CONFERENCE OF FEDERAL RESERVE GOVERNORS,

SECOND DAY.

Friday, March 21, 1919.

10 o'clock a.m.

The Conference reassembled at 10 o'clock a.m., pursuant to adjournment.

Present: The Governors of the Federal Reserve Banks, as indicated on yesterday's record.

Present also, Mr. E. R. Kenzel, Manager of Investments, Federal Reserve Bank of New York.

Governor Benjamin Strong, Jr., of the Federal Reserve Bank of New York, (presiding).

PROCEEDINGS.

The Chairman: The meeting will come to order.

Since the meeting yesterday, Mr. Leffingwell and I have had a little discussion about the status of the bills that Mr. Hines referred to yesterday as under contemplation as a means of helping to finance the railroads. I have taken the liberty of saying to Mr. Hines that the discussion is rather bare of details, and necessarily so, because it was a large meeting, and that if he would care to join the meeting this morning for a few minutes I thought he might get some information from the officers of the reserve banks as to what could be done with the bills, and what difficulties he would encounter. I just have word from Mr. Hines that he will be here in a few moments.

Before Mr. Hines comes, I would like to take up a matter which is not on the program: The general proposal of the Director General of Railroads for financing over a period of a few months, contemplates, as he explained, two methods. One is to issue certificates of indebtedness, or whatever they may be called, which to some extent will be used as collateral to loans at banks, and to some extent it is expected they will be purchased by the War Finance Corporation. They have assured me that no question of legality can possibly arise as to those obligations. The Director General can, it seems, make a certificate or an obligation of the character proposed to the War Finance Corporation. The War Finance Corporation is contemplating making an issue of bonds aggregating about $200,000,000, in the expectation that that will reimburse the Treasury for advances made or contemplated to the railroads, and put in their possession sufficient funds to very much enlarge its purchases of existing issues of Liberty Bonds and rather improve the market position of all the issues.

I have talked it over with Mr. Leffingwell and Mr. Meyer, of the War Finance Corporation, and they have finally suggested this tentative plan: That an issue of bonds of $200,000,000 be made and offered, the maturity of which shall be, at the option of the subscriber, either one year or eighteen months; that the notes or bonds shall bear 4-3/4 per cent interest, in order not to cause any unfavorable influence upon the price of existing Government securities (like the certificates of indebtedness or the Liberty Bonds); that if any additional concession is made in price, it would be made by a small discount from par. They suggest, inasmuch as the Secretary proposes to withdraw from the market entirely one issue of certificates of indebtedness, that this offer be made now and just exactly as though they were certificates of indebtedness of the Treasury, with a full explanation of the character of the obligation, and with the urgent request that the banks distribute them so as to realize possibly a profit from the discount. Their feeling is, that the organizations of the Reserve Banks, which have been so successful in selling certificates of indebtedness, should find very little difficulty in distributing as much as $200,000,000 of these bonds or notes, even though they had a year's maturity. In our district, I think we could sell a good many. It depends a little upon the amount of discount allowed to the banks.

The question for us to discuss possibly with Mr. Meyer himself later, is: First, what is the obligation of the War Finance Corporation, and how good is it? Second, are the terms that they are discussing right. Can the bonds be sold on those terms?

The provision for tax exemption is the same as in the Second Liberty Loan, complete exemption from all taxes on an income from not over $5,000 of these bonds, and I think they are also exempt from normal tax.

Governor Peple: Is that an additional five thousand or is it a part of the original five thousand?

Governor Strong: It would be in addition to the exemption now permitted on Liberty Bonds.

Governor McDougal: Do you know what they would be expected to net the banks?

Governor Strong: They would be expected to net the banks at least five per cent. They have discussed a discount of one quarter to three eighths of one per cent, depending upon maturity.

After examining the statements of the War Finance Corporation, and realizing how absolutely good those certificates are, beyond any peradventure, and realizing the tremendous margin of assets, I should think that five per cent would be all they should pay for a year's loan.

Governor McDougal: The Government is behind them?

Governor Strong: The Government is not directly obligated on the bonds.

Governor McDougal: Are they indirectly obligated?

Governor Strong: No, except morally.

Governor Wold: The Government has $500,000,000 in capital stock in the War Finance Corporation.

Governor Strong: If these certificates or bonds should not be paid the Government would lose its capital, of course.

Governor Peple: Of course, they would not be eligible.

Governor Strong: Yes, they would be eligible for loans by reserve banks.

Governor Wold: Under certain conditions, that is after rediscounting commercial paper first.

Governor Strong: The difference would be that borrowing banks would pay one per cent morethan the 90 day rate for dis count of such loans accrued by those bonds.

Governor Peple: Would they be eligible as collateral for 15 day notes with member banks, if the member banks held them?

Governor Strong: I understand that if they were turned into a reserve bank as collateral the borrower must pay a rate one per cent above the rate for the corresponding period for the other loans.

Governor Wold: Are you sure there is not a provision that they shall rediscount their commercial paper first. I have a recollection of that, but I haven't looked it up.

Governor Strong: I do not recollect.

Governor Peple: We ought to be in a position to make it perfectly clear to the banks that we are asking them to subscribe to all these conditions.

Governor Strong: The Treasury Department or Corporation will issue a circular which will assist us very much, because it will set up the assets, liabilities and legal status of those notes, and personally I believe that an investment for a year or eighteen months now is about as desirable as anything we can buy, because it will just take us over this period of uncertainty and liquidation, and the investor will then have an opportunity to look into conditions with respect to further investment of his money.

Governor Passmore: How soon are they likely to be offered?

Governor Strong: Right away.

Governor McDougal: How can those be eligible for use at a Federal Reserve Bank?

Governor Strong: There is an express provision in the War Finance Corporation Act as to their eligibility.

Governor Wellborn: Of course, it would not pay the banks to buy them for the purpose of rediscount, because they would lose the one per cent.

Governor Peple: But the ability to discount them in case of necessity would be attractive.

Governor Strong: My belief is this: That the banks would not need to carry a very large amount of these if they were diligent in offering them to their customers.

I think in our district they would be taken by investors very generally on account of the date of maturity.

Governor Morss: I think they would go pretty well, when they are really understood.

Governor Strong: Is there anyone here who believes it will be impossible to place any of them in his district.

Governor VanZandt: I do not think I could place any in my district.

Governor Passmore: The total issue will only be $200,000,000?

Governor Strong: Yes.

Governor Passmore: I should think they would be placed.

Governor Peple: Is it the idea to assign a quota to each district, as has been done in the case of the certificates?

Governor Strong: Speaking very frankly, as we always do at these meetings, my opinion would be that a quota should be assigned, with the expectation that possibly Boston, Philadelphia, New York and Cleveland would take up the slack.

Governor Peple: We are perfectly willing to cooperate in any way, but we would not want to have to place them on the same basis as we did the certificates of indebtedness, where, in many cases, we have had to carry them for the entire time for the subscribers.

Governor Strong: You would be protected against that on account of the special rediscount rate. The art in the transaction, from the reserve bank standpoint, would be to handle it with the banks in their district just as though it were a certificate issue, with a full explanation of the terms and conditions, possibly with a statement in each instance of the quota of the individual bank, which would be very small. Most of the banks would probably say, well, that is only a thousand or two dollars---and we will take it. I think generally it would be done in that way. I am sure they would take them in our district.

Governor Lynch: I would say that they could be placed in our district, but the banks would be a little slow to take hold of them. It would possibly take some time for them to make up their minds about those things, and by that time Boston, New York and Philadelphia would take them up.

Governor Strong: There can be no question of the legality of an issue of bonds by the War Finance Corporation. They are specifically authorized by the statute to do that. The holder of this obligation is not charged with any duty to inquire as to what the War Finance Corporation has done with its assets, even if the War Finance Corporation should make a loan to the Railroad Administrator which was clearly ultra vires. That would not invalidate the obligation of the corporation, and besides that, they have their assets in their treasury. They have nearly $200,000,000 in Government bonds in their treasury. They have loans to railroad corporations; they have some loans to public utilities. Theyare all presumably very good. The mere fact that they are proposing to make additional loans to the railroads, even if the proposed loans were ultra vires, would not invalidate the bonds.

Furthermore, the proceeds of this sale, possibly $100,000,000, or more, will be invested in Government bonds, which will go into the assets of the War Finance

Corporation.

Governor Wold: Will the interest follow the certificates until maturity, or will there be coupons attached?

Governor Strong: Coupons.

Governor Wold: That will help some.

Governor Strong: I am not so sure, thinking the matter over further, whether it would not be wise to issue discount certificates which would pay a better rate when figured as a discount.

Governor Wold: I think that would sell them more quickly.

Governor Strong: It may be desirable for us to discuss that with Mr. Meyer.

Governor Peple: Would we be at liberty, Governor Strong, to handle this in the way that seemed best to us? For instance, I think that we would have a very much better chance of placing the quota by offering it to certain banks than we would have by assessing it on all of the banks of the district. There would be a great many of the banks that would not touch it.

Mr. Wellborn: It would not be a great amount if it was prorated according to capital and surplus.

Governor Strong: It will afford great relief to the whole situation to have this sale take place, because it will take the cloud off that surrounds the railroad situation and will reassure the public that the railroads are going to get assistance.

Governor Peple: I have the feeling that if these could be offered generally, to all the banks, with an explanation of the provision that the subscriptions might have to be scaled, that some of the larger banks would be very much more apt to take it. Our difficulty in the certificate issues has been that considerably less than half of the banks of the district have paid no attention whatever to the certificates.

Governor Strong: We have had astonishing results in our district. Out of eleven hundred banks I think we get as many as nine hundred subscriptions to certificates.

Governor Peple: I do not know the exact figure, but I expect the subscribers to certificates in our district came nearer one quarter than one half, probably less than one quarter of the total number of banks.

Governor McDougal: It occurs to me, in view of the fact that most of those persons are talking about a five per cent bond issue, that it might be inconsistent to undertake to float this issue at 4-3/4 per cent., even if the time is short. I would like to have an expression of opinion on that subject. I may be wrong, but we have been discussing the advisability of a five per cent Government note issue, and would not the effect of it be bad if they undertook to put out this issue at 4-3/4 per cent. On the other hand, would they look upon them in the same way they do the certificates of indebtedness.

Governor Strong: The idea was to present them through the same channel, and in somewhat the same manner as the certificates of indebtedness were presented.

Governor McDougal: But they will be a different instrument, of course.

Governor Strong: Yes, of course.

Governor Morss: Because they would be sold at a discount.

Governor Strong: Yes.

Governor McDougal: The fact that they are sold at a discount, and are drawing 4-3/4 per cent, would seem to me that they might as well be sold at 5 per cent.

Governor Strong: I think it is their feeling that it would be a mistake to start a five per cent rate yet. I believe so myself.

Governor Morss: Of course, we would be at quite a little disadvantage as compared to a Government obligation, because if they were discounted at the bank they would carry a one per cent higher rate. They are not on the same basis as Government bonds.

Governor McDougal: What would you say with regard to discount rates against the notes secured by these certificates at Federal Reserve Banks?

Governor Strong: That is fixed by law, one per cent above the regular rate.

Governor Peple: Above the 90 day commercial rate?

Governor Strong: One per cent above the rate that applies oh all transactions, I gather.

Governor Peple: Then if they bore five per cent we would have to charge six per cent. It is one per cent above the 90 day rate on commercial paper.

Mr. Kenzel: If the 15 day rate was four per cent, then this rate would be five per cent.

Governor Morss: The rates we have applied to discounts on customers notes refer to notes with Government collateral.

This would not be Government collateral and it would take a high rate, would it not?

Governor Strong: Not necessarily. Don't you lend for 15 days on other collateral than Government collateral?

Governor Morss: Yes. We do for 15 days but not on customers notes for 90 days.

Governor Strong: Suppose one of your banks came in with a bundle of commercial paper on which they wanted a 15 day loan?

Governor Morss: That would be the same.

Governor Strong: Would not the same rate apply to those?

Governor Morss: Yes, it would, for 15 days.

Governor Peple: Our rate in reference to that is 4-3/4% on 90 day discounts, on the paper itself, 4-1/2% on 15 day notes secured by the paper, because the stamps make up the difference. Would the banks think that a fifteen day note would have to be stamped with this security?

Governor Strong: Yes.

Governor Morss: They have not any of the benefits which come from other Government obligations in that respect.

Governor Strong: No, they have not.

Governor Morss: We have got to accept those disadvantages.

