September 9, 1944

To: Chairman Eccles

From: L. M. Piser and D. M. Kennedy

Attached is the memorandum of the Executive Committee on speculation in the Fifth War Loan and proposals for the Six War Loan revised slightly to take into account Mr. Young's comments. Mr. Young does not agree with the suggestion for a 25 per cent down payment, a partial-payment plan, a reduction to $100 in the lowest denomination of marketable bonds, denying of the use of war loan deposits above a minimum percentage for banks that ignore the Treasury's request on speculative loans, or prohibition on trading in marketable issues until 15 days after the close of the drive. Since the Executive Committee had agreed upon those proposals, they have been retained in the memorandum.

We should like to add one additional suggestion that was mentioned in another memorandum to you. We believe that it would be advisable for the Federal Reserve by selling certificates, notes, and bonds to absorb part of the reserves that are released during the drive. If such a policy is carefully handled, it should reduce the expansion in bank holdings to the minimum amount that is necessary for war financing.

With respect to the fifth proposal, that the number of issues offered in drives that are available for bank purchase after the drive closes be reduced, we are of the opinion that certificates or short-term notes for corporations should be included, but not both. There are reasons both for and against the inclusion of 2 1/4 as well as 2 per cent bonds. If 2 1/4 per cent bonds are included, banks will purchase none of that issue and relatively small amounts of other issues that are sold by nonbank investors in order to increase subscriptions during the drive. If 2 per cent bonds are included, banks will purchase large amounts of both that issue and other issues, but purchases by nonbank investors for permanent holding will also be larger. Total subscriptions would be much larger, of course, for 2 than for 2 1/4 per cent bonds. If 2 per cent bonds are included, therefore, there is less chance that the Treasury will need to raise funds between drives.

After the Fourth War Loan, when 2 1/4 per cent bonds were included, the Treasury raised funds by selling additional bills, which were taken principally by the banking system. If 2 rather than 2 1/4 per cent bonds had been included in the Fourth War Loan, the increase in total bank holdings probably would have been no larger than was actually the case, and it might have been smaller. If Treasury requirements decline during the next few months, however, it is entirely possible that sufficient funds would be raised in a drive that included 2 1/4 rather than 2 per cent bonds to enable the Treasury to avoid a subsequent bank financing and consequently that a larger part of the debt would be held by nonbank investors.

LMP DMK

September 9, 1944

To: Chairman Eccles

From: D. M. Kennedy

Mr. Bell told me over the telephone that no decisions have been made with respect to the Sixth War Loan, except that it will take place in November and December. Representatives of the ABA are scheduled to meet with the Treasury on September 18 - 20. Following that meeting, Ted Gamble will hold a series of meetings with the State Chairmen. The Treasury would like to postpone the announcement of the drive until October 15, but they might have to announce it in the first week of October in order to provide time for printing. Mr. Bell said that he personally is going to begin work on the drive next week.

He gave me the estimates of the cash balance shown below. These estimates assume that 16 billion dollars will be raised in the drive, 12 billion in November and 4 billion in December, and that no additional bills will be issued prior to the drive. He is hopeful, however, that additional bills will be issued.

End of August	16.1 billion dollars
September	12.3
October	7.2
November	14.0
December	12.9
January	10.2
February	6.5

He did not project his figures beyond February, because of the recent favorable turn in the war picture. Our own estimates indicate somewhat lower war expenditures and consequent larger balances. According to our estimates, the balance will be 9.7 billion dollars at the end of February.

DMK

Sept 9 1944

STRICTLY CONFIDENTIAL

SIXTH WAR LOAN DRIVE

The Executive Committee of the Federal Open Market Committee has discussed the results of the Fifth War Loan, giving particular attention to suggestions that might be made for further improvement in performance during the next and succeeding drives. While recognizing the substantial accomplishments in increasing sales of Government securities to nonbank investors since the First War Loan in December 1942, the Committee is concerned about the large expansion in bank credit, the growth in speculative purchases, and the methods of indirect purchases of securities by banks that accompanied the recent drive. It is feared that these developments, which no doubt were profitable to those who evaded the rules, will lead to further evasion in the future, unless some simple and definite yardstick is provided for limiting subscriptions that can be applied when subscriptions are initiated. Under conditions that existed during the past drive, the Reserve Banks had no basis, except in the case of dealers and brokers, by which to impose effective and uniform policing of subscriptions and had to rely primarily on the commercial banks, inasmuch as the only subscriptions subject to policing were those that involved bank loans. It is the opinion of the Committee, therefore, that additional steps should be taken to curb undesirable practices and to increase the pressure for sales to nonbank investors, to the end that the proportion of the debt going to the banking system, particularly indirectly, may be further reduced.

At weekly reporting member banks, total loans on and investments in Government securities between June 7, the reporting date preceding the drive, and July 12, the reporting date following the drive, increased by 6.7 billion dollars. This total comprised 4.9 billion dollars of purchases of Government securities, 546 million of loans on Government securities to brokers and dealers, and 1.3 billion of loans on Government securities to others. A substantial part of the increase in bank investments and of the loans on Government securities to brokers and dealers represented securities that were sold in the market by nonbank investors desiring to increase their subscriptions in the drive. A considerable part of the loans on Government securities to others represented subscriptions that were made for the purpose of quick resale or to carry at a profit. In addition, there is evidence that a number of banks arranged with their customers, officers, directors, or affiliated corporations to place subscriptions during the drive, with the understanding that after the drive the banks would purchase the securities thus obtained. The loans that made possible these latter transactions are in direct contravention of the Treasury's request with respect to bank loans for the purchase of securities during the drive.

