JOHNSTON. Yes, sir; I see that. I would not want to take it even if it required fifty. I would not want to give anybody that power.

Senator GLASS. You do give somebody that power. You give the board of directors of each unit bank that power.

Mr. JOHNSTON. Yes, sir. The stockholders give them that. The stockholders have that right. There is quite a difference in what the stockholders choose to do with their property and what some legislative body chooses to do with it.

Senator GLASS. As a matter of fact, the stockholders do not manage the bank; the directors manage it?

Mr. JOHNSTON. They elect the board, of course. They can not manage it.

Senator TOWNSEND (presiding). Senator Bulkley, do you want to ask a question?

Senator BULKLEY. Yes; I want to get back to Mr. Johnston's statement about the tendency of this bill to outlaw the lending on collateral security. Did you really mean that it will "outlaw" it?

Mr. JOHNSTON. Yes. I do not know what we are going to do with $200,000,000 of assets that are in our bank under this law.

Senator BULKLEY. Will you explain that, please, what it will do to you and under what provision? I would like to correct that if it is as bad as that.

Senator GLASS. Yes. All of us would. [After a pause:]

Senator FLETCHER. Section 15, I expect it is. If you do not object, may I ask Mr. Johnston in that connection, not interrupting Senator Bulkley?

Senator BULKLEY. I do not think you can ask any questions now without interrupting me.

Senator FLETCHER. Then I do not interrupt. Go ahead and finish. I will take my own time. I thought you were not asking any question and I would put in one on the side.

Senator BULKLEY. No; that is all right.

Senator GLASS. Do you mean the section on page 37, section 15, at the bottom of the page, "The business of purchasing and selling investment securities"?——

Senator FLETCHER. Page 36, I think it is.

Senator GLASS. "Shall hereafter be limited to the purchasing and selling of such securities," and so forth?

Mr. JOHNSTON. Section 8 confers too much power on the Federal Reserve Board. It appears from the language used that the board may restrict within its discretion all loans made by member banks which may be secured by any type of collateral. The Federal Reserve Board may, also, by direct action prohibit any member bank from increasing "loans protected by collateral securities" upon pain of suspension for one year from all Federal reserve rediscount privileges. It gives the Federal Reserve Board power to fix from time to time for any member bank the percentage of capital and surplus of such bank which may be represented by loans protected by collateral security.

Senator BULKLEY. Now, Mr. Johnston, we have just been over that. Surely you do not mean that that outlaws making collateral loans?

Mr. JOHNSTON. I think it would.

Senator BULKLEY. Outlaws it?

Mr. JOHNSTON. Yes.

Senator BULKLEY. You could not make a collateral loan under that section?

Mr. JOHNSTON. I think we could make them, but I think we might find ourselves herded up within two or three weeks by some body or Government official that would say, "Don't you have this. We do not like some portions of that."

Senator GLASS. What "some body," what "Government official," and under what process?

Mr. JOHNSTON. The board, the Federal Reserve Board.

Senator BULKLEY. Will the members of the board make an improper ruling?

Mr. JOHNSTON. I know, after——

Senator BULKLEY (interposing). I want to know if that is what you mean by saying it "outlaws collateral loans."

Mr. JOHNSTON. Absolutely.

Senator BULKLEY. All right, that is something I can understand.

Mr. JOHNSTON. We do not want to give that power to any board.

Senator BULKLEY. That is a different statement from saying that it "outlaws collateral loans."

Mr. JOHNSTON. In effect, I think that is what it does.

Senator BULKLEY. All right; I want to know if there is anything else that outlaws collateral loans.

Mr. JOHNSTON. I think there is a lot in here. There is a tendency to do it.

Senator BULKLEY. Well, I would like to see what it is.

Mr. JOHNSTON. Senator, this bill, as I read it, gives the power, as I have said a number of times here, that we do not think any bank should give to any Government agency.

Senator BULKLEY. Yes; I understand your view about that.

Mr. JOHNSTON. And that gives you that power in relation to that amount of collateral loan—that is, the Federal Reserve Board—gives it carte blanche.

Senator BULKLEY. I just want to know if you think that that particular provision justifies your statement that collateral loans are outlawed.

Mr. JOHNSTON. I think the whole tendency of this is to outlaw that type of business.

Senator BULKLEY. Yes. Well now, some of my colleagues here suggest the meaning of the word "outlaw," that it gives the board the right to compel them to dispose of certain loans. I take it that the word "outlaw" means something entirely different from that and means that you are prohibited from making collateral loans at all.

Mr. JOHNSTON. No. The word "outlaw" just means that those loans are just out. It would be just out of the law, you see.

Senator BULKLEY. You mean that it prevents you from making any collateral loans at all?

Mr. JOHNSTON. It might. I do not say it does. It rests entirely with some other board and not with the owners of the bank. We do not want to give that power.

Senator BULKLEY. I appreciate the viewpoint, that you do not want to give the power, that is perfectly understandable; but I am trying to understand your statement about outlawing collateral loans. You do not mean that it puts you out of making any collateral loans?

Mr. JOHNSTON. I think we can make some. I do not know how many we could make, do not know how many it would be safe to make. I do not know what some board in its wisdom some day would say we should make. I would be afraid to run that risk. I should like to have a very early determination if we were faced with it, because you know it is very easy to make loans, not always easy to get them back in.

Senator GORE. You have noticed that?

Mr. JOHNSTON. Yes, sir. I think everybody appreciates that. I do not think there would be any argument on that, Senator.

Senator BULKLEY. Your objection should stand on that section?

Mr. JOHNSTON. Yes, sir.

Senator BULKLEY. You do not mean anything else. All right; on this idea in your prepared statement here concerning "the prohibition against banks owning more than 10 per cent of any particular issue of securities would compel the dumping of large holdings of inactive bonds on the market," can you tell us how much they would be compelled to dump?

Mr. JOHNSTON. No; but I know there are quite large amounts, Senator.

Senator BULKLEY. What would be your definition of "large amounts"?

Mr. JOHNSTON. Oh, running into many millions.

Senator BULKLEY. "Many" meaning three millions or a hundred million?

Mr. JOHNSTON. Probably two or three hundred.

Senator BULKLEY. Probably two or three hundred millions?

Mr. JOHNSTON. I do not know how much, but I do know there are banks that got caught in this avalanche with a large holding of these securities. We have helped many of those people, some in your district, you probably know. We haven't any ourselves. We would not put more than 10 per cent in any one security in any one State, Senator, Kansas or the State of Kentucky, for instance.

Senator BULKLEY. I want to get your opinion of how much this matter would affect the whole market, and I would like for you to give me a combined view on the two limitations. There is a limitation of not more than 10 per cent of any one issue and that the amount shall not exceed 15 per cent of the capital and the 25 per cent of the surplus of the bank itself.

Mr. JOHNSTON. I think that 10 per cent of any one issue is a very safe measure. I doubt the wisdom of putting it in now and throwing these bonds on the market.

Senator BULKLEY. If it did not mean that, if it only meant with respect to future underwritings, your objection would be removed?

Mr. JOHNSTON. I think it would. I think it would be very safe.

Senator BULKLEY. And both limitations would be sound on that basis?

Mr. JOHNSTON. You probably know that what caused a great deal of trouble is the constant forcing on the market of bonds. You probably know the Government has opened at the Federal reserve bank in New York a big agency to dispose of these bonds of failed banks. The thing is to get somebody to buy them. If we throw a lot more on the market at this time——

Senator BULKLEY (interposing). Yes; but right there I am trying to get your idea of how many would be thrown on the market. We want to analyze the effect of this thing.

Mr. JOHNSTON. I could not tell you how many, but I think it would be a very substantial amount.

Senator BULKLEY. You think the two limitations together might force the sale of five hundred millions?

Mr. JOHNSTON. Yes; I do.

Senator BULKLEY. Maybe more than that?

Mr. JOHNSTON. Maybe more.

Senator BULKLEY. You think it might be as high as a billion dollars?

Mr. JOHNSTON. Yes.

Senator BULKLEY. You think it might be as high as a billion?

Mr. JOHNSTON. I thought probably it might. I certainly would want to give some time on that. If that was going to be enacted I would certainly give them two or three or four years so that they could market those bonds, without taking very heavy losses.

Senator BULKLEY. But if it only relates to future acquisitions it is all right?

Mr. JOHNSTON. I would not have any objection to it personally.

Senator GLASS. That is what it relates to, if you will just read the bill——

The business of purchasing and selling investment securities shall hereafter be limited to purchasing and selling—

It does not require you to unload a dollar.

Mr. JOHNSTON. What page is that on, please, Senator?

Senator FLETCHER. Page 36.

Senator GLASS. Page 37, at the bottom of page 37, if you have the same print of the bill that I have.

Mr. JOHNSTON. It says here—

but in no event shall the total amount of such investment securities of any one obligor or maker held by such association exceed 10 per cent.

Senator GLASS. "Hereafter—hereafter to be held."

Mr. JOHNSTON. I do not see any "hereafter" here.

Senator GLASS. The "hereafter" relates to the whole paragraph, Mr. Johnston.

Mr. JOHNSTON. What line, Senator, please, is the word "hereafter" on? Maybe I have a different copy.

Senator GLASS. It is on your print, page 36, line 8, "The business of purchasing and selling investment securities shall hereafter be limited to purchasing and selling——"

Senator BULKLEY. In fairness to the witness, I would like to say that I do not think that that is as clear as it ought to be myself.

Mr. JOHNSTON. I see now, Senator, what you mean, and it is probably what you intended. I am very frank to say that it has fooled all of us—I mean the language has. We did not understand it that way. It has fooled some of the best lawyers that we have been able to employ—Rushmore, Bisbee & Stern, counsel for the clearing house committee. Mr. Hartfield, I think, it has fooled.

Senator GLASS. I am simply indicating what was the purpose of the committee.

Mr. JOHNSTON. Then we are together on it.

Senator BULKLEY. Now, Mr. Johnston, I would like to say just one more thing in reference to your general statement about the banks having a free scope to do as they please on the basis of the stockholders owning them. Senator Gore has pointed out the investments that are made by the banks are probably 7 to 1 other people's money as against the stockholders' money. That is one thing.

Mr. JOHNSTON. I say 5 to 1.

Senator BULKLEY. Well, 5 to 1. You yourself in the early part of your testimony advocated a careful restriction of who should go into the banking business, and that has got to be done by Government authority, and you know that a bank charter is a valuable franchise, and when people accept a bank charter or any other public franchise they expect a measure of public regulation, and you know that there is not a bank stockholder living in the United States that bought his stock with the idea that a bank was entirely free to go its own way. Everyone expected reasonable regulation from Government agencies, and I do not think you really believe what you intimated here in the first part of your statement.

Mr. JOHNSTON. I think you refer to the fact that I said that the British banks had been very successful with practically no regulation.

Senator BULKLEY. If we start an argument on the British banking system we get into so many ramifications that I do not think it would be profitable. I am talking about American experience and tradition as long as America has existed.

Mr. JOHNSTON. America is under even more regulation than probably all of the rest of the banks in the world and has not done very well, because it had too many banks.

Senator GLASS. Do you think there is an intelligent stockholder of a national bank who would be willing to accept the stockholders' double liability if he supposed the bank would be operated without restraint or restriction of any sort?

Mr. JOHNSTON. Lots of them.

Senator GLASS. Intelligent stockholders?

Mr. JOHNSTON. Yes, sir.

Senator GLASS. They are not stockholders; they are gamblers.

Mr. JOHNSTON. I would much rather—well, say it is gamblers—I would much rather bet on the management than I would on the Government supervision—and I have been on both sides of it.

Senator TOWNSEND (presiding). Thank you, Mr. Johnston.

Senator MORRISON. One minute, Mr. Johnston. How do you interpret section 9:

> No national banking association and no member bank shall make any loan or any extension of credit to any affiliate organized and existing for the purpose of buying and selling stocks, bonds, real estate, or real-estate mortgages, or for the purpose of holding title to any such property, or invest any of its funds in the capital stock, bonds, or other obligations of any such affiliate.

What do we mean by that?

Mr. JOHNSTON. I think if you had a mortgage company connected with your bank, building and loan company, or anything else that was affiliated with you in some way, it would take them all in—a security company or any kind of company.

Senator MORRISON. How much affiliate? Is there danger in that word "affiliate" there?

Mr. JOHNSTON. I think it ought to be made very clear.

Senator GORE. It is defined in the early part of the bill.

Senator MORRISON. They have a definition of it in there.

Senator FLETCHER. Mr. Johnston, may I ask you now, if I am not interrupting anybody, is it not a fact that the banks of the country——

Senator MORRISON (interposing). Senator, would you let me get through with mine?

Senator FLETCHER. I am through entirely. I quit.

Senator MORRISON. Well, sir, all right.

"The term 'affiliate,'" it says here, "includes a trust company, a finance company, securities company, discount or acceptance company, investment trust, or other similar institution, or a corporation," but does not anywhere say "in which they own a certain interest," and the word "affiliate," it seems to me, there would mean anybody that you were doing business with, under that definition of it.

Mr. JOHNSTON. It is very broad language, and I think should be clarified as to what it really means. I do not know just exactly what it means. It just covers everything, it seems to me.

Senator MORRISON. And it does not require you to own any interest in it at all.

Mr. JOHNSTON. If you are affiliated with it you can not do any business with it.

Senator TOWNSEND. Thank you, Mr. Johnston.

Mr. JOHNSTON. Senator, I am very appreciative of your letting me loose.

Senator TOWNSEND. Well, we have Mr. Hawes, from St. Louis, here, but he will probably require an hour. What is the pleasure of the committee? Shall we continue now or recess until 2 o'clock?

Senator WAGNER. Recess until 2 o'clock.

Senator TOWNSEND. Then, the committee will stand in recess until 2 o'clock, and we shall hear Mr. Hawes and two other gentlemen. But there will be no meeting of the committee to-morrow.

(Accordingly, at 12.30 o'clock p. m., a recess was taken until 2 o'clock p. m. of the same day.)

AFTER RECESS

The committee resumed at 2 o'clock p. m., at the expiration of the recess.

The CHAIRMAN. The committee will come to order. Is Mr. Hawes, of St. Louis, here?

Mr. HAWES. Yes; Mr. Chairman.

The CHAIRMAN. Take a seat at the committee table opposite the committee reporter, please. Now, you may go ahead and give your name, residence, and business.

## STATEMENT OF RICHARD S. HAWES, PRESIDENT ST. LOUIS CLEARING HOUSE ASSOCIATON, SENIOR VICE PRESIDENT OF THE FIRST NATIONAL BANK OF ST. LOUIS, ST. LOUIS, MO.

The CHAIRMAN. You may proceed with your statement.

Mr. HAWES. Mr. Chairman and gentlemen of the committee, I appear before you as a representative of the St. Louis clearing house, an association representing the banks of St. Louis, and probably a great many banks in the Mississippi Valley, because of our connection with them.

Let me prefix anything I may say by the statement that we feel this bill was introduced with the thought of having a constructive and effective measure of bank regulation, and that while we may disagree with you as to some of the provisions contained therein, and do in fact disagree, yet we realize the spirit which inspired the bill.

We feel, however, inasmuch as this legislation is probably of more far-reaching character than any that has been introduced in the Congress since the Federal reserve act, and to which Senator Glass gave then such outstanding service to the country by having it enacted, that this bill should not at this time be given right of passage. The country is going through a period just at present which is trying the nerves and the stamina of the bankers of the Nation. We are going through a period unprecedented in the history of finance, or at least that is true in my judgment, and therefore to enact legislation which will so violently change the method of operation of banks, during any such period as the present, appears to me to be unwise.

We are hopeful, therefore, that your committee will consider these facts and will give due thought to whether this legislation should not be laid over until a more propitious time is evident.

With these brief preliminary remarks, I should like to turn, if I may, to several sections of the bill and make comment thereon. And I will say quite frankly that if my interpretation is incorrect I shall be happy to be set right, but the interpretation that I place upon the bill, as evidenced in the memorandum which I have before me and which I shall not take any longer time in presenting to you than you gentlemen desire.