Governor Wold: It is contemplated that these notes, if distributed by the banks to individual customers, that the bank gets the difference between the par and the discount at which they are sold.

Governor Strong: Yes, possibly.

Governor Wold: It is not expected that they will be lodged in thebanks themselves?

Governor Strong: I am urged to suggest to the meeting that the discussion of this railroad situation is most confidential, and I hope everyone understands that. There is one other matter that Mr. Leffingwell asked me to bring up this morning and get an expression of views from the Governors The Treasury has money piling up too fast as a result of the success of the two recent issues of certificates of indebtedness, and the continuing receipt of internal revenues. It is considering taking action indicated by this statement which is supposed to be given to the press today. The statement is as follows:

"Treasury Certificates of Indebtedness of Series V A mature May 6, 1919. In view of the determination to open the Victory Liberty Loan campaign April 21, it is apparent that this issue must be refunded before the proceeds of the loan can reach the Treasury. Accordingly, the Secretary of the Treasury has authorized the Federal Reserve Banks, until further notice, to redeem, in cash before maturity at par and accrued interest to date of redemption, Treasury certificates of indebtedness of Series V A, dated December 5, 1918, at the holder's option, the right being reserved, however, to make such redemption only after ten day's notice, from the holder to the Federal Reserve Bank of the district, of the intention to exercise such option."

Mr. Leffingwell's feeling is that he will not get many certificates as a result of that offer to redeem, but that he will stiffen the whole situation as to his certificate program, and possibly assist in the sale of these war finance corporation bonds.

A little private inquiry discloses the fact that the banks do not want to sell all their short maturity certificates.

Last night Mr. Wing was not interested in selling any of the May sixth maturities. If, on the other hand, we should have a large number offered for sale, it would have the effect of squeezing out a certain amount of expansion in the banks' position by reducing both the Government obligations and the Government deposits, and would improve the reserve position. The reserve bank would have the right to require ten days notice in advance of taking up the certificates. The holder could get cash at once, but we would reserve the right to only buy certificates after ten days notice of the intention to sell to us.

Governor Fancher: That is to prevent them being dumped?

Governor Strong: Yes.

I think the proposition is to see what happens, and then if they come in too fast, put the brakes on.

How does the proposal impress you?

Governor Wold: How many were exchanged last month?

Governor Strong: I haven't the figures.

Governor Fancher: Mr. Leffingwell estimated not more than $100,000,000.

Governor Wold: How large an issue was put out on December 6th?

Governor McDougal: $618,000,000.

Governor Wold: There are $518,000,000, out?

Governor Fancher: Yes. That $100,000,000 was an estimated figure.

Governor McDougal: I think that would be a very good thing to do. I believe it would bring in certificates from the smaller banks, although perhaps not from the large banks, and I think it would give a very good impression.

Governor Strong: The moral effect of it would be good.

Governor McDougal: You were speaking about the number of subscribers. We have about four million, four hundred thousand of these certificates in the banks, and I think it would bring out some of those. It would be a good thing.

(The conference went into informal discussion with Mr. Walker D. Hines, Director General of Railroads).

Governor Strong: Without objection, I will make this statement to the Federal Reserve Board: While the Reserve Banks would like to have a favorable opinion from the Attorney General on the question of the legality of the Railroad bills, they are not so much concerned with that phase of the matter as they are with the possibility that these bills might be issued and fall due without an appropriation provided by Congress to meet them, in which case the banks would have to look to the endorsers to pay them. We would regard that as an unfortunate situation for the Reserve System if it should occur.

We have here a program, and Mr. Kenzel is here from New York, at Governor Harding's suggestion, to join us in the discussion of some of the items, which were not touched on yesterday at all. I think it would be wise to undertake a discussion of that now, keeping a record of the proceedings, which may lead to some suggestions to the Federal Reserve Board.

2. BANKERS ACCEPTANCES - OPEN MARKET:

a. Development of open market.

That does not indicate just what the Board desires to bring out in the discussion, but undoubtedly it involves a discussion of what steps, if any, can be taken to improve the open market for bills, and whether the matter should be dealt with by rates or otherwise.

I believe we had better start our discussion with sub-topic b.

b. Is a low rate at Federal Reserve Banks necessary to develop the acceptance market?

Governor Fancher: Mr. Chairman, there is a feeling in our bank that there should be a reasonably low rate in the matter of development of the open market for acceptances. We rather feel, by reason of the artificial conditions in our rates, made necessary by Government financing, that there has not been the proper spread between the rates, giving proper preference to bankers acceptances and that class of paper. When we get to the time when we can take up an adjustment of these rates, when the Government's needs have been further provided for, we will provide for a proper spread in rates looking to a rate that will be fair and will develop and make that class of paper popular.

Governor Morss: We have not felt so. The Bankers acceptance is a very good piece of paper, and it is entitled to a very good rate. It ought to have the benefit of its quality, and, of course, to take a basis of 4-1/4 per cent. On that basis, a bank's prime acceptance bill has been selling at 5-1/4 per cent when commercial paper of the best class has been selling perhaps at 6 per cent, and the minute the strain is off it is 5-3/4 to 5-1/2 per cent. It seems to me that is enough advantage to bankers' acceptances, the advantage it gets from its quality. I do not know whether the rate for the Federal Reserve Bank to buy should be lower as compared to what the bill would sell for on the market. Our policy has been to keep the rate at which we buy those bills high as compared to the rate at which they would sell in the open market. In other words, we have carried out the theory of the Bank of England whose rate is high, with the idea of taking the surplus. We have been able to do that in Boston. I would like to have you ask Mr. Spencer, who has given his best time and efforts to the acceptance question, as has Mr. Kenzel, how he feels about it.

Governor Miller: We have very little business of that nature. We buy most of our bills through you, Governor Strong.

Governor Wellborn: We really have no open market in our section We have taken all of our acceptances from member banks, just like a loan. We protect the acceptance of our member banks. If the billsare offered in New York we buy them so as to protect them. I do not think we ought to change the rate at the present time.

Governor Peple: I am very glad, Mr. Chairman, to have an opportunity to state the position of the Federal Reserve Bank of Richmond on this question.

We have not apparently cooperated with the other banks on the open market proposition. It has not been because of any selfishness on our part, but we have had two reasons for not doing it. In the first place, we have always been borrowers, and, consequently, we have hesitated to take participation in purchases which would necessitate an increase in our rediscount. That, however, has been a minor consideration.

Our main reason is, that we have gone very carefully, for a long time, into this whole situation with our member banks, and we are convinced that the banks in our district need a great deal of education before we can rely on them to put into the market bankers acceptances that we really think carry with them the qualifications that a bankers acceptance should have.

I have been in correspondence with the Federal Reserve

Board for some time in an endeavor to get a more definite and specific ruling as to what a bankers' acceptance ought to be.

With us, in many instances, a bankers acceptance is nothing more nor less than a collateral loan. Under the former regulations of the Board, the Board held that a bankers acceptance should arise out of a transaction involving a certain thing. In the draft of tentative regulations recently submitted that provision was left out entirely, and I have asked the Board definitely and positively if the Board had any opinion as to whether there was any difference between an acceptance and a collateral loan, and if so that that difference ought to be made apparent in the regulations.

I received a short time ago this long opinion from the counsel for the Federal Reserve Board as to the surrender of collateral in connection with bankers acceptances. You are all familiar with that. I immediately wrote to Governor Harding and told him that apparently the counsel had overlooked our particular point, and I got a letter from him in which he said that that point and all others was intended to be covered. There is nothing in that opinion which we can use with our member banks as a stoppage of their idea that a bankers acceptance can benothing more nor less than a loan.

I will give you one or two instances that have occurred during the last few days. A short time ago one of our large banks offered us three bankers' acceptances, amounting to $110,000.

Governor Strong: Mr. Peple, may I take the liberty of interrupting. We have under item 4, the subject of use and abuse of domestic acceptances, and I wonder if we had better not defer the discussion of this particular subject until we get down to it on the program.

Governor Peple: That is entirely agreeable to me, but I do wish to bring this up at some time and find out whether or not we have been too strict in our interpretation of it. We want to get a clear and specific regulation from the Board that will support us in this campaign of education that we have been conducting, if we have been doing the right thing.

Governor Strong: On the question of developing the open market, I understand that you have quite a large volume of acceptances?

Governor Peple: We have, and we have endeavored to keep the possibilities of the market development open in this way. We have taken the position that when we buy a bankers' acceptance from one of our member banks, the bank is acting as the agent of the drawer for the sale of the acceptance. We have taken the position that they should come to us direct from the bank because we require at the time a statement of all of the conditions under which that acceptance was drawn; we require a positive statement as to the collateral that the bank holds, and we have made regulations as to the amount of margin that the bank could hold.

Governor Strong: What do you do about rates?

Governor Peples: Our rate is 4-1/2 per cent.

Governor Wold: On what maturities?

Governor Peple: On all maturities. In many cases we require that the collateral be lodged with us, and to stay with us during the life of the bankers' acceptance.

Governor Strong: Is there any market for bills among the banks of your district, outside of the Reserve Bank?

Governor Peple: Not that we know of. Occasionally we have the acceptance of one bank offered to us with the endorsement of another bank.

Governor Strong: But the fact is, the marketing of bankers bills in your district is largely confined to making a rate at which the Reserve Bank will take them, after careful inquiry and scrutiny of the character of the transaction underlying the acceptances?

Governor Peple: Yes.

Governor Strong: There is no influence to be exerted in the development of an open market through your rate, as a result of dealings between banking institutions?

Governor Peple: There is not, for the reason that we thought it best to make this campaign of education before we endorse anything looking to an open market, so that we could be sure that the things that are being sold are real bankers acceptances. We prefer to keep absolute control of the situation until we are satisfied that our banks have learned what should constitute the proper form of a bankers' acceptance.

Governor Strong: In view of the fact that this is a large subject, I am going to ask that the expression of opinion be directed directly to this one point, as far as possible, (that is of an open market and the influence of the Reserve Bank rate) in order that we may get some recommendation on the matter.

Governor Passmore: Answering your specific question, I have an open mind on the matter, but I presumed it was essential that a low rate should obtain to continue the development of the acceptance market.

Governor Strong: You mean as compared with the commercial paper rate?

Governor Passmore: Yes.

Governor McDougal: The Reserve Banks have been the means through which the acceptance market has been developed, and my impression is that until the market develops to a much broader and bigger one it would be desirable to continue a low rate.

Governor Biggs: Our bankers have taken a very keen interest in acceptances. It has been a matter of education for several months, and I think every banker in the clearing house, probably, has someone working on this. We look forward to a large amount of it, especially after the Government's financial obligations are taken care of.

I am not in favor of any special change in rates. I think it should be quite a little lower than the commercial paper rate.

Governor Lynch: I think a market for acceptances is very desirable. I think for the present, and for some time to come, it may be necessary to have a distinctly preferential rate by the Federal Reserve Banks. In other words, it is something we have got to foster.

Governor VanZandt: I think without a very low rate for bankers acceptances that we will not get the bankers acceptance business developed throughout the entire country as it should be. You can educate the bankers in New York, but you cannot educate them out in our part of the country, unless it is the case of an acceptance of some bank that they know, in their own country, which they can take in their portfolio and be prepared any time to turn them over to the Federal Reserve Bank or dispose of them to some member bank at a low rate, based on the Federal Reserve Bank's rate.

Governor Wold: I assume "the development of an open market", refers to the distribution of acceptances among the member banks. An extremely low rate will not be helpful in distributing those among the banks looking for investments. Unless the rate is somewhere near the commercial rate they will buy commercial pap and wont buy the acceptances. We have been making quite an effort through one of our brokers, to distribute some of these acceptances, and have been successful in having some sold. If the rate is too low, as compared to the rate on commercial paper, the banks looking for investments will buy the commercial paper, because they are in the habit of buying commercial paper and know how to handle it.

Governor Morss: The reason that I do not believe in extremely low rates for acceptances is the fact that if you fix an artificially low rate on any class of paper the borrowers will go after that, and the abuses that may be connected with acceptances will be exaggerated because of the low rate. If the rate is too far out of line, as compared to the commercial rate, you cannot hope to have an open market with the member banks, but the paper will all come into the Federal Reserve Bank. There are two very good reasons to make the rate in relation to the commercial rate, and the prime reason is that it is better than the regular commercial note because it is a banker's acceptance, it is secured, and that gives it a preference in rate. I do not believe we should put an artificial rate on it.

