

The Papers of Charles Hamlin (mss24661)

359_04_001-

Hamlin, Charles S., Scrap Book – Volume 159, FRBoard Members

205.001 - Hamlin Charles S

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date June 26, 1941

To Files

Subject: _____

From Mr. Coe

After correspondence with Mrs. Hamlin (see letters of May 25 and June 4, 1941) the items attached hereto and listed below, because of their possible confidential character, were taken from volume 159 of Mr. Hamlin's scrap book and placed in the Board's files:

VOLUME 159

- Page 9 - Letter from F.R. Agent Hoxton to Mr. Hamlin enclosing chart showing for the member banks of District the ratio of various expense items to gross earnings.
- Page 53 - Earnings and Expenses of the F.R. Banks - March 1926.
- Page 57 - Report with Appendices Concerning the F.R. Pension Bill.
- Page 58 - Memo from Mr. Smead to Mr. Hamlin re nonmember banks eligible for membership in the F.R. System on basis of capital stock requirements.
- Page 67 - (X-4507) Re Letters to Committee on Banking and Currency re Legislation.
- Page 68 - Memo from Mr. Smead to Mr. Hamlin re System's holdings of U.S. securities.
- Page 69 - Proposals by Professor O.M.W. Sprague for the Consideration of the Advisory Committee.
- Page 71 - Memo to accompany report of F.R. Agents Committee on Member Bank Reserves.
- Page 75 - Report of Federal Reserve Agents Committee on Member Bank Reserves to the Federal Reserve Board.
- Page 77 - Bank and Demand Deposits (Index for 48 Banks in F.R. Dist. 1).
- Page 80 - Comparison of Capital, surplus, Deposits and Resources of Member and of Eligible Nonmember Banks.
- Page 83 - (X-4212) Article in the Commercial and Financial Chronicle re "Imperfect working of F.R. System - over-saturating credit and currency".
- Page 84 - Member Banks Borrowing Continuously in excess of capital and surplus during March 1926.
- Page 87 - Letter from Mr. Smead to Mr. Hamlin enclosing -
1. Statement showing the combined capital and surplus of the European central banks including Great Britain compared with the Federal Reserve System.
 2. Statement showing amount of notes outstanding of the F.R. Banks and of the various central banks of Europe.
 3. Statement showing the capital and surplus combined and the deposits of all the commercial banks in the U.S. compared with corresponding figures for Great Britain.
- Page 91 - Average amount of "Float" carried by the F.R. Banks on weekly statement dates during March 1926.

To: The Files

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- Page 95 - Letter to Mr. Hamlin from E.R. Kenzel re F.R. Pension Bill.
- Page 97 - (X-4314) McFadden Bill to Revise F.R. Act.
- Page 99 - Memo from Mr. Goldenweiser to Mr. Hamlin re Prices, Currency and the Reserve Banks.
- Page 107 - Limits of Expansion of Bank Credit in Relation to Member Bank Reserves.
- Page 114 - Statistical data on F.R. Banks.
- Page 116 - Memo to Mr. Hamlin from Mr. Goldenweiser re distribution of paper pledged with the F.R. Agent of New York as collateral for F.R. notes.
- Page 131 - Memo from Mr. Goldenweiser to Mr. Hamlin re total volume of member bank reserve deposits against net demand deposits of all member banks.
- Page 150 - Memo from Mr. Smead to Mr. Hamlin re amount of salaries paid to Governors and F.R. Agents and the total cost of the F.R. Agent's departments as compared with operating departments of the banks.
- Page 151 - Memo to Mr. Hamlin from Mr. Goldenweiser re wage increases of school teachers, etc., with cost of living.
- Page 155 - Memo to Mr. Hamlin from Mr. Goldenweiser re comparative strength of F.R. Banks of New York and Chicago compared with certain European Central banks.

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FEDERAL RESERVE BANK
OF RICHMOND

April 8, 1926.

Hon. Charles S. Hamlin,
Federal Reserve Board,
Washington, D. C.

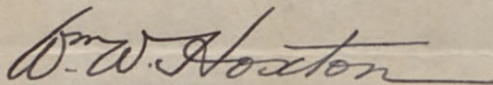
Dear Mr. Hamlin:

I am enclosing you a chart which I have had prepared, showing for the member banks of this district the ratio of various expense items to gross earnings.

This idea, of course, is not original with me, as the Federal Reserve Board has published in the Bulletin a similar chart for each district. My work has been to divide the chart of this district so as to cover seven typical banks of different sizes. This will enable each member bank to compare his own situation with that of the average in his particular group.

The chart has been supplied for distribution at our stockholders' meeting, it being my idea to furnish at every meeting of the stockholders some data with respect to the member banks' own business, which they may find informative and understandable.

Very truly yours,



Wm. W. Hoxton
Federal Reserve Agent

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ANALYSIS OF AVERAGE EXPENSES AND PROFITS

OF

MEMBER BANKS -- FIFTH FEDERAL RESERVE DISTRICT

CALENDAR YEAR 1925

PREPARED BY

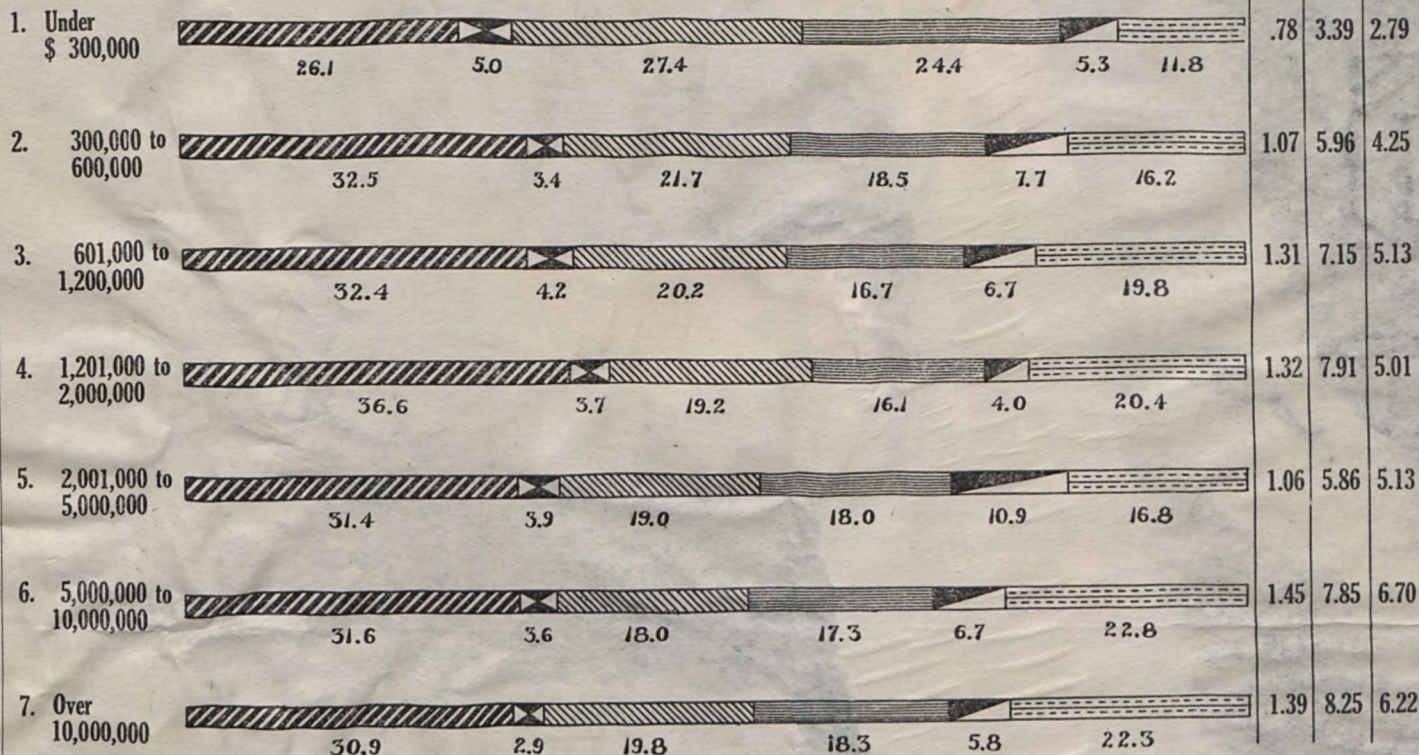
FEDERAL RESERVE BANK OF RICHMOND

GROUPS

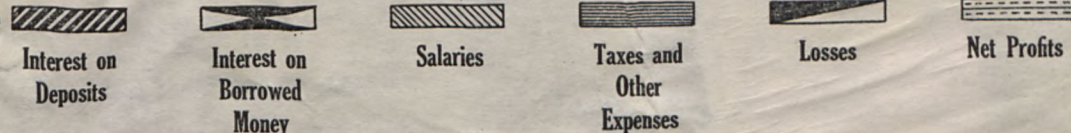
According to
Amount of
Loans and
Investments

PER CENT OF GROSS EARNINGS

Net Profits to Earning Assets
 Net Profits to Capital,
 Surplus and Undivided Profits
 Dividends Paid to Capital,
 Surplus and Undivided Profits



LEGEND



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EARNINGS AND EXPENSES OF FEDERAL RESERVE BANKS

St. 4916

Federal Reserve Bank	Month of March 1926				March 1926			Year 1926			
	Earnings				Current expenses	Current net earnings	Annual rate of current net earnings on average paid-in capital	Current net earnings to Mar. 31	Dividends accrued to Mar. 31	Balance available for depreciation allowances, surplus, franchise tax, etc.	
	From dis-counted bills	From pur-chased bills and U. S. securities	From other sources	Total						On Mar. 31	On Feb. 27
Boston	\$124,226	\$155,191	\$8,569	\$287,986	\$163,216	\$124,770	16.8	\$478,442	\$129,865	\$348,577	\$268,993
New York	477,759	384,612	21,502	883,873	530,002	353,871	12.3	987,258	499,624	487,634	302,956
Philadelphia	203,586	110,255	15,252	329,093	188,387	140,706	13.9	384,125	176,478	207,647	126,572
Cleveland	192,285	157,498	13,941	363,724	212,030	151,694	13.3	373,613	199,497	174,116	89,721
Richmond	147,978	47,015	22,031	217,024	117,764	99,260	19.4	205,239	90,342	114,897	45,820
Atlanta	140,297	100,601	6,765	247,663	113,035	134,628	32.3	453,343	72,198	381,145	271,047
Chicago	256,517	236,700	29,515	522,732	319,862	202,870	14.8	587,539	239,161	348,378	226,361
St. Louis	88,693	114,881	4,209	207,783	118,567	89,216	20.4	263,951	77,010	186,941	123,470
Minneapolis	22,759	76,860	9,989	109,608	88,639	20,969	7.8	44,961	47,518	*2,557	*7,194
Kansas City	59,453	143,482	23,575	226,510	138,243	88,267	24.5	245,415	63,581	181,834	114,747
Dallas	22,566	131,710	5,354	159,630	96,204	63,426	17.4	228,753	64,138	164,615	122,630
San Francisco	170,791	200,842	8,164	379,797	199,928	179,869	25.7	416,222	123,619	292,603	154,003
TOTAL:											
Mar. 1926	1,906,910	1,859,647	168,866	3,935,423	2,285,877	1,649,546	16.2	4,668,861	1,783,031	2,885,830	1,839,126
Feb. 1926	1,606,528	1,789,742	142,585	3,538,855	2,219,960	1,318,895	14.5				
Mar. 1925	1,197,272	1,894,870	126,417	3,218,559	2,345,594	872,965	9.0	2,150,025	1,696,154	453,871	154,624

FEDERAL RESERVE BOARD

DIVISION OF BANK OPERATIONS

APRIL 10, 1926.

*Deficit.

EARNINGS AND EXPENSES OF THE F.R. BANKS - MARCH 1926.

Total earnings of the Federal reserve banks during March 1926 were \$3,935,000, an increase of \$700,000 over the corresponding month last year, practically all of the increase being in earnings from discounted bills. Total earnings during the first three months of this year were more than \$2,200,000 in excess of earnings during the first quarter of 1925.

Current expenses during the first quarter of 1926 were \$290,000 less than during the corresponding quarter last year, \$40,000 of which represented the reduced cost of currency, and \$250,000 the decrease in operating expenses. Eight of the Federal reserve banks show substantial reductions in operating expenses during the first quarter of this year as compared with the corresponding quarter of last year, while Boston, Philadelphia, Atlanta, and St. Louis show increased expenses. Salaries of officers, clerical staff and other employees, the cost of Federal reserve currency, and other current expenses for the first quarter of 1926 and 1925 were as follows:

	1926	1925	Increase or decrease
Salaries, officers	\$611,217	\$612,345	- 1,128
Salaries, clerical staff	2,961,397	3,158,151	-196,754
Salaries, all other	638,021	636,172	+ 1,849
Cost of F.R. currency	432,405	471,862	- 39,457
Other current expenses	2,148,330	2,204,213	- 55,883
Total	6,791,370	7,082,743	-291,373

As a result of increased earnings and reduced expenses, current net earnings of the Federal reserve banks at the end of March amounted to \$4,669,000 as against \$2,150,000 at the end of March 1925. All of the Federal reserve banks except Minneapolis have earnings substantially in excess of expense and dividend requirements. Earnings of the Minneapolis Federal reserve bank on March 31 were \$2,557 less than expense and dividend requirements for the first quarter. It is understood that the Open Market Investment Committee transferred \$10,000,000 of acceptances to the Minneapolis bank on April 12, which will no doubt result in a substantial increase in that bank's earnings.

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Report with Appendices
Concerning the
Federal Reserve Pension Bill

This bill is to permit the Federal Reserve Banks and their staffs to unite in establishing and operating a pension system. The bill confers the authority in the form of creating a separate corporation, thus making it possible to maintain a segregation of the pension finances from the operations of the banks.

The plan which it is proposed to establish under the authority granted by this bill is to be maintained on the actuarial reserve basis so that at all times the pension corporation will be in a self-liquidating condition and in a position to meet all obligations without the necessity of an assessment against either the Federal Reserve Banks or their employees.

The bill and also the plan for the operation of the fund appear to have been prepared with care and are designed to permit of the operation of a pension plan which will be prudent without being meagre and reasonably adequate without being extravagant. The plan is obviously equitable as between the banks and the employees. It provides by its terms that the banks shall not be permitted to contribute to the support of the plan a sum greater than the total contributions of the employees with interest.

The entire plan is obviously designed to provide the benefits which may be reasonably expected from such a plan, both to the employees and to the banks.

The following discussion deals with the matter under three heads:

1. The general principles of the bill and of pension plans,
2. The detailed provisions of the bill,
3. A description of the pension system which it is proposed to set up under the authority of this bill.

1. The General Principles of the Bill and of Pension Plans:

The desirability of providing for the orderly retirement of superannuated employees through a formal pension plan is becoming more and more

recognized in large industrial, commercial and financial organizations. A very considerable number of the larger banks in the United States already have pension systems.

These pension plans are not, generally speaking, established because of philanthropic motives, even though in many cases the entire cost of the pension is borne by the employer, but, on the contrary, they are generally established because it is recognized that unless there is a formal plan providing for the retirement of the superannuated, there inevitably comes into being an informal and at times involuntary system of pensions under which many employees are kept in the service and on the payroll long past the period of their usefulness. This condition exists because there are few instances where a corporation will turn adrift at the age of 65 or 70 an employee who has rendered 20 or 40 or possibly 50 years of faithful service, at a salary which would have made it difficult for him to have saved an amount necessary to provide for old age. Furthermore, in all such cases there is, in addition to the direct loss, a further loss due to the general inefficiency of the organization and the inability to promote younger men to positions of responsibility.

With a formal pension plan, on the contrary, provision is made during the entire period of employment for the accumulation of such a sum as will, at the age of retirement, be sufficient to provide a pension, and such accumulation is generally in part provided by the employee. In the case of the particular plan under discussion, at least half of this cost will in the aggregate be provided by the employees.

The Federal Reserve Banks are in substantial competition for their personnel with the other banks of the communities where they are located. Other banking establishments are able frequently to offer financial rewards above the

salary paid. Officers can be stockholders and share in the bank's prosperity, often they are helped to do so. Employees receive bonuses in favorable years. The officers and employees of the Federal Reserve Banks can receive no financial advantages beyond the salary paid. It is highly desirable that the reserve banks should be enabled to secure and retain the services of competent officers and employees and that they should not merely act as training schools from which all of the more competent would graduate into more attractive service elsewhere. One of the largest problems in business administration is the turnover. Every time a trained officer or employee transfers himself from the service of one corporation to another, the corporation he leaves suffers a loss. It loses the experience he has built up in the course of his years of employment. It must train some other person in the duties he had already learned. Training is costly and the cost of losing large numbers of the right kind of men just when their training has reached the point where they become exceptionally efficient, can easily exceed the cost of a well organized pension system.

The purposes of the Federal Reserve Banks in establishing a pension system may be briefly stated as follows, none of which it will be noted is in any sense philanthropic.

1. To attract the most desirable class of personnel,
2. To create conditions of employment which will reduce to the minimum the turnover of the more desirable employees,
3. To improve the morale of the staff through providing, so far as it be feasible, a feeling of security with respect to the future and of confidence against the great unpreventable hazards of life,
4. To provide a means whereby the banks may fulfill their duty to their employees and to society in general through a pension plan for superannuated employees,
5. To accomplish all of the foregoing with the greatest possible efficiency and the minimum of expense through the establishment of a plan under which the employees themselves will contribute approximately one-half of the amount necessary to support it.

The following is a detailed analysis of the provisions of the bill.

2. The Detailed Provisions of the Bill.

The details of the proposed statute are important and deserve careful consideration. They seem such as are necessary and proper to carry out its general purpose. The following is an analysis of them.

Section 1. The incorporators are the Governor of the Federal Reserve Board and the Governors of the Federal Reserve Banks. The enabling authority is given in the form generally used by the most careful legislative charters to pension funds, such as those to the Carnegie Foundation, the Church Pension Fund and others. The purpose of the fund is stated as being to provide pensions or other forms of support for officers and employees of the Federal Reserve Banks, the Federal Reserve Board and the Federal Reserve Agents and their dependents on such terms and conditions as the corporation may from time to time approve and adopt. It also provides that the pension corporation may provide pensions for its officers and employees and their dependents. It is expressly prohibited from providing a pension or other form of support for any member of the Federal Reserve Board or for any persons other than those described. It also provides that the corporation may, if it seems desirable, extend the provisions of the plan to include member banks and their officers and employees under conditions hereinafter referred to under Section 5.

Section 2. The usual powers of a corporation are conferred.

The trustees are constituted as follows: One by the Federal Reserve Board, one by the board of directors of each Federal Reserve Bank, thirteen in all; one by the employees of the Federal Reserve Board, one by the employees of each Federal Reserve Bank, thirteen in all; the total number of trustees to be thus twenty-six.

Section 3. The corporation shall be without capital stock and shall be conducted without profit.

It shall be exempt from all taxation, except taxes on real estate, and such taxation as may be imposed by Congress.

The plan of pensions, or any substantial modification thereof, must be approved in writing by the Federal Reserve Board before it shall go into operation.

The corporation shall render an annual report to the Federal Reserve Board, as prescribed by it, and may be examined by that Board.

Section 4. The pension system shall be conducted on the contributory principle and it is expressly provided that the total contributions to be made by the Federal Reserve Banks and the Federal Reserve Board shall not in the aggregate exceed the total contributions to be made by the said officers and employees with interest.

Section 5. The corporation may, with the express approval of the Federal Reserve Board, open the pension system to member banks of the Federal Reserve System, upon terms to be laid down by it and approved by the Federal Reserve Board.

Section 6. The power of amendment and repeal is expressly reserved.

Section 7. The act is to become immediately operative.

There seems to be no good reason why Congress should not authorize the Federal Reserve Banks to establish this fund; indeed for the reasons already stated it would seem to be the duty of Congress to do so. It should also be remembered that Congress has itself already approved of the principle of pensions by establishing under the act of May 22, 1920, a retirement system for the employees of the classified civil service, and a pension system for the diplomatic and consular service under the act of May 24, 1924, for reorganizing and improving

the foreign service of the United States.

In an appendix will be found a discussion of the provisions of the plan which it is proposed to establish under the authority conferred by this bill and also a comparison of this plan with the retirement systems referred to above which have already been authorized and established by Congress. This appendix has been prepared by Mr. Monell Sayre, vice president of the Church Pension Fund of the Episcopal Church. He has had wide experience in the pension field and served as pension adviser to the committee representing the Federal Reserve Banks in the preparation of this plan and he is, therefore, thoroughly familiar not only with the theory and practice of pension plans in general, but with the proposed plan in particular.

APPENDIX

3. Description of the Pension Plan Which it is Proposed to Set up under the Authority of this Bill.

This pension system was prepared after a thorough discussion and a most exhaustive examination of pension literature and the organization and working of existing pension funds by the Committee on Pensions of the Governors Conference with the Federal Reserve Board, assisted by expert actuarial and pension advisers and by counsel. It has been approved by the Governors Conference and by the board of directors of each one of the twelve Federal Reserve Banks.

There are three great hazards which beset all human life and which are not within the sphere of preventability. When any of them happen great economic suffering may result unless there has been forethought. These hazards are:

- a. - Death
- b. - Old age
- c. - Permanent disability

The first two are an alternative which is certain to happen. The last does happen in a certain percentage of lives. It may be said to be the function of pensions to cover one or all of these hazards. The core of every pension system is the protection against the second, the hazard of old age. All pension systems have that in some form. There are a great number of pension plans in operation and hardly any two of them are alike in every respect. Some plans attempt to provide a pension for all of the dependents of the employee; others only to a widow or to a widow and minor orphans, and others only to the employee. Very careful consideration was given to all of these points with a view to providing a plan which would be economically sound and which would reasonably provide against the hazards which it was designed to meet, with the result that it was decided that the proposed plan should provide three benefits:

- 1. - An old age allowance
- 2. - An allowance for total and permanent disability
- 3. - A death benefit

There are two general methods by means of pensions of granting protection against the hazards of life.

One method is to promise the stipulated pension and to be satisfied if the money is in hand to pay it as it becomes due. This is known as the cash disbursement method. It may be reasonably satisfactory for a Government with its unlimited resources, although even then it might be better to know accurately to what extent the Government is committed, but with respect to all other organizations than the Government, this method has obvious disadvantages, both to the employer and the employees.

Under such a plan the contributions made by present employees, if the plan be a contributory one, are used for the payment of pensions to those already retired. For a few years all goes well, but the cost of the annual pension bill continues to grow and gradually its figures mount up to startling totals, until it is realized that staggering liabilities have been created and that the money which has been contributed by present employees to provide for their pensions has been used up in paying the pensions of those already retired, and that the employing corporation is faced with the necessity of either dipping deep into its own pocket or repudiating its promises to its employees.

There are several classic examples of this. The Government of New South Wales at the beginning of the Twentieth Century found the pension fund for the Government employees to have arrived at the point where there was literally not a penny in the pension treasury. The Carnegie Foundation, although endowed by Mr. Andrew Carnegie with the large sum of \$15,000,000, for the comparatively small class of professors in American colleges of a selected type, found itself at the end of ten years where it required a great additional sum and also was forced to undergo a drastic reorganization. The municipal pension funds of New York City were found, during Mayor Mitchell's administra-

tion by a scientific investigation inaugurated by him, to have a total liability above their assets of approximately \$315,000,000.

The other method is to accumulate the pension before it is due. This is known as the actuarial reserve method and is the one generally followed by all sound plans. Under it during the entire period of the employees service there is being paid either by himself or his employer or both, into the fund such contributions as will enable the pensioning authorities to have in hand when the contingency happens on which the pension is to become available, the actuarial equivalent of what is needed to pay it during all of its continuance.

There are numerous obvious advantages to such a plan:

1. It is absolutely reliable, provided, of course, that scientific methods have been used. When the employee becomes old enough to retire there is money in the treasury to pay the pension. The pension fund is solvent at all times and if necessary could be liquidated at any time.

2. It makes use of the power of interest. The relatively small payments made for a considerable period of years, together with the interest thereon, provide the funds necessary for the payment of the pension. In the average case, the pension paid will more largely represent the interest accumulations than the actual contributions.

3. This method provides its own automatic check against extravagant demands for pensions or ill considered promises. The danger of this in the cash disbursement method is great for nothing has the power to deceive like the cost of pensions. A mere technical change in the method of calculating the pensions, a reduction of only a few years in the required length of service, a slight lowering of the age of retirement, these would all seem of slight consequence if the cost were not carefully calculated on the actuarial reserve

basis. If every time employees are tempted to ask these little changes, they are necessarily also informed of the increased yearly cost to themselves, nothing of such a serious nature would be done thoughtlessly. In the actuarial reserve method the slightest variation in the rules is immediately reflected in the rates of contribution.

For these reasons the proposed pension system of the Federal Reserve Banks will operate on the actuarial reserve basis.

The following is a brief outline of the benefits and the method of determination of each.

BENEFITS

1. The Age Allowance

The age allowance can be claimed at age 65. At age 70 it is compulsory. The amount of the age allowance will be 1 1/2% of the average salary during the entire period of service, multiplied by the number of years of service. The advantage of average salary as the basis of calculation is great. It stabilizes all of the calculations and prevents violent changes in salary near the end of service from operating either to the disadvantage of the pension fund or of the employee.

2. Allowance for Total and Permanent Disability

This attaches after one year of service in the case of employees who have been subject to medical examination upon employment, or after five years in the case of the employee who was not subject to medical examination upon employment, and is granted upon the action of a medical department to be created by the pension fund. The amount of this allowance is 1 1/4% of the average salary, multiplied by the number of years of service, but with the minimum in any event of a calculation of 20 years' service, thus providing a minimum

disability allowance of 25% of average salary, except that if the age allowance upon retirement at age 65 would have been less than 25% of average salary, then the disability allowance shall be the same as the age allowance would have been. The purpose of this minimum of 25% is to provide such a sum as will be reasonably effective in the case of disability during the earlier years of service. Experience has shown that the two principal causes of total and permanent disability soon after entrance into the service are tuberculosis and insanity; except in a few such cases the period of disability is comparatively short.

3. The Death Benefit

This is one year's salary at the rate of salary being paid at the time of death and is paid only in the case of employees in active service at the time of death, i. e., not yet retired on a pension. A pension system does not perform its purpose unless there is some provision for the family. In a pension plan which makes no such provision there is always grave dissatisfaction on the part of those who place their family obligations ahead of the necessity of providing for themselves, yet the adjunct for provision for dependents no matter how arranged, will cause equal dissatisfaction. In a body of many thousands of employees there will be innumerable varieties of obligations to dependents; aged parents, a sister housekeeper, nephews or nieces who look to the employee as the sole support, even more remote relations or kinsfolk whose claim may be present in a moral sense. To include all possible cases in a financial system would be an intolerable financial burden, yet wherever the line is drawn there will be circumstances which will constitute a valid claim that it should be drawn elsewhere. It is doubtful if any pension system which has included any other than the pensioner himself has worked satisfactorily. Nevertheless there remains a need for some recognition of the claim of

dependents. A year's salary enables the family somewhat to adjust itself to the altered circumstances caused by the salary earner's death and relieves immediate necessity. It does not add too greatly to the cost. When to this is added the return of contributions made by the employee himself with interest thereon a reasonable compromise seems to be made in a difficult problem. For an employee of long service this return will be a considerable provision in itself.

VESTING OF CONTRIBUTIONS

The opinion is largely reflected in modern pension practice that where individuals themselves contribute to a pension system they or their estates should receive back the full amount of their contributions with interest, otherwise the pension system becomes a tontine arrangement for the benefit of the employees who survive. This is especially marked if the pension system contains no extension of pensions to dependents. Therefore, it is here provided that in the event of death, resignation or dismissal, the officer or employee or his estate shall receive back all that he has contributed with interest. If the officer or employee retires upon a pension and the amount of the pension he had drawn up to the time of his death does not equal the amount of his contributions with interest and the amount of the contributions of the bank on his behalf with interest, his estate or designated beneficiary shall receive the balance. This latter may be regarded as in lieu of the death benefit that would have been paid had the employee died in active service.

MAXIMUM BENEFITS

No contributions and no benefits are to be paid with respect to that part of any salary which is in excess of \$18,000 per annum. It is a grave mistake if such a maximum is placed at too low a figure. The retirement of

superannuated officers who have received comparatively large salaries is even more important than the retirement of the average class of employees whose duties may more easily be delegated or shifted, and experience shows that the retirement of higher officials is materially hastened or retarded accordingly as there is a pension provision reasonably apportioned to their salaries. The cost to an employer of contributing toward a few such cases is negligible. The overwhelming portion of pension costs is the average pension.

Under this limitation there would be very few pensions of more than \$2,000 per annum and probably none as much as \$6,000. Few things are more unwise than the sentimental considerations which, while permitting those in the average position to retire when superannuation impairs their efficiency, throw obstacles in the way of the elimination of those who in positions of authority when their faculties are impaired by age, materially diminish the effectiveness of the entire organization.

CALCULATION OF COST

The calculation of the cost is in terms of percentage of salary according to age of the employee at entrance into the service. This is the scientific method as it takes into consideration precisely the length of time over which the contributions will be made. Of course, this requires that the calculation of the pension also shall be in percentage of salary, so that the contribution required of each individual shall be exactly in proportion to the benefits he receives. The total normal cost of the plan outside of the accrued liabilities will average probably not in excess of 7 1/2 of the payroll.