Senator TOWNSEND. Before you make your statement let me ask you a question: Do you think it would be unwise to have any legislation affecting banking just now? Is that your feeling about the matter?

Mr. HAWES. Just at this time, yes; that is my feeling.

Senator TOWNSEND. That is all I wish to ask at this time.

Senator WALCOTT. I should like to ask you a question along that line: Have you studied the bill with the idea of picking out the good in the bill, or have you only confined your attention to what you think are the faults of the bill? In other words, is there not in your opinion a large proportion of this bill which is not only useful but important constructive legislation.

Mr. HAWES. I shouldn't say there was a large proportion. There are certain features of the bill which are constructive, but not a large portion of it.

Senator WALCOTT. Could you give us in the course of the hearing and at your own convenience a reference to those portions of the bill you substantially agree with?

Mr. HAWES. I probably could, but that would necessitate my going over the bill again and studying it. I have merely made a memorandum of those features which I think might be destructive or hurtful. And this is not done just as a matter of criticism, but in a spirit of trying to present constructive thoughts by way of amendments of certain sections so as to make them less hurtful than I think apparently they are as now presented in the bill.

The CHAIRMAN. You may proceed now with your statement.

Mr. HAWES. My first reference is to section 8 of the bill, "Limitations on Security Loans": In my judgment collateral loans should be more clearly defined in that section. How far-reaching is this section? Does this prohibition against security loans include loans on commodities or real estate pledged by a corporation or individual?

This clause confers upon the Federal Reserve Board new powers of direct action of great consequence. The board may restrict within its discretion all loans by member banks, which may be secured by any type of collateral. The Federal Reserve Board may also, by direct action, prohibit any member bank from increasing "its security loans" upon penalty of suspension for one year from all Federal reserve rediscount privileges.

This section also by indirection repeals all of the exceptions to section 5200 of the Revised Statutes which governs the amount which a national bank may lend to a single customer and makes the absolute limitation of 10 per cent of capital and surplus apply to all classes of loans including those secured by warehouse receipts, bills of lading and other such documents.

This section is designed toward further deflation and it is estimated $1,841,000,000 in securities would have to be sold, and the intent of it is to penalize banks which lend upon collateral security.

Senator GLASS. Mr. Hawes, you heard the testimony given here this morning. Do you persist in that view that that is a requirement of that section of the bill in spite of what was said here this morning?

Mr. HAWES. That is my view of it, Senator Glass. That is, unless it is changed or modified.

Senator TOWNSEND. You have no language to suggest that you think might be put in that section which would make it satisfactory to you, have you?

Mr. HAWES. Well, a clear definition of security loans might be made so as to include, in event it is the desire of the committee to do so, what are known as so-called call loans on Wall Street.

Senator TOWNSEND. Would it be satisfactory to you if that language were put in there and this section were so clarified?

Mr. HAWES. No, sir; it would not.

Senator GLASS. Mr. Hawes, what is the ordinary meaning in banking parlance of collateral security?

Mr. HAWES. It means security of any kind held on a note of an individual or corporation. That security may be stocks, bonds, wheat, corn, tobacco, or any other commodity, and it may be real estate.

Senator GLASS. Do you mean to say that you would call corn, wheat, and tobacco a collateral loan?

Mr. HAWES. Absolutely.

Senator GLASS. That is, do you mean that corn, wheat, or tobacco would be collateral security?

Mr. HAWES. Yes, sir.

The CHAIRMAN. I take it that Mr. Hawes means warehouse receipts for those commodities.

Senator GLASS. Oh, is that it?

Mr. HAWES. Why, of course that is what I mean.

The CHAIRMAN. You may proceed with your statement, Mr. Hawes.

Mr. HAWES. Now, I will take up section 8, "Collateral loan limitations of member banks."

We feel this section confers too much power on the Federal Reserve Board. It appears from the language used that the board may restrict within its discretion all loans made by member banks which may be secured by any type of collateral. The Federal Reserve Board may, also, by direct action, prohibit any member bank from increasing "loans protected by collateral securities" upon pain of suspension for one year from all Federal reserve rediscount privileges. It gives the Federal Reserve Board power to fix from time to time for any member bank the percentage of capital and surplus of such banks which may be represented by loans protected by collateral security. We feel that the power given the Federal Reserve Board is not of a specific nature. We would assume from the wording that a member bank can not exceed 100 per cent of its capital and surplus in loans protected by collateral security. Quite a large number of member banks have legitimate commercial and individual loans secured by collateral which would be affected by this provision, hence, in order to comply with this section, it would result in either these banks withdrawing from the Federal reserve system if such

loans are in excess of the limit fixed by the Federal Reserve Board, or in the liquidation of the loans, as it regulates loans of this nature even when the bank is not borrowing from the Federal reserve system.

We believe that section 8 gives to the Federal Reserve Board unnecessary powers of control over the policy management of member banks which are nonborrowers and who are making loans to their customers without the use of Federal reserve credit. We believe that section 8, with the amendments we have suggested, gives proper and sufficient protection to the membership of the system and to the public.

Next is section 9, "Laws to aid investments in affiliates."

This section provides that a member bank can not loan more than 10 per cent of its capital and surplus upon loans or extensions of credit to any affiliate organized for certain purposes or invest in the securities of such affiliate or accept the obligations of such affiliate as security where the aggregate of such loans, extensions of credit, investments, and acceptances exceeds 10 per cent of capital and surplus. This is a serious impairment to the competition which any member bank may have with a nonmember bank and will discourage real estate loans and farm mortgages now handled by such affiliates to the detriment of agriculture, home building, and industrial construction.

There are many affiliates of member banks which confine themselves to the handling of real estate mortgages and this prohibition would impede their activities and make competition with nonmember banks almost impossible.

May I take the liberty of referring to my own institution? We have a mortgage company affiliate connected with us. In that we handle no stocks of any character. We make loans on real estate, handle Government and municipal bonds and industrial bonds based on real estate. That affiliate would have to go out of business in my judgment, if this bill should be enacted into law, and yet we render a very distinct service to our community through that affiliate. It makes it possible for us to compete with our trust companies and State banks who have that privilege under the State laws.

Line 20 on page 10 requires that loans to affiliates shall be secured by stocks and bonds listed on the stock exchange, with a margin of 20 per cent, and shall be secured by paper eligible for discount or legal investment for savings banks in the State in which the association or member bank making the loan is located.

This prohibits affiliate companies who deal solely in real estate mortgages or farm loans from using such collateral to borrow from the parent bank. It is further discriminatory in that in certain States investments eligible for savings banks include real estate mortgages. This section, by virtue of this discrimination against real estate mortgages, would bring about a decided deflation.

Have the members of the committee any questions on that matter?

Senator BROOKHART (presiding). I believe not. You may proceed in your own way.

Mr. HAWES. Section 11, "15-day reserve loans."

We believe that the penalty of 1 per cent higher than the rediscount rate on 15-day advances will work a hardship on the member

banks of the system. It must be taken into consideration that outside of the banks in the large commercial centers other member banks in the United States have little or no eligible paper for rediscount. This has been occasioned by the changed form of financing by corporations through the issuance of preferred and common stocks, so that there is not at the present time the volume of eligible commercial paper which can be offered for rediscount. Consideration must also be given at the present time to the fact that the quality of the paper offered has changed to the depressed conditions in agriculture, industry, and commerce.

We realize it is the intention of the framers of the original Federal reserve act that Federal reserve credit facilities were to be used only upon commercial and agricultural paper. Members of the committee will recall that conditions incident to the World War and Government financing made necessary the acceptance by the Federal reserve banks of Government bonds as collateral on 15-day notes.

This has resulted in a majority of the member banks building up a secondary reserve of Government securities in order that they might avail themselves of the credit facilities of the Federal reserve banks and to assist in Government financing.

We believe that this provision is aimed to prevent the excessive use of Federal reserve facilities for stock-market operations and therefore a penalty rate is added. We believe that discrimination should be made between the use of investment credit for purely speculative purposes, as compared with investment credit used for productive purposes or for refunding operations, and therefore we feel that the penalties in this section can well be left to the discretion of the Federal reserve banks with the approval of the Federal Reserve Board under such rulings as they may make.

Any questions on that?

Senator GLASS. Suppose we should strike out the 1 per cent privilege, would you favor the balance of the provision?

Mr. HAWES. No, sir.

Senator GLASS. Then you would not put any legislative restraint at all upon the use of the Federal reserve facilities for stock-gambling purposes?

Mr. HAWES. No, sir; but let me explain. I would not put any restraint on it for stock-gambling purposes because I do not believe the average bank uses its funds for that purpose.

Senator GLASS. But that provision would apply only in case they do?

Mr. HAWES. Yes: but it goes much further than that.

Senator GLASS. How much further?

Mr. HAWES. Well, the very definition that you provide in the matter of secured loans is a bar to the situation.

Senator GLASS. But that definition is in the existing law.

Mr. HAWES. I understand that very clearly, but——

Senator GLASS (interposing). Yes. So why do you object?

Mr. HAWES. Does the fact that the Federal Reserve Board may come into our bank and say, "You can lend so much money on a secured basis and over and above that you are ineligible"; doesn't that show you what it would do?

Senator GLASS. But it does not say that.

Mr. HAWES. It does say that in another section.

Senator GLASS. Why, Mr. Hawes, you may loan every dollar of your money to a broker, and if the Federal reserve bank thinks you are too far extended in that direction it will say to you, "If you are going to increase these loans you can not get facilities of the Federal reserve bank for that purpose." That is all that it says.

Mr. HAWES. But I do not think that is all that it says.

Senator GLASS. Well, what does it say any more than that?

Mr. HAWES. I do not think that is the intent of the law.

Senator GLASS. Well, I know that it is the intent of the bill.

Mr. HAWES. I beg your pardon. I meant to say that as I read that section I do not think it in fact says that.

Senator GLASS. Well, it is plain enough English. Let me read it to you. [Reading:]

Any Federal reserve bank may make advances to its member banks on their promissory notes for a period of not exceeding 15 days at rates to be established by such Federal reserve bank.

You know that is a special privilege.

Mr. HAWES. Yes.

Senator GLASS. That is not the ordinary rediscount privilege. That is borrowing money, a special privilege.

Mr. Hawes. Yes, sir.

Senator GLASS. Under the existing statute a Federal reserve bank, subject to the ruling and determination of the Federal Reserve Board, has unrestricted power to make that rate anything it pleases, not only 1 per cent higher that we provide, but 2 per cent or 10 per cent. It has that power now, as you can see, very definitely.

Mr. HAWES. Yes.

Senator GLASS. I continue to quote that section. [Reading:]

Which rates shall in all cases be at least 1 per cent higher than the rediscount rate then in force at such reserve bank, subject to the review and determination of the Federal Reserve Board, provided such promissory notes are secured by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for rediscount or for purchase by Federal reserve banks under the provisions of this act, or by the deposit or pledge of bonds or notes of the United States.

Mr. HAWES. Any addition to the penalty I object to.

Senator GLASS. I continue reading. [Reading:]

If any member bank to which any such advance has been made shall, during the life or continuance of such advance, and despite an official warning of the reserve bank of the district or of the Federal Reserve Board to the contrary, increase its outstanding loans made upon collateral security, or made to the members of any organized stock exchange, investment house, or dealer in securities—

What about that?

Mr. HAWES. Yes; that the penalty shall apply.

Senator GLASS. In other words, a concrete example would be that a given bank in New York may have $50,000,000 of brokers' loans outstanding, and this provision does not undertake to interfere with that status. It may apply with eligible paper to the reserve bank for additional accommodation. This simply gives the bank the right to say: Well, we will rediscount your paper upon the condition that you do not extend that $50,000,000 of outstanding loans for stock operations.

Mr. HAWES. Haven't you overlooked one very important line in that paragraph you read?

Senator GLASS. No; I think not.

Mr. HAWES. I refer to this line [reading]:

Increase its outstanding loans made upon collateral security.

Senator GLASS. Yes; I read that.

Mr. HAWES. Then it goes on and mentions bankers' loans. In other words, it includes all collateral loans.

Senator GLASS. Well, we won't discuss the matter of definition of collateral loans. I thought every banker understood, and I thought I understood what in banking nomenclature collateral loans meant.

Mr. HAWES. Well, Mr. Senator, I do not think any practical banker in the world will define collateral loans as being only loans to stock exchange members or investment bankers.

Senator GLASS. Here is one important section that you ignore, found on page 25 of the bill, beginning on line 23. [Reading:]

For the purpose of purchasing and/or carrying investment securities (except obligations of the United States)—

And so on. In other words, it is literally the language used in the text of the existing law, which precludes rediscounts upon notes, bills, and other bank paper drawn for the purpose of purchasing or carrying investments.

Mr. HAWES. If you are going to put that provision in, why don't you just deliberately say: Call loans are loans to brokers and investment bankers, instead of penalizing all collateral loans?

Senator GLASS. I do not know of any section of any statute where there is the expression "call loans."

Mr. HAWES. I do not, either. I do not know of any statute either where it says that collateral loans are only loans secured by collateral of stocks and bonds.

Senator GLASS. I can read you a provision of the existing Federal reserve act which is just exactly in accord with that provision, section 13 of the act, which confers upon the Federal Reserve Board the right to define eligible paper, and says [reading]:

But such definition shall not include notes, drafts, or bills covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities.

Mr. HAWES. That is all right. But that does not talk about it as collateral security. That specifies what it is as I understand it.

Senator GLASS. Isn't that collateral security?

Mr. HAWES. Yes, sir.

Senator GLASS. Investment securities?

Mr. HAWES. Yes, sir.

Senator GLASS. And that is what this says.

Mr. HAWES. Yes; but there are other securities that are collateral securities.

Senator GLASS. For the purpose of purchasing or carrying investment securities, it says.

Mr. HAWES. But it must not increase its outstanding loans made on collateral securities.

Senator GLASS. Yes.

Senator BROOKHART (presiding). But for this limited purpose.

Mr. HAWES. Yes, sir; and in that way it is penalizing all collateral loans.

Senator BROOKHART. I do not think so. I think it restricts collateral down to this purpose.

Mr. HAWES. Well, any two of us are liable to disagree in the matter of interpretation of the section.

Senator TOWNSEND. Lawyers certainly do that.

Mr. HAWES. Yes.

Senator GLASS. Suppose we could better define the meaning of collateral loans, as meaning loans for purchases on the stock exchange, would you still want to eliminate that provision of the bill that would impose a penalty in case of violation of the law?

Mr. HAWES. Yes, sir. I think it puts too strict and heavy police power in the hands of a few men.

Senator GLASS. All right. I have nothing further to say on that.

Senator BROOKHART (presiding). You may proceed with your statement, Mr. Hawes.

Mr. HAWES. I now turn to section 10, subdivision 12–B, Federal Liquidating Corporation:

This section covers the organization of the Federal Liquidating Corporation and there can be no question but what some method of orderly liquidation of closed banks and early payment of money to depositors should be found. We feel that this matter is of such urgency that a separate measure should be introduced in Congress for that purpose. The measure, as now drawn, seems to be in unfair ratio to the banks, as it requires the banks shall subscribe one-half of 1 per cent of time and demand deposits and increase subscriptions as said deposits grow. Based on a rough estimate, this would require a capital subscription from member banks of approximately $150,000,000, or an immediate payment of approximately $75,000,000.

Senator GLASS. You are mistaken in the matter of the amount. The first call is for one-quarter of 1 per cent.

Mr. HAWES. Well, I stand corrected in that. In spite of this large investment the banks are given no voice in the management. The stock they buy has no voting power whatever. On the other hand, the Federal reserve bank subscribes one-fourth of their surplus, of which one-half of 1 per cent is payable immediately, an estimated amount of $1,500,000, the balance being subject to call on 90 days' notice and complete control of the corporation is vested in them.

Paragraph M sets aside $200,000,000 from the Treasury of the United States, which shall be used for the purchase of assets of closed nonmember banks.

As I read the law that would, as I think, be a discrimination in the use of the taxpayers' money in favor of one class of banks.