Governor Strong: It seems to me that the distinction has not been clearly brought out as to what is accomplished by a low rate for bankers acceptances, speaking of those arising out of international trade. The chief advantage of the low rate is the advantage of having a volume of bills created by having credit opened in dollars rather than in sterling or in some other market. If our rate for bills is too high the business will naturally drift to the cheaper money market, which doubtless will be London. Personally, I agree entirely with you, Governor Morss, that if the rate is too low it has a restricting effect upon the market because all of the bills will go to the Reserve banks, just as now the Government certificates of indebtedness come to us at a still lower rate than the acceptances.

Governor Morss: It seems to me that an open market for acceptances is strictly a competitive proposition, and it has got to stand on its own feet in competition. When you come right down finally to your being able to hold your own in dollar acceptances against sterling, it is going to be a question of general interest rates in all countries. It has got to be stabilized, and if we cannot compete we will lose the business.

Governor Strong: In the long run I think we are going to have a cheap rate.

Governor Morss: It is a matter of competition, and you must get down to a competitive basis.

Governor Passmore: But is not the rate artificially low in London, Mr. Strong?

Governor Strong: It is just now.

Governor Passmore: I do not mean just now. Has it not all along been much lower than the general discount rate?

Governor Strong: The London market is so differently organized from ours---

Governor Passmore: Don't they deliberately bid for these bills in order to control certain situations?

Governor Strong: You have got to distinguish between conditions of today and those that were normal, prior to the war.

Governor Passmore: Yes.

Governor Strong: Just now there is such a small volume of bills in the London market, on account of the scarcity of the ordinary commodity paper, that it is given a much lower rate than any other paper in the market.

The rate that you refer to, Mr. Passmore, is just now more artificial than it ever has been in the history of the business. There is no doubt about that. It is possible, for instance, to remit a bill in sterling to London from this country, and get discount for it, if it is an eligible bill, so to speak, at 3-7/8, or 3-3/4 per cent, or something like that, and turn right around and deposit the proceeds of that bill in a Joint Stock Bank at 4-1/4 per cent. Of course, that is purely an artificial situation, and that is done for the special purpose of keeping foreign balances in London.

Deputy Governor Spencer: I have felt all along, with respect to the development of an open market, that we were running with artificial rates, but if we attempted to lower those rates we would entirely close the open market. They would all converge into the reserve banks With the rate as it is now, in competition with the commercial paper, we have made some strides---although not very long strides---and they are distributing the bills in the New England market.

Mr. Kenzel: I do not believe it is required that there should be a very low rate at Federal Reserve Banks for bills, but the rate at the Federal Reserve Banks for the bills should reflect, I believe, the difference in rates between the bill rate and the commercial paper rate, and should reflect the fair market value of the bankers credit which the purchaser of the credit has bought and paid for when he drew the bill.

The present scale of rates, I think, is wrong. We have 4-3/4 per cent for 90 day, single name notes, and a 4-1/2 per cent discount rate or a 4-1/4 per cent purchase rate for prime 90 day bankers bills. That relatively high rate helps the distribution of bills in the open market, because the open market is dealing in indorsed paper and the rate for bills with the best prime names is right at our rediscount rate or purchase rate for indorsed paper. We have paper with bankers indorsements at a rate higher than the open market. The normal reserve bank rate should be a little higher than the open market. When it comes to very short maturities it is a different thing. I believe on short bills, normally, in a rising money market, the reserve rate should be lower than the open market. Recently, we have seen commercial paper of four, five and six months selling for 5-1/4 per cent, and costing the borrower

5-1/2 per cent per annum. That is cheaper money than he could get through taking domestic bankers acceptances, which would cost him at least one per cent per annum for the credit and at least four and five-sixteenths per cent per annum for the discount, making five and five-sixteenths per cent at the minimum. If we had to pay one-half per cent higher for the credit, as most of them do, it would put the cost above the single name paper rate.

There are a great many technicalities connected with the business which borrowers seek to avoid. If they could borrow money, as they always have borrowed it, on six months paper, at approximately the same rate that they could get the domestic credit, without being required to put up collateral and assign documents, and interfere in any way with their customers, they would prefer the commercial paper.

In regard to the international bills, I think the situation is different. Looking at it from the International standpoint, we have got to provide an open market, and if the reserve rates relate to the open market rate, it will permit the dollar bill to compete with sterling bills and other currency, if we want to have the dollar currency availed of.

Looking at it a little further, if we want to develop the export trade, we have got to develop imports also, so that the creation of unwieldy trade balances will be avoided. To make this a desirable market for foreign purchasers to sell their goods in, we have got to make a discount market here in which their bills, drawn against their imports, can be discounted favorably in comparison with any other open market in the world.

Governor Morss: How are you going to create an open market here for foreign bills if the discount rate or purchase rate of the Federal Reserve Bank is considerably below what it would be for a domestic bill?

Mr. Kenzel: I do not think there can be any distinction made in our market rates betweenthe domestic acceptance of a prime bank here and the foreign acceptance of a prime bank.

Governor Strong: No suggestion has been made, in discussing this matter, of the bearing upon the development of American credits of the decision by foreign Governments to pull the peg out of the exchange rate, and it has a most important bearing. The natural bill to flow into this market is the bill drawn and accompanying a shipment of goods to this market. Conversely speaking, the bill to be drawn on the London market is a bill covering movement of goods from this country to the London market, or the French market. The bills that were customarily drawn in connection with sales of cotton in England, France, Germany and Italy, you know, created a great volume of exchange in this country, because they were drawn in the currencies of those countries and discounted there, and created balances in favor of our banks abroad. The disturbances in the exchange situation are going to have a very material effect upon the drawing of bills.

I have always felt that we had two objects to gain, by the manipulation of our rate, which were inconsistent with each other. A high rate for the discount of bills in this country will widen the market for them. A low rate will increase the volume of credits and bills drawn. Possibly if we had the courage to accept the situation, we might be able to stimulate the opening of dollar credits by having the reserve banks stand ready with the bag and take everything that comes out at an abnormally low rate, and admit the necessity for doing it in order to develop the business, and stick right tight to that program until merchants and manufacturers and exporters of the world became accustomed to drawing in dollars for reimbursement on their exports to this country.

Geography has a lot to do with it. We cannot expect to finance the movement of goods between Africa and Europe with bills drawn on this country. That is out of the question. We might expect, possibly, to finance the goods moving from the West coast of South America to Europe that would go through the Panama Canal. It might be, with a cheaper money market here than the London market, we would be able to get a large part of that business, and a large part of the Eastern business, and we might be able to get the financing centered in this country for practically all of our own imports in time. In order to do that, we have got to make a rate that will take the business away from the markets where the rate has been cheaper, as in London. If we make a rate that stimulates the flow of credits to this country, we restrict the market for the bills which result from those credits. I cannot see it any other way.

Deputy Governor Spencer: And we would practically close the open market.

Governor Strong: It would in effect restrict the open market.

From private correspondence, I am led to believe that when the artificial character of the London market is eliminated they are going to have higher rates over there than they have ever known in the history of that market. Our rates, when we get our liquidation over here , will be lower than we have ever known them to be for bank credits with a resultant flow of bills to this country. I may be mistaken but I think that is true.

Furthermore, with regard to the subject of developing the open market in this country, there is one thing that we should do right away, and that is to get legislation that will permit foreign banks to open branches in this country for the purpose of handling bills just as is done in the London market. The bills do not flow to the London market through the agencies of the British banks alone. There are probably 150 bank agencies in London, representing banking business the world over. Japaneese, German, French, Italian and other banks are pouring bills into the London market all the time because it is a cheap and reliable discount market. Our problem is to develop a policy not for the moment but for the long future, and the question is how much of our resources can we appropriate in order to get that business.

Governor Morss: Of course, what I said with regard to the way it ought to be done had no reference to immediate market conditions.

Mr. Kenzel: In the long run we must develop a cheaper money market for strictly liquid commercial business as distinguished from having the stock exchange rate dominate all rates. The Canadian banks have shifted absolutely away from carrying reserves in New York in stock exchange loans and are buying bills to carry in their portfolios at a rate 2-1/2 per cent lower.

Governor Strong: There is another very important development in the rate for bills. It is possible that by reason of special things that are developing, there will be a special market for this kind of paper that wont apply to any other kind of paper.

The amendment to the banking laws permitting savings banks to buy just this type of bill, will make a market for a very large volume of this paper. It hasn't come yet. The savings banks have been putting all of their money into Government loans, and as long as they are expected to do that, and are charged with being unpatriotic if they do not, that special market will be deferred.

Mr. Kenzel: There has been a perfectly good, steady, demand for bills at the market rate, bills of corporations, some individuals and savings banks, and up until a short time ago from foreign banking agencies. The reason there has been considerable buying for foreign account was that there are few institutions that carry reserves in bills and throughout the country more and more banks are buying and carrying bills as reserves. There is a good demand.

(Governor Harding, Mr. Hamlin, and Mr. Miller of the Federal Reserve Board, entered the conference room).

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Mr. A. C. Miller. Have you taken into reckoning the fact in your forecast in the prospective development, and especially in dealing in foreign bills that the moment we get the courage and the wisdom and the prudence to put ourselves unequivocally on the basis of free finances that we are going to have tremendous power, and are going to be able to know precisely what the dollar is today, what the dollar will be one week hence, and one month hence. The franc and the pound sterling are probably going to be for some little time of a fluctuating value. We do not know what the sterling exchange will be. If a man buys it today, what it will be three weeks or three months hence -- that we do not know. I think that is going to be a factor of very distinct importance; it is going to make this market a contractive one to any one accumulatin exchange, or who is engaged in dealings where it is of conseqence that the unit of value in the terms of the bill drawn is absolutely known to be a definite quantity, not susceptible of any contingency of international commerce.

There is another thing that occurs to me in connection with what Mr. Kent said. I think it is ordinarily overlooked to what extent the open discount market has flourished in London is coupled with the fact that they had the open trade market. That is the reason why an enormous amount of financial business congregated there--the enormous amount of ordinary commercial business done with the open ports. We do not know what the tariff policy will be in the future--

Governor Strong: I hope they do away with it. Doctor Miller, there is one development which we can now watch with the greatest possible interest as to the London market, viz: the unpegging of sterling exchange, the control of rates of insurance, and of rates of ocean transportation of gold. The high cost of transporting gold has made a new parity for sterling exchange in this country.

Mr. A. C. Miller: Certainly.

Governor Strong: So that the arbitrary level fixed by a combination of rates of discount in London with the cost of exporting gold and the pegging of exchange after the level was established at 4.76-1-4, for awhile has resulted really in relieving the Bank of England nominally of its normal demand for gold for export. The minute they take the peg out of exchange the demand again arises. Will the bank of England give up gold for export?

Mr. A. C. Miller: If she does not, what becomes of foreign exchange?

Governor Strong: That is the point. The sentimental influence is one thing; the influence in fact is another thing; and the favorable feature of this situation from our standpoint lies in my mind in this fact,- if England now must rely upon an arbitrary embargo upon gold exports rather than an artificial exchange rate, the must announce to the world that she is internationally suspending gold payment, and, going a step further, in order to get back upon her gold basis, she has got to do the very thingthat will establish dollar credit in this country; in other words, she has got to put her interest rates up.

Mr. A. C. Miller: That is right.

Governor Strong: And when she puts her interest rates up, it is coincident with a period of liquidation in this country, which will lower our rates.

Mr. A. C. Miller: That is all definitely foreshadowed in the report; England says she has got to do that in order to recover her gold strength and her position in the international money market. That might take two or three years. In the meantime, business has largely headed in this direction;

4 our exchange had to be used first as a matter of necessity, and then it will become, if we are wise, a matter of superiority.

Governor Strong. We have come to no conclusion in the discussion of this matter at this meeting; I do not know whether in putting this topic on the program, it was intended to have any conclusion stated; but rather an exchange of views. This is a very fluid situation, as Mr. Leffingwell said yesterday, and I think all we can do is to watch the developments from day to day and govern our policy accordingly.

Governor Harding. The Treasury is in communication with Lamont, Strauss and Davis and Harris, asking their advice as to taking off all restrictions off the export of gold. The only question of any concern seems to be in South America, but it is very clear, so far as Europe is concerned, we are not going to lose any gold there. Under this tariff in England and France, nobody is going to want to ship any gold from America, to use their balances here to protect against it. We are trying to find out about how much gold Japan will draw; that seems to be the main problem.

5 Governor Strong. And Argentine --

Governor Harding. They cannot withdraw it under six months?