DIVISION OF COST

As stated in the bill, the banks will be prohibited from contributing more than the aggregate contributions of the employees with interest. The total

contributions to be made, therefore, will be borne by the banks and by the employees approximately equally. On the average the bank share of the normal cost, outside of the accrued liabilities, will approximate 3 1/2% of the payroll.

ACCRUED LIABILITIES

This is one of the great problems which confronts every pension system at its inception. The problem arises from the past service of present employees before the pension fund began to operate. The scope of the problem is the sum of all of the contributions which would have been made by all of the present employees and on their behalf during all of their previous service, with compound interest.

The Federal Reserve Banks are fortunately still comparatively young. When the plan was first projected the accrued liabilities were found to be a little less than \$2,000,000 (as of October 1, 1920), but they grow rapidly and as of October 1, 1924, they were estimated to be about \$6,000,000. As a general rule the employing corporation bears all of the accrued liabilities. Under the proposed plan the Federal Reserve Banks will be prohibited from paying more than half of these accrued liabilities, the other half must be borne by the existing employees themselves. There are various ways in which this problem may be met but the more practicable one and the one which will probably be adopted, is to amortize the accrued liabilities over all of the remaining years of the existing employees service by making their rates of contribution for those remaining years of service somewhat higher. The banks would have the option of raising their contributions correspondingly or of meeting their portion of the accrued liabilities at the inception of the plan.

CALCULATION OF INTEREST

Interest rates play an important part in any pension plan. To

guarantee any fixed rate might impose, under conditions which conceivably could arise, a severe strain upon the fund finances. Yet to impose a rate arbitrarily might amount to the fund's making a profit upon its individual contributors. A fair and equitable way would seem to be to adopt provisionally those rates which enter into conservative insurance and pensions calculations over extended periods of time with the proviso that once in every five years those rates, so far as the return of contributions are concerned, will be adjusted in accordance with the actual experience of the fund for the preceding quinquennium.

SCOPE OF THE SYSTEM

The proposed pension system will cover every employee entering the service of the Federal Reserve Banks and the Federal Reserve Board after the establishment of the fund. It is obvious that if the banks are to benefit fully from the establishment of the fund, there should be no exceptions with respect to those to be included. Employees already in the service of the banks are to have the option of joining. This option must for obvious reasons be exercised within a reasonable time. It has been fixed at one year. The bill confers the useful power of enabling this pension fund, with the approval of the Federal Reserve Board, to admit member banks on terms which will impose no financial obligation on the Federal Reserve Banks. Very few banks, and all of these are in the great cities, possess sufficient employees to enable them to establish a pension system of their own. It will, therefore, be most useful on equitable terms to give the member banks, especially those in the country and the smaller cities, each with only a handful of employees, the privilege of participating in a pension system. Particularly will this be true in a system which, by its employment of experts, should have a pension plan of

peculiar excellence, but whether this privilege shall be given to the member banks and on what conditions, is left in the discretion of the Federal Reserve Board.

ILLUSTRATIVE TABLE

Following will be found certain tables which may be useful in giving an idea of the plan.

Table I gives the percentage of salary payable as rates of contribution by employees and by the banks, without taking into consideration the accrued liabilities.

Table II shows the relative percentages with the accrued liabilities as they might be amortized over the entire remaining period of employment.

Table III is an illustration of the workings of the plan in an average case, showing the annuity that would be paid after various lengths of service in the case of total disability and also the pension that would be paid upon retirement either at age 65 or 70.

Table 1

Percentage of Salary Payable as Rates of Contribution
by Employees and by Banks, without taking into
Consideration the Accrued Liabilities.

Age at Entrance	Payable by Male Employees	Payable by Female Employees	Payable by Banks for Male Employees	Payable by Banks for Female Employees
21	3.36	3.34	3.02	2.96
22	3.42	3.42	3.09	3.04
23	3.48	3.50	3.18	3.14
24	3.54	3.58	3.27	3.27
25	3.60	3.66	3.36	3.40
26	3.66	3.74	3.45	3.53
27	3.73	3.82	3.54	3.66
28	3.80	3.90	3.65	3.79
29	3.87	3.99	3.77	3.92
30	3.94	4.08	3.89	4.06
31	4.01	4.17	4.01	4.21
32	4.09	4.26	4.13	4.37
33	4.17	4.36	4.26	4.53
34	4.25	4.46	4.39	4.70
35	4.33	4.56	4.53	4.89
36	4.42	4.66	4.69	5.08
37	4.51	4.76	4.86	5.28
38	4.60	4.87	5.04	5.49
39	4.69	4.98	5.23	5.73
40	4.78	5.09	5.43	6.01
41	4.87	5.20	5.65	6.31
42	4.97	5.31	5.88	6.66
43	5.07	5.42	6.12	7.04
44	5.18	5.54	6.38	7.46
45	5.29	5.66	6.64	7.91
46	5.40	5.78	6.94	8.43
47	5.51	5.90	7.26	9.01
48	5.62	6.03	7.60	9.58
49	5.74	6.16	7.93	10.02
50	5.86	6.29	8.28	10.36
51	5.98	6.42	8.54	10.64
52	6.10	6.56	8.79	10.92
53	6.23	6.70	9.04	11.17
54	6.36	6.84	9.28	11.42
55	6.49	6.98	9.52	11.67
56	6.62	7.12	9.82	11.91
57	6.75	7.27	10.13	12.10
58	6.89	7.42	10.50	12.23
59	7.03	7.57	10.90	12.28
60	7.17	7.73	11.33	12.24
61	7.31	7.89	11.82	12.34
62	7.46	8.05	12.47	12.59
63	7.61	8.21	12.48	13.02
64	7.76	8.37	14.86	13.62

Table II.

Percentage of Salary Payable as Rates of Contribution
by Employees and by Banks taking into Consideration
Service Rendered prior to the Establishment of the
Pension System.

Age at Entrance Into Retirement Fund	SERVICE RENDERED PRIOR TO ENTRANCE INTO RETIREMENT SYSTEM					
	0 Years	2 Years	4 Years	6 Years	8 Years	10 Years
	%	%	%	%	%	%
	<u>M E N</u>					
21	4.03					
25	4.28	4.38	4.47			
30	4.64	4.78	4.93	5.08	5.16	
35	5.05	5.27	5.48	5.68	5.85	6.01
40	5.52	5.84	6.15	6.44	6.73	6.98
45	6.05	6.54	7.00	7.44	7.86	8.26
50	6.65	7.40	8.12	8.82	9.50	10.00
55	7.31	8.60	9.84	10.00	10.00	10.00
60	8.03	10.00	10.00	10.00	10.00	10.00
64	8.65	10.00	10.00	10.00	10.00	10.00
	<u>W O M E N</u>					
21	4.01					
25	4.34	4.49	4.64			
30	4.78	4.99	5.19	5.38	5.56	
35	5.29	5.57	5.85	6.13	6.39	6.64
40	5.84	6.23	6.62	7.01	7.38	7.74
45	6.44	7.00	7.55	8.09	8.63	9.15
50	7.10	7.94	8.77	9.58	10.00	10.00
55	7.83	9.25	10.00	10.00	10.00	10.00
60	8.62	10.00	10.00	10.00	10.00	10.00
64	9.29	10.00	10.00	10.00	10.00	10.00

TABLE III.

ILLUSTRATION OF AVERAGE WORKING OF PENSION PLAN

at age 25

The following schedule gives an illustration of the average working of the Pension Plan in the case of a male employee engaged at age 25, when he can immediately avail himself of the advantages of the Pension Plan.

It is believed that the vast majority of employees will be engaged at an age younger than 25.

The employee's contribution rate at age 25 is 3.60%. The Bank's contribution rate is 3.36%, covering service pension, disability pension, and death benefit.

<u>After service for</u>	<u>Average year's salary for age attained</u>	<u>Employee's payments to fund accumulated with 4% interest</u>	<u>Payment to Beneficiary on death in service, viz: 1 year's salary and return of own contributions</u>	<u>Annuity in event of total disability in service</u>	<u>Pension on Retirement</u>
0 yrs.	\$1,440	0	\$ 1,440	0	
10 "	2,140	\$ 784	2,924	\$ 442	
20 "	2,660	2,226	4,886	519	
30 "	3,040	4,566	7,606	874	
40 "	3,340	8,184	11,524	1,272	\$1,526
45 "	3,460	10,644	14,104	- - -	1,780

When an employee enters on his pension the value of the pension vests and the pension is computed on the basis of guaranteeing the return of all the contributions available at the date the pension is entered upon. The following table shows

SUM PAYABLE AT DEATH OF PENSIONER

<u>After</u>	<u>Pensioner entering at 65</u>	<u>Pensioner entering at 70</u>
0 yrs.	\$16,900	\$17,200
5 "	9,270	8,300
10 "	1,640	0
15 "	0	0

APPENDIX

Comparison of
The Proposed Federal Reserve Pension Fund
with
The Civil Service Retirement and Disability Fund
and
The Foreign Service Retirement and Disability System.

BASIS OF SYSTEMS

The Civil Service Fund and the Foreign Service Fund are operated upon the cash disbursement method. That is, the pensions are paid out of the moneys in hand, and if those moneys at any time come to be insufficient to pay the pensions falling due in that year, the United States Treasury is drawn upon. The resources outside of appropriations to be made by Congress are manifestly insufficient of themselves to provide the pensions promised; the time will at length arrive when Congress will be asked to make appropriations from the Treasury. Those appropriations will consist of the difference, in each year, of the amount of the pensions and the total amount of the employees' contributions for that year. Each successive year will make this difference a larger amount, until the amount required from the Treasury will be a very great sum.

The Federal Reserve Pension Fund will operate on the actuarial reserve method. Each year there will be paid into its treasury, by the combined action of the employees and the banks, the exact amount which, placed at compound interest, will in the future pay the pensions arising from the proportion of their entire service given by the employees in that year. Thus there will never be, in any given year, the obligation to pay for services rendered in any other year than that one.

In the cash disbursement method, as illustrated by the two existing funds, all of the pensions, accumulating through a long succession of years,

must be paid with no resource but the contributions of employees due in that year and appropriations by Congress. In the actuarial reserve method, as illustrated by the proposed fund, the money to pay a pension, however long this pension may be payable, is accumulated before the pension is granted. The increase of the pension roll, no matter how high a figure it may attain, imposes no strain on the pension system; the strain has been taken care of during the years of the employee's service.

THE ACCRUED LIABILITIES

No specific provision is made in the Civil Service Fund and the Foreign Service Fund for the accrued liabilities which are nevertheless assumed. These must all be paid out of the public treasury. The accrued liabilities are always, in an old service, tremendous. But they never appear during the very early years, because not enough persons retire at once to equal the contributions of the active employees. These are certain, however, to appear within a limited number of years, and then to mount up progressively to gigantic proportions.

The proposed Federal Reserve Pension Fund will have its accrued liabilities all provided beforehand by the arrangement that the employees at the time the plan goes into operation (the class for whom the accrued liabilities attach), will pay such rates of contribution as will, during their period of service, provide their share (one-half) of such liabilities. The banks will do the same thing for their share (the other half) of the accrued liabilities, or may pay them down at once and forever get rid of them.

DIVISION OF COST

The existing Federal Government pension plans provide for the payment of certain specified contributions by the employees affected. The United States Government pays for the rest of the pensions, be they more or less,

except in the Foreign Service Fund, where the contributions of the Government are not to exceed the total of such by the employees.

The enabling bill before Congress for a pension system in the Federal Reserve Banks specifically provides that the total contributions of the banks cannot exceed the total contributions of the employees with interest.

CONTRIBUTIONS BY EMPLOYEES

In the Civil Service Retirement Fund all employees pay two and a half per cent of their salary. In the Foreign Service Retirement Fund each employee pays five per cent of his salary.

In the proposed Federal Reserve Bank Pension Plan the rates of contribution fixed for the employees are graduated according to age of entrance into the service and are sufficient, together with the contribution to be made by the banks, whose total contributions may not exceed the total contributions made by the employees with interest, to provide the total benefits promised by the plan. The average contribution by the banks for the normal operation of the plan, exclusive of providing for accrued liabilities with respect to present employees, would approximate 3 1/2% of the payroll.

THE BENEFITS

The Age Allowance.

This is available in the Civil Service Fund at either ages 62, 65 or 70, depending upon the class of service. In the Foreign Service Fund the retirement age is 65, and compulsory at 70. In both services there is the requirement of fifteen years of service.

The proposed Federal Reserve Plan fixes the age of retirement as optional at age 65, and compulsory at age 70. No service requirement is made, it being regarded as unnecessary when pensions are proportioned to length of service.

The amount of the pensions in the Civil Service Fund varies according to certain classifications. To employees with thirty or more years of service it may be as high as sixty per cent of the average basic salary during the last ten years of service. If employees have only fifteen years of service it may be as low as thirty per cent of the average basic salary of the last ten years of service.

There is a minimum of \$180 a year and a maximum of \$720 a year.

The pensions in the Foreign Service Fund are figured in the same general way as in the Civil Service. The difference here is that there appears to be no minimum; and the maximum, instead of being \$720 a year, is \$5,400 a year.

Service in tropical or especially unhealthy countries may have an allowance made by which each year of such service counts as a year and a half.

The Federal Reserve Banks will take as the basic computation always the average salary over the entire period of service and never any form of the terminal salary. The method of calculation for every employee is the same, one and one-half per cent of the average salary during the entire period of service, multiplied by the number of years of service. There is no minimum. A maximum is fixed by considering, both for contributions and for pensions, any salary over \$18,000 a year as at that figure. Under this plan there will be very few pensions in excess of \$2,000 per annum and probably none in excess of \$6,000 per annum.

Disability Allowance.

For the Civil Service Fund a disability allowance is provided for any employee totally incapacitated, with the provision that this is not to be available unless he has had fifteen years of service. The amount of the allowance is calculated in the same way as the age allowance. The Foreign Service

Fund has exactly the same provisions.

The Federal Reserve Bank will give a disability allowance in case of total and permanent disability after one year of service in the case of employees who were subject to medical examination upon employment, and after five years of service in the case of those who were not subject to a medical examination. The amount of this allowance is $1\frac{1}{4}\%$ of the average salary, multiplied by the number of years of service, with a minimum in any event of a calculation of twenty years' service, thus providing a minimum disability allowance of 25% of average salary; except that if the age allowance upon retirement at age 65 would have been less than 25% of average salary, then the disability allowance shall be the same as the age allowance would have been.

Death Benefit.

Neither the Civil Service nor the Foreign Service Fund has a distinct death benefit, but of course provides for the return of all of the unused contributions made by the employee, with interest to date of death.

A distinct death benefit is proposed by the Federal Reserve Fund consisting of a year's salary at the rate received at the time of death. Also, all contributions by the employee are returned with interest.

Separation from Service.

The Civil Service Fund returns to an employee resigning or being dismissed all of his contributions with interest at four per cent compounded annually. The Foreign Service Fund, upon the resignation or dismissal of an employee, returns to him seventy-five per cent of the total amount which he has contributed; no interest is allowed.

The proposed Federal Reserve Bank Fund will, to an employee resigning or being dismissed, return all of his contributions with interest.

Vested Interest.

In the event of the death of a pensioner in the Civil Service Fund who has not received in pension the equivalent of his own contributions with interest to date of death, his estate receives the balance. The rule is the same in the Foreign Service Fund.

In the proposed Federal Reserve Bank Fund the total contributions made by the employee and on his behalf will, upon his retirement, vest. If the total subsequent payments made to him as a pension do not equal the amount thus vested, then any excess is to be paid to his estate or a designated beneficiary. No other death benefit is provided in the case of death occurring after retirement on pension.

Office Correspondence

FEDERAL RESERVE
BOARD

Date April 20, 1926.

To Mr. Hamlin

Subject:

From Mr. Smead

2-8406

With reference to your memorandum of April 17, addressed to Mr. Goldenweiser, I wish to state that the latest figures of non-member banks eligible for membership in the Federal Reserve System on the basis of capital stock requirements are as of June 30, 1924. The following table shows the number and resources of such banks on June 30, 1924, the percentage of resources of state member banks to the total resources of all eligible state banks and trust companies, and the percentage of resources of all member banks to the resources of all eligible banks:

	Number of banks	Total resources	
State banks and trust companies:			
Members	1,570	\$13,221,983,000	53%
Eligible nonmembers	13,598	11,585,557,000	47%
Total eligible, member and nonmember	15,168	24,807,540,000	
Ratio of member state banks to total eligible state banks and trust companies	10.4%	53.3%	
All member banks, national and state	9,650	35,777,256,000	
All eligible member and nonmember banks, national and state	23,248	47,362,813,000	
Ratio of all member banks (National and state) to all eligible banks	41.5%	75.5%	

Between June 30, 1924 and December 31, 1925 the resources of member banks have shown a substantial increase as may be seen from the following:

June 30, 1924	\$35,777,256,000
December 31, 1925	41,425,295,000
Increase	5,648,039,000

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See An

FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

X-4507

January 21, 1926.

SUBJECT: Letters to Committee on Banking and Currency
re Legislation.

Dear Sir:

The Federal Reserve Board has recently addressed three letters to the Chairman of the Committee on Banking and Currency of the House of Representatives, copies of which are enclosed for your information, as follows:

- (1) Expressing the Board's views on and recommending certain amendments to H. R. 2, the so-called McFadden Bill;
- (2) Recommending an amendment to Section 13 of the Federal Reserve Act extending the maximum maturity of advances by Federal reserve banks to member banks on their promissory notes when such notes are secured by eligible paper; and
- (3) Recommending the enactment of legislation to prohibit the use of the words "Federal", "Reserve" and "United States" by banking associations, etc.

Very truly yours,

Walter L. Eddy,
Secretary.

(Enclosures)

TO CHAIRMEN AND GOVERNORS OF ALL F. R. BANKS

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(COPY)

X-4500

January 8, 1926.

Honorable Louis T. McFadden, Chairman,
Committee on Banking and Currency,
House of Representatives,
Washington, D. C.

My dear Congressman:

The Federal Reserve Board welcomes the opportunity afforded by the request conveyed in your letter of December 11, 1925, to express its opinion on your Bill, H.R. 2, amending the National Bank Act and the Federal Reserve Act.

The urgent importance of liberalizing the law so as to enable national banks to compete more effectively with State institutions has long been recognized by the Board, and appropriate legislation for this purpose has been under consideration during the last year by a special committee of officers of various Federal reserve banks assisted by the Board's Division of Research and Statistics. The opinions herewith submitted are based in large measure upon the work of this Committee after consultation with the Federal Advisory Council.

Many of the provisions of the bill as introduced are approved without change, but the Board ventures to suggest considerable changes in Section 5200 designed in part to clarify that very complicated section and in part to limit certain somewhat hazardous classes of loans. While strongly in favor of liberalizing the statute, the Board feels also that it is highly desirable to introduce additional safeguards, especially in view of the numerous bank failures in recent years. The Board, therefore, submits a limited number of suggestions with this object in view. They are designed mainly to secure more adequate data regarding the conditions of the banks through examination and it is not believed that they would hamper in any way the conduct of its business by any well managed bank.

SECTIONS APPROVED WITHOUT ANY SUGGESTED CHANGES.

The Board approves the following provisions of H.R. 2 in their present form:

Section 2(a), amending subsection 2 of Section 5135 of the Revised Statutes so as to give national banks indeterminate charters in lieu of charters for a term of 99 years.

Section 2(b), amending subsection 7 of Section 5136 of the Revised Statutes so as to regulate the safe deposit business and the business of buying and selling investment securities when transacted by national banks.

Section 3, amending Section 5137 of the Revised Statutes so as to permit the purchase by national banks of such real estate as shall be necessary for their accommodation in the transaction of their business rather than merely such as may be necessary for their immediate use.

Section 4, amending Section 5138 of the Revised Statutes so as to authorize the chartering of national banks in outlying sections of large cities with a capital of \$100,000.

Section 5, amending Section 5142 of the Revised Statutes so as expressly to authorize national banks to increase their capital by means of stock dividends.

Section 6, amending Section 5150 of the Revised Statutes so as to authorize the board of directors of a national bank to designate a director in lieu of the president to be chairman of the board of directors.

Section 13, amending Section 5208 of the Revised Statutes relating to the certification of checks by officers, directors, agents or employees of Federal reserve banks and member banks of the Federal Reserve System.

Section 14, amending Section 5211 of the Revised Statutes so as to permit reports of condition of national banks to the Comptroller of the Currency to be signed by the vice president or assistant cashier.

Section 15, amending the fourth paragraph of Section 13 of the Federal Reserve Act so as to permit Federal reserve banks to rediscount for member banks the eligible paper of any one borrower in an amount equal to that which may be borrowed lawfully from any national banking association under the terms of Section 5200 of the Revised Statutes as amended.

Section 16, amending Section 22 of the Federal Reserve Act, so as to make thefts by any bank examiner or assistant bank examiner from any member bank of the Federal Reserve System a Federal offense.

REAL ESTATE LOANS.

The Board approves of that portion of Section 17 of your Bill which would amend Section 24 of the Federal Reserve Act so as to broaden the power of national banks to make loans on real estate and increase the aggregate amount of such loans which may be made by any national bank from $33 \frac{1}{3}$ per cent of its time deposits to 50 per cent of the national bank's savings deposits; but the Board is opposed to that portion of this section of the Bill (page 27, lines 4 to 9, inclusive) which would provide that the rate of interest which national banks may pay upon time deposits, savings deposits or other deposits shall not exceed the maximum rate authorized to be paid upon such deposits by State banks or trust companies.

CONSOLIDATION OF NATIONAL BANKS.

Upon consideration of Section 1 of your Bill, which would amend the Consolidation Act of November 7, 1918, by the addition thereto of a new section simplifying the procedure involved in the consolidation of State banks with national banks, the Board voted to approve all of such proposed new section except that portion thereof which relates to branch banking.

SECTION 5200 OF THE REVISED STATUTES.

The Board recommends that the following be substituted for Section 11 of your Bill, which would amend and reenact Section 5200 of the Revised Statutes:

"Sec. 11. That Section 5200 of the Revised Statutes of the United States, as amended, be amended to read as follows:

'Section 5200. The total direct liabilities to any national banking association of any person, firm, company or corporation for money borrowed shall at no time exceed 10 per centum of the amount of the capital stock of such association actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund; and the aggregate liabilities to any national banking association of any person, firm, company or corporation, to wit, the direct liabilities for moneys borrowed and the indirect liabilities as surety, endorser or guarantor, where such surety, drawer, endorser, or guarantor obtains a loan from, or discounts paper with, or sells paper under guarantee to, any such association, shall at no time exceed 25 per centum of the amount of the capital stock of such association actually paid in and unimpaired, and 25 per centum of its unimpaired surplus fund.

'Within the meaning of this section: (a) The liabilities of any company or firm shall include the liabilities of the several members thereof; (b) where the majority of the stock of any corporation is owned by any borrower the liabilities of such corporation as surety, drawer, endorser or guarantor shall be considered part of the aggregate liabilities of such borrower; and (c) all liabilities of the actual borrower on accommodation paper, whether in the form of liabilities as maker, acceptor, surety, drawer, endorser, or guarantor shall be considered direct liabilities within the meaning of this section.

'The limitations prescribed above in the first paragraph of this section shall be subject to the following exceptions:

'(1) Liabilities arising out of the discount or purchase of the following classes of paper shall be subject to no limitation based upon the amount of such capital and surplus except where both the drawer and drawee, or both the maker and payee, are corporations and one of such corporations is affiliated with, or a subsidiary of, the other - i.e., where a majority of the stock of one of such corporations is owned by the other or by the stockholders thereof:

(a) Bills of exchange drawn in good faith against actually existing values.

- (b) Commercial or business paper actually owned by the person, company, corporation, or firm negotiating the same.
- (c) Drafts and bills of exchange secured by shipping documents conveying or securing title to goods shipped.

(2) Liabilities arising out of the discount or purchase of the following classes of paper shall be subject to no limitation based upon the amount of such capital and surplus:

- (a) Demand obligations which are or have been discounted or purchased for the account of the drawer or endorser and which are secured by documents covering commodities in actual process of shipment.
- (b) Bankers' acceptances of the kinds described in section 13 of the Federal Reserve Act.
- (c) Notes secured by not less than a like face amount of bonds, notes, or certificates of indebtedness of the United States.

(3) In addition to the 10 per centum permitted under the first paragraph of this section, liabilities to any national banking association may be incurred in an amount equal to 15 per centum of the paid in and unimpaired capital and 15 per centum of the unimpaired surplus fund of such national banking association, when such liabilities are evidenced by notes secured by shipping documents, warehouse receipts, or other such documents conveying or securing title covering readily marketable nonperishable staples, the actual market value of which is not at any time less than 115 per centum of the face value of such notes, and which are fully covered by insurance if it is customary to insure such staples; but this exception shall not apply to liabilities of any person, corporation, firm or company or the several members thereof arising from the same transactions and secured upon the identical staples for more than six months; Provided, however, That liabilities of this character may be incurred for a period of not more than three months in an additional amount equal to 15 per centum of the paid in and unimpaired capital and 15 per centum of the unimpaired surplus fund of such national banking association, in addition to the 10 per centum permitted under the first paragraph of this section and the 15 per centum hereinbefore permitted under this paragraph.

(4) In addition to the 10 per centum permitted under the first paragraph of this section, liabilities to any national banking association may be incurred in an amount equal to 15 per centum of the paid in and unimpaired capital and 15 per centum of the unimpaired surplus fund of such national banking association, when evidenced by notes secured by documents conveying or securing title to live stock which is being prepared for market during the period of the loan evidenced by such notes, and the market value of which is not at any time less than 115 per centum of the face amount of such notes; but this exception shall not apply to the liabilities of any person, corporation, firm, or company, or the several members thereof, for more than nine months; Provided, however, That exceptions (3) and (4) are not cumulative but only alternative exceptions - i.e., only one of the two shall be available to the same borrower and not both at the same time."

This proposed revision of Section 5200 is a result of a thorough study which the Board has caused to be made by a committee of officers of the Federal Reserve System aided by the Board's Division of Research and Statistics. The recommendations of this committee were also considered by the Federal Advisory Council. In the opinion of the Federal Reserve Board, this revision combines the best features of the various drafts of Section 5200 incorporated in the bills on this subject heretofore introduced in Congress, together with certain new provisions which the Board believes to be desirable. Those features of this proposed revision which are taken from drafts heretofore considered by Congress require no comment; but I shall comment briefly on certain of the proposed new features.

Subdivisions (b) and (c) of the second paragraph of the above draft are new and are intended to bring under the 10% limitation of the first paragraph the indirect liabilities of affiliated corporations and liabilities of the borrower on accommodation paper. The Board believes this is necessary in order to cover cases where the drawer and drawee or the maker and indorser are in effect a single interest.

The first and second exceptions are broadened so as to apply to liabilities arising out of the purchase of paper as well as the discount of paper. A provision is also inserted in the first exception excluding from the benefits of that exception paper on which the drawer and drawee, or the maker and payee, are affiliated corporations. The purpose of this provision is to exclude some portion of those notes and bills of exchange which are in substance nothing more than the obligations of a single interest.

Certain language is inserted in subdivision (a) of the second exception to exclude the holding of accepted demand obligations for an indefinite period of time by a bank, - a practice which involves making what is substantially an unsecured loan on single name paper.

A new subdivision (c) is added to the second exception, excluding from any limitation notes secured by not less than a like face amount of bonds, notes or certificates of indebtedness of the United States. This is based on the theory that, since banks may purchase an unlimited amount of these securities, it would seem logical to permit them to make loans in unlimited amounts on notes collateralized by such securities.

The third exception, which relates to liabilities on notes secured by shipping documents, warehouse receipts, or other such documents conveying or securing title, covering readily marketable non-perishable staples, would permit such loans to be made in an amount equal to 15 per centum of the bank's capital and surplus in addition to the basic 10 per cent for periods not in excess of six months, and in an additional amount equal to 15 per cent of the bank's capital and surplus for a period of not more than three months. The provision requiring such staples to be insured is qualified in such a way as not to apply to such staples as pig iron, lead, zinc, etc., which are not customarily insured. The above draft of this exception is believed to be a fair compromise between the corresponding provisions of the various other drafts of this bill which have heretofore been introduced in Congress; and the Board believes that it will enable the banks to supply all proper financial facilities for the marketing of such staples.

The fourth exception, which relates to loans on live stock is changed so as not to apply to loans on dairy or breeder herds nor to the liabilities of any one borrower for more than nine months.

SUGGESTED AMENDMENTS DESIGNED TO STRENGTHEN THE BANKS.

The Board also desires to recommend the following additional amendments to the National Bank Act and the Federal Reserve Act and requests that these proposed amendments be incorporated in your bill:

1. That Section 5202 of the Revised Statutes as amended be further amended by adding at the end thereof a new paragraph to read as follows:

"All obligations of every nature both direct and indirect arising out of the sale, pledge, or hypothecation of any one of its assets by a national banking association shall be definitely recorded upon its books at the time such assets are sold, pledged, or hypothecated. For each failure to comply with this requirement a national banking association shall be subject to a fine of Five Hundred Dollars, to be imposed by the Comptroller of the Currency."

