BANKERS TRUST COMPANY
SIXTEEN WALL STREET
NEW YORK CITY

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S. SLOAN COLT
PRESIDENT

May 23, 1935.

Honorable M. S. Eccles,
Governor, Federal Reserve Board,
Washington, D.C.

Dear Governor Eccles:

While our views may not coincide with yours with respect to pending bank legislation, I do frankly want you to know how we have treated the subject of this bill and, therefore, I am enclosing copy of the letter and pamphlet which have been mailed to our depositors, trust customers and stockholders.

With best wishes, I am

Sincerely yours,

S. Sloan Colt

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# BANKERS TRUST COMPANY

NEW YORK
16 WALL STREET
FIFTH AVENUE AT 42ND STREET
MADISON AVENUE AT 57TH STREET

CABLE ADDRESS—NEW YORK—BANKTRUST
CABLE ADDRESS—LONDON—BANTRUSCOM

LONDON
26 OLD BROAD STREET, E. C. 2

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May 22, 1935

TO THE DEPOSITORS, TRUST CUSTOMERS AND STOCKHOLDERS
OF BANKERS TRUST COMPANY:

In our Annual Reports for the past two years and in other ways we have informed you on matters which we thought of current importance in Federal banking legislation affecting you in your relationships with Bankers Trust Company. The House of Representatives has now passed the Banking Bill of 1935 (HR 7617), ninety-two pages in length and containing proposals which would affect fundamentals in our banking structure and policy. In conjunction with banking representatives from all sections of the country we have been active in the preparation of information and its presentation to those who have the responsibility for drafting legislation affecting banking, but much that has been incorporated in the bill does not reflect the views of bankers nor the results of banking experience.

The matters which we desire to bring to your attention are contained in Titles I and II of the proposed legislation. Title I has to do with Permanent Federal Deposit Insurance and Title II proposes fundamental changes in the Federal Reserve Act. We have prepared and are enclosing for your information a pamphlet which we ask you to read. This pamphlet describes in some detail the important provisions of these titles which we believe vitally concern your interests.

Our objections to Title I are that it provides no termination to federal bank deposit insurance and that it imposes an assessment which would greatly endanger the efforts of bankers to build up the capital funds of their banks for the protection of depositors. In our opinion deposit insurance is wrong in principle because it encourages unsound banking, and is unfair in application because it penalizes the well-managed bank.

Under the proposed bill Bankers Trust Company would have to pay approximately $1,000,000. per annum for the support of this plan.

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Our chief objection to Title II is that it centralizes control over banking and credit solely in a politically appointed body functioning in Washington, without the checks and balances which form such an essential part of our Federal system of Government and without sufficient recognition of the local interests which now find representation in the regional system of Federal Reserve Banks. This is a fundamental objection, irrespective of any particular administration which may happen to be in power. While admitting, of course, the necessity for coordination of policy through the Federal Reserve Board as provided in the Federal Reserve Act, we believe it essential in the best interests of the Federal Reserve System and of our financial structure as a whole to maintain the strength and integrity of the individual Federal Reserve Banks. In any country, but particularly in a country as large as this and with such a variety of local problems, we believe it is unwise and unsound to vest the sole control over money and credit policies in a Board located in the political capital, all the members of which are politically appointed.

The pending bill is now under consideration by the Senate Committee on Banking and Currency. The principles involved are so serious that they may affect permanently the soundness of the American banking system and the credit structure of the country. We believe that they merit your careful study and that your Congressmen and Senators are entitled to know your views thereon.

Very truly yours,

S. SLOAN COLT,
*President.*

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# THE
# PROPOSED BANKING ACT
# OF 1935

**A Communication to the**
**Depositors, Trust Customers and Stockholders of**
**Bankers Trust Company, New York**
***May 22, 1935***

# THE PROPOSED BANKING ACT OF 1935

BELIEVING that in the consideration of any banking legislation the interests of the American people can be best served by placing the emphasis on the creation and maintenance of a strong banking system, we are submitting to you the following comments regarding the proposed Banking Act of 1935 now before Congress (H. R. 7617). You are interested in this matter not only from the point of view of the general welfare, but also as it affects your relationships with the banking system of today.

The proposed act is divided into three titles. Title I contains amendments to the permanent federal deposit insurance plan, Title II provides for certain changes in the Federal Reserve System, and Title III contains clarifying amendments to the existing banking law. The amendments in Title III are mostly technical in character and are generally approved in substance. Our discussion here will be limited to Titles I and II.

## TITLE I

### Federal Deposit Insurance

The permanent federal deposit insurance plan, which, unless changed, will go into effect July 1, 1935, imposes on insured banks an unlimited assessment on total deposits to be levied whenever necessary to meet the losses of failed banks. The proposed bill, as it passed the House of Representatives, provides for a fixed annual assessment upon all insured banks equal to 1/8 of 1 per cent of total deposits, as against the maximum 1/12 of 1 per cent recommended by the Administration. The cost to this Company would be roughly $1,000,000 a year for insurance of only 5% of its deposits.