Governor Strong. Part of it they can withdraw at once, about $20,000,000 they can withdraw at once.

Governor Harding. Do you think they will draw it right away?

Governor Strong. I do not think so. I think the withdrawal of $17,000,000 was due to the same impulse that led them to bring their gold over from the other side.

Governor Harding. If they want to save the exchange, they are getting a premium on it, are they not?

Governor Strong. I do not know what the exchange situation is now.

Governor Harding. The question is whether they want to bring that gold down there in the present condition.

Governor Strong. Governor Harding, there were two matters that came up at the meeting this morning, and one yesterday, on which I should like to make a report, if I may, at the meeting.

Late in the afternoon yesterday, the proposal in regard to architectural supervision of building plans of reserve banks was fully discussed, and it was the unanimous view of the Governors of the twelve banks that the suggestion which you made, that a supervising architect should be retained by the Board to act as a clearing house for the exchange of information, and in an advisory capacity to the Board in passing on plans, would be a desirable thing. The view expressed was, as I understand it, that it would not only be a protection to the system to be able to state that supervision was obtained for all the building program but it really would have the effect of facilitating prompt action in getting plans approved. They would come before the Board through a channel which would be thoroughly acquainted and posted.

Governor Harding: We are very glad to know that.

Governor Strong: And we further thought it would be most desirable to employ Mr. Trowbridge, who made a very favorable impression.

Governor Harding: The members of the Board have reached the same conclusion, and we had a talk with Mr. Trowbridge, and I think we can make an arrangement with him at a very reasonable figure, so that we would pay him out of the Board's own funds and levy assessments upon these outside

7 banks, and the burden would not fall very hard on any bank.

Governor Strong. Of course, Mr. Trowbridge is a member of the staff of the Federal Reserve Bank of New York. He is on salary; a rather small salary now, because he has only been giving a portion of his time, but it would be a greatmisfortune to us to have a man who had worked for six months andstudied our problems taken away from the bank.

Governor Harding. I hope you gentlemen understand the Board's proposition. We are not interested down here in deciding whether the toilet rooms and lockers are located exactly in the right place. The main thing we are concerned in is this, that in the last analysis, these are government buildings; we want the Secretary of the Treasury to be familiar with everything that is done, and to have his seat with the Board, and approve everything the Board does in this matter, and the main thing that concerns the Board is this: We want these buildings to be adequate; we would not want a building put up at a cost of $800,000 or a million, and then have it develop as soon as it was finished that it wastotally inadequate and then have to be torn down

8 or done all over again, nor would we want a building, on the other hand, to overdo the proposition.

Then there is a third alternative, we would not want to go into a proposition of say a million and a half dollars, which amount we might think was a proper amount for a bank in a given district to expend, and approve those plans without any estimate at all as to whether or not it could be built for that estimated cost, and then find out, as soon as the contracts were let, and the matter had progressed too far to rescind our action, that the thing was going to cost two and a half million dollars. We want to act intelligently. If this were a law point, we would take the advice of counsel, and on this building project, we want the advice of an architect.

Another point which Mr. Trowbridge brought up was this: These banks have complete plans. It is pretty hard to make any radical change without incurring a good deal of expense on account of drawings and so on, but as to those banks which have not made plans, if rough, preliminary sketches were submitted first, andthese suggestions made, then before you go into these elaborate drawings, you will get the benefit of Mr. Trowbridge's suggestions and views

9 before the scale drawings are made, do you not see?

Governor Strong. Yes.

Governor Harding. There would certainly be a valuable interchange of ideas in this way; you gentlemen havin an independent architect and this general consultant we are going to get, I think the plan is the best of all the ideasthat have developed.

Governor Strong. I would assume, asfar as the New York bank is concerned, that it wasgenerally understood we would pay the greater part of Mr. Trowbridge's salary and employ the greater part of his time.

Mr. A. C. Miller. Can we not determine what portion of his time we shall want devoted to this general work and then pro rate the expense?

Governor Strong. I could not agree to that very well, because he is now employed by the directors of the bank, and I am not authorized to say that we will give this man up.

Governor Harding. We would expect to arrange with you before we made any arrangement with Mr. Trowbridge. Our talk with him was all tentative, based upon your cooperation and approval. We would not want to take your time. We

10 would want first to reach a definite conclusion and find out what Mr. Trowbridge is willing to do, to be able to say to him, "Here is the proposition; how does this strike you?"

Governor Strong. I anticipate no difficulty with our directors about it.

Mr. A. C. Miller. My own thought was that one-third of his time would answer our requirements, possibly less.

Governor Harding. You see it would probably redound to your own advantage, because he would be given the advantage of an examination of these various plans, and undoubtedly some part of those plans could be used in your bank.

Governor Strong. That would be an advantage. There is another very important advantage. We are proposing to have a competition of some kind, and the architect who is awarded the contract will step into a situation where another architect is already at work, and I do not want any question to arise about having two architects on the same job, and it will relieve us of that embarrassment by giving a different status to Mr. Trowbridge's employment;

11 to be able to state that he is acting for the system, so it would be a condition precedent of the program of competition that Mr. Trowbridge would be in this relationship to it.

Governor Harding. What would be the ideas of the Governors, assuming the Board and yourself reach an agreement on this proposition, and Mr. Trowbridge be employed, would it be your idea that all the banks interested should agree to pro rate the amount of the salary that the Board would pay him, or would it be paid out of the Board's general funds? What is your idea about that?

Governor Strong. May I suggest this on that subject? We will of course get the major benefit of his time, and that portion of his compensation that represents that contribution to our program by Mr. Trowbridge we should pay; as to the balance of his services that should be apportioned among the other reserve banks that propose to put up buildings. On that basis, let the Board make the assessments.

Mr. A. C. Miller. We might as well assess the expenses to the council. I think it is clear he is to be here as our adviser and supervisor, and probably we might

12 want to make larger demands on his time than he could grant.

Governor Strong. How about a bank that has a building already finished and would get no benefit whatever, as is the case with Atlanta?

Mr. A. C. Miller. That is their loss and our gain.

Governor Wellborn. I suppose we would be exempt.

Governor Strong. I do not mind; of course it reduces our expenses.

Governor Harding. I do not think, if we figured it out, that the Atlanta part of it would be over $300 or $400 a year.

Governor Strong. Well, I will submit anything you propose, of course, to our directors. I would be very reluctant, as I have said a number of times, to have Mr. Trowbridge drop his work with us.

Governor Harding. Here is the situation. We have got to negotiate with you in the Trowbridge matter, and in order to save a lot of correspondence, would it be possible for the Governors to put their case in your hands, and let you represent all of the Governors in the negotiations with the Board in this proposition?

Governor Strong. I think they would be willing to

13 do that; they have done it before.

Mr. A. C. Miller. I would rather approach it from the other angle. This is not their proposition; it is rather the Board's proposition, and the Board's architect. Tt is not the banks cooperating with the Board; it is the Board cooperating with the banks in trying t fulfill its part of the responsibility in seeing that these banks are within reasonable requirements.

Governor Harding. Still, whatever is paid to the architect will be paid by the banks, anyway.

Mr. A. C. Miller. Whatever is paid anybody is out of the Reserve Board's fund.

Governor McDougal. I am inclined to agree with Dr. Miller that this is a board matter, and anyway you see fitt to adjust it will certainly be satisfactory to all concerned.

Governor Harding. Of course we could make this a matter of special assessment and say we pro rate this among the other banks, all to make a special remittance, that would not be included in the general assessment.

Governor Lynch. It appears to me that this being a Board matter is a matter of general interest to the entire

14 system, and if the Board desires advice on any one particular point, they would have to call in an expert on that point and pay him, and it is a matter ofexpense to all of the banks in the system as well as it is of some one bank or some few banks that are not interested in that particular point.

Governor Wellborn. Governor Harding, I may say for the gentlemen who are letting our contract, we submitted everything to the Board in Washington, you will remember, all the plans and everything, and the total cost of it; we did not let any contract without the approval of the Federal Reserve Board.

Governor Harding. Yes; the architect of the Treasury.

Was there another matter you wanted to bring up, Governor Strong?

Governor Strong. The question again arose, Governor Harding, in regard to these bills that were under comtemplation to be accepted by the Director General of Railroads, and after some discussion we asked Mr. Hines if he would come over andclear up one or two points, He was r anxious to get expressions of opinion as to the busine aspects of the program as distinguished from the legal aspects, and I am frank to say that I think he got them at the meeting.

As I understand the feeling of the Governors of the banks, it is this: Immediately upon receipt of the ruling of the Board, which quoted Mr. Hines' letter, in which he referred to Judge Payne's opinion, the question did arise in every one of the banks as to the powers of the Director General to make this obligation, and in some of the banks that subject has been referred to counsel for investigation. Now the Governors of the Reserve Banks, I think, feel that even if the Attorney General gave an opinion that the Director General had power to accept bills in this transaction, that question of legality, pure and simple, is nevertheless a rather minor consideration; that the principal consideration involved in the purchase of these bills, or their discount with the Reserve Banks, is really this: That nobody knows whether the funds will be provided by Act of Congress to meet the bills when they mature; that cannot be told; and even if a syndicate of banks is organized to undertake to purchase renewal bills for another ninety days, nevertheless it is an undesirable thing for the Reserve System, and for their banks to be in the position of buying some hundred millions of bills which are dependent for their payment at their real maturity upon an Act of Congress, which might not be promptly passed, for various reasons.

As we all now realize, there is a certain reluctance on the part of the Governors of the reserve banks to say that they want the reserve banks, or their member banks, to buy bills subject to Congressional action at a time of a good deal of controversy.

Governor Harding: That is a reasonable position, I think. The Governors all understand, do they not, that when the Board gives a ruling that a certain class of paper is eligible, that no obligation rests on the bank to take that paper. The banks are all charged with notice of conditions attending the paper. If the paper were technically eligible, and you might have an averse opinion of the solvency of the maker, and so forth, you would not accept it. We do not want the impression to get out that if the paper is technically eligible and you ask for an opinion, the fact that the ruling is that the paper is eligible, does not mean that it is a desirable investment for the bank.

Governor Strong: It complies in form with the law?

Governor Harding: That is all.

Governor Strong: There is another practical aspect to this particular transaction that is important. These bills would be very largely marketed in New York, and it is contemplated drawing nearly $300,000,000 of them. Let us suppose that we were satisfied with the opinion of the Attorney General, and undertook to buy these bills, and the other reserve banks were not satisfied, as might be the case, and the great mass of the bills come east to the New York Reserve Bank? The only outlet we would have for the whole operation, if they did come to us, would be by endorsing those bills, or borrowing on other paper from other reserve banks in order to escape the objection they had raised, and which we had not. It struck me that the question focused a little bit in New York. It is a case where we should hang together or hang separately. I should not like to have the New York bank underwrite the whole issue and endorse all that paper in order to distribute it throughout the system.

Mr. Harrison: Your position would not be conclusive.

Governor Strong: I realize that, but after all, I think everyone feels that reliance can be placed ultimately upon Congress to make good an obligation incurred by an officer of the Government who is expressly authorized to enter into such obligations, but who has not been put in funds. That is the whole controversy.

Mr. Harrison: I mentioned that merely so there would not be any misunderstanding. The opinion of the Attorney General is not any more conclusive than the opinion of Judge Payne.

Governor Strong: No; it is helpful, that is all.

Mr. Harrison: There is another thing in reference to the appropriation. I am not very familiar with this particular point, but I relied solely on the opinion given me by the railroad attorneys themselves. Legally, the Director General has a perfect right to enter into certain contracts. If it were conceivable that the railroads were running at a considerable net profit themselves, there would be no occasion for an appropriation by Congress what-

19 ever, and the right of the Director General to accept or to purchase is no more dependent upon the appropriation of Congress than it is on the operating incomes from the railroads, so that it is conceivable that if they were running at a tremendous profit, or at a reasonable profit, that all these expenses would be paid out of the operating income rather than out of any appropriation of Congress at all. Therefore to say that because Congress has not appropriated any money for the railroads, the Director General shall not enter into obligations --

Governor Strong. That becomes academic when we consider the fact that all their earnings are absorbed in betterments and improvements, and they will not get those earnings back until Congress appropriates money to pay them compensation for their share of the earnings.

Mr. Harrison. But in the discussion of the legal right of the Director General it is important. The mere fact that Congress has not appropriated does not bear on the legality of these contracts.

Governor Strong. Yes; I see.