This proposal is designed to cover the rather common practice of the assumption of obligations by banks in an informal fashion, often in correspondence between bank officials. These obligations

frequently escape the notice of bank examiners because they are not definitely recorded on the books of the banks.

2. That Section 5240 of the Revised Statutes of the United States, as amended, be further amended by adding at the end thereof a new paragraph reading as follows:

"Whenever in the judgment of the Comptroller of the Currency any national banking association is so closely related in management, operation or interest to any other bank, banking association, trust company, securities company or investment company that an examination of such national banking association fails to disclose its true condition in the absence of detailed information regarding such other related institution, such national banking association shall (a) obtain from such related institution and furnish to the Comptroller of the Currency a copy of a report of an examination of such related institution made by the State authorities simultaneously with an examination of such national banking association made by examiners appointed by the Comptroller of the Currency, or (b) by such other means as may be deemed satisfactory by the Comptroller of the Currency, furnish to the Comptroller of the Currency detailed information regarding the condition and operation of such related institution. In such cases the Comptroller of the Currency may, upon request, furnish the State Supervisor of Banking, or other similar officers, copies of reports of examination of such related national banking association. If any national banking association shall fail to comply with the requirements of this paragraph after a demand for such compliance has been made by the Comptroller of the Currency, the Comptroller shall report the facts in the case to the Federal Reserve Board, which may, after a hearing, issue an order depriving such national banking association of the privilege of receiving any discounts, advancements or accommodations from the Federal reserve bank of which it is a member until it has complied fully with all demands made by the Comptroller of the Currency pursuant to the provisions of this paragraph. The Federal Reserve Board shall send a copy of such order by registered mail to such national banking association and a copy to the Federal reserve bank of which it is a member; and, after receipt of said order, such Federal reserve bank shall not rediscount any paper for, or make any loan, advancement, or other extension of credit to, such national banking association until said Federal reserve bank has been notified by the Federal Reserve Board that such national banking association has complied fully with the requirements of this paragraph."

This proposal is designed to secure adequate information regarding national banks which are related to other institutions and in particular to afford some check upon certain abuses frequently engaged in by chains of banks. During the last few years a number of such chains have collapsed,

and investigation shows that when a national bank is in such a chain an examination of it fails to disclose its true condition, due to the shifting of assets back and forth between the various institutions which make up the chain.

3. That Section 9 of the Federal Reserve Act as amended be further amended by inserting therein, immediately after the sixth paragraph thereof, a new paragraph reading as follows:

"Whenever in the judgment of the Federal Reserve Board any member bank is so closely related in management, operation and interest to any other bank, banking association, trust company, securities company or investment company that an examination of such member bank fails to disclose its true condition in the absence of detailed information regarding such other related institution, such member bank shall (a) obtain from such related institution and furnish to the Federal Reserve Board a copy of a report of an examination of such related institution made by the State authorities simultaneously with an examination of such member bank, or (b) by such other means as may be deemed satisfactory by the Federal Reserve Board, furnish to the Federal Reserve Board detailed information regarding the condition and operations of such related institution. In such cases the Federal Reserve Board may, upon request, furnish the State Supervisor of Banking, or other similar officers, copies of reports of any examination of such related member bank which has been made by direction of the Federal Reserve Board or of the Federal reserve bank by examiners selected or approved by the Federal Reserve Board. If any member bank shall fail to comply with the requirements of this paragraph after a demand for such compliance has been made by the Federal Reserve Board, said Board may, after a hearing, issue an order depriving such member bank of the privilege of receiving any discounts, advancements or accommodations from the Federal reserve bank of which it is a member until it has complied fully with all demands made by the Federal Reserve Board pursuant to the provisions of this paragraph. The Federal Reserve Board shall send a copy of such order by registered mail to such member bank and a copy to the Federal reserve bank of which it is a member, and, after receipt of said order, such Federal reserve bank shall not rediscount any paper for, or make any loan, advancement, or other extension of credit to, such member bank until said Federal reserve bank has been notified by the Federal Reserve Board that such member bank has complied fully with the requirements of this paragraph."

This proposal is similar to the preceding and is intended to apply to State banks and trust companies which are members of the Federal Reserve System. At present the only penalty for non-compliance with any provision of the Federal Reserve Act by State member banks is that provided for in the seventh paragraph of Section 9 of the Federal Reserve Act, which authorizes the Federal Reserve Board to expel from the Federal Reserve System any State member bank which fails to comply with the provisions of that Section. The penalty suggested above is less drastic but is nevertheless thought to be sufficient.

4. That Section 5146 of the Revised Statutes of the United States, as amended, be further amended to read as follows:

"Sec. 5146. Every director must, during his whole term of service, be a citizen of the United States, and at least three-fourths of the directors must have resided in the State, Territory, or District in which the association is located, or within fifty miles of the location of the office of the association, for at least one year immediately preceding their election, and must be residents of such State or within a fifty-mile territory of the location of the association during their continuance in office. Every director must own in his own right at least ten shares of the capital stock of the association of which he is a director, unless the capital of the bank shall not exceed \$25,000, in which case he must own in his own right at least five shares of such capital stock. Any director who ceases to be the owner of the required number of shares of the stock, or who pledges or hypothecates the same, or who becomes in any other manner disqualified, shall thereby vacate his place.

"No national banking association shall make a loan or loans aggregating more than Five Hundred Dollars to any salaried officer of such national banking association or to any corporation in which such officer or any director of such national banking association owns or controls a majority of the stock or of which he is an officer or director, unless (a) such loan is fully secured by readily marketable collateral, or (b) such officer or director has first made available to the board of directors of such national banking association by filing with such national banking association in approved form a financial statement of such officer or of such corporation, as the case may be, which financial statement shall accurately show the financial condition of such officer or corporation at the close of the last fiscal or calendar year preceding the loan. A violation of this provision shall disqualify any such officer or director from serving as such and vacate his place."

This would amend Section 5146 in two respects: (1) The last sentence of that section as it now reads would be amended so as to disqualify a director who pledges or hypothecates his stock. This is intended merely to meet an apparent oversight in the law. (2) A new paragraph would be added relating to loans to officers of national banks and to corporations the majority of the stock of which is owned or controlled by officers or directors of national banks.

5. That Section 5205 of the Revised Statutes of the United States, as amended, be further amended to read as follows:

"Sec.5205. Every association which shall have failed to pay up its capital stock, as required by law, and every association whose capital stock shall have become impaired by losses or otherwise, shall, within two months after receiving notice thereof from the Comptroller of the Currency, pay the deficiency in the capital stock, by assessment upon the shareholders pro rata for the amount of capital stock held by each; and the Treasurer of the United States shall withhold the interest upon all bonds held by him in trust for any such association, upon notification from the Comptroller of the Currency, until otherwise notified by him. If any such association shall fail to pay up its capital stock, and shall refuse to go into liquidation, as provided by law, for two months after receiving notice from the Comptroller, a receiver may be appointed to close up the business of the association, according to the provisions of section fifty-two hundred and thirty-four: And provided, That if any shareholder or shareholders of such bank shall neglect or refuse, after two months' notice, to pay the assessment, as provided in this section, it shall be the duty of the board of directors to cause a sufficient amount of the capital stock of such shareholder or shareholders to be sold at public auction (after thirty days' notice shall be given by posting such notice of sale in the office of the bank, and by publishing such notice in a newspaper of the city or town in which the bank is located, or in a newspaper published nearest thereto), to make good the deficiency, and the balance, if any, shall be returned to such delinquent shareholder or shareholders: Provided, however, That the Comptroller of the Currency may extend the time for payment of such assessment whenever in his judgment it may be deemed advisable."

The only effect of this amendment would be to shorten from three months to two months the period allowed for the payment of assessments to restore the capital of a national bank which has become impaired, with a provision authorizing the Comptroller of the Currency

to extend the time for the payment of such assessment when in his judgment it may be deemed advisable.

The Board has taken no definite action upon those provisions of your Bill which are not specifically mentioned above, but if it does so I shall advise you promptly of the action taken. The Board is also considering the advisability of recommending the enactment of certain other amendments to the National Bank Act and the Federal Reserve Act, but has not yet taken definite action upon the matter. If it decides to recommend any further amendments, I shall advise you at a later date.

It may be of interest to your Committee to know that this letter was considered in detail at a meeting of the Federal Reserve Board at which all members except the Secretary of the Treasury and the Comptroller of the Currency were present and was approved by all those members who were present.

If there is anything further that the Board can do to be of any assistance to you in this or in any other matter, please do not hesitate to call upon us.

Very truly yours,

D. R. Crissinger,
G o v e r n o r.

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P.S. If you so desire the Board will be very glad to furnish you with additional copies of this letter for the use of the other members of your Committee.

January 16, 1926.

Dear Mr. McFadden:

Reference is made to your letter of October 31st in which it is suggested that the maximum maturity of advances made by Federal reserve banks to member banks on their promissory notes be increased from fifteen days to ninety days.

After careful consideration of this suggestion, and after consultation with the Federal Reserve Agents and the Governors of the several Federal reserve banks, the Federal Reserve Board is of the opinion that an amendment to the law increasing the maximum maturity of such notes when secured by paper eligible for rediscount or for purchase by Federal reserve banks should be adopted. The Board does not believe, however, that this increase in maturity of such notes should apply when they are secured by bonds or notes of the United States or by bonds of the War Finance Corporation. I am enclosing herewith a draft of an amendment to Section 13 of the Federal Reserve Act which embodies the views of the Federal Reserve Board, which are concurred in by the Federal Reserve Agents and the Governors of the several Federal reserve banks.

The proposed amendment would permit Federal reserve banks to extend credit to their member banks for any period of time not exceeding ninety days on the security of eligible paper, whereas under the present law the length of the period of any such credit in excess of fifteen days is determined necessarily by the maturity dates of the notes which are offered for discount at the Federal reserve banks. The Federal Reserve Board believes that it would be of distinct advantage to member banks to be able to obtain credit for any desired period up to ninety days, regardless of the maturity dates of the notes in its portfolio. Especially is this true in those sections of the country where seasonal credit is greatly demanded.

It is also believed that the enactment of the amendment proposed will be a means of saving country banks much inconvenience. Member banks' notes with fifteen-day maturities are in many cases frequently renewed and the proposed amendment would eliminate the necessity and inconvenience of such frequent renewals. This would be of especial assistance to those member banks which are so situated that more than one day is necessary for the mails to pass to or from the Federal reserve bank by which they are served.

The Federal Reserve Board feels that the increase in maturity for member banks' notes should be limited to those notes secured by paper eligible for discount or purchase by Federal reserve banks because, in the opinion of the Board, it is unsound banking to permit the issue of Federal Reserve Notes against promissory notes secured by Government bonds as collateral. For this reason the Board believes that the present law is sufficiently liberal as respects advances to member banks on notes secured by Government bonds.

The foregoing recommendation is made by a majority vote of the Board.

Very truly yours,

D. R. Crissinger,
Governor.

Hon. Louis T. McFadden, Chairman,
Committee on Banking and Currency,
Washington, D. C.

A B I L L

To Amend Section 13 of the Federal
Reserve Act and for other purposes.

Be it enacted by the Senate and House of Representatives of the
United States of America in Congress assembled, That the seventh para-
graph of Section 13 of the Federal Reserve Act as amended be amended
and reenacted to read as follows:

"Any Federal reserve bank may make advances for periods not exceeding fifteen days to its member banks on their promissory notes secured by the deposit or pledge of bonds or notes of the United States or of bonds of the War Finance Corporation, or when authorized by the Federal Reserve Board and subject to such conditions, regulations, limitations and restrictions as the said Board may prescribe, may make advances for periods not exceeding ninety days to its member banks on their promissory notes secured by such notes, drafts, bills of exchange or bankers' acceptances as are eligible for rediscount or for purchase by Federal reserve banks under the provisions of this Act. All such advances shall be made at rates of interest to be established by such Federal reserve banks subject to the review and determination of the Federal Reserve Board."

January 16, 1926.

Honorable Louis T. McFadden, Chairman,
Committee on Banking and Currency,
House of Representatives,
Washington, D. C.

My dear Congressman:

The Federal Reserve Board has received many complaints about the use of the words "Federal" or "Reserve", or a combination of the two as part of the title of banks, corporations and firms other than Federal reserve banks. In most of these instances it is obvious that such words have been used in an attempt to take advantage of the prestige enjoyed by the Federal reserve banks and to arrogate to the firms or corporations using such words part of the benefits accruing from this prestige, and the Board has felt that not only is this purpose in itself objectionable but also that such use of these words is likely to mislead the public and to cause confusion. Indeed, in several instances it has been found that the use of such words by firms or corporations other than Federal reserve banks actually has led to confusion. The Board has always opposed such use of these words and feels that legislation to remedy the situation is very badly needed.

Under date of September 2, 1922, the Board called this matter to your attention with a request that you endeavor to secure the passage of a law which would prevent this objectionable practice as far as possible; and you introduced at the first session of the 68th Congress a Bill (H.R. 6145) for this purpose, a copy of which is enclosed herewith. This bill, however, was never reported out by the Banking and Currency Committee, and the Board desires to renew its recommendation that this bill, or some other bill having substantially the same effect, be enacted into law at the present session of Congress and to express its hope that you will exert your best efforts to this end.

It will be noted that the first provision of the enclosed bill would prohibit offering for sale as Farm Loan bonds any securities not issued under the terms of the Federal Farm Loan Act. This provision was included in the bill, at the time it was being prepared, at the request of the Farm Loan Board, but the Federal Reserve Board is not advised whether the Farm Loan Board is still desirous of securing the enactment of such legislation.

A precedent for the enactment of a law of this kind is found in Section 5243 of the Revised Statutes which prohibits the

use of the word "national" as part of the title of any bank not organized under the National Bank Act. While the validity of that provision has never been passed upon by the courts, it has been on the statute books since 1873 and its validity has never been questioned. It is well recognized that the good name or reputation of a bank is one of its most valuable possessions and it would seem clear that the same is true of any banking system. Any device or scheme the natural result of which would be to cause banks, corporations or firms of questionable standing to be confused with the Federal reserve banks or which is likely to mislead the public into believing that such banks, corporations or firms are affiliated in some way with the Federal Reserve System endangers the good name and reputation of the Federal Reserve System. It is believed, therefore, that the enactment of legislation to prevent such abuses is necessary to protect the Federal reserve banks and the Federal Reserve System. The Supreme Court of the United States has recognized the principle that the power to create national banks carries with it the power to preserve them, (See First National Bank v. Fellows, 244 U.S. 416 and cases cited), and the same must be true as to the Federal reserve banks. There would seem to be no doubt, therefore, as to the constitutionality of a bill designed to protect the reputation of the Federal reserve banks.

For your information there is also enclosed herewith a copy of a memorandum prepared for the information of the Federal Reserve Board containing a brief statement of the circumstances of each case which has been called to the attention of the Board in which the word "Federal" or the word "Reserve" or a combination of the two has been used as a part of the name of a bank, corporation or firm other than a Federal reserve bank or in the advertising of such a bank, corporation or firm or where such use of these words has been attempted. It is believed that a reading of the facts set forth in this memorandum will convince any one of the necessity for some legislation to prevent such abuses.

As you will note from the memorandum, the Board has sought various ways of preventing the objectionable practices, but usually with little success. The Board has several times requested the aid of the Federal Trade Commission in these matters, but as this body is without jurisdiction over banks or insurance companies its power to render material assistance has necessarily been greatly restricted.

The Federal Reserve Board hopes that you will do all that is possible to secure the introduction and enactment into law of a bill which will provide an effective remedy for this situation.

If agreeable to you, the Board will be glad to furnish a copy of this letter and the enclosed documents to each member of your committee in order that they may study them at their leisure.

Very truly yours,

Enclosures

WW OMC

D. R. Crissinger
Governor

H. R. 6145

IN THE HOUSE OF REPRESENTATIVES.

January 24, 1924.

Mr. McFadden introduced the following bill; which was referred to the Committee on Banking and Currency and ordered to be printed.

A BILL

To prohibit offering for sale as Federal farm loan bonds any securities not issued under the terms of the Farm Loan Act, to limit the use of the words "Federal", "United States", or "reserve", or a combination of such words, to prohibit false advertising, and for other purposes.

BE IT ENACTED BY THE SENATE AND HOUSE OF REPRESENTATIVES OF THE UNITED STATES OF AMERICA IN CONGRESS ASSEMBLED, That no bank, banking association, trust company, corporation, association, firm, partnership, or person not organized under the provisions of the Act of July 17, 1916, known as the Federal Farm Loan Act, as amended, shall advertise or represent that it makes Federal farm loans or advertise or offer for sale as Federal farm loan bonds any bond not issued under the provisions of the Federal Farm Loan Act or make use of the word "Federal" or the words "United States" or any other word or words implying Government ownership, obligation, or supervision in advertising or offering for sale any bond, note, mortgage, or other security not issued by the Government of the United States or under the provisions of the said Federal Farm Loan Act or some other Act of Congress.

SEC. 2. That no bank, banking association, trust company, corporation, association, firm, partnership, or person engaged in the banking, loan, building and loan, brokerage, factorage, insurance, indemnity, or trust business shall use the word "Federal", the words "United States", or the word "reserve", or any combination of such words, as a portion of its corporate, firm, or trade name or title or of the name under which it does business: Provided, however, That the provisions of this section shall not apply to the Federal Reserve Board, the Federal Farm Loan Board, the Federal Trade Commission, or any other department, bureau or independent establishment of the Government of the United States, nor to any Federal reserve bank, Federal land bank, or Federal reserve agent, nor to the Federal Advisory Council, nor to any corporation organized under the laws of the United States,

ner to any bank, banking association, trust company, corporation, association, firm partnership, or person actually engaged in business under such name or title prior to the passage of this Act.

SEC. 3. That no bank, banking association, or trust company which is not a member of the Federal reserve system shall advertise or represent in any way that it is a member of such system or publish or display any sign, symbol, or advertisement reasonably calculated to convey the impression that it is a member of such system.

SEC. 4. That any bank, banking association, trust company, corporation, association, firm or partnership violating any of the provisions of this Act shall be guilty of a misdemeanor and shall be subject to a fine of not exceeding \$1,000. Any person violating any of the provisions of this Act, or any officer of any bank, banking association, trust company, corporation or association, or member of any firm or partnership violating any of the provisions of this Act who participates in, or knowingly acquiesces in, such violation shall be guilty of a misdemeanor and shall be subject to a fine of not exceeding \$1,000 or imprisonment not exceeding one year, or both. Any such illegal use of such word or words, or any combination of such words, or any other violation of any of the provisions of this Act, may be enjoined by the United States district court having jurisdiction, at the instance of any United States district attorney, any Federal land bank, joint-stock land bank, Federal reserve bank, or the Federal Farm Loan Board or the Federal Reserve Board.

SEC. 5. That if any clause, sentence, paragraph, or part of this Act shall for any reason be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair or invalidate the remainder of this Act, but shall be confined in its operation to the clause, sentence, paragraph, or part thereof directly involved in the controversy in which such judgment shall have been rendered.

Office Correspondence

FEDERAL RESERVE
BOARDDate April 15, 1926.To Mr. Hamlin

Subject: _____

From Mr. Smead

2-9496

With reference to your memorandum of April 14, with which you enclosed a copy of your confidential letter to Mr. Vrooman, and asked if during the period of declining prices in 1920 the System bought many Government securities, I beg to advise that the index of wholesale prices in the United States reached its peak, 247, in May 1920, and then declined each month until July 1921, when it stood at 141. During this period the System's holdings of United States securities remained fairly stable, the average daily holdings by months being as follows:

1920 - May	\$302,000,000	1921 - January	\$298,000,000
June	348,000,000	February	287,000,000
July	318,000,000	March	296,000,000
August	303,000,000	April	277,000,000
September	339,000,000	May	303,000,000
October	304,000,000	June	302,000,000
November	320,000,000	July	261,000,000
December	339,000,000		

During the above period the earning assets of the Federal Reserve System were relatively high and open market operations played but a small part in the System's credit policy. The average daily holdings of total earning assets of the System were \$3,256,000,000 in May 1920, and fluctuated between \$3,201,000,000 and \$3,390,000,000 during the remainder of 1920, then began to decline, reaching \$2,013,000,000 in July 1921 at the time the wholesale price index was approaching the low post-war point.

When member banks are heavily in debt to the Federal reserve banks, as they were during all of this period, purchases and sales of Government securities by the Federal reserve banks have but slight effect upon the volume of Federal reserve bank credit in use for the reason that when the Federal reserve banks buy securities the funds thus paid out are returned to liquidate borrowings at the reserve banks, and when the reserve banks sell securities the member banks have to increase their borrowings at the Federal reserve banks in order to supply the funds with which to pay for the securities. In times like the present, however, when the earning assets of the System are on a relatively low level, and especially at times when borrowings of banks in New York City, the central money market, are fluctuating between \$50,000,000 and \$100,000,000, purchases and sales of Government securities have a very decided influence upon the credit situation, as there is not at such times the same automatic adjustment in borrowings that takes place when the volume of Federal reserve bank credit in use amounts to \$2,000,000,000 or \$3,000,000,000 as was the case in 1920 and 1921.

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CONFIDENTIAL

PROPOSALS BY PROFESSOR O. M. W. SPRAGUE
FOR THE CONSIDERATION OF THE
ADVISORY COMMITTEE

October 15, 1925.

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SECTION 5200. REVISED STATUTES.

Suggested changes are enclosed in brackets.

Sec. 5200. The total liabilities (other than those incurred under Section 24 of this title and under Section 13 of the Federal Reserve Act), to any (national banking) association of any person, firm, company, or corporation for money borrowed, including in the liabilities of a company or firm the liabilities of the several members thereof, shall at no time exceed 10 per centum of the capital stock of such association actually paid in and unimpaired, and 10 per centum of its unimpaired surplus fund. This limitation as to such liabilities to such association shall be subject to the following exceptions:

No change in the present statute other than the specific exclusion of real estate loans, investment securities, and acceptances.

(1) Liabilities arising out of the discount (or purchase) of the following described paper shall be subject to no limitations based upon the amount of such capital and surplus:

The phraseology of the Senate draft of the ~~McFadden~~ bill is followed here, with the addition of definite provision to cover purchased paper. Much may be said in favor of the policy embodied in recent legislation in a number of States, notably New York and Missouri, limiting the total amount which may be lent to any one interest regardless of the form or nature of the obligation. Under the New York law, banks in large cities may not lend more than 25 per cent of capital and surplus and other banks not more than 40 per cent. As it seems impracticable to move for such a restriction in the national law, I am suggesting in the following paragraphs a more careful definition of the varieties of bills of exchange and of commercial paper that may be taken without limit.

(a) Bills of exchange drawn in good faith against actually existing values; (b) Commercial or business paper (taken at or about the time of the sale or delivery of goods), actually owned by the person, firm, company, or corporation negotiating the same; (c) drafts and bills of exchange secured by shipping documents conveying or securing title to goods shipped--(but provided that no such drafts, bills of exchange, or commercial or business paper shall be included within the meaning of this exception when both drawer and drawee, or both maker

and payee are corporations and one such corporation is affiliated with or a subsidiary of the other, i.e., if a majority of the stock of one such corporation is owned by the other or by the stockholders thereof).

The purpose of the proposed changes is to exclude notes taken for past due accounts, and also at least some portion of bills of exchange and commercial and business paper that are in substance nothing more than the obligations of a single interest.

(d) Demand obligations when secured by documents covering commodities in actual process of shipment (when such obligations are or have been discounted or purchased for the account of the drawer or endorser).

The additional proviso here is designed to exclude the holding of accepted demand obligations for an indefinite period of time by a bank, a practice which involves making a straight unsecured loan to the borrower. It is possible, however, that a short period of time, say ten days, may be proper in some instances to meet the marketing requirements of cotton dealers in small towns.

(e) Bankers' acceptances of the kinds described in Section 13 of the Federal Reserve Act.

(f) (Notes secured by not less than a like face amount of bonds, notes, or certificates of the United States.)

A bank may purchase an unlimited amount of these securities. Loans thus secured would appear to be a no less satisfactory investment. It is, therefore, proposed that the present limitation to an additional 15 of capital and surplus be removed. At the Treasury this might be regarded as an offset to the proposal of the Reserve Committee to subject government deposits to reserve requirements.

(2) Liabilities arising out of the discount of the following described paper shall be subject to the following limitations based upon the amount of such capital and surplus:

(a) Liabilities as surety, drawer, endorser, or guarantor, other than of bills of exchange and commercial and business paper excepted under (1) hereof and excluding accommodation paper, having a maturity of not more than six months, where the surety, drawer, endorser, or guarantor obtains a loan from or discounts paper with or sells paper to any national banking association, shall at no time exceed 15 per centum of such capital and surplus in addition to such 10 per

centum of such capital and surplus (but provided further that such obligations as surety, drawer, endorser, or guarantor of any corporation a majority of the stock of which is owned by any borrower shall be included as a part of the aggregate obligations of such borrower).

This paragraph does not appear in any form in the existing law, which imposes no limitation whatever upon indirect liabilities, altho under a ruling of the Comptroller endorsements of accommodation are included within the 10 per cent limitation. A definite exclusion of accommodation seems desirable, and I venture also to suggest the elimination of guarantees of interrelated borrowers.

(b) Notes secured by shipping documents, warehouse receipts, or other such documents conveying or securing title covering readily marketable non-perishable staples when such property is fully covered by insurance and provided that the market value of such staples is at no time less than 115 per centum of such obligations shall be subject to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus for a period of not more than six months in any consecutive twelve months; and provided further that obligations of this character shall be subject to a further increase of limitation of 15 per centum of such capital and surplus in addition to such 25 per centum of such capital and surplus for a period of not more than three months in any consecutive twelve months.

The McFadden Bill as it passed the House lengthened the period from six to ten months on loans secured by staples, but it was restored to six by the Senate Committee. The House bill, also, contained provision for loans on staples up to 50 per cent of capital and surplus, requiring additional margins in a succession of steps until for the final 5 per cent of a loan a 40 per cent margin was necessary. This extension of the loan limit was eliminated in the Senate draft. There is reason to believe that it will be brought forward again and with strong backing. I, therefore, would suggest as a substitute a more liberal provision than is contained in the present law, but for the relatively short period of three months.

(c) Notes secured by documents conveying or securing title covering livestock when the actual market value of such livestock is not less than 115 per centum of the face amount of the notes secured by such documents when such livestock

are being prepared for market during the period of the loan and provided no part of the total accommodation granted the borrower is unsecured shall be subject to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus, but this exception shall not apply to the obligations of any one borrower for more than six months in any consecutive twelve months.

The present law includes livestock in the paragraph in which an additional 15 per cent loan is allowed for six months secured by insured staples. Insurance for livestock is generally impracticable, and this restriction was eliminated in both the House and the Senate bills, which contain separate livestock paragraphs. The House bill further fails to retain the six months limitation which reappears in the Senate draft. I have omitted the requirement that the margin of 15 per cent be maintained at all times, and have inserted a provision designed to exclude breeder and dairy loans. On the ground that livestock loans are less liquid than those secured by staples, a further provision is added requiring the entire loan of the borrower to be on a secured basis.

AMENDMENT TO SECTION 19 OF THE FEDERAL RESERVE ACT

The Federal Reserve Act following in this respect the National Banking Law absolutely prohibits the making of any loan or the payment of dividends when reserves are deficient. This is one of those provisions in the National Banking Law which tends to discredit the Statute because it imposes an absolute prohibition under conditions which may naturally arise from time to time in any bank however well managed. This prohibition may also be supposed to be in part due to the excessive significance attached to the maintenance of reserve ratios in this country. It was a prohibition for which something might have been said at the time when each bank was directly responsible for the maintenance of its own reserve. Under existing arrangements with the reserve banks constantly supervising the situation and imposing fines for failure to maintain reserves, it would appear entirely proper and consistent with safety to remove this prohibition from the Statute. An alternative proposal, one however difficult of administration, would permit banks to continue to lend when reserves were deficient for a period of some days or weeks and then apply the prohibition until the required balance had been restored. I do not think that the banking system would be strengthened by this arrangement to an extent sufficient to warrant undertaking to administer such a requirement.

AMENDMENTS TO THE NATIONAL BANKING LAW DESIGNED TO FURNISH MORE ADEQUATE
DATA REGARDING THE CONDITION OF THE BANKS THROUGH EXAMINATIONS

I.

All obligations of every nature both direct and indirect arising out of the sale, pledge, or hypothecation of any of its assets by a national banking association shall be definitely recorded upon its books at the time such assets are sold, pledged, or hypothecated. For each failure to comply with this requirement a national banking association shall be subject to a fine of Five Hundred Dollars. (Possibly the fine should be imposed upon bank officers rather than upon the bank.)

This proposal is designed to cover the rather common practice of the assumption of obligations by banks in an informal fashion often in correspondence between bank officials. These obligations frequently escape the notice of bank examiners because they do not appear in any regular fashion in the records of the banks.

II.

Where an officer or director of a national banking association is an officer or director of any other bank, banking association, trust company, securities company, or investment company, and where in the judgment of the Comptroller of the Currency the national banking association is related in management and operation in such close degree with such other bank, banking association, trust company, securities company or investment company, that the examination of the national bank fails to disclose its true condition in the absence of detailed information regarding such other related institutions, then such other bank, banking association, trust company, securities company or investment company shall furnish the Comptroller of the Currency with a copy of an examination simultaneously made by the State authorities of such other bank, banking association, trust company, securities company or investment company, and upon failure so to do the officer or director shall be disqualified from further acting in such capacity, and in such cases the Comptroller of the Currency, upon request, is authorized to furnish the State Supervisor of Banking, or other similar officers, copies of such examination of the affiliated

national bank.