In view of the poor earnings of banks at present and the strenuous efforts by banks throughout the country to rebuild capital structure to a point of safety, an assessment of 1/8 of 1 per cent of deposits would be unduly burdensome to most banks and, we believe, unwise. The truth is that any assessment at the present time will be paid out of the capital funds of most banks because their earnings are not sufficient to provide for the necessary operating expenses and write-offs. Partial figures available indicate that for four years, 1931-1934, the banks of the country as a whole have shown net losses after write-offs and, with reduced interest rates generally, the trend of earnings is still downward. The process of rebuilding the capital structure is a slow one, especially among the thousands of smaller banks whose sources of earnings have been sharply curtailed. The emphasis at the present time should be placed on strengthening the capital structure of banks for the protection of depositors rather than on speed in building up the deposit insurance fund.

Our position with reference to the general question of guaranty of deposits has not changed. As a temporary emergency measure, deposit insurance may have served a useful purpose but it should not be made a part of our permanent banking policy. At the most, it should be used only during the transition period until a stronger banking system can be developed. It is not and never can be a substitute for sound banking. On the contrary, in our opinion it is an invitation to careless and unsound banking. We are opposed to the principle of guaranty as a permanent measure and believe that its life as a temporary measure should be limited to a short period—not over five years.

## TITLE II

## Fundamental Changes in Federal Reserve Act

Title II of the Banking Bill proposes fundamental changes in the Federal Reserve System. The two chief purposes of these proposed changes are, *first,* to concentrate control in the Federal Reserve Board in Washington and to curtail the powers of the individual Federal Reserve Banks, and, *second,* to liberalize the lending powers of the member banks and to broaden the character of assets which member banks may use to secure funds from the Federal Reserve Banks, either through rediscounting or borrowing.

## Concentration of Credit Control

The concentration of credit control is to be accomplished by placing in the Federal Reserve Board full power over open market operations, over the reserve requirements for member banks and over discount rates charged by Federal Reserve Banks.

One of the most effective instruments of monetary policy is known as "open market operations." This means the buying and selling of government obligations and acceptances in the markets by the Federal Reserve Banks for the purpose of affecting the total supply of member bank reserves. Furthermore the power is broad enough to include the buying of government obligations directly from the Treasury. At present open market policies are initiated by the Federal Reserve Banks, subject to the approval of the Federal Reserve Board. Under the proposed bill, the Federal Reserve Board would be given sole power to determine open market policies and the Federal Reserve Banks would be legally obligated to carry out such policies no matter how strongly they might disagree therewith. The effect of the change would be to lodge this extremely important power solely in the hands of a politically appointed body functioning in Washington. In this connection, the following comment of the President, in his radio address on April 28, 1935, is pertinent: "The most difficult place in the world to get a clear and open perspective of the country as a whole is Washington."

It seems to us that on the all important open market committee the Federal Reserve Banks, located in different sections of the country and with a closer knowledge of commercial, industrial and agricultural needs than a Washington board could possibly possess, should have representatives with full voting power.

The pending bill also proposes to give the Federal Reserve Board the power to determine and vary at will the reserve requirements for member banks; that is, the proportionate amounts of their own deposits which the member banks must keep on deposit with the Federal Reserve Banks. This change will give to this politically appointed body the most powerful weapon ever placed in the hands of a central bank. Under the present law, the Board may change the reserve requirements under emergency conditions with the approval of the President. Under the new bill, the Board, without securing the approval of the President and without declaring that an emergency exists, could make the reserve requirements 100% of member bank deposits which would mean the end of credit banking as we know it today, or 1% which would tend to encourage unlimited credit expansion and inflation.

We do not believe that such a power as this should be given to any board anywhere, and we see no reason to change the provisions of existing law on the subject of reserve requirements. The banks of the country are accustomed to doing business under the existing requirements, which already make provision for changes to meet emergency conditions, and we believe it would be highly disturbing to the country's banking business and thoroughly unsafe as a matter of general policy to give the Federal Reserve Board or any other board the power over bank reserves which this bill proposes.

Under the present law the Federal Reserve Banks have the power to initiate changes in the interest and discount rates which they charge, "subject to the review and determination of the Board." In practice this order of procedure has generally been followed, although there have been exceptions, and the Board considers that it has the right to initiate changes as well as to approve them. The bill which has passed the House clearly seeks to resolve the question of initiating rate changes in favor of the Board. We do not see the occasion for any change in the law on this subject.

With the additional powers discussed above, the Board would have practically complete authority over the three instrumentalities of credit control, namely, open market operations, reserve requirements and discount rates. Furthermore, the bill provides that the appointment of the Governor of each Federal Reserve Bank shall be subject to the approval of the Federal Reserve Board every three years. The Federal Reserve Banks would thus become largely operating branches functioning under the control of the Board in Washington. They would tend to lose their local character and independence and it would become increasingly difficult to find men of first-rate ability to manage them.

The danger to our banking system involved in this centralized domination is serious. The government would control at one and the same time both the borrowing power and the lending power and this at a period when an unbalanced federal budget seems to have become a chronic condition. Under this situation, the test of sound finance need never be applied to the government's own activities, and there can be no checks on government borrowing and spending except those which the government may choose to impose upon itself. Unrestricted borrowing by governments from their central banks has practically always been accompanied by serious inflation.