Senator GLASS. You would like to see that provision stricken out of the bill, would you?

Mr. HAWES. No, I should not like to see it stricken out, but I think this Federal Liquidation Corporation can take care of the whole proposition if you organize it. Certainly $200,000,000 of the people's money should not be set aside for nonmember closed banks.

Paragraphs O, P, and Q have the possibility of the issuance of practically a billion dollars of new tax-exempt securities, reducing thereby the revenues of the Government.

Senator GLASS. Are you opposed to tax-exempt securities?

Mr. HAWES. I am opposed to any great increase in them.

Senator GLASS. I am opposed to any of them for that matter. I wanted to know whether you and I were in agreement on that matter.

Mr. HAWES. Yes, sir; we are fairly in agreement on that.

Now, are there any questions on that section?

Senator BROOKHART (presiding). No. You may proceed.

Mr. HAWES. I now come to section 13, (A) and (B).

This increases the reserve requirement on time deposits to equal those on demand deposits in five years. This means an increase of $130,000,000 a year or $650,000,000 in five years additional reserve which must be carried by the member banks with the Federal reserve banks against which the Federal reserve banks must carry their own reserves of 35 per cent in gold or $227,500,000 in gold for five years. But that has been modified since by the Glass-Steagall bill.

To this extent this section of the act nullifies the release of gold reserve provided by the Glass-Steagall bill. We do not see the necessity of increasing the amount of reserve carried with the Federal reserve banks by reason of the fact that at no time since the creation of the Federal Reserve System has the entire system been unable to meet the credit needs of its members. As a practical matter the so-called secondary reserves (reserves by cash, Government bonds, and eligible paper) of a member bank is in reality the primary reserve which would be used, when necessary, for the purpose of building up deficits in reserves and meeting decreases in deposits; the reserve carried with the Federal reserve bank being a sum which decreases only fractionally in proportion to the decline in deposits of the member banks, and can only be withdrawn under severe penalties for reserve deficiency. This section, if enacted into law, would work a particular hardship upon the banks of the country located in cities where there is not a Federal reserve bank or branch bank, particularly in the rural sections. We believe that this would cause a withdrawal from membership of this type of bank through its inability to compete with nonmember banks whose legal reserve requirements are such as to make their reserves more readily available to them at all times.

Senator GLASS. How many of them withdrew before we reduced that reserve behind time deposits to 3 per cent?

Mr. HAWES. Well, a very considerable number of them withdrew, but I do not know the exact number.

Senator GLASS. Of national banks, do you mean?

Mr. HAWES. No; nonmember banks; State banks. National banks can not withdraw.

Senator GLASS. Oh, yes: they can. They can change their charter.

Mr. HAWES. Yes; they can go out of existence as national banks and do that, of course: but the average national banker does not want to do that. He is rather proud of the national bank system.

Senator GLASS. Some are rather proud of the Federal Reserve System, too.

Mr. HAWES. I for one am.

Senator BROOKHART (presiding). You may proceed with your statement.

Mr. HAWES. To the extent that member bank reserves are increased against savings deposits and not protective of income, to that same extent are the bank's earnings affected. The banks would of necessity be obliged to reduce the amount paid in interest, which action would have a material effect upon the millions of savers in the country. In other words, if you increase the reserve requirements of savings banks, we can not afford to pay the higher rate of interest on that kind of deposit.

Senator TOWNSEND. What is your rate of interest in St. Louis on that kind of deposit?

Mr. HAWES. In St. Louis it is 3 per cent. It just means the difference of having invested funds and being able to invest at 97 per cent, as against 93 per cent as would be the case under this bill.

Senator GLASS. To what extent did State banks withdraw from the system before we cut the reserve behind-time deposits to 3 per cent, and what percentage of them have withdrawn since we cut the reserve?

Mr. HAWES. I have not those statistics. I do not know. But I believe that would be the effect of the bill.

Senator GLASS. You are suggesting now that if we restore the reserve behind-time deposits, banks will withdraw from the system, and I am trying to develop how many withdrew from the system before we reduced the reserve, and how many have withdrawn from the system since we reduced it.

Mr. HAWES. I do not know. Can you tell me?

Senator GLASS. No. But I wanted to know upon what you based your broad statement that banks would withdraw if we raised the reserve.

Mr. HAWES. I did not base it on what you have stated, but I based it upon what is in bankers' minds as to increased cost of handling depositors' money.

Senator GLASS. And I am trying to develop what happened under the two conditions I have mentioned. Until recent years the reserve behind-time deposits was 7 per cent. Then we reduced that reserve to 5 per cent. I think it would be interesting to ascertain how many banks withdrew from the system on account of the 7 per cent requirement, and how many have withdrawn from the system since we reduced it to 3 per cent.

Mr. HAWES. I think that would be interesting. However, all banks did not withdraw because——

Senator GLASS (interposing). If you had these statistics it might furnish a basis for apprehension that a restoration of the reserve would cause banks to withdraw from the system. But my information is that more banks have withdrawn from the system during the period of a lower rate of reserve than did at the higher rate.

Senator BROOKHART (presiding). You may proceed with your statement, Mr. Hawes.

Mr. HAWES. Consideration should be given to the use of till money as reserve, particularly as it affects thousands of member banks not located adjacent to Federal reserve banks or branch banks. This principle is recognized by the Federal reserve committee making recommendations for change in reserve requirements, which provided that in the case of banks not located in cities where there is a Fed-

eral reserve bank or branch bank, a large percentage of their legal reserve may be carried in currency or so-called till money.

Senator GLASS. Are you in favor of the velocity reserve proposition?

Mr. HAWES. Yes, sir: I think it would be sound.

Senator GLASS. Well, I don't doubt it would be sound, but do you think banks generally would like to see it immediately made effective?

Mr. HAWES. No, sir; I don't think they would. But from my own personal viewpoint I would not object to it particularly.

Senator BROOKHART. Does the term "velocity reserve" have any well-understood meaning in banking circles?

Mr. HAWES. No, sir; it is a new term.

Senator BROOKHART. What does it mean?

Mr. HAWES. It means volume of business handled on any day. It is the velocity of ins and outs, of deposits and withdrawals.

Senator BROOKHART. Suppose this law should make 30 days the dividing line between time and demand deposits, then would that be the way you would determine velocity?

Mr. HAWES. If an account turns within 30 days, it would be a matter in terms of velocity whether it would apply on a demand account, and then in ratio to savings accounts.

Senator BROOKHART. Would it be counted for reserve in the matter of the definite turnover on demand accounts?

Mr. HAWES. Yes, sir.

Senator BROOKHART. So that one month there would be a larger reserve than there would be another month.

Mr. HAWES. Yes, sir.

Senator BROOKHART. How are you going to regulate that matter in advance?

Mr. HAWES. You can not regulate it in advance under the velocity method. You regulate it day by day.

Senator BROOKHART. Well, suppose you are caught with a short reserve, what would happen to you then?

Mr. HAWES. Well, you would have to watch yourself pretty closely, I should say.

Senator BROOKHART. Then you have to estimate it in advance at least, don't you?

Mr. HAWES. Well, as Senator Glass has said, it is rather a revolutionary suggestion. I said I did not object to it and I do not, because, speaking very frankly, from a personal standpoint, it would reduce the reserves our bank would have to carry.

Senator BROOKHART. Suppose we were to take time accounts and say if they were disturbed within 30 days we would put them into demand accounts and make that the rule, how would that work?

Mr. HAWES. I do not believe I follow you.

Senator BROOKHART. Well, say here is a time account of 60 days, but the depositor checks it out or checks on it within 25 days. Bankers I believe say they always honor any demand for them even though they are not required to do so under the terms of the account.

Mr. HAWES. Well, I do not think that is generally true. My bank does not do that. We do not waive the 31-day notice for depositors if they want their money. On a five or six months' certificate we require them to carry it on through.

Senator BROOKHART. But other bankers have said they do honor them universally, and thereby save to themselves paying the 3 per cent interest.

Mr. HAWES. They might also have to withdraw their investments drawing 5 or 6 per cent interest.

Senator BROOKHART. Perhaps. But I was trying to figure out some way to define the difference between time and demand accounts.

Mr. HAWES. I think you have it pretty fairly defined in your Federal reserve act and in your provision here.

Senator BROOKHART. Thirty days?

Mr. HAWES. Yes, sir; 30 days.

Senator BROOKHART. Suppose a time account were drawn out within 30 days would that change it to a demand account?

Mr. HAWES. Well, if it is withdrawn it goes out immediately and it is not in the reserve at all.

Senator GLASS. A great many banks have changed demands into times, haven't they?

Mr. HAWES. Well, now, Senator Glass, I can't speak for other banks, but——

Senator BROOKHART (interposing). The complaint has been made that they have changed demand accounts into time accounts in order to get the benefit of the difference in reserve.

Mr. HAWES. Yes; I understand that there has been some such contention made here, but I do not think that has been the rule at all. Of course, one might say that there will always be bankers who will evade the rules and the law, but I think bankers will generally recognize that if there is to be a 31-day notice given, it will be required to be done that way. I know that if we have a certificate of deposit requiring 31 days' notice called, we put it in our demand deposits. And I think that is the custom in all well-regulated banks.

Senator GLASS. The testimony we had last spring before our subcommittee was to the effect that a very large number, if not—well, to be more specific, we were told that 80 per cent of the banks manipulated their deposit accounts so as to take advantage of the 3 per cent reserve.

Mr. HAWES. Well, Senator Glass, of course I do not know who testified that way, but I doubt it very much myself.

Senator GLASS. All right.

Senator BROOKHART (presiding). You may continue your statement.

Mr. HAWES. These provisions increase the cash liquidity, particularly of the country banks, thereby releasing funds for loaning purposes and giving better recognition to the savings accounts than the proposed bill through the increase of reserves would do to activity.

Now we come to section 13 (D): This refers to what is termed as "loans for account of others." A number of clearing houses have already passed resolutions forbidding their members from making loans of this character. We understand, however, that it is the intention of the framers of the act to prevent a recurrence of the practice of placing loans on call for nonbanking corporations or individuals.

I think it is wise.

Senator GLASS. Well, we will just frame that provision if you think it is wise. Some of your confreres do not think it is wise, but we are glad to know that you do, Mr. Hawes.

Mr. HAWES. Thank you.

Senator BROOKHART (presiding). You may go ahead.

Mr. HAWES. Section 13 (F): The practice of buying and selling Federal exchange has led to a difficult situation in that the Federal reserve bank can not keep account of the borrowings of the bank. This section refers to the purchase and sale of excess Federal reserve funds. The purchase of these funds, in reality, constitutes a loan. This section provides that under regulations of the Federal Reserve Board, a fee must be charged, based upon the rate of discount, then charged upon 90-day paper of the Federal reserve bank of the district in which the bank making such sale or transfer is located.

I think that is a wise recommendation.

Senator GLASS. I thank you.

Mr. HAWES. Senator Glass, I assure you that I am not trying to be always critical. I am trying to give you my thoughts on these matters as I am best able to see them.

Senator GLASS. I am sure of that.

Mr. HAWES. Section 13 (g): This refers to the Federal reserve power to suspend all dealings in reserve balances for such period as it may deem best. It also refers to the net differences in amounts due to and from banks before calculating reserves. Reserves would include all repurchase agreements. We believe that the provision adding repurchase or similar agreement entered into by a member bank to the base for the purpose of computing reserve balances is a proper one, and that the general practice of repurchase agreements between banks should be penalized.

Section 14: This section refers to real-estate loans made by national banks, also the segregation of time deposits and the investment of a percentage of those deposits in real estate and the balance in legal investments. The percentage of real-estate loans is limited to 15 per cent of capital stock and 15 per cent of surplus, or one-half of its time deposits.

This provision is discriminatory as between national banks and other member banks for a period of two years, during which time much harm might be done to national banks. It also imposes upon the Comptroller of the Currency as impracticable burden of revising and reappraising at each examination each real-estate loan made by a national bank and also by each State member bank.

We consider it unsound to require investment in bank premises to be carried as real-estate loans, and to be held as security for time deposits. As practical bankers it is almost impossible to define unsecured loans whose eventual safety depends upon real-estate values. And we have in our bank hundreds of loans that eventally might depend upon real-estate values, and yet we did not think so when we made the loans. It is a realized sound principal that banks should be limited to a certain degree in their investment in banking premises.

That provision requiring segregation of assets behind time deposits will show necessity for two fundamental effects. First, it will drive from ten to twelve billion in money now used for com-

mercial purposes out of that avenue of activity, and, secondly, it will encourage individual commercial concerns to place their time deposits into time money so as to get additional security as against the open account upon which they have no preferential position.

The provision requiring an aggregate valuation not to exceed the aggregate market value in reports to the Comptroller of the Currency is impracticable of operation.

The new provision that the required reserve against time deposit shall be counted as a corresponding part of such investments is unsound as a reserve is a reserve against deposits and is not an investment.

The provision of properties and securities of any insolvent national bank held against time deposits be applied by the receiver thereof in the first place ratably and proportionately to the payment in full of its time deposits is another form of guaranty of deposits. That is, securing one depositor against another—which has proven unsound in practice in many States—which is intended to repeat what has already been said, toward the decrease of open accounts and the reduction of investment funds available to banks and at the same time invest the funds of savings depositors in what are commonly known in commercial banks as nonliquid assets. We do not believe that this provision is necessary, as in our judgment the existing law is adequate and carries the proper regulations.

Any questions?

Senator BROOKHART (presiding). No, you may continue your statement.

Mr. HAWES. Now we will take up section 15: That provision referring to banking conducted under the laws of the various States will make it difficult for the comptroller to handle the national banks as he would have to be thoroughly conversant with the laws of the 48 States.

The provision that in no event shall any bank purchase investment securities in excess of 10 per cent of total amount of any issue outstanding will be a serious detriment to necessary financing by many small corporations for protective purposes and will work a greater hardship on industry than on banking.

I think the language from line 7 on page 36 to line 2 on page 37 should be revised and clarified as to the intent of the act, as the present wording is subject to misconstruction. A reading of this section creates the impression that while a national bank could purchase and hold 10 per cent of any one issue of one obligor, lines 14 to 19 on page 36 convey the impression that the total investment securities which a national bank may hold could not exceed 15 per cent of its capital and 25 per cent of its surplus. If this were true it would, if enacted into law, cause tremendous deflation through the forced sale of an estimated amount of $2,500,000,000 investment securities now held by national banks. It is not admitted that the percentages set forth in the bill are sound for bank operation, and conservative bankers would hardly view as sound the purchase of issues of one obligor to an amount which might be considered excessive.

We understand from the reading of line 22 on page 36 to line 2 on page 37 that a national bank is not to be limited by any of the

investment securities regulations contained in section 15 as to purchase, sale, and/or holding for its own account obligations of the United States or general obligations of any State, or of any political subdivision thereof, or obligations issued under authority of the Federal farm loan act and in order that this may be accomplished this clause should be amplified.

Any questions?

Senator BROOKHART (presiding). It seems not. You may continue.

Mr. HAWES. We now come to section 18, which seems to be very drastic. This section, it would seem to me, would be very injurious to investment bankers. As I read it, it would affect not only investment bankers but business at large, in that it has the effect of prohibiting the acceptance of deposits, the making of loans, or handling any transactions of a credit nature; that is, of any individual. partnership, unincorporated association, and corporations which deal in securities. This might work a great hardship upon the bill market, where it is necessary for the dealer to purchase at once large blocks of bills which must be cleared through banking transactions.

This section also prohibits any investment bankers from being directors or officers of any national or member bank, thereby depriving the member bank of valuable counsel and assistance. It would probably nullify section 8 of the Clayton Act, as amended, which permits that any private banker may be an officer, director, or employee of not more than two banks, if the Federal Reserve Board shall issue its permission.

In other words, as I read that section—and I should be glad to be corrected if my interpretation is not true—no member bank could accept a deposit from an investment banker or broker or handle their affairs at all. Nonmember banks only would be allowed to handle the business of investment bankers.

Any questions?

Senator BROOKHART (presiding). It seems not. You may proceed.

