

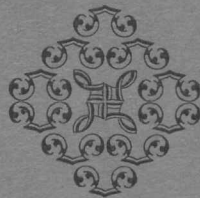
Volume 1

# CONFERENCE OF GOVERNORS OF THE FEDERAL RESERVE BANKS

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TREASURY BUILDING \* WASHINGTON, D. C.

MARCH 22, 23, 24, 1926

WALTER S. COX, SHORTHAND REPORTER

472 Louisiana Avenue, Northwest      Washington, D. C.

A CONFERENCE OF GOVERNORS OF THE FEDERAL  
RESERVE BANKS.

Washington, D. C.,

Monday, March 22nd, 1926,

10:30 o'clock a.m.

A Conference of Governors of the Federal Reserve Banks was convened in the Board Room of the Federal Reserve Board, Treasury Building, Washington, D. C., on Monday, March 22, 1926, at 10:30 o'clock a.m.

PRESENT: Benjamin Strong, Governor, Federal Reserve Bank of New York (Chairman).

W. P. G. Harding, Governor, Federal Reserve Bank of Boston.

George W. Norris, Governor, Federal Reserve Bank of Philadelphia.

E. R. Fancher, Governor, Federal Reserve Bank of Cleveland.

George J. Seay, Governor, Federal Reserve Bank of Richmond.

M. B. Wellhorn, Governor, Federal Reserve Bank of Atlanta.

J. B. McDougal, Governor, Federal Reserve Bank of Chicago.

D. C. Biggs, Governor, Federal Reserve Bank of St. Louis.

R. A. Young, Governor, Federal Reserve Bank of Minneapolis.

W. J. Bailey, Governor, Federal Reserve Bank of Kansas City.

Lynn P. Talley, Governor, Federal Reserve Bank of Dallas.

J. U. Calkins, Governor, Federal Reserve Bank of San Francisco.

George L. Harrison, Deputy Governor, Federal Reserve Bank of New York, and Secretary to the Conference of Governors.

P R O C E E D I N G S .

The Chairman. All members are present, and the meeting will please come to order. I am advised by Governor Crissinger that the Board will join us later, and we may proceed now with the program.

The first topic is 1.

1. CREDIT TRANSACTIONS AND POLICIES.

A. Open Market Operations.

1. Report of Open Market Investment Committee.
2. Policy.

Copies of the Open Market Committee report are before you. The Committee had a meeting on Saturday and unanimously adopted this report. We then discussed it with the Board. As it contained no recommendations for immediate transactions, it does not require any special comment, but does express some views of the committee as to what we may find it necessary to do in the near future. If you will glance through the report possibly we may take some action on it.

Governor Young. The report requires no action, does it?

The Chairman. No. We have generally submitted it and then taken some steps to approve it or disapprove it and file it.

Governor Young. Mr. Chairman, I move that the report of the open market committee be approved and filed.

Governor Fancher. I second the motion.

The Chairman. Is there any discussion of the report?

Governor Bailey. Governor Strong, I would like to ask whether or not this means that you may possibly have to

take some unusual or drastic measures? Does that grow out of the stopping of the boom in stocks and speculative real estate transactions in several sections of the country? Is that a reaction from that? I notice you say business was not as good last month as it was in January.

The Chairman. Well, Governor Bailey, I think the feeling in New York, in our bank, is that there has been a change of public attitude a little bit. People are hesitating and getting a little cautious about the outlook. Under those conditions, when the member banks owe us as much money as they do, sometimes it leads the bankers to reduce their line of loans and get out of debt to us. That should not happen when prices are declining and business is good as a whole, realizing, as you do, that every dollar of loans paid off at the reserve bank, unless there is gold coming into the country, means a shrinking of the loan and deposit account of the member banks by something like ten dollars.

Governor Seay. I notice some statement of the prospect of the importation of a considerable of gold from Japan, to the extent of thirty or thirty-five million. Is there any intimation of that?

The Chairman. Well, they have not told us what they propose to do beyond saying that the Government policy now of supporting the yen would probably make it necessary to ship gold from time to time to the United States. You have reports from business in your section, do you not?

Governor Bailey. Yes.

The Chairman. I think possibly this decline in stocks may have had something to do with it, and some other things, probably.

Governor Bailey. We have on our Board a new member, which is the head of the largest store in Oklahoma City. He is a very shrewd fellow. He has been at our bank serving on the executive committee and learning the ways of the bank. He gets a report from his house showing that January was a good month but that February had fallen off. He said that this last week was a little better than the week before, but there were two or three weeks when business was falling off. I asked him why and he said he could not tell. He is an old timer at it. He says that condition comes periodically without finding any reason. Down with us, the climatic conditions are good, and it looks as if prospects for crops are fine. We have

had all the moisture that we we really need at this time, although we have got to have more to make the crop; but there is no alarm or anything of that kind. When it gets too dry, people begin to husband their resources until the thing opens up, and if we get our seasonal rains from now on business will pick up and the outlook will be good. I asked him what he thought of that and he said that was his idea. So far as prices are concerned, there is one peculiar condition: We don't see a great deal of corn any more. Wheat is a good price, and we have got the hogs in Kansas and generally in the Tenth District. Nebraska may be a little short on hogs but the rest of them have got plenty of hogs. That bunch that are feeding hogs and cattle are on the opposite side of the fence and the crowd that has come here from Iowa are trying to put up the price of corn.

The Chairman. They haven't got the hogs to feed.

Governor Bailey. They have an unmarketable corn, a soft corn.

Governor Seay. From what region does that report come, Governor Bailey?

Governor Bailey. I am speaking of the Tenth District.

Governor Seay. You spoke of some gentleman who was an

unusually good judge of conditions in his locality.

Governor Bailey. Oh, that was from Oklahoma City.

Governor Wellborn. The agricultural conditions are in very good shape in Oklahoma, are they not?

Governor Bailey. Yes.

Governor Wellborn. They raised a very large crop of cotton.

Governor Bailey. Yes.

Governor Wellborn. Did they hold that cotton or sell it?

Governor Bailey. I think they have mostly sold it. Some of them have gone in cooperative marketing outfits. A lot have held the cotton. In a general way the banks of Oklahoma are in good shape, with a few exceptions that were busted four or five years ago and never can be any good. They are a liability, that is all. They are struggling along, but mostly I would say that the banks in Oklahoma are in first class shape, especially the member banks.

Governor Harding. How is the State guaranty fund getting along?

Governor Bailey. It has blown up; they don't



pay any attention to it. They just abandoned it.

Governor Harding. Do the banks keep putting up for it?

Governor Bailey. No. They have been trying to enforce it; they have got to, but the only way they will ever be paid is by the State to make a bond issue or find some other way to pay them. There are ten people who haven't got one of those certificates in Oklahoma to every one that has. I do not think they are going to burden themselves. I think it has blown up. Our guaranty loan law in Kansas is almost as bad. In Nebraska they have gotten along pretty well. It is hard sledding for the member banks against the State banks that have really paid, but they have taxed the State banks until they are pretty nearly taxed to death. They have the law so fixed that they cannot get out unless they pay up all the assessments made against them while they are in. They have a system now where they take over the insolvent banks and the State department runs them and takes the deposits and segregates the new deposits and holds them, and they are running the insolvent banks. We have one member that is a State bank and I want to get some information how to unload it,

because we cannot get rid of it.

Governor Harding. That guaranty business is just like a life insurance company issuing insurance on a man without requiring any medical examinations. If the banks had put up the money and had something to say about the operation and charter of new banks it would be better, but they haven't anything to say about it.

Governor Bailey. That is the trouble. He said that it was insurance, and I tried to answer it by saying that an insurance company that insures either for life or fire and takes no recognition of the condition of the risk would go broke. It is just like taking a town of ten thousand people and writing insurance on the life of every man in the town at the same rate. That company would go broke. No State would grant an insurance company like that a license to do business in the State. That is just what they do. They just insure every bank without reference to solvency, conduct or anything of that kind, ~~it is a~~ most uneconomical and unsound proposition. Aren't they trying to get it out in Iowa now, Mr. McDougal?

Governor McDougal. Yes. The proposition has been

demonstrated in every State that has tried it as unsound in principle, and that it would not work out in principle.

Governor Seay. You take a lot of sick fellows like they have in Iowa and they will take any kind of medicine once or twice. There ought to be some effort made not to have that law passed, because it is a dangerous law .

Governor Young. It has been a complete failure in North Dakota, South Dakota, and still Montana this fall will pass a guaranty State law.

Governor Bailey. I am in hopes it will be repealed in our State.

The Chairman. If there are no further remarks, the motion is that you approve and file the report of the Committee. Do you want to say something about the report?

Governor Norris. No, Mr. Chairman.

The Chairman. Were you satisfied with it on Saturday?

Governor Norris. Yes, and I am still satisfied with it on Monday.

Governor Calkins. I would like to ask one question.

The report says "The release of funds now employed in the security market, a decrease in currency requirements, and some decrease in bank loans for business undertakings would likely be partly offset by increased requirements for funds to carry accumulating inventories ." Is it the opinion of the Committee that there is any evidence of accumulating inventories at this time?

The Chairman. That is a most difficult thing to detect. You cannot get a real line on the inventory position of most businesses until they take an inventory and publish their figures. They only do that once or twice a year. But I have here a statement made that sales in the retail business are disappointing in some lines; that most merchants ended the season feeling pretty optimistic about the outlook when they made their contracts last fall. If that is so, you might have an inventory piling up that did not sell. Now probably the only way of detecting such a development would be through some decline in prices of commodities generally and with reports which we get every month on the let up in retail sales. Then if our banks loans do not go down you can say almost certainly that inventories are increasing and goods are not being

distributed.

Governor Seay. Do they make contracts as far ahead as that now, from fall to spring?

The Chairman. The big drygoods stores in New York send their buyers throughout the country, made their contracts in the latter part of last year for spring and Easter trade, on silks, and their patent goods and things that have to be made up. For instance, the head of one of the biggest stores in New York told me that they had confidently expected an increase in the neighborhood of 20 per cent in sales for their recent business but that as a matter of fact their figures showed an increase of only three per cent. That might be due to a cold March.

Governor Bailey. Have you any well defined idea why business should drop off, Governor Strong?

The Chairman. Well, it is awfully hard to say. I think there has developed a feeling of pessimism that might partly have come through the progressive increase in interest rates. We hear a good deal of talk about easy money; but with four per cent discount rates in the Reserve Bank, about the easiest money in the country is in New York. That is on the very highest grade of collateral loans and commercial paper,

four and a quarter and four and a half per cent; but most all the banks in New York are charging 5 per cent to their customers now, and to their good customers. I do not think you can say that 5 per cent is cheap money. It is not a burdensome rate possibly on industry, but it is not cheap money. We do not feel that it is possible to have a big change in the speculative temper of the country, such as took place both in stocks and in real estate, without it being reflected.

Governor Bailey. We have sent a lot of money to Florida. We have a lot of call money in New York all the time, but whether it will affect the trade out there I do not know.

The Chairman. I will tell you, Governor Bailey. It is because 60 per cent of the money that went into this speculation came from all over the United States, and probably as much, if not a larger percentage of all the speculation came from all over the United States. These wire houses are doing an enormous business. That feeling of conservatism does spread around when these fellows find that they are stuck on their marginal accounts. Then another thing I think is the feeling that things abroad

are not quite as comfortable as they have been politically. What seemed to start the stock market going to pieces was this decision against the railroad merger, because the next day the stock market had its big break. It may be because the most observant people do detect a little change in attitude.

Governor Bailey. I think out with us it is largely this propoganda of the Des Moines meeting, that farming did not pay any more and that you could not make a go of it. If you believe the story that those fellows tell of Iowa, the greatest agricultural State in the Union, is in awful shape, and agriculture has gone to pieces. As a matter of fact I happen to know a little about Iowa. I think there are more prosperous farmers in Iowa than there are of the other kind, but you don't hear from them.

Governor McDougal. The State of Iowa, generally speaking, is in good condition. There are 99 counties in the State and probably 85 of them are in excellent condition. There are three or four counties where the banking machinery has broken down and where the recovery has not been as good as it has been in other sections of the country. The difficulty that the majority of the well managed banks

in Iowa are having at the present time is finding a use for their money.

Governor Bailey. That kind of propoganda gets out, people commence to wonder if there isn't something in it and they begin to retrench a little here and there. We are doing a lot of this installment buying out there and have been for the last couple of years and I am wondering whether a man who has anticipated his wants for three years, and bought on time, isn't going to slow up in the interim.

The Chairman. There is another topic on the program with regard to that, Governor Bailey.

Governor Bailey. I am just wondering if that isn't one of the things that is controlling the situation.

The Chairman. The thing that interests me most in the present situation is the question, and this is true at this time and almost any time, of how much goods are being distributed to the consumer. That is what tells the story.

Governor Calkins. That goes back to my question. The fact is that recent changes in business procedure have made it more difficult to obtain any dependable information in regard to this inventory question, and I was therefore



led to ask the question of the Committee whether it feels that it has enough information or enough indication to justify the conclusion that we are in for a period of payment because of accumulating inventories.

Governor Strong. I think the report does not indicate that. It further points out that there are indications of a tendency, which ought to become clearer a little later, and I suppose within a very short time, because we are in the spring season where you can tell pretty well if the spring trade comes across or not. At least you can tell that in New York.

Governor Seay. Did we not have the same feeling of hesitancy both in 1924 and 1925 at about this period in the year?

The Chairman. No. In 1924 we did, but not in 1925. About this time in 1925 it was just the other way. Things were going too fast.

Governor Seay. In 1925 such a journal as "The Analyst," which I read from time to time, week after week was practically unable to see any activity of business that was going on and the prosperity. It held that way clear up to the end, when it transpired that the greatest business

ever done was being done.

The Chairman. There wasn't any feeling of hesitation that we discovered or that was reported here early in 1925, because we started to sell some of our securities in December of 1924, and by March of 1925 we had sold 290 million of the 500 million we then held. Then we put up our discount rates, first in New York, and then later in the year in the other Reserve Banks. But in 1924, in the winter of 1923 and 1924, there was a very considerable feeling of hesitation. We had a report on the rubber and automobile business here and the textile business in New England; the steel business had dropped a little and there was a slight slump under way then.

Governor Seay. The borrowings on the New York Bank in March, April and May of 1925, dropped from the peak in February and ranged low until August. Then they went up very rapidly.

The Chairman. In 1925?

Governor Seay. In 1925. Borrowings were high in February.

The Chairman. They were not very low at any time in 1925.

Governor Seay. If you will take the blue line you will see that they dropped down in May to almost nothing.

Governor Calkins. The fact is there was no such marked hesitation in 1924 or 1925 as appears at the present time.

Governor Seay. There was in 1924. My recollection is that there was some doubt in 1925 during the spring and early summer months, but then the activity began and the volume of business was very high.

The Chairman. Of course there is a seasonal movement right at the beginning and end of each year.

Governor Seay. Yes, that is customary.

The Chairman. Those are purely seasonal. The picture is that as the result of security purchases in 1923 and early 1924, the 1924 borrowings pretty well disappeared in New York. Then beginning after the seasonal movement in 1925 we started to sell our securities and sold a good many of them. It established a mean of borrowing through 1925 of from fifty to one hundred millions above 1924. So the high points in 1925 are pretty high.

Governor Seay. Yes. I was speaking about the time of the year that we are in now, March, April and May. It would seem to me that there has been a disposition in the

last two or three years not to admit the prosperity that evidently has been here, or the tremendous volume of business.

The Chairman. What do you think we should have as a policy, if any? That do you think the outlook indicates?

Governor Seay. I think it is an uncertain one; that we are unable to prognosticate. I will say that the employment being as heavy as it is and the wages being as much as they are, that they are the elements for very large activity in business. That there will be some decline from the rate of activity that has prevailed, I believe is doubtful.

The Chairman. What will be the cause of the change—

Governor Seay. Sentiment, Mr. Chairman.

The Chairman. Hasn't that change of sentiment to some extent taken place? Hasn't the effect apparently shown it has taken place?

Governor Biggs. I can give you an illustration. Within the last ten days our directors have visited, with the exception of one, the branches at Memphis, Louisville and Little Rock. We found conditions entirely different

in those places. Members at Little Rock are cotton towns. They have had an enormous cotton crop, the biggest I think they have ever had in Arkansas and Mississippi. Cotton was at a good price and they picked a little over 50 per cent of the good cotton and then went to work and contracted and bought goods on the basis of 100 per cent of their cotton. Then the rains came on and 50 per cent of the cotton was ruined practically so that they sold it on an average of less than 10 cents a pound. Therefore they did not get the high price that they expected and that section of the country found themselves with a lot of stuff that they had bought and hadn't paid for, and which they never did get the money to pay for. They had a lot of stuff that they had bought when they thought they had the cotton. They had the money spent. The cotton out there looked fine, with indications of a big crop.

Then we jumped over to Louisville, where conditions are unusually good. They had sold their tobacco at a high price, their corn, and everything was prosperous. There was no question but that in the Louisville district business was good. They got a good price for the tobacco crop of last year and the year before and they sold it in

large quantities, and there was an entirely <sup>different</sup>/situation.  
There wasn't any <sup>gloomy</sup>/sentiment there, because they had had no  
depression in anything.

And, further, at every one of these towns we found  
building expansion going on. You never saw such building  
in all these towns. Memphis alone has got a hotel that  
you hardly have anything in New York that will compete with  
it. They built that last year. It has 800 rooms. The  
same is true in Little Rock, they are just laying out sub-  
divisions; the building of houses and apartments has been  
going on and the boom has been very high. It is going on  
in Louisville. In Memphis, Little Rock and those sections  
they have just let up to a great extent. They haven't quit  
entirely, but they are not going ahead. Then you can  
go north of us into Illinois where they have raised an  
enormous corn crop and where they were fortunately able to  
get hogs and cattle to feed and dispose of it in that way.  
So I feel there is a little more than sentiment in the  
thing when you go into these districts and sift down the  
causes of why there is a slackening in business. There is  
great uneasiness in all of these towns about this install-  
ment payment proposition. They have just gone crazy on

the subject. Everybody is selling on installment and selling anything on earth.

The Chairman. That is the kind of thing that has got to correct itself.

Governor Biggs. Just to give you an illustration, in a little town in Kentucky they are selling lots at a dollar a week. They will sell you a lot for \$200, let you pay \$10 down and a dollar a week. A man said he had 600 lots that he had sold that week and got \$600 every week for a little patch laid out on the edge of town. That is the smallest proposition of its kind on the installment plan basis, but they are selling everything on the installment plan.

Governor Wellborn. In the Atlanta District we have not noticed up any slackening up of business in a general way. Our cities seem to be very prosperous, New Orleans, Nashville, Birmingham and Atlanta. Business seems to be pretty good. Building operations are continuing on the same scale on which they were going last year. In Florida they have had a cessation of speculation in lots, which had probably reached its peak last summer, but building operations are going on at a tremendous rate. They are

carrying on the improvements that they have started.

Governor Seay. Are any of those large building companies in trouble that you know of?

Governor Wellborn. Building companies?

Governor Seay. Development companies?

Governor Wellborn. No, I haven't heard of any. I have heard rumors coming through New York that they were, but that is the only source from which we have heard it. They seem to send that persistent rumor out of New York about some of the development companies down in Florida, but they are continuing with their development there.

Governor Seay. Do the people continue to flock in and occupy those buildings?

Governor Wellborn. Oh, yes. They are all full up. The new hotels built there last winter are full this winter. The development from Palm Beach to Miami is just one continuous thing, all along the coast. They are spending not only millions of dollars but hundreds of millions. They are making a regular paradise.

The Chairman. I was in Palm Beach last spring, in February of last year, and you could not get a room in Palm Beach. A friend of mine has just come back from



there who says that the new hotel that they have built in Palm Beach with something like a thousand rooms, is hardly half full. They cannot be making money on property that has been developed as expensively as that has been, with labor as high as it is, with a very short season, unless they are jammed full.

Governor Wellborn. I was in Palm Beach in January and things were very crowded then. The hotels were full. It was very difficult to get a room. The same conditions prevail at Miami. In fact they prevail all along through Florida. I took a trip of a month, and I went to every town where there was a member bank, and the hotels were full and the towns crowded.

Governor Seay. In what month were you there?

Mr. Wellborn. In January. However, the peak of the speculation seems to have been reached.

The Chairman. If there are no further remarks on the report the motion is to approve and file the report in the record.

(The motion, having been duly seconded, was unanimously carried, and the report is as follows:)

REPORT OF THE OPEN MARKET INVESTMENT COMMITTEE TO  
THE GOVERNORS' CONFERENCE, March 22, 1926.

Since the last Governors' Conference the changes in the special investment account have consisted of (a) temporary readjustments to offset the effects on the money market of government financing at tax periods, (b) purchases and sales to offset seasonal changes over the turn of the year, and (c) a reduction in total caused by the repayment of March 15 maturities, which have not yet been wholly replaced.

At the December 15 tax period temporary sales of 30 million dollars were made to New York City banks, and at the March tax period temporary sales of \$38,000,000 were made, of which \$35,000,000 were made in New York and \$3,000,000 in Chicago. The result of these sales was to exert a considerable stabilizing influence on the market at these periods.

During the latter part of December the committee purchased 50 million of short-term government securities to decrease the seasonal strain in the market, and those securities were resold in the latter part of January and early in February.

On March 15 there matured 65 million dollars of securities held in the special account, and in addition \$32,500,000 held for foreign account. These amounts have been fully replaced for the foreign accounts but only partially replaced as yet by the purchase of \$34,355,600 of securities for the System account. This leaves a balance of \$31,411,100 to be purchased for the special account in order to restore it to 210 million dollars; the \$38,160,000 of Treasury notes which matured December 15, 1925, were replaced by purchase of other maturities, thus causing no change in the account.

In the past few weeks, there has been some change in credit conditions, but more particularly in business and financial psychology. The stock market boom has lost its impetus and the amount of funds employed by the market has diminished by about 300 million dollars from the date when public reports were commenced. Real estate speculation has calmed down somewhat. There are also reports of business hesitation, evidence of which may be found in a weakness in commodity prices, a decline of unfilled orders of the Steel Corporation, some recession in retail trade and some decrease in the amount of building permits taken

out, although the actual volume of current business transactions continues very large. But some business hesitation appears to be a not unusual accompaniment of a rather sharp arrest of stock speculation following a long extended period of activity.

Thus far it would appear that the diminution of speculative activity is wholesome. The movements which have taken place have been orderly and there has been no indication so far of untoward consequences. It is not yet clear how far liquidation will be continued and it is, of course, still possible that there might be a revival of speculation with the dangers it involves. It appears more probable, however, that the peak of this speculative and business expansion has been passed. It therefore seems appropriate in view of the above to discuss at this time what our open market policy should be in the event a business recession calls for a revision of policy before we meet in another governors' conference.

Experience in the past has indicated that member banks when in debt at the Federal Reserve Bank of New York, and in less degree at other money centers, constantly endeavor to free themselves from that indebtedness, and as a conse-

quence such pressure as arises is in the direction of curtailing loans. This is now accentuated over a year ago as the discount rate at New York is a full one per cent higher, and one half of one per cent higher at four other banks. As the accompanying table of the earning assets of the System shows, the amount of credit furnished by Reserve Banks on member banks direct borrowing, just prior to the March 15th operations, was larger this year than on any corresponding date since 1923.

EARNING ASSETS - FEDERAL RESERVE SYSTEM  
(In millions of dollars)

	1922 Mar. 8-	1923 Mar. 7-	1924 Mar. 12-	1925 Mar. 11-	1926 Mar. 10.
Discounts					
New York (City)	14	149	53	149	103
Chicago (City)	3	22	7	2	17
Other	614	400	423	259	382
Total.	631	571	483	410	502
Bankers Acceptances	102	219	243	301	285
U. S. Securities-Committee	-	-	140	275	245
U. S. Securities-Other	444	345	72	113	115
Other Earning Assets	-	-	-	15	12
Total	1,177	1,135	938	1,114	1,159

The total amount of borrowing undoubtedly exerts some pressure upon the business community. Should we go into a business recession while the member banks were continuing to borrow directly 500 or 600 million dollars, (if bills are included nearly 800 million dollars,) we should consider taking steps to relieve some of the pressure which this borrowing induces by purchasing government securities and thus enabling member banks to reduce their indebtedness.

It is not possible to predict to what extent member banks will continue their borrowing on the present scale in the event of a business recess. The release of funds now employed in the security markets, a decrease in currency requirements, and some decrease in bank loans for business undertakings, would likely be partly offset by increased requirements for funds to carry accumulating inventories. Perhaps the major determining factor will be the movement of gold. During the first half of March we received 30 million dollars of gold from Canada and this movement resulted in easy money rates in New York in the second week of the month. It seems possible that this gold movement may be continued somewhat further, and, if

so, it would correspondingly liquidate the borrowings of member banks in New York. The usual movement of gold, however, if seasonal causes operate, would lead us to anticipate gold exports rather than imports during the summer months, with perhaps further imports in the fall. With these conflicting tendencies future changes in our loan account are especially significant as a guide and we should see that the total does not become or continue too burdensome.

FUTURE POLICY. As a guide to the timing and extent of any purchases which might appear desirable, one of our best guides will be the amount of borrowing by member banks in principal centers, and particularly in New York and Chicago. Our experience has shown that when New York City banks are borrowing in the neighborhood of 100 million dollars or more, there is then some real pressure for reducing loans, and money rates tend to be markedly higher than the discount rate. On the other hand, when borrowings of these banks are negligible, as in 1924, the money situation tends to be less elastic and if gold imports take place, there is liable to be some credit inflation, with money rates dropping below our discount rate. When member

banks are owing us about 50 million dollars or less the situation appears to be comfortable, with no marked pressure for liquidation and with the requisite elasticity. Under those circumstances no single bank tends to be in debt for any extended period and borrowings are passed around among the different banks. Call and time money rates tend to be but slightly above our discount rate. With this situation existing in New York, there is less tendency for funds to be attracted to New York (particularly since commercial rates at such times are apt to be higher than stock exchange rates for call money) and the situation has a considerable degree of stability.

The accompanying chart shows the amount of borrowing of New York City banks by weeks during the past four years. It shows borrowings to be large during 1923, when, as we all know, there was some pressure for liquidation. Allowing for the seasonal increase and decrease in December, 1923, and January, 1924, borrowings were very small during 1924 and we recall that during the balance of that year while there was considerable instability in money conditions, it was accompanied by a gradual revival of business



over 1923. In 1925 borrowings were sufficiently high during parts of the year to place some pressure on the New York City banks. It was in this stage that rate advances were made. In the event of business liquidation now appearing it would seem advisable to keep the New York City banks out of debt beyond something in the neighborhood of 50 million dollars. It would probably be well if some similar rule could be applied to the Chicago banks, although the amount would, of course, be smaller and the difficulties greater because of the influence of the New York money market.

In general it would appear that we should not increase or diminish the special account immediately beyond gradually replacing the issues which matured on March 15 as market conditions warrant, but that we should prepare ourselves now for the prompt purchase of some further amount of securities if and when there should be further evidence of a recession in business activity, especially if there is no further liquidation in the amount of Federal Reserve credit employed.

insert  
hibits)

## Exhibit A

STATEMENT SHOWING PARTICIPATION BY FEDERAL RESERVE BANKS IN SYSTEM SPECIAL INVESTMENT  
ACCOUNT AND CLASSIFICATION OF ISSUES HELD IN THE ACCOUNT BY MATURITIES

	<u>Holdings</u>	<u>Holding Ratio</u>	<u>Holdings by Maturities</u>		
Boston	\$ 1,688,000	1.0%	June	15, 1926 3%	C/I \$ 1,800,000
New York	43,733,900	24.5%	June	15, 1926 3 1/4%	C/I 28,900,000
Philadelphia	1,331,000	.7%	September	15, 1926 4 1/4%	T/N 17,901,000
Cleveland	9,908,500	5.5%	December	15, 1926 3 3/4%	C/I 47,260,000
Richmond	3,488,500	1.9%	March	15, 1927 4 3/4%	T/N 44,856,600
Atlanta	10,289,000	5.8%	December	15, 1927 4 1/2%	T/N 35,371,300
Chicago	18,718,000	10.5%	September	15, 1928 4 1/4%	3rd L/L 2,500,000
St. Louis	16,049,500	9.0%			
Minneapolis	7,671,000	4.3%			
Kansas City	17,726,000	9.9%			
Dallas	18,831,500	10.6%			
San Francisco	29,154,000	16.3%			
	<u>\$178,588,900</u>	<u>100.0%</u>			<u>\$178,588,900</u>

This statement includes future purchases to be delivered on or before March 20, 1926.