This proposal is designed to secure adequate information regarding the situation of chains of banks--in many respects the most dangerous type of branch banking. During the last few years a considerable number of the chains have collapsed and investigation indicates that where a national bank was in a chain the examination of the bank failed to indicate its true position because of the shifting of assets back and forth between the various institutions in the group.

III.

That Section 5146 of the Revised Statutes of the United States, as amended, be amended by adding at the end thereof a new paragraph as follows:

It shall be unlawful for any national banking association to make a loan or loans of more than Five Hundred Dollars, unless secured by readily marketable collateral, to any salaried officer of such association or to any corporation in which such officer or any director of such banking association owns or controls a majority of the stock or is an officer or director, except upon submission to such association, as a condition precedent, of a financial statement from such officer or from such corporation as the case may be. A violation of this provision shall disqualify any such officer or director and vacate his place.

It would appear to be entirely reasonable to require that all directors should furnish financial statements when securing loans without marketable collateral but it is highly probable that such a proposal would excite serious opposition and consequently I content myself with the recommendation of financial statements from salaried officers and for the corporations in which directors are interested.

MISCELLANEOUS AMENDMENTS

Sec. 5205. Shorten the period allowed for payment of assessments in cases of impaired capital from three months to two months with a further provision authorizing the Comptroller of the Currency to extend the period when in his judgment it may be deemed advisable.

Sec. 5146. Last sentence. Any director who ceases to be the owner of the required number of shares of the stock (or who pledges or hypothecates the same), or

who becomes in any other manner disqualified, shall thereby vacate his place.

This is a minor change, designed to cover an apparent oversight in the Act, which fails to disqualify a director who pledges or hypothecates his stock.

ADDITIONAL SECTION TO THE NATIONAL BANKING LAW OR THE
FEDERAL RESERVE ACT

A Board is hereby created which shall be known as the Special Board of Bank Supervision. Said Board shall consist of the Governor of the Federal Reserve Board, the Comptroller of the Currency, and the Under Secretary of the Treasury, who shall receive no additional salary for their service on said Board. The expenses of said Board, if any, shall be paid by the Federal Reserve Board out of the fund derived from assessments against Federal reserve banks as provided in the Federal Reserve Act.

Whenever any national bank or any officer or director thereof shall continue to violate the law after his attention has been directed to such violation by the Comptroller of the Currency, and whenever any national bank or the officers or directors thereof shall continue to engage in unsound or dangerous banking practices which, in the opinion of the Comptroller of the Currency, will, if persisted in, endanger the solvency of the bank or cause loss to depositors of the bank, the Comptroller of the Currency shall report the facts to the Special Board of Bank Supervision which shall issue an order requiring the officers and directors of said bank who are guilty of such violations of law or unsound banking practices, or who are responsible for such violations of law or unsound banking practices on the part of the bank, to appear before said Board and show cause why they shall not be summarily removed from office. If such officers or directors shall fail to appear before said Board at the time and place specified by said Board, or if they shall appear and after a hearing the said Board shall reach the conclusion that such officers and directors have been guilty of such continued violations of the law or such continued unsound practices, the said Board shall have discretionary author-

ity, by unanimous vote, to issue an order declaring the offices of such officers and directors vacant. Upon the issuance of such an order the offices of such officers and directors shall be deemed to be vacated and such officers and directors shall be thereafter disqualified for a period of one year after the next annual meeting of the shareholders of the bank. The vacancies thus created shall be filled in the same manner as any other vacancies.

Note: In order to meet the case of State member banks, it is suggested that a Board of Supervision be established which shall be constituted in a somewhat different manner. This Board would be composed of the Governor of the Reserve Board, the Reserve Agent of the reserve bank in the district in which the State member is established, and the Supervisor of Banks in the state where the State member is situated. Certification of violations of law, or of unsound banking practice, would in each case be made by the Federal Reserve Agent of the particular district in which the State member bank was situated.

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MEMORANDUM TO ACCOMPANY REPORT
OF FEDERAL RESERVE AGENTS COMMITTEE ON MEMBER BANK RESERVES

May 12, 1925.

Theory of Banking Reserves:

The reserve of a bank consists of its uninvested funds immediately available to meet its liabilities. Banking experience in all periods and all countries has demonstrated beyond question the necessity for the maintenance of reserves by all institutions receiving deposits from others, especially where such deposits may be withdrawn upon demand by the depositor. The teachings of experience are much less conclusive as to the proportion which such reserves should bear to the liabilities which they support. In the early days of banking, banks in many cases carried the entire amount of their deposit liabilities in cash, charging for service. As the business of banking became better understood, it was demonstrated that a portion of the funds could be loaned and that all probable demand for payments in cash could be met provided a safe proportion of cash was held as reserve. What such a proportion should be depends upon many factors including the character of the community which the bank serves, the character and activity of the deposits, the likelihood of their withdrawal, the effect of seasonal or periodical demands for cash which the bank has to meet, the likelihood of emergency requirements, and finally and perhaps most important, the facilities which a bank has for replenishing its cash reserve. A bank which can rely upon prompt addition to its cash reserve by obtaining a loan from a correspondent bank or a central bank upon its own loans or investments can safely operate with a reserve relatively lower than would be required by a bank not having such facilities available.

While the amount of reserve necessary to be held by an individual bank is simply the amount needed to enable it promptly to meet demands

or payment of its liabilities, when the problem of what constitutes adequate reserves for all the banks of a country is considered, weight must be given to other considerations. The reserves of banks in any one country must be sufficient in amount to meet not only withdrawals of cash for domestic purposes but also demands for gold for export. The reserves must also be large enough in proportion to deposit liabilities to safeguard in a measure the volume of credit extended by the banks. Since neither of these considerations always appears compelling when considered from the viewpoint of an individual bank, it becomes the particular duty of the legislative and supervisory authorities to give due weight to them in determining what should be the aggregate reserves of a country's banking institutions.

Reasons for legally fixed reserves in the United States:

In most countries having highly developed and modern banking systems, there is no legal requirement as to the amount of reserves which banks must carry against their liabilities. The maintenance of a proper reserve is the responsibility of the banks' management, and the general experience in the leading countries has been that the responsibility in this particular has been well met. In countries other than the United States, however, banking development has led to the consolidation of banks into a small number of large banks with many branches, and with experienced management, which might be depended upon to maintain adequate reserve without direct legal requirement.

In the United States differing conditions have led to, and practically compelled the adoption of a policy of legally fixed reserve requirements for all incorporated banking institutions accepting from the public deposits payable on demand. It has been the disposition of the Federal Government and most of the State Governments to encourage or permit the establishment of independent banking institutions of limited capital wherever such banks could operate and serve a community. Obviously with a large number of banks it cannot be expected that the management in all cases will be comparable in experience to that of

the large banks typical of the leading banking systems elsewhere in the world. Nor are the managers of these numerous small banks, however competent, in favorable position to acquire the knowledge and appreciation of the national and international aspects of the problem necessary for safe and satisfactory administration of the nation's banking reserves without any prescribed reserve requirement. Experience of many years has clearly demonstrated that for our system of independent banks prescribed legal reserve requirements are necessary and in the best interest of all concerned, for they protect not only the banks whose management might otherwise be inclined to court disaster by failure to carry adequate reserves, but also give protection to the well managed bank by lessening the dangers of reckless competition by poorly managed neighboring institutions. The banking system of the United States having developed and our bankers having become thoroughly accustomed to operation with legally fixed reserve requirements, it is believed that this method cannot be departed from with safety at the present time.

Liabilities against which reserve should be carried:

Liabilities, in whatever form, for money deposited and subject to withdrawal by the depositors should be protected by reserves. Deposits of differing character require reserves of differing relative proportion. A very important distinction has for years been made between deposits subject to withdrawal on demand, termed demand deposits, and those not subject to withdrawal on demand or for which notice of withdrawal must be given, and which are referred to as time deposits. The principle is generally accepted that time deposits do not require the maintenance of a reserve as large proportionately as that required against demand deposits, but that a reasonable and proper reserve should be maintained against time deposits.

A distinction has also been made between demand deposits received from banks and those received from individuals. Students of banking and writers on the subject have for many years recognized the need for higher re-

reserves against deposits from banks than against deposits from individuals. Deposits from banks are subject to wider and more rapid fluctuations than are deposits from individuals. The former represent the reserves on the deposits of the bank which has deposited them with the bank reporting them as bank deposits. In the case of deposits due to banks not members of the Federal Reserve System, such deposits are legal reserve for the depositing bank. Thus a bank which keeps a portion of its reserves against demand deposits deposited with another bank will be obliged, in the event of withdrawals of funds by its own customers, to make withdrawals of about like amount from its depository correspondent bank, which withdrawals will constitute a relatively larger proportion of such redeposit. The strain of withdrawals is thus concentrated upon the bank which holds the redeposited reserves of other banks and it should be prepared to meet this strain.

The committee has sought to ascertain by statistical means whether the well established belief in the greater fluctuation of bank deposits is justified by actual experience. To this end experience of a considerable number of banks, showing substantial amounts due to other banks, has been charted (See Exhibit A). The results indicate that bank deposits show greater fluctuations than do demand deposits and that the difference in fluctuation is of moderate degree in the case of banks in large centers having large amounts of bank deposits from large numbers of individual banks, while in smaller centers bank deposits tend to show far more violent fluctuations than do individual demand deposits in the same institutions.

Reserves against bank deposits are at present unduly low in the case of banks outside of reserve and central reserve cities which have actively solicited such deposits in competition with banks located in the cities formally recognized as reserve centers and therefore required to carry higher reserves. Competition for deposits of other banks is not local in character but is statewide and even nationwide. All banks competing to obtain bank deposits should be upon a substantially similar basis as to the percentage of reserves to be carried against such

deposits. The Committee therefore favors a minimum reserve requirement of 10 per cent. against bank deposits no matter where the bank holding them is located.

Reserve requirements for members of Federal Reserve System:

The Federal Reserve Act as originally enacted provided for the gradual elimination of deposits in banks other than a Federal Reserve Bank from the status of legal reserves. In 1916 a committee of Federal reserve agents, of which two members of the present committee were members, recommended that vault cash should not be classified as legal reserve and that the aggregate reserve should be reduced proportionately. In 1917 this change was made by legislative enactment, and a compensating reduction of 5 per cent. was made in the percentage of reserve required against demand deposits and a similar reduction of 2 per cent. in the reserve against time deposits. Thus the only reserve required by law to be held by member banks is that carried with the Federal Reserve bank. Experience has shown that the banks can operate satisfactorily without a fixed requirement for cash in vault and that each institution carries such amount as suits its particular location and business. A material economy in the amount of idle vault cash has been achieved with reduced expense and risk to the individual institutions and at the same time concentration of reserve cash in the Federal Reserve banks has been made possible.

The committee has had data assembled from banks in several Federal Reserve Districts to show the amount of vault cash now carried and its ratio to the banks' deposits. These figures furnish convincing evidence that the elimination of the requirement has been of distinct advantage to the banks of these districts in that it has permitted them to adjust the vault cash carried to meet the needs of their individual requirements. The reduction in vault cash which the banks have actually made has been greater than the investigations made in 1916 and 1917 indicated as probable. Following is a table showing the percentages

of vault cash to net amount of all deposits on which reserves are computed on May 1, 1917 before adoption of the 1917 amendment and on October 10, 1924.

Percentages of Vault Cash
To Net Amounts of all deposits on which Reserves are computed

Banks in	May 1, 1917	October 10, 1924	Reduction
New York City	11.7	1.2	10.5
Chicago	10.9	1.7	9.2
Other Federal Reserve Bank and Branch Cities	7.1	2.0	5.0
Other Reserve Cities	7.2	3.9	3.3
Country Banks	6.9	3.6	3.3
<u>Total United States</u>	8.2	2.5	5.7

The reduction in required reserve made in 1917 was in, the case of most banks more than adequate to offset the discontinuance of counting vault cash as part of the legal reserves. It is believed that most of the country banks now carrying vault cash in amount greater than 5 per cent. of their net deposits can by the adoption of methods found practicable by the majority of country banks, reduce their vault cash sufficiently to come within that limit. If for any reason vault cash were again to be counted as part of the legal reserve, the total reserve required by law should be proportionately increased. The suggestion is sometimes made that vault cash be deducted from deposits in determining the amount against which reserve should be computed. The following tabulation shows the effect

which would result from such deduction from demand deposits, with the present reserve percentages in effect.

EFFECT OF DEDUCTION OF CASH IN VAULT FROM GROSS DEMAND DEPOSITS (000 Omitted)

Banks in	Pro- posed Reserve Require- ment	Data from Reports of Condition					
		Sept. 14, 1923			Oct. 10, 1924		
		Vault cash held	Reduction in re- serve requirement Amount	Percentage	Vault cash held	Reduction in reserve requirement Amount	Percentage
	%	\$	\$	%	\$	\$	%
New York City	13	57,424	7,465	- 1.4	63,027	8,194	- 1.2
Chicago	13	23,538	3,060	- 2.3	21,590	2,807	-1.7
Other Fed. Res. Bk. and Branch Cities	10	114,528	11,453	- 2.2	114,531	11,453	- 2.0
Outside Reserve Cities	10	46,320	4,632	- 4.2	46,397	4,640	- 3.9
Country Banks	7	287,597	19,712	- 3.8	282,344	19,764	- 3.6
Total U. S.		523,407	46,322	- 2.5	527,889	46,858	- 2.2

The elimination of the deduction of balances due from other banks whether from the deposits due to other banks as at present permitted or from gross deposits would be favored by the committee, were it not that such a change would result in violent increases for individual banks.

The reserve of the member bank required by law to be carried with the Federal Reserve bank serves to replenish the member bank's vault cash, to meet clearing house balances and other daily demands, to meet seasonal or emergency withdrawals, and to contribute to a central reserve fund which will furnish the basis for rediscount accommodation at the Federal Reserve bank, and at the same time safeguard the volume of credit expansion.

Secured deposits. Secured deposits should be, and in many states are, subject to reserve requirements. Security intended to insure ultimate liquidation does not relieve the bank from the necessity of paying out cash when a deposit is withdrawn.

A test of need for reserve. The committee has had extensive studies made of the velocity of turnover of deposits, that is, the amount of checks paid by a bank during a period in relation to the amount of its deposits. These studies disclosed such extreme variations as clearly to indicate that velocity of turnover is not a reliable test of the need for reserve against deposits. Velocity of turnover indicates activity but not necessarily likelihood of withdrawal, which is the obvious test of reserve needs. (See Exhibit A for illustration of fluctuation in deposits).

Classification of Deposits. For reserve purposes, deposits should be divided into three classes: bank deposits, demand deposits and time deposits. Other liabilities not subject to reserves with Federal Reserve banks should include national bank notes which carry reserve in form of the 5 per cent. redemption fund at Washington and all other liabilities not subject to reserve of any description. Deposits and other liabilities are listed in detail below, with the present reserve practice indicated and also that recommended by the committee. Items 25 - 30 include certain assets which pertain to reserves.

	<u>Present Reserve Practice</u>	<u>Committee's Recommendation</u>
1. Balances due to bank, bankers and trust companies in United States and foreign countries.	Demand deposit rate on balances remaining after deductions.	Bank deposit rate on net balances.
2. Certified and cashier's checks	"	Demand deposit rate
3. Individual deposits subject to check	Demand deposit rate	"
4. Certificates of deposit due in less than 30 days	"	"

	<u>Present Reserve Practice</u>	<u>Committee's Recommendation</u>
5. State, country or other municipal deposits, secured by pledge of assets of the bank or Surety bond, requiring less than 30 days notice	Demand deposit rate.	Demand deposit rate
6. Deposits requiring notice but less than 30 days	"	"
7. Dividends unpaid	"	"
8. Other demand deposits	"	"
9. Uninvested trust funds deposited in commercial department and payable within thirty days	"	"
10. U. S. deposits (other than postal savings deposits) including war loan deposit account and deposits of U.S. disbursing officers	None	"
11. Cash letters of credit and travellers' checks.	"	"
12. Postal Savings deposits	Time deposit rate	Time deposit rate
13. Certificates of deposit payable after 30 days	"	"
14. State, country or other municipal deposits secured by pledge of assets of the bank or surety bond requiring at least 30 days written notice of withdrawal	"	"
15. Other time deposits	"	"
16. Circulating notes outstanding	5% Redemption Fund	5% Redemption Fund
17. United States Government securities borrowed	None	None
18. Bonds and securities other than United States borrowed	"	"
19. Bills payable	"	"
20. Notes and bills rediscounted including acceptances of other banks and foreign bills of exchange or drafts sold for endorsement of this bank	"	"
21. Acceptances executed by this bank less acceptances of this bank purchased or discounted	"	"

	<u>Present Reserve Practice</u>	<u>Committee's Recommendation</u>
22. Acceptances executed by other banks for account of this bank	None	None
23. Capital stock, surplus and undivided profits	"	"
24. Other liabilities	"	"
25. Balances due from national and state banks, bankers and trust companies in United States	Deductible from bank deposits only.	Deductible from bank deposits only.
26. Balances due from foreign banks	Not deductible	Not deductible
27. Checks in process of collection with Federal Reserve bank (or other banks).	Deductible from bank deposits only.	Deductible from gross demand deposits only.
28. Exchanges for clearing house	"	"
29. Checks on other banks in same place	"	"
30. Cash in vaults	Not deductible	Not deductible

Bank deposits.

In the classification of bank deposits should be included balances due to all incorporated ~~banks~~ or private bankers which themselves receive deposits from customers. This would include all balances due to

National banks
State banks and trust companies
Federal Reserve banks
Foreign ~~banks~~
Mutual savings banks

In addition, it should also include the following or similar institutions if they receive deposits from customers repayable upon demand or short notice. If they do not receive such deposits, or if the deposits are not subject to withdrawal upon demand or short notice, balances due them should be included among demand deposits:

Private bankers
Acceptance corporations
Building and loan associations
Cooperative banks
Credit unions
Federal Farm Loan banks
Joint Stock Land banks
Intermediate Credit banks.

Classification of banks as to reserve requirements:

The practice of classifying banks according to location in fixing the reserve requirement of each bank has been followed in the case of the national banks for sixty years and is so thoroughly a part of the banking practice of our country that a change is not to be thought of except for compelling reasons.

In the course of its studies of the reserve problem, the Committee has tested various proposals for changes in the method of computing member bank reserves and the percentages of reserve required. In order to examine the effect of such changes over thirty different formulae were developed and applied to the aggregate figures of the several groups of member banks. The formulae which appeared practicable when applied to total figures were tested also with the figures of 2,543 individual member banks selected from all twelve Federal Reserve districts and representative of banks of all sizes. It was found that most of the formulae studied, even though making slight change in the aggregate reserves of the member banks, would cause material changes in the reserves of many individual banks. The committee has reached the conclusion that the formula set forth in the report which this memorandum accompanies is the most satisfactory one which has been developed.

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REPORT OF FEDERAL RESERVE AGENTS COMMITTEE ON MEMBER BANK RESERVES
TO THE FEDERAL RESERVE BOARD

May 12, 1925

REPORT OF FEDERAL RESERVE AGENTS COMMITTEE ON MEMBER BANK RESERVES
TO THE FEDERAL RESERVE BOARD

May 12, 1925.

At the joint conference of the Federal Reserve Board, the Federal Reserve bank governors, and the Federal Reserve agents, held in Washington in November 1924, the Federal Reserve Agents Committee on member bank reserves, consisting of Frederic H. Curtiss, Chairman, Pierre Jay and William McC. Martin, which had been engaged in studying the subject, was reappointed, and D. C. Wills added to the committee. The committee has had extensive studies made on the subject of member bank reserves and has held several meetings, at which the results of these studies and the general problems of member bank reserves were thoroughly discussed. It is the view of the committee that a change in the aggregate reserves carried by member banks should be avoided if possible. The credit system of the country has become adjusted to the present level of reserves and any material change therein would involve readjustments, the effect of which it is difficult to forecast. It is also desirable to avoid changes in reserve requirements which would bring about violent changes in the reserves of individual banks. The committee would, therefore, prefer to avoid any change in the present requirement. It recognizes, however, that in certain particulars changes are desirable and recommends that the requirements of the Federal Reserve Act relative to member bank reserves be so changed as to:

1. Permit the deduction from demand deposits of (a) exchanges for clearing house, (b) checks on other banks in the same place and (c) checks in process of collection (whether with Federal Reserve banks or correspondent banks) according to Federal Reserve schedule of time required for collection of checks.

2. Retain the present provision of the law that "the net difference of amounts due to and from other banks" shall be taken as the basis of ascertaining the net amount of balances due to banks.

3. Provide that the reserve required to be held against net balances due to banks be 10 per cent. for all member banks except those in New York City and Chicago. This involves an increase from the present requirement of 7 per cent. for country banks.

4. Provide that reserve shall be carried against government deposits at the same rate as against demand deposits.

With the proposed amendment in effect, the amount of deposits subject to reserve would be computed by the following formula:

Bank deposits

- 1. Balances due to banks, bankers and trust companies in United States and foreign countries \$ _____
- Deduct:
- 2. Balances due from banks (other than Federal Reserve Bank) **in the U.S.** \$ _____
- (A) 3. Net balances due to banks (Item 1 minus Item 2) \$ _____

Demand deposits

- 4. Demand deposits \$ _____
- 5. Cashiers' and certified checks _____
- 6. U. S. Government deposits _____
- 7. Cash letters of credit and travellers' checks _____
- 8. GROSS DEMAND DEPOSITS (Excl. bank deposits (Items 4,5,6 and 7) \$ _____
- Deduct:
- 9. Checks in process of collection with Federal Reserve or correspondent banks according to Federal Reserve time schedule \$ _____
- 10. Exchanges for Clearing House _____
- 11. Checks on other banks in same place _____
- 12. TOTAL DEDUCTIONS (Items 9,10 and 11) \$ _____
- (B) 13. NET DEMAND DEPOSITS (Excl. bank deposits (Item 8 minus Item 12) \$ _____

(over)

Time Deposits:

14. Savings accounts (subject to not less \$ _____
than 30 days notice)
15. Certificates of deposit (subject to _____
not less than 30 days notice)
16. Postal savings deposits _____
17. Other deposits payable only after _____
30 days
- (C) 18. TOTAL TIME DEPOSITS (Items 14,15,
16 and 17) \$ _____

" Should the aggregate "due from banks" (Item 2) exceed the aggregate "due to banks" (Item 1), both items must be omitted from the calculation.

Required Reserves:

- (A) 13% in New York and Chicago; 10% elsewhere.
- (B) 13% " " " " ; 10% in other Reserve cities; 7% elsewhere
- (C) 3% wherever located.

Figures are given below showing the estimated effect of the proposed changes in reserve requirements based upon the reports of condition of member banks on two dates, September 14, 1923 and October 10, 1924, and with the following reserve percentages.

	<u>Net Bank Deposits</u>	<u>Net Demand Deposits</u>	<u>Time Deposits</u>
New York City	13	13	3
Chicago	13	13	3
Other Fed. Res. Bank & Branch Bank Cities	10	10	3
Outside Reserve Cities	10	10	3
Country Banks	10	7	3

Effect of Proposed Changes in Reserve Requirements

(000 Omitted)

As of September 14, 1923:

	Present Required Reserve	Change by Deduction of Uncollected Checks	%	Increase by Reserve on Government Deposits	%	Increase Reserve on Reserve Country Banks	Reserve Bank de- posits of Country Banks	Reserve with Proposed Ef- fective Changes	Net Change	% Chge.
New York City	\$ 546,015	\$- 4,427	- .8	\$+ 3,259	+ .6	0	\$ 544,847	\$-1,168	- .2	
Chicago	133,189	- 1,007	- .8	+ 644	+ .5	0	132,826	- 363	- .3	
Other F.R.B. & Br. Cities	515,322	-10,366	-2.0	+ 6,828	+1.3	0	511,784	-3,538	- .7	
Outside Re- serve Cities	111,476	- 2,908	-2.6	+ 1,405	+1.3	0	109,973	-1,503	-1.3	
Country Banks	<u>524,201</u>	<u>-24,038</u>	<u>-4.6</u>	<u>+ 2,249</u>	<u>+ .4</u>	<u>+2,000#</u>	<u>504,412</u>	<u>-19,739</u>	<u>-3.8</u>	
<u>Total U. S.</u>	<u>\$1,830,203</u>	<u>\$-42,746</u>	<u>-2.3</u>	<u>\$+14,385</u>	<u>+ .8</u>	<u>+2,000#</u>	<u>\$1,803,842</u>	<u>\$-26,361</u>	<u>-1.4</u>	

As of October 10, 1924:

New York City	\$ 688,060	\$- 2,629	- .4	\$+ 5,675	+ .8	0	\$ 691,106	\$+ 3,046	+ .4
Chicago	163,122	- 321	- .2	+ 1,357	+ .8	0	164,158	+ 1,036	+ .6
Other F.R.B. & Br. Cities	574,467	-23,935	-4.2	+17,827	+3.1	0	568,359	- 6,108	-1.1
Outside Re- serve Cities	120,336	- 1,305	-1.1	+ 1,393	+1.2	0	120,424	+ 88	+ .3
Country Banks	<u>542,948</u>	<u>-24,346</u>	<u>-4.5</u>	<u>+ 3,886</u>	<u>+ .7</u>	<u>+2,000#</u>	<u>524,488</u>	<u>-18,460</u>	<u>-3.4</u>
<u>Total U.S.</u>	<u>\$2,088,933</u>	<u>\$-52,536</u>	<u>-2.6</u>	<u>\$+30,138</u>	<u>+1.4</u>	<u>+2,000#</u>	<u>\$2,068,535</u>	<u>\$-20,398</u>	<u>-1.0</u>

#---A rough approximation

This formula has also been applied to 2,543 individual banks, so selected as to be representative of conditions existing in each Federal Reserve District. A summary of the resulting changes in the reserve requirements of these banks appears on the following page.

EFFECT OF FORMULA PROPOSED BY FEDERAL RESERVE AGENTS' COMMITTEE FOR RESERVES OF MEMBER BANKS
ON 2543 SELECTED BANKS AS OF OCTOBER 10, 1924.

	*Boston 424 Banks		New York 182 Banks		Philadelphia 213 Banks		Cleveland 177 Banks		Richmond 172 Banks		Atlanta 151 Banks		Chicago 401 Banks		St. Louis 151 Banks		Minneapolis 173 Banks		Kansas City 178 Banks		Dallas 145 Banks		San Francisco 176 Banks		All Districts 2543 Banks			
Per cent Change Zero	27		17		8		12		15		6		26		10		25		14		8		15		183			
	-	+	-	+	-	+	-	+	-	+	-	+	-	+	-	+	-	+	-	+	-	+	-	+	-	+	-	+
1	38	26	26	11	22	2	18		10	4	9	4	26	16	10	1	19	7	-	+	-	+	-	+	-	+		
2	59	20	29	8	31	6	18	7	29	5	19	5	70	8	13	4	31	3	20	5	15	6	20	2	233	84		
3	68	10	40	5	44	6	39	6	38	3	27	4	76	4	22	1	31	3	12	3	12	6	23	3	346	78		
4	58	12	19	3	36	4	32	4	16	3	28	3	73	4	24	4	21	1	35	2	11	1	18	2	449	47		
5	53	15	8	2	20	1	22	1	8	2	13	1	38	3	24	2	9	4	42	1	24	4	38	1	411	44		
6	15	1	8		5	2	8	3	9	2	4	3	22	1	9	3	2	4	20	2	18		20	1	253	34		
7	4	3			6	3	1	1	2	2	7	3	8	4	4	2	1	1	8	1	15	5	16		121	25		
8	3	3			3	2			3	2	5	2	2	1	4	1	1	4	6	1	5	1	3	1	46	21		
9		4	2		2	3			2	1	1		4	1	3	1	1	4	3	1	1	1	4	1	29	17		
10		1	1		1		1		4	4	2	1	2	1	3	1	2	2	3	1	2	1	2	1	18	14		
11	2	1	1		1			3	2	2	1		3	1	1		1						3	1	8	12		
12			1			1	1		1	2		1	1	3							1				8	5		
13				1				1					1	3							1				2	9		
14					3				1				1						1		2				3	3		
15							1						1			1			1	1	2					8		
16		1												1		1				1	1					4		
17											1				1						1					2		
18					1		1					1				1				1	1				1	1		
19								2					1			1			1				1		1	4		
20							1			2		1	1				2								1	4		
Over 20								2			1	1	3		1	1		1				1			1	9		
Total-	300		135		171		138		121		115		322		117		114		148		103		147		1,931			
Total*		97		30		34		27		36		30		53		24		34		16		34		14		429		

*As of September 14, 1923

Deduction of Checks in Process of Collection:

The deduction of exchanges for clearing house, checks on other banks in the same place and other checks in process of collection from demand deposits instead of from "due to banks" is proposed in order to correct the unequal bearing of the present requirement on different banks. The difficulty has been that while banks holding deposits of other banks could, under the present law, deduct checks in process of collection from the amounts due to banks in computing the net amount against which reserve is to be carried, banks not having balances due to banks could not avail themselves of this deduction. It is believed that the deduction of checks in process of collection should be available to all member banks alike, for the reason that it is the general practice of banks in the United States while giving immediate credit for such checks deposited with them, to assert and maintain the right to refuse to pay against such checks until they are actually collected. Thus a portion of the banks' deposit liability is deferred until the checks which created it actually have been collected. Moreover, the volume of "checks on other banks" suffices to offset like amounts of checks which may be outstanding against the bank in question when exchanges are made through the clearing house or through other banks.