Mr. HAWES. We now come to sections 19 and 20 dealing with the voting power of holding company, and holding company examination.

Section 19 prohibits any corporation, association, or partnership holdin gmore than 10 per cent of the stock of any national bank from voting without permit, as provided in section 20, covering all elections of directors.

Section 20 provides a number of conditions which must be complied with in order to obtain such voting permit.

Assuming that "affiliates" are defined as in section 2 with the elimination of the words "or a corporation," we believe that subsection A of section 20 providing for examination by and reports to the Comptroller of the Currency is a proper procedure.

Subsection B and C of section 20 requires an affiliate holding an amount of more than 10 per cent of the capital stock of a national bank to set up specifically reserves so as to protect double liability of stock in that it must hold 10 per cent of the par value of the bank stock owned in Government bonds and 15 per cent in investments other than the bank's stock; furthermore, this amount so held must ultimately be brought up to 100 per cent of national bank stock owned.

This provision is definitely intended to strike at holding companies of bank stocks, but it is so far reaching that in a number of ing as a division of national banks, who hold substantial stock in cases it would create a serious situation, and trust companies, operatsuch national bank and are conducted purely as fiduciary institutions, might impair their soundness and service to estates and individuals. The amount of free assets required is so excessive as possibly to require the dissolution of holding companies—their embarking on an investment trust business.

But, of course, you gentlemen are familiar with the details. I should like to ask if this section would have the effect stated on the affiliate that we have in connection with our institution? In 1929, three banks in St. Louis were consolidated into the First National Bank of St. Louis, and in the set-up there is the St. Louis Union Trust Co., which has one-third of our stock.

I should like to explain that the St. Louis Union Trust Co. does nothing but a fiduciary business, accepts no deposits. It does not deal in stocks. It does not deal in bonds, mortgages, or stocks. It is a purely fiduciary trust company, acting in that capacity.

As I read this bill the St. Louis Union Trust Co., in order to have a voting privilege in our bank would have to get a permit, and would further have to set up 10 per cent of its capital as a reserve for the double liability of our stock. And furthermore, this amount would have to be built up ultimately to the 100 per cent of the bank stock it owned.

Now, gentlemen of the committee, there is an affiliate that has no connection whatever with stocks or bonds of anything but is doing a purely trust company business. At the same time it now owns 31 per cent of the stock of our bank. Would that section apply to such a case?

Senator GLASS. That section was intended to prevent holding companies from controlling Federal reserve banks? In the Minneapolis district that may be done now, holding companies may elect six of the nine directors.

Mr. WILLIS. I think, Mr. Hawes, that your question would be answered by referring to the definition of affiliate on page 2.

Mr. HAWES. I have been over that.

Mr. WILLIS. It calls there for a majority. I understand that your trust company holds a third of the stock of your bank.

Mr. HAWES. Yes. But it also goes on to say in paragraph 3 [reading]:

> Of which either a majority of the members of its executive committee or a majority of its directors, trustees, or other managing officers or directors of a national bank or member bank.

Mr. WILLIS. Well, Mr. Hawes, you did not mention anything about that point. Perhaps you would enlighten us on it.

Mr. HAWES. I am sorry I did not mention it, but practically 90 per cent of their directors are also our directors.

Mr. WILLIS. That would evidently bring you under section 2 as an affiliate, but not, I think, as the kind of affiliate you spoke of first. You there seem to identify yourself with so-called group banking as described in a later section.

Mr. HAWES. I might say that our bank owns no stock in any other bank whatsoever, nor has it any interest in any other bank.

Senator GLASS. This provision is intended to apply to group bankers.

Mr. HAWES. Would it apply to my case?

Senator GLASS. Not as you described it.

Mr. HAWES. It would not even if the directors were the same?

Mr. WILLIS. It would not fall under the head of group banking, no, sir. In a case of that kind you would be an affiliate, very distinctly.

Mr. HAWES. Then they would have to set up those reserves?

Mr. WILLIS. No; I think not. Of course, one would want to have all the details before giving a positive answer.

Mr. HAWES. While we are on that, Senator Glass, I do not want to sail under false colors. I said we have no interest in any other bank except we do operate the First National Co., which deals solely in mortgages, Government bonds, municipal bonds, and real-estate bonds. It handles no stocks whatsoever.

Mr. WILLIS. It might do so, however, if you so chose.

Mr. HAWES. It might do so. It never has, however.

Mr. WILLIS. The control of that is specified by a paragraph right here.

Mr. HAWES (reading):

SEC. 20. *Restrictions on loans to affiliates.*—This section extends the 10 per cent limit on loans to corporations to include all obligations of all subsidiaries.

Therefore how shall subsidiaries be defined, and how far is this provision to be carried?

Senator GLASS. We think we give a pretty comprehensive definition of affiliates in the bill.

Mr. HAWES. It covers the corporations in there. In other words, would that cover a 10 per cent limit on a corporation that owned half a dozen other corporations or one corporation that owned the stock of two other corporations? Does this limit mean that we could only lend 10 per cent to the parent company and nothing to their affiliates?

Senator GLASS. Well, I would think so; yes.

Mr. WILLIS. What provision is that, Mr. Hawes? I have lost track of it.

Mr. HAWES. That is section 20, division (a). That is all I have, Mr. Chairman.

Senator BROOKHART. Any questions?

Senator GLASS. I do not wish to ask any.

Senator MORRISON. In this definition of an affiliate here, at the end of it it says "or a corporation." Is it not attended with some possible difficulty? It might mean just any sort of little business enterprise.

Mr. HAWES. Yes, sir; I think it is.

Senator MORRISON. "Or a corporation." That might be an investment company or a bonding company; it might be a manufacturing enterprise or a store or anything that a bank had to take over for a debt.

Mr. HAWES. That is correct, and that is the reason I asked the question, how are subsidiaries to be defined?

Senator MORRISON. The definition of "affiliate" is described at the last by saying "or a corporation" without any modification whatever.

Mr. HAWES. I agree with you, Mr. Senator. I want to thank you gentlemen for your courtesy.

Senator BROOKHART. Mr. Wolfe.

## STATEMENT OF EDMUND S. WOLFE, PRESIDENT FIRST NATIONAL BANK, BRIDGEPORT, CONN.

Senator BROOKHART. You may proceed.

Mr. WOLFE. Mr. Chairman and gentlemen of the committee, as former president of the national-bank division of the American Banking Association, and as president of a bank in Bridgeport, Conn., in a manufacturing community, and as representing a State in which we have, unfortunately, but few members of the Federal reserve system, we have been somewhat concerned with the general effect that the bill has had. Not only are we afraid that we shall have further deflations—deflation from the system, but any opportunity we had of adding State member banks to the system has almost passed. There are three main objections that banks of our type find to the bill, and I am going to confine my remarks, first, in the form of a written statement, to those three sections.

The sections are: first, section 8, relating to collateral loan limitations; section 13, dealing with reserve requirements; and section 14, providing for segregation of time deposits.

I feel that section 8 confers too much power on the Federal Reserve Board in that it appears from the language that the board may restrict, within its discretion, all loans made by member banks which may be secured by any type of collateral. If the bill were specific, naming the percentage of capital and surplus that could be so invested, the banks would feel more assured regarding the wording of this section, which now seems dangerous and uncertain. If, in naming a specific percentage, it were low it would have the same objection as naming no percentage. The power thus given the board is not of a specific nature. Quite a number of banks have legitimate commercial and individual loans secure by collateral, which would be affected by this provision; and in order to comply with the section it might result in these banks having to withdraw from the Federal reserve system.

Senator COUZENS. What percentage would you suggest not to make it too low and at the same time not to make it too high?

Mr. WOLFE. Senator, not under 500 per cent of capital and surplus.

Senator COUZENS. What percentage of the deposits?

Mr. WOLFE. Well, the limitation has been with reference to capital and surplus. It has not been with reference to deposits.

Senator COUZENS. It occurs to me it would be better to have the percentage on deposits rather than on capital and surplus.

Mr. WOLFE. That may be true.

Senator COUZENS. If so, what percentage would you say?

Mr. WOLFE. That would be difficult to say, except at the present time, unfortunately, a large percentage of our loans have drifted

into just that collateral loan because of lack of eligibility loans and other exorbitant types.

Senator COUZENS. Would you say 10 per cent was a reasonable percentage of the deposits?

Mr. WOLFE. That is entirely too low, I would say.

Senator COUZENS. If that is entirely too low, what would you say would be right?

Mr. WOLFE. There is no intention to evade entirely. To be helpful in answering your question direct, I could answer it more by saying what I thought was too low rather than expressing an opinion as to what I think would be the proper percentage. At the present time, as much as 50 per cent.

Senator COUZENS. Is not that too high?

Mr. WOLFE. Under some circumstances, yes; depending on the type of bank. I think the type of bank and the management of the bank would have a lot to do with it and the character of the loans.

Senator COUZENS. We can not write into the law specifying the type of management, can we?

Mr. WOLFE. Well, you are trying to get authority for the Federal Reserve Board to control the management so the management has but little discretion. That is what rather alarms us.

Senator COUZENS. I rather object to that myself. I was trying to get at some reasonable method whereby we could take that control out of the board.

Senator GLASS. You see, the section relates itself wholly to the carrying of speculative securities; that is, stock-exchange securities, and then places that under the discretion of the membership of the board, defining what they shall be. I have been a little puzzled sitting here, Mr. Wolfe, hearing objections to giving the Federal Reserve Board authority in these matters. I pick up the existing law—the provision as to national bank collection in the Federal reserve act—and note in scores of instances, where just as much power is given the board in other matters, and the bank itself, as decided by the courts, has unlimited right to refuse to rediscount for a member bank altogether if it pleases. This power is conservatively comparable, I think, to many other powers of the board by the existing act, and this particular provision, subsection M of section 8 of the bill, relates itself altogether to carrying speculative securities.

Mr. WOLFE. Senator, in that——

Senator GLASS. Other people call them speculative. I sometimes, unhappily, use the term "gambling." Maybe that is not that. But is there any good reason to suppose that we could be wiser in fixing legislatively the percentages better than the Federal Reserve Board may do it? The whole implication of this provision is that the board may not do it except when circumstances themselves require that it should do it; and that provision requires that there shall be concurrence of at least six of the seven members of the board to do it.

Mr. WOLFE. That is perfectly true, Senator Glass; but I know we in Connecticut rather view with alarm the unfortunate tendency to lowering of our holding of eligible paper, and the banks can not

escape the large holding they have as security loans. So to say what the percentage is to be is to say that our section would be the same as any other section of the country and to have the Federal Reserve Board say a particular percentage would apply right straight through, and it does not work out that way.

Senator GLASS. No; it does not necessarily imply, and certainly does not require, that the board shall pass a general regulation. It says "for any member bank." In other words, the situation would present itself that here is a member bank carrying such a high percentage of speculative loans that it might be that six of the seven members of the Federal Reserve Board would deem it desirable to call upon that bank to change the percentage of its speculative loans.

Mr. WOLFE. I think the banks as they view the regulation as now drawn would feel far safer if some percentage were put in there, and, as previously remarked, that percentage not seemingly too low as to work a hardship. That might withdraw any objection to that particular section. But as it is now, it is left so open that even though it might be applied to only one member bank, conceivably it could be applied to all member banks and voting for it would make that possible.

Senator GLASS. It could be that the member banks were making extensive speculative loans, yes, and it might be that the board would enact a general regulation based upon its intimate observation and experience with the member banking business that would put a safe limitation upon it; and it occurred to the subcommittee that we could better rely upon the board to do that intelligently than by the committee or by the act itself.

Mr. WOLFE. Taking our own specific bank and answering Senator Couzens direct: Our collateral loans at the present time are 50 per cent of our total loan portfolio. They were, at that figure, about two and a half times our capital and surplus.

Senator COUZENS. What is it of your aggregate deposits? What percentage of your deposits?

Mr. WOLFE. About 35 per cent of our deposits. Our deposits are about $17,000,000. About $6,000,000 collateral loans.

Senator COUZENS. Do you consider the Federal Reserve Board has functioned properly up to date?

Mr. WOLFE. That is a rather broad question. I would rather not answer.

Senator COUZENS. I understand that the reason some of these restrictions are placed in the bill is because there is a conviction in some parts of Congress, at least, that the Federal Reserve Board has not functioned properly. I assume that you are afraid you might be penalized if you would answer in the affirmative.

Mr. WOLFE. Not at all.

Senator GLASS. I think Mr. Wolfe has given us a sufficient answer.

Senator COUZENS. I think he has, too.

Senator BLAINE. Does not the Federal Reserve Board claim that it has not certain powers it seems to have?

Senator GLASS. The Federal Reserve Board claims that under existing law—I do not agree with it, I may say—but it does claim that under existing law its powers in this respect are not definite enough, and the board itself asks us to make them definite.

Senator BLAINE. That is my understanding.

Senator COUZENS. There is plenty of authority in the bill that has not been exercised.

Mr. WOLFE. That may be true of the authority under the present bill.

Senator COUZENS. I say, under the present bill it has not been exercised, and we had a distinguished witness here yesterday or the day before yesterday who thought it ought not to be exercised, that the law should not be enforced.

Senator BROOKHART. Proceed.

Mr. WOLFE. Quite a number of banks have legitimate commercial individual loans secured by collateral which would be affected by this provision, and in order to comply with this section it might result in these banks having to withdraw from the Federal reserve system. The effect on the banks not borrowing from the system is practically the same as that on the banks who do borrow, for they must keep in condition to use the rediscount privileges. I believe that section 8 gives the Federal Reserve Board unnecessary power of control over the policy management of member banks which are nonborrowers.

With regard to section 13, I believe that the increase in reserve requirements on time deposits as provided in the bill is an unnecessary burden on the banks. Experience has shown that the Federal reserve banks have had ample funds to meet all member-bank requirements, and this additional reserve burden draws from the working funds of the member banks and transfers unneeded deposits to the Federal reserve banks. This section, if enacted into law, would work a particular hardship upon the banks located in the cities where there is not a Federal reserve bank or a branch bank, particularly in the rural sections. It could not result otherwise than in a withdrawal from membership of this type of banks through its inability to compete with nonmember banks whose reserve requirements are not so burdensome. Consideration should be given to the use of till cash as reserves.

Senator GLASS. Do you think, really, that the reserve requirements of the existing law are very burdensome?

Mr. WOLFE. Not the existing law. I think they may prove to be in the proposed bill, that increases them.

Senator GLASS. Were they so regarded before we made this one alteration as to time deposits? You know, since the enactment, or beginning with the enactment of the Federal reserve act, we have constantly reduced the reserves of the banks. We have never increased them. This rejection of reserves held behind time deposits to 3 per cent was made, not because it was generally thought that a reserve was burdensome, but more to encourage time deposits; and instead of doing just exactly that the information that we have got from our questionnaires and from our previous hearing and inquiries was to the effect that the demand deposits and reserve deposits had been so manipulated as to take advantage of the 3 per cent for demand deposits.

Mr. WOLFE. Is that true? A deliberate shifting to time and segregated deposits.

Senator GLASS. Yes, sir.

Mr. WOLFE. I would like to report I do not believe that has been the practice in my section of the country. We are only fearful as to

just what else may be behind the increase in reserve on segregated savings funds; whether putting them all on the same basis with regard to reserves is not, after all, a merging, a gradual doing away with the type of deposits which banks in communities such as ours can not escape. We have a lot of funds that, owing to customers requirements, have drifted into time deposits. The bank tries to avoid that because it means increased interest rate paid on them, and the loss in that respect is much higher than the additional reserve requirement on demand deposits.

Senator GLASS. Have you considered the question, and would you like us to incorporate in this bill immediately the proposed velocity method of computing reserves?

Mr. WOLFE. We were rather impressed with the report that that special committee made. We think that is the scientific way of establishing reserves—the activity of deposits or reserves as against deposits, in relation to their activity.

Senator GLASS. You think it would readily be preferred by the banking community generally throughout the United States and would create no confusion?

Mr. WOLFE. I think there has been a very favorable reception to that report, particularly among those who are technically informed of the reasons for that form of computation.