## Exhibit B

PURCHASES OF BANKERS ACCEPTANCES FROM JANUARY 4 TO MARCH 10, 1926 AND AMOUNT  
EACH BANK HAS RECEIVED IN EXCESS OR SHORT OF ITS PRO RATA SHARE  
UNDER APPORTIONMENT PLAN PUT INTO EFFECT JANUARY 4, 1926

	<u>Ratios of Participation</u>	<u>Bills Acquired (Net)</u>	<u>Bills Entitled to Acquire</u>	<u>Bills Over Pro rata Share</u>	<u>Bills Short Pro rata Share</u>
Boston	7%	\$ 19,830,000	\$ 19,247,000	\$ 583,000	\$ 0
New York	24%	62,659,000	65,992,000	0	3,333,000
Philadelphia	8%	25,752,000	21,997,000	3,755,000	0
Cleveland	10%	27,395,000	27,497,000	0	102,000
Richmond	5%	13,792,000	13,748,000	44,000	0
Atlanta	4%	11,390,000	10,999,000	391,000	0
Chicago	14%	38,012,000	38,495,000	0	483,000
St. Louis	5%	13,262,000	13,748,000	0	486,000
Minneapolis	4%	10,691,000	10,999,000	0	308,000
Kansas City	6%	15,908,000	16,498,000	0	590,000
Dallas	4%	10,732,000	10,999,000	0	267,000
San Francisco	9%	25,543,000	24,747,000	796,000	0
Totals	<u>100%</u>	<u>\$274,966,000</u>	<u>\$274,966,000</u>	<u>\$5,569,000</u>	<u>\$5,569,000</u>

STATEMENT SHOWING EFFECT OF DISTRIBUTION OF SYSTEM OPEN MARKET PURCHASES DURING 1925 TO MEET EXPENSE REQUIREMENTS OF FEDERAL RESERVE BANKS, WHICH DISTRIBUTION (1) DURING FIRST NINE MONTHS WAS ON BASIS OF CURRENT EXPENSES AND DIVIDENDS AND (2) DURING BALANCE OF YEAR TO PROVIDE FOR CHARGE-OFFS AS COMPLETELY AS POSSIBLE

	<u>Gross Earnings</u>	<u>Current Expenses and Dividends</u>	<u>Current Net Earnings</u>	<u>Charge-offs, Depreciation Charges, etc.</u>	<u>Net After all Charges and Dividends</u>
Boston	\$ 3,288,546	\$ 2,528,503	\$ 760,043	\$ 122,110	\$ 637,933
New York	10,217,174	8,213,398	2,003,776	788,674	1,215,102
Philadelphia	3,135,549	2,709,480	426,069	21,162	404,907
Cleveland	4,013,456	3,378,441	635,015	203,250	431,765
Richmond	2,182,460	1,809,776	372,684	154,736	217,948
Atlanta	2,072,378	1,502,220	570,158	820,455	250,297
Chicago	5,424,663	4,686,253	738,410	551,153	187,257
St. Louis	2,055,637	1,696,853	358,784	759,078	400,294
Minneapolis	1,438,341	1,291,388	146,953	105,558	41,395
Kansas City	2,309,986	1,985,870	324,116	299,621	24,495
Dallas	1,813,626	1,478,583	335,043	312,147	22,896
San Francisco	<u>3,848,890</u>	<u>3,171,555</u>	<u>677,335</u>	<u>677,335</u>	<u>-</u>
Totals	<u>\$41,800,706</u>	<u>\$34,452,320</u>	<u>\$7,348,386</u>	<u>\$4,815,279</u>	<u>\$2,533,107 Net</u>

## STATEMENT SHOWING EARNING ASSET HOLDINGS OF ALL FEDERAL RESERVE BANKS MARCH 10, 1926 COMPARED WITH PREVIOUS WEEK AND MARCH 11, 1925; ALSO WEEKLY AVERAGE OF EARNING ASSETS FROM DECEMBER 31, 1925 TO MARCH 10, 1926 AS COMPARED WITH CORRESPONDING PERIOD AND ENTIRE YEAR 1925

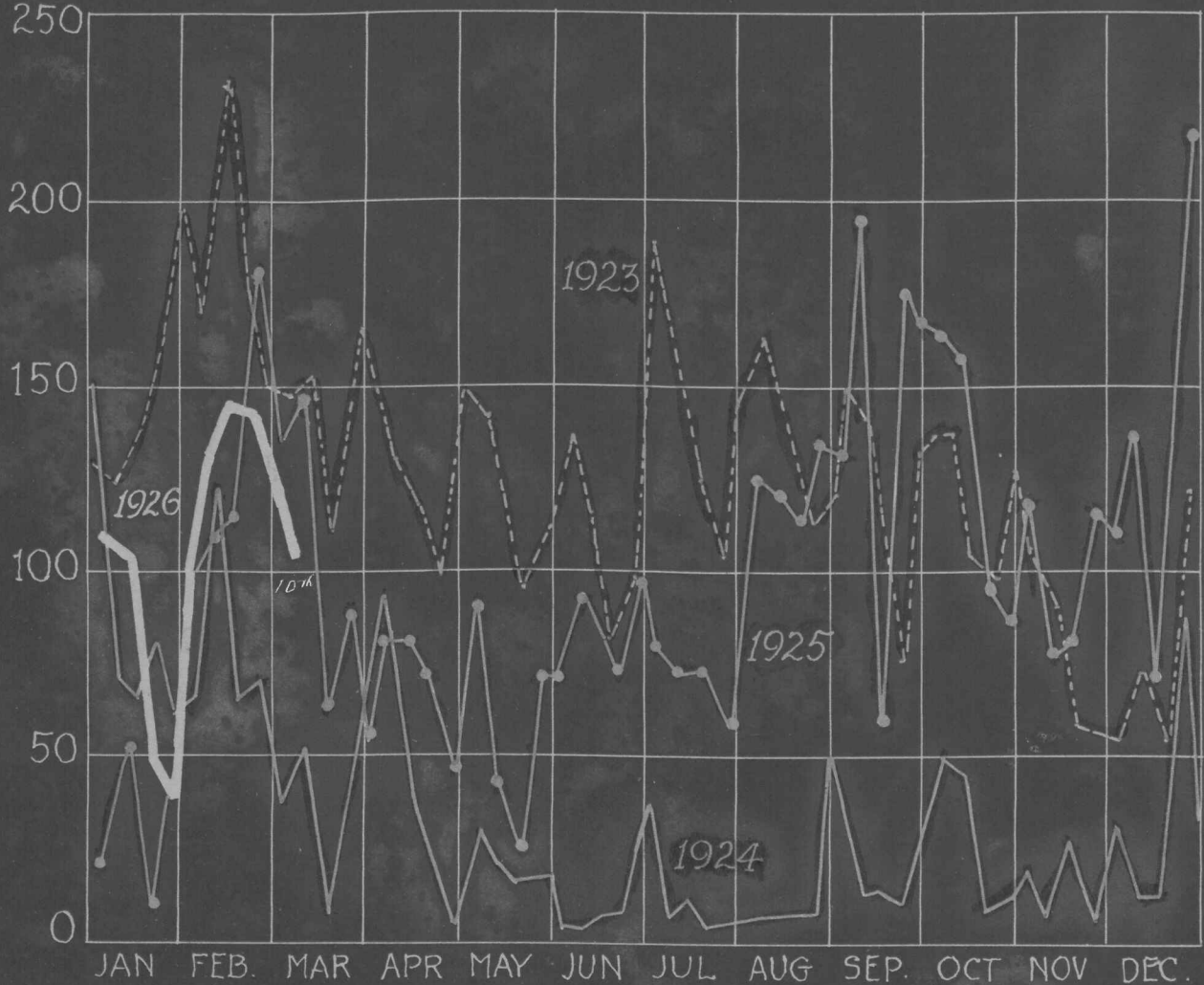
(000 Omitted)

		Boston	New York	Philadelphia	Cleveland	Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco	Total
Bills discounted	- March 3	\$36,089	\$172,576	\$53,887	\$48,620	\$43,417	\$33,055	\$88,667	\$25,607	\$10,518	\$22,558	\$ 6,644	\$41,576	\$ 583,214
" "	" 10	22,311	156,018	51,117	52,007	43,650	30,336	64,501	20,214	3,876	14,145	6,705	37,545	502,425
Net Change		13,778-	16,558-	2,770-	3,387+	233+	2,719-	24,166-	5,393-	6,642-	8,413-	61+	4,031-	80,789-
Bills purchased	- March 3	43,375	67,263	19,299	19,124	9,374	22,312	31,092	13,797	7,047	14,739	14,194	24,991	286,607
" "	" 10	40,595	69,140	19,717	21,009	10,841	18,499	30,234	14,300	7,974	13,896	13,723	24,592	284,520
Net Change		2,780-	1,877+	418+	1,885+	1,467+	3,813-	858-	503+	927+	843-	471-	399-	2,087-
Government securities	- March 3	8,267	54,349	19,063	31,559	5,443	15,208	44,021	23,907	16,578	33,960	29,458	43,945	325,758
" "	" 10	7,778	61,297	21,309	33,496	6,125	17,219	46,816	27,044	18,078	37,474	33,387	49,643	359,666
Net Change		489-	6,948+	2,246+	1,937+	682+	2,011+	2,795+	3,137+	1,500+	3,514+	3,929+	5,698+	33,908+
Total earning assets	- March 3	88,392	296,572	96,126	100,234	58,695	70,923	164,972	63,685	34,421	71,696	50,601	111,112	1,207,429
" "	" 10	71,353	288,866	96,029	107,453	61,082	66,406	142,757	61,936	30,209	65,958	54,123	112,387	1,158,559
Net Change		17,039-	7,706-	97-	7,219+	2,387+	4,517-	22,215-	1,749-	4,212-	5,738-	3,522+	1,275+	48,870-
<u>Weekly Average of Earning Assets</u>														
Dec. 31, 1925 to March 10, 1926		109,703	269,672	93,283	100,275	52,909	82,023	153,667	63,756	31,940	67,702	56,654	103,448	1,185,032
Corresponding period 1925		92,788	323,935	76,011	122,724	34,709	24,422	129,811	38,668	27,033	45,023	41,791	103,775	1,060,690
Net Change		16,915+	54,263-	17,272+	22,449-	18,200+	57,601+	23,856+	25,088+	4,907+	22,679+	14,863+	327-	124,342+
December 31, 1925 to Mar. 10, 1926		109,703	269,672	93,283	100,275	52,909	82,023	153,667	63,756	31,940	67,702	56,654	103,448	1,185,032
Entire year 1925		93,459	287,133	85,078	113,904	54,734	56,548	138,045	55,936	37,271	57,293	49,024	109,866	1,138,291
Net Change		16,244+	17,461-	8,205+	13,629-	1,825-	25,475+	15,622+	7,820+	5,331-	10,409+	7,630+	6,418-	46,741+
<u>Comparison of Earning Assets</u>														
March 10, 1926		71,353	288,866	96,029	107,453	61,082	66,406	142,757	61,936	30,209	65,958	54,123	112,387	1,158,559
March 11, 1925		91,730	384,709	87,649	125,294	44,466	29,501	121,914	31,195	30,581	43,490	32,469	91,062	1,114,060
Net Change		20,377-	95,843-	8,380+	17,841-	16,616+	36,905+	20,843+	30,741+	372-	22,468+	21,654+	21,325+	44,499+

SUMMARY FOR SYSTEM

Bills discounted for week	\$ 80,789-
Bills purchased for week	2,087-
Government securities for week	33,908+
Total earning assets for week	48,870-
Weekly average of earning assets Dec. 31, 1925 to Mar. 10/26 against corresponding period 1925	124,342+
Weekly average of earning assets Dec. 31, 1925 to Mar. 10/26 against entire year 1925	46,741+
Comparison of earning assets March 10, 1926 with March 11, 1925	44,499+

MILLIONS  
250



Borrowings of New York City Member Banks at Federal Reserve Bank

The Chairman. We do not want to discuss discount rates before our meeting with the Board.

Governor Seay. I think we might crystallize the opinion here, Mr. Chairman.

The Chairman. I suggest we postpone discussion of that until we meet with the Board, unless you want to take a poll to see if there are any strong opinions here about what ought to be done. If there is no call for discussion we will pass that and take up Topic 1-C.

1. CREDIT TRANSACTIONS AND POLICIES.

C. Discount or Loan Policy in respect to:

1. Continuous Borrowers.
2. Large Lines.

The Chairman (continuing:) I suggested putting this on the program because we had had a great deal of discussion of our policy in New York recently and I think we have made progress in the handling of some cases that have been a little difficult.

Governor Calkins. Does this topic refer to continuous borrowings by banks or from banks?

The Chairman. Continuous borrowing at the Reserve Banks by members. We made up some figures recently, or

the Board did, I forget which, from which it appeared there were nearly 900 member banks which had been continuous borrowers for over a year in their Reserve Banks, for the whole system. The number in New York runs from eight to nine, twelve and fifteen. I doubt if there are any more than that. I would like to take back some report of what the experience of the other banks has been and what they do to these members that come in for a certain amount of credit and just stay as steady boarders. I mean banks that are in good condition and can take care of their obligations.

Governor Seay. Do you mean large banks, Mr. Chairman?

The Chairman. Oh, the country banks, moderate sized banks and the small banks.

Governor Norris. My recollection is that those figures that you have just alluded to were gotten up when the Reserve Board asked each Reserve Bank to supply them. I do not recall whether they have all been supplied or whether the banks have been advised of the results of the complete tabulation.

The Chairman. We have the figures in New York but I <sup>have</sup> not seen any report on the subject.



Governor Morris. I have no recollection of having received one from the Board and I think if I had received one it would have interested me and I would have remembered it.

Governor Calkins. As a matter of fact a compilation of figures showing the number of banks that borrow for more than one year continuously, without some discrimination, would not be informative. The mere fact that 900 banks of the country have been borrowing for more than one year does not provide information of value. The only information that we can use in considering the subject or acting upon the subject is discriminating information. Roughly speaking there are about three different kinds of continuous borrowing banks. This does not apply to those happy, untroubled spots like some of the eastern districts, but refers to the larger part of the country. First there is the bank that has been continuously in since it got in over its head and has not yet gotten out, and which cannot get out. We have got some of those in all parts of the country except in the eastern districts. Second, there is the bank that is buying business by using the Federal Reserve Bank funds and doing it persistently. Third, there

is occasionally, and I think only occasionally, the bank that sees a profit in using the Federal Reserve Bank and does it for no other purpose except the small profit involved.

Governor Norris. I did not catch your second classification. I thought the last one you stated was your second one.

Governor Calkins. The bank buying business with the use of Federal Reserve Bank funds.

Governor Norris. What is the distinction between your second and third classes?

Governor Calkins. The second class is not necessarily operating through the Federal Reserve Bank or in a Federal Reserve Bank exclusively for the amount of profit but in order to get business which it could not otherwise carry. It is generally a new or a very enterprising bank. There are some of those in all districts, and I think there is a distinction between the two classes.

Governor Young. We have had a little experience with that in the Northwest, and if I recall correctly the figures made were asked for on September 1 or October 1 of last year. That was not the best time to secure those fig-

ures. For instance, I think we reported some 75 banks that had been in our debt for a year or more, and just before I went away I checked that up. At the present moment we have twenty banks that have been in our debt for five years, two for three years and one for two years and one for one year. I presume the same thing is true of Dallas, Kansas City, Chicago and elsewhere, but we found in the start that a great number of banks attempted to use the Federal Reserve System solely for profit. That perhaps had a great deal to do with conditions that developed and which I presume are the same all over the United States. We got those directors in and talked with them. It required a great deal of patience, but I think so far as our District is concerned now that there isn't a single solitary bank that will borrow for profit; there isn't one that would not pay up if it could not pay up. I find all over the District that they will send United States bonds or dispose of prime commercial paper or anything else to avoid borrowing.

Governor McDougal. I have a memorandum here prepared by Mr. Blair, who is directly in charge of this matter in our institution. He states there are three classes of

continuous borrowers: First, those banks that have accumulated such a line of slow loans that they have not been able to reduce their discount to the proper relation to their deposits, and for that reason have been continuous borrowers. We have a large number of this class of borrowers in our district, especially in Iowa, growing out of the situation in Wisconsin. We have followed the policy of urging the State banks to make collections as rapidly as possible but have continued to let them borrow as far as necessary to keep the banks open, taking especial care that we have a proper margin of collateral on paper discounted and that the character of our securities is fully maintained. Secondly, there are continuous borrowers for the purpose of making profit on the rediscount. I think that should be modified to the effect that there are tendencies on the part of certain banks to borrow continuously for profit. It is our policy to watch those cases and to correct them. Then there is a third class of country banks, located in places where the demand continuously exceeds the supply of local capital. Those banks should also be restrained and the borrowing bank urged to increase its capital, although this class of banks is probably

entitled to more consideration than the bank borrowing continuously for profit. Governor Calkins made reference I think to continuous borrowings being confined largely to banks that are not in good condition, if I understood him correctly, and that is true in our case.

Governor Calkins. Mr. Blair's first class is exactly the same as mine. I have no case in mind in our district where long continuous borrowing exists in connection with any banks that are in real good condition.

Governor Wellborn. I do not notice that any of our banks, hardly, are borrowing for profit. There are some banks that have not gotten over their 1920 troubles, are unable to pay out, and they are just merely working themselves out. Apparently some are borrowing for profit, but not really so. In our section they cannot afford to increase their capital stock. They have to borrow pretty heavily every year, but that is not done for profit. It is done merely to accommodate their customers in the community.

The Chairman. Your banks are pretty steady borrowers, probably more than any other Reserve Banks in the System, are they not? Your discount account has been about as

steady as any.

Governor Wellborn. Ours has been very low last year. We had to appeal to the Committee in New York to give us some open market paper in order to provide for our earnings, because our discounts were very low. But their recent offerings have been quite heavy, and they are increasing now very rapidly. Our policy with the continuous borrower is to insist upon the member banks, which borrow from us seasonally, to pay up their indebtedness once a year. That of course is sometimes prevented by crop failures and other emergencies. But our experience with the banks that borrow continuously is that sooner or later they find themselves in serious difficulties, and it is therefore our practice either to call them to the office for a conference or send one of our officers to talk with the directors of the member bank and endeavor to bring them in line with our policy.

The Chairman. Are there any further remarks?

Governor Seay. We are familiar with the three classes of banks described by Governor Calkins. I think you stated that your consideration of the matter had been profitable and you had arrived at a policy in dealing with those banks.

Is that correct?

The Chairman. Well, we are shaping something up that seems to be working by classifying all the banks in the District, that is those that borrow from us and that we are watching. I suppose the classification will get down ultimately to a consideration of the circumstances of each individual bank, as it should; but in the meantime it is pretty difficult, until your men are thoroughly experienced in the condition of each bank and its history of borrowings, to pick up an individual bank unless you have some rule of thumb to go by. If you are interested in it, Governor Seay, I can tell you the way in which we are approaching it.

Governor Seay. I would like to hear it, Mr. Chairman, because I am interested.

The Chairman. There are five classes of banks in the District that we watch especially in connection with their borrowings. First of course are those that are on the special list, when the examiners of the Comptroller indicate that they are not in tip top condition; second, are those which show a tendency to borrow an unduly large amount; third, those that show a tendency to a continue

borrowing for too long a period; fourth, a special group of banks in the uptown section of New York in the cutting up trade, the needletrade, the fur business, and so on, where they borrow seasonally very heavy amounts, beginning at this season of the year and paying off in the fall. Those fellows are all inclined to over-borrow. Since Fifth the Wall Street banks which lend money on the Exchange and are in and out with very large amounts, and whom we do not want to ride us to death when the Stock Exchange rates go up.

Now, in going over this little analysis of the types of borrowers with Professor Sprague, he says that we should have a sixth class, and then he thinks it will be pretty well covered. That class contains those banks which become borrowers and which give the excuse for borrowing the fact that they have lost deposits and where the loss of deposits becomes rather a permanent or continuous thing, indicating some decline in confidence in the bank, and some reason for a need of change of management or change of policy of the bank. I am satisfied myself, and have so stated to our officers, that the management of the borrowing account of any member bank has got to be



judged individually as to each bank on its own merits in each instance. Unless that is done you might do an injustice in driving those fellows to pay off when they should not, or in some cases the banks may be borrowing quite in accordance with what we regard as the orthodox principle, and nevertheless be borrowing a great deal.

Governor Calkins. Of course this discussion with regard to the classification of banks is questionable, because roughly there are only two classes — good and bad banks, although I will say that there probably isn't any probability or possibility of classifying them in that way. However, I am particularly interested in the second classification, that is banks that are borrowing unduly large amounts. How do you determine whether a bank is borrowing a larger amount than it should? What is your standard, and what is the definition of over-borrowing?

The Chairman. That type of borrowing has got to be dealt with by consideration of the circumstances of each bank.

Governor Clakins. In other words, you cannot classify over-borrowing.

The Chairman. There are very few banks in our District

which, if we applied a rigid rule, very few banks outside of New York which would not have securities or bought paper, or something of that sort, which they could sell so that they would not need to borrow a cent from us. There are some that need more money, and the situation is about like this: When the country bank applies for a discount we look over their affairs and we find that they have got some Government bonds and some good bonds or securities that they can dispose of. We let them have a loan and write to them at once and say "This makes your reserve good, but we want you to liquidate some of that stuff and pay us off." That situation would arise with almost every bank in the District and the result would be that these country banks, which borrow anywhere from eight to ten to twenty or twenty five millions, at different times, would say "All right, we will borrow from our New York City banks, our old correspondents"; we would not lend any money to our country members; they would all borrow in the City of New York and then we would simply have to lend so much more to the New York City banks. You cannot carry those rules too far or have them rigid or bureaucratic. I regard one of the functions of the bank as being that of supplying

the amount of credit that is required to make good the reserves of the member banks, and not to run each bank individually and say that it should be the one to borrow, or that some other bank is to be the one. Today the Reserve System has got to furnish eleven hundred million dollars in credit or there will be a big deficiency in the reserves of the member banks and we will have a period of sharp liquidation. So it is a question of which among the member banks, assuming that they are in good condition, are really entitled reasonably to borrow from you, even if they have got securities that they could sell. It is just a question of not letting them ride you to death. But we could not call the loans from all the banks which are borrowing from us which have other resources to which they could turn, because if we did we would have a very difficult time in this country.

Governor Calkins. If you said to a bank that came to you to borrow "You have Government bonds and commercial paper and things that you can sell, and you don't need to borrow", the obvious retort would be "It is evidently to be your policy to loan money only to such banks that cannot take care of the proposition in any other way; in other

words you are discriminating against your well managed bank in favor of your badly managed bank," and that would be perfectly sound criticism.

The Chairman. On the other hand, if a bank in first rate condition has made some Stock Exchange loans and comes to you to borrow two or three times their capital, and with the proceeds of that loan they appear to be buying more securities and commercial paper, and are riding you to death, then there is something to be said to them, obviously, and it is a question of judgment in each individual case, is it not?

Governor Seay. Governor Calkins asked what would be the measure of a bank's borrowing. I would like to ask if he does not think that the bank's capital funds, with some consideration as to the size of its deposits, is not a measure of what the bank should borrow, or be permitted to borrow, either occasionally or with some degree of continuity?

Governor Calkins. It ought to be some indication, but it could not be used to determine a policy.

Governor Seay. Wouldn't you think it could be if it was disposed to borrow continuously? If it was out of pro-

portion to those funds, then there ought to be a check-up.

Governor Calkins. But we are not now talking about continuous borrowers, but borrowers of large amounts.

Governor Seay. That would cover both.

The Chairman. We are talking about borrowers of large amounts. I can give a very good illustration of the difficulties of determining that question. You know towards the end of the year in New York there is a very heavy draft made by the interior banks, which carry balances in New York, and which wish to pay off at their own reserve bank and clean up their statement or statement day. It happens that this last year the drafts on New York and other circumstances, doubtless owing to the fact that the New York banks were already borrowing quite heavily from us towards the end of the year, as they always are, and the fact also that we had been talking to some of our banks about the amount they were borrowing from us when they had a considerable amount of money on call on the Stock Exchange, all led to a sort of jam at the end of the year. The New York City banks were losing deposits to the interior over the wire transfers; that rather checked them up in borrowing too heavily from us a little bit, and towards the very last two

or three days of the year the Stock Exchange was in need of a hundred or a hundred and fifty million dollars more than was there, because everybody wanted to call loans at the same time, and somebody had to put the money up. We bought, as you know, 50 million in securities. Then at the last minute the deadlock was broken and one of our large banks borrowed a large sum of money from us and put the money out. There is an illustration of the difficulties that applies to the System as a whole. Who is going to borrow this money from us to make good the reserves of the banking system as a whole? Somebody has got to do it. If we took our loan and acceptance account out of the market today, of say eight or ten million dollars, we would have a contraction of bank loans and deposits in the United States of seven or eight billion dollars, which the country could not stand. So there is another question, as to whether the borrowing bank ought to be censured, per se, just because it is borrowing. Somebody has got to borrow the money.

Governor Wellborn. We have had a situation in our District of the country banks coming to us early in the

year and wanting to know how much credit they could get, they anticipate a certain amount of business from their customers, and they almost force us to establish a line, just like the New York banks did when the Federal Reserve System started. We gave a good deal of thought to the situation, we discussed it in our board, and decided we would give them up to capital and surplus, that is the invested capital in the bank. That is our rule, but it is not a rigid rule and it is altered quite frequently when an individual case comes up, if a bank happens to lose deposits and needs additional accommodation, or where they have State funds or county funds or bond issues and need additional credit from us. In cases of that kind we relax that rule. But at the beginning of the year, when they ask us how much they can borrow, we tell them up to their capital and surplus. We find out that that works out very well and keeps them down to reasonable borrowings.

Governor Talley. Do you take into consideration other borrowings that they contemplate?

Governor Wellborn. It includes all borrowings with us, and outside borrowings. We advise the banks that we do not think it is safe for them to be borrowing more than

their capital and surplus from all sources. However we relax our rule in special cases.

Governor Young. That request has come to Minneapolis a great many times and we have never made a promise as to what we would lend. We tell those banks that we will lend them what is necessary, depending entirely on what they do during the interim. We find that is a pretty good check to keep on the country banks. We do not want to say to them that we will not lend them \$25,000 or that we will not lend another one \$50,000. We prefer not to put any limit on it, but we will tell them that at the time they want the money they will take the question up; that if they have been conducting their institution in the way that it should be conducted that they will find liberal credit at our bank; otherwise not. We find that that has had a good effect, and we have never made any definite commitments for the future.

Governor Seay. Have you ever established a limit in their borrowings beyond which you would not permit them to go?

Governor Young. No, never. We loaned a bank in our District \$575,000 that had a capital of \$25,000, and any



man around this table would have made the same loan under the same conditions.

Governor McDougal. Of course you do not extend any further credit when they have gone the limit with you?

Governor Young. Oh, no. When they are through, they are through.

Governor McDougal. You are contemplating a policy, Governor Strong, if I understood it correctly, under which you would gauge the borrowings or determine the propriety of the borrowings on the part of the country banks to some extent on what they had in the way of marketable stuff in the way of bills or other good securities?