Fiscal needs at times are bound to run counter to the demands of sound credit control. Central banks are frequently called upon to pursue an unpopular course of action. Experience shows that the popular course, the politically expedient course, is all too often a policy of easy credit when the situation requires a restrictive credit policy. Thus, early in 1929, the Federal Reserve Board refused to adopt a restrictive credit policy notwithstanding the fact that the Federal Advisory Council, made up entirely of bankers, was strongly urging restrictions through increasing the rediscount rates. For several weeks during a period running from February to May, 1929, the directors of the Federal Reserve Bank of New York voted an increase in the discount rate from 5 per cent to 6 per cent, but the increase was not approved by the Federal Reserve Board.

## Broadening Member Bank Borrowing and Lending Powers

The pending bill grants to the Federal Reserve Banks, subject to regulations of the Federal Reserve Board, much broader powers than they now have to rediscount paper for member banks and also provides that the Federal Reserve Banks may lend to member banks on their own notes secured by any "sound" assets. The bill also would increase the powers of member banks to make loans on the security of real estate.

The framers of the original Federal Reserve Act intended that federal reserve credit should be based chiefly on short term self-liquidating paper arising out of industrial, commercial and agricultural transactions. In this way it was thought that federal reserve credit could be restricted to the commercial requirements of the country and not used for capital or speculative purposes. Later, member banks were empowered to borrow directly from Federal Reserve Banks on government securities, and the new bill would relax the standards further so that member banks may borrow in the normal course of business on any "sound" assets.

It is probably desirable to broaden borrowing facilities to be used in periods of emergency, but we question the wisdom of making broader facilities available in the normal course of business. Greater borrowing facilities would not have prevented the banking practices which led to such heavy losses and necessary liquidation in recent years. It seems probable to us that the effect would have been just the opposite. The remedy for such mistakes as were made during the 20's lies in more consistent adherence to conservative banking policies rather than in easier borrowing facilities. To assume that lessened restrictions on the borrowing power of member banks would prevent losses from improvident loans and investments is to ignore realities.

## Recommended Changes by Special Committee of ABA

A special committee of the American Bankers Association, which represents bankers in all parts of the country, wrote to

Chairman Steagall of the House Committee on Banking and Currency, under date of March 22, 1935, recommending certain changes in the bill which were designed principally to minimize political domination of the Federal Reserve System. The most important of the committee's suggested changes which had not already been recommended by the Governor of the Federal Reserve Board may be summarized as follows:

(1) Reduce the Federal Reserve Board from eight members to five by retiring from the Board its ex-officio members, namely the Secretary of the Treasury and the Comptroller of the Currency, and reducing the appointive members to five as soon as a vacancy occurs;

(2) Provide that the members of the Federal Reserve Board, including the Governor, shall be removable during their terms of office only for cause;

(3) Provide that the open market committee shall consist of the five members of the reduced Board and four Governors of the Federal Reserve Banks, the latter to be selected by the Governors of the twelve Federal Reserve Banks annually, the committee to be entrusted with open market policy, changes in discount rates and changes in reserve requirements.

These suggested amendments of the special committee of the American Bankers Association are in the right direction and, if adopted, would modify some of the objectionable features of the bill. They would tend to lessen political domination of the Board and preserve for the Federal Reserve Banks some voice in the determination of policies. They were not incorporated in the bill as it passed the House of Representatives.

## Conclusions

The Federal Reserve System was established only after years of intensive study and scientific research in the principles and practices of central banking. The proposals in Title II would radically change the basic principles underlying the System. No one would claim that the System has operated perfectly or that some change might not be wise. Without further time and study, however, it is hardly possible to get general agreement on what changes should be made.

Title II cannot cure the major defects in our banking system. It does not even recognize them. No plan of politically managed credit control can take the place of sound credit policies. Emphasis must be placed on the quality of credit as well as on control of the quantity. Unless we are willing to set up a banking structure and devise a system of supervision which will prevent the kind of banking that led to our recent difficulties, there is no way we can avoid the consequences.

There are facts in the records of the various supervisory officials as to the causes of our banking troubles in recent years and as to present banking conditions which should be made available to those who are called upon to endorse this legislation or pass upon it in Congress. A compilation and analysis of these facts would furnish a clearer picture of our fundamental banking problems than we now have, and would supply the basis for handling these problems with the understanding and foresight essential to their successful solution.

No emergency exists which justifies the speedy enactment of Title II without adequate analysis and discussion of the problems and principles involved. The Banking Act of 1933 and other legislation has given to the Federal Reserve Board and other authorities very broad powers to check speculative activities and other unsound banking practices and to prevent over-expansion of credit. These powers include the right to limit the amount of collateral loans by any member bank, to restrict or suspend Federal Reserve credit facilities to those banks following unsound credit policies, to remove for cause officers and directors of member banks and to increase reserves under emergency conditions. It is difficult to see how Title II can add to the effectiveness of these controls or why additional powers are necessary. We believe that the passage of Title II should be postponed and that further consideration be given to the questions involved.