Senator GLASS. You would think the New York banks should be technically informed, would you not? The reaction there was very antagonistic. I did not mean to interrupt you.

Mr. WOLFE. You did not. Consideration should be given to the use of till cash as reserves. This principle is recognized in the report of the committee on reserves, which provides that in case of banks not located in cities where there is a Federal reserve bank or branch bank a fair percentage of their legal reserve might be carried in currency on hand.

The other subsections of section 13 do not concern the type of bank that I referred to, and consequently I will not refer to them.

With regard to section 14, I believe there will be much hardship worked on banks in the rural districts having time deposits, and restriction on the investment of these funds has been so narrowed that it can not help but hinder the bank in its work. While the national banks are the backbone of our commercial activity, nevertheless in the rural sections there does come the necessity of making real estate loans. Under the bill the investment in bank premises and the attempt to define unsecured loans whose eventual safety depends upon real estate value and reserve against time deposits, all classified as real estate loans, will absorb much of the funds that otherwise might go into legitimate real estate loans for the account of customers. The requirement that the Comptroller of the Currency revise and reappraise real estate loans at each examination seems impossible of satisfactory administration, for no asset of a bank is more difficult of appraisal than a real estate loan. It is fair to assume that large amount of funds now in commercial use in our banks will be transferred to time deposits because of the security afforded and also time deposits in excess of real estate collateral, which deposits are now in commercial use and must be diverted to eligible securities.

Senator BROOKHART. Have you any questions?

Senator FLETCHER. Have you any suggestions of any amendments by which you could make this bill more acceptable?

Mr. WOLFE. On the particular clauses that I have mentioned, Senator?

Senator FLETCHER. Yes.

Mr. WOLFE. I would rather have the present bill let alone than attempt to change it in the manner that you have——

Senator GLASS. You mean the present law?

Mr. WOLFE. The present law. Pardon me.

Mr. WILLIS. I notice you use the word "collateral," Mr. Wolfe, frequently in your testimony. In what sense do you use it there?

Mr. WOLFE. Depending on the section, Mr. Willis. Which one did you refer to?

Mr. WILLIS. You were speaking of it right along.

Mr. WOLFE. As collateral loan?

Mr. WILLIS. Section 8. You spoke of your bank as having a large percentage of its loans in the form of collateral loans. In what sense do you use the word there?

Mr. WOLFE. Listed bonds, stocks, and other securities.

Mr. WILLIS. You do not lend much to farmers on warehouse receipts?

Mr. WOLFE. Practically none. We are not a rural community. We are a manufacturing community.

Mr. WILLIS. So that in your sense "collateral loan" means loans on stocks and bonds?

Mr. WOLFE. Generally listed securities.

Senator WALCOTT. Do you carry any foreign securities?

Mr. WOLFE. Very few.

Mr. WILLIS. In connection with what you say of the change in reserves there, I notice you say you think till cash should be given a status as reserves. In the plan that you referred to suggested by the Reserve Committee, that till cash is made to include national-bank notes and Federal reserve notes, you remember?

Mr. WOLFE. Yes.

Mr. WILLIS. Does that seem to you right, or not, to include those in the till cash?

Mr. WOLFE. I see no objection to it. The percentage of them would be so low it would have no appreciable effect.

Mr. WILLIS. It seems to me one ought not to take a hypothesis of that kind. Suppose your percentage would be beneficial—we are making a general rule that applies to cases where they are both large and small.

Mr. WOLFE. I would say I see no objection.

Mr. WILLIS. No matter how large they were. There has been some difference of opinion. I should like to know what you thought on that.

Senator BROOKHART. If you count the till cash as reserve, that would reduce the reserves in the Federal reserve bank?

Mr. WOLFE. In the Federal reserve bank.

Senator WALCOTT. Mr. Wolfe, with reference to affiliates, have you given any particular thought to the question of regulating the affiliates?

Mr. WOLFE. Senator Walcott, we have been a little selfish in that. Our bank has an affiliate but it is merely a holding company and not a marketing or underwriting company.

Senator WALCOTT. I understand, but I was anxious to get your individual opinion as to the advisability of regulating affiliates along the lines outlined by this bill.

Mr. WOLFE. If I do not answer your next question, I would like to say I think they could bear some moderate regulation.

Mr. WILLIS. About this reserve question, Mr. Wolfe—am I interrupting you, Senator?

Senator WALCOTT. No; I had finished.

Mr. WILLIS. Do you regard reserves at the present time as too small or about right?

Mr. WOLFE. Not as a hardship, Mr. Willis.

Mr. WILLIS. Not as a hardship, certainly; but if you were establishing reserves, would you establish them about where they are now, or larger or smaller?

Mr. WOLFE. About where they are now; and I only have our own experience in our own type of bank.

Mr. WILLIS. Under any new plan, such as this one we speak of, would it not be well to have a minimum requirement that they should not be less than they are now, for example? The plan contains a maximum requirement, as you remember.

Mr. WOLFE. Yes; I remember.

Mr. WILLIS. Would it be well to go so far as to take it without either maximum or minimum?

Mr. WOLFE. Well, obviously it would be fair for both the maximum and minimum.

Mr. WILLIS. If you had one, you would have the other?

Mr. WOLFE. Yes. It would naturally follow.

Mr. WILLIS. If you were going to put in a minimum, would you think it would be fair to put the two at the existing level?

Mr. WOLFE. I think so; again speaking from our own experience only, because it strangely works out there is no hardship, and it meets our wishes very well.

Senator WALCOTT. May I insert a question there? Would it in your city be safe or advisable to have a minimum expressed without a maximum?

Mr. WOLFE. I see no objection to that, Senator Walcott. I can not see how there would be any hardship in that.

Senator GLASS. Would it be wise to have a maximum expression without a minimum?

Mr. WOLFE. You have done that.

Mr. WILLIS. I notice in your testimony you use the word "segregate" assets behind savings deposits. That is merely colloquial, is it not? That is, you do not think this bill does any segregation?

Mr. WOLFE. It says, "in liquidation."

Mr. WILLIS. It simply gives a prior lien on certain assets after the other assets have been exhausted.

Mr. WOLFE. But it does specifically say "in liquidation." Those time deposits shall be paid out of that.

Mr. WILLIS. It says these shall be a prior lien for certain deposits.

Mr. WOLFE. I do not see anything else to that but segregation.

Mr. WILLIS. There is nothing? You do not think——

Mr. WOLFE. No segregation in a physical sense, but a form of security.

Mr. WILLIS. In the event of liquidation only?

Mr. WOLFE. Yes.

Mr. WILLIS. But you do not gather there is anything here that compels the investment of any special amount in various kinds of assets?

Mr. WOLFE. Except as regulated by one-half.

Mr. WILLIS. It is permissible, though.

Mr. WOLFE. Yes; but the percentage of any investment—and I think the bill is unfortunate in that respect—that is a capital investment—the percentage in loans whose final payment is realized on real-estate security, would be the hardest problem any bank would have to determine.

Mr. WILLIS. That is all permissive, however.

Mr. WOLFE. That is perfectly true; but about that it must go into acceptable securities up to one-half of your deposits.

Mr. WILLIS. It is not compulsory in any case, you understand.

Mr. WOLFE. If you are going to invest it——

Mr. WILLIS. You can go on generally as you do now.

Mr. WOLFE. You see, we have the problem in Connecticut, particularly germane to us, where we do have segregation of practical guarantee of savings in time deposits of our commercial banks, and it is quite a problem with us.

Mr. WILLIS. But under this if you wanted to do so, of course, you could go on using your funds largely as you do now, could you not? This is simply a permissive limitation.

Mr. WOLFE. Yes; but in liquidation it is——

Mr. WILLIS. A prior lien?

Mr. WOLFE. A prior lien, and it tends to drive your commercial deposits to your time deposits, for two reasons: First, in liquidation they would be obviously apparently security; secondly, there would be a higher rate of interest.

Mr. WILLIS. Other witnesses have testified about the prospect of driving them in the opposite direction.

Mr. WOLFE. There would be some portion of them that would be driven away.

Mr. WILLIS. So if you get them too high, you would have to contrive some way to force them back.

Mr. WOLFE. I would have to get a pencil and paper and figure that.

Senator BROOKHART. Is that all? Thank you, Mr. Wolfe.

The next is Mr. Allendoerfer.

## STATEMENT OF G. W. ALLENDOERFER, VICE PRESIDENT OF THE FIRST NATIONAL BANK OF KANSAS CITY, MO.

Mr. ALLENDOERFER. Gentlemen, I expected to be called for to-morrow's hearing and to prepare a statement to-night after having learned something about the methods of the hearing. Since there is to be no hearing to-morrow and I have no prepared statement. if I may, I will speak from some notes.

I represent the Missouri Bankers' Association. I was reared in a country bank. Our bank in Kansas City is the correspondent for

a large number of country banks, with whose relations with our bank I have a great deal to do; and what I have to say will be from the standpoint of an interior banker with the thought of his country constituents very close to his heart. The First National Bank, of which I am vice president, has a capital of $2,000,000 and a surplus and undivided profits of $3,600,000; total deposits, $54,000,000; and $10,000,000 time deposits. The bank is 46 years old, 45 of which have been under its present management, during all of which time there have been no consolidations. Our bank has no affiliates. We are not interested in branches or groups. We do not sell bonds or real-estate loans. Our par value is $100, and we expect to remain an independent unit.

Senator GLASS. That is a pretty nice bank.

Senator WALCOTT. A real commercial bank.

Senator FLETCHER. It sounds like a real bank.

Mr. ALLENDOERFER. Yes, sir. I have had no opportunity since the call to come down here was made to confer with——

Senator COUZENS. Who called you to come down here?

Mr. ALLENDOERFER. The officials of the American Bankers Association, and particularly the president of the Missouri Bankers Association. I have had no opportunity to talk with officers of that association or officers of our own bank. What I will say will be my own thinking on this subject.

I have, of course, known of Senator Glass for many years and know of his wonderful work in the Federal reserve act and his hand in recent legislation has been very apparent, and it has been with much gratitude in my heart that I have known that in his position we have a man so zealous for the preservation of the integrity of our banking and currency system. It is, therefore, with a great deal of diffidence that I appear in opposition to any bill which he has submitted. If I guess properly the intent behind many of the provisions of the bill, I am in sympathy with the purposes aimed at, but the general situation of the country is such that I do not believe the bill in its present form and at this time should be passed. We are just beginning to recover confidence, both the public and the bankers. This bill contains matters of so much importance and so difficult to understand quickly that I believe that the bankers and the public alike will be stunned and that fear of its effect will cause hesitation and set back our recovery. In my judgment the bill should be broken up and presented as several subjects so that the particular features of each part may be concentrated on and given serious and long consideration. I believe some of them should be reintroduced and acted on by the Senate; others, if held for a few weeks or a few months for further consideration, would, I believe, be somewhat changed before they were presented to the Senate. Some of them I think could be held for as long a period as two years without doing any serious damage.

I will not speak on the sections dealing with affiliates, groups, or branches or capital stock, as others are much better qualified to speak on those things. The matters about which I will speak are in a measure details. Some of them I think are quite important and are mentioned largely for the purpose of bringing to your attention the fact that a number of these provisions need fuller and more serious consideration before going to the Congress.

I mention first, in a general way, that the words "collateral security" should have some definition.

Senator FLETCHER. Will you refer to the sections?

Mr. ALLENDOERFER. I will, except that "collateral security" appears in so many sections that it is general.

Senator BULKLEY. Will you tell us what is your definition of collateral security?

Mr. ALLENDOERFER. Well, collateral security in its general acceptance would include, for example, things which I think you do not mean to include in that, which I am about to speak of.

Senator BULKLEY. Give us some examples, if you will.

Mr. ALLENDOERFER. Collateral security as generally accepted would include warehouse receipts covering commodities. I think it is not the intent of the bill to prevent or to hold down the loaning of a bank in an agricultural community on warehouse receipts secured by commodities. In our relations with country banks, even some member banks, we have as collateral to their bills payable their customers' notes, a large part of which would be eligible for rediscount at the Federal reserve bank, but you call it none the less collateral security. It is collateral security. That word is generally accepted.

Senator BULKLEY. Would the phrase "security collateral" mean anything different from "collateral security"?

Mr. ALLENDOERFER. I am afraid I can not furnish the definition, but I think one should be provided.

Senator BULKLEY. You think it should be put right in the act?

Mr. ALLENDOERFER. I do not see how you are going to get around having it to some extent defined in the act.

Senator GLASS. If a highly intelligent and long-experienced banker of your type can not define it for us, it leaves us with an almost impossible task, does it not?

Mr. ALLENDOERFER. I believe that the experts who drew this bill, if it is reconsidered and a definition sought for, will be able to find words which will express just the type of collateral security they had in mind in drawing these sections.

Senator GLASS. My dear sir, I can say to you that we have done everything but sleep with experts, and I have dreamed about them, and other members of the committee have eaten with them. I have not.

Mr. ALLENDOERFER. Is it in order for me to ask questions, Senator? May I ask, then, whether you have found that a difficult thing to define?

Senator GLASS. I know very definitely, sir, what I mean by that. I do not mean warehouse receipts for commodities at all. I mean more or less speculative transactions represented by the market. I mean paper defined by the existing act as ineligible for rediscount by the Federal reserve bank.

Mr. ALLENDOERFER. Would it be, as a suggestion, possible to work that out by exclusion and say that collateral security consisting of warehouse receipts, bills payable secured by eligible paper or by Government securities would not be classified as collateral security?

Mr. WILLIS. May I call your attention, Mr. Allendoerfer, to section 5200 of the Revised Statutes, in which warehouse receipts are men-

tioned? They are not described there as collateral. The term "collateral" is not so used there, as you recall.

Mr. ALLENDOERFER. No; I did not recall that.

Mr. WILLIS. Is there not danger that if you introduce a definition of "collateral" here it will bring you into conflict with the word as used elsewhere in the Revised Statutes.

Mr. ALLENDOERFER. Just on the theory of being safe I would like to see some of these things excluded from the possible classification as collateral security.

Mr. WILLIS. I agree with you.

Senator GLASS. Yes. We want to be safe.

Senator FLETCHER. Do you think this definition of collateral security excludes those that were specified in section 5200, that Mr. Willis mentions?

Mr. ALLENDOERFER. In the general acceptance of the words, "collateral security" notes secured by warehouse receipts on wheat would be in a classification which I do not think the purpose of this bill intended.

Senator FLETCHER. It is expressly provided for in that section 5200.

Mr. ALLENDOERFER. Yes. Now, in some matters to which I will call your attention I hope that I may not seem to be nagging. I do not mean to be. I am going to speak of some points which I think are not clear here, and if I seem to be silly—I know that they ought to be clear to me—and they do not do the committee any good, perhaps the record will help some others who are trying to get this through their heads and understand it a little better.

I will refer now to page 5 of the act, beginning with line 7. This is in connection with the subscription to the stock of the Liquidating Corporation by the Federal reserve banks (reading):

> After the aforesaid dividend claims have been met, the net earnings beginning with the net earnings for the year ending December 1, 1932, shall be paid to the Federal Liquidating Corporation provided for in section 12–b of this act and shall be used by said corporation for carrying out the purposes of said section.

On a first reading of that—and a second and third in my case—it would appear that the surplus funds of the Federal reserve banks were being fixed at the figure at which they were on December 31, 1931, which could not be increased by earnings because these would go into the capital stock of the Liquidating Corporation; which I object to, first, on the theory that more surplus funds would not hurt the Federal reserve banks; second, because that limiting of their surplus funds may result in the dividends to member banks being deferred from time to time instead of being paid annually as was probably intended. And, furthermore, in a general way, the effect of that is to divert Government money which otherwise goes into the general revenue into another arm of the Government without appropriation. Now, I know that has been done.

Senator BULKLEY. That is the point. It is in no sense Government money. These banks are owned by the member banks and not by the Government, and it goes, not to another arm of the Government, but into another corporation owned by the member banks and for their benefit.

Mr. ALLENDOERFER. Yes, Senator. This takes away that part of the earnings of the Federal banks which has in the past been paid as a franchise tax to the Government; as we think, rather unjustly.