The Chairman. No. That is simply one of the factors to take into consideration.

Governor McDougal. If you did that with the country banks it would only be proper, I think, to apply the same rule to the city banks, would it not?

The Chairman. We have generally said to the New York City banks that have gotten down in reserves and have come to borrow from us, and who have got a lot of money out on call, to readjust their reserves and not to borrow continuously from us when they have call loans. But there is no

mathematical rule that you can apply to it.

Governor McDougal. None at all.

The Chairman. When a bank is borrowing too much or too continuously, and there is ground of complaint about the way that they run their borrowing account, and you find that they have other resources, you have an argument to use with them that you would not have if they had no investment they could call in and were just borrowing from you in order to take care of the local demands of the community. That is rather the case in our District, though.

Governor Young. We have no cases at the present time of long and continuous borrowing on the part of banks located in any of our Reserve cities. We had one that smacked of that and it was given the kind of treatment that you refer to, being one where they were carrying a very large and unjustifiable amount of Government securities. In that case we approached the officers of the bank and told them that it had been clearly demonstrated that they were carrying more of their securities than they could carry conveniently without steady borrowing; we asked them to dispose of them, and that was done.

The Chairman. With a four per cent discount rate

and the present level of return on governments, there is very little inducement to do that. They were losing money every day.

Governor Young. It was a case where the Government securities were bought some time ago and they have carried them continuously.

The Chairman. But they are losing money.

Governor Young. They haven't lost money on these transactions because of the increase in value of the Government securities.

The Chairman. I know, but if they can sell the bonds on a 3.70 basis and they are borrowing to carry them at the 4 per cent discount, they are certainly losing money every day.

Governor Young. They were not borrowing for profit. They were borrowing because they did not want to dispose of their government bonds, and they were carrying too many of them.

Governor Calkins. They were borrowing in anticipation of an increase in the value of the bonds which they were carrying which would make up more than the differential in rates.

Governor Wellborn. I want to add to my previous statement, that in making this rule of permitting them to borrow up to the extent of the capital and surplus, we excepted from that offerings of government bonds and commodities, because they are self-liquidating paper.

Governor Seay. As to continuous borrowing, there can be very little, if any, difference of opinion. It ought not to be permitted.

Governor Bailey. We have some cases where we would like to prohibit it if we could.

But

Governor Seay./ As to the size of the borrowings I am in quite in agreement that it depends upon the circumstances of each case.

The Chairman. We have discussed this topic pretty fully. As to Topic L-D, we will postpone discussion of that until Mr. Baker is here tomorrow.

The next topic is L-E.

#### 1. CREDIT TRANSACTIONS AND POLICIES.

E. Should a Federal reserve bank make advances to member banks on bills payable secured by United States Government securities held in safekeeping without taking steps to ascertain that such securities are the property of the

offering member banks.

Governor Bailey. I asked that this be put on the program simply because I wanted to find out from the other Governors just what they do in the case of banks that leave securities with the Reserve Banks for safekeeping. There is so much of this in our Bank, the leaving of other peoples' bonds for safekeeping, that we are up against this proposition: We have put out an open letter saying that we will only take from member banks and receipt to the bank for the bonds. They send in a letter saying that they are transmitting certain bonds, telling us who they belong to, and we will write back and say that we cannot take those bonds under those conditions, but that we can only take them as the bonds of the member bank and that we will receipt to the member bank for the bonds. They have told us that they belong to their customers, and three fourths of the bonds in our bank now which we have gotten from country banks are those of firms and business men who live in their communities, who have left their securities with the little country bank, where they are just as unsafe as they can be. I think it is one of the best services that we are rendering out in that section of

the country in taking those securities and keeping them in our vaults with all the protection that we have. As a matter of fact they write and tell us that they enclose bonds belonging to so and so and we always write back and say that we cannot receive the bonds except bonds of the member banks. And then this question comes up: Suppose that a bank to whom we have sent such a letter comes in and wants to borrow a hundred thousand dollars, and we will say that they have \$200,000 on deposit for safekeeping with us, \$100,000 of which is their own. They come in and want to borrow a hundred thousand and we loan them a hundred thousand. Those bonds are not segregated, but are just allowed to stay in safekeeping. Now in case the bank should fail, and we have that balance of bonds that we could take, but suppose it develops that the hundred thousand dollars that we have taken as security belong to the customers of the depositing bank and were not the property of the bank? Where would we be?

The Chairman. It would depend on whether you had notice or not.

Governor Bailey. Is that notice?

The Chairman. Surely.

Governor Young. There are two means of checking that up.

Governor Bailey. Just a moment. When we make a loan of that kind we make them certify that they are his bonds. We always make them do that.

The Chairman. Yes, but he certifies that they are his bonds sometimes when they are not. His certificate isn't any good.

Governor Bailey. The point is how are you going to get around that? They may not have been his bonds when he sent them to you. He may have bought them afterwards. How are we going to tell? If the member bank comes in and says they are his bonds, when he has told us a year before that they were not, would that constitute notice?

The Chairman. I do not know. That is a nice question to be decided by a jury. It is a legal question. I will tell you this: If you make loans to your member banks where there is doubt in your own mind as to the title to the collateral, if you have records in your own bank that puts you on notice of that fact, you want to be very careful that you don't lose that collateral, because the chances are that the Court will take it away from you.

Governor Bailey. I hadn't run against anything of that kind but I know we have them in there. Take the First National Bank of Kansas City, than which there is no better bank than I know of. I presume they have 25 millions on deposit with our bank for safe keeping and we have receipted for them. Their statement will show that they own about ten million dollars. Now, the First National Bank comes over to borrow, which they do every once in a while, five or six million dollars for two or three days to keep up their reserve, and we have got their \$25,000,000 there, have we got to separate out the securities to cover the five or six million dollars and make a new record of that in order to make a loan for five days? I do not think we would ever have any chance of losing anything with the First National Bank, but that is a point I want to hear discussed here, the experience of you other gentlemen.

The Chairman. Ask Mr. Harrison. He is a good lawyer and a good practical man. Did you follow the statement, Mr. Harrison?

Mr. Harrison. I followed part of it. The same question came up some time ago. Governor Calkins had a case out in Seattle in which there was some ground for doubt



as to who were the owners of the bonds, and I think there was discussion as to whether or not a bank should adopt a policy of requiring every member bank to certify that the bonds belong to it. The general feeling, as I remember it at that time, and certainly it is my feeling now, was that it would be impolitic for the Reserve bank to require such a certificate, it being a very much better position for the Reserve bank to assume that the bonds presented to it by its member banks were the member banks' own bonds, unless, as a matter of actual fact, the Reserve bank was on notice to the contrary, or on notice to question the fact. I myself have thought that we would be in a better position to assume that the bonds are the bonds of the member bank unless you have knowledge that they are not. If you do have such knowledge, then we should not take them.

Governor Calkins. Wouldn't you go a step further and say that in the absence of knowledge to the contrary you are safe in assuming that the bonds are the property of the pledging bank?

Mr. Harrison. Yes.

Governor Calkins. In the absence of knowledge to the contrary. Governor Bailey indicated that they had records

showing that the bonds belonged to somebody else. If those records are in the bank then I think you are in an extremely precarious condition. If he has made a sufficient analysis to find that the bank that borrows ten million dollars does not own the ten million dollars in securities, then he is on notice, and that is the most dangerous thing that we meet in litigation.

Governor Young. I think you have four very safe checks. The first is that when the bank offers the bonds as collateral for their government deposits or bills payable, you have a statement from the institution showing that they own so many bonds. In addition to that you have the Examiner's report showing that those bonds are pledged for public funds, and it is very easily to determine whether the bank has sufficient bonds left so that they can put them up.

The Chairman. We ordinarily have a list of all the bonds that they do own.

Governor Young. Yes. In addition to that, that bank never knows when it is going to be visited by a National Bank Examiner or a State bank examiner. Then the fourth proposition is that I never in my experience saw a

National bank or a State bank that had any United States Government bonds unless they were pledged with the Secretary of the Treasury or pledged with a county official, so that you are very well protected. We check up every loan that goes through.

Governor Bailey. Of course you may have a statement from the bank, but it is probably six months old, and since that last statement they may have bought those bonds, and they are their bonds as a matter of fact.

Governor Young. In that case you can ask them whether they are pledging the right bonds or not. We can tell those banks to describe the bonds by number and issue.

Governor Bailey. That is the point. If they tell us when they come there that the bonds belong to them. For instance, here is a letter that we have received, "We are sending you today by express U.S. coupon bonds to the amount of \$11,300 as per enclosed descriptions of said coupons. We understand you will take care of this, clip the coupons as they become due and notify us of the amount due each customer." We received that letter and we answered it by saying that we did not clip coupons, that we would not take the bonds on that basis, but would only take them

and receipt for them as bonds of the member bank. Then in our general circular or letter we say that this is a service rendered to member banks only and insofar as the Federal Reserve bank is concerned the securities deposited for safe-keeping will be considered the property of the depositing bank and a custody receipt will be issued accordingly. We write them and say unless they leave them there and take a receipt for them we cannot handle them, and of course they always leave them. Six months after that that man may have sold his bonds. Now the question is when a member bank comes there, or sends in a hundred thousand or ten thousand or five thousand dollars in Government bonds as collateral for his note, it is fair to assume that they are his bonds. We are innocent purchasers. If they have been left by the customer or he has stolen them and hypothecated them with us we do not know the difference. There wouldn't be any difference from a man going over to a broker and selling them and using the money.

Governor Wellborn. I should think that would put you on inquiry and you should get a personal letter from the bank saying that they had bought the bonds in the meantime.

Mr. Harrison. I think you were on notice that the bonds actually did belong to the customer --

Mr. Bailey. They did belong to the customer when he put them in there, but the customer sold the bonds to the bank, and the bank bought them.

Governor Norris. If the bank wrote us a letter like that we would decline to accept the bonds at all.

Gov. Bailey. Wouldn't you accept them if they would take a custody receipt?

Governor Norris. No. We wouldn't accept any bonds except those that belonged to the bank.

Governor Bailey. That is the question. Should we take any bonds that we know are not the property of the bank?

Governor McDougal. We would not take them.

Governor Harding. We would not accept custody of any securities except the property of the bank.

The Chairman. That is our position.

Governor Seay. We had occasion recently to investigate the ownership of bonds that were held in custody and we found a very confused situation among our member banks. There is no doubt in my mind, or in the mind of our counsel,

that we will be charged with knowledge with whatever information was in our possession as to ownership of those bonds and it is our responsibility to make a search of our records and find out. We recently propounded eight inquiries to the several Federal Reserve banks as to what course they pursued with respect to securities in their possession and we found quite a variety of courses followed by the various Reserve banks. There has grown up, among the country banks in our District, a practice of permitting those bonds to be sent to them to be held for their customers, and they have a rule in the receipt which they give for those bonds, sometimes, that although they hold them merely for safe-keeping for their customers, but that nevertheless they have the right to borrow on those bonds. That is a very reprehensible practice engaged in by some of the country banks; it is rather spreading, and I have arrived at the opinion that there is no safe course, when we are making loans upon securities in our possession, other than to ascertain ourselves that they are the property of our member banks making the borrowings, and we should pursue that course.

Mr. Harrison. Do you mean affirmatively take the

steps to that effect?

Governor Seay. Yes, affirmatively.

Governor Norris. We feel that if we have to do that that we would go out of the custody business altogether.

Governor Seay. We have the statement from the bank that it owns them.

Governor Harding. We get that statement in advance.

Governor Seay. We found that the practice in the various Federal Reserve banks varies and that Cleveland was perhaps the only bank that required a certificate of ownership at the time of deposit.

The Chairman. Governor Bailey, you have suggested another topic, 4-A, "Should a Federal reserve bank accept for safe-keeping securities which are not the property of the depositing bank?" That appears as another topic on the program.

Governor Bailey. It is the same thing and should not have been separated. I do not know why it was done.

Mr. Harrison. That was done in error.

The Chairman. What is your proposal with regard to the topic we are now discussing, Governor Bailey?

Governor Bailey. I just wanted to get an expression

as to what the rest of the banks were doing. I know that we are taking from our country banks bonds that belong to their customers in the country, that they are pretty well scattered through the farmers and one thing and another. They leave them with their country bank. They are not safe there. They elect to send them to us or to one of the banks in Kansas City, which will deposit them with us. Personally I think it is one of the best services that we are rendering.

Governor Young. You can check it up all right.

Governor Bailey. I don't worry so much about that. There are very few of our country banks borrowing on Government bonds. Several of the big banks have bonds with us, but they own their bonds. The point I am trying to get at is when a bank comes and says the bonds belong to them and asks us to loan money on them whether it is necessary for us to go back and dig up information that we may have had previous to that of a different kind? We only have the information from the bank depositing them. They come over and say that they are their bonds and sign a certificate to that effect. It seems to me that that relieves us of liability.



Mr. Harrison. Not if you are on notice to the contrary.

Governor Young. Mr. Chairman, we have had a good deal of experience of that in the Ninth District. As Governor Bailey says, lots of these small country banks have nothing but cracker boxes for safes, and they send those bonds to us. We check them up and call attention to the fact that the bonds cannot possibly belong to them. We got in bad with everybody in the Northwest some four or five months ago by doing that, and my directors told me to accept the bonds of the customers of the bank, realizing that there was a slight liability, but figuring that there were two ways of losing money, one by taking that position and the other by perhaps losing something on the bonds. So we are taking anything sent into us by our member banks.

The Chairman. It is awfully difficult to protect yourself when you have a large business of that kind. A letter may come in accompanying a shipment of bonds; you have not been advised of any different ownership and yet a letter may come in with a memorandum attached to it saying that the bonds are the property of so and so, some clerk will overlook it, it will be left with the bonds, the bank

will borrow on them and then later somebody will come in and claim the bonds and the first thing you know they have got proof in the trial of a suit that there was a notice attached, and then you have lost entirely. Notice of that sort is almost invariably likely to be construed against you.

Governor Young. That is true, but there is very little chance of that.

Governor Calkins. I think Mr. Harrison has epitomized the proposition in saying that in the absence of notice to the contrary the assumption that the bonds are the property of the borrowing bank is the best security or protection that you can have.

Governor Seay. What is notice to the contrary?

Governor Calkins. Anything that is notice to the contrary.

Governor Seay. Do you agree that we are properly charged with whatever information we have in our possession as to the ownership of those bonds?

Mr. Harrison. Yes, I think that is true.

Governor Seay. Suppose upon a search of the records of the bank it is determined that we have among those re-

cards some notation that those bonds are not the property of the member bank? Don't you believe the courts will hold us responsible for that fact?

Mr. Harrison. Yes, I think that is very true.

Governor Norris. And going one step further: Suppose a bank deposits 25,000 of Government bonds with you and you see a contemporaneous statement of theirs showing that they have only 10,000 in governments, is that notice that 15,000 of those bonds do not belong to them?

Mr. Harrison. I should think not, because very often these member banks do legitimately borrow bonds, just for the purpose of hypothecating them. In that case they would have full authority to do it and your title would be entirely valid. I do not think that a contemporaneous statement showing ownership of bonds would put you on notice of the equities of the third person.

Governor Calkins. It would not unless it was actually a contemporaneous statement, and that you would never have, probably.

Governor Norris. Would they be under any liability to investigate and analyze the statement of every member bank under that situation?

Mr. Harrison. No, I should think not. That is a position I think the Federal Reserve Bank should avoid.

Governor McDougal. I think that is where the danger lies.

Mr. Harrison. If you are going to establish a policy of that kind you would place the burden not only of asking the member bank to inform you about title to the bonds but also the burden of analyzing their statements and of getting contemporaneous statements. I think the whole thing would be impossible of operation.

Governor Norris. It seems to me the safest plan is to take the certificate that the bonds belong to them and make no further investigations.

Mr. Harrison. And in the absence of the certificate assume that they belong to the member bank unless you have in your bank records showing that they do not.

Governor Seay. It may be incumbent upon the bank to search the records to satisfy itself on that point or otherwise if they transfer that amount of bonds, without knowledge, then someone might go to our records and find that they did not belong to the bank and hold us for them.

Mr. Harrison. I think that is true. It is important

to make an internal search in the Reserve bank if that does not involve going to the bank that sends them.

Governor Seay. We have found also in quite a number of cases that banks have borrowed bonds and have not shown them as a liability in their statement. In fact we found a very mixed up condition and I believe that any of the other reserve banks that deal with country banks very largely would find the same thing.

Mr. Harrison. The liability of the member bank for bonds which it has borrowed is nothing but what the Comptroller calls a memoran<sup>dum</sup> liability, which for a long time was not shown, but which is shown now.

The Chairman. What I don't like about Governor Bailey's case is that his circular is ambiguous and suggests possibly that the language has been used in order to get around the situation. He says, as I remember the language, that these securities will only be received as the property of the member bank, and yet he admits that he received notice in many cases that they were not the property of the member bank. Now if he said in his circular that unless he is notified to the contrary it is understood that they are the property of the member

bank it would not appear to be dressing up the situation. Then when he gets notice to the contrary he will be governed accordingly in case the bonds are used as collateral.

Mr. Harrison. I am afraid he tries to <sup>deny</sup> the equity of the third person by merely saying that he will not recognize it.

The Chairman. He quoted a letter in which the bank said they were offering to deposit the bonds, stating they understood he was to receive them for safekeeping, clip the coupons, and advised him of the customers that owned the bonds. Now no circular in the world would protect you against notice like that. Now, we decline to receive any securities except those which are the property of the member bank. We will receive none from the banks in New York City except those which come in incident to our deposits and borrowings.

Governor Seay. You have not issued a circular to that effect. You replied in the negative to that inquiry from our bank.

The Chairman. Then we have not done so.

Mr. Harrison. We assume that they are the property

of the member bank unless we have some notice in our own bank, some memorandum attached to the bonds, or some other data.

The Chairman. In which event they go back.

Governor Seay. You just assume that they know that is your general policy?

Mr. Harrison. That is correct.

Governor Norris. We give them a receipt stating that they are their property.

Governor Seay. Do you do that, Mr. Harrison?

Mr. Harrison. Yes, we do that.

Governor McDougal. It seems to me we are going far beyond the text of the inquiry I made. The question is whether or not the Reserve banks should make advances against securities held for safekeeping without taking steps to ascertain that such securities are the property of the offering member banks.

The Chairman. No, Governor McDougal. We skipped that topic and took up topic 4-A on the next page.

Governor McDougal. All right. I would like to discuss it from this standpoint anyhow. We require securities sent to us for safekeeping to be accompanied by a statement

in which there is incorporated a declaration of ownership. We would not hesitate under those circumstances to make advances of the kind referred to in this Topic 1-E. I think as a matter of fact that a bank is endangering its own position if, by correspondence, it questions the ownership in the way that has been mentioned. I think we can safely proceed along the lines of commercial banking practice and accept these securities as the property of the member bank unless we do have notice to the contrary.

Governor Norris. Before the discussion on this subject is concluded, and I suppose it is about at an end now, I want to offer a suggestion which may not be of any value, but I want to give it to you in case it is. We have had the impression that there might be a minor distinction made between the degree of caution and care required of us if the word "safekeeping" were not used and the word "custody" was used. We never use the word "safekeeping." We accept securities for custody, not for safekeeping.

The Chairman. I think that is a very good point. Governor Bailey, do you wish this subject to be discussed further?

Governor Bailey. No, Mr. Chairman.



The Chairman. I have put on the program Topic 1-F.

1. CREDIT TRANSACTIONS AND POLICIES.

F. Stock Exchange Loan Account. - Its relation to the New York money market and the credit situation in general.

I put that on more to offer opportunity for any questions that you might wish to ask me than because I had any particular statement to make about reporting loans and so on. You may all of you be interested in the mere fact of the report from the loan account, the history of it, its significance, and so on. I do not want to bother you with a long talk about the matter, but if it is a matter of interest I will be glad to answer any questions.

Governor Calkins. It seems to me it is a matter of vital interest to all of us and that any information you can give will be of very great value, Mr. Chairman.

Governor Seay. I would like to ask if you think the information finally arrived at is misleading or if it gives the information that it was desired to obtain.

The Chairman. It is still somewhat misleading, I am sorry to say. It will in due time correct itself when we have the basis for comparison with previous periods. The history of making the report, so far as I know it, is this:

Doctor Stewart had long had a feeling that the publication of the stock exchange loan account was a desirable thing; that it would inform the public about a very important item of credit conditions on which no information which was dependable was being published, and that the information that they did get from the Wall Street publications, and so forth, was known to be decidedly misleading. We took the position in the New York bank that we would not oppose the publication of the figures but we were in great doubt of the wisdom of having the Federal Reserve System collect the figures and be responsible for the publication, and assume some responsibility for the Stock Exchange Loan account which they could not possibly discharge. That we would much prefer to use our best efforts and persuasion on the management of the Stock Exchange to have them compile the information and publish the figures. The Board considered all this carefully, wrote us a letter saying that they had decided to collect the data and publish it. Whereupon we got in touch <sup>with</sup> the President of the Stock Exchange, explained the situation; he took it up with the management of the Exchange and they agreed to collect this information and publish it. We worked out a plan by which the Federal Reserve System collect the figures and be responsible for the pub-

the figures would all come out together, and that is the figures collected by the Board and the figures collected by the Stock Exchange and from the operators. That proposition fell down. The Board notified us that they would not publish their figures as was originally intended when the Stock Exchange figures were to be published, but would defer publication. So the Stock Exchange figure of \$3,513,000,000 was published first. That included all the borrowings by the members made in New York from New York banks, being loans for account of New York banks, for account of their out-of-town bank correspondents and for account of other customers who were not banks; it included also many private concerns like agencies of foreign banks, and so forth, which do not report to us at all. Therefore the Stock Exchange figure of \$3,513,000,000 proved to be a good deal larger figure than the one we subsequently published, inasmuch as it took in all loans to borrowers and our reports did not cover all the lendings of the lenders.

Governor Seay. That is a report of the borrowings of the members of the entire Exchange?

The Chairman. Yes.

Governor Norris. You used the expression just now

that it included all of the borrowings in New York.

The Chairman. I was just going to answer that. The Stock Exchange of New York made an announcement that their figures did not include borrowings from out of town because many firms in New York have branches in different cities and their branches borrow money locally, as in Boston, Philadelphia, Chicago and elsewhere. Those figures have not yet been compiled and if they were it would make the accounts still larger. That is the situation today. Since the first figure was reported the size of the account appears to have decreased, so far as the reports, still rather incomplete, indicate, by nearly \$400,000,000, due of course to the decline in the values of stock traded in, which requires more margins to be paid in. That has the effect of reducing the deposit and loan account, and that, together with sales of stock that have taken place by real cash buyers in this period of decline, has brought the account down. Now we have a feeling in New York that there is quite a little danger in taking part in getting reports, especially from individual banks, which would appear to be a voluntary assumption of responsibility for controlling the management or limiting the amount of loans that banks may

on the Stock Exchange. You see how the danger might arise. Let us suppose, as was proposed and discussed at one time, that every Federal Reserve bank required its member bank, when submitting an application for discount or loan, to put on the application a statement of the amount of money that it was loaning on the Exchange. Now there are three possible courses of action by the Reserve Bank when it gets that knowledge. First is to ignore it. If it ignores the information which it gets and the getting of the information implies admission of responsibility, then indeed the Reserve Bank appears to be avoiding the discharge of that responsibility. If on the other hand whenever we get an application for a discount from a member bank which showed the amount of money loaned on the Stock Exchange, and all the other Reserve banks and all branches should decline to make loans to those banks which had Stock Exchange loans, you can see what a calamity it would bring about. All those loans would have to be called or something done. It would drive the loans on the Stock Exchange by those banks which did borrow from us into our hands. The third course and the one that really  
the  
I would consider/less dangerous of the three would be

recognition of the responsibility on the one hand and an attempt to meet it on the other hand by an effort to ration the Exchange and say how much credit they should have. When we start on the Stock Exchange then we have got to go into other things, and there is no limit to the extent to which a bureaucratic view of that sort would go. That is the position the matter is in at the present moment.

Governor Young. Mr. Chairman, I move you we adjourn at this time until 2:15 this afternoon.

(Whereupon, upon motion duly seconded, the Conference recessed from 12:40 o'clock p.m., until 2:15 o'clock p.m. of the same day.)

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A F T E R   R E C E S S .

The Conference reassembled pursuant to recess at 2:30 o'clock p.m.

Governor Norris. I will call the meeting to order, and I move that Governor McDougal take the Chair until Governor Strong arrives.

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

Governor McDougal (Presiding.) Topic 1-G it is understood we will pass until tomorrow. Topic 2-A we will pass because it is understood that Mr. Strater will be here tomorrow morning. The next topic is 2-B - Withdrawals from the Par List.

## II. COLLECTIONS AND CLEARINGS.

### b. Withdrawals from the Par List.

Governor Biggs. That topic is submitted here for discussion rather than any action. We have found that in Mississippi particularly we have had a large number of withdrawals in the last year. In other words, we had 159 banks that were not on the par list in our District a year ago and now we have 401. I wanted to know whether that same thing was occurring in the other districts or not. It has practically all taken place in Mississippi. We have had three banks withdraw from the System and 250-odd that have withdrawn from the par list.

Governor McDougal (Presiding.) Would you like to canvass the situation?

Governor Biggs. Just in a general way, yes.

Governor McDougal (Presiding.) Mr. Harrison can speak for New York. The question is whether or not there

have been any withdrawals from the par list.

Mr. Harrison. In the New York District there have been no withdrawals from the par list. We have had a complete par list in the District for some years. There has been no indication on the part of any of our members that they contemplated withdrawing.

Governor Bailey. You mean non-members?

Mr. Harrison. None of the banks in our district, members or non-members.

Governor Harding. We have had no withdrawals.

Governor Norris. None at all.

Governor Biggs. These banks give the same reason practically. If one bank in a locality does it, then all the banks around there say that they are forced into it.

Governor Seay. We only have an occasional withdrawal. Sometimes there is some involuntary withdrawals of banks which do not remit to our entire satisfaction.

Governor McDougal (presiding.) But no general tendency?

Governor Seay. No. We rarely have a withdrawal.

Governor Fancher. We have had a few withdrawals on the part of our non-member banks in Kentucky, but the



number is inconsequential. In a few cases we have suggested that they discontinue relations when they were not remitting satisfactorily.

Governor Wellborn. We have had no withdrawals that have amounted to anything.

Governor McDougal (presiding:) In Chicago we have 260 banks not on the par list. We have 369 on the par list. Of those 260, 36 have been removed because we preferred not to handle checks on them on account of their unsatisfactory condition, and of the remaining 224 would not remit at par.

Governor Fancher. That is of the banks originally on your par list your list has shrunk that number of banks?

Governor McDougal (presiding.) Yes.

Governor Biggs. Ours has come from practically two States, Mississippi and Tennessee, particularly Mississippi. They are just like a lot of sheep. When one fellow starts the rest follow him. I was wondering if other Districts had had the same experience.

Governor McDougal (presiding.) You have had something over 400 withdrawals in a comparatively short time?

Governor Biggs. No. We have had 401 at the present time as against 159 a year ago, so that we have had practically 240 withdrawals.

Governor Young. We have 1070 banks off our par list. Some have been taken off but many have withdrawn.

Governor McDougal. How many have you on the par list?

Governor Young. 3106 banks. There are 1070 off and 2036 on, which is just 265 too many. When I get that 265 more off I am going to be happy.

Governor Talley. We have had no withdrawals. Those that do not remit properly we just drop off. In a little while they come around and want to get back on again. We have had no withdrawals. In Nebraska there are 179 on the list. At one time Oklahoma had the entire list, Kansas the entire list, Colorado the entire list. All of them that were off were over in Nebraska, and some of them have come on. As far as that is concerned we haven't lost any unless we have asked them to withdraw where they did not properly remit. About six months ago we had a little epidemic of withdrawals among the non-member banks of Texas, but in the last two or three months there has been

a tendency for them to want to get back. I think that is due to the fact that it is the policy of our larger banks to draw too heavily on checks drawn on banks that are not on the par list, which is objectionable to their customers, who object to having the check discriminated against, although they never give us their reasons. At present we have 760 on the list out of 942, or 182 off the par list. Recently we have dropped more banks from the par list than we have had withdrawals.