Mr. Harrison. Because all that money would be paid out of the income of the railroads. And that is their strongest point and the one they rely on a great deal. I mention that just as a matter of interest. The fact whether or not Congress has appropriated should not be taken as conclusive one way or the other as to the right of the Director General.

Governor Strong: The practical aspect of the matter is this, no more and no less as I view it, and I think every man in the room in this discussion will agree with it. If the Federal Reserve Bank alone should say to the banks of New York City, having received the opinion of the Attorney General, that the Director General has the power to do this, "we will buy these bills", then they would buy them. If we said we would not buy them, then they would not buy them, and the responsibility is right up to our bank. Are we justified in saying that we will buy a bill without knowing whether it will be paid at maturity, and when we do not know whether Congress will appropriate the money? The Director General of Railroads himself says he will have no money to pay the bills unless he gets the appropriation from Congress, which he thinks he will get.

Mr. A. C. Miller: How about the French bills? We were two or three years in getting renewal drafts.

Governor Strong: Yes.

Mr. A C. Miller: There was a hazard there that was not very unlike this.

Governor Harding: The amount was very much smaller in the first place.

Mr. A. C. Miller: It was smaller; it was guaranteed by the French Government.

Governor Strong: That was a very different situation, Doctor Miller, because the bank of France agreed to furnish the gold in case the bills were not met with exchange at maturity, and all necessary acts by the French Government had been taken to secure our getting that gold. Here, there are not only no earnings available, no fund available to pay the bills at maturity, but our Government has not yet taken the necessary step to provide payment of the bills.

Mr. A. C. Miller: Still there is a question there as to the certainty of the French Government making good. In our case the hazard with the railroads is the good faith of Congress to support a high officer of the Government

in doing things that are necessary to

22 sustain the functioning of a most important element of trade. I should say I would rather take the chance of the government of the United States violating its faith than I would the actual physical capacity of most European governments to make good.

Governor Strong. As to the French credit, I think that was so copper-fastened that it was absolutely secure. You know in all those credits, we got the obligation of the Bank of France, approved by the Minister of Finance, and the gold was actually segregated and it was merely a question of its physical transportation across the Atlantic, as to whether the bill should be met in gold, or whether it should be paid out of exchange in case the French government hadcredits here for the purpose, and those bills, as a matter of fact, were all identified with specific exports of goods abroad.

Mr. A. C. Miller. Yes, by the time the last renewal was made, the goods were gone, gone before that.

Governor Strong. Yes; they moved over into Germany, many of them. However, Mr. Hepburn raised the underlying, fundamental question yesterday, when he inquired whether it would be a good thing for the Federal Reserve

System to have notes outstanding, Federal Reserve notes outstanding, in part secured by these acceptances, where their payment was absolutely dependent upon the willingness of Congress. to appropriate the money.

Mr. A. C. Miller: I should say this was one case that had been raised where there might perhaps be some virtue in the fact that these notes were the obligation of the United States Government.

Governor Strong: Yes; we get Uncle Sam obligated anyway, do we not? But then we have to put up the gold to redeem the notes, so it goes around the circle back to us.

Governor Harding. How do the other Governors feel about this?

Governor Strong: They have all expressed themselves to Mr. Hines as being desirous of doing anything that is feasible to meet the situation. They pointed out to him the difficulties; it is really right up to the Federal Reserve Banks to decide whether this is a practical transaction or not they have asked opportunity just to give him an impression of the sentiment that now exists about it, and he is going to meet his finance committee and have a

24 further talk about it. I think he will probably see you, Governor Harding.

Governor Harding. I think the position of the Federal Reserve Board in regard to it is that it isvery unfortunate that there is any possibility ofa necessity of recourse to this expedient, but if on the other hand it is necessary to do something of this sort to avoid even worse conditions that might follow, even a delay in Congress to make this appropriation, you ought to put the full circumstances in the scales and weigh them very carefully, and po ssibly do it if we feel Congress ultimately is going to make the appropriation, even if it involves a few renewals.

Governor Strong. I askedMr. Wing last nighthow he felt about the bills, andhe said, "I would not touch them with a ten-foot pole." I said, "Would you buy a bill drawn by the American car and Foundry Company on a railroad where the Director General did not appear as the obligator at all?" He said, "I would buy all those bills I could get," but, he said, "I do not like the idea of having a bill in my portfolio that will only be paid in case Congressgets in the humor to pass that appropriation bill, 25 and a great many banks are going to feel the same way about it."

Governor Harding. Of course, Mr. Hines made the statement yesterday which I think is absolutely true, that in case we should pass this matter, there is no opposition that has developed to the bill itself; that the bill was defeated because of a situation which had developed, but we cannot tell just what the Congressional humor is going to be; we do not know what feeling may be aroused or how this next Congress may look at the entire proposition.

Governor Strong. They may get to squabbling about so many things that they may never reach this.

Governor Harding. It may be two years before they do it.

Governor Strong. I, personally, am convinced that in a very short time Congress will pass that bill. It would be a monstrous situation if they did not. Do you not think so, Doctor Miller?

Mr. A. C. Miller. I should expect so, but if they do not, I think we had better treat this as a part of the work Congress has got to do after getting an attitude on

26 public questions. I feel that the slight risk, or if you want to put it so, the considerable risk, the Federal Reserve System is taking on these bonds, I think every one would admit that the bad banking that the situation has forced is trivial as compared with the horrible situation that will be created if the railroads cannot be f nanced. It is more important that the railroads of the country should be safe than that the Federal Reserve System should be safe.

Governor Strong. You think that it is more important?

Mr. A. C. Miller. I do.

Governor Strong. I am not so sure about that. Let us look at another aspect of it that we have not discussed at all. Congress used the power of appropriation as a club over the President to call an extra session, very succesfully, and they are going to get their extra session I have no doubt. Now let us suppose thatthe purpose which Congress had in mind, whether it is a malign purpose or not, was defeated by the Rese ve System stepping in to relieve the railroad difficulty, among others, and that it did it on the basis of a transaction where there was a question as to its

27 being ultra vires. May not some partisan newspapers in the United States, (not that I care a rap about what the newspapers say,) may they not say that the Federal Reserve System is being prostituted for political purposes?

Mr. A. C. Miller. If we have taken every reasonable precaution to get competent legal opinion, and the legal opinion is that it is not ultra vires, that is the assumption on which we are proceeding in the discussion, and that it is then purely a question of judgment of the banking hazard, I think we are on the whole in a very defensible position in saying, taking account of the whole situation, as we have in several other matters that have come up during the war, I have thought the Federal Reserve System was justified in discounting these bills knowing there was a hazard there. The Attorney General as well as the railway counsel all take the view that the Director General has an undoubted power to accept these drafts.

Governor Strong. I did not want to raise the question for discussion when the Director General was here about the political aspect of it at all, but you can see the possibility that if there is danger of the charge being made that a compliant Attorney General, with a fertile minded Director of Railroads, and a supine Federal Reserve System get their heads together and put it over on Congress, we might be in a rather unpleasant situation.

Mr. A. C. Miller: Of course, as to the Federal Reserve System, there is no such thing as a compliant Attorney General. His opinion is the opinion of the Attorney General.

Mr. Hamlin: You might have each particular road put its name on these acceptances.

Governor Strong: I did suggest to Mr. Hines the one thing that seemed to me would cure all doubts of this business, but I am afraid from what he says that it is not feasible. It is to have the railroad companies to whom the equipment is allocated, enter into an arrangement with the equipment company to draw a draft, to draw bills, which the Railroad Company would accept. That would be a bill representing the cost of goods, sold, from the seller to the buyer. Have the bill accepted by the buyer and have the Director General simply endorse on the back, "This represents a part of the cost of the equipment purchased by such and such a railroad, and that the cost of equipment so purchased will not be exceeded in these drawings." There would not be any possibility of a question arising then. It is such a transaction as a railroad might enter into anyway, and a very customary method of financing the building of ships in England. It is done constantly.

Mr. Hamlin: We ruled two years ago they could do that.

Governor McDougal: I think Mr. Hines made it very clear that could not be arranged.

Governor Strong: Except as to a part of it.

Governor McDougal: A very small part, 15, 20 or 25 per cent of it.

Governor Strong: 25 per cent.

Mr. Hamlin: If that is so, then they would be simply financing building.

Governor Harding: Have you gentlemen considered paragraph A on this page here, and the desirability of the Federal Reserve Banks making miscellaneous sales of bankers' acceptances to members, and so forth. We have heard of cases where banks have been given an opportunity to sell

30 acceptances to member banks in their own district, or buy and sell acceptances in other districts through brokers. I should like for Mr. Kenzel to present his viewpoint on that. That is the main acceptance district. The idea has been suggested to us that it would bedesirable, as far as possible, to confine all these acceptance transactions to the Federal Reserve Banks, all member reserve banks in one district that want any acceptances from New York, for instance, to communicate with the Federal Reserve Bank of New York, with the idea of giving each Federal Reserve Bank a kind of control of acceptances in its own market.

Mr. Kenzel. My feeling, Governor, is that it would distinctly not be desirable for Federal Reserve Banks to make miscellaneous sales of bills from its portfolio or to become market dealers in bills. That is a function of dealers in discount, and I do not think it is the proper function of banks to distribute bills. That is a specialized business and belongs to the dealers in the market, and who should be recognized in it, and the Federal Reserve Banks should not be competitors of theirs. They may, however, I think, very properly be

31 buyers in the market for member banks. We are doing that right along, every once in a while a member bank will come in, become interested in acceptances, it wants to know what they are and we go over it with them. They say, "We would like to have some of those." We assist them in purchasing them, very often buy them for them, charge their account andhold them until maturity and collect them for the bank, sometimes buy them back from them. Here is a little bank at Mt. Vernon, New York, carrying a portfolio of $100,000 all the time. I do not know that it is necessary to make this of record.

Governor Harding. You feel that it is important you know something about the transaction and the rates that rule in the sale of these bills in the New York market?

Mr. Kenzel. Yes.

Governor Harding. Would you not prefer if the Federal Reserve Banks were to either buy or sell bills in your market to let you know something about it?

Mr. Kenzel. I think the sales between banks should be known to the Reserve Bank in the district where the transaction is to take place.

32 Governor Harding. I want to explain to the governors that the Board desires to be informed first about these special sales of acceptances between banks. It does not arise from any disposition to interfere with your independence of action at all, but it comes from this reason, there are a number of banks doing a lot of inter-banking discounting and reserves are running low in some banks. Now if one bank haddealings with another bank for a large amount of acceptances and we did not know anything about it, we would not know about that until the next day, then an application for rediscount would come along, and we might make a request of a bank that had already bought these bills that would bring their reserves down below the point, we would be working at cross purposes about it. So if we were advised in advance of these propositions, we can keep tab on our sheet as to how these reserves are going. We know how to put it.

Mr. Kenzel. And I think if other reserve banks want to buy bills in the market, we are perfectly glad and willing to work for them, and I think probably it would be better for the whole system that there should be consultation and concerted action of that sort, rather than one bank buying bills in the New York market or in Boston or in the Cleveland market, and another bank buying the same bills at possibly a different rate through some other broker, dealing in these bills.

Governor Harding: The Board would be glad if the Governors would discuss that at your convenience and see if some understanding cannot be reached on that aspect of the case.

Governor Strong: We had an understanding originally and had a committee on this subject of which Governor Seay was the chairman, but when the government came into the money market our agreement went overboard. While in the early days we were called upon to give up every dollar of acceptances we could afford to spare, and more, later on we had to take them all, and the account has since fluctuated back and forth. Sometimes the other banks want them, sometimes they do not.

Governor Harding: You have a standing agreement with some of the banks to take a proportion of them?

Governor Strong: Yes; still that arrangement is fairly flexible nowadays. We take them when we have to without limit in New York, and simply supply other reserve banks when they want them.

Mr. A. C. Miller. Item 1, paragraph E, as I remember the question, was put up by the Federal Reserve Bank of San Francisco as to whether or not there should be a sale by a member bank of acceptances to its member banks. I wondered if anything was done there that has given rise to the question, or whether it is purely in anticipation of what might later develop.

Governor Lynch. We consider it desirable that member banks should be customers in high grade bankers' acceptances. We think they are probably the most dependable resources they should have, and for that reason I think it is desirable we should act as a dealer in them for our members, that is, if they come to us, as some banks have already done, and say, "We desire to invest so much money; can you give us bankers' acceptances?" There is not any objection to our selling them. And we assumed that when a market was developed and the banks grew accustomed to these acceptances, we would drop that as something no longer necessary. But you see our condition out there is very different than Mr. Kenzel has described in New York. We are dealing with people who do not understand these acceptances andhave no habit of buy-

35 ing them.