Senator GLASS. Yes. We think that the Government really ought to restore to the system the 147 millions of dollars it has already gotten out of the system.

Mr. ALLENDOERFER. I will not dispute that with you at all. The point I am getting at is this: The capital of this corporation is really to be provided out of Government income to a considerable extent, if it is considerably Government funds anyway——

Senator BULKLEY. I do not think that is a fair statement. We do not conceive any of this as Government funds. We are simply deciding that the Government shall stop taking that which in fairness does not belong to it.

Senator GLASS. We think, sir, that the 12 Federal reserve banks in their essential operation do an unrequited service to the Government that a long way more than compensates the banks for any privileges they get from the Government. The fact of the business is that all of the Liberty loans and the Victory loans and the placing of the Treasury certificates was done largely through the organization of the Federal reserve banks for the Government without any compensation at all.

Mr. ALLENDOERFER. Senator, I quite agree with you about that.

Senator GLASS. And I may say to you, right on that point, that as that section was originally drafted by me, before we agreed to this liquidation corporation, I was proposing to distribute a greater share of the earnings of the banks to the member banks direct.

Mr. ALLENDOERFER. The fault that I am poorly expressing is that, indirectly at least, the Government is getting some of the money which it formerly did receive into the stock in this corporation.

Senator GLASS. No; the Government is not getting it there. We have stopped paying that money to the Government and are taking it for another purpose of the member banks.

Mr. ALLENDOERFER. May I reread part of the sentence I just read, in order that what I am driving at may be clear? [Reading:]

After the aforesaid dividend claims have been fully met, the net earnings beginning with the net earnings for the year ending December 31, 1932, shall be paid to the Federal Liquidating Corporation, provided for in section 12–D.

Senator GLASS. Before you leave that——

Mr. ALLENDOERFER. I am not leaving it, Senator.

Senator GLASS. Well, right on that point, you did suggest that it might be inadvisable to retain Federal reserve bank surplus at the existing figure.

Mr. ALLENDOERFER. I would rather not have it fixed at that minimum figure.

Senator GLASS. Well, what I want to say in that connection is, the Federal Reserve Board after a long experience with the system recommended to Congress to authorize a surplus of 50 per cent fixed and definite. Congress went along and went beyond that, and authorized a surplus of 100 per cent and an annual surplus thereafter of 10 per cent, and it seemed to the committee that that surplus was adequate.

Mr. ALLENDOERFER. The point that puzzles me about the wording of that which I have just read, is tying in with section 12–B, page 14, beginning with line 13. This provides for the payment of the remainder of the subscription of the Federal reserve bank based on their present surplus. [Reading:]

The remainder of such subscription shall be subject to call from time to time by the board of directors upon 90 days' notice, and annual subscriptions to such stock shall be made by such bank in an amount equal to one-fourth of the annual increase in such surplus.

Section 5 says that "the earnings" shall be paid in. This section says that one-fourth of the increase in surplus shall be subscribed. Now, it may be intended there the increase of surplus earnings out of additional memberships.

Senator GLASS. That is one way the surplus could be.

Mr. ALLENDOERFER. The only way it could be.

Senator BULKLEY. I do not think that is quite accurate, and I do think you have made a criticism there that needs a little fixing because, as I conceive it, the surplus is none the less increased because the amount of it is paid from the Liquidating Corporation. The stock of the Liquidating Corporation is acquired for it, and it increases the surplus just the same.

Mr. ALLENDOERFER. Well, it does seem it might need a little smoothing.

Senator BULKLEY. I think it does. I think you are quite right.

Mr. ALLENDOERFER. While we are on section 12: The provision is that the directors of the Liquidating Corporation shall be the members of the Federal open-market committee. I just can not see why the members of the Federal open-market committee should be selected to handle a liquidating corporation. It is assumed that the members of the Federal open-market committee are men who are specialists in that field, and why those men also fit over into a liquidating corporation instead of the selection of any other men does not occur to me.

Senator GLASS. It avoids a multiplicity of activities, a multiplicity of committees and boards in the system.

Mr. WILLIS. Is it not a fact that the persons who managed the open-market operations in the past have not been experts in that field at all, but have been officials of reserve banks who got their information from persons more or less expert? Is it not also a fact that when acting as directors of this Liquidating Corporation they would not do the work themselves, but that they would employ qualified men for the work of a $218,000,000 corporation so that they would simply act in the same way that directors of banks act? Surely their judgment would be good on banking customs in general.

Mr. ALLENDOERFER. Well, at any rate they are operating officers of the Federal reserve banks and they are the directors of the Liquidating Corporation. It seems to me that they are very likely to be in rather a bad situation. In the first place, the failed bank is likely to be a debtor to the Federal reserve bank. They are officers of the Federal reserve bank that lends them the money, and they are the officers of the Liquidating Corporation that works out the security of the makers of the notes. The Liquidating Corporation is certain not to be a very popular proposition. To tie the Liquidating Corpo-

ration closely with the operating officers of the Federal reserve banks, it seems to me to be rather bad psychology as to those debtors who are being forced to liquidate to pay their obligations held by the Liquidating Corporation. There is likely to be a feeling, it seems to me, that "There is the Federal reserve bank set up to save us. Now this other arm makes us sell the old homestead in order to pay that loan."

Senator GLASS. It would not be any worse psychology than the receiverships that have been extending over a prolonged period of time. I had a letter only the day before yesterday from a man from your State of Missouri claiming that the bank in which he was a depositor had been in the hands of a receiver for six years, and the man who had manipulated the whole transaction is a very high official in the Federal Government here in Washington now and he has not got a cent of his money in the whole six years. You could not imagine any worse psychology than that. And when I was Secretary of the Treasury my attention was called to the fact that a bank out in Montana, I think it was, had been in the hands of the receiver 23 years and had not been closed.

Mr. ALLENDOERFER. The thought I have, Senator Glass, is the idea of tying this liquidating corporation and its necessary functions, identifying them so closely with the Federal reserve bank, which is supposed to be and is, of course, doing work of a most constructive, beneficial nature.

Senator GLASS. That is not an unreasonable comment.

Mr. ALLENDOERFER. I am afraid you will find a good many of mine unreasonable.

Going down on page 14, a very minor matter, in line 22, reference is made to the last call date of the year. The call date of the comptroller and the call date of the commissioners where the members are State banks may not be the same—there would be a little confusion as to which call date is meant. That follows on through, onto page 15, line 6 and line 11. Where banks are called on to increase the amount of their holding of stock in the corporation by reason of an increase in their time and demand deposits, it says that this shall be increased annually. I presume it means that last call date of the year, though it is not so indicated.

In line 22 on page 15 we have about the same thing again: That when new banks go in they are required to subscribe for a proportion of their time and demand deposits. It does not say as to what date their time and demand deposits shall be taken, whether the date of the last call or the date of their application for entrance.

That also carries over onto page 16, line 7, where a member bank's time and demand deposits are decreased: That it shall surrender part of its stock. It does not say there the decrease shall be on some certain date. If that date is the last call of the year and approximates December 31, I think it would be physically impossible for that bank not later than January 1 thereafter to surrender a portion of its stock.

Back on page 15, line 9, is a provision that the shares of the capital stock of the corporation owned by member banks shall not be transferred or hypothecated. I can think of some very good reasons that probably actuated the writer of this bill to put that in. The effect of that, however, is to make that an absolutely frozen

asset. No matter how good, the bank owning it positively can not use it for any purpose. Banks get plenty of frozen assets without setting one up by legislation.

Mr. WILLIS. Could they not borrow on it at the reserve bank?

Mr. ALLENDOERFER. I would say no. It can not be transferred or hypothecated. It seems to me that might be modified without destroying the purpose for putting it in, by something along this line; that it might be hypothecated with another member bank, the Federal reserve bank or the Reconstruction Finance Corporation, provided that the transferee can not surrender that stock for cancellation unless the bank to which it is issued has gone into liquidation.

On page 20 are the provisions with reference to the purchase of the assets of closed banks by the liquidating corporation. I think it begins on line 13. It seems to me that it will be next to impossible for the liquidating corporation to purchase all of the assets at an upset price without danger of loss to itself. It would be almost impossible to value in a short period the total assets of an institution. Now, if they are going to purchase for less than they think it is worth, even though the excess which they receive is afterwards turned over to a receiver, it looks like rather strange way to handle it. But what I am leading to is, if they do not purchase all, but purchase part, you then have left a portion of the assets of that bank being liquidated by the liquidating corporation and a portion of it being liquidated by the receiver. If it is a Federal receiver, you have the comptroller sitting in two jobs, which might not be too great a conflict, but if the receiver is acting under State laws as a receiver of a State bank, also a member bank, there is a conflict there, the answer to which I do not try to give you, but I believe there might be some improvement made in that section of the bill.

Senator BROOKHART. On that proposition: This whole liquidating idea is somewhat the idea of the cooperative banking system, and in order to carry that out in a sound way, the proper way to do it would be to take over all the assets at a price where it would be sure to be exceeded and then return it back in a trade dividend.

Mr. ALLENDOERFER. Well, if that is to be done, then the provisions for loans to the receivers which occur all through the same section here are superfluous, because if you are going to take it over in full by purchase with the excess afterwards returned to them, there is no occasion for making loans to the receiver.

Senator BROOKHART. Perhaps that is true. I did not write this section. It had no cooperative ideas in it.

Mr. ALLENDOERFER. Gentlemen, these suggestions are not intended to be pin pricks and nagging. What I am trying to get at is that there are in several of these sections points which I think require some mature and more detailed consideration before the whole bill goes through as it now is.

Mr. WILLIS. What would happen in this case: Suppose that the tender of assets was made to the liquidating corporation. It, of course, would look over the ground pretty carefully before it would buy a lot of assets of that kind at an upset price. Perhaps it would reject a certain portion of them. Would that not result in a second tender of them to it so that it would eventually buy all of them?

In other words, have you not got to give it a little bit of a bargaining power in order to afford some self-protection to the concern?

Mr. ALLENDOERFER. I think so. As I see it, though, you get into conflict with two different groups of people liquidating part of the bank's assets.

Senator BLAINE. I would like to ask you a question. As I read this law, does it not establish two agencies to handle closed banks—the receiver on one hand and this board on the other? Who is in charge?

Mr. ALLENDOERFER. The receiver is in charge. Of course, if a corporation bought a portion of the assets, they would own those assets and would liquidate them as they thought best, with the restriction that it must be with due regard to the condition of credit within the district.

Senator GLASS. And the purchase would enable the receiver promptly to pay depositors in the failed bank whatever may be coming to them.

Mr. ALLENDOERFER. Yes. I am quite in favor of the liquidating corporation. I think it is an essential thing, and one of the early things that should be done. I am talking away here, trying to have you see that there may be thoughts on these provisions which are worth some further consideration.

Senator GLASS. We are glad to have them.

Mr. ALLENDOERFER. Which might result in this being taken out and put through instead of being left a part of the whole bill.

Senator GLASS. You want to take out the popular provisions of the bill, do you, and let us have our bitter fight over those that certain interests do not want? Is that the idea?

Mr. ALLENDOERFER. No. I know that question is asked in a good-natured spirit, Senator.

Senator GLASS. Oh, yes.

Mr. ALLENDOERFER. On page 20—we are still talking about this liquidating corporation—in line 20 it says [reading]:

> The corporation after it has realized on the assets shall make an additional payment to the receiver of the bank equal to the amount of such excess, if any, after taking a liquidation fee of 6 per cent of the sum thus realized.

Senator FLETCHER. That is page 21, not 20. You said on page 20.

Senator GLASS. He has a different print there, perhaps.

Mr. ALLENDOERFER. It is on page 20 of the copy that I have.

Senator FLETCHER. That is right. I beg your pardon.

Mr. ALLENDOERFER. The question is coming to my mind on that: I take it that that 6 per cent is on the total amount of assets which are liquidated into cash.

Senator BROOKHART. That is on the cash realized.

Senator BULKLEY. On the total amount realized.

Mr. ALLENDOERFER. I would take it so. Now, then, are any of the costs of liquidation to be deducted from this excess, and is any deduction to be made for interest on the advances made by the liquidating corporation during the time that they are carrying this advance and before they have been reimbursed? If that is not contemplated it seems to me that it is impossible for this corporation to have any net income out of which to pay any dividends and to pay its expenses and interest cost on its debentures and so forth for 6 per

cent of the total amount the collection of which might extend over a period of several years. It just won't work.

Senator BULKLEY. You are not forgetting that it owns assets outright and would be entitled to any earnings that might be made on those assets?

Mr. ALLENDOERFER. That is what I want to know; whether it means that. It owns them outright. But it says that the entire amount recovered in excess of that paid shall be turned over.

Senator BULKLEY. The question now is whether earnings on the purchased assets would be part of the amount recovered. I should think not, but perhaps you have raised a fair question.

Mr. WILLIS. May I say just by way of interest: We originally had that much higher, and the reduction to 6 per cent was made after various computations and data furnished by some of those who had been engaged in liquidating closed banks. I think it is a very low figure, 6 per cent.

Mr. ALLENDOERFER. Unless some of the cost of liquidation or earnings on assets while in liquidation may go to the corporation——

Mr. WILLIS. If the corporation bought certain stocks and bonds, they would belong to it and, obviously, the earnings on those would apply to the person that bought them.

Senator BULKLEY. No doubt they would apply to him.

Mr. ALLENDOERFER. The point I would like to make in reply is, if they apply to them, they would not figure here at all but they would be earnings on something they owned. If they realized an excess on it, they would have to turn it back to the receiver.

Senator BULKLEY. You can see the income was on a given number of shares of stock that they bought, and under this language in your opinion they have figured that as a part of the amount from which the 6 per cent would be taken?

Mr. ALLENDOERFER. It should not, but I think it is not at all clear.

Senator FLETCHER. It says: "If the amount realized on the assets so purchased exceed the sum paid therefor, the receiver is to pay over this last 6 per cent on the amount realized."

Mr. ALLENDOERFER. Well, the amount received on the assets—shall we say the principal amount received on those assets? Income will be received on them in the meantime. Does the corporation retain the income?

Senator FLETCHER. I mean the amount received on the assets should be in one fund, and then, if that exceeds what it costs, then you deduct 6 per cent.

Senator BROOKHART. I think there is no distinction between principal and interest. It is all realized into the corporation there.

Mr. ALLENDOERFER. It seems to me there is a point; that the intent should be expressed a little more clearly.

Senator BULKLEY. That is right.

Mr. ALLENDOERFER. With that thought in mind, that the corporation may not make any money and, therefore, no dividends, the next question becomes quite silly. But on page 14 the provision is that the class A stockholders shall receive dividends to the extent of 30 per cent of net earnings in any one year. Class B stockholders get no dividends. The life of the corporation is 20 years. It may be liquidated sooner by act of Congress. If it is liquidated at the end

of 20 years or sooner, who gets the 70 per cent of the earnings that has not been paid out? These stockholders? Class A stockholders?

Senator BROOKHART. That would all go, by the franchise tax, to the Treasury.

Mr. ALLENDOERFER. When it goes to the Government, what becomes of it?

Mr. WILLIS. It seems to me it is clear what becomes of it.

Mr. ALLENDOERFER. Would you mind telling me what becomes of it?

Mr. WILLIS. It would be distributed to the owners of the stock of the corporation.

Mr. ALLENDOERFER. The Federal reserve banks get no dividends.

Mr. WILLIS. No.

Mr. ALLENDOERFER. Would they share in this dividend?

Mr. WILLIS. Evidently, unless you have some other provision, they would do so.

Mr. ALLENDOERFER. Perhaps so. On page 23 there is a provision for loans to receivers of banks. I have had no opportunity to look at the law, but I recall that in the Reconstruction Finance Corporation the law specifically gives the receivers of failed national banks the right to borrow from the Reconstruction Finance Corporation, evidently under the assumption that they do not have a general right to borrow money. If there is anything in that thought, then this act should also include authority for a receiver of a national bank to borrow money.

