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April 11, 1935.

Mr. J. P. Thornton,
Vice President-Cashier,
The National Metals Bank,
Hancock, Michigan.

Dear Mr. Thornton:

It was kind of you to write me about my speech before the Ohio Bankers Association and I was glad to receive your comments about it.

The particular paragraph of my speech which you referred to in your letter dealt with the monetary situation existing in 1931-32 - a period of large gold exports, large currency withdrawals for hoarding and rapid deflation. The Federal Reserve Act at that time required that Federal Reserve notes shall be secured by a 100% collateral of gold or eligible paper placed with the Federal Reserve agents and that notes in actual circulation shall have a 40% gold reserve. Owing to the fact that eligible paper was held by the reserve banks in relatively small amounts, the majority of notes in circulation had to be backed 100% by gold. In order to relieve the pressure of liquidation, the Reserve System might have adopted a policy of purchasing government securities, thereby incfeasing the reserve balances of member banks. To do this, however, would have further decreased the reserve banks' holdings of eligible paper because member banks in such a period normally apply any Federal Reserve funds they receive to reducing their indebtedness at the Federal Reserve banks. This loss of eligible paper would have necessitated the pledging of gold to replace the paper which was then held as collateral behind notes, thus further diminishing the reserve banks' "Free gold" and further encroaching upon the legal gold reserve requirements. Therefore, the reserve authorities were deterred from following an open market policy designed to stem the tide of deflation.

Of course, the Glass-Steagall Act of 1932 corrected the situation by making government securities eligible as collateral for the issuance of Federal Reserve notes. However, this bill was an emergency measure which expires in 1937 and was passed only after much of the harm had been done. The proposed Banking Act of 1935 will prevent a reoccurrence of these difficulties.

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by completely abolishing the specific collateral requirements and simply providing that 40% gold reserve shall be maintained behind the Federal Reserve notes in actual circulation.

I hope this brief explanation has clarified the point which you raised. Enclosed are additional copies of my address.

Very truly yours,

(Signed) M. S. Eccles

M. S. Eccles,
Governor.

Enclosures.

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