Suggestion has at times been made that no deduction of any kind should be permitted from gross deposits and that the percentage of reserve should be reduced to compensate. Study of the deposits of individual banks clearly shows that great fluctuations take place in the amount of checks on other banks held from day to day which are offset by fluctuations in checks drawn against them, and which, therefore, do not produce corresponding fluctuations in the net deposits of the banks. The allowance of the deductions referred to is therefore believed to be equitable for the reason that thereby fluctuations in amount of reserve required will be minimized.

The deduction of these items, representing checks in process of collection, should be made from demand deposits for it is through the demand deposit accounts that most of the checks are received.

10 Per cent. Minimum Reserve Requirement on Bank Balances.

The recommendation of the committee that in no member bank shall a reserve of less than 10 per cent. be carried against net balances due to banks, is based upon two considerations:

(1) that the National Banking Act has always recognized that banks in cities authorized to hold the reserves of other banks should be required to carry higher reserves than banks in cities not so authorized. This is the requirement also under the laws of some of the states, while under laws of other states banks which wish to hold the reserves of other banks in the state are required to carry higher reserves. A bank which keeps a portion of its reserves deposited with another bank will be obliged, in the event of withdrawals of funds by its own customers, to make withdrawals of about like amount from its depository correspondent bank, which withdrawals will constitute a relatively larger proportion of such redeposit. The strain of withdrawals is thus concentrated upon the bank which holds the re-deposited reserves of other banks and it should be prepared to meet this strain.

(2) that balances "due to banks" are found by the committee, after investigating the experience of 315 banks in seven Federal Reserve districts, to fluctuate much more widely than other demand deposits; also that the smaller the number of out-of-town ^{bank} accounts held by a bank the more widely does the balance "due to banks" fluctuate.

(See Exhibit A)

The committee feels that where a bank not in a central reserve or a reserve city undertakes to solicit the accounts of other banks in its territory or in more distant places, particularly the balances of nonmember banks whose legal reserves are among its deposits, the protection of the bank itself as well as the protection of the communities whose banking reserves it holds, justifies the committee in recommending that such a bank, with respect to balances due to other banks, should be placed at least on an equal footing, as to reserve requirements, with banks in those cities, other than New York and Chicago, which the law now designates as reserve cities. Reserves against balances due to banks are at present unduly low in the case of banks outside of reserve and central reserve cities, many of which have actively solicited such deposits in competition with banks located in the cities recognized as reserve centers and therefore required to carry higher reserves. Competition for deposits of other banks is not local in character but is statewide and even nationwide.

The change of from 7 per cent. to 10 per cent. on net balances due to banks does not seriously affect the figures of many individual banks. The change recommended affects only a small number of country banks which are actively seeking to become reserve centers for large numbers of banks in their respective territories. In most of the other cases of country banks holding out-of-town bank accounts the balances "due from banks" substantially offset the balances "due to banks." The aggregate change is estimated to be less than \$2,000,000.

Reserve on Government Deposits:

Government deposits are subject to withdrawal even more promptly and certainly than other deposits and should be subject to the reserve required against other demand deposits. Before the passage of the First Liberty Loan Act in 1917 government deposits payable on demand (not including postal savings deposits) were subject to the same reserve requirements as other classes of demand deposits. At that time in order to facilitate government war financing, the re-

quirement of reserve against government deposits (other than postal savings deposits) was removed. The exigencies of war time financing now having passed, the Committee believes that reserves should again be required against all classes of government deposits. The effect of this change upon the required reserves of the banks would be as shown below:

EFFECT OF REQUIRING RESERVE ON GOVERNMENT DEPOSITS
ACCORDING TO PROPOSED FORMULA

Banks in	%	Condition Reports			
		Sept. 14, 1923		Oct. 10, 1924	
		Required	Change	Change	Change
		Amount	%	Amount	%
New York City	13	\$ 3,259,000	.6	\$ 5,675,000	.8
Chicago	13	644,000	.5	1,357,000	.8
Other Fed. Res. Bk. and Br. Cities	10	6,828,000	1.3	17,827,000	3.1
Outside Reserve Cities	10	1,405,000	1.3	1,393,000	1.2
Country Banks	7	2,249,000	.4	3,886,000	.7
Total United States		14,385,000	.8	30,138,000	1.4

Adjusted credit and debits to member banks for currency shipments:

The committee does not favor the practice of the Federal Reserve banks' deferring charges in member banks' reserve accounts for shipments of currency to member banks until sufficient time has elapsed for such shipments to arrive, nor of allowing credit for shipments from the banks as of the date on which the shipments were made. The difference in reserve requirements of country banks as compared with the requirements for banks located in Federal Reserve bank and branch bank cities should adequately meet the purpose of compensating the out-of-town bank for its relative inconvenience in obtaining currency. An arrangement whereby charges for outgoing shipments might be deferred but incoming shipments not credited until receipt, would appear to be the maximum concession which should be

allowed in this matter, and the fact that the size and destination of outgoing shipments are known to the Federal Reserve banks and therefore might be logically considered as a part of the member bank's reserve until received by the member bank would give a measure of propriety to such a practice. On the other hand, even though currency sent by the member banks to the Federal Reserve banks is not actually credited in advance of receipt, the effect on the amount of reserve carried is the same as if the currency were actually credited before receipt and this is a radical departure from established banking custom. The practice might afford encouragement to unnecessary shipments to the Reserve banks and to involve a disregard of the possibilities of loss from delay or shortage in shipments. Moreover, it results in a further reduction of reserve requirements already moderate in relation to those of banks in Federal Reserve bank and branch cities. The Committee, therefore, recommends that if and when the proposed deduction from demand deposits of checks in process of collection becomes effective, the practice of adjusting credits and debits to member banks for currency shipments be discontinued.

Currency Depots:

The Committee doubts the expediency of establishing currency depots, and recommends that where such depots are or may be established the reserve requirements of the member banks in the currency depot city be increased to the equivalent of the requirements for member banks in Federal Reserve Bank or Branch cities (other than New York City and Chicago).

Classification of outlying districts of reserve or central reserve cities:

The Committee believes that the presumption should be against granting reductions of reserve for outlying sections within municipal limits of central reserve or reserve cities. There are cases where such reduction is justifiable, and such cases should be determined upon an investigation of the character of the individual bank or banks making application for reduced reserves.

Segregation of savings deposits:

The Committee believes that the tremendous growth which has taken place in time and savings deposits of member banks raised the problem of protection of savings depositors by the setting apart or segregation of the assets in which such deposits are invested. The experience in states having laws providing for the segregation of savings deposits has been satisfactory and depositors in savings departments have thus avoided loss on many occasions. In the absence of provision for segregation of savings deposits, the development of a run on a weak bank is very likely to result in the prompt withdrawal through the clearing house or mail of large amounts of demand deposits while savings depositors are by the application of the requirement for 30 days notice of withdrawal or by the physical difficulty of presentation of pass book at the counter, prevented from participating in the withdrawal of the funds representing the liquid portion of the bank's assets. The segregation of the assets representing savings deposits would not necessarily be accompanied by legal restriction as to the investment of the funds. The Committee suggests that this subject be referred to the Committee on Legislative matters for its consideration.

Reserve against time and savings deposits.

Members of the Committee have from time to time received suggestions that inasmuch as many states have no requirement for legal reserve against time deposits, the requirement of the Federal Reserve Act for 3 per cent. reserve against time deposits should be reduced or eliminated. The Committee is not in sympathy with this proposal. The reserve against time deposits should not be lower than 3 per cent. and the Committee believes that the states should be urged to adopt an equivalent requirement, and suggests that this also be referred to the Committee on legislative matters. The Committee has given careful consideration to the Federal Reserve regulations regarding time deposits and believes that they are adequate

Enabling Acts in States:

The Committee believes that efforts should be continued to have all states adopt legislation authorizing the substitution in the case of member banks, of Federal Reserve Act requirements relative to reserve for those of the State law.

Restrictions concerning loans and dividends when reserve is deficient:

While Section 19 of the Federal Reserve Act authorizes a member bank to withdraw its reserve balance, it also provides that no bank shall at any time make new loans or pay any dividends unless and until the balance required by law is fully restored. Exercising its statutory authority the Federal Reserve Board has fixed penalties only for average deficiencies over weekly periods for Reserve city banks and semi-monthly periods for country banks. As a result of these provisions, a member bank may withdraw its balances below the legal reserve minimum provided the average reserve for the specified period is at or above the minimum, without being subjected to penalty. But while the penalty for deficient reserve may not attach in such a case, the restriction against making new loans or paying dividends is operative whenever the reserve is below the amount required by law. The Committee believes that the Federal Reserve Act should be amended to make this provision less onerous and suggests that the subject be referred to the Committee on legislative matters.

Survey of reserve principles and practice:

A supplementary memorandum on the general subject of bank reserves accompanies this report in which comment is made on the principles involved and the results of investigations made by the Committee are described.

Conclusion:

The Committee believes that changes proposed in the foregoing report will eliminate all serious inequalities in the present method of reserve computation with only a slight reduction in the aggregate amount of reserves carried by member banks. The major portion of this reduction would be in the reserves of the country banks.

Respectfully submitted:

FREDERIC H. CURTISS, Chairman

PIERRE JAY

WILLIAM McC. MARTIN

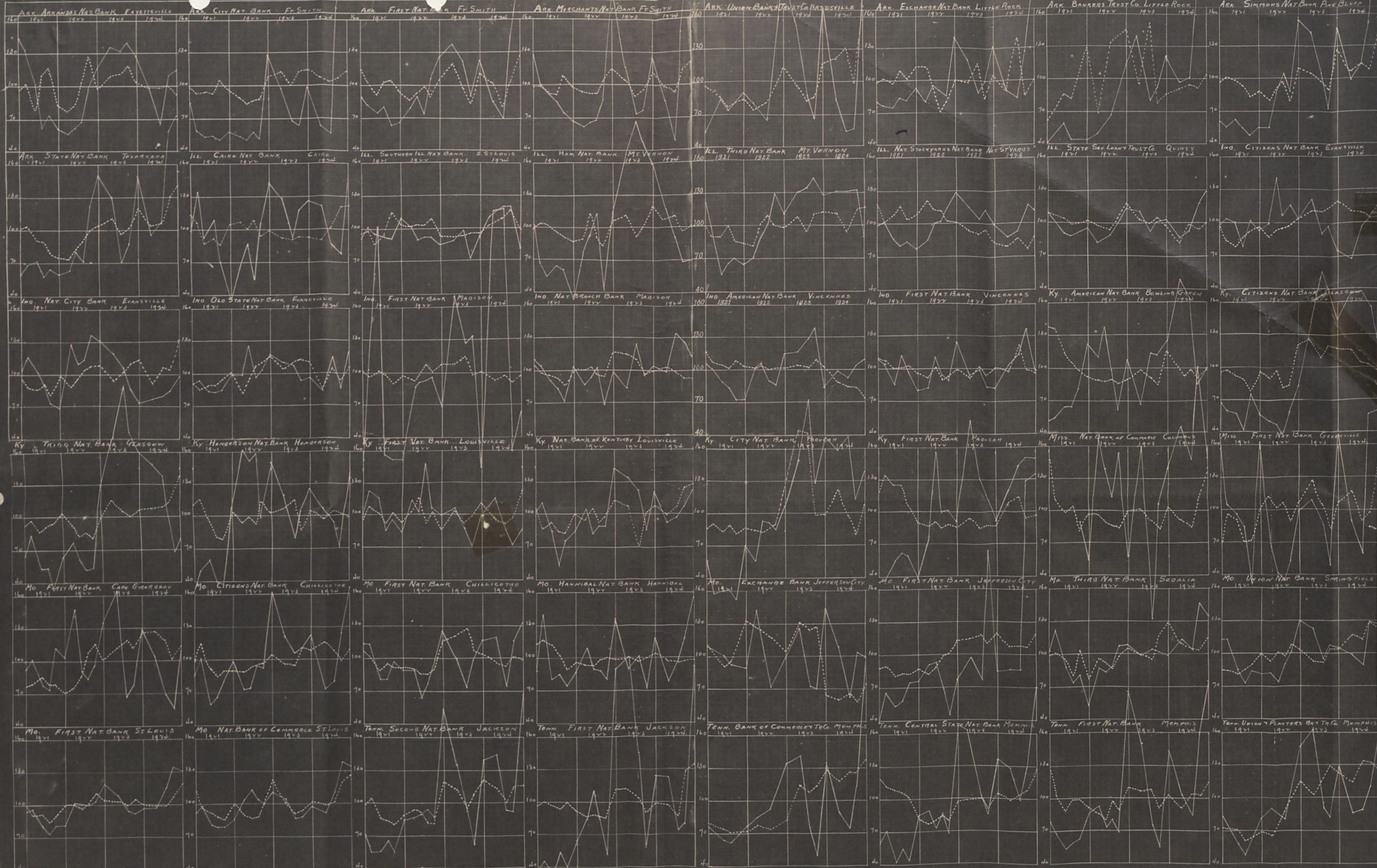
D. C. WILLS

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BANK AND DEMAND DEPOSITS INDEX FOR 48 BANKS IN FEDERAL RESERVE DISTRICT 8 (1921 - 1924 AVERAGE 100)

— BALANCES DUE TO BANKS
- - - - - INDIVIDUAL DEMAND DEPOSITS



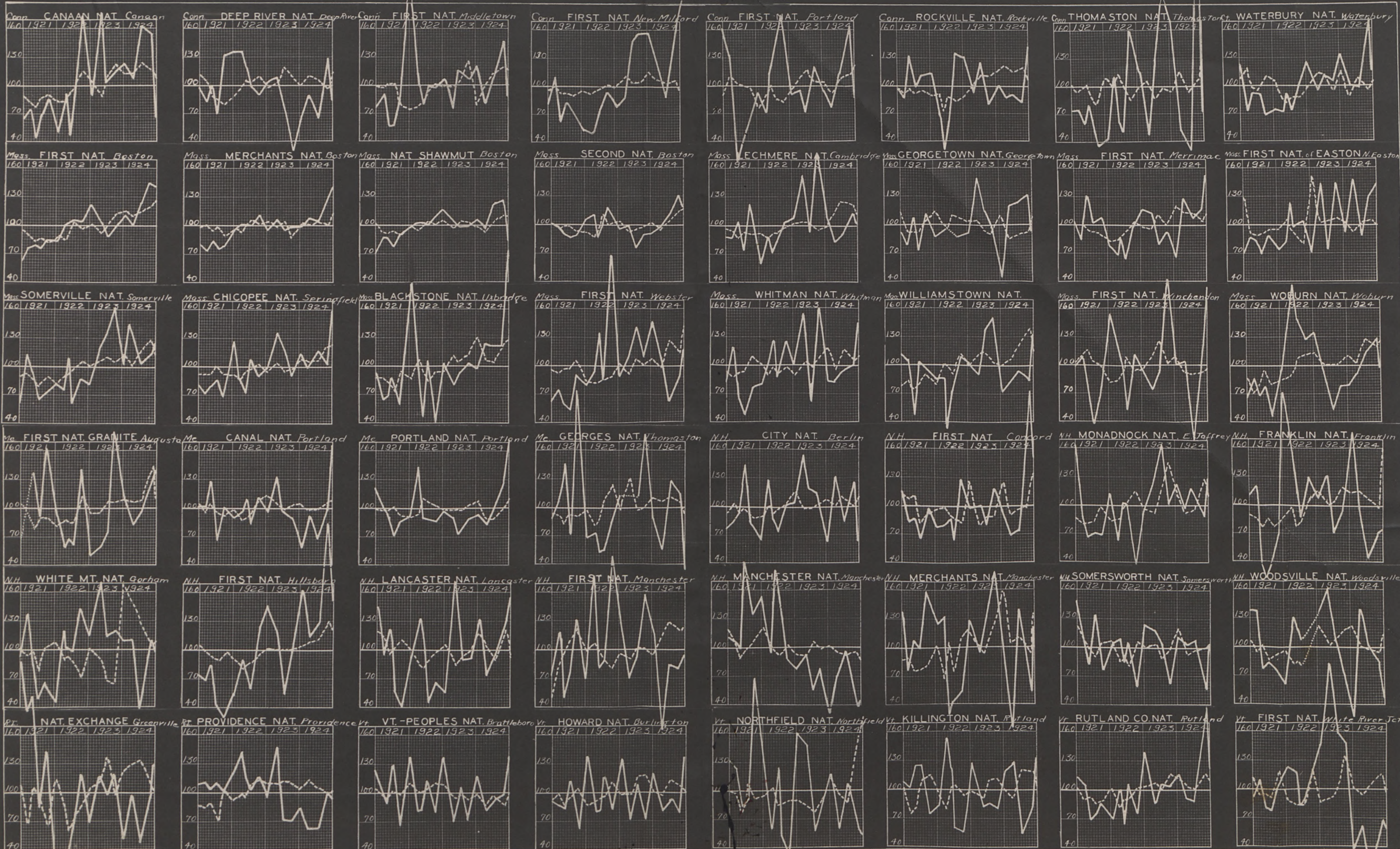
FEDERAL RESERVE BANK OF ST. LOUIS

BANK AND DEMAND DEPOSITS

INDEX FOR 48 BANKS IN FEDERAL RESERVE DISTRICT I

(1921-1924 AVERAGE = 100)

— BALANCES DUE TO BANKS
 - - - INDIVIDUAL DEMAND DEPOSITS

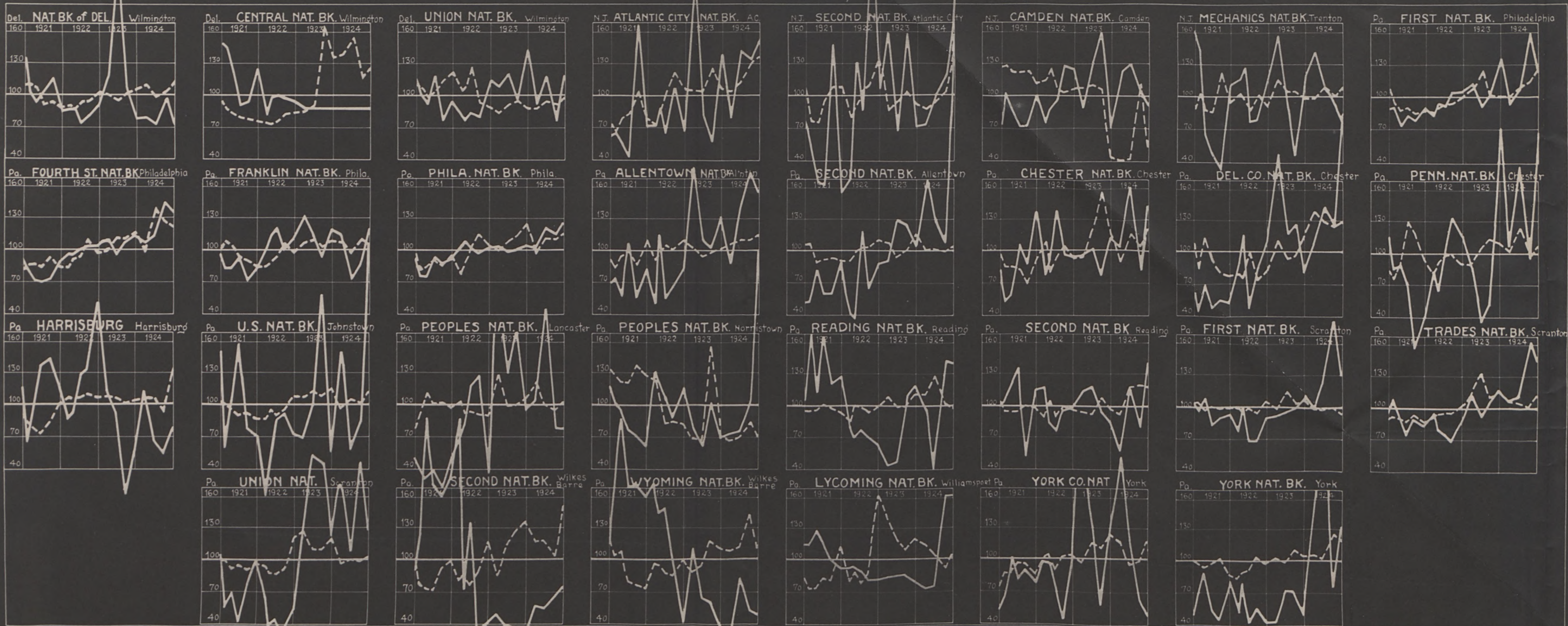


— BALANCES DUE TO BANKS
 --- INDIVIDUAL DEMAND DEPOSITS

BANK AND DEMAND DEPOSITS

INDEX FOR 30 BANKS IN FEDERAL RESERVE DISTRICT 3

(1921-1924 AVERAGE = 100)