Governor Calkins. We lost three banks in the last year and now have 64 on the non-par list, 31 in Oregon and 35 in Washington. It was practically as a consequence of a little disturbance we had in Oregon.

Governor McDougal. (presiding) Is there anything further on this subject, Governor Biggs?

Governor Biggs. Nothing at all. I just wanted to get the general idea of the situation.

Governor McDougal (presiding.) The next is 2-C, Desirability of final settlement of controversy regarding non-cash collections. I think Governor Strong ought to be here when we discuss that so we will go to No. 3, Coin, currency and circulation. A. under that, Gold holdings

and payments, will be held over until Governor Strong gets here, but we will take up B., absorption of shipping charges on silver dollars.

### III. COIN, CURRENCY AND CIRCULATION.

#### B. Absorption of shipping charges on silver dollars.

Governor Bailey. We are paying it outgoing and they have to pay it coming in. We feel that we ought to either cut it all off or pay it coming in, because it works a hardship on commercial centers like Tulsa, Wichita and Hudson, and other places, where we send the free silver out, load them down with it, and they have to ship it back and pay for it. As I remember it, we did it at the request of the Treasury Department to try to force these silver dollars into circulation. It did not work.

Governor Young. The member banks in Tulsa can ship those silver dollars free from charge if they want to. You haven't any option in the matter. They can ship them in in payment of transit items, so you might just as well pay it both ways.

Governor Bailey. They don't take advantage of it, but I guess they could do that.

We have figured that our member

banks paid \$1600 last year in shipping silver into us.

Governor McDougal (presiding.) That is entirely in agreement with the policy agreed upon by the System, that the charges would be paid both ways on silver dollars and all other classes of currency.

Governor Bailey. Both ways?

Governor McDougal (presiding.) Yes.

Governor Young. It was left optional on silver dollars.

Governor McDougal (presiding.) Governor Bailey, what would you like to do about this? You have the privilege of doing as you please.

Governor Young. We pay both ways.

Governor Calkins. Not only can he do as he pleases about it, but all the banks are doing exactly as they please. There isn't any iniformity about it.

Governor Bailey. Well, if it is the consensus of opinion that we have the authority to do it, why it is perfectly satisfactory to us.

Mr. Harrison. That was voted upon in May of 1922 and it was decided that we would pay all costs both incoming and outgoing on all kinds of currency and coin with the exception of silver dollars, with regard to which it was

left discretionary with each Reserve Bank.

(Governor McDougal retired from the Chair.)

Governor McDougal. Mr. Chairman, I suggest that we return to Topic 2-C, placed on the program by New York.

#### 11. COLLECTIONS AND CLEARINGS.

C. Desirability of final settlement of controversy regarding non-cash collections.

The Chairman. There seems to be an impression still in the minds of some members of the Federal Reserve Board that this matter is up to the Governors. It has been in the lap of the Board, as I recall, for a good while, and unfortunately has the appearance now of being held up because of this last questionnaire sent out by the Barton Committee. That questionnaire produced such results, which were sent to me in confidence by Mr. Wells. <sup>did</sup> And/he also send in to you, Governor Harding?

Governor Harding. No.

The Chairman. When you come to consider that that questionnaire was prepared and sent out with the argument of the Barton Committee without any reference to the brief which we had prepared and which had been furnished to them by the Federal Reserve Board, it struck Mr. Harrison

and me as leaving matters in such shape that we were not justified in asking for any further consideration by the Board, except a final decision. If the Board still considers that this is unfinished business, I do not see why we would not again urge them to put a final end to this thing and decide what should be done about it.

Governor Seay. What has the Barton Committee done in reference to it? Have they reported the results of the questionnaire?

Governor Young. Yes, they have reported it to the Board.

The Chairman. Yes.

Governor Bailey. I have a copy of it here. In favor of continuing the service as at present, 779; in favor of discontinuing, 2,804; in favor of continuing with the charge covering cost, 831; in favor of discontinuing entirely unless the service is charged for, 208. 4,420 banks answered out of a possible 9,000.

Governor Harding. The figures showed 80-odd banks in Boston that wanted to discontinue it. That rather astonished me, in view of the fact that at a stockholders' meeting they were unanimously in favor of it. So I

canvassed every member bank in the District and only got three of them to say that they answered the questionnaire in favor of abolishing it, and that they did not really understand the questionnaire and were really not in favor of it.

Governor Seay. Have you the figures for each district, Governor Bailey?

Governor Bailey. Yes.

Governor Harding. Only three admitted that they had voted that way, and they said they didn't understand the proposition, and meant that they were in favor of continuing the service.

Governor Fancher. I think the manner in which the questionnaire was put out was very misleading.

The Chairman. Very misleading and very unfair.

Governor Seay. Have you the Fifth District there?

Governor Bailey. 48 in favor, 149 in favor of discontinuance, 52 in favor of continuing with a charge to cover cost of service, and six favoring discontinuing entirely unless there is a charge.

Governor Wellborn. What are the figures for my District?



Governor Bailey. 22 in favor, 180 in favor of discontinuing, 24 in favor of continuing with a charge to cover cost, and three in favor of discontinuing entirely unless a charge is made.

Governor Wellborn. 181 in favor of discontinuing?

Governor Bailey. Yes.

The Chairman. I think undoubtedly that this method of a questionnaire is an unfair and misleading way to do it, because the banks themselves are divided in their personal interest in the matter. Some benefit by it; some lose by it, and many do not understand what it is all about anyway. Here is a case where a certain class of banks get a service which they want and claim they need and in performing that service for the banks that want it and claim to need it we appear to be injuring other banks as a result. The Federal Reserve Act specifically provides that this is a service that we should offer to our members and for us to decline to offer it or to discontinue it is simply to veto that provision of the Act.

Governor Calkins. What is more, the service is set up at the request of the Federal Reserve Board in order to meet needs of member banks who are entitled to the service.

Governor Fancher. Not at the request, but at the direction of the Federal Reserve Board.

Governor Calkins. That is true.

The Chairman. I do not see why the Board does not settle it one way or the other.

Governor Harding. In view of that statement I would like to offer a motion that it is the sense of this Conference that the service should be continued and that the Board is respectfully requested to take steps to end the agitation against it.

Governor McDougal; I will second that.

The Chairman. Is there any discussion of the motion?

Governor Young. Mr. Chairman, I think this had better be handled with a good deal of care. I have been one who has been opposed to the non-cash collections. The others have been in favor of it and for that reason I have continued it. Our directors have gone so far as to pass a resolution discontinuing non-cash collections, with the approval of the Federal Reserve Board.

Governor Bailey. So has our Board.

Governor Young. It is best to go back a little on this. I originally brought the question before this Con-

ference because the bankers conventions in Minnesota, North Dakota and South Dakota and, if I remember correctly, in Montana, passed resolutions discontinuing non-cash collections, or requesting that they be discontinued. I came before this Conference with that information, presented it, and it was argued that these people did not know what they were voting for, that they thought it was par collections which they thought they were getting rid of, and I accepted that view of it. This Conference appointed a committee to investigate and see what the sentiment was with some of the member banks. I am not going to criticize the way in which that was done. I think it was done in a fair way. Certain results were shown, that the non-cash collections were desired by the banks. In the face of the that/Illinois Bankers' Convention passed a resolution discontinuing non-cash collections. The American Bankers' Association is not satisfied with the vote that the System got; they do not believe it was a fair vote and they sent out a circular, which they attempted to make a fair circular. I read the thing. It seemed to be a fair presentation of the entire case, and they got these results. The astounding part of it is that half of the member banks

in the United States have replied to this, and the other astounding part is that the great majority of them are not in favor of non-cash collections. I do not think you can let that report go unnoticed. I think you have got to give some consideration to it. We want a few friends in the American Bankers' Association, whether as representatives of the Association or as individuals.

The Chairman. Governor Young, suppose a vote of the American Bankers' Association or of the member banks, on the question of whether we should buy and sell government obligations, or whether the Reserve bank should do so, was two to one in favor of our discontinuing the buying and selling of Government securities? Would you be guided by that vote?

Governor Young. No, sir.

The Chairman. They would vote against it, many of them— I think possibly a majority of them, because they think it affects their earnings to have us do it. Congress gave these powers to the Reserve banks for purposes, some of which appear to be hostile to the membership of the System. If the majority of the banks voted to discontinue the collection of checks in the country you wouldn't for a minute

expect to discontinue the collecting of checks?

Governor Young. I could give my opinion in a minute. I wouldn't waste any time on it. If you wanted an expression from me as to whether we should take the par collection of checks out of the Federal Reserve System I would give it to you in a hurry, so far as my vote is concerned.

The Chairman. Congress has said that those banks that want to send you these matur<sup>ing</sup> items and items payable on presentation, are entitled to collect them.

Governor Young. Well, there is a question as to the interpretation of that.

Governor Bailey. If you read the act you will see it is not a mandatory thing.

The Chairman. No, but nothing in the act is mandatory, practically. This is a privilege which is extended to those banks who want to enjoy it, and those who do not want to use the system do not have to. They are objecting because they think you are taking business away from them.

Governor Young. Does the act say that you should do it gratuitously?

The Chairman. No. It may be desirable to make a charge, and that question is open to discussion.

Governor Young. If you charge you will get rid of it in that way.

The Chairman. As I understand the position taken in this meeting it is the same as it has been before, nine banks thinking this is a service that should be continued and three thinking that it is not. We cannot expect all the banks to agree always as to what is wise and what is not wise. Conditions differ in the different districts. Take the question of holding securities for safekeeping. The Federal Reserve Bank of New York encountered tremendous opposition in New York to having any securities from our members carried in custody, because it took business away from the banks. Conditions in your District and Governor Bailey's District are very different. If it came to a vote where we were controlled by the votes of our members we would have to vote against that thing right along because of the opposition in New York; but that does not justify me in voting against it because I think it is a service that I think the System as a whole believes ought to be extended to the members.

Governor Harding. I have understood the Board has felt that this was up to the Governors. Now I know the

Board itself is not always unanimous and I don't expect this resolution would be carried unanimously, if carried at all; but it does seem to me that the Board is entitled to know just how this body stands on the proposition. When you take a vote those who want to be recorded as against it can be so recorded.

The Chairman. What is troubling me about the situation, Governor Harding, is this: I do not see any means by which the Federal Reserve Bank of New York can say to a member bank in the country, or in the city, as the case may be, that sends us an item for collection in Governor Bailey's District, which the Act says that we may collect for our members, that we shall decline to receive it, just because we may vote not to do so or because the member banks may vote that we should not. If we are to take a position as to non-cash collections which is consistent, if we believe it is a detriment to the System, then we ought to go to Congress and get the Act amended. Every time we it comes up we find that there are nine banks who believe in the thing and three who do not. It has dragged along now for two years, it is in the hands of the Federal Reserve Board. We have voted on it repeatedly here.

Governor Harding. Possibly we might get somewhere if we pass one resolution expressing the sentiment of this body on the question and then offer as a separate resolution the request that the Board take final action on it one way or another.

The Chairman. We have never committed ourselves as to charges and the question of whether or not we shall perform the service and charge for it is still open.

Governor Seay. We have, however, adopted the report of the standing committee on collections which is against charging, as I remember it.

Mr. Harrison. That was qualified to this extent, that there should be no charge imposed unless we decided that the investment policy of the Reserve System should become affected by it one way or another.

Governor Seay. There is no subject within my recollection which has been considered more carefully than this subject, no subject which has been handled by an abler committee. I understand how there may be differences of opinion in our body, but I do share the opinion that it is desirable that there should be a final settlement of this controversy. It is disturbing to have it continually



before us and I am throughly in sympathy with Governor Harding's resolution, as first offered. We can do no more than express a majority opinion upon it. We are clearly divided.

Governor Harding. I think the motion should be separated. My first motion is that it is the consensus of opinion of this body that the collection system should be continued as at present, the non-cash collections, and secondly, that in view of the fact that this question has been thoroughly discussed and has been before the Board for two years, that we respectfully request that they take final action upon it.

Governor Wellborn. It seems to me that we ought to pay a little more attention to the committee of the American Bankers' Association. I think this whole question is very different from anything else in the Federal Reserve System because it is doing business with the public, and, so far as my observation goes, it is very unpopular with the public. They do not like it. There is a great deal of dissatisfaction in our District, in all the cities where we make these collections; we have a great deal of trouble with the people upon whom the drafts are drawn, and there-

fore I would have to vote against Governor Harding's motion.

The Chairman. Do you think we are doing business with the public, Governor Calkins, when we collect a draft off a member bank?

Governor Wellborn. Yes.

The Chairman. That is not payable at a bank?

Governor Wellborn. Yes. I think also that it is not fair to the member banks in that it discriminates against them. It doesn't apply to banks in other places, but only where there are Federal Reserve Banks or branches.

Governor Calkins. I would like to ask Governor Harding if he minds expressing an opinion on whether the Board has authority to order discontinuance of this service in view of the language of the Act?

Governor Harding. I do not think so.

Governor Bailey. It irritates our people more than any one thing. I have a letter here with regard to a case that happened day before yesterday.

(Governor Bailey thereupon read two letters which were not handed to the Reporter.)

The Chairman. It is a very curious thing, but do you know that there isn't anything in the rules or regula-

tions with regard to non-cash collections that prohibits the imposition of these charges upon the banks; not a thing?

Governor Bailey. But we have got to send a man out in the city of Omaha to collect them. We cannot charge them.

Governor Young. My directors have gone on record as to how they feel about this. The member banks in my territory have expressed themselves, not only once but twice, and thoroughly understand this subject. I have my own views about it. Our banks have voted no on this every time it has come up and will vote no on it, and then we will attempt to continue the work. I was simply expressing the sentiment in my District and trying to correct any erroneous opinion that there might be here or any erroneous view as to how our banks felt about it. I know how they feel about it. There isn't any question about that. I do not think it is right for this System to hold that a bank is not entitled to pay for sending an item out on the street and collecting it. I had a rather peculiar experience with one of your member banks. A short while ago we had a couple of hundred bond men in Minneapolis and St. Paul

selling securities out through the country. They collected those securities by drawing drafts, with securities attached, and depositing them in one of your member banks, which would then go through you and be presented to our bank.

The Chairman. They did not come through us.

Governor Young. Then they came to us direct. I do not know how they got to us, but they got to us. That necessitates a collector and handling something that we did not know anything too much about. We asked for a certified check, which irritates them, and they throw all the obstacles they can in our way to delay giving the certified check, and finally tells our man that if he wants a certified check to go on downstairs and get it certified. Now the man has got to stay there with the securities, but finally he goes downstairs and tries to get it certified. Meanwhile the dealer has made arrangements with the bank and they fuss and fool around for two or three hours and finally we get the certified check. Therefore a few months ago we told the collection department to simply call up these dealers and tell them that the draft with security attached was there and that they could bring a certified

check over there and get it. One of the representatives of the New York bank came to me and told me that I was in bad with everybody in the community and I explained to him why we had to do it.

Governor Bailey. We have had exactly the same experience.

Mr. Harrison. What would the commercial banks do?

Governor Young. That do you mean?

Mr. Harrison. Suppose these drafts were routed through a member bank in Minneapolis, ~~then~~ what would happen?

Mr. Young. They would charge one tenth of one per cent.

Governor Fancher. They would have a certified check.

Governor Young. Certainly they would, but let them do it.

Governor Seay. I have very great respect for the adverse opinion, particularly for the opinion of those Governors who hold that adverse opinion. But I think we have every reason to believe that the good accomplished by this far outweighs the disadvantages and objections that are urged against it, and I think will continue to far outweigh the disadvantages and objections. I believe after while that it will become a recognized function of the Reserve

bank and I also believe that if it were discontinued that they would make a very much greater fuss than is now being made against it.

Governor Harding. Would not the average country bank feel that it was discriminated against in having to pay the Federal Reserve Bank one-tenth of one per cent to get the service, and being called on at the same time to remit for checks drawn on him at par?

Governor Seay. I believe so. I believe we could do no more here than to take the majority and minority opinion on this subject. We have discussed it time and time again and we always come right back to where we start. In the beginning of this thing I think I recall correctly that we were not in favor of undertaking the business of collecting against individuals. Since we have undertaken it my own opinion has undergone modification. We have examined as carefully as we could the reports and the reasons which have been before the committee on non-cash collections, and we believe that they are good.

Governor Bailey. But a majority of the bankers of the United States apparently are against it.

Governor Harding. This matter came up at one of our

stockholders' meetings two or three years ago. Before it came up we had several protests from the city banks in Boston about undertaking to make these collections. They said we were taking business away from them. Then it came up at the stockholders' meeting and the curious part was that there was a chorus of country banks in favor of it, the motion was put, and everyone of the Boston banks voted in favor of it. They did not want to go contrary to the wishes of these country banks that had reserve accounts with them.

Governor Wellborn. I haven't heard mentioned the foundation for this practice that we are engaged in. My recollection is that that amendment was put into the Act, that the Board requested that it be put into effect on the ground that there would be a good many member banks that did not have correspondents, that they would discontinue their correspondents and do business entirely with the Federal Reserve System; that therefore they ought to have some means of transacting their business through the Federal Reserve System. But that is not the case. Every member bank has its correspondents in the cities.

The Chairman. Would you be in favor of discontinuing

it entirely, Governor Wellborn, arbitrarily?

Governor Wellborn. Yes, entirely; cut it out entirely.

The Chairman. Irrespective of what the Act says?

Governor Wellborn. I think the Act just makes it optional. I think it is a bad practice and is useless on the ground that I have stated, that every bank has its correspondents.

The Chairman. Do you know that more than a majority of our banks are using the service?

Governor Bailey. I do not believe so, Mr. Chairman.

The Chairman. I believe so and I think the committee's report showed that.

Governor Bailey. Not ten per cent of them in the Tenth District.

Governor Calkins. This matter has been pretty thoroughly discussed over a considerable length of time. In regard to Governor Wellborn's recollection, the fact is, as I recall it, that this function was undertaken at the direction of the Federal Reserve Board and one of the reasons advanced was that inasmuch as all member banks were compelled to carry their entire reserve in the Federal Reserve Bank they would not be apt to carry as many correspondents!



accounts as they had theretofore. I do not know whether Governor Wellborn intended to say that the memberbanks do maintain as many correspondent accounts as they did before the inauguration of the Federal Reserve System, but I am quite sure, myself, that they do not; they have not the same facilities for collection that they had before and therefore they are entitled to this service as a matter of law and as a matter of equity.

The Chairman. Would you decline to accept items from banks that tendered them to you for collection?

Governor Young. We are doing it now.

The Chairman. If we passed a resolution now to discontinue this service, would you be willing to say to these member banks you would not handle them?

Governor Young. Yes, sir.

Governor Bailey. Yes, sir.

Governor Harding. The statement was made a moment ago that this Act was not mandatory but left it to the option of the Reserve Bank. I want to read a part of section 13 of the Act:

"Any Federal Reserve Bank may receive from any of its member banks, and from the United States, deposits of cur-

rent funds in lawful money, National Bank notes, Federal Reserve notes, or checks, and drafts, payable upon presentation, and also, for collection, maturing notes and bills." Now if there is any option in receiving notes and bills for collection, that same option must necessarily go to receiving deposits and current funds or lawful money or checks and drafts payable on presentation. It seems to me this is meant to be mandatory, because clearly we have got to receive those other things.

Governor Wellborn. I would be willing to do this: If counsel decide that it is mandatory I will have nothing more to say about it.

Governor Harding. That "may" applies to both, and the "may" is equivalent to "shall".

Governor Norris. They are all of the same parity, with the word "may" applying equally to both.

Governor Wellborn. But that word "may" can be used in a different sense under different circumstances.

Governor Norris. Yes, but it is used only in the one circumstance there.

Governor Young. If that is true I am breaking the law right now.

Governor Wellborn. I will keep quiet if it is decided that it is mandatory.

The Chairman. I think it is mandatory to this extent, if there is any meaning in the words at all; that is when you say "may receive on deposit", and so forth, National bank notes and items payable on demand, that it at any rate gives those banks that want to make those deposits the right to do so.

Governor Wellborn. Why should not the Federal Reserve Board undertake to give us special instructions on this?

The Chairman. Well, we were declining to receive anything of this sort and then they said you have got to receive them from those banks that want to deposit them.

Governor Harding. I think any member bank that wanted you to take them could force you to do it.

Governor Young. We feel that a very dangerous situation would develop. Take the banks of Minneapolis and St. Paul and they will lend a great deal of money to the country banks on the bills payable basis. Those notes are not due when they come to you, and if the member banks in the large centers of the United States learn that they can send in

those notes for collection and that you have got to take them, why then you are going to get them, and that is the easiest way I know of of getting them paid. I remember making inquiry of this Conference at one time as to what you would do in a case of that kind and you were all unanimous in saying that you would not take the notes of a member bank, a matured note, payable at a bank out in the country. If you have got to take these others you have got to take them, and you would be flooded in 24 hours. We had one bank down in Illinois that was pretty smart. They had some \$72,000 worth of notes drawn on Sidney, Montana. They sent them to Chicago; Chicago sent them out to Helena, Helena sent them down to Sidney, and, to make a long story short, we were put to the expense of \$170 to \$175 to go down and get those notes, and I simply told Chicago if any more of that stuff came in that they could keep them; that we did not want them.

The Chairman. Let us see about that practically. A bank in Connecticut, we will say, sends to its New York correspondent a bundle of receivables and say they want to borrow \$50,000 on them?

Governor Young. Yes.

The Chairman. Those things have all sorts of maturities. Some fall due before the collateral note falls due and in that case they substitute other collateral, and those that fall due subsequently are held until the loan is paid off.

Governor Young. Yes, sir.

The Chairman. When a note which forms a part of that collateral for that loan becomes due the bank that holds the notes, that made the loan to the country bank, is not going to bring that note over to us for collection.

Governor Young. But suppose they do?

The Chairman. They could not possibly do that.

Governor Fancher. You wouldn't take past due paper.

Governor Young. No, but we would take paper that is not due.

The Chairman. The note goes out, is presented, not paid, and comes back again into your hands, and that ends it.

Governor Young. But suppose that bank closes during the interim?

Governor Strong. Isn't that one of those awful calamities that are constantly held up before us as

reason for not doing things which do not materialize?

Governor Young. Well, it materialized out in San Francisco to the extent of \$32,000.

Governor Calkins. That has not the remotest relation to the point under discussion.

Governor Young. I thought it had.

Governor Calkins. Not the slightest.

Governor Young. It doesn't make any difference whether you send a transit item or a non-cash item to a bank that is in bad condition. Those are the only kind of notes you get. You don't get them on the good banks.

Governor Calkins. We did not send anything to the bank. We took in something from the bank, unfortunately.

The Chairman. It strikes me that there are a variety of ways of dealing with this. We have voted on it so often that the little black box in which the ballots are deposited has a hole worn in the bottom of it. But it does seem to me that it can be handled in this way: First we can go to Governor Harding's first motion, which again makes a record of approval of continuing the service; then vote on a second motion asking the Federal Reserve Board to end the discussion by submitting a final ruling on it;

third, we can take up the question of whether or not we should impose a charge for the service; fourth, we could discuss and vote on the proposition of asking Congress to repeal this part of the Act; fifth, we could vote on a motion asking Congress to qualify it, by saying that as to those items we might take those which we want and not take those which we did not want.

We have two motions before the meeting. One is to reconfirm our position that this service should be continued. Has that motion been seconded?

Governor Fancher. I will second it.

Governor Biggs. It has been discussed a great many times, Mr. Chairman, and if you will go back over the record you will find that the same arguments have been presented.

Governor Norris. And I believe they were for the same vote of nine to three.

Governor Biggs. It is not doing the System any good, and the matter ought to be settled.

Governor Fancher. Did you have a communication from the president of the American Bankers' Association in connection with the matter?

The Chairman. Yes.

(After informal discussion:) The question before the meeting is upon Governor Harding's motion.

(The motion, having been duly seconded, was carried, nine voting in favor of the motion and three against it, Governors Young, Bailey and Wellborn voting no.)

The Chairman. The second motion was to request the Federal Reserve Board to take steps to bring the discussion to a conclusion and settle the matter.

Governor McDougal. Seconded.

The Chairman. Is there any discussion of that motion?

Governor Calkins. I think the Board might well be questioned if they are disposed to consider the matter as to whether they have authority to order the discontinuing of a function which is, in my own opinion, made mandatory by the Federal Reserve Act.

The Chairman. Is there any further discussion?

(The motion, having been duly seconded, was carried, there being 11 votes in favor of it, and one against it, Governor Wellborn voting no.)

Governor Wellborn. I vote no because I do not think the Federal Reserve has the right to make it mandatory.



The Chairman. That disposes of that topic.

Governor Norris. Had you finished your statement in reference to L-F, Stock Exchange loan accounts, Mr. Chairman?

The Chairman. No, I was interrupted. I just concluded a statement of what position we would be in with the information of the character that I have described furnished by the member banks on their application blanks. Now I would like to explain to you how entirely ineffective it would be anyway. Let us suppose that the Mellon National Bank of Pittsburgh has an account with a very rich concern or man who accumulates a balance of a million dollars, that the Mellon National Bank of Pittsburgh is lending no money on the Stock Exchange at all; that the customer draws a check for a million dollars on his balance in favor of the Union Trust Company to pay for a loan that he has there, a real estate mortgage, possibly; the Mellon National Bank has not sufficient funds immediately available on that day and sends some commercial paper over to the Pittsburgh branch of the Federal Reserve Bank and borrows a million dollars to make good its reserve? The Union Trust

Company, however, which has borrowed nothing from the Reserve Bank, has a large amount of money and is lending money on the Stock Exchange, it has the mortgage paid off and it sends the money to its New York correspondent and increases its loans on the Stock Exchange a million dollars. Now if there is to be a minute and accurate control of the type of loans of the member banks, it has got to be by some other method than that of having the member bank report, because the money will go into the Stock Exchange anyway. In other words, anything to affect the control of the Stock Exchange loan account has got to deal with the borrowers and not with the lenders. That is the fact of the matter. I think we have had enough experience in New York to know that that is so, because during the war we actually did deal with both the borrowers and the lenders and the borrowers were placed under restraint by the Stock Exchange management limiting the amount that each house could borrow of the total borrowing. We had to deal with the bank and the management of the loan account simply meant that we arranged how much of the total loan account each of our banks should carry. There is a good deal of rather loose thought, I think, about the

whole question of control of Federal Reserve Bank credit. We cannot control it once it leaves our doors. It is unfortunate that the discussion so frequently is in the direction of indicating that the Federal Reserve System in some way, in published figures and so on, has assumed some responsibility to control the account itself. I do not want to see that and I do not want it done. I think it would be dangerous and ineffective.

Governor Norris. Is the rule on the New York Stock Exchange still in force limiting members' total borrowings to a certain proportion?

The Chairman. The rule to which I referred was the rule that limited the borrowing of any house to an amount not in excess of the amount which they were borrowing on a certain date, after we got into the war.

Governor Norris. I thought they had a rule that limited the amount of borrowing by members in proportion to their capital.

Governor Young. At ten times their capital, so I am told.

The Chairman. The business conduct committee of the Exchange now requires regular reports from all members in

which certain information is given. I have seen the form and it is quite elaborate. On the basis of the information reported, which is examined by experts in the Stock Exchange management, where a house appears to be borrowing an amount which is greater in proportion to their capital than the Stock Exchange believes justified, then they call them in, make inquiry about it, and, if necessary, correct it. That is where the effective control of this borrowing account really lies with the Stock Exchange.

Governor Seay. Membership in the Stock Exchange is individual. Does the report of the member cover only the borrowings of the member or the borrowings of the investment house to which he belongs? If they are members they are members merely through one of the members of the firm.