Mr. WILLIS. There has been testimony on both sides before the committee, both that you do and that you do not have to do that.

Mr. ALLENDOERFER. It would not hurt to have it in, would it? In the matter of the debentures of the liquidating corporation it seems to me that the only market for those debentures is going to be the banks. They will not be of a character which the public will purchase. Now, if the market for those debentures is with banks and the need for money from the sale of debentures comes at a time, naturally, when the banking situation is bad, then where are the debentures going to be sold?

Senator GLASS. My presumption was that none would be sold; that it would not be necessary to sell any.

Mr. ALLENDOERFER. Let us hope that is true, Senator.

Senator GLASS. Unless we are going to have another era of numerous bank failures, which I hope we are not ever going to have again.

Mr. ALLENDOERFER. Well, I would not advocate that these debentures be eligible for purchase by the Federal reserve banks or the Treasury; but if they are not and the bill does not make them so eligible, then there is no certainty that funds will be available through the sale of debentures for the liquidation in large percentage of bank failures such as you had last October.

Senator GLASS. There is no certainty of it, no. My surmise is they will never have to sell a dollar of those debentures.

Mr. ALLENDOERFER. I hope not.

Senator FLETCHER. If they are tax exempt, do you not think the public might take them?

Mr. ALLENDOERFER. I think not. That leads me to this——

Senator GLASS. If we have another era of bank failures such as we have now, the public will not buy anything, because it will not have anything to buy anything with.

Mr. ALLENDOERFER. Let us suppose that there may be a limitation on the amount available for the liquidating corporation with which to pay out the deposits of closed banks. Now, the experience has been that the wave of bank suspensions begins in the northeast section of the country, exclusive of New England, and rather spreads. That is a section where the bank units are large. If the funds of this corporation are going to be limited, I do not contemplate with pleasure the idea that that section of the country, with its large units, may have failures and that the funds of this corporation will be paid out in large percentage of liquidation of those banks that failed first, and when the banks out our way begin to fail, as they do later, as is usual in those waves, that the funds of the corporation will be exhausted.

Senator BROOKHART. The first wave was an exception to that rule. In these last waves we have had the failures began out our way.

Mr. ALLENDOERFER. They have not. During my lifetime all major waves of bank suspensions have come from the Northeast out toward us.

Senator BROOKHART. One of the first was the United States Bank failure in Louisville.

I think it hits the agricultural section first, and that starts the failures in the agricultural section of the country.

Senator BLAINE. You believe that the early failures will get all the money?

Mr. ALLENDOERFER. Yes. What I am getting at is, if there is not to be a market provided for these debentures and the amount of money available for liquidation is to be limited, whether there should not be some allocation of the funds available into Federal reserve districts, based on capital participation and ownership of debentures or something of that kind.

Senator GLASS. Some persons who have been interested in the passage of this bill have expressed the hope that this revolving fund will so accumulate as eventually to enable us to insure deposits in banks, to guarantee deposits in banks. I do not apprehend that it is going to be so meager that it can not take care of the bank failures of the entire country and we could not divide it up geographically.

Senator BROOKHART. If I remember, in 1920, when the representative of the Federal reserve system allocated $36,000,000, or rediscount privileges to the State of Iowa—well, even in starvation times they have $600,000,000 of crop production out there, and I remember the deflation that so-called allocation brought on. Would this plan of yours be somewhat similar to that?

Mr. ALLENDOERFER. You will recall that this has reference to the amount of liquidation which depositors will get from closed banks by the use of available funds in the hands of this corporation.

Senator GLASS. Senator Brookhart gave the Federal reserve system the compliment of saying——

Senator BLAINE. We have had two periods of bank failures within 10 years.

Mr. ALLENDOERFER. Yes.

Senator BLAINE. Do you think this fund would be sufficient within a 10-year period?

Senator GLASS. Senator Brookhart gave the Federal reserve system the compliment of saying that its rediscounts in that period in the State of Iowa were twenty-six times greater than the rediscounts of all the national banks in the United States put together before the adoption of the Federal reserve system.

Senator BROOKHART. Even if that were true, they were very small compared to our needs at that time in the crops.

Senator GLASS. I am talking about what the Federal reserve banks did.

Senator BROOKHART. They made this allotment, and I heard them say it. I know they said it.

Senator GLASS. You went far above the allotment.

Senator BROOKHART. We had $91,000,000 at that time, and they were calling us for that $55,000,000.

Senator GLASS. You went far above the allotment in one southern State.

Senator BROOKHART. There is no authority in the law.

Senator GLASS. No; but it was a practical proposition, and in one Southern State, whose Senators were more vociferous than any other Senators at all, they exceeded the allotment all the way. No member bank in the State was less than 50 per cent over its allotment, and several banks were 1,700 per cent over the allotment.

Senator BROOKHART. There was not any authority in the law for an allotment. That was a violation of the law.

Senator GLASS. It was not in violation of law. It was just a practical thing. The system wanted to prevent a few banks from "hogging" it all.

Senator BROOKHART. I have never seen the necessity of the Senator from Virginia defending that act of the Federal Reserve Board, because he has criticized them on other acts.

Senator GLASS. I would not. I was not defending the Federal reserve system. I was just telling you that the Federal reserve system gives you twenty-six times more credit than all the national banks in the United States combined have heretofore.

Senator BROOKHART. Yes. I saw letters early in 1919 from the Federal reserve system soliciting rediscounts and stating that we were not availing ourselves of the privilege in the Federal reserve system; that we ought to send more paper to rediscount. Then a year later, after we had done that, they were calling that paper and it put us into the worst deflation in the latter part of 1920 that agriculture has ever known in the West or anywhere else. I do not know this debate ever will end between Senator Glass and me.

The CHAIRMAN. We will continue it at some other time, Senator Brookhart. The witness may go on.

Mr. ALLENDOERFER. I should like to speak a word on section 11, page 25, which has reference to the discounting of the 15-day notes by member banks. I think I may suspect why this section was drafted, but it seems to me that as it is written it makes the normal operation among member banks pay a penalty. I do not just see why we should pay 1 per cent above the rediscount rate simply because we want to borrow for only a day or two or three days if

our bills payable are secured by eligible paper or by acceptances that are eligible or bonds of the United States. Why do we need to avoid paying that 1 per cent penalty rate by discounting a lot of notes to maturity and then have them taken up before maturity and refund of interest paid and all that kind of business?

Senator BULKLEY. Would it satisfy you to make the penalty apply only to loans secured by Government bonds and not to the loans secured by eligible paper?

Mr. ALLENDOERFER. Well, now, I have a suggestion on it which I will come to if I may in a moment.

Senator GLASS. Before you do that, let me supplement Senator Bulkley's question with this question: Would you agree to the balance of the section if you were to eliminate the penalty of 1 per cent altogether?

Mr. ALLENDOERFER. I might answer indirectly by suggesting an amendment to it. I am quite sure yes or no is not the right answer to that question. I do know that as the bill now stands it will have the effect of making holdings of Government bonds by banks tremendously less desirable than they are at present, for the reason that they may have to pay that penalty rate if they want to borrow.

Senator GLASS. They can rediscount with the support of United States bonds without paying the penalty.

Mr. ALLENDOERFER. Rediscount with the Federal reserve bank bonds?

Senator GLASS. They are available as security; yes. They may be used to strengthen eligible paper—United States bonds.

Mr. ALLENDOERFER. Without paying a penalty?

Senator GLASS. Yes.

Mr. ALLENDOERFER. But for a longer period than 15 days?

Senator GLASS. Yes.

Mr. ALLENDOERFER. Well, over on page 26 is a provision that the board may suspend this penalty provision, and so on for 90 days at a time and may renew that suspension for one 90-day period. I take it that that is aimed at an abuse of this 15-day discount period. Would it not accomplish the purpose that you wish, if instead of putting the penalty in, with the board having a right to suspend it, the penalty were not retained but the board were authorized to make a penalty for 15-day notes secured by Government bonds if desired and to allocate such temporary provision to specific districts if necessary?

Senator GLASS. Would you be astonished if told that the board has had that power for 16 years and has never exercised it?

Mr. ALLENDOERFER. I am astonished to know it.

Senator GLASS. That is a fact.

Mr. ALLENDOERFER. I am just a country boy. I am no expert on it.

Senator GLASS. That accounts largely for this provision here in the act.

Mr. ALLENDOERFER. That is a thought, then, Senator, to make the board do something that they had authority to and have not done for 16 years?

Senator GLASS. Why, certainly, it is a law, has been a dead letter, and it has been ignored, and that is the reason why a prominent

banker in New York ventured to tell the board to go to hell, that he would not do anything they told him to do.

Mr. ALLENDOERFER. May I ask, then, about this additional period of 90 days, how long would it be before they could make another suspension? If it can only be renewed for 90 days, can you at the end of one renewal then make a new suspension?

Senator GLASS. No. The intention there was to permit an extension of only six months periodically.

Mr. ALLENDOERFER. One hundred and eighty days. In the meantime, the normal operation of that which is convenient and safe and sound, I think, is interfered with in order to prevent the abuse of it, which could be done, it seems to me, by action of the Federal Reserve Board, putting the cart after the horse, instead of the order in which it is.

Senator GLASS. Will you pardon me if I explain again? Perhaps you did not hear the two other explanations or have not read them. What was the intent of the law that the normal operation under that section should be? It is just as clear as the day what the intent was. That 15-day provision was put into the act after the Federal reserve system had been in existence for two and a half years. It was not in the original act. It was put in there as a war measure, and its normal operation was intended to be to prevent a bank from being suddenly embarrassed overnight by any phases of the war activities. It was apprehended at the time, and accurately apprehended, that this country would get into the World War—it had not then gotten in—and that provision was put there then.

I remind you that at the time there were perhaps less than $100,000,000 of United States bonds that were available for this purpose, the balance of the less than a billion dollars of United States bonds being held by national banks for circulation purposes and by fiduciary funds, estates, and individuals.

So that there was that hundred million dollars that might be used for what was intended to be the normal operation of this provision. You can judge from that that it was not intended to be used in a frantic and riotous way for stock speculation purposes.

Mr. ALLENDOERFER. I do.

Senator GLASS. You can readily observe that it would have been impossible for us to have conceived at that time, for the Congress to have conceived at that time, that over a brief given period of six months that provision could be used for approximately one billion of dollars by as few as 10 New York banks alone. That is why it was put there.

Mr. ALLENDOERFER. I thought so.

Senator GLASS. And the normal use of it was so designed and it has been perverted.

Mr. ALLENDOERFER. I thought that was the intent. I thought it could be accomplished without interfering with the normal operation by reversing the order of the prohibition.

Senator GLASS. Well, I grant you that it might be accomplished without interfering with the legitimate and normal operation of the law, if we were to expunge the 1 per cent penalty. I am not saying that that would be in accord with my own judgment or under-

taking to forecast what the action of the committee or the Congress would be, but that might be accomplished in that way. So that when the provision gets beyond the realm of legitimate transaction, and I mean by legitimate transaction commercial uses, and is being adapted to frantic stock speculation, certainly it ought to be provided that upon warning from a Federal reserve bank and the board a bank that persists in that practice may be by order of the board suspended from the privileges of the Federal reserve bank. At least, that is my view.

Mr. ALLENDOERFER. I am not arguing that point.

Senator GLASS. You can not argue it. You can talk about it.

Mr. ALLENDOERFER. I could not argue it. All I have tried to get at is that as so set up it does interfere, it seems to me unnecessarily, with normal operations.

Senator GLASS. It interferes with what lately have been normal operations.

Mr. ALLENDOERFER. I do not want to trespass on the committee too long.

Senator GLASS. We are glad to hear you. At least I am sure I am, and I feel that I voice the opinion of the other members.

Mr. ALLENDOERFER. I have heard the discussion of Mr. Wolfe on the matter of reserves, and will omit that.

On page 31, line 3, in connection with the provision "for the sale and transfer of Federal funds," I think I know what you are getting at there. I think as written now it prevents normal transactions, which are not aimed at. The word "transfer" in its ordinary acceptance would cover such a situation as this: Our country correspondent member bank at Topeka, Kans., wishes to restore their balance with the Federal reserve bank, writes or wires us to charge their account, transfer to the Federal reserve bank, $10,000, $100,000, out of realized funds that they have with us.

Can it be the intent of this section that it covers a transaction of that kind?

Mr. WILLIS. Certainly not. Mr. Allendoerfer. because, as you say here, the words in line 7, "unless the Federal Reserve Board shall have first authorized by general order the making of such sales or transfers within such district," and so forth, and it is to be assumed as soon as this provision goes into effect, if it ever does, you would have circulars of the Reserve Board specifying exactly how these transfers should take place. Is that not a reasonable assumption?

Mr. ALLENDOERFER. Yes; if the Federal Reserve Board does it. But why not put it in here, that "other than balances to the credit of the transferring bank on the books of the member bank."

Mr. WILLIS. Where would you put that in?

Mr. ALLENDOERFER. I think you could put it at the beginning of the paragraph, that "except for balances to the credit of the bank asking for transfer, on the books of a member bank."

Senator FLETCHER. What page is that?

Mr. ALLENDOERFER. Page 31, line 3.

Mr. WILLIS. It seems to me just offhand that that is not at all touched by this.

Mr. ALLENDOERFER. It says "any transfer." That is a transfer on the ordinary banking——

Mr. WILLIS (interposing). No transfer of any balance standing upon the books of the Federal reserve bank—is that what you mean?

Mr. ALLENDOERFER. No, no; on the books of the bank making the transfer.

Mr. WILLIS. Then I do not quite understand you. The language is:

No member bank shall sell or transfer to another member bank or to a nonmember bank, private banking house, or banker, any balance standing to its credit—

That is, to the credit of the member bank.

Mr. ALLENDOERFER. Yes.

Mr. WILLIS (reading):

upon the books of the Federal reserve bank of its district.

Mr. ALLENDOERFER. The language that I am clumsily presenting as a revision is that "except balances to the credit of a bank on the books of a member bank, no member bank shall sell or transfer to another member bank."

Mr. WILLIS. I do not see how you bring this in as being already included. I am not trying to make difficulties or mere argument.

Mr. ALLENDOERFER. Well, I may not understand and perhaps I am all wrong. As I read it, it says that—

No member bank shall sell or transfer to another member bank or to a nonmember bank, private banking house, or banker, any balance standing to its credit—

That is, the member bank's credit—

upon the books of the Federal reserve bank of its district in excess of the balance required by this section, unless the Federal Reserve Board shall have first authorized by general order the making of such sales or transfer.

Now, why need an order of the Federal Reserve Board for us to transfer to the Federal reserve bank $10,000 of the balance of First National Bank of Topeka, Kans., with us to their credit?

Mr. WILLIS. Perhaps you mean to say that if you already have on the books credit of $10,000 that you want to be able to transfer it to them.

Mr. ALLENDOERFER. That is right.

Mr. WILLIS. There is no reason why you should not be allowed to give that in exchange for the $10,000 on the books of the Federal reserve bank.

Mr. ALLENDOERFER. Yes.

Mr. WILLIS. I do not see any reason why you should. It seems to me the board in making the regulations would cover that under this language.

Mr. ALLENDOERFER. It would seem to me so. In that same connection, at the bottom of page 31, line 23——

Senator GLASS (interposing). The way the thing has been operated the reserve with the Federal reserve bank has been reduced to a minimum.

Mr. WILLIS. Yes.

Senator GLASS. We tried to avoid that.

Mr. ALLENDOERFER. I am not getting at that point. Line 23:

and the liability created by every repurchase or other similar agreement entered into by a member bank shall be added to such net difference as ascertained under the provisions of this paragraph.

Does that "repurchase or other similar agreement" there have reference to dealings in Federal balances?

Mr. WILLIS. No; no reference to the Federal balance.

Mr. ALLENDOERFER. Then does that have reference to a situation where, if the First National Bank of Topeka—and there is no such bank—had sold us $200,000 worth of Government bonds at par and interest with their agreement to repurchase same; does that have to enter into figuring amount of our deposits?

Mr. WILLIS. Yes; if either bank had incurred a liability to repurchase anything, that is treated then as equivalent of a deposit.