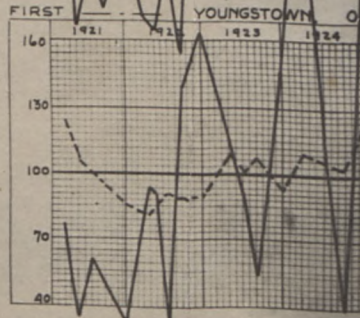
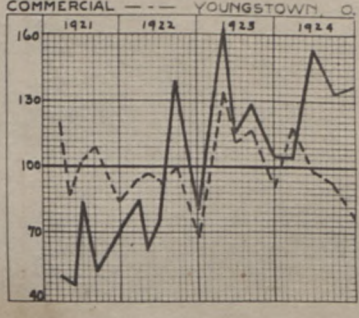
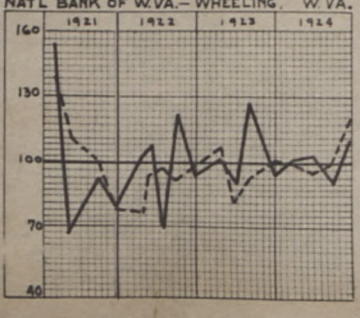
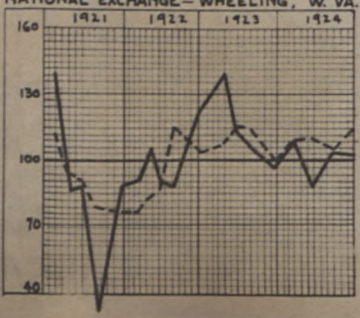
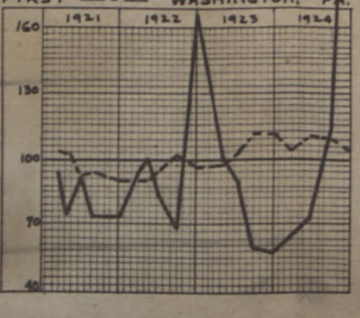
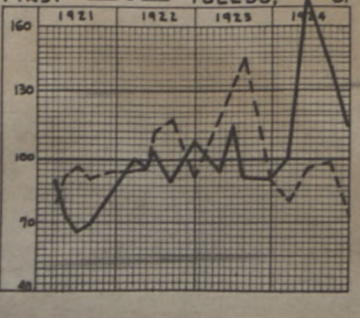
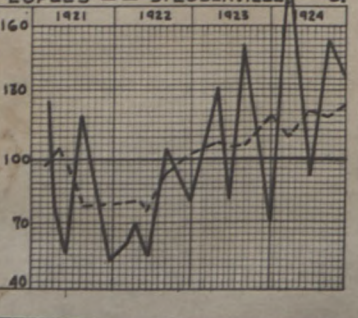
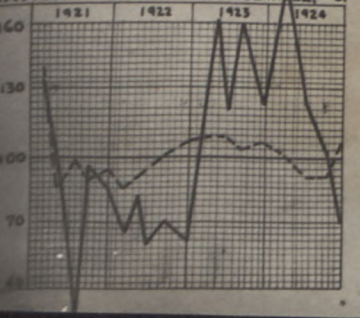
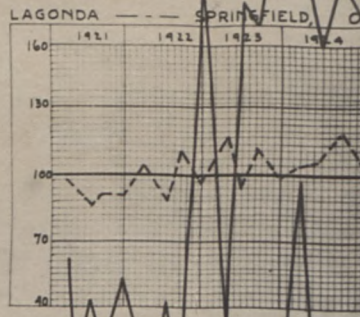
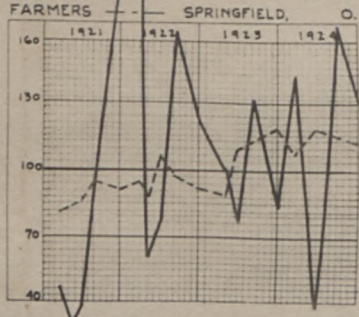
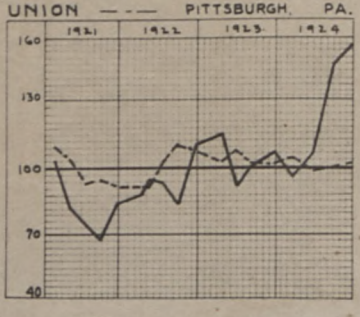
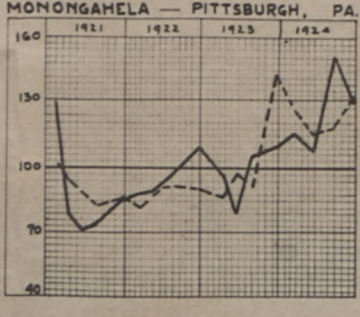
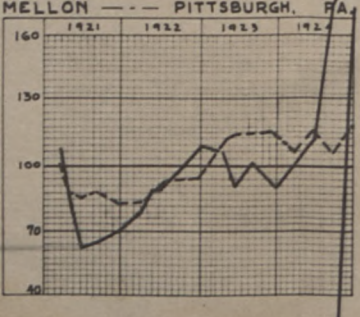
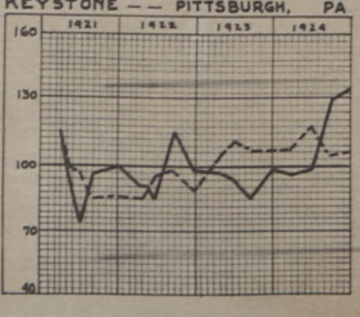
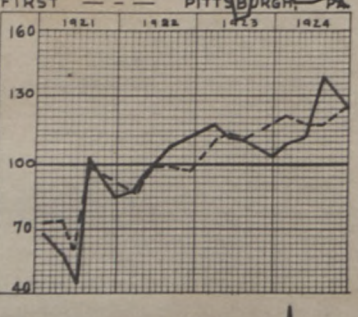
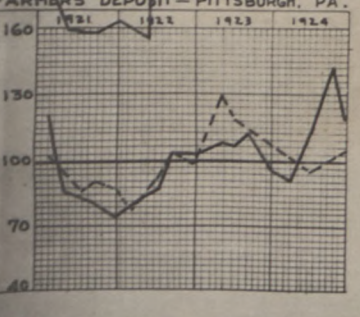
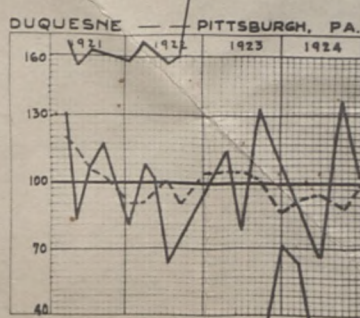
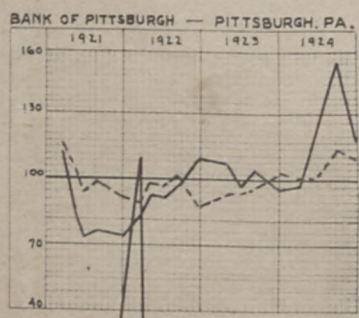
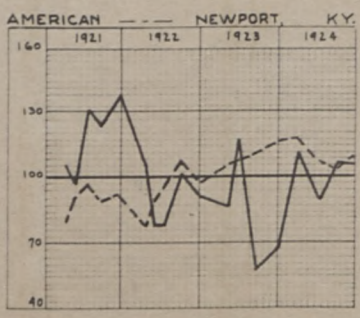
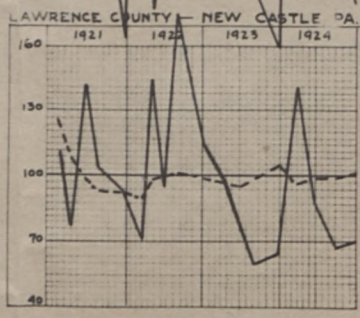
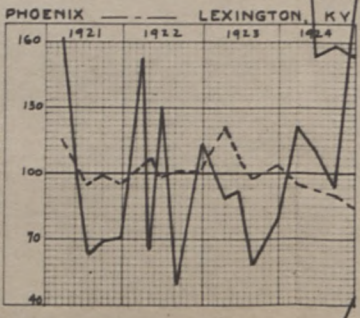
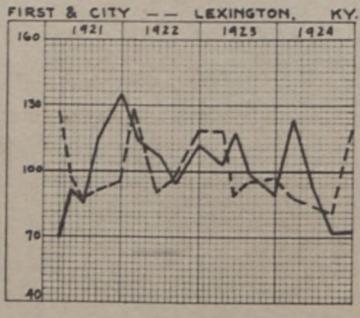
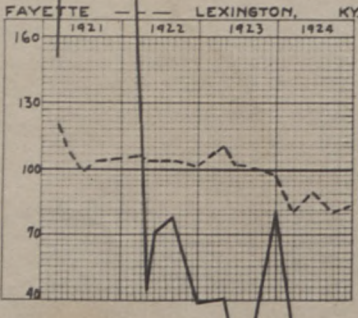
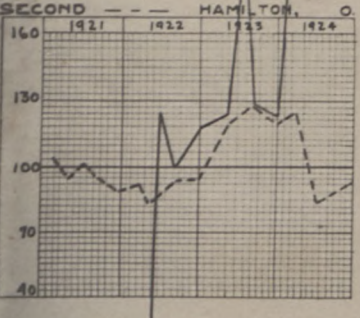
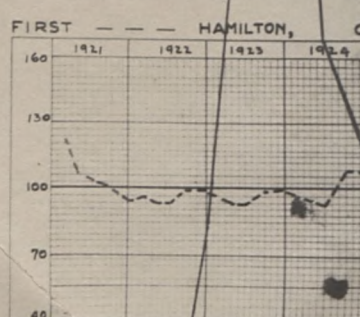
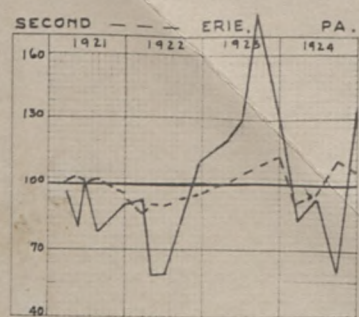
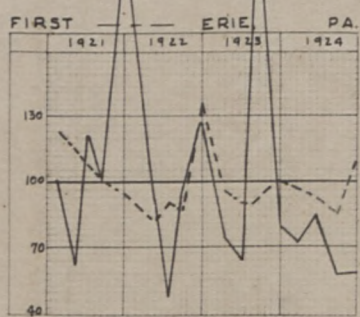
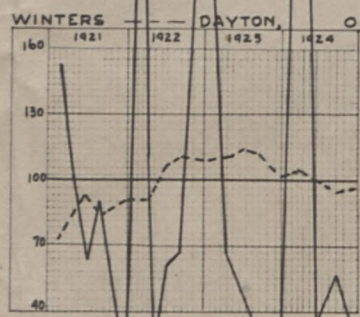
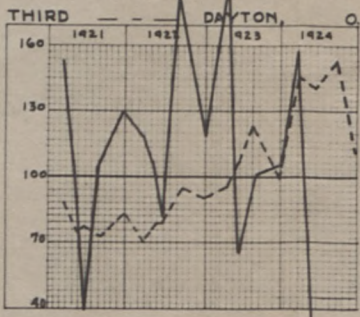
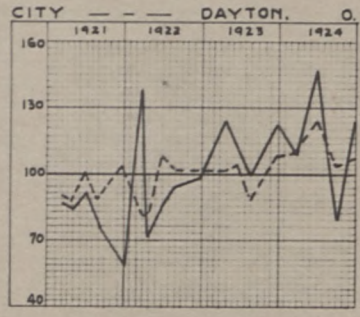
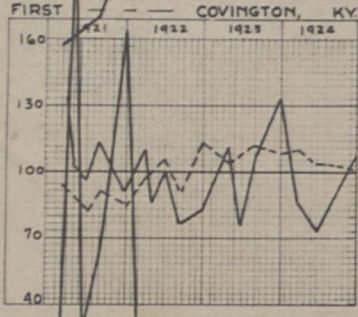
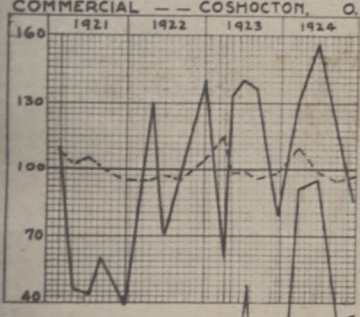
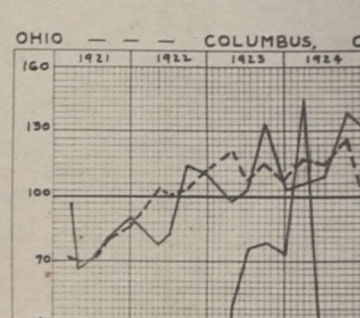
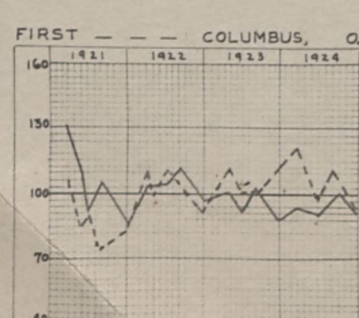
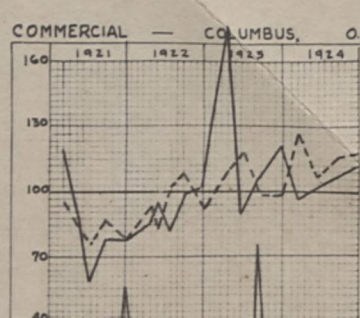
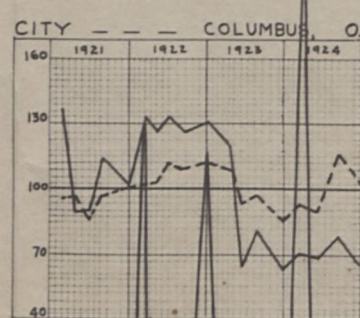
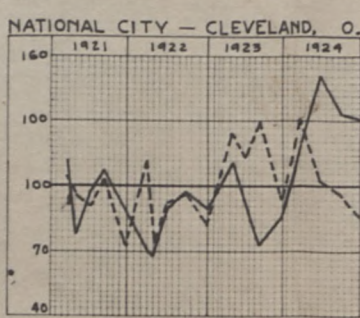
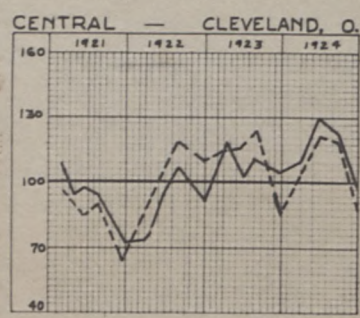
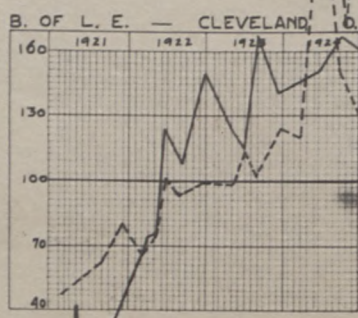
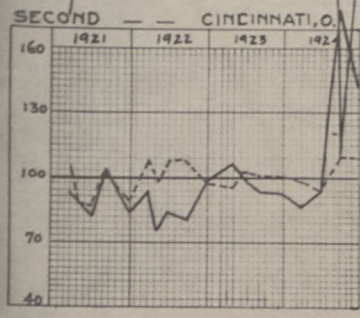
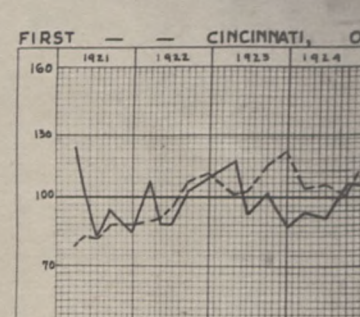
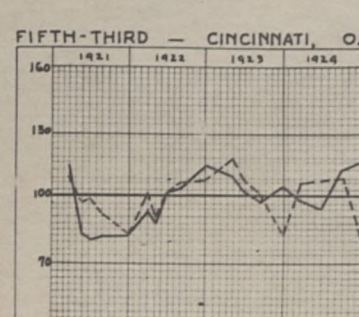
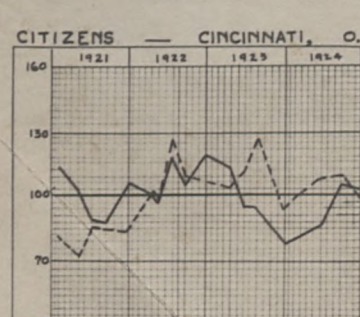
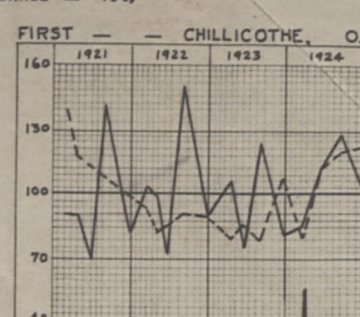
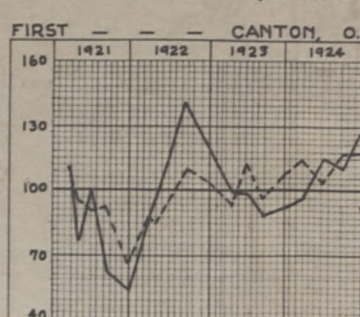
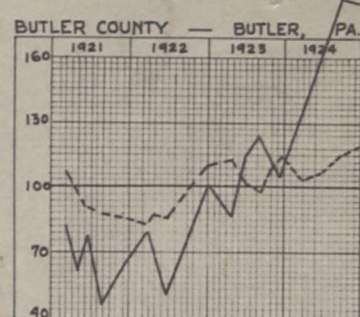
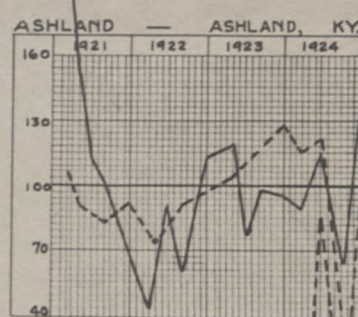
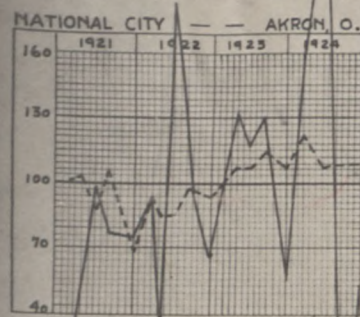


FEDERAL RESERVE BANK OF PHILADELPHIA — FINANCIAL STATISTICS DIVISION

BANK AND DEMAND DEPOSITS

INDEX FOR 48 BANKS IN FEDERAL RESERVE DISTRICT 4
(1921-1924 AVERAGE = 100)

— BALANCES DUE TO BANKS
- - - INDIVIDUAL DEMAND DEPOSITS

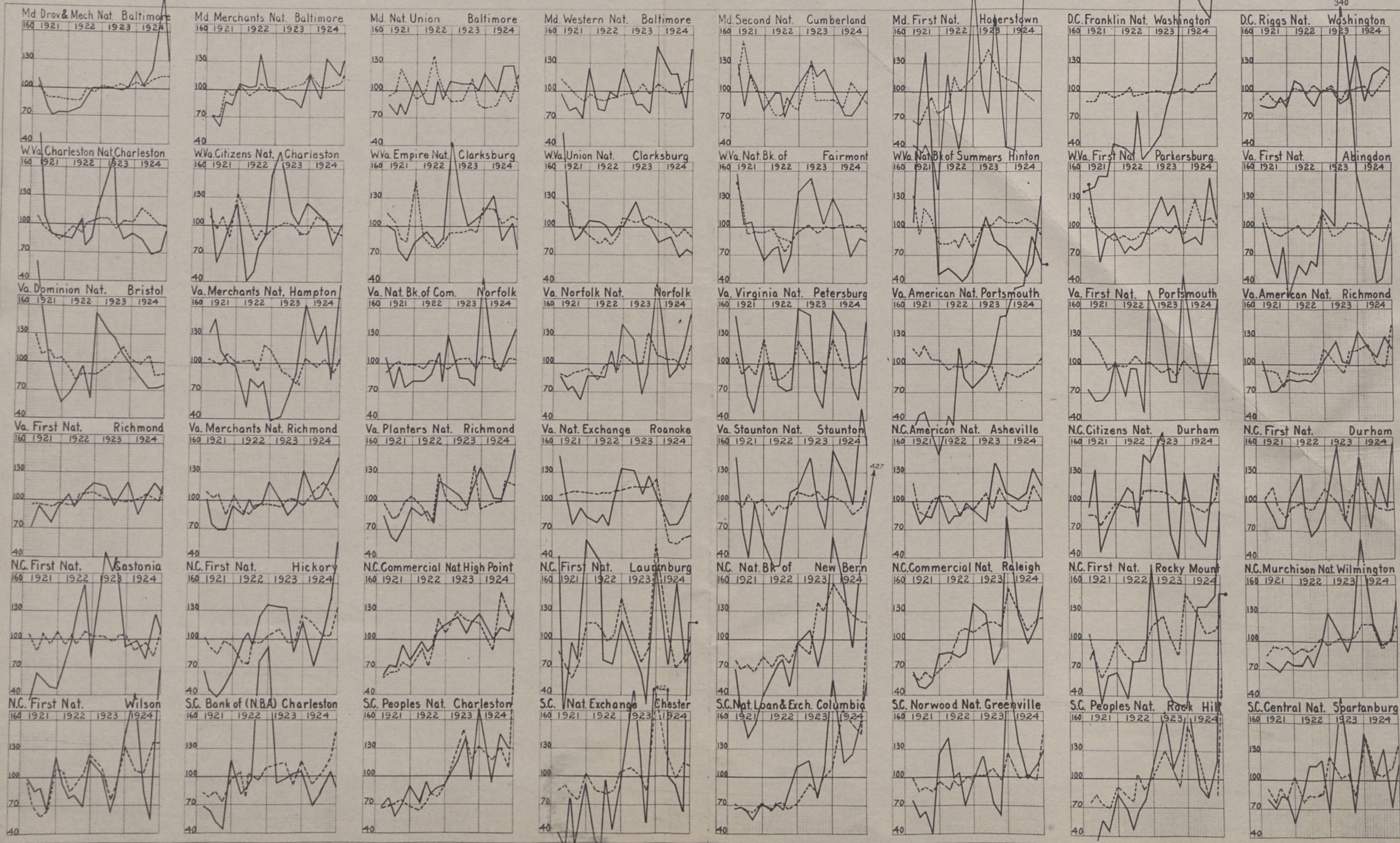


BANK AND DEMAND DEPOSITS

INDEX FOR 48 BANKS IN FEDERAL RESERVE DISTRICT 5

(1921-1924 AVERAGE = 100)

— Balances due to banks
 - - - Individual demand deposits



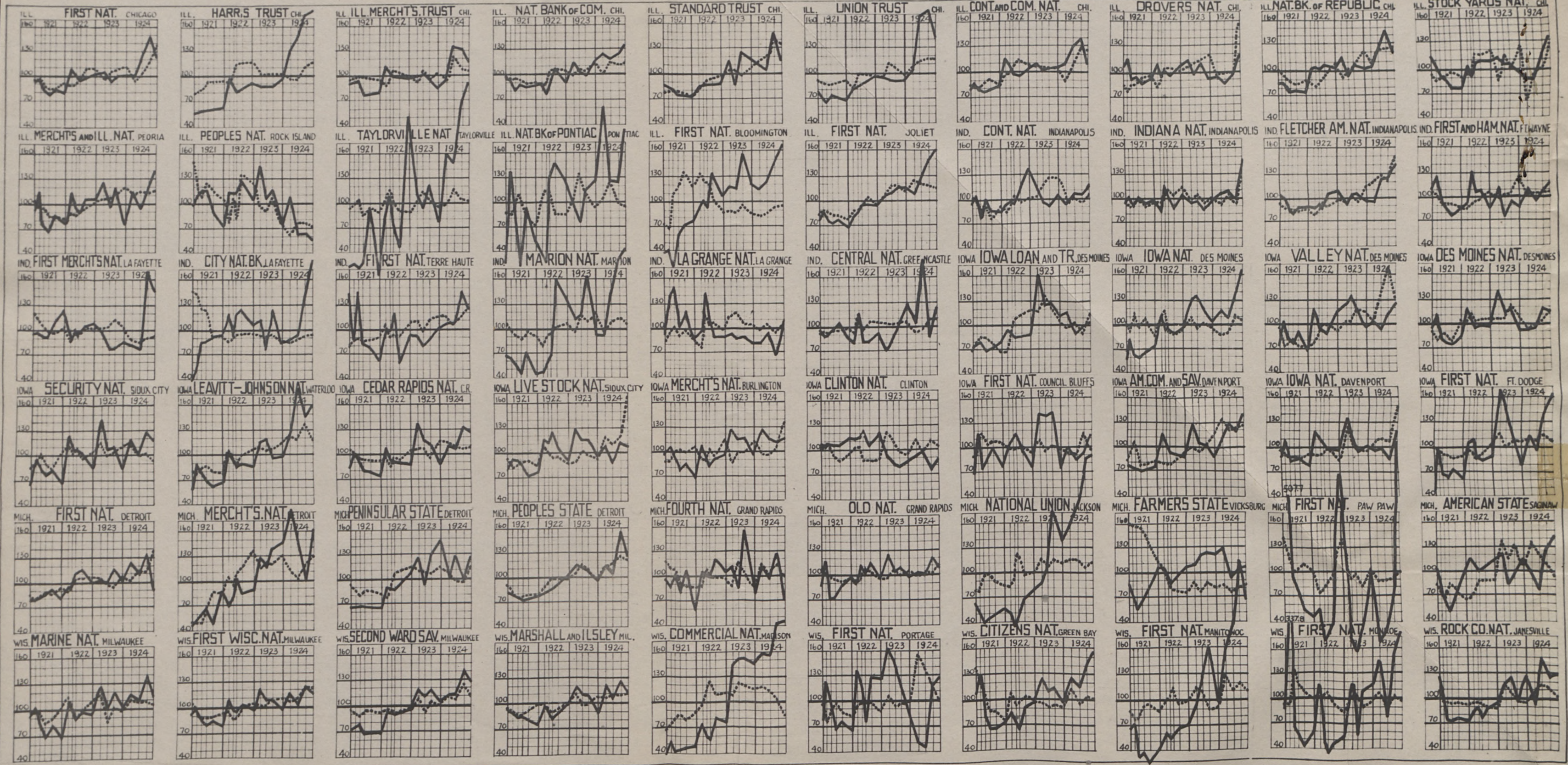
BANK AND DEMAND DEPOSITS

INDEX FOR 60 BANKS IN THE SEVENTH FEDERAL RESERVE DISTRICT

(1921-1924 AVERAGE=100)

PREPARED BY THE DIVISION OF RESEARCH AND STATISTICS
FEDERAL RESERVE BANK OF CHICAGO

———— BALANCES DUE TO BANKS
- - - - - INDIVIDUAL DEMAND DEPOSITS

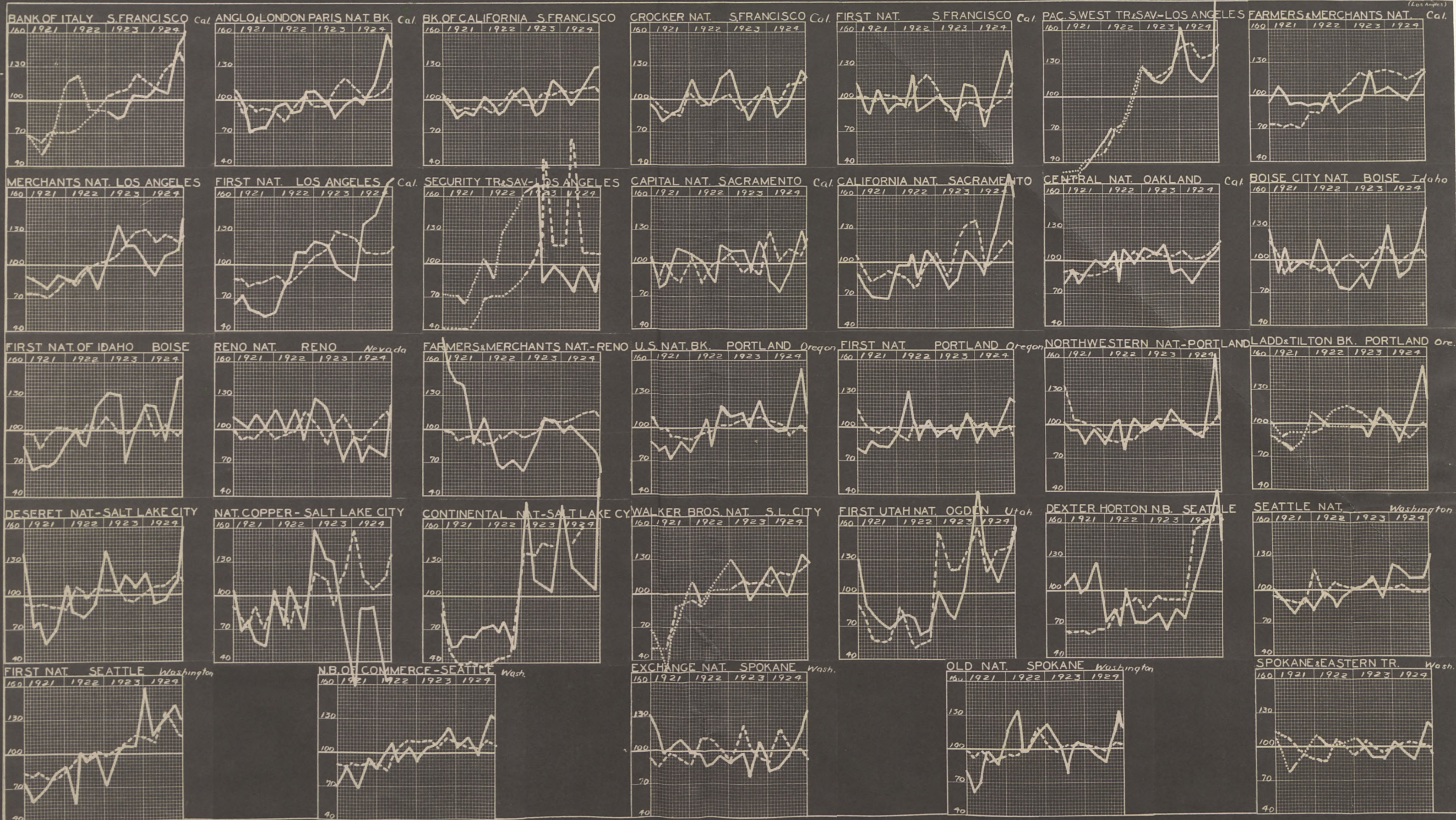


———— BALANCE DUE TO BANKS
 - - - - - INDIVIDUAL DEMAND DEPOSITS

BANK AND DEMAND DEPOSITS

INDEX FOR 33 BANKS IN FEDERAL RESERVE DISTRICT 12

(1921-1924 AVERAGE=100)



See Pa

Exhibit a

See A1

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COMPARISON OF CAPITAL, SURPLUS, DEPOSITS AND RESOURCES OF MEMBER
AND OF ELIGIBLE NONMEMBER BANKS

	Number of banks	Capital	Surplus	Total deposits (including bank deposits)	Total resources
<u>June 30, 1924</u>					
Member banks: National	8,085	\$1,334,011,000	\$1,080,578,000	\$18,347,837,000	\$22,565,919,000
State bank and Trust companies	1,570	697,075,000	589,669,000	11,190,198,000	13,221,983,000
Total	9,650	2,030,336,000	1,669,592,000	29,529,561,000	35,777,256,000
Eligible nonmember banks	13,598	899,346,000	559,659,000	*9,731,868,000	11,585,557,000
Total member and eligible nonmem- ber banks	23,248	2,929,682,000	2,229,251,000	39,261,429,000	47,362,813,000
Ratio of member banks to total of member and eligible nonmember banks (per cent)	41.5	69.3	74.9	75.2	75.5
<u>April 6, 1925</u>					
Member banks: National	8,010	1,360,644,000	1,105,834,000	19,372,828,000	23,820,192,000
State banks and Trust companies	1,521	716,858,000	626,242,000	11,853,699,000	14,129,073,000
Total	9,531	2,077,502,000	1,732,076,000	31,226,527,000	37,949,265,000

*Estimated as 84% of total resources.

Federal Reserve Board

X-4212

OFFICE CORRESPONDENCE

December 8, 1924.

TO Governor Crissinger
FROM Mr. Goldenweiser

SUBJECT: Article in the Commercial and Financial Chronicle for November 22, 1924.

Eight pages of the Chronicle for November 22 were devoted to an article entitled "Imperfect working of Federal Reserve System - over-saturating credit and currency". In view of the wide circulation of the Chronicle among persons interested in financial problems, it is worth while to consider some of the points in this editorial.

Resolution of Bankers' Association.

The article begins with a quotation from the resolution of the American Bankers' Association last October in Chicago to the effect that the operations of the Federal reserve banks "may tend to accentuate the swings of the financial pendulum rather than to keep the swings from going too far in either direction," and that it should be carefully considered whether it would not be "wise to limit the Federal reserve banks to their primary function as banks of issue and rediscount." The writer believes that the Bankers' Association resolution "has come not a moment too soon." He thinks that "in view of the recent glutted condition of the money markets of the country no one can truthfully assert that the Federal reserve banks have functioned properly" and that "the volume of the circulating medium of the country is being kept at a level enormously above what it should be."

Causes of excessive ease in the money market.

The writer discusses the reasons usually assigned for the over-abundance of funds, namely, the trade recession and the gold inflow, but is convinced that in addition to these causes the activities of the Federal reserve banks have contributed to the excessive supply of credit. He is of the opinion that, while the member banks have gone back to normal conditions after the war, "the reserve banks have been unable or unwilling to get back and have stopped at the half way point." On this point the writer is clearly mistaken, since the total volume of member bank credit at the present time is about \$2,300,000,000 larger than at the post-war peak in the autumn of 1920, while total earning assets of the reserve banks are about \$2,300,000,000 less than they were at that time.

As proof of the statement that the reserve banks have increased the amount of credit in the market the writer points out that while what he calls "mercantile paper" (discounts) at the reserve banks is now only about \$234,000,000, the reserve banks have bought during the year over \$500,000,000 of Government securities and lately have purchased large volumes of acceptances. In this statement the writer overlooks; first, that while the reserve banks have purchased Government securities to the extent of \$500,000,000 there has been an equivalent decline of discounts, and, secondly, that purchases of acceptances have been largely on the initiative of acceptance dealers who have offered their bill holdings to the reserve banks because the firmer conditions in the money market have caused the member banks to call some of their loans to these dealers. A comparison of conditions now and a year ago

and an examination of the gold imports during the period indicate that for the year as a whole the increase of member bank credit approximately corresponds to the amount for which the gold imported from abroad furnished a basis. Total loans and investments of all member banks increased by about \$2,000,000,000 between September 13, 1923 and October 10, 1924, and net gold imports for the period were about \$375,000,000, indicating that the gold inflow alone, when added to the reserves of member banks, has been much more than sufficient to serve as a basis for the increased lending power of member banks. Earning assets of the reserve banks, on the other hand, are no higher now than they were a year ago.

Functions of the reserve banks.

The writer's views on the scope and functions of the Federal reserve system are that "the reserve banks exist only to provide surplus or excess credit" and that "in a period of pronounced ease in the money market ... not a dollar of their deposits ought to be put out in the shape of reserve notes." The question whether the reserve banks are to be merely emergency institutions operating at times of seasonal or cyclical demand for excess credit or whether they shall be continuously in the market, is a question on which there has been much difference of opinion. The Federal Reserve Board, however, has from the beginning taken the position that it is important for the reserve banks at all times to remain in touch with the market and that for this reason it is necessary for these banks always to have in their possession discounts, acceptances, or securities in order not to be cut off entirely from contact with the credit situation.

The writer's views on currency.

On the subject of Federal reserve notes the writer has strong convictions based largely on a misunderstanding of the nature of the Federal reserve note. He says that when money rates are down to 3 and 3 1/2 per cent and there is no mercantile demand for reserve bank credit, this is conclusive evidence that there should be no Federal reserve notes outstanding, and that gold rather than notes should be in circulation. This view overlooks the fact that Federal reserve notes are not issued by the reserve banks, except in response to a currency demand, and that it makes no difference in the existing credit and money market situation whether the reserve banks issue Federal reserve notes or gold in response to this demand. It is true that by paying out gold the reserve banks decrease their potential lending power more than by issuing Federal reserve notes, but in view of the fact that this potential lending power is now far in excess of any probable demand for reserve bank credit, this effect of paying out gold is of only academic interest.

The saturation point.

The writer says that the only way the reserve banks can acquire gold is either by issuing Federal reserve notes or by accepting gold on deposit. From this he argues that if the note issues and the deposit liabilities of the reserve banks exceed their gold reserves, this is evidence that the reserve banks have put into use more credit than they have received from the public. This statement is fundamentally correct. It is true that to the extent that the deposits and notes exceed the reserves of the reserve banks there is more bank credit in use, as a result of the operation of the reserve banks, than there

would have been if the deposits had been held by the member banks and the gold had been in circulation. The conclusion, however, that this excess, which amounts to about \$1,000,000,000 represents "saturation" of credit by the reserve banks does not follow. While the excess measures the extent to which the existence of the reserve banks has added to the volume of credit in existence, it is not clear what is meant by saturation. The fact is that the larger volume of currency in circulation at the present time compared with 1914, prior to the establishment of the Federal Reserve System, is due to the higher level of prices. The level of wholesale prices is about 50 per cent above what it was in 1913 and the volume of money in circulation is about 40 per cent above its level at that time. It may be argued that it is because of the increase in currency that prices have increased, but whatever truth there may be in this argument its proper application is to the war period and not to recent activities of the reserve banks. Prices increased during the war in the United States and throughout the world, and in order to meet the requirements of business at the existing price level more currency is required than was needed in 1914.