The Chairman. They report just the same.

Governor Seay. Does that report cover the borrowings of the firm?

The Chairman. Always. The member is simply a representative of the firm.

Governor Seay. Then the report to the Stock Exchange does include the borrowings of the investment house?

The Chairman. Where they have members on the Exchange,

yes.

Governor Norris. Do those figures that have been published include borrowings of the investment houses who do not have membership on the Exchange?

The Chairman. No.

Governor Norris. So, for example, <sup>if</sup> Kuhn, Loeb & Company had a member of their firm who is a member of the Stock Exchange their borrowings would be included; if they had not a member on the Stock Exchange they would not be included?

The Chairman. They would not be included. I put this on the topic not to make any apologies about what was done, but I wanted to explain it and give you opportunity to ask any questions.

Governor Fancher. I wasn't here during some of the discussions this morning, Mr. Chairman. What has been the effect of the publishing of those figures?

The Chairman. I think the first effect was to startle people a bit as to the size of the account, which had been variously estimated, but the highest figure of which had not been over two to two and a half million, when it developed that it was a billion dollars above the

highest figure.

Governor Seay. Does the opinion prevail that we are on debatable ground in asking for this information?

The Chairman. I don't know that it prevails. I cannot answer that question. I think it was very well received generally that the figures should be published.

The next topic is 3-A.

### III. COIN, CURRENCY AND CIRCULATION.

#### A. Gold holdings and payments.

Mr. Harrison. This topic was put on largely because of the fact that we have had it on the program for the last three or four meetings and with a view of discussing two features of the question. The first is the total amount of gold held in relation to the total amount of monetary gold in the country, which is controllable by us through our policy of gold payments. Second, to consider again the percentage of payable gold to the total amount of gold held by the Federal Reserve banks. I do not know how deeply the Conference would care to go into that, but our directors have shown considerable interest in it lately from both aspects.

You will remember, taking up the last feature first,

that three or four years ago we were all very much surprised to find out the small percentage of payable gold the System held in proportion to the total amount of gold held. At that time the average for the System was only 11 per cent of their total liabilities, that is, their note and deposit liabilities. Through some arrangement with the Treasury, which began a fairly substantial coinage program, we have gradually increased the percentage up to 18 per cent, but even now, in the case of some Reserve Banks, the percentage is fairly low. It occurred to us that perhaps those Reserve Banks might care to review the situation a little bit and study their own condition with regard to the amount of payable gold held in relation to the total gold held.

The other question, that is the gold payment policy of the System, you will remember in May of 1922 we adopted a payment program which placed gold at the bottom of the list; in other words, we were not <sup>to</sup> pay out gold certificates until after we had exhausted all other forms of currency available, which was equivalent to an agreement that you would not pay out gold certificates at all. At that time Governor Strong made a reservation with regard

to New York, because he anticipated that on account of large increases in the gold imports it might be advisable for us in New York to pay out enough in certificates to offset imports. As a result, in August of 1922, we commenced a gold payment policy, which for a period of two years and a half we followed. At the end of 1924 we had paid out net a little over 700 millions in certificates. At the end of that period the gold held by the System was, to a dollar, the same amount that was held in August, 1922, in spite of the gold imports. In other words, we started out in August of 1922 with three billion, 71 million, gold in the System and, in spite of the imports, during that two and a half year period we ended up in December of 1924 with exactly the same amount, \$3,071,000,000. It might be explained that during 1924 the efforts of New York were helped by Chicago, who commenced payment of gold some time in February of 1924. During the year Chicago paid out over \$200,000,000 net. None of the other Reserve Banks at that time were paying out any gold. At the end of 1924 we ended all square. Then came the question, with the shift in the flow of gold from the import to the export trend, what our policy should then



be. We discussed it at one meeting here. We had long talks with the Treasury about it. The Treasury program coincided with ours, and I think was agreed to by some of the other Governors, and that was that we should pay out just enough certificates in 1925 to maintain the gold certificate circulation at about the level it was then, or a billion dollars. During 1925, owing to the fact that some of the other Reserve Banks, particularly Boston, commenced gold payments, the gold certificate circulation went up to pretty nearly \$1,100,000,000. It is down now to a billion, fifty million, and still it is our feeling that we should continue that program, which is payments by the System in amounts sufficient to keep the gold certificates in circulation at a billion dollars. It might be well worth while for the conference now to review it. If we proceed under that policy then any gold flow, whether it is in or out, will manifest itself immediately in the total gold holdings of the System. In other words, if we just keep our present certificate circulation at about a billion dollars, and do not try to offset either the imports by further payments or the exports by further contraction, then any change in the

international flow of gold will necessarily reflect itself in the System's holdings. I think I am correct in saying that, so far as we have reviewed it, we feel that we should continue our present policy and maintain that certificate circulation at about a billion dollars.

In that connection, and reviewing a little bit, when the System was first organized the total monetary gold in the country as estimated by the Treasury was a billion, eight hundred million. In 1917, when the 1st<sup>shift</sup> in reserve took place, the total amount of gold was about three billion. In 1922, when we commenced our gold payment policy, it was three billion, eight hundred million, and at the present time it is estimated to be about four billion, four. We have four billion, four, and the System as a whole holds a little under three billion — I think it is about two billion, eight hundred million, and of that two billion, eight hundred million, we have only about seven to eight hundred million in payable gold. The rest is in bullion in the gold settlement fund.

Governor Harding. It would be helpful to us in the gold program if you would let us know when you get a

gold movement in New York, either incoming or outgoing. It may be several days before we are affected in Boston. So far in our gold payments we have just had to be a little arbitrary, but if we could get from you, just as we get our allotment of acceptances bought, just as we get a statement about the probable amount of Federal Reserve notes that we will have outstanding during the coming months, it would be a pretty good guide to us in our payments. We do not want to overdo it or underdo it. If the Treasury wants to keep a billion dollars in gold in circulation it would be very helpful to us if you would figure what our proportion would be, let us know, and we could work on that during the month.

Mr. Harrison. I think it would be most helpful, certainly to our program in New York, if we could have a little closer cooperation between Chicago and Boston.

Governor Harding. If you would give us those figures we would be very glad to cooperate with you. We would like to have something to guide us, because as it is now we are going it blind and do not know.

Governor Fancher. We would like to have that too, Mr. Harrison. In the latter part of 1924, in the last

two or three months, the Cleveland Bank paid out between forty and fifty million dollars.

Mr. Harrison. I think your net figures for 1924 were in the form of receipts rather than in the form of payments. I may be mistaken.

Governor Fancher. No, Mr. Harrison. We lost on the 1924 but gained in 1925. We paid out liberally in the last three or four months of 1924.

Mr. Harrison. Then I must modify my statement to the extent that it was a fairly insignificant amount in comparison with the total net payments by the System.

Governor Harding. If we are going to have a System gold policy it seems to me it is important to have the several banks informed as to what they shall do.

Governor Fancher. I think that is a very good suggestion, Governor Harding. We could operate our gold payments possibly more intelligently.

Mr. Harrison. The difficulty in the past has been that when we took the matter up in the Conference here -- I remember Mr. Winston appeared before the Conference -- there was not very much sympathy expressed by the other Governors towards any gold payment program. In

fact I think we ran contrary to the general thought of the Conference, but there was no/objection on the part of the others to our continuing the payments.

Governor Young. We have tried to pay out gold out there and issued certificates, but it is extremely hard in our District. The banks out there want the five dollar bills and we cannot pay them in gold. We pay it out whenever we can. We were in sympathy with the program, we tried to do it, but could not do it.

The Chairman. Here is the real situation that presents itself, as we figure it out in New York. Before the War gold-paying countries like England had but two kinds of currency, gold coin and national bank notes. Now the kind of currency that always reached the saturation point was the gold coin. They always had all the gold coin that they could use because they would go to the bank and get the gold coin whenever they wanted it. Consequently the circulation in England was very stable and a fairly definite amount, with gold coin circulation always at the saturation point. Over here, in contrast, we have all kinds of paper money in circulation, and the kind that fluctuates is the Federal Reserve notes. But inasmuch as our gold cir-

ulation is simply a different colored piece of paper, they cannot distinguish between a piece of paper which is gold and a piece of paper which is a Federal Reserve note, so there is no such thing as a saturation point in this country of gold coin circulation. Then another thing, in the Federal Reserve System we pay out Federal Reserve notes and take in gold certificates and pay out gold certificates and take in Federal Reserve notes and, according as we do one or the other, our reserve goes up or down. Our reserve percentage will increase quite rapidly as we take in gold certificates and pay out Federal Reserve notes. We get dollar for dollar, which increases our percentage. So we have got the choice of having the fluctuation take place in the amount of gold currency in circulation or in our reserve. It is a question of policy whether it is wiser to have the reserve fluctuate, especially when the gold movement becomes slack to some extent, or whether it is better to have a lot of gold certificates in circulation fluctuating.

Governor Seay. When did you begin the policy of paying out gold notes?

The Chairman. In 1922. We felt that during this

heavy gold importation it was better not to have it piled up in the Reserve Banks, just to be a show piece all through this country and the rest of the world and have them think that there was unlimited credit available here, and we paid out, as Mr. Harrison said, some \$700,000,000. Now we have got to the point where the gold movement is in both directions, instead of just coming in all the time, and we feel that the time has come to have the amount of gold in circulation constant and to have the changes brought about by gold imports shown in our reserve. So we are trying to keep the amount of gold certificates in circulation at a billion dollars. If we have a big loss of gold by export our reserves will come down. If we get a lot in our reserves will go up. It probably is a more illuminating situation for the public than if we handle it in a haphazard manner without any policy, or if we had the amount in circulation the fluctuating item, because no one will know about that.

Governor Fancher. Have you any figures to indicate how this Treasury policy is working out of keeping up the amount of gold certificates? The banks are all paying gold, are they not, and have you any figures to show?

Governor Seay. If you have the Bulletin before you, on page 215 you will see the variation in gold certificates.

Mr. Harrison. I have here a chart which we follow pretty closely in New York. It gives the additional amount of money in circulation in relation first, to the general price level, and second, in relation to the gold imports. It also shows the gold certificate circulation in contrast with the Federal Reserve notes circulation. It illustrates what Governor Strong has just referred to, that when we pay out gold certificates the Federal Reserve notes come in, and vice versa. If you are interested in it I will be glad to send you one of them.

Governor Norris. I would like to have a copy of that. I would also like to know on what basis the Treasury reaches the one billion dollars as the amount of gold certificates desirable to have in circulation.

Mr. Harrison. That happened to be the figure at which the circulation stood at the end of 1924, when the flow in gold changed from an import flow to an export flow. In order to show the imports in our reserve and to give up payments in order to offset imports we thought we



would keep the certificate circulation at its then figure of one billion dollars.

Governor Seay. In December, 1924, it was \$933,000,000.

Governor Calkins. I would like to have a copy of that chart. The Chairman's view at the present time is that it is probably unnecessary to conceal the gold that is coming into the country. That we should only keep concealed that which is already concealed in the billion dollars in circulation and let the balance of the flow, which ever way it may be, appear in the statements of the banks.

The Chairman. Yes.

Governor Calkins. In other words, we can probably continue to do approximately what we have been doing, pay out as much as we take in, unless there is some considerable movement, and that would then be adjusted in New York.

The Chairman. Yes; we would then take up the new policy.

Governor Calkins. If there was a considerable movement it could be taken care of by the bank in New York and the others could continue the same practice?

The Chairman. We could compensate for it, yes.

Governor Seay. The important thing to me seems to be to continue the policy that has prevailed since it would bring about confusion in the situation if you changed it.

The Chairman. Yes. One or the other figure has got to be constant in order that the other one, which is not constant, shall mean anything.

Governor Seay. It has to be. If you change the policy in that respect the result will be a change in the reserve and there will be some inquiry as to the reason for the change which does not show on its face, which would not perhaps be as good a thing as might be.

The Chairman. We are not figuring on any change in New York just now. We will just rock along as we have been and to supply the other Reserve banks with these figures, if you want them.

Governor Calkins. It appears to me if the other banks continue to carry out the policy they have been carrying out approximately, that is, of paying out as much gold as they receive, that all the adjustment necessary will be made in New York and will appear in the New York reserve figures.

The Chairman. That is so.

Governor Calkins. If a very great change should come it might be necessary to change the policy of the other banks, but not otherwise.

Mr. Harrison. There was one practical thing that would have helped us in 1925, and that was if we had known a little bit in advance that Boston was going to commence a substantial payment policy we would have checked up a little in New York so that the total circulation would not have bounced up a hundred million dollars, as it did, without our being able to check it until it was too late.

Governor Harding. You could have told it from our weekly statement, could you not?

Mr. Harrison. The circulation had gone up before we realized it. Your gold payment policy would not be reflected in your weekly statement, Governor.

Governor Norris. Where would you find out in your statement how many gold certificates you were paying out?

Governor Harding. He could have found out what our outstanding note issue was the week before.

Governor Norris. Yes, but that may have gone out through the gold settlement fund. You couldn't tell

whether or not it was going into circulation.

Governor Fancher. I would like to ask Mr. Harrison a question as to the amount of minted gold and as to the holdings of the banks in the matter of coin. What is the presenting minting program? Have they got a surplus of gold, do you know?

Mr. Harrison. At the present time the Treasury has a surplus of about \$50,000,000 in coin over and above the base required for certificates, that is all.

Governor Fancher. That is quite an improvement.

Mr. Harrison. That has been reduced by \$20,000,000 in the last two days on account of a withdrawal that New York has made, so that there is really only about \$30,000,000 now.

Governor Norris. Are they minting gold this year?

Mr. Harrison. I believe they have minted this year on the same program that they have followed in the last two years, Governor Norris.

The Chairman. Now gentlemen, if there is nothing further on this we will pass to Topic 3-C.

### III. COIN, CURRENCY AND CIRCULATION.

C. Currency counting machines. Volume of work per-

formed and estimated savings.

Mr. Harrison. These currency counting machines have been discussed at a previous meeting. A number of the Reserve Banks have sent representatives to New York to see them in operation. Since then we have sent trial machines to five of the Reserve Banks. We have had in operation for a year now 40 machines in the New York Bank. We have had a pretty fair test to determine how much these machines have increased our output, and we have estimated that on five dollar bills, for instance, the counters have increased the output by 64 per cent. So that whereas a girl was counting, spreading, bundling and sealing eleven packages or 11,000 notes a day before we had the machine, we have increased that to 18,000 notes on the average. There are some girls who have been on machines longer than others who are averaging between 22 and 24 thousand notes a day. We figure that is a little high and that after the girls have had adequate experience that they will probably average about 20,000 notes a day. That is almost double what the counters were able to do before the advent of these machines.

The only purpose in bringing the question up again is to refer to the contract which we have with the inventor. At the time we negotiated for these machines we provided not only for a possible 100 machines for New York but also, at a special price, we provided for the other Reserve banks in the event that they would give an aggregate order for the entire System for 200 machines, including the 100 that New York might order. Our program has been a little bit delayed owing to the fact that the inventor, having almost a unique product, that is almost exclusively for use in the Reserve Banks, has not been willing to build up his manufacturing plant to a point where he can produce as quickly or economically as he might otherwise have done if he had secured the order for the other Reserve Banks. While we appreciate the desire of the other banks to try the machine out and see how it works in their own shop, nevertheless if all of you could, in some way or another, satisfy yourselves as to the effectiveness of the machine it would be very helpful to us in getting our own 100 machines and very helpful to the inventor if, within the reasonably near future, we could give an order for the System.

The Chairman. Mr. Harrison expresses these things in much gentler phraseology than I do. The fact is this: If we send test machines to all the reserve banks it is going to materially increase the cost of the thing and delay the program materially and throw us out of line in New York. Now we have had the machines going for a year, 40 machines, and we are absolutely satisfied with the demonstration that we have had. We have pulled a machine to pieces to see how it stands up, and it stands up beautifully. I think the other Reserve Banks could settle the question quicker by sending someone to New York to test it out, because I do not believe a test in the other banks would be anywhere near as satisfactory as the one that we have made in New York.

Mr. Harrison. We brought the matter up because most of you have not realized that this delay is being expensive to all of us. I do not think we have received an order other than for a trial machine from any Reserve Bank.

Governor Harding. Our people have been turning out twenty to twenty-one thousand bills a day on it as against about 14,000 before. We found there was a little prejudice

against it at first. The girls had an idea that it was a labor saving machine and would throw a lot of them out of jobs. I told them they need not be uneasy about that, because we have a pretty considerable turnover up there, of people getting married and taking other positions, and so forth, and that this would undoubtedly require less operators in the long run, I would see to it that the use of these machines would not throw anybody out of a job.

The Chairman. I think the machines have pretty nearly paid for themselves this year.

Mr. Harrison. We figure we are saving \$830 a year per counter.

Governor Bailey. How much does the machine cost, Mr. Harrison?

Mr. Harrison. \$1500.

Governor McDougal. That saving is based on what hand count per individual?

Mr. Harrison. 12,000.

Governor McDougal. Ours is about 13,500. We have figured a saving of about 25 per cent, and then there are other advantages, doing away with the drudgery, and things



of that sort. I do not think we are ready to give any substantial order for those machines but I think we will be in a position pretty soon to give an order for machines if you desire an answer on it.

The Chairman. The point is we have made a contract with this man which is to a certain extent dependant upon his being able to make a manufacturing program and build either a hundred machines, two hundred, or some definite number. We probably will need a hundred machines anyway.

Mr. Harrison. We have a total of fifty now. We have 40 in our own place and five in the other Reserve Banks. We have ordered forty more, or a total of 90 machines for our own use.

Governor Calkins. When does the contract expire?

Mr. Harrison. It was a three-year contract and we made it about a year and a half ago, as I remember.

Governor Fancher. How soon could we get delivery on machines?

Governor Seay. We have been waiting for one for eight months or more.

Mr. Harrison. But the reason you have had to wait is the fact that he has had to put on some sort of a spe-

cial adjustment, on account of the fact that you have an alternating current.

Governor Seay. He was not able to supply a universal motor and has had to devise a special motor for the alternating current. I thought in most cases that the tendency had been to change to the alternating current and I was surprised when he could not do it. The main question is to determine how many machines we need in the bank and we can hardly determine that until our machine has been put in working condition.

Mr. Harrison. Even if you only estimated a conservative number that you might be sure to need, if you are going to take any at all, which would give him an order which would be a minimum order and which would enable him to build up his organization. He was just an inventor. He had no organization at all when he first started. He has been working along from hand to mouth on the funds we advanced him. He has not been willing -- and I do not blame him -- to build up an organization for the purpose of building quickly and economically three or four hundred machines.

Governor Seay. The point of uncertainty with us is

whether this motor will operate with our machine.

Mr. Harrison. I think there is good reason for Richmond to hesitate because it is necessary to have this new adjustment, which has not been tried out.

Governor Seay. That is the point with us, Mr. Harrison.

Governor Wellborn. Have you been able to determine the reduction that has been made in the unit cost of this work?

Mr. Harrison. I do not know quite what you mean by unit cost.

Governor Wellborn. The cost per piece handled. We express it in our bank as the unit cost.

Mr. Harrison. I think for your purposes you could tell better by letting me tell you what has been the increase per employe rather than trying to estimate the unit cost.

Governor Wellborn. That all enters into the unit cost, of course.

Governor Biggs. We have had one of the machines for three months but only one operator, who has grown to be very efficient. In that three months we have made a

saving of 50 per cent. It sorts unfit money according to my judgment better, or just as good, as the till money. The man in charge of the currency recommends it very highly. He has had no mechanical trouble whatever with it. It works every day. I do not know how many more we want, but I will find out and let you know later. We are very much pleased with it.

The Chairman. You have a basis for making a calculation, because you know how many counters you have, how much currency they handle and then what the machine does.

Governor Biggs. We have saved 50 per cent in a period of three months.

Mr. Harrison. We have shown a 64 per cent increase.

Governor Fancher. We have shown an increase of 57 per cent. It is 20,300 by machine and 12,980 by hand.

Governor Seay. As soon as it is determined whether the adjustment necessary in the motor is successful, I believe we can give a pretty quick reply. Of course it has got to be tried out first.

Governor Norris. Has the electric company given you the alternating current?

Governor Seay. We have that, and that necessitated a change in the motor.

Governor Talley. Mr. Harrison, what will be the market for this machine after the Federal Reserve Banks and the Treasury have been supplied?

Mr. Harrison. He estimates that he is not going to have any market other than the Federal Banks and the Treasury, that is any substantial market. For that reason he is not prepared to build up an organization to supply us with these machines as rapidly as we would like to have them in New York.

Governor Talley. That is what I gathered. What provision is there for maintenance and replacement?

Mr. Harrison. We have found in our one year's experience there is very little wear on the machine. We took one machine down entirely and the wear on the parts was hardly noticeable at all. The inventor himself estimates that the life of the machine will be about 15 years, and I think that is fairly conservative.

Governor Talley. After the original output, what will keep him going?

Mr. Harrison. He figures that there will be enough of demand for the output, even after we are supplied, to keep him going.

Governor Norris. Until the time comes that we will want new ones.

Mr. Harrison. There are certain businesses, such as large department stores, that have considered taking them up, and he might get a market there. Then he figures that there will always be a sufficient market with the Reserve Banks to justify him in maintaining parts. At the present time he sends these parts around and has the machine manufactured. He hasn't any organization of his own at all.

The Chairman. Mr. Harrison, have you consulted Mr. Dewey as to when he wishes to appear?

Mr. Harrison. He expects to come tomorrow, but will be willing to come today, Mr. Chairman.

The Chairman. The next topic is 4-B.

#### IV. OPERATION AND ADMINISTRATION.

B. Should not the Federal reserve banks be reimbursed by Federal Land Banks for expense involved in paying Federal Farm Loan coupons?

Governor McDougal. The Federal Farm Loan coupons have been paid to the Federal Reserve Banks. Under existing arrangements Reserve banks sent the coupons, cancel

them and return them directly to the issuing bank, making a charge for the amount thereof against the Federal Reserve Bank in New York, where the funds are carried to cover the various issues of farm loan bonds that have been called for redemption, making it necessary for the clerk who handles the coupons to check carefully the serial numbers, in order that the coupons detached from the called bonds may not be paid. At the present time the Land Banks are not making any reimbursement for the time of the clerks in handling the coupons. The expense with us is estimated to be from seventy-five to a hundred dollars a month, and it seems to us that we might reasonably ask for reimbursement of this item. The amount with us would only be \$1200 a year perhaps, but it makes eight to ten to twelve thousand dollars for the system. It is simply submitted for consideration.

The Chairman. We pay about 600,000 coupons a year, to the value of \$18,000,000; and we estimate the cost to us to be about \$2350.

Governor Seay. Are you reimbursed for that?

The Chairman. No.

Governor McDougal. The System would save probably ten

or twelve thousand dollars a year, and it seems to me that it would be perfectly proper that we should ask for reimbursement. I simply submit this for consideration.

Governor Norris. The situation has changed in two respects from what it was in the beginning. In the beginning of course there were no call bonds so that there was no occasion for that handling of coupons to which Governor McDougal has referred. At that time also the Federal land banks were young and comparatively poor. Now they are rich. They have taken all the expenses over that the Government formerly paid voluntarily and I do not imagine that they would have any objection to making reasonable compensation to the Reserve Banks for this extra service that they are now rendering. I suggest, before we pass a resolution on the subject, that we take it up with the Governor of the Federal Farm Loan Board.

The Chairman. Do I understand you make that in the nature of a motion?

Governor Norris. Yes.

The Chairman. The motion is that the circumstances justify the unusual procedure of appointing a committee of one to handle this matter, namely, Governor Norris; that



the whole subject be referred to Governor Norris, with power.

Governor Fancher. I second that.

Governor Seay. I am agreeable to that. I would like to say that it occurs to me that as a matter of principle these various organizations ought to bear all the expenses which are incident to their operation.

Governor Norris. I am frank to say that this arrangement was made in the beginning not with a view of imposing anything on the Federal Reserve Banks or to get their services free, but it was simply one of the additional advantages that it was sought to get for the bonds to assist in their sale, the statement that coupons could be cashed at any Federal Reserve Bank.

The Chairman. There is one other point, Governor Norris. In order to avoid the multiplicity of accounts, and so on, this scheme has been set up by which all the coupons come to us, we check up on it, and send them in. Do you send any direct?

Governor Norris. That I do not know.

The Chairman. I think you all send your coupons to us.

Governor Seay. I think we do, and settle with you

through the gold settlement fund.

The Chairman. All these coupon accounts, which of course are separate accounts for each coupon payment, so far as the Farm Loan System is concerned, aggregate now something like \$2,000,000, and my attention is called by this memorandum to the fact that if we impose the charge these fellows might say that they can go into any bank and get them to pay these coupons without a balance. It wouldn't break my heart to have another bank pay the coupons and take the balance, but that is probably the answer that you would get.

Governor Norris. I do not think so, because of the fact that they can be cashed at any Federal Reserve Bank. That is of advertising value. In the beginning they wanted to establish a connection with the Federal Reserve System, and because of that advertising value I think they would want to continue it. Of course I was going to suggest to you that it gave you a nice deposit, twice a year, but a very temporary deposit.

The Chairman. Yes.

Governor Norris. I suppose they only put it in a few days before coupon day.

Mr. Harrison. No, that is their average balance.  
Governor Talley. It might impose a small loss on us, Mr. Chairman; it will probably cost us more to get reimbursement than it will to handle the coupons.

The Chairman. You have heard the motion, which has been duly seconded.

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

The Chairman. The next is 4-C.

C. Progress in budget control of Federal Reserve Bank Expenses.

Are there any remarks from whose banks which have recently undertaken budget control of expenses, as to their experiences in doing so?

Governor Wellborn. We adopted it several years ago, Mr. Chairman, and had it operating on a quarterly basis. Now we are operating it this year on a monthly basis and it has operated very well in our bank. We are very well satisfied with it and I am sure it will help us to keep down expenses.

Governor Calkins. We operated the budget system in the San Francisco Bank in 1925. It was satisfactory, and I

think I might say successful. The variation in expense between the actual expense and the budget was \$14,000, all due possibly to fluctuations in the cost of currency.

The Chairman. Are your people trying to keep within the budget?

Governor Calkins. Yes.

The Chairman. Did the budget figure represent a saving over the previous year?

Governor Calkins. The budget figure for 1925 was \$205,000 less than the cost of 1924.

The Chairman. Any further remarks? If not, the next topic is 4-D.

D. Further exchange of views relative to the steps taken at each Federal reserve bank to make sure that the bank and the system are not properly subject to criticism because of the practices of the bank or its personnel.

This was discussed at the last meeting, that discussion being followed up by our sending a memorandum to the other Reserve Banks as to a certain field of inquiry covered by the New York Bank. I would like to know whether you got any definite reactions where the matter was taken up with the officers and clerks of the bank.

Governor Talley. I have a report here which I would like to quote.

"Governor Talley made a statement regarding the action of the Conference of Governors of the Federal Reserve Banks last fall upon the subject of the ethical conduct of directors, officers and employees of Federal Reserve Banks. The various points raised were fully discussed and, upon motion of Director Patrick, seconded by another director, it was voted that the matter be referred to the Chairman of the Board for such investigation and survey from time to time as might be desirable."

That is taken from a meeting of our Board of our Board.

Of course there was a great deal more discussion of this matter than is reflected in these minutes.

The Chairman. How was the suggestion received in general, Governor Talley?

Governor Talley. It was right cordially received. The chairman of the board, having it brought to his attention, stated that working through the executive committee we could watch for such violations of certain ethical principles that not only might be laid down in

the schedule, but arrived otherwise, and bring them back to the board immediately as soon as noticed.

Governor Young. Mr. Chairman, I would like to report that I did not refer this to the directors at a meeting but I have talked with the various directors about it. They thought your rules were a little bit too severe. I asked the officers of the bank to watch the situation, but they thought it was impossible to lay down any fixed rules, that each individual case had to be handled on its merits. That is all that I have done with it. I assume from that that the reaction was not entirely favorable.

