

**FEDERAL RESERVE BANK**  
**OF CLEVELAND**

November 26, 1938

Hon. M. S. Eccles, Chairman  
Board of Governors of the  
Federal Reserve System  
Washington, D. C.

Dear Mr. Chairman:

I have just finished reading your remarks made at the conference of Federal Reserve Bank Examiners on Tuesday afternoon, November 1, and I wish to congratulate you on the position you take. I have not read anything for a long time which impressed me as much. My only regret is that it is not for release or publication.

It is unfortunate that our member banks do not have knowledge of your views concerning the matter of examinations and of the great work you have done toward preserving the Federal Reserve System.

Your remarks relative to paper other than the old so-called "eligible" paper interested me greatly. My experience as manager of the local agency of the Reconstruction Finance Corporation in 1932 has been of great value to me. Looking back upon those loans, I believe that in the application of purely cold figure facts a great many injustices were done simply because we were confined to markets and without any consideration for intrinsic values. Markets, you know, controlled loan values in so far as securities were concerned, either directly owned by or offered as collateral on loans made by banks. An arbitrary percentage was set up for loan values on unsecured paper and on mortgages, the latter, of course, running from about 75% down to a very small percentage. I made the statement early in the days of the local agency that the unsecured paper would pay out first. Some of my advisory committee did not agree with me but history has proven that I was right.

Getting back to the question of intrinsic values, let me cite an instance - the Cleveland Cliffs Iron Company, which is a very large and, today, very strong corporation in this district; the company owns, perhaps, the second largest amount of available ore in the country. In 1932 the stock was down to \$3.00 per share; today, it is quoted \$61.00 to \$63.00 per share. At that time, the company had obligations held by banks amounting to approximately twenty some odd million dollars and, if I remember correctly, about four million dollars of interest. When notes of this company were submitted to me as collateral on an R. F. C. loan, I was very much concerned. The application for the loan was made in June of 1932, the company's notes maturing in January of the following year. I had visions of the control of the

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company passing out of the city of Cleveland but, luckily, through renewals and better conditions the last eight million dollars odd was paid by the Cleveland Cliffs Iron Company in liquidation of the obligation. We had statements of the various affiliates of the company; the trust indenture was about two inches thick, and as the demand was insistent for a loan upon these notes, I arbitrarily placed a value of 60% of the face value of the notes, not having sufficient time to make a real investigation of all of the constituent companies.

This may not be entirely clear to you, but what I am endeavoring to show is that there was, and is, a very large amount of intrinsic value in the ownership of the Cleveland Cliffs Iron Company. I have been firmly convinced since 1932 that the procedure under which the loan agencies operated went a long way toward deflating values. Many banks sold securities at prices which were slightly in advance of loan value in order to procure more money than they would have procured from the R. F. C. Real estate mortgages were sacrificed and I have been of the opinion for a long time that if the Federal Reserve System had been in position, by law, to have done a "real job" in 1932, the System would not have been so unfairly criticized during the last few years.

Isn't there some way that the System can place before the country its position in so far as all assets of a bank are concerned? If this can be accomplished, we will have gone a long way toward improving the standing of the System.

Bankers should know that the 10(b) section of the Act is now permanent; it has been brought to their attention many times, but the businessman and the public generally have no knowledge of this facility, which I believe would go a long way toward preventing a recurrence of such terrible conditions as arose in 1931 and 1932.

I was particularly pleased with your reference to the matter of men in the field refraining from making criticisms. I do not know how many examiners there are in the System but I presume there must be close to three hundred, and I am glad you have suggested these examiners be "fact-finding" men, referring matters of policy and criticism back to the officer in charge of examinations at the Federal reserve banks. This procedure would confine differences of opinion to possibly only twelve men, where, under the present procedure, every man in the field has his opinion and, in many cases, does not hesitate to state it. Naturally,

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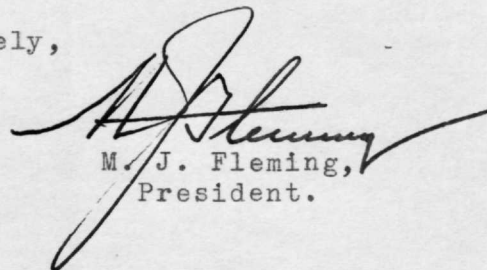
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with so large a force, it is impossible to have a clear understanding of policy. The procedure you outline would go a long way toward eliminating criticism of the examination function of the Federal reserve banks.

Yours very sincerely,



M. J. Fleming,  
President.

F-B

November 30, 1938

Mr. M. J. Fleming, President  
Federal Reserve Bank of Cleveland  
Cleveland, Ohio

Dear Mr. Fleming:

This will acknowledge your letter of November 26 in which you comment on the remarks I made at the Conference of Federal Reserve Examiners here in Washington on November 1, copies of my remarks having recently been distributed to each of the Reserve banks. It is naturally gratifying to me to have you compliment my brief address so highly.

While my remarks at the Examiners' Conference were not intended for publication, I do not see that the matters contained therein are confidential, in fact, I think it would be helpful if bankers generally were aware of the underlying principles behind the revised examination procedure. Therefore, I see no objection whatever to your furnishing copies of the paper to any bankers who you think would be interested.

With kind regards, I am

Yours sincerely,

M. S. Eccles  
Chairman

LC/fgf