Mr. A. C. Miller. And they cannot take a train and come down to your office and inform themselves?

Mr. Kenzel. No; some of them are too far away.

Governor Wold. There is a disadvantage, though, in the Federal Reserve Bank only buying endorsed bills, and how are we going to get distribution of bills except through discounting these, selling unendorsed bills to banks, and coming back to the member banks endorsed. The San Francisco bank, in order to make it profitable for member banks, will have to buy endorsed bills, will it not?

Governor Lynch. That is about all we deal in, endorsed bills.

Governor Wold. You buy endorsed bills. I am not speaking of the endorsement of the Federal Reserve Bank.

Mr. Kenzel. But your member bank, Governor, could buy a bill in the market at a better rate than you could afford to sell it to them.

Governor Lynch. On the other hand, that would be --

Mr. Kenzel. On the Coast there are some houses dealing there, are there not?

36 Governor Lynch. Yes; but occasionally they have bills andoccasionally they have not. Then, again, the member bank would have more confidence in a bill we would offer them, if we had it all ready in our portfolio, than they would in a bill that was offered by a dealer, so that condition, I think, is a temporary one.

Mr. Kenzel. It should be very temporary.

Governor Harding. There is another question in connection with domestic acceptances, against warehouse receipts, especially, there seems to be a disposition on the part of some member banks to avail themselves of the right to accept up to 50 per cent of their cash and surplus merely to evade the requirements of Section 5200 ~~252~~, Revised Statutes. With the semi-colon there, it looks as though, on a strict construction of the act, that member banks would have the right to accept up to 50 per cent merely for holding purposes, even if there is no intent to transfer or sell the goods in contemplation. What is the view of the banks on these domestic acceptances? If you have a member bank that sends up warehouse receipts for cotton or grain and they accept against those warehouse receipts up to 50 per cent of their capital and surplus, 37 do you look into it to find out whether there is any sale in prospect or whether it is a temporary condition, or whether it is merely a holding proposition?

Governor Lynch. Speaking of our institution, we would look into all those acceptances with a great deal of care. Last year we did some things that were perhaps a little bit of a stretch, but it was to assist the holding of goodsthat were sold to the government until such time as the government would requisition them. It was not possible to sell them under usual trade terms. The goods had already been commandeered in the sense that the government had given notice they were going to take them, but the day they were going to take them was entirely uncertain, and in order to facilitate that we did pass bankers' acceptances which were really a holding proposition.

Governor Harding. This question is of importance particularly in the cotton districts. The board cannot legislate, and does not feel justified in ruling that acceptances against warehouse receipts must be only where there is a sale pending, or shipment in the near future is certain to come. It comes up in the Richmond andAtlanta districts very frequently.

38 Governor Wellborn. Yes. In answer to your qes-tion, we can nearly tell from the source from which it comes, the bank and the size of the credit, whether it is a shipment or not. Freqently it is the case that it is just for holding purposes.

Governor Harding. What do you do in those cases?

Governor Wellborn. We accept the paper for 90 days. When it comes from Savannah we know it is a ship-ment, a small amount, 100 bales, say. Where we observe that it comes in pretty full amounts from interior towns, some small towns, we judge it is simply held for storage purposes, practically a loan, but they have complied with the regulations, they have put up their warehouse re-ceipts, and the bank accepts it.

Mr. Kenzel. Does the bank in that case accept for one drawer in excess of its capital and surplus as a rule?

Governor Wellborn. Oh, yes; they usually avail themselves of that. That is the attractive feature of the acceptance. It gets them over th 10 per cent rule. There are a great many small banks, you know, that other-wise would not be able to handle the cotton.

39 Governor Strong. Is that having any influence upon holding cotton for the market in the South now?

Governor Wellborn. Considerable.

Governor Strong. The ability to borrow beyond the 10 per cent limit in this form?

Governor Wellborn. Formerly they did, but Mr. Williams' rulings have been very strict with them, they had no other recourse until the Federal Reserve Board provided this avenue they would have been almost helpless, those small towns such as Athens, Huntsville and Selma, and so forth, they could not have carried the cotton at all.

Governor Wold. Would it not have forced a liquidation if you had not allowed those bills to go on the market, if you had said that you only bought endorsed bills?

Governor Wellborn. They would have found some other recourse; they would not have submitted to the runover in that way; they would probably have shipped to Atlanta and borrowed from the larger banks. It would take the business from the smaller banks to the larger banks at the ports in larger cities. They could easily send cotton to Birmingham

40 where the banks are borrowing no money at all except on government securities, and could accommodate them very easily.

Governor Harding. I believe Richmond and Dallas both have a great many bills in other banks secured by government obligations which were given them to enable them to carry cotton. I believe i the cotton situation were paid up you could pay up your discount.

Governor Lynch. They have loaded up with cotton.

Governor Peple. I think you said, Mr. Strong, you would give me an opportunity when you discuss the qestion of bankers' acceptances.

Governor Harding. Would it be agreeable this afternoon if you should have a discussion among yourselves and we meet you tomorrow or tonight? Is there any special topic here you wish to advise the Board on now?

Governor Strong. There is one matter that has just come up, it is rather confidential, and I expect a Copy of the cable that brings it up in just a minute. In the early days of the war, when there was difficulty in settling with Holland for securities that the Dutch were sending over here for sale in this market, we enteredinto an arrangement with the Bank of the Netherlands to receive gold in preference to shipping gold, (on account of the difficulties of the British embargo), and we have accumulated six, seven or eight million dollars in gold for the account of the Bank of the Netherlands which does not appear in our statement and is held for safe keeping. It was received prior to the passage of legislation authorizing the embargo on exports of gold, and I understand that on the ruling of the Board it is not subject to the limitations of the embargo on that account. Two suggestions have been made in regard to that gold, one that it might be purchased from the Bank of the Netherlands against some German gold that will be provided by the German Government to pay for foodstuffs. In other words, we will use gold in this country against gold delivered, say, to the Bank of the Netherlands by the German Government on the other side of the water. That suggestion is pending, and no further action has been taken on it.

Governor Harding: You would like to carry that gold off of your reserve?

Governor Strong: If that transaction were made, it would depend on whether it was an actual purchase of

42 the gold or not. It probably would be in this case.

Governor Harding. We have already discussed that, and a second alternative relating to it was where you make a loan against that gold, the other is where you would buy that gold from member banks under repurchase.

Governor Strong. That would not apply to this gold. You see this gold would be absolutely released to us against the deposit of gold with the Bank of the Netherlands, and we would simply put it in our reserve and be free of any obligation.

Governor Harding. Would you be willing to carry it in the Bank of the Netherlands?

Governor Strong. We would not expect to.

Governor Harding. You would rather have it in London?

Governor Strong. In case the German Government deposits equivalent gold with the Bank of the Netherlands, that would be six, seven or eight million dollars of free gold here, and we would furnish six, seven or eight million dollars to pay for foodstuffs, the transaction would wash itself and clean up the Netherlands account.

But now another situation arises. We have a cable, just received from the Bank of the Netherlands, inquiring whether we will take that gold, or some portion of it, over, and invest it in prime American bills for the account of the Bank of the Netherlands, and hold them for their account to maturity, or, in case of need, if we will enter into an agreement to discount the bills for them, and against the proceeds of discount whip gold as they need it. Of course, it is a very ordinary transaction.

Now, there are peculiar reasons in the present situation which led me to believe it would be a very desirable thing to do that. We will have no difficulty, I believe, in working out an arrangement with the Bank of the Netherlands about acting as their agent to purchase bills, but I would not want to enter into an arrangement under which they should really use us, (this really being an open gold market) to give them the proceeds of discount of their bills, if they discounted them with us, or sold them to us, unless we could actually ship the gold. That is the c rux of the whole situation.

Mr. A. C. Miller: Here is your chance to stand on the basis that this is a free gold market.

Governor Strong: To convince Holland that we are a free gold market.

Mr. A. C. Miller: If you will say no to this, it is equivalent to saying that we are not a free gold market?

Governor Strong: Yes.

Mr. A. C. Miller: That is the point that is embarrassing.

Governor Strong: Yes. My disposition is, provided we are assured of no difficulty about the embargo on gold, to say yes, we will do it, and our rate is so and so.

Governor Harding: What is the amount of gold involved?

Mr. Kenzel: About $9,000,000.

Governor Harding: I had this confused with the other proposition of $70,000,000.

Governor Strong: It bears on that, because if we had $70,000,000 gold ear-marked for the Bank of the Netherlands now, the Germans would turn over their gold to the Bank of the Netherlands; we would take the gold deposited here, settle with the Bank of the Netherlands, and send foodstuffs. That we cannot do, simply because we have not enough gold, and if we do this, it will preclude our doing

45 the other.

Governor Harding. Would this be just a single transaction, or would there be more?

Governor Strong. Our relations with the Bank of the Netherlands are very friendly, and I have no doubt if we put through this transaction it will lead us into a more or less active arrangement with them, and what I regard as a very desirable arrangement.

Mr. Kenzel. The market here would lose no gold?

Governor Strong. We would gain gold.

Governor Harding. Have you discussed this with Mr. Kent?

Governor Strong. Yes; he called up.

Governor Harding. What does he advise about it?

Governor Strong. I have just got a copy of the cable. I did not discuss it with him, and I am to call him up later. If the gold committee makes it clear, which is my present understanding, that the embargo does not apply to that gold, and it certainly should not, because it would be a distinct violation of the contract --

Governor Harding. I think this, if you thought the transaction was such that you would like to engage in it

46 and cannot advise that it be done, I am satisfied the gold committee would approve.

Governor Strong. I would need a little time to discuss it with Mr. Kent. He is going back this afternoon on the 4 o'clock train.

Governor Harding. I suggest you discuss it with Mr. Kent, because if it comes up we would confer with him before we took any action on it.

Governor Strong. Suppose I go to the Treasury Department right after luncheon and ask Mr. Kent to have a conversation with you about it, Governor Harding?

Governor Harding. All right; I can see him before he leaves and call a meeting of the gold committee this afternoon.

Governor Strong. This is a splendid opportunity to put this country on a definite gold basis with Holland, and doing it with the government bank of Holland, the right atmosphere would be created rightaway.

Governor Harding. It looks very good to me. But I make no pretentions of being an expert on foreign exchange policy; we have got an expert advising us.

Governor Strong. If that is entirely agreeable, I will come in after luncheon.

Governor Morss: Could any program be laid when we finish here?

Governor Harding: So far as I know, we shall finish tomorrow.

Governor Strong: Governor Harding, if we now have one of our old-fashioned meetings and control the discussion, we might get through most of this program tomorrow afternoon. But I think we have got to expedite the discussion by rather arbitrary methods.

Governor Harding: We have laid out all the topics here and I do not think there is anything in the program that needs any explanation. There is only one little minor point here. A good many banks, not located in branch bank towns, do not like this discrimination against them by the Federal Reserve; they would like to be on the discretionary list. We are having a good many applications for branches, and that, by the way, is a question I should like the Governors to discuss and advise us upon, as to what policy should be pursued in determining whether or not branches should be established. There are a great many ambitious towns, you know, with civic pride that think

48 they want a branch, who really do not need any branch, but they think so, so it makes the pressure just about asbad. There are other towns that have no ambition to have a branch and they do not want to lose their acceptances to the reserve cities. Take cases like Roanoke and Richmond, for instance, the National Exchange Bank of Roanoke has made arrangements, as I understand it, with the Federal Reserve Bank at Richmond, that any check coming into Richmond drawn on the Exchange Bank, that Richmond may immediately charge its reserve account with it.

Governor Peple. There are two banks in Roanoke.

Governor Harding. But it does not do them any good, because these checks going into New York have to wait the time allowance. They want to be put on the exact Richmond basis, and of course there is serious objection to having anything stamped on a check payable at the Reserve Bank in Richmond. They raise the point that the Richmond bank signifies to the New York Clearing House its willingness to give immediate credit at Richmond on a check drawn by either one of these banks, which had stamped or printed on the face of it, "Amount of this check is immediately available upon presentation at the Federal Reserve Bank of Richmond," Of course, that would bring about a pretty tremend-

49 ous enlargement of your clearing system.

Governor Lynch. It looks to me like that is a too-far reaching proposition.

Governor Wold. They could not give final credit under that check until it had gotten to Roanoke, either that or the Roanoke Bank would have to take the chances of the Federal Reserve Bank in Richmond paying a forgery.