While no data are available as to the exact extent of these speculative and indirect purchases, it is evident from the figures of reporting member banks and from reports of sales in certain categories that such purchases were not only widespread but reached exaggerated proportions in certain localities. In eight States, sales of Series E bonds ranged between 83 and 121 per cent of quotas, but sales of other securities to individuals, partnerships, and personal trust accounts were disproportionately large, reaching more than three times the quota in Georgia and between two and three times the quotas in Alabama, Florida, Kentucky, Maryland, Mississippi, Oregon, and Tennessee. Such comparisons, together with knowledge of practices carried on in certain cities, created much dissatisfaction on the part of bankers and other members of the War Finance Committee organization and so impaired the usefulness of quotas.

Bankers who respected the Treasury's request and made no speculative loans and no special subscription arrangements with their customers or with others feel that they were placed at an unfair disadvantage in relation to their competitors who engaged in such practices. They resent purchasing securities at a premium from speculators when their competitors by virtue of prior arrangements have obtained the interest on loans, obtained the use of war loan deposits, and purchased the securities at or near par. Unless the Treasury takes strong steps to eradicate such practices, it is likely that other banks will follow them during the next drive, and sales organizations in communities that reached their quotas the hard but the sound way may be tempted to adopt the easier method. Few bankers would object to restrictive measures if they were satisfied that these measures were being applied uniformly.

With this background in mind, the Committee suggests consideration of the following measures to improve the situation:

1. The Treasury should appeal more strongly than heretofore for the wholehearted cooperation of commercial banks in complying with Treasury wishes regarding loans on securities offered in the next drive, and at the same time the Treasury should condemn the undesirable practices that developed during the Fifth War Loan and indicate that in the future any subscriptions not entered in accordance with the Treasury's request will be subject to rejection. Bank examiners should be requested to report transactions in apparent violation of the Treasury's request.

2. Subscribers for market issues, other than brokers and dealers, should be required to make a down payment of 25 per cent of their subscriptions from existing funds when entering subscriptions that involve bank loans. Policing of subscriptions from investors, other than brokers and dealers, by the Federal Reserve Banks is probably physically impossible because of their volume and timing when the drive technique is used. The only practical way to police or limit them, therefore, is at the commercial banks before they are entered and paid for. This method in any case would cause the least resentment. Since it is only those subscriptions involving bank loans that are subject to policing, it is the feeling of the Committee that the requirement of 25 per cent down payment will serve naturally to reduce speculative subscriptions and to bring about uniform action by the banks in all parts of the country. In this connection, banks should be required to certify on the subscription form that at least 25 per cent of the amount of each subscription has been paid in cash without borrowing from the certifying bank for the purpose and that they have no beneficial interest in such subscriptions.

3. The Reserve Banks should again police subscriptions from brokers and dealers, and the Treasury should provide a more specific yardstick, one that can be readily understood and uniformly applied.

4. A partial-payment plan should be inaugurated, and the lowest denomination of marketable bonds should be reduced from $500 to $100 in an attempt to increase subscriptions from permanent investors. These measures would also reduce the demand for securities between the drives and meet the reported demand from an increasing number of investors who would prefer to purchase marketable bonds rather than add further to their holdings or regular current purchases of Series E bonds.

5. The number of issues offered in drives that are available for bank purchase after the drive closes should be reduced. A substantial part of the speculation during the last drive arose from the fact that the basket included three issues available for bank purchase after the drive closed. The Treasury should recognize, however, that large quotas might be more difficult of realization if the number of issues eligible for banks were reduced.

6. Consideration should be given to denying the use of war loan deposits above a minimum uniform percentage to all qualified depositaries who ignore the Treasury's request concerning speculative loans.

7. Consideration should be given to a return to the practice of offering securities directly for commercial bank subscription. It is just as inflationary for banks to acquire securities indirectly as directly. If the indirect method serves to reduce bank purchases, it should be continued. If, however, it does not so serve, it would be preferable again to offer securities directly for commercial bank subscription. Banks might be permitted, as after the Third War Loan, to purchase a limited amount of securities shortly after the close of the drive, when their excess reserves are large. Such purchases should serve to reduce the amount of speculative subscriptions from nonbank customers, since the secondary demand would be reduced. The corporate but not the individual quota should be reduced by the amount of the offering for direct bank subscriptions.

8. Trading in the marketable issues included in the drive should be postponed until 15 days after the close of the drive. In lieu of this suggestion, banks might be required to list on a separate form all subscriptions involving loans above a specified amount or a specified percentage of the subscription, and delivery of such securities might be delayed until 15 days after close of the drive. The postponement of delivery of these securities would prevent a quick profit by speculators and give the Reserve Banks an opportunity to police the subscriptions after the close of the drive, when they will not be burdened with the work of the drive. The effect of such a provision might prevent many speculative subscriptions from being entered.

9. The Treasury should make no increase in outstanding bills during the drive. Increases in outstanding bills are taken largely by the Federal Reserve, thereby adding to excess reserves, and consequently stimulate bank purchases.

September 9, 1944