Governor Calkins. I might say that we are entirely in accord with the outline of the New York Bank in principle. As I indicated at the time we discussed the matter before, we might find cases in which it would not be expedient to be quite as rigid as you have been in New York in some cases.

The Chairman. I think it is a fact, Governor Calkins, that where you are right next to a great big, active Stock Exchange, to an atmosphere of speculation, when stocks are going up and money seems easy, that there are

temptations presented to the employes of banks that may not be the case where they are further away from that atmosphere.

Givernor Fancher. After the discussion of this matter at the other conference we have been paying special attention to the loans of our employes, having our examiners when they went into the banks give us a list.

That has been going on for some time. This memorandum was submitted to our managing committee on receipt of Mr. Harrison's letter enclosing it. They gave it consideration and our feeling was that perhaps you go a little further in New York than conditions would warrant in Cleveland. We do, however, watch very carefully the outside operations of our employes and also try to keep close tab on their borrowings for member banks.

The Chairman. If there is no further discussion of this topic we will take up 4-E.

4-E. Federal Reserve Bank Buildings.

1. Character of tenants.
2. Segregation of building expenditures and receipts from other expense and income accounts.
3. Chargeoffs on account of depreciation in

machinery.

We have been asked the question in New York a number of times about tenants in the Federal Reserve Bank Building, as to whether or not they were suitable tenants, and it is difficult to answer the question. We have had one or two cases like that of Governor McDougal's, but we have adopted a plan in New York of having no financial houses in the building at all. If we get inquiries of that sort from the other Reserve Banks, I just want to make clear that it is not prejudice on our part at all. It is a principle under which we do not think we can have financial houses. We had an offer to rent an entire floor in our building the other day from the Trust Company of New York for some of their clerks but we do not think we can afford to have our building occupied by institutions of that kind.

Governor Calkins. We have the General Motors Acceptance Corporation, Mr. Chairman.

The Chairman. I do not think we would take them.

Governor Wellborn. We have tried to rent some of our vacant space but are unable to do so, because we have been so critical in getting the right kind of ten-



ants. We have tried to rent it to general agents for insurance companies or for the general offices of a railroad company, or something of that kind, but we have not succeeded in getting anybody to take the space.

Governor Calkins. I would like to pursue the subject a little further, Mr. Chairman, since you have expressed your disapproval. It was difficult for us to find any reason for objecting to the General Motors Acceptance Corporation or to find any more desirable tenants than that corporation. We have a freight tariff bureau, which is just a few steps further removed from a finance corporation. I would like to have you indicate why you would not look with favor upon the General Motors Acceptance Corporation, as to the advantage which might be gained by them or by a similar corporation by reason of their occupancy of the Federal Reserve Bank building?

The Chairman. That is rather a borderline case. Concerns engaged in selling securities --

Governor Calkins. Which they are not --

The Chairman. They are not, but those that are, or dealing in margin accounts, represent to my mind pretty

fairly the type of tenant that we should not have.

Governor McDougal. This question I think perhaps arose in Chicago before it did in any of the other districts. We adopted a policy there under which we declined to accept for tenants -- we are now running five floors or thereabouts -- those who were engaged in the investment business, private banking or anything of that sort. We have adhered to that up to the present time. Six months or more ago we decided to rent, if possible, the first floor of our building, which was set aside for our fiscal agency activities, and which is not now used to any great extent. We reversed our policy and decided that there would be no objection to accepting some investment concern as a tenant provided they had been long enough established and that the character of their business was satisfactory. I think possibly this has happened since you and I discussed the matter in Chicago, Mr. Chairman.

The Chairman. Did you take the firm about which you made inquiry of me?

Mr. McDougal. We did not take them. As a matter of fact they were not willing to come in on the terms

which we offered.

The Chairman. They do a very heavy speculative business, of course.

Mr. McDougal. We have thought of the railroads, but they will not pay any rent. The quarters we have are right in the financial district and are better adapted to something of that sort than anything else, except cigar stores and little shops. We haven't had any success in getting any tenants.

The Chairman. Couldn't you occupy that floor with some department of your bank and get the tenants for upstairs?

Governor McDougal. We could do that, but as a matter of fact we are pretty well placed there now and permanently fixed.

The Chairman. You brought up this No. 2, segregation of building expenditures and receipts from other expense and income accounts, Governor McDougal.

Governor McDougal. That was put on the program by reason of the fact that at the present time all expense incurred in the operation of the bank building is charged to the general expense account of the bank and the income

received from space leased to tenants is credited to income from bank building, which is grouped with other earnings and results in an incorrect showing. We have given some consideration to this and believe that those banks, such as ours, that are renting large amounts of space, that their accounting method would be improved if they would treat the building as though it were a separate corporation, crediting that account with all receipts for rent, crediting it also perhaps for amount of rent of that part of the bank which the bank uses itself, and charging it with the expense, including alteration, changes, and so forth, settling the account possibly once a month or once in every six months. Under the present forms it is not practical to do that and I would suggest that building operating expense and income be segregated from other current expense and income and the Board be requested to adjust their accounts accordingly. I am submitting that for the consideration of the Conference. If we were to set up a building account and credit it with income from tenants and would agree upon a fair rental charge for the space occupied by the bank itself and credit it with that, then charge the account

with the expense involved, I think it would present even a better accounting method than a more correct statement of the real condition. I think this question has been before the Conference at least once before but I do not remember whether any action was ever taken.

Governor Bailey. We tried to have the board segregate it, but they wouldn't do it.

Governor McDougal. I understand that.

Governor Bailey. I am in sympathy with what you say. We do a lot of leasing. We lease nine floors.

Governor McDougal. You are the largest landlord in the system.

Governor Seay. Under that view of the proposition you would have to charge to expense of operation the rental of your own quarters, would you not?

Governor McDougal. Absolutely.

Governor Bailey. It would all come out in the wash.

Governor McDougal. You would credit it with a fair rental and the account would then reflect at any time the accurate results from operating the building.

The Chairman. It would show a much heavier expense account than you show now.

Governor Seay: It would swell the gross expense of the Chicago Bank and of the System.

The Chairman. What is your rent roll now, Governor McDougal?

Governor McDougal. About \$240,000.

The Chairman. You are getting \$240,000 for five floors?

Governor McDougal. Yes.

The Chairman. What would you charge yourself as rent if you made a charge against your own occupancy?

Governor McDougal. We haven't made a calculation of that.

The Chairman. It would be four or five hundred thousand dollars.

Governor McDougal. If we charged ourselves with two dollars and a half a foot --

The Chairman. What would it amount to?

Governor McDougal. It would amount to enough to give us a little profit in that operation.

The Chairman. What would the total figure be?

Governor McDougal. I do not know.

The Chairman. How many feet do you occupy?

Governor McDougal. I do not know that.

The Chairman. It would be something around four or five hundred thousand dollars, say 400,000?

Governor McDougal. It would be more than that.

The Chairman. Six hundred thousand?

Governor McDougal. I would guess that we would charge ourselves six or seven hundred thousand or more. I would estimate 600,000.

The Chairman. If you collected 240,000 from your tenants and charged yourself with 600,000 rent you would increase your expense by over \$400,000 a year?

Governor McDougal. No, we would not, Mr. Chairman.

The Chairman. I think you would.

Governor McDougal. It is only a book-keeping matter. It keeps a more accurate account of the building.

The Chairman. It would change your book-keeping method and the result would be to show a heavier expense account.

Governor McDougal. No, I think we show a heavier expense account as it is now.

The Chairman. No, Governor.

Governor Young. You are not charging yourself now

with any investment that you have there. Under your other scheme you would.

Governor McDougal. In the interest of keeping an accurate record of the receipts and income of the building I think it would be an improvement if we set the building out and kept it just as though it was a separate corporation, settling the account perhaps once a month or maybe once every six months.

The Chairman. What is the cost of the building set up on your books today?

Governor McDougal. About nine million.

The Chairman. If you charge yourself five per cent interest it would amount to \$450,000.

Governor McDougal. We are not going to do that.

The Chairman. I cannot see but what the plan would make your account look much worse than it does now.

Governor McDougal. I do not think it would.

The Chairman. There is a plan that could be adopted that would improve it, which would be to segregate all expense of operating the building in an account and credit it with rent collected, charging yourself with the net amount as cost of space.



Governor Norris. That is what he wants to do.

The Chairman. Is that what you really mean to do?

Governor McDougal. That is one plan. We could charge ourselves with a rent agreed upon and then take credit, or take a penalty, if the net result showed that it was a loss rather than profit.

Governor Norris. If you charge yourselves with a fair rental it would increase your expense, because in determining that fair rental you would have to take your plant and investment into account.

Governor Seay. And would have to credit yourself with interest on the investment.

Governor McDougal. Oh, no. We are not going to pay any attention to the amount invested, of course. None of the Reserve Banks are doing that. They cannot do that and figure a profit.

Governor Seay. If you charge yourself with the expense you have to credit yourself with the interest on the investment.

Governor McDougal. You charge expense of maintenance and expense of alterations and repairs.

Governor Seay. No, I mean occupancy.

Governor McDougal. I think there should be an account established on the books of the bank which will show the results of operating the building.

The Chairman. Why is not the best way to do it to segregate the expense of the building, that portion of the expense which applies to the tenants; charge that to your real estate and tenant account and credit rents to it. That would have the effect of reducing the expense of operating the building by the amounts of the rents, or thereabouts, and adjust the balance at the end of the year to profit and loss.

Governor McDougal. That is what we are doing now, all of us.

The Chairman. No, we are carrying our rents as income and charging all expense to general expense.

Governor Young. In Minneapolis we have three million dollars invested in the building and we have no tenants. Expense of operation of the building is all that we have. Let us assume that we arrive at a conclusion as to what our own rent should be, and it would just increase our expense five per cent on three million dollars, or four per cent, or whatever it might be, and that

is all there is to it.

Governor McDougal. There is no intention here of charging expense account with five per cent or any other per cent.

Governor Young. If you pay yourself any rental you are bound to do it and cannot get away from it.

Governor Norris. You cannot fix the rent without taking that into account. An accounting system can be set up that will show more clearly the results of operating the building, and it should be maintained separately.

The Chairman. Let me illustrate it in this way, Governor McDougal. We have got 60 million dollars invested in real estate and building. Suppose we said, roughly, that we would pay 5 per cent interest on that as our rent. We would add three million dollars expense to the gross expense account of the Federal Reserve System next year. Then you would show in your income interest on the amount invested in this property, at five per cent, and you will increase the income of the Federal Reserve System by three million dollars a year. All you would do would be to pad both sides of the account. Then the critics would say "That is a bad system. Look

at what the buildings are costing. Their rents are going up three million dollars a year." They would not analyze the proposition at all. I think we had much better leave it alone.

Governor McDougal. There is no intention to make a charge of five per cent or of any other per cent.

The Chairman. But the net amount shows as an expense.

Governor McDougal. No. The cost of operating the building in our case exceeds of course the amount that we get from the tenants. Part of that is cost by the requirement of the tenant and the other part is cost of our occupancy of our part of the building. It seems to me that if we would set up a building account and credit that account with the income that we get, and with a reasonable charge for rental -- we are not considering investment at all -- that we would then have a more accurate account of the cost of operating our building. As it is now at times our expense account is very much padded because of maintenance, alterations and repairs.

The Chairman. I do not get that point. Let us stick to the accounting part of it. You say you credit your building account with the rent collected?

Governor McDougal. Such rents as we receive, yes.

The Chairman. And you would include what you pay?

Governor McDougal. They go to building income account --

The Chairman. All right. Where would you charge your rental?

Governor McDougal. We would charge our rental to expense.

The Chairman. Then your expense would go up by the difference between what you credited and what you collected from your tenants, which would be 400-odd thousand dollars, assuming your rental to be \$650,000.

Governor McDougal. It wouldn't go up, because it goes up as it is now.

The Chairman. But you are going to pay your own rent for the building in addition.

Governor McDougal. That is only a book-keeping matter which is washed out when the books are balanced either once a month or once in every six months.

Governor Calkins. But at the end of the year the expenses of your bank would be much greater than they are at the present time. It doesn't make any difference

whether it is on a percentage basis or what basis.

Governor McDougal. I do not think they would be. The way I think it would work out would be this: What ever amount we set up for rent for the bank would be charged where it belongs, in the general expense account, and once a month the expense of operating the building would be credited to that.

Governor Seay. But you would have to publish both sides of the account.

The Chairman. The result would be that you would be simply increasing the account without accomplishing anything.

Governor McDougal. I think we are doing that as it is.

The Chairman. If there is nothing further on this perhaps we had better take up 4-E, 3, chargeoffs on account of depreciation in machinery.

Our directors are taking the position with us that two per cent depreciation on buildings and five per cent on machinery and office equipment is not enough. We have asked them not to disturb the two per cent arrangement because it is uniform, has apparently been accepted

by the Treasury and does not raise any difficult question.

Governor Fancher. Two per cent on the buildings?

The Chairman. Yes. Depreciation on machinery and equipment, under the Board's ruling, is not to exceed ten per cent per annum. We only charge off five per cent, because we had the whole subject reviewed by the contractor and builder and the engineers and they said that five per cent was ample on our building, because so much of the equipment in the building is really not subject to very great deterioration. The engines and boilers and elevators have an estimated expectancy of 35 years, with a salvage value after that. But we are willing to go ahead and increase this to 10 per cent if our directors want to do it, if it does not throw some of the other Reserve Banks out of step and cause some discussion.

Governor Fancher. Do you mean depreciate at a higher percentage?

The Chairman. Depreciate equipment at a higher rate.

Governor Fancher. We are depreciating certain parts at 10 and certain parts at 5.

The Chairman. Take the engines and boilers in our building. Of course you have got to put in new tubes in

the boilers, but that is charged to operating expense. The engines put in our building are the same type as were put in the Bankers' Trust Company in 1911. Those engines were examined and it was discovered that the expense on them had only been \$45 in repairs, which might be called capital repairs, or due to defects, and those engines are just as good now as they were when they were put in. Those are the Providence engines, the best in the country. They keep putting in new tubes and keep them in good condition, the water is kept clean, and those boilers will last for years and years. We think ten per cent depreciation on our engines is too much to set aside and we do not want to do it unless there is some object to be gained. I do not see any object to be gained in charging the buildings off/ at any greater rate. We have all got large surpluses and the building would probably go to the Government in the case of liquidation anyway.

Governor McDougal. We are charging 6-2/3 per cent to equipment, Mr. Chairman.

Governor Young. We are charging ten.

Governor Harding. We charge ten.

Governor Seay. Five and ten.



Governor Wellborn. Ten.

Governor Calkins. I think we charge off ten.

Governor Fancher. We charge five and ten.

Governor Talley. We have a schedule based on an estimate made by the equipment people that put the equipment in and we charge two and ten. A good deal of it we charge off at ten.

The Chairman. Have you started yours yet, Governor Biggs?

Governor Biggs. No.

Governor Bailey. We charge ten off for machinery.

The Chairman. Apparently ten per cent is the pretty well settled figure of the banks.

Governor Seay. I think that figure was arrived at simply because it was approved and has been taken advantage of because it is permitted.

The Chairman. I have gotten all the information I want on this matter.

Governor McDougal. As I understand it, you are charging five per cent, Mr. Chairman?

The Chairman. Yes.

Governor McDougal. We are charging  $6\frac{2}{3}$ , and all

the other banks appear to be charging ten.

The Chairman. There are two banks that charge five and ten, five on part and ten on part.

Perhaps we should go ahead with our program and review it. We have left for discussion the subject of discount rates, which I think you are all in favor of leaving until we meet with the Board. We have two topics that we can consolidate and discuss with Mr. Baker tomorrow. We have the report of the committee on collections. Mr. Strater will be here tomorrow and we have the discussion of the Treasury currency program with Mr. Dewey. Then we have the committee reports.

Governor Calkins. Mr. Chairman, I move that we adjourn until tomorrow morning.

(Whereupon, upon motion duly seconded, the Conference adjourned at 5:40 o'clock p.m., until Tuesday, March 23rd, 1926, at 10 o'clock a.m.)

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## S E C O N D     D A Y.

Conference of Governors of the Federal Reserve  
Bank.

Washington, D. C.,

Tuesday, March 23, 1926,

10 o'clock a.m.

The Conference of Governors met pursuant to adjournment  
in the Hearing Room, Federal Reserve Board, Treasury  
Building, Washington, D.C., at 10 o'clock a.m.

APPEARANCES: (As indicated in yesterday's record.)

P R O C E E D I N G S.

The Chairman. The meeting will please come to order.  
Mr. Strader is here and we will take up Topic 2-A.

II. COLLECTIONS AND CLEARINGS.

## A. Report of Standing Committee on Collections.

The Chairman. The first section of the report is  
the revision of time schedules with a view to reducing  
float and avoiding existing inequalities. Mr. Strader,  
we will be very glad to hear from you.

Mr. Strater. Mr. Chairman and gentlemen, this is  
merely a report of progress. The Committee has not been

able to get together enough data yet to submit a complete report. We are going about it very carefully because we feel that the Governors want something that will cover the whole subject, if possible, and we would like to be in a position to give it to them.

Governor Young. I move that the report be approved and filed.

The Chairman. That is the first part of it?

Governor Young. Could we not act on the whole report? It has been read by everyone.

The Chairman. I do not think the motion is in order now. Governor Fancher, you are chairman of this committee.

Governor Fancher. No, Mr. Strater is chairman of the committee, Mr. Chairman.

Mr. Strater. It would not take very long to go over the report. There may be some points that the Governors would like to question the committee on, particularly in the report of progress.

Governor Wellborn. I will second Governor Young's motion.

Governor Young. It is perfectly all right with me. I

thought everyone had read it and that the quickest way to dispose of it would be to dispose of the whole report at once.

Governor Fancher. There are only four or five major matters and I thought perhaps it would be better for Mr. Strater to touch on them.

Governor Young. I will withdraw my motion at this time.

Governor Wellborn. I will withdraw my second temporarily.

Mr. Strater. The Committee gave a lot of study to the facts that would be necessary to arrive at to form a foundation on which to build. They have asked each Federal Reserve Bank to furnish the committee with the tabulation showing the exact time required to collect States in their districts.

It was not at all the idea of the committee to exceed its authority and attempt to revise the time schedules of each Federal Reserve Bank as it applied to their own districts, but there are so many split States and so much difficulty in working up an intra-district time schedule that the Committee felt it might be materially

aided by having all of the data at its disposal so that we could propose such changes here and there in intra-district schedules that would perhaps take up a little float and at least make it a little more intelligible to the member banks.

The Chairman. In connection with this time schedule I have often wondered whether it might not be possible, by a very painstaking canvass of the banks of the country, with the aid of the American Bankers' Association, to have symbols on checks to facilitate accurate sorting and routing of all checks. In England the checks bear one of three symbols. Practically all of the checks go through the London Clearing House. They have three symbols. One is a square, another is a circle, and the third is a triangle. Inside are the letters C, M and P. That represents city, Metropolitan and provincial, the provincial being the same as our country banks. They have three clearings and the symbol is in the same place on all checks. Every check has a symbol on it and when they get to the clearing house it is the simplest thing in the world to handle them. If a customer of a bank in Huddlesfield sends a check it bears the P symbol; if he keeps

an account in a bank in the city of London it is a C, and if it is out at Keysbridge it is an M. It would be very advantageous if we could get our banks to adopt a symbol plan.

Governor Harding. Several years ago the Federal Reserve Board worked up a scheme which did not seem to create much interest. The idea was to have a symbol on each check, or have each check bear the district number, as a good many of them do now, and also a symbol showing which branch it was to be sent to; then there was a further symbol showing the number of days' time allowance. A good deal time was spent on that back in 1918 and 1919.

The Chairman. I remember something about that. It took a long time to get the banks in England to cooperate on it. The main difficulty is that the banks are not interested in the clearings, and it has got to come from the banks themselves, I think.

Mr. Strater. Mr. Chairman, if I may be permitted, the committee has had a communication from Mr. Ambrose of San Francisco on that subject, and the American Bankers' Association Bulletin No. 43 takes up the question of standard sizes for checks. There is also a paragraph in it

which it might be well for me to refer to. "Transit number should appear in Gothic or Roman type and not in script and should properly include, in addition to the transit number of the bank on which the check is drawn, the number of the Federal Reserve District and the branch Federal Reserve symbol in which such Federal Reserve Bank is located. Such Federal Reserve District number and symbol should appear immediately beneath the transit number of the bank on which the check is drawn." For example, 68-12 in line, with 5 below that, showing the Federal Reserve District.

Mr. Ambrose in his letter to the committee says in part, "We will in all probability have a number of inquiries from banks who are about to renumber their checks and who should be in a position to give some definite answer regarding symbols." Mr. Ambrose thinks that some action should be taken on the subject in order to get something accomplished while it is possible to do it. He suggests that the standing committee submit the matter to the Conference. I receive his letter too late to put it before the last meeting of our committee and it was therefore not possible to get it into our report.



The Chairman. Might it not be possible to pass a resolution relating to this first part of the report and refer the subject of symbols generally to this committee with power to take it up with the American Bankers' Association?

Governor Young. I will make such a motion.

Governor Talley. I will second it.

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

The Chairman. Is that what you wanted, Mr. Strater?

Mr. Strater. What I had in mind was if the Conference wanted to do anything to help along the American Bankers' Association scheme, which we believe to be a good one, that now would be the time to do it.

The Chairman. And the resolution passed would enable you to do it.

Mr. Strater. Yes. Our committee can go ahead, if that meets with the desire of the Conference.

The Chairman. The second topic in the report is —

Governor Young. Mr. Chairman, I did not know we had completed the first topic.

The Chairman. We have not if you have something to say about it, Governor Young.

Governor Young. I note from the report of the standing committee on collections, from the time schedule printed for the Federal Reserve Bank of Minneapolis, that in the case of items on the State of New York which are sent to the Federal Reserve Bank of New York, that they show that our time schedule calls for an availability on such items in four days, while the actual time required to collect, as they show it, is five days. That comes up because we have added two days to our New York schedule — the New York schedule is three days — for the simple reason that we cannot get the mail in there in time to collect, so that so far as New York City is concerned they could be collected in four days. That also applies to several other points. In other words, the schedule should be corrected.

Mr. Strater. I might explain the tremendous work in connection with compiling that schedule. Of course we had to use what we could find in the way of data to make it up. We used to begin with the latest time schedule of each Federal Reserve Bank. I do not know whether we were able to get the very latest or not. This was prepared first in our bank and then checked over at a

meeting of the committee later; it was then taken to Richmond and rechecked. We still believe there are a number of inaccuracies in it because we did not have absolutely accurate information with which to build it up.

Governor Seay. There were about 4,000 items to be checked.

Mr. Strater. Yes. It was a tremendous job. Now what the committee would like to have done next would be to have each Federal Reserve Bank check this over very carefully and report all inaccuracies so that we can correct them if possible and reconcile them as between districts. It is going to be very difficult. These split States are going to present probably the greatest difficulty. I do not know how we are going to be able to work them out on a sound basis. There is not a District that does not have at least one split State, I do not believe. In working up an intra-district time schedule the simplest thing to do, and the thing that would appeal to the member banks, would be to have an entire State on one basis, if it can be done; but it is really essential that each Reserve Bank and branch check these schedules over carefully and report inaccuracies back to us so that

we can correct them. I wanted to take this opportunity to mention it to the Governors so that it would not be overlooked.

Governor Talley. I presume the committee has given consideration to the fact that the further away a State is from the District the volume of items decrease in proportion.

Mr. Strater. That is true, but we expect to get the volume, or at least some idea of the volume, from the figures that you are now compiling in your District. The Dallas District is going to be the most difficult one to work in in an intra-district time schedule because you have so many different divisions for your own States. If we cannot work out an average time for the State, we might handle it somewhat after the fashion of San Francisco --

Governor Talley. We are not very much concerned about the time schedule for the State of Washington.

Mr. Strater. No, you two are far away. I do not think Boston, Philadelphia, New York or Cleveland are, but Kansas City, Minneapolis and St. Louis might be.

Governor Norris. I notice the report states "The

committee is preparing to obtain certain data from each bank which will enable it to continue the study, looking to the completion of the final report." As I understand the Chairman of the committee, that data is now being collected?

Mr. Strater. Yes.

Governor Norris. And that will enable the Committee to make their final report, or at least a supplemental report, well in advance of the next Conference, I suppose?

Mr. Strater. Well, I would not undertake to say that it would be well in advance of the next Conference, because it will require a meeting or two of the committee to assemble what we get.

Governor Norris. I mean a sufficient length of time in advance of the next Conference to enable you to place that report in the hands of the members of the Conference before it assembles.

Mr. Strater. We hope to be able to do that, Governor.

Governor Calkins. I would like to ask Mr. Strater whether it would be worth while, or helpful to them, to have a conference of those officers of the Federal Reserve Bank who operate the par collection system before the

committee makes its final report. In other words, they could get these men together and reconcile any differences that might exist.

Mr. Strater. That might be the quickest way of ironing out the difficulties.

Governor Calkins. It seems to me that more progress and better progress would be made by that means than by having the Conference of Governors attempt to iron out the differences in detail; that a conference of operating men with Mr. Strater's committee would probably accomplish more than would be accomplished by any other means.

The Chairman. I think that is the best way to do it.

Mr. Strater. After the work has been partly completed. That is I do not think it really worth while to have a meeting of that sort at the beginning because there are so many problems and there will be so many questions raised, and I am afraid it would simply delay progress.

Governor Calkins. My idea, Mr. Strater, was that after your committee had pretty nearly completed its work and was perhaps ready to put in a report, that this conference of operating men might be helpful to you.

Mr. Strater. I think so.

Mr. Calkins. And it would save the time of this conference.

The Chairman. Gentlemen, Mr. Baker from Cleveland is here. By an arrangement with him we are to have a discussion of the Grimm-alfalfa case and its effect on our loan operations, and I think it would be well to interrupt the program at this time and invite him to come in, or we can conclude this particular subject by a resolution that such a meeting be called.

Governor Calkins. I make a motion that, upon the call of Mr. Strater, chairman of the standing committee on collections, a conference of operating officers be held with his committee for the purpose of ironing out any differences that might have arisen in the matter, and that the Conference be called at the call of Mr. Strater, the chairman of the committee.

Governor Seay. Would you be willing to add if he thinks one desirable?

Governor Calkins. Mr. Strater has expressed his opinion on that and I do not imagine he will change it.

Governor Norris. As it is to be at his call, if he does not think it worth while he will not call it. I will

second that motion.

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

The Chairman. We will now invite Mr. Baker in and take up this discussion on the Grimm-alfalfa case.



(Governor Crissinger, Vice-Governor Platt, Messrs. Hamlin, Miller, James, Cunningham, of the Federal Reserve Board, and Mr. Newton D. Baker, of Cleveland, Ohio, entered the Conference room, and the following proceedings were had:)

Governor Crissinger. Mr. Baker is here at the request of the Governors, to give an account of the Grimm-alfalfa case, as to the effect it might have upon the re-discount operations of the Federal Reserve Banks. Mr. Baker will explain the situation to you.

Mr. Baker. Governor Crissinger, and gentlemen, the Grimm-alfalfa case is largely a lawyer's brief to me. So far as that particular case is concerned I confess I thought the Supreme Court would hear it on a writ of certiorari, because I believed then and believe now that while it does not change the law, that it is a misapplication of the law to the facts in that particular case. My hope was that the Supreme Court of the United States would regard the legal principles in that case as so vital to the business of the country that they would not be willing to let that case stand with the possibility of the confusion that it might cause throughout the Federal

Reserve System. I suspect that the Supreme Court excluded it for two reasons. In the first place the docket of the Court is very heavy and they are excluding all cases that they can. It was easy for them to exclude this case because it is a question which arises more on a determination of the facts in the lower court than determination of principles of law. If one takes the opinion of the Circuit Court of Appeals and takes the statement of law made by it no particular exception can be taken to what they state the law to be, with the single exception that in the opinion written by Judge Rodman they do say that the Federal Reserve Bank wittingly or unwittingly became party to a fraud which was committed by the Stanrod Bank, which was the member bank in the case. But if you read the rest of the Judge's opinion, and of course the Supreme Court did, it seems fairly clear that they held that there were facts enough to go to the jury on the question of fraud.