Governor Harding. All they want Richmond to do is to absorb the float, then the contingent liability would exist until it was finally paid.

Governor Wold. Would the endorsing bank give credit before the ultimate payment was made?

Governor Harding. I presume the endorsing bank does give credit subject to any allowances.

Governor Wold. They could not reduce the time allowance until the check was absolutely paid at Richmond.

Governor Strong. If that principle is applied throughout the country, we would gradually have all checks drawn and made available at New York, and we would have to tote the float.

Governor Peple. I want to say we were rather forced into that arrangement early in the collection system with

50 reference to Roanoke and Baltimore. In Baltimore we were very careful andhad the arrangement made by every bank in the city. By some oversight, I do not remember now why it w as or what it was, they only took two of the three Roanoke banks. We have positively refused in a number of other cases to par the checks unless the entire city would go into it, and, frankly, we do not want to do any of it. We would be glad if Roanoke would stop it. The situation has been cleaned up in Baltimore by the establishment of the Baltimore branch. We are now taking Baltimore checks on one day deferred, and Baltimore takes Richmond checks on one day deferred, and we would be very glad to get rid of those two Roanoke banks, and I had a talk with one of them andtried to persuade him to stop it.

Governor Wellborn. I suppose the Roanoke bank does that for the purpose of holding balances?

Governor Wold. For holding balances.

Governor Harding. If you can work out the rest of these topics yourselves, I think the board will leave you alone. There will be two or three governors, I take it, who will remain over until Monday, anyway, andif your finance committee has anything further to communicate to the Board, 51 we can take it up at our convenience on Monday. I do not think there is any further occasion for any joint meeting. If you will let us know at any time that you want any member of the Board over here, we can come over.

(Whereupon, at 1:30 o'clock p. m., recess was taken until 3 o'clock p. m., on the same day.)

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AFTER RECESS

The conference reassembled, pursuant to recess, at 3 o'clock p.m.

Governor Strong: The meeting will come to order.

Gentlemen, these meetings, as they were held sometime ago, were run rather arbitrarily in order to reduce discussion toa minimum. If it is agreeable to everyone we will go through the program speedily.

Governor Biggs: I would like to make a motion that we send a suitable telegram to Governor Seay.

Governor Fancher: A self-appointed committee has already attended to that. The committee consisted of Governor Wold and myself.

Governor Strong: We will have the telegram inserted in the record at this place:

"Geo. J. Seay,

Clifton Springs, N.Y.

C/o Clinton Springs Sanitorium.

Governors in conference miss your presence and counsel extend their warmest regards and hope for your speedy recovery.

Fancher & Wold,

March 21, 1919. Committee."

It has also been suggested that we get through in time to avail ourselves of the invitation to visit the Bureau of Engraving and Printing.

Now, gentlemen, the topics suggested for the conference that were taken up at the meeting on Tursday, contained on the first page of the program, have been pretty well covered and, unless requested, we will omit any discussion of those matters of general interest.

The first topic is discount policies.

1. DISCOUNT POLICIES.

This topic has been discussed, but in order to complete the record, it might be that you will want to pass some resolution in line with similar action taken by the Federal Advisory Council. The action of the Federal Advisory Council is as follows:

"Until the Liberty bonds already issued and the Victory bonds to be issued are distributed among permanent investors and paid for by them and until the banks are relieved of the obligation they are under to carry such large lines of them for their patriotic customers who have gone in debt for them, and until our Government gets through with its temporary financing on short time certificates, the discount rate at the Federal Reserve Banks should continue to show some preference on loans covered by Government securities. The rates might well be continued as they now are until after the next bond issue has been placed, but there will come a time when such preference should not be continued, otherwise loans on Government securities will continue to form too large a proportion of the Federal Reserve Bank loans to the disadvantage of industrial and commercial enterprise.

The financial necessities of the Government for the payment of its war debts will, however, have to be met and provided for before such discrimination in favor of loans covered by Government securities as will induce people to borrow to pay for them in anticipation of their future earnings and incomes, can be discontinued.

(After informal discussion, the following action was taken on topics, a, b, c, d, and e of Topic 1.)

a. How long should reserve banks continue the present differential rates in favor of notes secured by Government obligations.

Governor Strong: It is the opinion of the meeting that present differential rates in favor of notes, secured by Government obligations, should be continued until after the fifth loan is placed, and for such reasonable period thereafter as will permit a considerable liquidation of such borrowings without imposing undue penalties upon the banks which are required to rediscount with the Federal Reserve Banks.

It is further suggested that no recommendation for a change in the present differential rates can well be made until it is known at what rate the next loan will be offered, at which time some readjustment of rates for loans to be secured by bonds of that issue may be necessary. The establishment of a different rate for loans secured by the bonds of the Fifth loan may necessitate a review at that time of rates applying to loans secured by bonds of the earlier issues.

b. Current rates of member banks for bank loans in the several reserve districts, and their relation to present rediscount rates of Federal Reserve Banks.

The current rates of member banks referred to are regularly reported by the reserve banks to the Federal Reserve Board, and it is not understood that any recommendation isrequested on this topic.

c. Liquidation of Government secured paper at Reserve Banks.

d. Expression of opinion as to the length of time which will be required to make a permanent distribution of the Government securities held by member banks.

Governor Strong: It is the opinion of the meeting that if no further permanent borrowing is required by the Government after the fifth loan is placed, and provided the general tendency toward a general commercial liquidation continues as expected, the amount of unliquidated paper held by member banks and by the Reserve banks at the end of a period of say a year from June 1st, next, will be so small as to be a negligible factor in the position of the Federal reserve banks and can be readily dealt with at or before the expiration of that year by readjustment of rates.

e. Discussion of recommendations made by Advisory Council as to discount rates and policies.

Governor Strong: The answer to topic (a) fully answers topic (e), except that it is the unanimous opinion of the meeting that the rates to be adopted and maintained by the reserve banks, for loans secured by Government bonds and notes should be uniform in all the reserve banks.

2. BANKERS' ACCEPTANCES -- OPEN MARKET.

a. Development of open market.

b. Is a low rate at Federal Reserve Banks necessary to develop the acceptance market?

Governor Strong: It is recommended that in general the present policy as to rates for bankers acceptances be continued. The present developments in foreign exchange may, however, present the opportunity for securing a large increase in the volume of bills drawn in dollars, of which advantage should be taken, in case it does arise, by quoting favorable rates for open market purchases, and particularly forward rates for bills to arrive, even though that involves a larger accumulation of bills by the Reserve market for bills.

It is further recommended that in order to develop an active market for bills in the different reserve districts, that steps should be taken by the reserve banks to insure dealers in bills a sufficient supply of credit with which to carry them, without penalty of a high rate, until they are able to market them.

It is suggested that the Reserve banks can facilitate the development of carrying arrangements for dealers by making arrangements for special purchases of bills from them under contract to repurchase within fifteen days, in cases where member banks are not willing to make collateral loans on bills at reasonable rates.

c. Reserve Bank-policies in making purchases.

1. Direct from accepting banks.

Mr. Peple calls attention to the fact that the immediate discontinuance of this practice in the Richmond district would cause undue hardship upon the member banks.

2. From Member Banks, with or without endorsement.

(Miscellaneous bills other than own acceptances).

It is recommended that the purchase of bills be made freely from member banks, with their indorsement, unless bearing otherwise satisfactory indorsements, those bills, however, to be other than those accepted by the selling banks.

3 3. Through Brokers and Accepting Houses.

It is recommended that steps be taken by the Reserve Banks to encourage the development of the business of dealing in bills in each of the reserve bank cities, as a facility for the development of this market and that dealers be encouraged by having free access to Federal reserve banks, to sell bills and to carry them under a 15 day repurchase arrangement.

4. Through other Federal Reserve Banks.

5. Through brokers or banks, other than reserve banks, of Acceptances of member banks in other districts.

It is recommended that Federal Reserve Banks should not appear as purchasers of bills in other Federal Reserve districts, except through the Federal Reserve Banks of those districts.

d. Bills of acceptances to other Reserve Banks, with or without reserve bank endorsement.

It is recommended that where voluntary open market purchases are made by one reserve bank through another reserve bank, no endorsement be expected or required.

Where sales of bills by one reserve bank to another reserve bank are made by mutual arrangement, indorsement may be required by the purchasing reserve bank and such transactions should promptly be reported to the Federal Reserve Board. That where rediscounts are arranged through the Reserve Board, at rated fixed by the Board, endorsements should always be given by the borrowing bank.

e. Expression of opinion is asked as to desirability of reserve banks making miscellaneous sales of bankers' acceptances.

1. To member banks in its own district.

2. To other banks, bankers, brokers, or accepting houses in its own district.

3. To banks, bankers, brokers, or accepting houses in other districts.

It is recommended that it be the policy of the System that no sales of bills to be made by reserve banks out of their portfolios, except to other reserve banks; but as a temporary matter, to aid in the development of the market for bills among member banks, certain reserve banks may find it necessary for the time being to act as the agent of member banks in making purchases of bills and to some extent to act as dealers in bills for that purpose. That Federal Reserve Banks may very properly buy bills for member banks, assist them in their purchases by giving advice and taking deliveries for them.

f. Necessity for general cooperative policy covering all interdistrict purchases, sales and rediscounts.

Governor Strong: It is the sense of the meeting that where one Federal reserve bank takes its bills in another Federal reserve district, it should be through the bank of that district.

(Whereupon, at 6:15 o'clock p.m., the conference adjourned until 8 o'clock p.m. of the same day).

EVENING SESSION

The conference reassembled, pursuant to recess, at 8 o'clock p.m.

Governor Strong: The meeting will come to order.

Governor Passmore: I move that a recommendation be made to the Board that the federal reserve banks be permitted, as local circumstances warrant, to establish free luncheon facilities for their employees, in the belief that the expenditure involved will be more than offset in economy of time and increased control of the efficiency of the workers.

(The motion, having been duly seconded, was carried).

Governor Strong: The next is number 3.

3. BANKERS ACCEPTANCES--GENERAL.

There are two sub-topics under this:

a. To what extent is inquiry made by reserve banks to determine eligibility of bankers' acceptances.

That topic will require a little inquiry around the table.

Mr. Kenzel will be good enough to explain what we do in New York.

Mr. Kenzel: Our practice is to inquire of the accepting bank, in every instance where the bill itself does not disclose the nature of the transaction, or if it is with regard to commodities, what the commodity is; and if it is an import or export bill we inquire as to the country of origin and the country of destination. We seldom have occasion to go into the question of the agreement which the bank has with its client. Occasionally, in our general inquiries, we turn up the fact that the bank has accepted under a misapprehension, and we then take it up with the individual banks to correct any error that they have been following in order to bring about a correct practice.

Deputy Governor Peple: Do you do that before you have bought the bill, after you have bought ir, or how?

Mr. Kenzel: Our purchases from dealers in the market are subject to approval when the paper is finally delivered to us. We buy names from them, but it is understood it is subject to being satisfactory to us when we examine it.

Governor Fancher: That is about our procedure, Governor Strong. We try to satisfy ourselves in all cases. In the case of bills in large volume which come from New York, your schedule gives that information. When bills are offered by a member bank we are very particular about getting information on the underlying transaction. Where it is not clear we write to the accepting bank. If it is a question of commodities being stored, we bring out the point that they must remain secured until the obligation is liquidated.

In that connection, it might be of assistance to us if the Board incorporated in its new ruling a provision that the accepting bank indicate on the instrument the nature of the underlying transaction. I think it would help very much.

Governor Strong: There is a question involved there of impairment of negotiability, which would make it serious.

Governor Wold: Some of them carry that information now. Nearly all the foreign bills indicate what the nature of the transaction is. I think it is common practice with foreign bills.

Governor Fancher: They give the commodity and give the nature of the transaction. Why could that not be followed in domestic acceptances? Several of our member banks who are doing a good deal of accepting are doing that.

Mr. Kenzel: Several exporters in New York have a form bill which they provide their customers, on which space is provided to show the nature of the transaction.

Deputy Governor Spencer: We satisfy ourselves as to the underlying commodity credit. In the case of a new bill we usually send for the form and satisfy ourselves that they have started out right. Every two or three months we go through the portfolio, pick out one bill from each exporter, send them a form letter inquiring as to the transaction, and ask for the underlying commodity.

Governor Miller: We buy our bills from New York, Governor Strong.

