BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date January 13, 1948

To Chairman Eccles

Subject: Dealing in International Bank securities

From Mr. Knapp

From the papers which Mr. McCloy has sent to you, it appears that the Bank is asking the Council to submit to the Congress an omnibus bill which would:

(1) Exempt International Bank securities (direct or guaranteed issues) from the limitations contained in section 5136 of the Revised Statutes. This exemption would permit member banks of the Federal Reserve System to underwrite, deal in, and invest in International Bank securities without limitation. This status is presently enjoyed by bonds issued by the U.S. Government, any State or political subdivision thereof, the Federal Home Loan banks, and the Home Owners Loan Corporation, and obligations issued under authority of the Federal Farm Loan Act.

(2) Exempt International Bank securities from the requirements of the Securities Act of 1933. This exempt status is now enjoyed by U.S. Government securities and securities issued by any State or any political subdivision thereof.

(3) Exempt the securities from the requirements of the Securities Exchange Act of 1934. This exempt status is now enjoyed by U.S. Government securities and securities issued by any State or any political subdivision thereof.

(4) Exempt the securities from the requirements of State blue sky laws.

(5) Make the securities eligible for investment by D.C. insurance companies.

In short, the Bank argues that in view of the special character of the institution, and in view of the control of its operations by the National Advisory Council through the U.S. Executive Director, the Bank should be freed of all the limitations and requirements to which non-governmental securities are subject in this country.

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1. Exemption under banking laws

You will recall that the Aldrich Committee originally suggested the desirability of having member banks deal in International Bank securities and

that for this purpose they suggested increasing the limit on member bank holdings of these securities from 10 per cent to 20 per cent of capital and surplus. The Council considered this problem in November 1946 and took a firm stand against increasing the 10 per cent limit.

Subsequent discussion in the Council revolved around the question of whether banks should be allowed to deal within the 10 per cent limit. This question was settled for the time being at a meeting of the Council in April 1947 at which, upon your strong recommendation, the Council rejected the idea of member bank dealing. However, at that time you took the position that dealing by member banks was not necessary to assure the success of the Bank's debenture issues, and that "if legislation were necessary a year hence to insure the marketing of the Bank's securities, you would be prepared vigorously to back such legislation". The full text of your remarks from the N.A.C. minutes follows:

> "Mr. Eccles said that he had had discussions with Mr. McCloy, Mr. Sproul and Mr. Black on this matter. Mr. Sproul had agreed with Mr. Eccles that even if legislation were easy to obtain at this time it would not be advisable to do so for market reasons. If the Bank were contemplating a billion dollar issue the situation would be different but with an issue of $250 million there would not only be no need for such legislation but there might be certain dangers. If banks were permitted to deal there could be considerable speculation in a $250 million issue which might force the bonds to a substantial premium. If this occurred the next issue would have to be priced on a lower basis than would be desirable and the issue would probably subsequently drop below par or would need market support.
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> "Mr. Eccles stated that he was not arguing the question as a matter of principle but rather in the interest of the Bank. If legislation were necessary a year hence to insure the marketing of the Bank's securities he would be prepared vigorously to back such legislation."

The Bank will no doubt argue that in view of the decline of International Bank securities in the market to their present level of about 95, a case has been established for the necessity of member bank dealing. It should be borne in mind, however, that most if not all of this decline has reflected the general adjustment of the bond market (I am having some material prepared on this subject).

You may also desire to raise the question of why the Bank has not itself undertaken some stabilizing operations in the market for its securities. The Bank has authority to engage in such operations under its Articles of Agreement.

2. Securities Act of 1933

In earlier discussions of this subject the Bank requested and obtained an exemption from the section of this Act imposing civil liabilities of underwriters upon distributors of International Bank securities. The Bank is now asking for blanket exemption under this Act, however, in order to achieve the following principal purposes:

(a) removal of the ordinary civil liabilities of dealers from distributors of International Bank securities (it is argued that commercial banks even if authorized under the banking laws will not engage in dealing unless this liability is removed);

(b) removal of restrictions on the Bank's negotiations with distributors prior to the effective date of this registration statement;

(c) relief from the obligation to file a registration statement.

3. Securities Exchange Act of 1934

In previous discussions the Bank initially requested blanket exemption from the requirements of this Act, but as a result of a compromise it accepted concessions from the S.E.C. on two minor points. The Council specifically rejected the Bank's request that it be exempted from the anti-manipulation clauses of this Act and from the section of this Act (and Federal Reserve Board regulations issued thereunder) imposing margin restrictions on loans by brokers and dealers (but not banks) against International Bank securities.

The Bank is now renewing its request for blanket exemption in order to secure freedom from these restrictions and in order to avoid the necessity of filing "burdensome" registration statements. Incidentally, on the question of exemption from the anti-manipulation provisions, the Bank argues that supervision by the S.E.C. is unnecessary in view of the fact that the Bank is obligated to keep the Federal Reserve Bank of New York fully informed concerning its market transactions. I have called this matter to the attention of Mr. Rouse, who assures me that he has no desire to take over the S.E.C.'s responsibility for policing the Bank's operations.

4. State blue sky laws

So long as the International Bank securities have been registered with the S.E.C. they have been automatically freed from the restrictions of blue sky laws in a large number of States. If they were now no longer to be registered with the S.E.C., the blue sky laws become a serious problem, and the Bank recommends dealing with the situation through Federal legislation over-riding the State blue sky laws. While this may be legally feasible, it certainly raises major questions of policy concerning Federal-State relations.

5. Investment by D.C. insurance companies

This matter is non-controversial. Secretary Snyder sent a bill up to the last session of Congress to accomplish this purpose, but the bill was not acted upon.

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Since writing the foregoing I have talked on the telephone with Mr. Rouse, who read to me a memorandum which he sent to Mr. Sproul on December 11 concerning the question of member bank dealings in International securities. In this memorandum Mr. Rouse states:

> (1) that the New York banks have been among the weakest holders of International Bank securities, i.e., that they were the first to sell when the decline commenced. He draws the moral that it would be very little help to the market for International Bank securities to have member banks obtain dealing powers.
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> (2) that under the circumstances it would be undesirable to make a breach in the basic philosophy of the Banking Act of 1935 by allowing member banks to deal in International Bank securities.

Mr. Rouse said that Mr. Sproul expressed his agreement with these conclusions and that they both felt strongly that even if member banks were allowed to deal, the 10 per cent limit should not be increased.