

STRICTLY CONFIDENTIALR&S 100-1724
October 15, 1945

To: Board of Governors

Subject: Government security dealers

From: L. M. Piser

Several matters relating to Government security dealers were discussed in a letter dated September 11, 1944, from Chairman Eccles to Mr. Sproul and by the Chairman at the meeting of the Executive Committee on September 21, 1944. Three of these matters have been settled since that time. First, the members of the Executive Committee have received an analysis of the dealers who failed to qualify. Second, they have received each month a report showing the amount of transactions for the System Account with each dealer and broker. Third, Mr. Rouse reported that the New York Reserve Bank has encouraged the dealers individually to adopt desirable rules of conduct and has encouraged the dealer group to strengthen its organization and to endeavor to eliminate market practices that cause criticism.

The remaining four matters, however, have not been settled. First, the Chairman suggested that the Executive Committee be advised of any instances when the position of a dealer reaches an abnormally high level, of any action that is taken by the New York Bank regarding the position of a dealer, and of the response by the dealer to this action. The Chairman also mentioned that the earlier drafts of the dealer terms included a provision that the amount of borrowings by any dealer should not exceed ten times his net worth, that this provision subsequently was discarded on the grounds that the objective could better be attained by continuing the existing informal supervision over the positions of dealers, and that, although ten times the net worth of a dealer might not be a satisfactory measure, some maximum should be established and any instances when that maximum is exceeded should be reported to the Executive Committee. Mr. Rouse's reply to this suggestion was that the amount of dealer borrowings should not be limited by any rule or regulation and that, on matters of general policy such as this, the Executive Committee should, in his opinion, express its views and should make the details of the application of such policy a responsibility of the Bank.

Second, the Chairman suggested that the Executive Committee recognize at least informally the present commission of $1/64$ of a point on transactions with dealers for the System Account in notes and bonds and the present limitation to exceptional cases of transactions in these securities on a net basis and that the Executive Committee establish a commission of perhaps 0.01 per cent on transactions in certificates. Regarding the latter part of this suggestion, Mr. Rouse felt that a differential of 0.01 per cent, while satisfactory on the longer maturities of certificates, would not permit the dealers to make a reasonable profit on the shorter maturities. He suggested that, if the Executive Committee wants to issue formal instructions, the instructions be sufficiently broad to permit the Bank to operate within the range of a maximum commission, rather than at set commissions for each type of security, and that the instructions limit the commission to no more than $1/32$ of a point.

Third, the Chairman suggested that the annual statements of condition of qualified dealers and brokers include the following items: (1) holdings of Government securities, by issues, (2) Government securities borrowed, by issues, (3) borrowings from banks, trust companies, and other financial institutions, (4) borrowings from officers and directors, (5) borrowings from others, (6) loans to officers and directors, and (7) net worth. In reply Mr. Rouse said that, with the exception of the detailed lists of securities owned and securities borrowed, all of the suggested information ordinarily is obtainable from the annual statements and that the dealers' long and short positions by groups of issues are reported to the Bank on a daily basis. He said that, if the Executive Committee so desires, he would be glad to forward copies of the financial statements and of the analyses prepared by the Credit Department of the Bank.

Finally, the Chairman suggested that the Reserve Bank Presidents be requested to furnish to the Executive Committee a record of any information that they may obtain in the future regarding violation by dealers of the terms. Such a record would include information that dealers have induced customers to sell when purchases were being made for the System Account, that dealers have made recommendations to customers that had the effect of disturbing the market, and that dealers have manipulated quotations in order to increase their transactions. In reply Mr. Rouse suggested that, if such reports are made, they should be authenticated in so far as possible and forwarded to the Bank for further investigation.

GOVERNMENT SECURITIES SECTION, BOARD OF GOVERNORS