The complete adjustment between the demand for currency and the volume of it outstanding under the present plan is one of the definite gains resulting from the establishment of the Federal Reserve System, and this adjustment is in no way affected by the policy of the reserve banks to pay out one or another kind of currency, a point which the writer fails to understand. He is entirely mistaken when he says that if the gold coming from abroad had merely displaced

Federal reserve notes in circulation there would be no such redundancy of currency and no such plethora of funds as now prevails." The fact is that the Federal reserve banks have paid out \$700,000,000 of gold into circulation in the last two years, an amount somewhat in excess of gold imports for the period, and Federal reserve note circulation has declined by approximately the same amount. The Federal reserve banks have paid out more gold into circulation since the middle of 1922 than they have received from abroad, so that the total cash reserves are now smaller than they were two years ago, but this policy has had no effect on credit and currency conditions, beyond merely changing the form of money in circulation.

Expenses of the reserve banks.

The author also discusses the necessity for the reserve banks to earn their expenses, and expresses his conviction that this was the one reason why the managers of the system permitted the issuance of a large excess of reserve bank credit,- whatever ingenious arguments they may have put forth to explain their actions. In this connection he quotes B. M. Anderson to the effect that gratuitous services by the reserve banks should be discontinued, and Willis to the effect that earning assets of about \$1,000,000,000 a year will be required to meet the expenses of the reserve banks and that, therefore, the banks should enter the market more actively. He does not argue with Willis, who believes that the reserve banks should at all times be a large factor in the market, but draws from Willis' view the opinion that the free services are a great menace because they make it necessary for the reserve banks to keep \$1,000,000,000 of credit constantly in use.

The discount rate.

The writer quotes Anderson to the effect that the discount rate should be regularly kept higher than the market rate, but goes farther than Anderson by saying that the rediscount rate should never be less than 5 or 6 per cent. This is in keeping with his general theory that the Federal reserve banks should function only in emergencies. Reserve bank credit, according to his view, should be used only when it is badly needed and when a difference of a few per cent would hardly be noticed.

To the writer "there is something preposterous about the attempt to thrust excess credit, the only credit at the command of the Federal reserve banks, upon the member banks when they have no need for it." He thinks that the effect of this is to force banks into speculation. He says that in view of the fact that the banks can borrow from the reserve banks at 3 and 3 1/2 per cent and can buy good investments at 4 and 5 per cent, their refraining from doing this is a sign that they have better vision than the reserve banks. The fact that member banks have at all times lent or invested funds up to the limit of their available reserves and that they have now a volume of credit far in excess of the 1920 peak is not taken into consideration in this statement. He also sees a danger in the fact that, the lower the discount rate the more the reserve banks will have to have invested in order to earn their expenses, and that this vicious circle would lead to progressive inflation.

The writer's remedies.

As a final conclusion from this discussion the writer proposes the repeal of the 1917 amendments which required that all the reserves of the member

banks be kept with the reserve banks and permitted the reserve banks to issue notes directly against gold. If the writer's views on the situation were correct his remedies would not be adequate. With the present volume of reserves the reserve banks could transfer to the member banks that proportion of the reserves held by these banks prior to 1917 and still have enough funds left for any amount of credit expansion that may reasonably be anticipated. Prohibiting the reserve banks from issuing notes against gold would under the present circumstances have no effect whatever, as is indicated by the fact, already mentioned, that the reserve banks have actually paid out gold rather than notes to the extent of \$700,000,000 without any effect on the credit situation.

To sum up, the author, displeased with the fact that the interest rate is what he considers abnormally low and believing that the reserve banks are at least in part responsible, has based his arguments on a misunderstanding of our system of currency issues and of the scope and limits of the power possessed by the Federal reserve banks. There may be too much bank credit in use, but the writer offers no fresh evidence on this point and proposes no remedies that would accomplish his purpose.

CONFIDENTIAL

For use of Federal Reserve Board only

MEMBER BANKS BORROWING CONTINUOUSLY IN EXCESS OF CAPITAL AND SURPLUS DURING MARCH, 1926,
ALSO BORROWINGS OF ALL MEMBER BANKS AT THE END OF THE MONTH

St. 4926

Federal Reserve District	GROUP I--All banks borrowing continuously in excess of capital and surplus during the month				GROUP II - Banks in Group I whose borrowings at the end of month were at least twice capital & surplus				GROUP III- All member banks in district				
	Num-ber	Capi-tal and surplus	Borrowings on Mar. 31		Num-ber	Capi-tal and surplus	Borrowings on Mar. 31		Accommo-dated during month	Total Num-ber	Capi-tal and surplus	Borrowings on Mar. 31	
			Amount	Ratio to capital & surplus			Amount	Ratio to capital & surplus				Amount	Ratio to capital & surplus
Boston	3	\$2,700,000	\$3,356,000	124%	-	-	-	-	199	418	\$292,400,000	\$42,770,000	14.6
New York	5	599,000	988,000	165	1	\$125,000	\$296,000	237%	401	883	1,130,100,000	149,725,000	13.2
Philadelphia	4	2,970,000	3,660,000	123	-	-	-	-	393	757	397,733,000	61,376,000	15.4
Cleveland	4	261,000	368,000	141	-	-	-	-	295	860	448,667,000	64,183,000	14.3
Richmond	6	837,000	1,220,000	146	1	60,000	123,000	205	283	594	200,000,000	45,387,000	22.7
Atlanta	2	4,906,000	6,294,000	128	-	-	-	-	203	495	164,466,000	49,991,000	30.4
Chicago	36	2,750,000	4,108,000	149	5	236,000	575,000	244	488	1,383	543,333,000	111,731,000	20.6
St. Louis	14	3,556,000	5,025,000	141	1	30,000	78,000	260	200	622	171,567,000	33,617,000	19.6
St. Paul	10	419,000	602,000	144	-	-	-	-	86	822	105,067,000	4,856,000	4.6
Kansas City	22	3,374,000	5,127,000	152	1	50,000	157,000	314	175	1,016	141,200,000	14,081,000	10.0
Dallas	-	-	-	-	-	-	-	-	134	850	143,800,000	5,648,000	3.9
San Francisco	5	1,045,000	1,354,000	130	1	50,000	126,000	252	188	724	275,900,000	49,026,000	17.8
TOTAL													
Mar. 1926	111	23,417,000	32,102,000	137	10	551,000	1,355,000	246	3,045	9,424	4,014,233,000	632,391,000	15.8
Feb. 1926	104	18,224,000	25,296,000	139	11	689,000	1,547,000	225	2,659	9,437	3,982,800,000	576,643,000	14.5
Mar. 1925	140	16,213,000	24,568,000	152	18	1,340,000	3,565,000	266	2,731	9,535	3,816,133,000	397,810,000	10.4

FEDERAL RESERVE BOARD

DIVISION OF BANK OPERATIONS

APRIL 22, 1926.

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FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

August 12, 1925.

Dear Mr. Hamlin:

In accordance with the telephone request from Mr. Moore I am enclosing herewith three statements as follows:

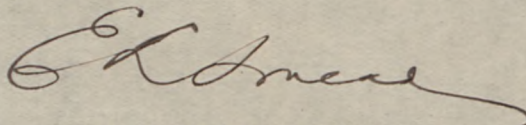
First, a statement showing the combined capital and surplus of the European central banks including Great Britain compared with the Federal Reserve System.

Second, a statement showing the amount of notes outstanding of the Federal reserve banks and of the various central banks of Europe.

Third, a statement showing the capital and surplus combined and the deposits of all the commercial banks in the United States compared with corresponding figures for Great Britain. In the preparation of this statement we have used figures published in the May 16, 1925, edition of the London Statist which represent the condition of 44 banks in Great Britain and Ireland.

For your convenience in using the statements we have shown figures in all of the statements as published in the reports issued by the various central banks and have converted such amounts into dollars by using the average rates of exchange during July.

Very truly yours,



E. L. Smead, Chief,
Division of Bank Operations.

Hon. Charles S. Hamlin,
Mattapoisett, Mass.

Enclosures.

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Volume 159

COMBINED CAPITAL AND SURPLUS OF THE FEDERAL RESERVE BANKS
AND OF THE PRINCIPAL EUROPEAN CENTRAL BANKS.

	Monetary Unit	Combined capital and surplus	Amount converted to dollars at average rate of exchange for July		Date
			Rate at which converted (cts)	Amount	
Federal Reserve Banks	Dollar	\$333,514,000		\$333,514,000	Aug. 5
Bank of England	Pound	18,072,702	*486.65	87,950,804	July 29
Bank of France	Franc	369,259,951	4.70	17,355,218	July 16
Reichsbank	Reichsmark	275,191,000	*23.82	65,550,496	July 15
Bank of Italy	Lira	240,025,412	3.67	8,808,933	July 20
Austrian National Bank	Schilling	45,878,711	*14.07	6,455,135	July 23
National Bank of Bulgaria	Lev	500,000,000	.73	3,650,000	May 31
National Bank of Denmark	Krone	38,340,000	21.37	8,193,258	June 30
Bank of Finland	Markka	150,000,000	2.52	3,780,000	July 15
National Bank of Greece	Drachma	300,000,000	1.60	4,800,000	Dec. 31, 1924
National Bank of Hungary	Krone	434,740,591,843	.0014	6,086,368	June 15
Bank of Latvia	Lat	14,180,960	*10.00	1,418,096	July 22
Bank of Lithuania	Lita	12,625,000	*19.30	2,436,625	July 15
Netherlands Bank	Florin	38,483,598	*40.20	15,470,406	July 20
Bank of Norway	Krone	50,044,488	18.07	9,043,039	May 30
Bank of Poland	Zloty	101,197,010	19.08	19,308,390	July 10
Bank of Portugal	Escudo	18,018,749	5.14	926,164	July 1
National Bank of Rumania	Leu	101,820,109	.49	498,919	June 6
Russian State Bank	Chervonetz	10,790,000	514.50	55,514,550	April 1
National Bank of the Kingdom of Serbs, Croates & Slovenes	Dinar	34,245,608	1.76	602,723	July 22
Bank of Switzerland	Franc	31,940,858	19.41	6,199,721	July 23
Bank of Spain	Peseta	234,000,000	14.51	33,953,400	July 24
Bank of Sweden	Krona	62,500,000	*26.80	16,750,000	June 30
National Bank of Belgium	Franc	106,262,962	4.70	4,994,359	June 25

*Par of exchange.

NOTE CIRCULATION OF F. R. BANKS AND OF PRINCIPAL EUROPEAN CENTRAL BANKS.

	Monetary Unit	Amount	Amount converted to dollars at average rate of exchange for July		Date
			Rate at which converted (cts)	Amount	
Federal Reserve Banks	Dollar	\$1,605,557,000		\$1,605,557,000	Aug. 5
Bank of England	Pound	144,750,795	*486.65	704,429,000	July 29
Bank of France	Franc	44,532,375,170	4.70	2,093,022,000	July 16
Reichsbank	Reichsmark	2,297,861,000	*23.82	547,350,000	July 15
Bank of Italy	Lira	14,031,031,750	3.67	514,965,000	July 20
Austrian National Bank	Schilling	746,647,099	*14.07	105,053,000	July 23
National Bank of Belgium	Franc	7,590,033,630	4.62	350,660,000	July 9
National Bank of Bulgaria	Lev	4,173,537,067	.73	30,467,000	May 31
Banking Office, Czechoslovakia	Crown	7,035,685,000	2.96	208,256,000	July 23
National Bank of Denmark	Krone	468,279,384	21.37	100,071,000	June 30
Bank of Finland	Markka	1,243,101,277	2.52	31,326,000	July 15
National Bank of Greece	Drachma	5,062,054,818	1.60	80,993,000	June 15
National Bank of Hungary	Krone	4,153,880,419,361	.0014	58,154,000	July 23
Bank of Latvia	Lat	28,283,590	*10.00	2,828,000	July 22
Bank of Lithuania	Lita	80,309,381	*19.30	15,500,000	July 15
Netherlands Bank	Florin	883,516,080	*40.20	355,173,000	July 20
Bank of Norway	Krone	380,711,295	18.07	68,795,000	May 30
Bank of Poland	Zloty	467,481,405	19.08	89,195,000	July 10
Bank of Portugal	Escudo	1,641,272,686	5.14	84,361,000	July 1
National Bank of Rumania	Leu	19,333,011,266	.49	94,732,000	June 6
Russian State Bank	Chervonetz	67,243,337	*514.50	345,967,000	July 16
National Bank of the Kingdom of Serbs, Croates & Slovenes	Dinar	5,626,431,080	1.76	99,025,000	July 22
Bank of Spain	Peseta	4,276,782,825	14.51	620,561,000	July 24
Bank of Sweden	Krona	522,866,032	*26.80	140,128,000	June 30
Bank of Switzerland	Franc	772,125,195	*19.30	149,020,000	July 23

*Par of exchange.

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COMBINED CAPITAL AND SURPLUS AND DEPOSITS OF COMMERCIAL BANKS IN THE
UNITED STATES AND IN GREAT BRITAIN AND IRELAND.

	<u>United States</u>	<u>Great Britain and Ireland</u>	
Capital and Surplus	\$5,522,766,000	£176,669,000	\$859,760,000
Deposits	41,006,177,000	2,335,993,000	11,368,110,000

Figures for the United States are as of June, 1924, and include National banks, State banks, trust companies, stock savings banks and private banks. Figures for Great Britain and Ireland are for December, 1924, and are as given by the London Statist for "Banks in Great Britain and Ireland exclusive of the Bank of England."

CONFIDENTIAL
Not for publication

AVERAGE AMOUNT OF "FLOAT" CARRIED BY THE FEDERAL RESERVE BANKS
ON WEEKLY STATEMENT DATES DURING MARCH 1926.
(Amounts in thousands of dollars)

9/ See Bk

St. 4924

Federal Reserve Bank	Total deposits	"Float" (excess of uncollected over deferred availability items)		Classification of Uncollected items					Classification of Deferred availability items		
		Amount	Per cent of total deposits	Transit items	Clearing House Exchanges	Other cash items	F. R. notes of other F. R. banks	Total	Government transit items	Other transit items	Total
Boston	148,404	1,230	.8	58,333	1,466	58	262	60,119	2,539	56,350	58,889
New York	887,593	24,280	2.7	131,345	19,581	403	4,255	155,584	5,527	125,777	131,304
Philadelphia	134,989	5,059	3.7	53,115	7,958	2,822	6	63,901	3,536	55,306	58,842
Cleveland	180,181	5,573	3.1	59,607	2,864	51	1,331	63,853	2,346	55,934	58,280
Richmond	71,082	3,066	4.3	54,594	2,601	120	712	58,093	4,083	50,944	55,027
Atlanta	86,765	5,290	6.1	35,852	713	80	1,899	38,544	1,854	31,400	33,254
Chicago	326,877	11,304	3.5	81,689	4,799	624	2,830	89,942	5,416	73,222	78,638
St. Louis	85,114	224	.3	32,148	105	105	1,258	34,046	659	33,163	33,822
Minneapolis	56,851	583	1.0	12,085	301	436	327	13,149	1,045	11,521	12,566
Kansas City	87,536	4,797	5.5	40,770	155	465	1,147	42,537	1,561	36,179	37,740
Dallas	61,573	(a)2,849	-	26,156	10	2	207	26,375	1,335	27,889	29,224
San Francisco	170,076	(a)1,066	-	35,110	1,760	1,102	1,365	39,337	1,869	38,534	40,403
TOTAL											
Mar. 1926	2,297,041	57,491	2.5	620,804	42,803	6,274	15,599	685,480	31,770	596,219	627,989
Mar. 1925	2,222,140	65,546	2.9	594,191	42,090	12,560	12,788	661,629	27,201	568,882	596,083
Mar. 1924	2,006,034	63,572	3.2	555,043	44,238	7,172	14,486	620,939	27,723	529,644	557,367

FEDERAL RESERVE BOARD
DIVISION OF BANK OPERATIONS
APRIL 17, 1926.

(a) Excess of deferred availability over uncollected items.

C.

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FEDERAL RESERVE BANK
OF NEW YORK

April 21, 1926.

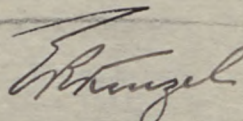
Dear Mr. Hamlin:

When Mr. Platt, Mr. Curtis and myself appeared before Senator McLean's committee, he requested that we consider whether or not we would consent to an amendment in the Pension Bill to put a limitation on the amount of pensions that might be provided under any plan approved by the Federal Reserve Board.

You will doubtless recall that our committee had considered this question from every angle and most thoroughly before we decided that limitations in the bill as distinguished from limitations contained in the plan would be extremely unwise and undesirable.

Under the circumstances, I have thought that it would be well to fortify myself with a carefully considered opinion and argument against any limitation in the bill, particularly against a limitation expressed by way of dollar amount of pension. Accordingly, Mr. Sayre has written me a letter, stating the basic arguments against it, which seems to me to be extremely good and I am enclosing several copies of it for your consideration and such use as you might find for them before the next hearing before Senator McLean's committee. I am enclosing some copies of it also to Mr. Platt and to Governors Fancher and McDougal.

Very truly yours,



E. R. Kenzel,
Chairman, Pension Committee.

Hon. C. S. Hamlin,
c/o Federal Reserve Board,
Washington, D. C.

Encs.

C O P Y

THE CHURCH PENSION FUND

14 Wall Street

New York

April 20, 1926

My dear Mr. Kenzel:

In regard to the question of Senator McLean as to the advisability of inserting in the Charter of the proposed Federal Reserve Pension Fund a provision for a maximum pension, I would say that I think that such a provision would be highly inadvisable and I would suggest that the Committee of the Governor's Conference strongly urge the reasons which make it inadvisable.

Pensions are one of the few things in which it is necessary to take into consideration long stretches of time. This differentiates pensions sharply from most business enterprises which do not have to look forward more than a comparatively short time.

On account of this essential characteristic of pensions, that it must look forward over a long period of years, it is highly inadvisable that its fundamental regulations should contain arbitrary restrictions. We live in a changing world, a world in which change tends to become more rapid. In few things have there been greater or more rapid changes than in the value of money and, therefore, in the cost of living and the remuneration for services. It is well known that many charitable and educational institutions in England, established between the reigns of James I and Anne, that is, roughly during the seventeenth century, have become wholly obsolete and have had to be entirely reformed owing to arbitrary regulations in regard to payments, quite suited to the seventeenth century, but inappropriate even to the middle of the nineteenth century. Since the middle of the nineteenth century, the change in the value of money and in the cost of living has proceeded with accelerated activity, so that those regulations which would have been quite appropriate in 1880 are entirely out of place in 1926.

If, therefore, the Committee on Banking and Currency in the United States Senate should put in the proposed Charter any arbitrary maximum, while the figure might be defended at the present time, it is quite conceivable that by 1950 it might be a most burdensome restriction.

It should be pointed out that the regulations in regard to pensions are to be made by a Board, on which there is a representative of the Board of Directors of each Federal Reserve Bank and a representative elected by the Federal Reserve Board. These representatives will naturally be interested in preventing undue drafts upon the treasuries of the Banks. Furthermore, whatever regulations are made by these Trustees must be approved by the Federal Reserve Board and it will naturally be alert to prevent impositions. In the last analysis, Congress reserves to itself the right to alter and amend the Charter and could take further legislative action in the improbable event that the Board of Trustees so constituted should act unreasonably and that their unreasonable action was approved by the Federal Reserve Board. It will be realized that it is one thing for Congress to have the power to change some

action which may appear unreasonable, and quite another thing for it to put in the fundamental regulations a provision which may afterwards have to be gotten out. Apart from the different aspect of the parliamentary situation, all kinds of questions of equities would arise in the latter case, and make administration extremely difficult.

The above considerations would apply, it seems to me, to any kind of arbitrary provision inserted in the Charter of an organization whose essential characteristic is that it must act on suppositions stretching over an exceedingly long period of years. But I think they are still stronger when the suggested restriction concerns the maximum pension.

While it is important that there should be a provision for the retirement of the clerks and minor officials of any commercial institution, it is still more important that there should be a provision for the retirement of the higher officials. If a clerk in a department becomes incapacitated by age or disability, and cannot afford to resign, his fellow clerks generally close around him and carry his work; and while there may be some inefficiency, and some loss, the matter is not especially serious. It becomes serious, of course, if it is apt to be multiplied by many instances. But when the head of a department, or the supervising official in charge of a group of departments begins to display those qualities of lack of initiative and lack of openness of mind, etc., which sometimes go with advancing age, the result, if he is retained in office, may be serious indeed. It may mean absolute calamity to the business enterprise. Yet the fact that he has had a fairly high salary is absolutely no guarantee that he may be more able to retire without a pension than a clerk is. In fact, it might be a greater wrench for him to give up his salary and live without a pension than would be the change in the circumstances of a small clerk. The same thing is true, in lesser measure, but still with great effect, if some pension is offered to the higher official, but it is grossly inadequate.

Nothing is so valuable in pensions as the ability to retire the top men. And, of course, the pension has no tendency to enable the top men to be retired, unless it is a fairly adequate pension. Therefore, arbitrary limitations about the amount of any pension are a direct defeat of the very aim for which pensions exist. And in the case of a contributory system, like the proposed Federal Reserve one, where half of the cost is paid by the officials and employees themselves, there is an obvious automatic check on any undue demand as to the size of pensions.

The above arguments apply primarily to a maximum expressed in terms of dollars. They are much less cogent if the proposed maximum should be couched in terms of percentage of salary, although even in this case, I think it unnecessary to put in a Charter those regulations which may well be provided otherwise. A maximum in terms of percentage of salary alters with a fair correspondence to the ratio in which the value of money and the standard of salaries alter, and therefore, does not tie up a pension organization irremediably to a social condition which may become obsolete. Such maximum percentages are usually defined in terms of some form of a terminal salary, as that no pension should exceed seventy percent of the average salary for the last five years of service.

The proposed pension plan for the Federal Reserve Banks is a conservative one, and one of the main aspects in which it is conservative is in

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the adoption of the average salary throughout the entire term of service as the basis of calculating the pension, and not any form of terminal salary. There are other advantages in the use of the average salary, but the main one is its strong and constant tendency to keep down the amount of the pensions. The basis of calculation for the pensions in the proposed Federal Reserve system will hardly ever make the amount of a pension exceed fifty percent of the terminal salary.

For these reasons, which it will be observed are basic ones, I sincerely trust that the Committee on Banking and Currency of the United States Senate will be willing to leave this matter to the determination of the Trustees of the proposed fund, under the supervision of the Federal Reserve Board, it being provided in the draft of the System, which will be laid before these Trustees as soon as they are constituted, all salaries in excess of \$18,000 a year, for the purposes of the pension system, be considered as of that amount. This seems a reasonable rule for the present, but it can hardly, it is respectfully submitted, be embodied in the fundamental document constituting such a far reaching organization as the pension system.

I am

Very sincerely yours,

(Signed) Monell Sayre

Mr. E. R. Kenzel
Deputy Governor of the Federal Reserve Bank of New York
33 Liberty Street
New York City

TO: The Federal Reserve Board

X-4314

From: Divisions of Bank Operations and Research and Statistics.

THE MCFADDEN BILL TO REVISE THE FEDERAL RESERVE ACT

General purposes of the amendments

The amendments to the Federal Reserve Act proposed by Congressman McFadden immediately prior to the adjournment of the last Congress apparently have two purposes: (1) To reestablish a closer connection between the volume of Federal reserve notes in circulation and the currency requirements of business. With this in view the bill prohibits the use by reserve banks of gold and of acceptances purchased in the open market as collateral for Federal reserve notes, leaving discounted paper as the sole authorized collateral. (2) To reduce the lending power of the reserve banks, by permitting member banks to withdraw from the reserve banks, and to hold in their own vaults, a part of their required reserves.

Both of these objects appear to be based largely on misconceptions arising from imperfect appreciation of the experience of the system. The first of them assumes that the volume of Federal reserve notes in circulation currently depends upon the character of the paper or other collateral which may be used as cover for the notes, but experience has demonstrated that this is not the case. Notes get into general circulation only when customers of member or nonmember banks withdraw currency to meet their current needs. Member banks retain in their own vaults only such an amount of currency as they need to meet daily requirements, because it does not pay them to keep more, and it is only when these daily requirements increase, by reason of the demands of the public, that member banks find it necessary to obtain more currency from the reserve bank, using any acceptable collateral that they may have. The

elasticity of the Federal reserve note does not depend on the character of collateral that member banks use to obtain currency. Federal reserve notes issued against gold come in for retirement as promptly as notes secured by commercial paper. It is through the Federal reserve banks' meeting the currency demand when it arises that the amount of currency in circulation is constantly adjusted to the requirements of business.

The provision authorizing member banks to hold part of their reserves in their own vaults, which is apparently intended to diminish the lending power of the reserve banks, through a reduction of their reserves, would have little effect, when taken in conjunction with the other proposed amendments, because member banks would have no inducement to exercise their option to any extent. That portion of their resources which the law or experience requires the member banks to hold as reserves would remain inactive and unproductive of earnings, under the proposed amendment as it is under existing laws, and a mere transfer of reserves from reserve banks to member banks would not increase the member banks' lending power or earning capacity, but would merely reduce the lending power of the reserve banks.

Gold with the reserve agents not to count as reserves

The provision in the McFadden bill that gold held with the Federal reserve agent shall not count as part of the reserves of the reserve bank is a repeal of an amendment adopted in 1917, principally for the purpose of facilitating note issues and permitting the reserve banks to count all the gold, whether held by the agent or by the reserve bank, as part of their reserves. Notes were exchanged for gold prior to the amendment but this was accomplished in a roundabout way, and it was thought best to authorize the direct exchange.

The effect of this proposal at the present time would be that of the \$1,700,000,000 of Federal reserve notes in circulation, only about \$400,000,000 could continue to be a liability of the reserve banks because this is the total amount of discounted paper held by the twelve reserve banks. Against the remainder of the notes, the Federal reserve agents now hold gold and in order to comply with the proposed amendment the reserve banks would have to follow one of two courses; either to pay this gold out into circulation in exchange for an equivalent amount of Federal reserve notes; or to impound the gold with the agent to be held by him exclusively for the redemption of notes. The reserve banks would probably adopt the procedure of letting the \$1,300,000,000 of gold held by the agents as cover for notes be applied to the reduction of the banks' liability on reserve notes. Thus the gold as an asset and an equivalent amount of notes as a liability would be taken out of the reserve banks' balance sheet and would appear only in the account of the Federal reserve agents. Under present conditions the reserve banks would after this transaction still have a reserve of about 60 per cent against their combined note and deposit liability. In some of the reserve banks, however, the result would be a deficiency of reserves even at the present time.

The reserve banks could increase the volume of paper eligible as note cover at their disposal; i.e., paper eligible as cover under the amendments, by selling acceptances and securities and thereby causing member banks to discount paper with the reserve banks. While technically this would be a method of increasing the volume of paper eligible for note cover, it would involve a complete withdrawing of Federal reserve banks from open-market operations.

Under the McFadden proposal the note-issuing power of the reserve banks,

which is now limited by reserve requirements, will be limited in addition by the amount of eligible paper available as collateral for note issue. As pointed out earlier, this additional limitation does not increase the elasticity of the reserve note but merely erects a cumbersome piece of machinery that might under certain conditions prevent the smooth performance of their functions by the reserve banks. A situation might even arise, under the proposed amendment, where reserve banks, by reason of low reserves and shortage of eligible paper, could not issue Federal reserve notes to member banks unless these banks borrowed \$3.00 from the reserve banks, and kept \$2.00 of this on deposit with the reserve banks, in order to obtain \$1.00 of Federal reserve notes. Under conditions of unusual credit and currency demand, therefore, the McFadden amendment would cause unnecessary difficulties to our banking system, and since the test of the soundness of a banking system is the way it would stand up under a strain - this is a serious argument against the proposal.

In considering the possible effect of these amendments in decreasing the gold reserves of the reserve banks through further increases of gold in circulation, the fact should not be overlooked that the gold now held by the reserve banks for the most part was not withdrawn from domestic circulation but was imported from abroad. As the result of paying out gold certificates the volume of gold in circulation at the present time is nearly as large as before the system was established, and the reserve banks in recent months have also met out of their reserves a considerable demand for gold for export.

The chief effect of the proposed amendment relating to gold cover appears to be to lower the reserve ratio of the reserve banks by impounding a part of their reserves with the Federal reserve agents. At a time when reserves are ample, as at present, the impounding of the gold would not bring the reserve ratio near the legal minimum, but under conditions of exceptionally large demand for credit and currency the amendment would interfere with the smooth operation of the reserve banks and might make necessary a suspension of reserve requirements.