Deputy Governor Peple: We take those bills from the accepting banks, as I stated when the matter was referred to before, considering that they act as the agents of the drawer to sell us the bill. We require the bank, in a letter, or frequently in a memorandum attached to the bill, to state the entire nature of the transaction, the kind, amount, and value of the security, and frequently state that the security will be held for the payment of the bill. As I stated before, we have thought it necessary to follow that direct purchase practice for awhile in order to get our banks educated in respect to what they should do and what they should not do.

I will take up the results of that practice when we discuss the question of abuse of bankers acceptances.

Governor Passmore: We do not handle a large volume, and what we handle are usually bought through Mr. Kenzel. As they come to us from member banks, we follow the same procedure as outlined by Mr. Fancher and other Governors.

Governor McDougal: We have not made a practice of investigating the underlying transactions except in exceptional cases. I do not know what it is worth, but we have an arrangement with our Chief Examiner under which he looks very carefully into these matters as he goes around. We are not doing a great deal of it, but in the early stages exceptions were taken to the plan and operation there, a form was agreed upon which all of the Chicago Banks are using. We do not investigate every transaction.

Deputy Governor Peple: I would like to add to my statement, that in very many cases, particularly with small banks, which we do not consider to be very well managed, we require the deposit of the security with us.

Governor Biggs: We make an effort to investigate them very closely. We pursue about the course outlined by Mr. Kenzel, and investigate all of them.

Governor Lynch: My answer would be about the same as Governor McDougal's. Our credit department is very rudimentary, and it is not properly organized. We depend upon Mr. Kenzel in very considerable measure. In the case of bills that we take directly, we, of course, investigate unless we know the people well.

Governor VanZandt: We investigate transactions on all bills which we buy, except those that come from your bank, and those are outlined in the schedule submitted.

Governor Wold: We are not buying any now, and Mr. Kenzel does the investigating. We do investigate when we buy.

b. Distinction.--Foreign and Domestic Acceptances as to Security Required at the time of and subsequent to Acceptance.

Mr. Kenzel: Our general practice is to buy bills on the strength of the credit of the names on the bill. Such inquiry as is made as to the practice of member banks in accepting is more of an educational character to insure that the banks are following sound practice, and the inquiry is conducted with a good deal of diligence.

4. BANKERS' ACCEPTANCES--DOMESTIC.

a. Use and abuse of domestic acceptances.

b. Custody of collateral.

(c) Discrimination in purchases by reserve banks.

The discussion at the meeting developed the fact that there is a growing tendency on the part of member banks to misuse, and possibly abuse, the right of granting acceptance credits in domestic transactions. These abuses doubtless grow, in many cases, out of a lack of knowledge of what are correct practises, and to some extent out of difficulties incident to the war.

The principal abuses noted were in the employment of acceptance credits for transactions which are in fact loans upon commodities. In such cases the use of acceptance credits is frequently a subterfuge to escape the provisions of section 5200 of the National Bank Act, and in other cases an improper drawing of bills against domestic shipments of goods. It is the belief of the meeting that it would be a mistake to endeavor to correct these practices through general regulations applying to the purchase of bills by the reserve banks. It is, therefore, recommended that the Reserve Board obtain the services of bankers who are thoroughly familiar with both domestic and foreign acceptance credits, to prepare literature for use by the reserve banks in educating their member banks in sound methods to be employed in all branches of the acceptance business.

It is further recommended that no attempt be made, by regulation of the Federal Reserve Board, to control the method employed by member banks in conducting their business, until the literature above referred to has been prepared.

Attention is directed to the following memorandum in regard to the ruling by the Comptroller of the Currency. If this ruling is strictly construed, no bank buying the acceptances of another bank, in excess of 10 per cent of its own capital, would be able to ascertain whether the provisions of section 5200 had been violated or not, without inquiry as to every transaction under which these bills originated. The danger lies in the possible impairment of the marketability of the bills, resulting from the fear of granting excessive loans to member banks through the account "bills purchased".

The ruling by the Comptroller of the Currency is as follows:

"Subject: Limitations of Section 5200
as applied to bankers' acceptances.

"Recently Mr. Newnhan, supervising examiner of the Comptroller's office, called to discuss this subject in the light of present practice and rulings of the Federal Reserve Board, and the theories of the Comptroller's office.

"He explained that in the Comptroller's office it had been held for many years that only paper which resulted from the sale of goods could be classed as commercial paper, actually owned, etc., or if bills of exchange as bills of exchange drawn against actually existing values, that the mere fact that there were goods as collateral security pledged to a bill of exchange would not constitute actually existing values.

"The opinion of council published in the Federal Reserve Bulletin of March 1, 1917, citing from the decision of the case of the Second National Bank of Oswego, versus Burt, 93 N.Y. 233, is considered affirmative of this view. Mr. Newnhan also inclined to the belief that with regard to acceptances discounted for or purchased from the acceptor, such purchase or discount constitutes a loan to the acceptor and would be liable to the limitations of the statute as borrowed money; that they could not be considered as commercial paper actually owned, etc., by the accepter offering them for sale or rediscount.

"Also, that with regard to bills drawn on a national bank against the pledge of goods in warehouse owned by the drawer:

(a) If the bill is taken by the accepter that it is merely a secured loan and falls within the limitations of the statute.

(b) That in the hands of a third party, as there is no sale for goods antecedent to the instrument it is within the limitations of the statute and could not be held by a national bank purchaser for an amount in excess of 10% of the capital stock and surplus of the national bank purchaser."

5. LOANS TO MEMBER BANKS.

a. What is the policy with respect to discounts by reserve banks of notes and bills secured by commodities; margin required.

Deputy Governor Peple: The loans we have now are the result of the cotton situation, and we have required a margin of at least 20%. We have refused lately to take any loans at more than 20 cents a pound on cotton. This same matter will come under the next heading.

We have always followed the practice, whenever the commercial and agricultural loans of a bank reaches the amount of its capital stock, to require marginal security of their bills receivable. We always have excluded Government loans from that amount, and last year we excluded cotton. This year we made no exception of cotton.

As the loans increase we increase the percentages of margin. We have a number of banks now that are putting up with us 100% marginal paper, with the idea of securing absolute safety for ourselves, although we look carefully into the security on the notes and get a statement of the borrowers, where the bank is loaning the borrower as much as 10% of its capital stock, or $5,000.00. We always get the net worth and we frequently make inquiries in addition to that. We require a margin and a statement, partly for the security and, in extreme cases, to get the paper away from the bank so they will not have any more of it to offer.

Governor Biggs: We have a little cotton at Memphis and Little Rock, and we aim to keep a margin of about 20%. We have no fixed practice , but we can loan according to the grade of the cotton.

Deputy Governor Peple: That is the same way with us.

Governor Biggs: Some of the banks in the cotton section, about 60 days ago, were extending a little too much. They were borrowing what we thought was too much. We probably had eight or ten at one time that got above what we considered a basic loan, and we wrote and told them they would have to check it. We checked it in ten days and experienced no trouble.

The Memphis banks were heavy borrowers, but they are borrowing now largely on Government securities and have gotten in better shape. In some of the sections in the smaller towns, where the banks' capital are not much but there is a great deal of cotton and rice being moved, they are getting in better shape. They were borrowing in excess of what we thought should be their requirements, and in that case we required them to put up additional collateral. We did not require them to put up over 50% . We would ask them for additional collateral and they would send it to us. We do not require them to put up as much as Governor Peple has stated. We have three or four banks where additional collateral has been put up. They are small banks, and we think the commodities are perfectly good.

We have had the feeling that it has not been so much the question of abuse by these people in the cotton section as it has been a question of necessity; they have had to meet a necessity; I think that is what the reserve banks are for. We are perfectly safe in those matters, and as long as things are running along smoothly and we can help them, I think it is the thing to do.

Governor VanZandt: It all depends upon the worth of the borrower, as shown by his statement, as to the amount of margin that we require on a note; and in the case of a bank statement, the showing of the bank itself, how good a bank it is. We investigate very carefully the margin on each note, and investigate the commodity, just the same as we do on cattle, sheep, etc.

Governor Wold: We have very little of this business.

We have had a few thousand dollars on grain. When wheat is a dollar a bushel, or less, the margin is ten cents a bushel. When wheat is over a dollar a bushel, it is ten per cent.

We do not consider warehouse receipts, outside of terminal or regular houses, a collateral. That is, registered terminal houses.

Governor Strong: In view of the statements made, it seems to be the opinion of the meeting that special conditions exist in only one or two of the Federal reserve districts, and they had best be dealt with directly by the Reserve Board with the banks in those districts, rather than be made the subject of a recommendation by this meeting.

b. The attention of the Board has been called to what has been termed "extraordinary liberality" of loans to small member banks , The margin between the reserve bank discount rate and the rate charged to customers of rediscounting banks, tends to encourage easy credit.

Governor McDougal: There is no hard and fast rule that can be applied by the reserve bank granting credit to member institutions. Each case must be considered separately and decided according to its merits. In the case of banks which apparently are in weak or over-extended condition, it is a general custom among the reserve banks to secure either additional collateral or to strengthen the paper by additional indorsements or guarantees of directors.

Governor Strong: It is the sense of the meeting that during the period when the Government is making such heavy demand upon the banks, it is impossible to restrict the lines to individual borrowers, as would otherwise be the case, and individual inquiry and remonstrance as a general practice is checking the tendency on the part of member banks to profiteer.

The development of the special department of examination in the reserve banks has provided facilities for making not only special credit investigations in cases where eded, but examinations of member banks themselves, with a view to checking up their condition and improving their banking practice.

In general, the examining Board for the Reserve Banks cooperates with the examiners of the State Banking Department.

6. CREDIT STATEMENTS.

a. Extent to which reliance is placed upon the standing and condition of an indorsing bank and its certificate as to eligibility of notes submitted for rediscount, rather than determination as to eligibility as well as desirability, through analysis of financial statement of the payers of the notes rediscounted.

Governor Strong: Discussion of this topic discloses the fact that all the reserve banks require financial statements for all commercial paper discounted, where the regulations of the Board require it. In the case of some of the reserve banks, statements are required where the amount of the note taken is considerably less than the minimum required by the regulations of the Board. In general, all large lines of paper taken through the member banks are considered not only upon the standing and condition of the indorsing bank, but also the value and quality of the paper discounted.

b. Corporations operating subsidiary companies; suggested requirement, that such companies furnish to Reserve banks, separate financial statements of parent and all principal subsidiary corporations as of the same date.

Governor Strong: In the opinion of the meeting, it is desirable that separate financial statements of parent and principal subsidiary corporations, as of the same date, be furnished.

7. RE-DISCOUNTS BETWEEN RESERVE BANKS.

At present when the reserve bank percentage against combined note and deposit liabilities is reduced to about forty per cent, bills are sold to or rediscounted with other Federal reserve banks. At present, the the reserve percentage of a number of reserve banks is in excess of 65%. It has been suggested that the rediscounting point be raised from 40 to 45 per cent.

Governor Strong: It was the unanimous view of the meeting that there should be no change in the present practice.

8. CREDIT BAROMETRICS.

Consideration of the suggestion made by A. Wall of Detroit, that a Bureau of Barometrics be established by the Federal Reserve Board. Would the benefits warrant the expense?

Governor Strong: It is the unanimous belief of the meeting that the benefits of the employment of this service would not warrant the expense involved.

9. RESERVE BANK BUILDINGS.

Need for cooperation and interchange of ideas in the development of plans for the erection of new bank buildings, installation of vaults and other equipment.

Governor Strong: After full discussion, it was the unanimous opinion of the Governors of all the reserve banks, that it would be desirable to adopt the suggestion of the

Federal Reserve Board, that an architect be employed to act as a clearing house for information in regard to building plans between all of the reserve banks, and to act as adviser to the Federal Reserve Board in giving approval of certain plans.

The meeting also favored the employment of Mr. Alexander B. Trowbridge, as recommended by the Board.

10. RESERVE BANK INSURANCE.

Governor Passmore offered a resolution covering this topic and the several sub-topics thereunder, that Mr. Kenzel be appointed Chairman of a committee, with authority to select representatives from two other reserve banks, to act with him as a committee in making recommendations, which recommendations are to be submitted in writing to the reserve banks at a later date.

(The motion, having been duly seconded, was carried).

The conference entered into informal discussion with Mr. Meyer, Director of the War Finance Corporation, at the conclusion of which informal discussion, at 11:25 o'clock p.m., the conference adjourned until tomorrow, Saturday, March 22, 1919, at 9:30 o'clock a.m.