Now with regard to the Grimm-Alfalga case, taking it altogether, I think it is fair to say this: That the trial Judge, with great respect to him, floundered a good deal in the trial of the cause. The case involved

some drafts which had been deposited with the Stanrod Bank by the Grimm-Alfalfa Association and a deposit liability created for the proceeds of those drafts in favor of the Grimm-Alfalfa Association. Those drafts had been discounted at the Federal Reserve Bank, and when suit was brought after the Stanrod Bank closed, there were six causes of action, based upon the three drafts in question. The odd-numbered ones, 1, 3 and 5, applicable to separate drafts, rather irregularly charged the insolvency of the Stanrod Bank at the time that they were deposited there and inferentially charged, though they did not directly do it, the pleadings were not clear, two things: That the drafts were only deposited for collection purposes and also that there had been a fraud upon the Grimm-Alfalfa Association in the creation of a deposit liability and the acceptance of that deposit after the insolvency of the Stanrod Bank was known to its officers, and that the Federal Reserve Bank knew that also.

The even numbered drafts were dismissed. They set up causes of action on another theory, they were dismissed ultimately and did not figure in the law suit. The Judge allowed the cause, however, to be brought on the six

causes of action, and allowed all the evidence to go before the jury, saying that he did not know whether he should try the case in equity or at law, that instead of trying to decide that question, which would have cleared the decks, he decided he would try it both ways; that if it was a law question the verdict of the jury would stand as a law verdict, and if it was an equitable question he would regard the jury as having been empaneled as an aid to the Chancellor in determining the question of facts; that he would adopt the decision of the jury on the question of fact as the Chancellor's decision, Judge Rodman in the Circuit Court of Appeals said that he was inclined to think that the case was at law, but that it wasn't necessary to decide that, since the double course which the Chancellor had taken was enough to justify the judgment if it would stand on other grounds.

Out of that somewhat confused situation in the lower courts, caused by the determination of the Trial Judge not to decide exactly what kind of case he had, it was very difficult to conduct the case and it is very difficult to apply facts to the law. Now the net result of all of that is this, that the Circuit Court of Appeals held that

a jury having passed on the question the only thing they would determine was whether there was enough evidence to go to the jury on the question of either a tort or a fraud, or a tort in the nature of a fraud, and they decided that there was enough evidence. Now that evidence which the Circuit Court of Appeals reviews, is based on two or three things. First, the application that was made for discount of this paper at the Federal Reserve Bank of San Francisco, on which was the letter "D", which indicated to everybody in the Federal Reserve System, so far as I know the origin of the paper, that it had come from a depositor. That fact got twisted around ultimately and the Court of Appeals thought that it belonged to the depositor instead of belonging to the Federal Reserve Bank. It would seem very important, therefore, in your future course of action, to clarify that misunderstanding and either explain it on the application or take out of the application that designation of source which is ~~confus-~~able into a designation of ownership, thereby overcoming that difficulty.

The next thing that the Court of Appeals commented on was the fact that the Stanrod Bank had endeavored to

borrow money from the Federal Reserve Bank of San Francisco and had been told by the Federal Reserve Bank that they would not lend them any more money, that their directors must put in some money to get the bank out of its difficulty; that they must have a statement signed by every member of the board of directors that they would reform their conduct, and growing out of that transaction there was the correspondence between the Utah branch of the Federal Reserve Bank of San Francisco and the Stanrod Bank which indicated to the Court of Appeals knowledge on the part of the Utah branch of the condition of the Stanrod Bank.

Then there were one or two other transactions, one the failure of the Stanrod Bank to pay a draft which had been presented to it for payment upon which it had failed to remit, and which fact was within the knowledge of the Federal Reserve Bank. All of those things put together, the Court of Appeals held, constituted some evidence, and enough evidence to go to the jury, and the jury having determined the facts, they would not disturb it as a question of fact.

So much for the Grimm-Alfalfa case as a case. I think it leaves the law exactly where it has always been,

which you gentlemen know as well as I, and that is this: When a bank is in fact insolvent and is known by its officers and directors to be insolvent, the creation of deposit liability by that bank, with knowledge of its condition on the part of the officers and directors, is a fraud on the depositor. Any body that takes evidence by which that fraud was possible to be committed, like the paper that was deposited and sold to the Stanrod Bank, and takes it with knowledge of the condition of the bank, and also of the fact that the officers and directors of that bank itself had knowledge of its insolvent condition, becomes a party to the fraud. That has always been the law and is still the law, as stated in the Grimm-Alfalpa case. My judgment therefore is, as I said at the outset, that the Grimm-Alfalpa case has not changed the law and we must meet the question you have raised, it seems to me, from another set of considerations. The Grimm-Alfalpa case may be quoted hereafter in some cases like it, but it is not strong enough in itself to change the very authoritative opinion of the Supreme Court of the United States in favor of the law as I have stated it to you; that is, that mere sus-

picion is not enough, a condition of insolvency in a bank or a condition of suspicion in a bank which is bad enough to challenge the suspicion and alertness of the Federal Reserve Bank, will not be enough. There must be actual insolvency and it must be brought home to the Federal Reserve Bank in order to create liability. The Grimm-Alfalfa case, while it may be cited to show that a less degree of knowledge than has heretofore been supposed to be enough to charge a Federal Reserve Bank with knowledge, is not enough to overcome an oft-repeated decision of the Supreme Court of the United States on that subject.

I think the next time a case arises in any of the Federal Reserve Banks which involves this question in any of its forms, that it ought to be regarded as — no matter in what form it arises or where it arises — it ought to be regarded as an opportunity to bring about a conference of lawyers representing the banks, and should become, if I may make a suggestion, what I think you would call a system matter, so that from its inception clear through to the end it can have the attention of the entire system with a view of getting, if you can get, a decision from some other Circuit Court of Appeals which



will clarify the atmosphere. The decision in the Grimm-Alfalpa case has not in any degree affected the integrity and validity of those well established principles of law which I think the Grimm-Alfalpa case does not undertake to alter, but may be regarded as having altered the situation of the application of those principles to these facts, so I would suggest that the very next time a case arises anywhere in the System that involves this question, that it be made a System matter, and that from the very outset the record <sup>be</sup> molded with a view of presenting it to the last court that will hear it, the Circuit Court of Appeals, or the Supreme Court, as the case may be. That this precise question be extracted and made as much an issue as possible in the case in order that we will get an authoritative determination of it. The difficulty is not with the Grimm-Alfalpa case. It is the difficulty inherent in the system. Taking the law as I have stated it to you, where a Federal Reserve Bank has actual knowledge of the insolvency of a member bank, it takes by discount paper from that bank, it incurs liability.

Now what is to be said on the question of a statute giving the Federal Reserve Bank the right to examine the

member bank and to become acquainted with the condition of the member bank, and where the Federal Reserve banks have access to examinations made by the Comptroller and by State bank examiners, even working in concert with those examining bodies in making a joint examination? Does that attribute knowledge of the condition of a bank to the Federal Reserve System of a kind that can be pleaded in a suit of this sort? I think that raises a very difficult and, perhaps, a very parlous question. That question was not raised in the Grimm-Alfalfa case. There was no suggestion in that record, or in any of the briefs, that the Federal Reserve Bank of San Francisco had any knowledge of the condition of the Stanrod Bank by reason of any examination it had ever made, as a mere examination. They attributed to it knowledge growing out of transactions which it had with the Stanrod Bank but it never attributed to it any knowledge growing out of its function as an examiner, or the fact that it had examined the bank. That question is going to be raised some time. A suit is going to be filed in which the Federal Reserve Bank will be held accountable by reason of the fact that it has knowledge which it has gained through an examination

of a bank, or that it ought to have had it. That is, that it ought to have had knowledge if it had examined the bank as it had power to do. That is going to make it more difficult. I do not mean to say that that would be conclusive. I think it would not be conclusive. I think it is going to make it more difficult to get by a court on a motion to arrest the case from the jury on the usual grounds of such a motion, that there is no evidence which would justify submission of the question to the jury. Courts are going to raise the question as to whether there is not always some evidence of knowledge on the part of a Federal Reserve Bank where a Federal Reserve Bank has been examining and has had the fruits of the examination made by the Comptroller or the State bank examiners, as the case may be. Whether there is anything you could do to moderate that responsibility I do not know. It is a curious kind of responsibility. You have the power to examine and obviously you have the duty to examine, but you have no visitorial power in the sense that you can close the bank. You can expel it from the Federal Reserve System if it fails to live up to its condition of membership but you are not given power to

close banks by reason of any condition disclosed by such an examination on your part. Your power as examiners falls short of being a visitorial power, and yet it is a power that is very essential to you in order to enable you to help banks for one thing and to deal safely with banks for another thing.

You have that power under the statute. I should think it would be undesirable to surrender that power, although it increases your difficulty in defense when you are charged with having knowledge in any situation where possession of knowledge imposes liability. Now, I am not a practical banker. I can merely state to you what the principles of law are. As I have tried to think it over it seems to me that the only answer that there could be would be to put a red ticket in your own banks upon every bank an examination of which, either by the Comptroller or by the Federal Reserve Bank or State Examiner, or because of the condition of its reserve account, showed that the bank was extended and in trouble, and that in dealing with any such institution an abundance of caution should be used with regard to paper offered by them for discount or as collateral to the Federal Reserve

Bank. That is a statement of principle which is very easy to make and very difficult to apply. The problem you have of course is whether you should play high executioner to a bank that is in trouble -- and is not insolvent, but is in trouble -- but may get out of trouble, and make a catastrophe because of your knowledge of the bank by closing its doors and refusing to help it. I do not think there is any set rule you could apply. You have got to exercise just human judgment in each one of those cases and continue constantly to exercise that judgment. Doubtless it may mean some losses to the Federal Reserve Bank, but those losses will be moderated and minimized if care is used. In my judgment it would be very much better for you to take some risks and lose some money than it would be to put the Federal Reserve Bank in a situation of rigidity with regard to banks that are in trouble. I should be very happy to answer any questions.

Governor Crissinger. In a case where a bank proves to be insolvent, and there has been indication all the time that something is going wrong, and the Federal Reserve Bank neglected to supervise the examination, would you tell us what position you would get into?

Mr. Baker. I think failure to examine is just as bad as that kind of examination. That is to say, where you have the power and do not use it I think you would be charged with responsibility just as though you did have knowledge.

Vice Governor Platt. Would that apply to your National Banks as well as your State banks?

Governor Crissinger. Right in the beginning of the Statute the Statute says it is for the purpose of creating a better supervision of banking and a better system of banking, or something of that kind.

Vice Governor Platt. Yes, it does say that.

Mr. Baker. I would not say that it was the duty of the Federal Reserve Banks to conduct independent examinations, or that they would be held to responsibility for not doing that where examinations are being made by others if they are perfectly free to take those examinations. I think the statute gives you that power.

Vice Governor Platt. Yes, it does.

Mr. Baker. So that where a Federal Reserve Bank relies upon examination and report of the Comptroller's office, then I think you would have a perfectly good

alibi.

Governor Crissinger. Assuming that the report of the Comptroller on one of these examinations does show a lax banking system in the bank, and does show that there are things going on that are being criticised, would it be the duty of the Federal Reserve Bank to take notice of that fact?

Mr. Baker. Obviously I think where you find in the Comptroller's report or the Examiner's report such conditions as would put an ordinarily prudent man on guard, that you are then charged with any knowledge that you might discover by an independent examination.

Governor Calkins. I would like to ask a question with no regard to the kind of examination you were just speaking of. Inasmuch as the Federal Reserve Banks or the Federal Reserve Board have the power to accept the examinations of State and National departments, are they not charged with responsibility of determining whether those examinations are sufficient or not, and whether they are acceptable examinations? We believe that we are. I think in reviewing the reports of examinations that come to us, mainly from State departments, and possibly in some cases from the National department, that we are

charged with responsibility of determining whether the examination is a sufficient examination, whether it is a dependable examination, and whether we can accept it or not. Is that your idea?

Mr. Baker. I think in view of the fact that the statute gives you the option to decide whether you will rely upon the examination of others, that it also imposes an obligation on you to determine whether that examination is reliable, or one that you can rely on.

Governor Calkins. The other question that I have in mind, and I would appreciate it very much if you would elucidate it for my benefit, is the question of how, previous to the decision in the Grimm-Alfalpa case, insolvency might be determined or should be determined; in other words, what are the determining elements or factors, by which insolvency was determined in the absence of the actual closing of an institution?

Mr. Baker. Of course the law is perfectly easy to state, but the application is again difficult. In the Grimm-Alfalpa case there never was, and has not to this date been, any determination that the Stanrod Bank was insolvent. There never has been to this hour any determina-



tion that the Stanrod Bank was insolvent. What took place there was the bank closed its doors; I think its elderly president got scared and its principal directors got together on Thanksgiving Day, they decided that the situation was pretty dangerous, they did not want to do anything wrong and they closed the doors. Two or three months after that had taken place, when their assets had obviously lost a great deal of value, a schedule of their assets, with the appraised values then fixed, was exhibited in the case and it showed, on the basis of the valuation made two months after the bank closed its doors, that the bank could be inferentially regarded as having been insolvent at the time it did close its doors. But they never did determine the insolvency of the bank as of the date when those drafts were deposited in the bank.

Governor Calkins. I think you missed the point I had in mind, Mr. Baker. In practice we may say that a bank is insolvent under two conditions. First when it has committed the unmistakable act of insolvency by being unable to meet the demands of its depositors. A bank that cannot meet the current and local demands of its depositors is an insolvent institution in practice. Secondly, it may be determined by constituted authority,

such as the Comptroller of the Currency or the State superintendent of banking, to be insolvent. But as applied to banks from a practical point of view I do not know of any other kind of bank insolvency except those two kinds.

Mr. Baker. I think there is a third kind, which would perhaps be a rare occurrence; but you can imagine a bank in such an extended condition that every member of the board of directors would feel hopeless about being able to rescue it and yet be unwilling to face the music; where you would say there was nothing to do but close the doors, and they would say we know we have to do it but we are not going to do it, we just cannot face the wrath of this community. We will not do it today. Maybe something will happen tomorrow. When a bank is in an obviously hopelessly insolvent condition and yet they adopt a Micawber attitude toward it, and put off the evil day hoping that something will happen, then I think you know that bank is insolvent.

Governor Crissinger. What would you say as to the effect of evidence against a bank which demanded and was receiving a large amount of excess collateral for loans? Would not that be a fact that would be taken as charging

the bank with knowledge there was something wrong?

Mr. Baker. Well, it does not seem so to me, Mr. Crissinger. It may be perhaps that I do not apply that as I ought to.

Governor Crissinger. I mean a bank that knows of criticism, through a National Bank Examiner, of that institution, knows it is very much extended, and because of that fact demands a large amount of excess collateral, in order to make the bank a preferred creditor? Aren't those some facts that would go to a jury to determine the question of whether the bank is on notice?

Mr. Baker. I should think so if that were an exceptional case; if you made an exception of that bank as against other banks.

Governor Crissinger. They are not exceptional cases. There are a great many cases of that kind, where the Federal Reserve Banks do know that those banks are largely extended and, for the purpose of trying to pull them through the condition in which they find them, they demand large excess collateral, sometimes all of the resources of the bank, to secure the lending bank? Isn't that one of the things --- at least it is so down in Ohio, if I re-

member it correctly -- which would reflect upon the question of knowledge of that bank's insolvency or solvency?

Mr. Baker. I think it would be, although as I understand it the Federal Reserve Banks, when they do get marginal or excess collateral, get it not only to secure the existing obligations but future obligations as well. I think if we were arguing to a jury we might well say that the reason for the excess collateral was not to take care of this particular claim, but that the Federal Reserve Bank was more or less a continuing creditor of the bank in question, and the excess collateral was deposited for that purpose as well. I understand, from something Mr. Mason said to me, that banks very often, of their own motion, deposit excess collateral as convenience for themselves, so that I should think that was a more or less equivocal circumstance in any particular case where excess collateral was demanded, unless it was done regularly in regard to a bank of which you otherwise had knowledge of its extended condition.

Governor Seay. It has really become a banking practice.

Governor McDougal. Requiring additional collateral is common banking practice. It has always been required

by commercial banks, which have required a large margin of collateral, in connection with advances to other banks.

Governor Crissinger. I understand that, but I am inquiring about this because there are cases, about which you gentlemen of the Northwest know, where nearly all the paper of the bank has been taken by the Federal Reserve Bank, at least paper that is worth anything, and yet that bank is permitted to run and receive deposits.

Mr. Baker. Of course, Governor Crissinger, that is a different case from the one I was discussing. Here are a hundred member banks. The Federal Reserve Bank comes to the conclusion that Bank A, or No. 1, in that hundred, is in a different situation from all the other 99 banks. It says to Bank A, "You must put up more collateral than anybody else in this whole list of a hundred banks, in proportion to the service that you get from this bank." I think that places you in a prejudicial position and I think it would be prejudicial to argue it to any jury.

Now the condition of the reserve account of member banks is a circumstance that you are going to have to face before juries. The statute makes it obligatory to

maintain those reserves, and a bank which over any substantial period of time is low in its reserves and sometimes has an overdraft in its reserves, creates a situation that challenges the attention of the Reserve Bank to the condition of that bank, and in some suit that we are going to have to face some day we are going to have the lawyer on the other side get up and produce in court the state of the reserve of the bank in question and the circumstance which we ought to have taken notice of which ought to have put us on our guard.

The Chairman. Of course the reserve banks are loaning a hundred million dollars and it is natural I think for every banking officer in the Reserve System to feel safe in observing the rules which have always applied to the loaning of money in commercial banks. We have now learned that those rules do not apply to the Reserve Banks because we are charged with certain special knowledge which the commercial bank never receives from its banking customers, and therefore we have got to consider to what extent, unwittingly, we may be building up evidence in our own transactions and in our method of conducting them which, even under the most excessive

care, will cause losses to us which would not arise with a commercial bank at all. What I hope would result from the meeting here today is something like this: Here is the question of the application of the bank. We must be very careful to have that changed in such a way that we will not building up evidence against ourselves. Then comes the question of examination, the examiner's report. We ought to have as a result of our discussion and the advice that we get, I hope, some general principles to guide us in dealing with the reports that we get where conditions are disclosed that would put us to some extent on notice of the difficulties of the bank. Then there is the question of taking additional collateral, where we made collateral loans, additional collateral above the face amount of the paper discounted, where it would appear that we are making evidence against ourselves by giving exceptional treatment to individual banks. Under the general form of our liability contract, which many of the banks have, the additional collateral on one loan must serve as collateral on other loans which they may make, and which makes securities held in custody for a member bank

pledges in effect of those securities for loans. There is a difficult question as to information disclosed in connection with collections we are making for banks, in cases where it is difficult to get checks paid, and which sometimes are held up. I have a feeling that we have got to have a very careful review of the practices of reserve banks so as to safeguard ourselves against making unnecessary records against ourselves. It seems in cases of failed banks or where we have earnestly endeavored to help a member bank at times, that our very efforts in that direction make us liable. It is a case of where our liability increases with the degree of care with which we conduct our business increases, so to speak. If we do business blindly, without any knowledge of the condition of the bank, and loan money to it, we are safer than we are if we know all about it.

Mr. Baker. Is it possible to see difficulties arising out of another situation than the creation of deposit liability? I mean, for instance this: Where you have demanded excess collateral, is it possible for the title to that collateral to be attached by the general creditors of the failed bank on the theory that your



knowledge of the extended condition of the bank to which you were giving accommodations was indicated by your demand for excess collateral, and were assisting in continuing that failed bank beyond a point where it should have continued, to the prejudice of the general creditors, who could thus assert their right to the collateral held in preference to you. I do not know whether that is a practical proposition, but perhaps if it is you bankers have met it.

The Chairman. I should think that it would arise.

Mr. Wyatt. We have a suit of that kind now pending.

Governor Harding. I would like to ask a question with regard to this excess collateral. The banks in Artoostook County, Maine, which is purely an agricultural section, producing one crop, potatoes, up to last fall were in a very badly extended condition and had been for about five years. The Federal Reserve Bank of Boston, ever since 1919, which was the last good year that they had, carried those banks along, at times carrying them for as much as a million dollars, for those three little banks. We took excess collateral. They

managed to get those loans down, in 1923, to \$750,000. But in 1924 they were up again, caused by a crop of potatoes the prices for which were as low as 60 cents a barrel. The condition of those banks a year ago was such that if they had had another low priced crop or a very short crop those banks would have been insolvent. In other words, there was no actual insolvency at the time, but there was prospective insolvency if those adverse conditions continued. Fortunately they sold their crop at \$6 a barrel, they have all paid out, their deposits have increased 50 per cent and the automobile agents and radio agents are traveling up through there and selling them stuff. Those banks will certainly be back some time this summer for more money. They don't any of them owe anything now, but I have made up my mind when they come back that we will take excess collateral right from the start and while they are in perfectly good condition, but while we are in a position to point out that while we do not need it now that they are liable to have a repetition of that same thing and may have some bad years, and those people may go crazy again and spend the money that they have made. I want to establish

a precedent by demanding excess collateral right at the start. If there is any objection to the demand for excess collateral against rediscounts we will just take their bills payable, and they can make a 15-day paper and put up collateral on the basis of one and a half for one, or something of that sort.

Mr. Baker. In order to get my own mind clear, the excess collateral you are now speaking of is an excess of paper?

Governor Harding. Yes.

Mr. Baker. On the theory that if hard times come up there again you will have established the precedent?

Governor Harding. If the 1924 conditions had continued those banks would have all been insolvent by this time. Their liabilities were such that they could not possibly have pulled through.

Mr. Baker. You would make this distinction: If they offered Government bonds as collateral you would not want any excess.

Mr. Harding. No, not on Government bonds, but they do not have Government bonds. All they have got are the

notes of those farmers. The farmers have all got their land mortgaged.

Mr. Baker. Then your question comes down to this: Is there any imputation of knowledge against your bank growing out of the fact that you demand excess collateral of the kind which experience has shown you has a tendency to get frozen from seasonal causes? In answer to that question I would say no, there is no imputation of that kind. I think the proper administration of your bank would require you to exact more of that kind of collateral, when it depends upon anything as seasonal as the success of the potato crop in Aroostook County, Maine.

Governor Harding. In the South, when banks lend money not against the crop, actually made but against a crop that they hope is going to be made, they always demand three for one.

Mr. Baker. They demand that excess collateral because of the nature of the collateral rather than the condition of the bank, I believe.

Governor Harding. Here is another situation, and a practical case. The First National Bank of Putnam,

Connecticut, got in trouble in August of 1924. On Wednesday afternoon the Examiner was in. The previous examinations had shown that the bank was somewhat extended but the reserves were always carried intact and the paper with the Federal Reserve Bank was satisfactory. It turned out to be good paper because we collected practically all of it. When the cashier walked out they found that his peculations, as at first thought, were about \$40,000 and the National Bank Examiner stated that as far as he knew the bank was solvent; that the losses that they had discovered were about \$40,000, which was more than covered by the surplus profit. The checks were beginning to come in through the Boston Bank to be sent by us to this bank. We sent a man down there so that we could send these checks to him. The first day they paid us by giving us a check on a bank in Boston where they had an account. The second day they didn't have any money in any bank account to pay the checks with. The checks came in in increasing volume. You can see if we had demanded payment in cash for those checks and protested non-payment, we would have closed the bank Monday morning. The Bank Examiner stated that they had dis-

covered losses amounting to a hundred and twenty thousand dollars, but they still thought the bank was solvent. He said they were going to get the directors together to do something. That day we had \$43,000 worth of checks on the bank which we sent down there. We had our agent down there, one of our own officers to send the checks to. In order to take care of the checks that we had on we had them them/send in some paper, not by way of excess collateral, but merely paper that we could put to their credit in case we needed the funds to pay these current checks that were coming in. The point I want to bring out is this: The paper we took was not paper that the bank had taken a day or two before they finally closed; it was not sight draft or demand draft, but it was paper of the manufacturing concern which they had there for over two months, and was renewal of paper that they had been carrying for a year or so. We took care of those checks and finally on Tuesday the bank directors closed the bank. We had no trouble with the checks that we got on Monday because our man down there protested them all and they were sent back. The point was that we had a little dispute with the people whose note we had dis-

counted on this Monday. They claimed that our discount had deprived them of their right of offset; that they had a deposit of \$4500 in the Putnam Bank and that we had taken \$15,000 worth of their paper; they said if we had not taken the paper they would have had an offset against that bank of \$4500 that that bank owed them. They said our taking the paper deprived them of this right of offset. We temporized with them by telling them that if we managed to collect our debt in other ways that we would be glad to release the paper. The thing was finally adjusted and we came out without any loss, but it was a very ticklish situation. As I understand it, in the Grim-Alfalpa case the discounts were demand drafts.

Mr. Baker. Yes.

Governor Hardin. The discount here was not a sight or demand draft but part of a customer's regular line of paper. The bank had this particular paper in its possession for over two months and it was a renewal of a loan that the bank had been carrying for several months, or perhaps years.

Mr. Baker. I confess that I do not see any spe-

cial difference between the two cases, that is to say, if you believed that this particular bank was insolvent at the time you were taking its paper.

Governor Harding. We did not know whether it was insolvent or not. We were in a bad fix, because the Examiner did not know. This man did not keep any books of these transactions, but as cashier he received deposits and put them in his pocket and they were not shown on the books. The bank had a liability which was not shown on its books.

Mr. Baker. It is a difficult question. The elements necessary for liability are three. First, the bank must in fact be insolvent; second, its own officers and directors must know it is insolvent, or believe it to be; third, you must know both that the bank is insolvent and that its officers know it. In the case you put the officers and directors of the bank itself did not know that it was insolvent, did not believe it was insolvent, but believed otherwise.

Governor Harding. The only man who knew it was insolvent had shot himself in the head and was then in a



comatose condition.

Mr. Baker. The case that you put plainly was not the kind of knowledge, as a matter of abstract law, that the statute covers. But if that case had ever gotten before a jury, and they had had all the knowledge produced before them which you had, whether or not they would have taken the position that you should have known, is a question that deals with the human element and which no one can answer.

Governor Harding. On the question of excess collateral, if a bank in an agricultural region takes excess collateral on a farm crop which is not produced, why is not the Federal Reserve Bank clearly entitled to take excess collateral from the bank whose entire loans are with those farmers on their crops?

Mr. Baker. I think it is. I think wherever the demand for excess collateral is due to the character of the collateral that you are perfectly within your rights and there is no indication of knowledge in that demand for excess collateral.

The Chairman. If it were possible -- I do not know whether it would be, because practices of reserve banks

differ quite materially and the situations in which they deal differ in the different districts — but if it were possible to prepare a statement which would make fairly clear what the practices of each Federal Reserve Bank were on these various points, if that could be assembled in such shape that it would be illuminating as to any danger, any special danger to be guarded against, do you think it would be possible for you to review all of them and give us some sort of suggestion of how to shape our course?

Mr. Baker. Do you mean in the way of a questionnaire? Mr. Wyatt has practical knowledge of these things, and if they were sent to him he and I could spend some time with them. I think he would be glad to do that.

The Chairman. That is exactly what I had in mind: That we arrange at this meeting some scheme by which each Federal Reserve Bank could submit to Mr. Wyatt an accurate statement of their attitude on these matters, how they handle them in the banks, and in fact get the information up in intelligible form so that you would not have to go over a mass of papers. I was wondering

whether Mr. Wyatt and yourself might not advise all of the Reserve Banks in this matter.