Acceptances ineligible as collateral against notes

In prohibiting the use of acceptances as cover for Federal reserve notes, the amendment places acceptances in regard to ineligibility as cover for notes on the same footing with United States securities, the other class of open-market purchases of the reserve banks. Acceptances, however, are as directly connected with the financing of current business as are promissory notes, and reflect the underlying commercial transactions in contrast to paper secured by United States obligations which is now eligible and would continue to be eligible under the amendment, to serve as cover for Federal reserve notes. It is probable that the object of this amendment is not so much to increase the elasticity of the Federal reserve note as to limit the reserve banks' open-market operations.

Authority to hold part of reserves in members' vaults

The proposal to authorize member banks to hold part of their required reserves in their own vaults would in its present form permit member banks to count as part of their reserves the vault cash which they now carry as till money. If the amendment were adopted without increasing the reserve requirements of member banks, it would make available to the member banks about \$500,000,000 which they could use either as a basis for additional lending or to reduce indebtedness at the reserve banks. When in 1917 reserve requirements changed so as to make only balances at the reserve banks count as legal reserves for member banks, at the same time required reserve percentages were reduced in recognition of the fact that the cash which member banks would continue to carry in their vaults would no longer count as reserves. The present proposal to permit the vault cash of member banks to be counted as reserves without correspondingly increasing the legal reserve requirements would result in reduced borrowing at the reserve banks and in member banks seeking increased investment for their released funds.

If the proponents of the bill would upon consideration decide to include in the amendment an increase in reserve requirements equal to the amount of cash in vault, the proposal would have relatively little effect on the credit situation.

Existing provisions not emergency measures

The McFadden proposal has been generally understood to have the object of restoring the Federal Reserve Act to its original form through repeal of war time amendments. Experience indicates that the 1917 amendments, though their passage may have been expedited by the war emergency, are not in the nature of emergency provisions, but are a logical rounding out of the reserve system. In effect the McFadden proposal would have the system return to the ideas and theories of the framers of the Federal Reserve Act prior to the system's establishment, and would thus sacrifice the lessons of practical experience acquired during the decade of its operation.

Office Correspondence

FEDERAL RESERVE
BOARD99 see 13A
Date April 8, 1926

To Mr. Hamlin

Subject: Prices, Currency, and the

From Mr. Goldenweiser
G.O.G.

Reserve Banks

-446

Personally I am opposed to the inclusion in the Federal Reserve Act of any reference to price stabilization as an object of Federal reserve policy. Such a clause in the law would tend to encourage the belief that the Federal reserve system has the power, not merely to influence, but actually to control prices, and would thus make the system responsible in the public mind for price fluctuations. The worst of this matter is, furthermore, that a great many people would expect the system not only to regulate the price level, which to them is an abstract proposition, but to influence the prices of the particular commodities in which they are interested. The system would be blamed by the cotton growers, for example, whenever the price of cotton declined and by the wheat producers when the world price of wheat was lower than they might desire. These considerations in themselves are a sufficient reason for opposing the Strong amendment to the Federal Reserve Act.

From a broader point of view, it may be stated with assurance that at certain times and under certain circumstances the Federal reserve system can exert an influence on prices. This would be particularly true at times when there is an extremely rapid advance in prices as the result of unusual circumstances. It is now pretty generally believed, for instance, that an earlier advance in discount rates might have prevented some of the extreme price rises in 1920. As you know, there were good reasons for not advancing the rates, but had it been possible to advance them, it is probable that prices would not have gone up as high as they actually did in 1920. On the other hand, I am doubtful whether reductions of rates can be as effective in

Office Correspondence

FEDERAL RESERVE
BOARD

Date _____

To _____

Subject: _____

From _____

3-2405

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arresting a fall of prices as advances in rates can be in stopping a rise in prices. The principal reason for this difference is that at the time of falling prices member banks are rapidly paying off what they owe to the reserve banks and reductions in discount rates are not likely to hasten these repayments. In 1921 and 1922 there was a series of reductions in rates from 7 per cent to 4 per cent, but borrowings at the reserve banks continued to decline..

Whatever influence the Federal reserve system can have on prices can best be exerted, not by following changes in price index alone, but by taking into consideration the entire series of business and credit indicators which the system has at its command. In other words, the system can best contribute to the stability of prices by working for the stability of business. The price index, as was pointed out in the 1923 report, registers an accomplished fact and becomes known usually too late for effective action by the Federal reserve system. By following developments in production and distribution, the accumulation of inventories and the use of bank credit, the system may be able to detect evidences of maladjustment in industry long before these maladjustments have been reflected in price changes, and to take measure to exert a corrective influence that may prevent the occurrence of changes in the price level.

In connection with the relation between the volume of currency and prices, it ought to be kept in mind that in the United States the great bulk of pay-

Office Correspondence

FEDERAL RESERVE
BOARD

Date _____

To _____

Subject: _____

From _____

1-4406

- 3 -

ments are made by check and not by currency, and that the volume of currency outstanding at any time in our banking system is closely adjusted to the requirements of the public in meeting payrolls and providing till money and pocket money. No one carries any more cash in his pocket or in his till just because there is more currency outstanding. The currency that is not needed is immediately deposited by the public with the banks and by the banks with the reserve banks, so that no direct influence on prices can be exercised by the Federal reserve system through issuing additional currency. On the other hand, to contract currency is almost impossible under existing conditions without greatly disturbing trade and industry. The attached chart shows that there is a fairly close correspondence between the big swings in money in circulation and in prices. This is due to the fact that at ^athe time of full employment and high prices there is an increased demand to meet payroll and till money requirements. It is interesting, however, to note that minor fluctuations in prices and in money in circulation do not by any means coincide. Thus, in 1923 prices declined and the volume of money in circulation increased; in 1924 prices increased and money in circulation remained constant; in 1925 money in circulation remained constant and prices once more declined. The problem of the elasticity of credit and of currency requires more space to discuss than can be given to it in this memorandum, and I am sure you are thoroughly familiar with the argument. I do wish to point out here, however, that the demand for currency arises at a much later stage in the business

Office Correspondence

FEDERAL RESERVE
BOARD

Date _____

To _____

Subject: _____

From _____

2-4195

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situation than the demand for credit, and that at a time when there is a currency demand the Federal reserve system can not afford to be placed in a position of restricting the supply of cash necessary for the conduct of the nation's business.

The substance of this memorandum may be summed up by saying that the Federal reserve system can best work towards price stability by being guided in its policy largely by other factors than the price index, and it can best contribute to the proper adjustment of the volume of currency to the public's needs by shaping its credit policy with reference to changes in credit conditions rather than in the volume of currency.

I attach herewith a table showing the volume of money in circulation by months from 1917 to date, showing also changes for the first and last half of each year.

TOTAL MONEY IN CIRCULATION

(In millions of dollars)

	1917	1918	1919	1920	1921	1922	1923	1924
January		4,256	5,105	5,312	5,645	4,605 ✓	4,733	4,951
February		4,105	4,869	5,128	5,348	4,353 ✓	4,509	4,66
March	3,916	4,193	4,851	5,278	5,297	4,402 ✓	4,611	4,80
April	4,101	4,267	4,841	5,273	5,150	4,413 ✓	4,656	4,81
May	4,117	4,310	4,846	5,291	5,107	4,385 ✓	4,668	4,74
June	4,153	4,283	4,809	5,353	5,085	4,370 ✓	4,706	4,83
July	3,849	4,336	4,795	5,332	4,843 ✓	4,374 ✓	4,730	4,78
August	3,869	4,450	4,794	5,265	4,723 ✓	4,337 ✓	4,696	4,66
September	3,940	4,653	4,853	5,480	4,659 ✓	4,394 ✓	4,778	4,77
October	3,970	4,926	4,959	5,553	4,665 ✓	4,521 ✓	4,850	4,80
November	4,035	5,066	5,034	5,628	4,611 ✓	4,570 ✓	4,635	4,68
December	4,131	5,130	5,172	5,584	4,561 ✓	4,617 ✓	4,923	4,99
		<u>1925</u>	<u>1926</u>	<u>1927</u>				
January		4,993	5,006					
February		4,752	4,740					
March		4,804	4,814					
April		4,776	4,806					
May		4,725						
June		4,774						
July		4,734						
August		4,720						
September		4,784						
October		4,827						
November		4,901						
December		4,972						

NOTE: April 1, 1917, November 1, 1920, July 1 (each year) and July 1, 1921 to date fully comparable. All others former Bulletin basis, as corrected.

To June 1, 1922, total in Three

INCREASE OR DECREASE IN MONEY IN CIRCULATION - SIX MONTHS' PERIODS - JULY, 1917 TO JANUARY, 1926

(In millions of dollars)

1917:		
July 1 to January 1		+ 407
1918:		
January 1 to July 1		+ 80
July 1 to January 1		+ 769
1919:		
January 1 to July 1		- 310
July 1 to January 1		+ 517
1920:		
January 1 to July 1		+ 20
July 1 to January 1		+ 313
1921:		
January 1 to July 1		- 802
July 1 to January 1		- 238
1922:		
January 1 to July 1		- 231
July 1 to January 1		+ 359
1923:		
January 1 to July 1		- 3
July 1 to January 1		+ 221
1924:		
January 1 to July 1		- 196
July 1 to January 1		+ 238
1925:		
January 1 to July 1		- 259
July 1 to January 1		+ 274

CONFIDENTIAL

Tentative Statement Subject to Revision.

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LIMITS OF EXPANSION OF BANK CREDIT IN RELATION TO MEMBER BANK
RESERVES.

Definition of the problem.

The extent of probable expansion of the total volume of bank credit outstanding on the basis of a given increase in the reserve funds available to member banks is a problem of considerable importance in estimating the effect upon credit conditions of an increase in reserve balances of member banks arising from an extraneous cause, such, for example as the inflow of gold, or a change in the reserve requirements imposed by law upon member banks. This problem is distinct from the question of a potential expansion of credit based on a larger use of the lending power of the Federal reserve banks, sometimes called secondary expansion, which has no direct bearing on the probable extent of growth in the volume of bank credit consequent upon the addition of a given amount to the reserve funds at the disposal of member banks.

Need to isolate the influence of factor under consideration.

In order to measure the probable extent of this growth the influence of the addition to reserve funds must be isolated from other counteracting influences. If, for instance, \$50,000,000 were added to the available reserve funds of member banks through a reduction in legal reserve requirements, the effect of this increase in reserves on the credit situation might be entirely offset by a simultaneous export demand for an equal amount of gold, by an equivalent reduction in member bank borrowings at the reserve banks, or by a sale of these banks of an equal amount of securities in the open market. The operation of offsetting factors such as these might neutralize the effect of the increase in reserve funds, and thus obscure its influence, without, however, changing the character

and extent of the influence. It is only by isolating a factor and by assuming that it will operate without interference from other unconnected circumstances that it is possible to arrive at an estimate of the influence of the particular factor taken by itself. In making the following estimates of probable expansion it will be assumed, therefore, that \$500,000,000 have been added to the reserve funds of member banks, that no part of this amount has been used to reduce borrowings at the reserve banks, and that the effect of this addition to reserves on the growth in the volume of credit has not been offset either by the sale of securities by the reserve banks or by a demand for gold for export.

The tendency of banks to expand and the limiting factor.

In determining the extent of credit expansion that is likely to result from an increase of a stated amount, \$500,000,000, in member bank reserves, two circumstances must be taken into consideration: (1) member banks tend to make full use of their funds and seldom carry a considerable amount of reserves in excess of legal requirements, and (2) there is a relationship between the volume of bank deposits at a given time and the amount of currency in circulation. The bearing of these two circumstances on the problem under discussion is that member banks may be expected to increase their own deposits, by granting loans and making investments, to the full extent that the additions to their reserves would legally support, but this growth in deposits would lead to an increased demand for currency by the customers of member banks. In meeting this additional demand for currency, the member banks would use a part of their newly acquired reserve funds, and the currency demand would thus limit the amount available as reserves for deposits. It should be recalled that an increase in the deposits of member banks increases their reserve requirements on the average by only one-tenth of the increase, while in meeting

a demand for a given amount of currency member banks must employ an equal amount of their reserve funds. For this reason, an addition of \$500,000,000 to reserves, if there were no increase in the demand for currency, would enable member banks to extend additional credit to the extent of about \$5,000,000,000, while they could extend only \$500,000,000 of additional credit if there were a demand for that amount of additional currency. At what point within this range from \$500,000,000 to \$5,000,000,000 the actual expansion on the basis of the additional reserve funds would ^{fall would} depend upon the extent of the demand for currency that would accompany the growth in the deposits.

Elements entering into the problem.

The three elements entering into the determination of the probable credit expansion on the basis of \$500,000,000 added to the available reserve funds of member banks are (1) the resultant growth in demand deposits of all banks in the United States, (2) the growth in currency demand, and (3) the increase in the reserve requirements of member banks. Individual demand deposits of all banks in the United States have been chosen as the most significant figure because they represent, broadly speaking, the total volume of bank credit available to the public as immediate purchasing power, and it is with the effect of the increase in reserve funds upon this total that the present discussion is primarily concerned. Time deposits have been eliminated as not being primarily a factor in the volume of current purchasing power, and bankers' balances as being to a large extent a duplication of individual deposits. While it is thus the growth in individual demand deposits of all banks that is to be determined, it is the increase of the reserve requirements of member banks alone, together with the increase in currency demand, that would actually employ and use up any additional reserve funds made available to the member banks. The growth in the deposits of nonmember banks would lead to increased reserve requirements for these banks, both in the form of balances with

correspondents and of cash in vault. This growth in nonmember bank reserves would enter as a factor into the growth of the deposits of member banks, with which the bulk of nonmember bank reserve balances are held, and into the increased demand for currency to be held as vault reserves by state banks and trust companies. Money in circulation, as defined by the United States Treasury, and as used in this analysis, includes all currency outside of the Treasury and the Federal reserve banks and, therefore, an increased demand for vault cash by banks would be reflected in an increase in the volume of money in circulation. The growth of nonmember bank deposits would, therefore, enter only indirectly into the problem of how the additional \$500,000,000 of reserve funds would be employed, the channels through which these deposits would be felt being the growth in reserve requirements of member banks, arising from holding the reserve deposits of nonmember banks, and the increased demand for currency arising from increased vault cash requirements of nonmembers. It is through these channels that an addition to reserve funds of member banks becomes felt throughout the entire banking structure and serves as a basis for growth in the volume of credit extended not by member banks alone, but by all banks in the United States.

Diffusion of reserves throughout banking system.

The fact that the banking system as a whole may be expected to utilize the full lending power arising out of an addition to the reserve funds of member banks does not imply that any individual bank can increase its lending and investment operations by several times the amount added to its reserves. On the contrary, a bank can lend or invest immediately only such funds as it has, but in so far as the use of new deposits by the depositors is by means of checks in favor of other depositors without an actual withdrawal of cash, the additional reserves become gradually diffused throughout the entire banking system, and after a time the growth in the aggregate deposits of all banks becomes as large as the additional reserve funds that remain after the demand

for more currency has been met, will support.

Estimate on basis of conditions in 1924.

In estimating the probable credit expansion arising out of the addition of \$500,000,000 to the reserve funds of member banks, let it be assumed for the moment that the three elements under consideration, namely, individual demand deposits of all banks, reserve deposits of member banks, and money in circulation, will remain after the subsequent growth in the volume of bank credit has occurred, in the same relationship to each other as that which prevailed at the end of June, 1924, the latest date for which figures for all banks are available. On June 30, 1924, individual demand deposits of all banks in the United States were approximately \$21,089,000,000 $\frac{1}{10.8}$; reserve deposits of member banks with the reserve banks were \$1,944,000,000, and money in circulation was \$4,755,000,000. The ratio of deposits to reserves was, therefore, 10.8 to 1, and the ratio of deposits to currency 4.4 to 1. The problem is how much would be added to deposits and how much to currency if reserves increased by \$500,000,000. With the ratios shown above remaining constant this problem can be easily solved. Since both additional reserves against deposits and additional currency would have to come out of the additional funds placed at the disposal of member banks, the sum of the two items must equal \$500,000,000. If we call the growth in deposits x , then the growth in reserves will be $\frac{x}{10.8}$ and the growth in currency $\frac{x}{4.4}$, and the sum of the two, $\frac{x}{10.8} + \frac{x}{4.4}$ would equal \$500,000,000. Solving this equation, we find that $x = \$1,563,000,000$, i.e., individual demand deposits of all banks would increase by that amount; reserve deposits of member banks would increase by $\frac{1}{10.8}$ of that amount, or \$145,000,000, ^(2.9%) and currency by $\frac{1}{4.4}$ of the amount, or \$355,000,000. ^(7.1%) The total additional

$\frac{1}{10.8}$ Individual demand deposits for all banks in the United States were arrived at by combining demand deposits subject to check, certified and cashier's checks and certificates of deposits subject to less than 30 days' notice. The unclassified deposits were distributed between demand and other deposits in New York State on the basis of the proportion prevailing among member banks in that State and for the remainder of the country on the basis of the proportion prevailing for all banks.

extension of credit by banks in the form of individual deposits (\$1,563,000,-000) and of currency (\$355,000,000), would be \$1,918,000,000, or roughly \$2,000,-000,000, that is, about four times the amount added to the reserves of member banks.

Range of fluctuations in ratios of deposits to reserves and to currency.

The above calculation is based on the assumption that the ratios of individual demand deposits of all banks to the reserve deposits of member banks and to currency in circulation remained constant at 10.8 to 1 and 4.4 to 1, respectively. What has been the actual experience with these ratios? Below are given these ratios for the seven years 1918 to 1924:

Date	Ratio of Individual Demand Deposits of all Banks in the United States to--	
	Reserve deposits of member banks	Money in circula- tion
June 30, 1918	10.1 to 1	3.6 to 1
1919	11.6 " "	4.2 " "
1920	12.0 " "	4.1 " "
1921	11.3 " "	3.7 " "
1922	10.4 " "	4.3 " "
1923	10.1 " "	4.0 " "
1924	10.8 " "	4.4 " "
Seven-year average	10.9 " "	4.0 " "

It will be observed that the range of fluctuation of the ratios has been relatively limited from 10.1 to 12 in the case of the deposit-reserve ratio, and from 3.6 to 4.4 in case of the deposit-currency ratio. The comparative steadiness of these ratios indicates that a definite and fairly constant relationship has existed during the period between individual demand deposits of all banks and the reserve balances of member banks, and between individual demand deposits of all banks and currency in circulation. In fact, even if the lowest and the highest

ratios for the period were taken as a basis of calculation, the range in the resulting estimates of expansion would not be great. This calculation is made in the following table, on the basis of a \$500,000,000 addition to reserves:

(In millions of dollars)			
	: Increase in : individual : deposits	: Increase in : currency	: Total increase in : credit extended
Both ratios lowest in seven years	1,327	369	1,696
Both ratios highest in seven years	1,610	357	1,967

It would seem, therefore, that the expansion of bank credit on the basis of \$500,000,000 added to member bank reserves, on the basis of the ratios between deposits, reserves, and currency existing in the seven-year period, 1918 to 1924, would not have been lower than \$1,700,000,000 or higher than \$2,000,000,000, or at the rate of between 3.4 to 1 and 4 to 1.

Immediate and long-term adjustments.

The course of developments over the seven-year period, 1918 to 1924, indicates that the existence of a certain volume of individual demand deposits at a given time makes it probable that the volume of money in circulation at the same time is about one-fourth of the amount of deposits, and that an increase in the volume of deposits will be accompanied by a corresponding increase in currency, and a decrease in deposits by a corresponding decrease in currency. Over longer periods of time there is every reason to believe that this is true, but it does not necessarily follow that every change in the volume of deposits is immediately reflected in a corresponding change on a smaller scale in money in circulation. As a matter of fact, over the same period as that considered above, the relationship between changes in deposits and in currency from year to year has not been

in the same proportion as that for the total volume of outstanding deposits and currency. Below are shown the changes in individual demand deposits and in currency from year to year for the period, 1918 to 1924:

(In millions of dollars)		
	: Individual demand deposits : of all banks	: Money in circulation :
Change during:		
1918-1919	+ 4,156	+ 459
1919-1920	+ 2,048	+ 537
1920-1921	- 3,905	- 489
1921-1922	+ 857	- 469
1922-1923	- 223	+ 355
1923-1924	+ 2,390	+ 26

In most cases, but not in all, changes in deposits and in currency have been in the same direction, but the ratio between them has varied from 3.8 to 1 in 1919-1920 to 92 to 1 in 1923-1924.

The relative growth of deposits and money in circulation depends largely on the current business situation. In 1919-1920, when prices were advancing rapidly and business was booming, with the consequence that more cash was required for pocket money and for payrolls, the increase in currency was as much as $1/3.8$ of the growth in deposits. At the other extreme, between June, 1923 and June, 1924, when business activity was going through a period of recession and prices tended downward, the growth in deposits, due largely to gold imports, was not accompanied by a growth in currency. The immediate course of developments, therefore, consequent upon the addition of a given amount of reserve funds to member banks would be influenced by the prevailing business situation and there are likely to be delays in the adjustment between the volume of deposits and the volume of currency. That such an adjustment may be expected to take place in the long run, however, is indicated by the relative constancy already pointed out of the ratio between

deposits and currency maintained during a period of cover , 1918 to 1924, during which the volume of business activity and prices went through wide fluctuations.

Other factors to be considered.

The foregoing analysis shows that the immediate effect that an increase in reserve funds would have on credit expansion would be influenced by the prevailing business situation, while, as mentioned in the beginning, the actual course of bank credit subsequent to the addition to the reserves would be affected by such factors as the extent of member bank indebtedness at the reserve banks, the open market policy of these banks, and the volume and direction of gold movements. It would be impossible, therefore, to make a definite forecast of the course of bank credit following an addition to the reserves available for use by member banks.

The present study indicates, however, that the tendency would be, in the absence of offsetting factors for the volume of bank credit to increase in the long run by between 3 1/2 and 4 times the amount of increase in member bank reserve balances.

See 131

FEDERAL RESERVE BANKS
(In thousands of dollars)

Item	: April 21, : 1926	: Amount	Peak : Date
Reserves:			
Gold	2,795,227	3,167,527	July 23, 1924
Total	2,950,470	3,273,542	July 23, 1924
Discounts	449,670	2,826,825	November 5, 1920
Acceptances	229,474	585,212	December 26, 1919
United States Securities	388,583	629,683	June 14, 1922
Total Earning Assets	1,081,062	3,421,976	October 15, 1920
Federal reserve note cir- culation	1,662,284	3,404,931	December 23, 1920
Deposits:			
Members reserve acc't	2,171,145	2,308,614	December 30, 1925
Total	2,219,750	2,357,141	December 30, 1925

Office Correspondence

FEDERAL RESERVE
BOARD116 see BH
Date April 28, 1926

To Mr. Hamlin

Subject:

From Mr. Goldenweiser
G. G. G.

5-495

In connection with your inquiry about the distribution of paper pledged with the Federal reserve agent of New York as collateral for Federal reserve notes, I have ascertained that on April 27 the total amount of paper pledged with the Agent was \$139,000,000, of which ^{77%} \$107,000,000 were collateral notes, ^{8%} \$11,000,000 were acceptances, and ^{15%} \$21,000,000 rediscounts.

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Office Correspondence

FEDERAL RESERVE
BOARD

Date April 30, 1926

To Mr. Hamlin

Subject:

From Mr. Goldenweiser

2-8495

Attached is a very rough chart showing for the end of June of each year from 1917 to 1925 the total volume of member bank reserve deposits against net demand deposits of all member banks. This figure is obtained by deducting from the total reserve deposits that portion which represents 3 per cent of time deposits. This figure has been divided between deposits arising out of loans on securities and other loans and the curves for these items are also shown on the chart. The allocation is necessarily a rough one and is based on the distribution of the loans of member banks between security loans and all other loans as given in the June 30 reports of the Comptroller of the Currency and of our own Division of Bank Operations. I have not tried to give figures prior to June, 1917 for the reason that, as you remember, it was only by the June, 1917 amendments that member banks were obliged to keep their entire reserves with the reserve banks, while for the earlier dates when reserves were distributed between the reserve banks and the member banks' own vaults, it would be much more difficult to make the allocation. It should also be mentioned that the large amount of reserves against security loans in 1918-1919 was due to the large volume of loans secured by Liberty bonds, representing purchases of these bonds on deferred payments. This class of security loans, of course, was different from security loans made in recent years.

We will be glad to prepare a finished chart showing this information in case you are interested.

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Million

1800

1700

1600

1500

1400

1300

1200

1100

1000

900

800

700

600

500

0

Total Res. Deposits
Against Dem. Dep.

Against Other
Deposits

Against Deposits
arising from
Security Loans

End of June

1917

1918

1919

1920

1921

1922

1923

1924

1925

....., 191

Account of

settled by the Auditor for the Department , per Certificate
No., dated, 191

Upon a revision of the above-named account, upon the application filed, 191 ,
of, I certify the following differences found by me:

Office Correspondence

FEDERAL RESERVE
BOARDDate May 4, 1926.To Mr. Hamlin

Subject: _____

From Mr. Smead

2-5496

We have your request of May 3 addressed to Mr. Goldenweiser regarding the amount of salaries paid to Governors and Federal reserve agents and the total cost of the Federal reserve agents' departments as compared with operating departments of the banks, and in accordance therewith are giving you the following figures:

Salaries on May 1, 1926 of -

	<u>Governors</u>	<u>Agents</u>		<u>Governors</u>	<u>Agents</u>
Boston	\$25,000	\$20,000	Chicago	\$35,000	\$24,000
New York	50,000	40,000	St. Louis	25,000	20,000
Philadelphia	25,000	20,000	Minneapolis	25,000	20,000
Cleveland	30,000	18,000	Kansas City	25,000	20,000
Richmond	25,000	20,000	Dallas	24,000	20,000
Atlanta	25,000	20,000	San Francisco	25,000	24,000
			Total	339,000	266,000

No figures are available showing the complete cost (including rent, heat, light, and general overhead) of maintaining departments under the supervision of the Federal reserve agents. Our reports do show, however, expenses which are directly chargeable to each department under the supervision of the agent as distinct from the operating departments of the bank. Such figures for the calendar year 1925 are as follows:

Federal Reserve Agents' departments:

Statistical and Analytical	\$468,407	
Federal reserve note issues	37,748	
Bank examinations	521,641	
Total		\$1,027,796

Operating departments of Federal reserve banks

(includes salaries of Governors, Federal reserve agents and other general overhead expenses)	20,812,931
Printing, shipping and redeeming of F. R. currency	1,802,918
Provision of space	2,935,119
Auditing	663,490
Total	27,242,254

As Federal reserve agents are also Chairmen of the Boards of Directors, it is impracticable to say just what proportion of their salaries should be charged to the Agents' departments and what proportion to the banks, and consequently, it has been the practice for several years to include total salaries of the Chairmen and Agents, which now amount to \$266,000 per annum, in the General Overhead of the banks.

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Office Correspondence

FEDERAL RESERVE
BOARD

Date

May 27 1926

To Mr. Hamlin

Subject: 151

From Mr. Goldenweiser

2-8495

In reply to your request of April 24 for statistics showing wage increases of school teachers, clerks, etc., compared with the cost of living, I am pleased to transmit the attached memorandum prepared by Mr. Thomas of this Division. If we can be of further assistance to you in this matter, please let me know.

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GOVERNMENT PRINTING OFFICE

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yet been put in usable form.

Salaries of Teachers and Cost of Living

	Average Salary <u>1/</u>		Cost of Living Index <u>2/</u>	
	In Dollars	Index (1915 = 100)	(1913 = 100)	(1915 = 100)
1915	\$ 543	100.0	105.1	100.0
1920	871	160.4	208.5	198.4
1922	1,166	215.0	167.3	159.1
1924	1,227	226.0	170.7	162.4
1925	--	--	175.7	167.2

1/ Average annual salary of teachers, principals, and supervisors in United States. Source: Bureau of Education.

2/ Bureau of Labor Statistics index of cost of living in the United States.

Office Confidential

Date _____

To Mr. Goldenweiser

Subject: _____

From Mr. Thomas *MT*

In regard to Mr. Hamlin's request on the attached memorandum concerning salaries of teachers, clerks, and the like, I have been able to secure limited information. The table below gives average annual salaries of teachers, principals, and supervisors as reported by the Bureau of Education for certain years. Cost of living indexes are shown for corresponding years and both salaries and cost of living have been reduced to a comparable base with 1915 equaling 100.

The statistics on clerical positions so far as I can determine are not available. The Bureau of Efficiency has collected figures which may throw some light upon this subject, but their statistics have not yet been put in usable form.

Salaries of Teachers and Cost of Living

	Average Salary <u>1/</u>		Cost of Living Index <u>2/</u>	
	In Dollars	Index (1915 = 100)	(1913 = 100)	(1915 = 100)
1915	\$ 543	100.0	105.1	100.0
1920	871	160.4	208.5	198.4
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1925	--	--	175.7	167.2

1/ Average annual salary of teachers, principals, and supervisors in United States. Source: Bureau of Education.

2/ Bureau of Labor Statistics index of cost of living in the United States.

Office Correspondence

FEDERAL RESERVE
BOARD

205.001

Date May 3, 1926To Mr. Hamlin

Subject: _____

From Mr. Goldenweiser

2-8495

In accordance with your request, I have had prepared the attached statement showing the comparative strength of the Federal Reserve Banks of New York and Chicago, compared with certain European Central banks.

I trust that this will meet your requirements.

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