Mr. ALLENDOERFER. If we are holding United States Government bonds which Topeka has agreed to repurchase from us, we are to regard that as a balance due us from the Topeka bank?

Mr. WILLIS. If I understand you correctly.

Mr. ALLENDOERFER. The situation is just this: The First National Bank of Topeka owns $200,000 of Government bonds. They want to use some money temporarily. They sell us those bonds at par and interest, with an agreement on their part to repurchase those at par and interest on demand.

Mr. WILLIS. Yes.

Mr. ALLENDOERFER. Where does such a transaction, which is apparently described in this wording, affect the amount of reserve which we have to have?

Mr. WILLIS. It leaves one bank liable for the putting up of the funds that it has agreed to supply, does it not? As you know, that repurchase idea has been very extensively availed of in recent years for the purpose of making a different appearance in an accounting way from that which would otherwise be made.

Mr. ALLENDOERFER. I can not get that, but I just do not see where that transaction has anything to do with our reserve requirements. Perhaps it does.

On page 33, if I may skip along a little, on line 17, referring to real-estate loans in connection with this investment in real-estate securities by national banks, it says:

> Investments in bank premises and unsecured loans whose eventual safety depends upon the value of real estate shall be counted for the purposes of this section as real-estate loans.

Now, in Senator Brookhart's State and in every Western State where a large part of loans are made to farmers, they are made to produce crops. The maker will pay if he raises a crop, will pay this year. If he raises no crop or gets no price, he will pay next year.

Senator BROOKHART. The last few years that has been turned around in our country. They said to them to "lay off these farmers. They can not produce anything in three or six months, the limits of the loans. You buy New York bonds, listed bonds." That is what they said.

Senator GLASS. Oh, we gave you farmers six and nine months.

Senator BROOKHART. But it takes three years to produce a steer, you know.

Mr. ALLENDOERFER. Those loans really depend upon real estate.

Mr. WILLIS. You call a farm real estate?

Mr. ALLENDOERFER. Yes; I would call a farm real estate.

Mr. WILLIS. Why is the word always repeated then in addition to farm loans?

Mr. ALLENDOERFER. Beg pardon?

Mr. WILLIS. I say, why do we distinguish between them here in the law?

Mr. ALLENDOERFER. I do not know.

Mr. WILLIS. Well, it is not fair to assume that where the two words are used in one place while in another one is used alone there is a difference between the meaning.

Senator FLETCHER. It may be farm loans on crops.

Mr. ALLENDOERFER. If real estate does not include a farm, why, I have said all I have to say on that.

Now, I would like to refer a little more to this savings matter, on page 33, line 20. For quite a while I have been very much interested in the thing that this is aimed at, I believe, and that is the safety of a savings depositor who, by reason of the possible requirement of notice on his balances, may not be permitted to withdraw from banks, whereas the customers in the commercial department get all of the money before the bank closes. There is a little argument in favor of it being left as it is, in that the savings customer gets a preferred rate of interest, and therefore gets compensated for his risk in that.

Senator GLASS. Largely that is not a fact, is it, that he gets a preferred rate?

Mr. ALLENDOERFER. Yes.

Senator GLASS. Do not the big borrowers get a rate on their bank balances that approximate the rate on time deposits?

Mr. ALLENDOERFER. No, sir.

Senator GLASS. They do not?

Mr. ALLENDOERFER. Not in our country.

Senator GLASS. They do not?

Mr. ALLENDOERFER. But I do not oppose teetotally the idea of segregation of assets as against savings deposits. I submit that it is awfully hard to do a good job of legislation in that respect at this time. In the first place, you are setting up there as assets to protect saving deposits 50 per cent of it in real-estate loans, possibly at least. Now, nothing could have been more unliquid during the last few months than real-estate loans, and yet I am perfectly willing to say that I have not lost my faith in real-estate loans. Some of the best performances that we have had for trust funds have been by the real-estate loans. But we are going through a time now where real-estate loans may justify themselves or may have additional reproach against their record. It can not be seen just yet.

Senator BROOKHART. You mean farm loans or city real estate?

Mr. ALLENDOERFER. Well, I will say both, Senator. I have faith in both and they are both making their record.

Senator BROOKHART. You mean there is security in a farm loan when farmers are getting 3 cents a pound for hogs and 25 cents for corn?

Mr. ALLENDOERFER. Yes. I still have some faith in those real-estate loans.

The CHAIRMAN. Is your hope based on any hope in the commodity price, or is it the hope that a farmer can produce hogs at 3 cents a pound?

Mr. ALLENDOERFER. No; it is based on experience. I know a number of farm loans which have been foreclosed on during the last few months, and the foreclosed property has been sold for cash for enough to pay the holder of the mortgage.

Senator BROOKHART. But he probably had a pretty low mortgage.

Mr. ALLENDOERFER. It was a good mortgage.

Senator BROOKHART. The joint-stock land banks are foreclosing those farms out in your country and mine now, selling them for little or nothing and buying in enough of bonds at 30 to 40 cents on the dollar and balancing their books.

Mr. ALLENDOERFER. As a class, I do not think that we should say that real-estate loans just ought not to be good assets for savings deposits.

Senator BROOKHART. I think real-estate loans ought to be as they were for 55 years, the best security we had in the world.

Mr. ALLENDOERFER. I still think that.

Senator GLASS. Yes; but for 55 years, under the national bank system, in fact until the Federal reserve act was passed, no national bank was permitted to have a real-estate loan.

Senator BROOKHART. That is true, and I think we got along until the Senator's Federal reserve bank came along with some of this deflation policy and things like that.

Senator GLASS. No.

Mr. ALLENDOERFER. Now, as to the rest of the investment of assets to be segregated for savings accounts, I would say this: The State of Missouri has a savings bank law under which very few banks have ever been organized, I think almost none operating at this time. It is totally antiquated. I presume your answer to that is, Missouri ought to pass a new savings bank act. Whose act shall they adopt? What savings bank act is satisfactory? New York State's is an excellent act. There have had to be suspensions, modifications, exceptions in it during the last year, due to the uncertainty of payment of securities which were eligible, and because of the failure of corporations to earn the amount which is required in order to make their securities eligible.

Senator BROOKHART. The Bowery Savings Bank was down here before this committee and claimed to be the biggest savings bank in the world, and it is organized almost as a cooperative. Some features are not cooperative. It has no capital stock. But through all of this, it has been prosperous and is rather more prosperous to-day than it has ever been.

Mr. ALLENDOERFER. An excellent bank.

Senator BROOKHART. And it has charged a low rate of interest and everything.

Mr. ALLENDOERFER. But the law governing their investments had to be waived this past year. I do not know whose savings bank law the State of Missouri could copy after.

Senator BROOKHART. I do not know whether it was stated or not, that the law had to be waived or whether securities were sold that took care of all their withdrawals without any trouble at all.

Mr. ALLENDOERFER. It was not the condition of that bank. What I mean is that the savings-bank law had to adjust requirements about their investments.

Senator BROOKHART. I think any cooperative idea makes for stability in the banking system, for that matter.

Mr. ALLENDOERFER. The requirements which they had in that law had to be waived this year. I do not see how anybody can write at this time a proper description of investments for savings accounts.

Senator FLETCHER. How do you operate your savings accounts?

Mr. ALLENDOERFER. They are merely part of the general assets of the bank and the general liabilities of the bank. There are no assets segregated to the savings liability. This act seeks to do that. What I am trying to say is that I do not see how they can write such a law defining the assets that may be segregated for the benefit of the savings customers at this time. That is one of the things I should like to have left for a period of two years, until there has been a better demonstration of the results of assets which are eligible for investment of savings funds in such States as New York.

Senator FLETCHER. Would this law interfere with your operation at all?

Mr. ALLENDOERFER. Oh, yes.

Senator FLETCHER. In what way?

Mr. ALLENDOERFER. It interferes in this way: We will have to segregate assets to meet our savings deposits. Those assets which we set over to meet those deposits may be 50 per cent in real-estate loans and the remainder may be in such assets as are permitted for the investment of savings banks in our State. Our law does not amount to anything in that. The answer is, you should have a new law. I do not know who can write that new law. There is not any savings bank act that I know of which can be taken as a perfect model at this time.

Senator FLETCHER. You are simply free to operate without regard to that?

Mr. ALLENDOERFER. No; we are not. We have a law limiting the investments of savings banks in Missouri, but that law is so antiquated that it is impossible to act under it.

Mr. WILLIS. Do I understand you to think that on this page 33, line 20, and the following, it does not meet that situation?

Mr. ALLENDOERFER (reading):

> Every such bank may apply the moneys deposited therein as time deposits to the loans herein authorized and the balance of such time deposits shall be invested in property and securities in which savings banks may invest under the law of the State where such national bank is situated, or where there is no such law relating to investments by savings banks, in such property and securities as may be specified by the Comptroller of the Currency.

Mr. WILLIS. That would not meet your case, you say?

Mr. ALLENDOERFER. No; we have a law, a savings-bank law. Banks have never operated under it. It is still in existence.

Mr. WILLIS. Would that be regarded as a law actually in effect, then?

Mr. ALLENDOERFER. It is in effect. It is on the statute books.

Senator BROOKHART. Do you ignore it?

Mr. ALLENDOERFER. If the law should be amended how should it be amended? Whose savings act of what State should it be copied after?

Mr. WILLIS. I think the thing to do would be to repeal it in that case.

Mr. ALLENDOERFER. Well, maybe that is it. On page 36, line 16, this 15 or 25 per cent which seems so confusing, I believe, has been clarified in some manner, I do not know just how.

The CHAIRMAN. What page?

Mr. ALLENDOERFER. Page 36, line 15, where it says:

nor shall the total amount of the securities so purchased and held for its own account at any time exceed 15 per centum of the amount of the capital stock of such association actually paid in and unimpaired and 25 per centum of its unimpaired surplus fund.

The CHAIRMAN. I do not think that any of the witnesses here found any fault with the intent of the bill. They wanted it clarified.

Mr. ALLENDOERFER. Yes.

On page 39, line 16:

No national bank or member bank shall perform the functions of a correspondent bank on behalf of any such individual, partnership, unincorporated association, or corporation—

Is it the intent by the words "perform the functions of a correspondent bank" to mean that we may not receive the deposits, pay checks, and handle the account in the ordinary course?

Mr. WILLIS. I do not so understand it; no.

Mr. ALLENDOERFER. It is a little vague to me just what it means.

Mr. WILLIS. What would you say was the difference between a correspondent bank and a depositary bank?

Mr. ALLENDOERFER. I do not know.

Mr. WILLIS. You never use the word "correspondent"?

Mr. ALLENDOERFER. "Correspondent" in our lingo refers almost exclusively to where we act as a depositary bank for another bank, and does not refer to where we act as depositary for a corporation, association, individual, and so forth.

Mr. WILLIS. Is not a correspondent in that case one who performs all banking functions for you in another city, as, for example, your New York correspondent?

Mr. ALLENDOERFER. Yes; that is right.

Mr. WILLIS. Performs all your banking functions that you have to perform in New York?

Mr. ALLENDOERFER. Yes.

Senator BROOKHART. If you have correspondents, then, in Kansas City you perform the same functions for them that New York does for you?

Mr. ALLENDOERFER. Yes; that is true. Does it mean that we can not handle the ordinary transactions?

Mr. WILLIS. If you were carrying a deposit account now for yourself in one of the New York banks would you refer to that bank as your correspondent in New York?

Mr. ALLENDOERFER. Yes.

Mr. WILLIS. Or would you refer to it as your depository bank in New York?

Mr. ALLENDOERFER. Correspondent.

Mr. WILLIS. That is a usage that is hardly in line with custom. Is not a correspondent bank a bank, or that acts for another bank, that performs full banking functions in another city?

Mr. ALLENDOERFER. Well, perhaps it is, but in our western language "correspondent bank" does not mean just what it does in your thinking.

Mr. WILLIS. Is there not a sharp distinction between "correspondent bank" and "depositary bank"?

Mr. ALLENDOERFER. Not in our parlance.

Mr. WILLIS. It certainly is in the usage in this part of the country.

Mr. ALLENDOERFER. I see.

Mr. WILLIS. But, of course, if there is a difference in usage anywhere, since this is a national statute, the language ought to be made clearer.

Mr. ALLENDOERFER. I thought it would be misunderstood over large sections of the country.

I am only going to mention one other thing. That is on page 48, line 7.

Mr. WILLIS. Before we leave that, may I ask you one further question about that?

Mr. ALLENDOERFER. Yes.

Mr. WILLIS. During the recent difficulties, you noticed, I presume, the cases in which it turned out now and then that a bank failure had occurred in one of our cities where investigation showed that it had a number of national banks as correspondents, although it itself was in some cases a private bank—an unincorporated private bank. Offhand would you think that that was a desirable situation or not, that a private banker, say, in New York, largely engaged in security dealings, should be the correspondent of a national bank?

Mr. ALLENDOERFER. No.

Mr. WILLIS. You agree entirely with the purpose of this provision?

Mr. ALLENDOERFER. Yes; but it does not say that to me. On page 48, line 7, the provision—

**and shall include in the case of obligations of a corporation all obligations of all subsidiaries thereof.**

I do not believe that that is a proper test of banking credit. Perhaps I can without offense point to a particular instance. If the General Motors Corporation should be a borrower from our bank and at the same time the General Motors Acceptance Corporation, a subsidiary connection with separate assets, also carrying an account with us, should borrow money from us, I should think it would not be a violation of good banking and good banking credit if we loaned both of them.

Mr. WILLIS. Of course, it probably would not, but in many instances you know from your large banking experience that it would be?

Mr. ALLENDOERFER. Where it should not be?

Mr. WILLIS. Yes; where the subsidiaries are organized for the purpose of obtaining larger credit?

Mr. ALLENDOERFER. Yes. But I do not believe that that is in here.

Mr. WILLIS. What would you suggest in place of that?

Mr. ALLENDOERFER. I do not have an offhand suggestion. I think it is improper to take the time of the committee while I fumble about for it. If you care to try me on guessing outside, I will be glad to do it.

The CHAIRMAN. Would you submit a draft of your suggestion that will cover that?

Mr. ALLENDOERFER. I will be glad to.

Senator GLASS. Yes, sir; we are not immune, sir, to good suggestions.

Mr. ALLENDOERFER. May I take your time for a second only to say that I have presented all of these things, some of them minor, some of them I think highly important, with the idea of stressing the need for more considerate thought on many of the provisions of this bill before it goes to Congress.

Senator GLASS. I would not like the implication to be that every provision of the bill has not had prolonged and critical consideration.

Mr. ALLENDOERFER. I am sure, Senator, you know there was no reflection, no intent to reflect, in my remarks.

Senator GLASS. No; there has not been any haste about it. There has not been any lack of care about it. It has been gone over and over and over again by a variety of experts.

Mr. ALLENDOERFER. The consideration by the general banking public has been very brief. I only got a copy of this a day or two ago.

Senator GLASS. My dear sir, a bill containing almost every single fundamental provision of this bill, with the exception of the liquidating corporation perhaps, and the last provision giving the Comptroller of the Currency authority to impose an intermediary penalty upon offending banks, was introduced by me on June 17, 1930.

The CHAIRMAN. That will soon be two years.

Senator GLASS. And it has been discussed ever since.

The CHAIRMAN. And seven volumes of hearings have been sent out to all who were interested in it. We have been at it a year now.

Senator GLASS. I can take you around to my office and show you a pile that high [measuring] of answers to questionnaires, operations of short sales, of long sales too, for that matter, speculative activities of the banks, every conceivable phase of banking.

Senator FLETCHER. That is to encourage you in the belief that all you have suggested will be complied with.

Senator GLASS. Not will be complied with; will be very respectfully considered though.

Mr. ALLENDOERFER. Thank you, sir.

The CHAIRMAN. It is late enough now. So that will be all until Monday, 10.30 Monday.

(Thereupon, at 5.10 o'clock p. m., the committee adjourned, to meet again at 10.30 o'clock a. m. on Monday, March 28, 1932.)