Mr. Baker. I am wondering, and I am willing to think out loud about it, and some of the questions I ask may be very foolish to you practical bankers, but I am wondering whether it would be possible to put in the application a certificate to be signed by the applying bank that it was the owner of the paper.

The Chairman. Quite possible.

Mr. Baker. That avoids the question as to whether the paper is there for collection or whether it is paper that is owned by the bank. In this case, for instance, if the Grimm-Alfalga paper had been sent to the Stanrod Bank and the Stanrod Bank had sent it to the Federal Reserve Bank with a statement on the application that it was the owner of that paper, it would have eliminated half a dozen confusing questions from the case when it came to be tried.

Mr. Miller. I am wondering whether this provision of Section 4 of the Federal Reserve Act has any bearing on these matters. It is in the nature of a direction to the directors of the Reserve Bank to extend to the member bank such advances as may safely and reasonably be made. I can conceive that a loan might be made by a Reserve

Bank to a member bank which is close to the point of insolvency and yet it be an individual loan in the sense that it is well secured and the Reserve Bank would have no loss. Does this mean that such loan shall be made to a bank which is not safe, although the individual loan may be safe? Does it mean that the Federal Reserve Bank must make a loan, or according to the language in the Act, shall extend to each member bank such discounts, and so forth, as may be safely made? The question that it raises in my mind is, under the various circumstances that lead the member banks to come to a Federal Reserve Bank for accommodation, what constitutes a safe loan?

Governor Strong. Certainly a loan that is charged with fraud would not be a safe loan. Where the circumstances of this Grimm Alfalfa case applied they were charged with knowledge that it was distinctly unsafe, the statute would not impose any mandatory obligation to make a loan under those circumstances.

Mr. Miller. I wonder whether there is anything mandatory there.

Mr. Baker. I think not. That statute has to be

read as though it was turned about, that the Federal Reserve Bank shall not refuse to extend to a member bank any discount or advancement or accommo<sup>dation</sup> on any other ground than that it is not safe or reasonable. The mandate is that you are to assist the bank where it can safely and reasonably be done, but you are not under mandatory obligation to assist banks in all cases.

Mr. Miller. What do you say as to the distinction between a loan that is safe and a bank that is not safe?

Mr. Baker. I do not think that distinction is there. I think the reasonableness of the extension of the discount or the advancement of the accommodation has to do with the condition of the bank.

Mr. Miller. With the condition of the bank?

Mr. Baker. Yes. Obviously it would never be that they should accept a piece of paper that was not in itself safe.

Mr. Miller. Of course that is done, the paper is not safe in the sense that it unquestionably will liquidate itself at maturity, and the Reserve Bank therefore demands what is called excess collateral, because it has doubt as to that paper. In addition to that, Mr. Baker,

in connection with this interpretation, all of the paper that the Reserve Bank takes from a member bank comes in of course with the member bank's endorsement, and the minute it exacts excess collateral does not that suggest a question in the mind of the Federal Reserve Bank as to the safety of that bank?

Mr. Baker. I think not.

Mr. Miller. You think not?

Mr. Baker. I think it might in certain cases, but not necessarily. I think Governor Calkin's proposition illustrates the situation. His Utah bank had been in the center of the district where everything was extended and everything frozen, and the duty of that bank, under this Act as a part of the general fiscal agency of the Government, seems to me to have been that of tiding over that situation in the national interests. I think that is the first duty of that bank. It is a duty that carries with it the responsibility and likelihood of loss, and such loss as the Federal Reserve Bank of San Francisco has suffered by reason of its desire to tide over a bad, widespread situation affecting that section, it seems to me a loss that is expected by the statute that

the Reserve Bank should sustain. The most that the statute can require of a bank dealing with that situation is that it act with caution and reasonableness. Fortunately the statute uses the word "reasonable" as well as the word "safe." So that if there is reasonable hope, based on any facts that Governor Calkins could show that the situation that happened in the Middle West that happened in such and such a year, that the situation had changed favorably and he could on past history anticipate a sufficiently favorable change in the situation to justify the extension of credit, then I think that history of what had happened in the past would impose that liability upon him.

Governor Calkins. Mr. Baker, I would like to say that you talk as if you had been running the Federal Reserve Bank of San Francisco during the period to which you have referred. You have stated the policy followed by the Federal Reserve Bank in that situation almost exactly. However, I would like to return to the crucial question with which we are dealing, and that is what is the ground upon which you must determine the solvency or insolvency of a member bank. This Grimm Alfalfa



case, and the other cases we have been talking about, hinged entirely upon the question of whether the bank in question was solvent or insolvent at a certain moment. Now I stated my two causes for, or my two kinds of insolvency, and you added one more. I realize the force of that. I am wondering if you will undertake to say that the Federal Reserve Bank was chargeable with knowledge of insolvency under certain conditions as you described, and for the purpose of illustration, I would like to say this: We have another bank, and this is a good illustration of the point I am trying to make, in the same town in which the Stanrod Bank is located, the officers of which were desparately incompetent. The bank was in a terribly over extended condition, in fact it found itself in almost the same difficult situation in which the Stanrod Bank found itself. But it happened that the President of this bank, a man 86 years old, is a man with an ample fortune, and that man said, "This bank is not going to close; I have sufficient fortune to protect it and to protect all of its depositors and stockholders. I will pledge, without any reservation, everything that I have to protect the creditors and depositors of this bank."

And he did that. That bank today is in first class condition and doesn't owe a cent to anybody. Now by the usual test of the condition of a bank, the knowledge of its officers and the knowledge that we had, that bank was as truly insolvent as the Stanrod Bank ever was, and yet it never was insolvent. This is a crucial question in our dealings with the member banks in extended condition.

What puts us on notice that a bank is in a dangerous condition first, because then we must exercise additional caution, and second, what puts us on notice that a bank is insolvent, because then we must stop making any further advances to it. The whole thing boils itself down, in my opinion, in these cases and comparable cases to this: What facts may we apply to determine the solvency, or more particularly the insolvency, of a member bank? I go back and say that there are two kinds of bank insolvency known to those who practice banking. One is the insolvency as evidenced by an act of insolvency and the second is insolvency because of the declaration of the constituted authority, such as the Comptroller of the Currency or the superintendent of banking, that a bank is insolvent. I am still somewhat at a loss to find

some debatable ground upon which we may determine that a bank is insolvent.

Mr. Baker. I do not think there can be any answer to that question. I think each case has to stand on its own facts. It is just a question of exercising sound judgment with regard to each case. Take the Stanrod Bank case. You recall the exact facts better than I do, but someone sent in a draft for ten or twelve thousand dollars to be collected and the proceeds remitted. They did not get the remittance.

Governor Calkins. The facts in that case were such as would appeal to a jury as constituting an act of insolvency but which, as a matter of fact, did not constitute an act of insolvency, because as you will recall, the reason that that draft was not paid was that a junior officer of the Stanrod Bank had misapplied the funds provided to meet the draft and the other officers held back payment of that draft in order to apply pressure to the father of the junior officer who had misapplied the funds, in order to make him get the money back. That was not in fact an act of insolvency, but it appeared to the jury as such an act.

Mr. Baker. While the explanation in regard to the pressure being applied to the father is not in the record in just that form, it was a circumstance that was known, but not put in the record in that form. The naked facts that stood in the record were these, and the Circuit Court of Appeals puts them in alongside of one another: A draft for ten thousand dollars was sent to the Stanrod Bank and no remittance followed. The transmitter of the draft sent a personal agent down to find out why they didn't get their money. They were told by the cashier of the Stanrod Bank that they could not pay it immediately but would in a few days. In a few days they did. But concurrently with that, about the same time, the Stanrod Bank was endeavoring to borrow \$10,000 from the Federal Reserve Bank and the Circuit Court of Appeals put those two circumstances together and held that they were in effect committing an act of bankruptcy by failing to remit the proceeds of that draft and at the same time trying to borrow ten thousand dollars from the Federal Reserve Bank. When things come as close together as that it is not strange that a jury regards them as related to one another. If you are unfortunate enough

to have those two things happen at the same time the freedom of your judgment is not always credited.

Governor Young. Naturally Minneapolis is very much interested in this question. We attempt to work it out as well as we can ourselves as to when a bank is insolvent, but I think I can say with safety that so far as reports on National banks and State banks are concerned that I have never seen one which showed an insolvent condition, even with 206 closed banks. Now that is not any reflection on the Comptroller's office or the National Bank Examiner. It is an extremely difficult thing to set up losses in a bank unless the directors of that institution want to admit the losses. An examiner has an extremely difficult job. He cannot set up any losses unless the directors of the bank admit those losses. So far as the Examiners' reports are concerned I think our bank could safely say that we have <sup>never</sup> had any knowledge of insolvency of any of the 206 banks that have

Let us assume that a man discounted a note in a member bank, payable to the bank, that they sent it to us and we rediscounted it. He could not set up the defense very well that he had put his own note in the bank and could collect it upon himself. I do not think, so far as 99 per cent of the notes that we get are concerned in the Ninth District, that we are assuming any liability. Those people have got to pay those notes. <sup>But</sup> / in the transit department I think there <sup>may</sup> be liability.

Mr. Baker. I do not feel as confident as you seem to feel about your safety when it is a customer's own note that is discounted.

Governor Young. But suppose he has no dealings with the bank at all. He is simply a customer of the bank and we take that as a negotiable instrument. He does not lose anything.

Mr. Baker. That is a different question.

Governor Young. On 99 per cent of the notes they have the offset balance, we get then to pay down to the amount that we have advanced collateral -- we get in a position where we can return the paper to the Receiver so that it works out from a practical standpoint. But

there is another feature of the situation that has concerned us a good deal. We are dealing with a great number of banks that are slow in paying. In the Northwest the grain trade is financed by the country elevators. They draw a draft on a car of wheat with a bill of lading attached and send that in to us for collection, the same as in the Grimm Alfalfa case. They do not ask for any time credit, they do not ask us to rediscount but simply want us to present it, collect the proceeds and place to their credit. Now it seems to me that there is a great liability on our part in handling these non-cash items and passing credit to a member bank that we are on notice is insolvent. Am I correct in that?

Mr. Baker. Do you think there is any danger if you do not pass credit to the member bank until after the collection is made?

Governor Young. I should think so. That is what I would like to know. I do not know whether it belongs to the bank or belongs to the customer. Here is an insolvent bank and we have got to find out to whom it belonged. We are handling millions of dollars worth of that every day.

Mr. Baker. That does not seem to me to impose liability. You have done what you were asked to do. You are selected as the agent to collect the money. You have turned the money over to the person you were authorized to turn it over to. It certainly cannot be your duty to go to the man who started that collection and tell him that the agent that he picked out and selected was not worthy, that you could not operate through him and that therefore you would have to seek him out and turn it over to him personally.

Governor Young. And there would be no liability in that?

Mr. Baker. I should not think so.

Governor Young. Then I am satisfied.

Mr. Baker. I think it would be important for you to get some concurrence, in my judgment, I am just trying to follow it through as you stated it. I had not thought of it before.

Governor Seay. Not to multiply suppositious cases, but along the lines of Governor Calkins' inquiry as to what definite thing constitutes notice of insolvency, when the Comptroller's examiner reports that he has as-



certained that the doubtful paper in the bank is more than sufficient to wipe out the capital of the bank, and yet the Comptroller has taken no steps to close that bank, would that constitute, in your opinion, notice of insolvency, or merely evidence of insolvency?

Mr. Baker. I should think that the wiping out of the complete capital and surplus of a bank would be so striking a suggestion that it would impose the duty upon you of assuring yourself of conditions by proper inquiry. I do not think the impairment of capital would be enough to put you on inquiry. I am surprised that no Comptroller's report ever showed that. When you speak of never having seen a report which showed an insolvent condition, it seems to me of course that that is so because if the Examiner's report showed insolvency the Comptroller would close that bank before he made the report to you.

Governor Young. Governor Seay was inquiring about doubtful paper. I do not know whether you would be justified in calling it doubtful paper, but much of the paper in the Northwest is paper that what is very difficult <sup>to</sup> tell whether it is good or bad.

Mr. Baker. It depends on whose doubt it is.

Governor Young. You have to wait to see whether it is bad or not bad. That is the only way you can determine whether it is good or not.

Mr. Baker. As I say, it depends on whose doubt it is. Certainly a Federal Reserve Bank is not clothed with such knowledge of the widespread clientele of a member bank such as to enable it to assay all the commercial paper that is presented. That is a human element and you haven't that information. I do not believe the burden goes that far. Your examination of the bank shows apparently good paper and nothing about the paper or nothing about the banks to suggest the possibility of the paper being bad. I do not think it is up to you to trace out each piece of paper and find out for yourself that it is good paper. Until your attention is challenged by something in the bank which shows it to be indulging in a dangerous practice or is in an extended condition — and if that is called to your attention, then you are put on notice.

Governor Young. You always have that in the transit department. You cannot avoid notice. It is right there.

Governor McDougal. The practice established many years ago by the Comptroller's Department, and I think likewise by many of the State departments, to determine solvency or insolvency, was first to determine a fair appraisal of the assets and then to find out whether those assets, based on that appraisal, were of sufficient value to protect the depositors; or, in other words, if the known losses were equal in amount or greater than the capital and surplus then the bank was declared to be insolvent. Now it seems to me that as the result of this decision the Federal Reserve Banks have a greater responsibility than ever before in the matter of extending credit to their member banks. It seems to me also that we probably have greater responsibility than we have been aware of in the matter of determining solvency and insolvency. I think we ought to have some understanding about that and I would like to get your views upon what constitutes insolvency. There have been times when a bank in difficult circumstances has not been able to pay at the moment the checks that were presented, but hours later, or possibly the next day, they have been able to pay them. I have known cases of that sort that might constitute in-

solvency according to the decision quoted in this opinion, but I would like to know if that constitutes insolvency in your own mind, Mr. Baker.

Mr. Baker. Would you mind reserving that question until Governor Strong's suggestion is carried out, that is that an examination be made of the practices of all the banks, with a view of making suggestions that will protect the banks so far as they can be protected in these situations? I want to include in that the traditional and established definition of insolvency and ascertain if they apply to the Federal Reserve Banks in view of the facilities placed at their disposal.

Governor McDougal. That would be entirely satisfactory to me. I should like to go a little further and say that my experience over a number of years has been in accordance with that of Governor Young. I have never seen a report of the National Bank Examiner which reported a case of insolvency from the standpoint that I have pointed out, with respect to which we have been called upon to render any assistance, and, of course, under those circumstances, we could not and would not do it.

Governor Crissinger. Take a bank of that kind that

was running along for two or three years to your knowledge, in a very extended condition; you know that things are a little slipshod in the bank, and you make no effort to ascertain from your own examining department the condition of the bank, and don't you think you create liability in that way?

Mr. Baker. You cannot establish insolvency in that way.

Governor Girsinger. No, you cannot, but you can make yourself negligent in not checking up on that bank, can you not?

Governor McDougal. There are no cases of that sort where we do not check them up.

Mr. Baker. In the Grimm Alfalfa case we were satisfied with the appraisal made by the bank authorities ---

Governor McDougal. But it does not constitute necessarily insolvency. As a matter of fact experience has demonstrated the fact, in connection with closed banks, that their insolvency frequently is not known before the closing but can only be determined by closing the bank and thereby forcing them to make an appraisal of the assets of the bank through an outside authority, the bank

examiner or somebody else.

Vice Governor Platt. If that is true, when a bank is closed and they subsequently pay only 45 to 50 cents on the dollar, it would seem to indicate that the bank must have been insolvent for a year, anyway, before it was closed,

Governor McDougal. But in most cases the officers and directors themselves do not admit insolvency and the reports of the Examiners do not show insolvency.

Mr. Miller. Does it not mean a little more than that? Isn't insolvency something like human death? We don't have to wait until somebody certifies to the death of a man in order to satisfy ourselves that he is dead. It is a question of judgment of value of assets set alongside liability,

Mr. Baker. It is a question of judgment, until an act of insolvency is committed, as Governor Calkins has said.

Mr. Miller. I rather refer to your statement to the effect that as the Federal Reserve banks legally are equipped with the power to inform themselves at first hand, if they so desire, of the condition of their member banks,

they are in a position where they can form a judgment as to whether or not the bank in question is solvent or insolvent, or approaching insolvency, and therefore they are not obliged to wait until that fact is declared by some authority. I do not understand that the declaration of that fact by a State superintendent or by the Comptroller of the Currency makes a bank insolvent. It is simply a public announcement of the fact, made upon his best belief and judgment after an examination of the bank and after certain facts have been brought to his attention, or after some actual act shows that the bank cannot pay its obligations and, as a matter of fact, is insolvent.

Mr. Baker. I think that is perfectly true. The determination by the Comptroller or the State bank examiner that a bank is insolvent, may in fact be erroneous.

Mr. Miller. Yes, it may.

Mr. Baker. But it is rarely erroneous.

Governor Seay. Would you think it desirable to attempt by statute to define technical insolvency of a bank?

Mr. Baker. I do not think so. I think the Supreme Court of the United States -- and I am speaking now just

from general recollection — has stated what constitutes insolvency so authoritatively, that a statute could not clarify it very much.

Governor Norris. The Federal Reserve Act, in its general title, states that there shall be a more effective supervision of banking, and then it provides, as a condition of membership, that such bank shall likewise be subject to examination made at the direction of the Federal Reserve Board or the Federal Reserve bank. Then as to State banks it provides that when the directors of the Federal Reserve Bank shall approve examinations made by State authorities, they may be accepted in lieu of examinations made by the examiner of the Board. You do not think, do you, that anywhere in that act there is any duty imposed upon us, or even authority given to us, if we wanted to exercise, to constitute ourselves the power and authority to determine when a bank is insolvent and to take such action as would result in closing that bank?

Mr. Baker. No, I think not. I think that statute was plainly passed for the purpose of enabling you to exclude the banks from the privileges of membership in the system which did not live up to the conditions imposed upon



members; and when you have determined that you won't have a bank in the System I think that is as far as you can go. The question of determining the insolvency of that bank is, in the case of the national bank placed upon the Comptroller and in the case of a state bank upon the State bank examiner, by authority of Congress, and not upon the Federal Reserve Bank.

Governor Norris. One more question, as to banks that are not on the special examination list of the Comptroller or of the State department. They certainly are entitled to a presumption of solvency until they show some evidence of insolvency. If in the course of operations of their transit department or otherwise any suspicious circumstances arise that give us a doubt as to the condition of a bank that is supposed to be in good condition, we immediately request either the local chief examiner or the State banking department to make a special examination of that bank; if the circumstances that lead us to make that request are substantial, or they think it worth while -- in fact, almost without exception they have always made those examinations, there never has been a case where such an examination disclosed the fact that the

bank was insolvent, but it shows that there is a certain amount of paper in which certain loss is estimated, or there is a certain paper that is slow, but the Comptroller or the State department does not regard that bank as insolvent and does not make any objection to the bank continuing in business; they may impose some conditions with regard to a change of officers or a change of policy or something of that sort; but they do not report that bank as insolvent, and if that report appears on its face to us to be a fair and intelligent report, made by proper authority, are we not absolutely justified in relying on it?

Mr. Baker. Entirely so, in my judgment. You have met the entire burden by your action.

Governor Young. Is my interpretation of the ruling of the Supreme Court correct, that insolvency may be determined by the inability of the bank to meet its due obligations?

Mr. Baker. Yes.

Governor Young. That is correct?

Mr. Baker. Yes.

Governor Young. Let us assume that we take the spe-

cific case that Governor Norris has cited. Let us assume that we find the assets of the bank satisfactory but we find that the bank has no reserve, that it has many cash items unpaid which have been unpaid for several days, haven't you got pretty good knowledge that that bank is insolvent from a financial standpoint? In other words, you have got to lend them some money to pay those obligations.

The Chairman. No bank can pay all of its depositors overnight if they have a run.

Mr. Baker. No, it is a question of judgment. You look at the bank's assets; you find that those assets are perfectly good according to the best judgment you can exercise but they are not sufficiently fluid and flowing to meet the demands as rapidly as applications are made, then you can tide that bank over with perfect safety. If you make a mistake where you have exercised reasonable discretion, I think you have relieved yourself of any liability. Does that answer the question?

Governor Young. Yes, I think it does.

Mr.

/ Baker: But the question I want to raise, and I want to do it for my own information, is a practical question. Suppose a situation would arise like that in the case of the Stanrod Bank, an extended bank where, due to the view of the Circuit of Appeals, the Federal Reserve Bank had knowledge of the perilous, if not the insolvent condition, of the Stanrod Bank, is it impracticable for the Federal Reserve Bank, which is appealed to for assistance, to say to the bank, with regard to the paper presented, "Where did you get this; how did you come to have it? Was there any deposit liability created at the time you got it, which still exists?" And to take only paper which did not come concurrently with the creation of a deposit liability after the dangerous/condition of that bank was known? Is that impracticable?

Governor Seay. As to the existing deposit liability, I think that is impracticable; but it certainly is not impracticable to require a statement that the paper was discounted, because we have already done that and do it now. We do require the statement that this paper has been discounted for so and so, but we do not

now, and never have, nor do I believe has any Federal Reserve Bank, required any statement as to the contingent deposit liability of the applying bank.

Mr. Baker. Such a statement required might be helpful but it would not be conclusive. The Stanrod Bank would undoubtedly have told the San Francisco Bank that it was the owner of that paper.

Governor Bailey. Didn't the evidence show that they never lost title to that paper until they actually got the money? Didn't they have that kind of an agreement?

Mr. Baker. There is a statement of that kind in the opinion of the Circuit Court of Appeals, or something that looks in that direction in the evidence; but it is also in evidence in that case that the Grimm Alfalfa Association knew that that paper was going to the bank for discount and had done nothing to put the Federal Reserve Bank on notice that they had any claim to the paper.

Governor Young. From a practical standpoint, as I said before, in our district the offsets are few and far between, because the borrowers as a rule are not heavy depositors. What we do is to just get it paid down to the offset, get the money and turn the balance of it back

to the receiver, in cases where we are not going to get it paid out in full. Where we think we have the right to collect from the banker, which may involve a hundred dollars or two hundred dollars, and it is a question of paying an attorney a thousand dollars to collect the \$200, we just forget it and keep on forgetting it.

Governor Crissinger. That is rather hard on the attorneys.

Mr. Baker. Yes, but it is good for the bank.

Governor Harding. With regard to the Grimm Alfalfa case, suppose instead of drafts that they had made their fifteen day note and put the drafts up as collateral for the note; then the note with drafts attached was sent to the Federal Reserve Bank. The bank could have collected the draft just the same, and it seems to me that they would have been barred from making the plea that the Federal Reserve Bank had discounted a note of an institution that they knew was insolvent. They could not have said that the bank was on notice that this was their property.

Mr. Baker. Why not? In the case as you put it they deposited the draft as collateral security.

Governor Harding. But if they made their fifteen-day

note to the Stanrod Bank, which discounted the note and gave them credit for the proceeds, and put up as collateral the drafts, then they would send the note with drafts attached to the Salt Lake City branch of the Reserve Bank of San Francisco, the Salt Lake City bank would give the Stanrod Bank credit for the proceeds of the note, and then proceed to collect the collateral.

Mr. Baker. How would the Stanrod Bank get title to that collateral with the reserve bank?

Governor Harding. When they discounted the note to which the drafts were attached as collateral.

Mr. Baker. Then the Grimm Alfalfa Association note is itself discounted with the Federal Reserve Bank?

Governor Harding. Yes.

Mr. Baker. And carries the collateral with it.

Governor Seay. The note of the member bank is discounted for the member bank and carries the assignment of the Grimm-Alfalfa Association.

Governor Harding. Instead of putting the draft up they get the Stanrod Bank to take their note for fifteen days.

Governor Bailey. The Court went so far as to say that the Stanrod Bank was not rich enough to loan \$30,000.

Mr. Baker. I think implication of knowledge in that case is very remote. The Circuit Court of Appeals says that the Federal Reserve Bank had knowledge of the fact that the Stanrod Bank could not have paid the note because it didn't have money enough to pay it, and I think that is going pretty far.

Governor Bailey. Ordinarily if notes of that kind come to our bank we give them credit, if they have drafts attached of that kind, but we don't pass the money over.

Mr. Baker. The case which Governor Harding has put I have not gotten straight in my head. The Grimm Alfalfa Association makes its own note for \$30,000?

Governor Harding. Yes.

Mr. Baker. And discounts that with the Stanrod Bank.

Governor Harding. Yes. It takes credit for it and secures that note with these drafts.

Mr. Baker. What relation does the Stanrod Bank have to the Federal Reserve Bank of San Francisco?

Governor Harding. The Stanrod Bank would send that collateral note ---

Mr. Baker. With the collateral, the note and the collateral?



Governor Harding. Yes, to the Federal Reserve Bank, which would immediately put that collateral in process of collection, and when they collected the collateral they would pay off the note.

Mr. Baker. I don't quite see that the fact that it was the note of the Grimm Alfalfa Association which was discounted would make it any different from the draft of an outside party, because the note is a collectable note; the Grimm Alfalfa Association would have to pay that note unless it was paid out of the collateral. I do not see that it would make any substantial difference whether it is a note or whether it was a draft endorsed by it. There may be something practical that I have missed in it, but I do not see that it would be different.

Governor Harding. Suppose it had been a case of bonds; that they had the bonds in the bank for safekeeping, the bank had sent the bonds to the Reserve Bank and borrowed money and sold the bonds to the Reserve Bank? Then the man could say "Those are not the property of the bank; those are my bonds. I had them there for safekeeping and they had no authority to negotiate them." But if that man has gone ahead and made a note and put the bonds up as

collateral back of the note, he certainly would be barred from showing that the bank had made any improper use of the bonds.

Mr. Baker. Yes, I think he would be barred from that. That is not quite the question, Governor Harding. The question that faces us is the relation between the first bank of discount and the customer. Now if those relations are fraudulent and the Federal Reserve Bank has knowledge of the fraud, then that transaction is a thing that becomes infirm. If I go to a bank and give my note for \$30,000 and deposit Government bonds to secure that note; they discount it and place to my credit \$30,000 and fail the next day, and knew at the time that I put my note in there and they put that \$30,000 to my credit as a depositor that they were going to fail, and that they were insolvent, that is certainly fraud.

Governor Harding. I can see where you might raise the question that the bank had deprived you of your right of offset.

Governor Crissinger. It goes further than that. It goes to a question of fraud, to the condition that nothing ever passed.

Mr. Baker. Nothing ever passed. What they are entitled to have back is their note and their bond and have the deposit cancelled as though it had never been made. If that note and those bonds had gotten into the hands of the Federal Reserve Bank with notice of fraud, then they are entitled to come back from the Federal Reserve Bank; and if the Federal Reserve Bank, with knowledge of the fraud, has disposed of those bonds and changed that situation, they are liable to make good out of their own funds what is due to the depositor by reason of their knowledge of and participation in the original fraud. That is the way the proposition works out.

Mr. Miller. What is going to happen in the Grimm Alfalfa case? Is it going to be appealed?

Mr. Baker. We tried to get the Supreme Court of the United States to take it in. Governor Calkins did not think they would. I think I told Governor Calkins I thought we had a fifty-fifty chance -- that we had better than a fifty-fifty chance to get it in and a fifty-fifty chance to reverse it after we got it in.

Mr. Miller. On what grounds did they refuse?

Mr. Baker. They never assign grounds when they decline a writ of certiorari. My best judgment is that they took the statement, as contained in the opinion of the Circuit Court of Appeals, that the verdict of the jury was taken as a special finding of fact, and they took that statement of fact as being some evidence and let it go on the question of fact.

Governor Crissinger. Is there anything else that you want to bring up at this meeting? If not it is about time to adjourn for lunch.

(Whereupon, at 12:50 o'clock p.m., the Conference recessed until 2:30 o'clock p.m. of the same day,) the members of the Federal Reserve Board and Mr. Baker retiring from the conference room.)

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