The Papers of Charles Hamlin (mss24661)

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FRBoard Members

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 17, 1941

To The Files

Subject:

From Mr. Coe

MPC.

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 172 of Mr. Hamlin's scrap book and placed in the Board's files:

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June 27, 1927.
St. 5420.

TO: Federal Reserve Board

FROM: Mr. Smead

SUBJECT: Report on member bank reserve requirements.

Under date of May 12, 1925, a committee of Federal reserve agents composed of Frederic H. Curtiss, Chairman, Pierre Jay, Wm. McC. Martin, and D. C. Wills, submitted a report to the Federal Reserve Board recommending certain changes in the legal reserve requirements for member banks. This committee, after an extensive study of the subject, came to the conclusion that the credit system of the country had become adjusted to the present level of reserves, that any material change therein would involve readjustments, the effect of which would be difficult to forecast, and that it was desirable to avoid changes in reserve requirements which would bring about violent changes in the reserves of individual banks. While the committee preferred, therefore, not to make any radical change in existing requirements, it recognized that in certain particulars changes were desirable and recommended:

(1) That the requirements of the Federal Reserve Act relative to member bank reserves be changed so as to permit the deduction of exchanges for clearing house, checks on other banks in the same place, and of checks in process of collection (whether with Federal reserve banks or correspondent banks), from demand deposits instead of from bank deposits as at present;

(2) That all member banks outside of New York and Chicago be required to carry a reserve of 10 per cent on net balances due to other banks; and

(3) That all banks be required to carry a reserve against Government deposits at the same rate as against demand deposits.

It is generally agreed that the present total volume of reserves is reasonably satisfactory from a credit standpoint, and consequently it would be both unnecessary and inadvisable to undertake any revision of reserve requirements which would involve a material raising or lowering of the aggregate reserves carried with the Federal reserve banks. There are, however, three questions of considerable importance which it is believed should receive consideration, namely: Are the present differentials in reserve requirements for the various classes of banks reasonably satisfactory, or do they result in some banks' carrying a larger or smaller proportion of the aggregate than the character of their deposits justifies; should the definition of time deposits be revised so as to check the conversion of demand into time deposits; and should not the method of computing the deposit liability on which reserves are required be materially simplified.

It should be borne in mind that one of the fundamental principles which was incorporated in the original national bank act, and which has been followed without question ever since, is that banks which make it a practice to solicit deposits from other banks and act as their correspondents and, in many cases, as their reserve agents, are in a sense bankers' banks and are likely to have to meet unusual withdrawals of deposits whenever there is a tightening in the credit situation. In recognition of this fact, Congress provided that banks located in the larger financial centers should be required to carry a higher reserve against their deposit liabilities than banks located elsewhere, which presumably would carry no material amount of bank deposits.

The reasons prompting Congress to require member banks in reserve cities to carry higher reserves are believed to be universally recognized as sound, and, as a matter of fact, the agents' committee above referred to recognized this by recommending that all banks outside New York City and Chicago, wherever located, be required to carry a 10 per cent reserve against net bank deposits.

If it is conceded that banks located in reserve cities should carry higher reserves than so-called country banks, because the former generally carry substantial deposits of, and act as correspondents or reserve agents for, other banks, it would seem to follow that a more equitable arrangement would be to require a uniformly high reserve to be carried on bank deposits by all banks, wherever located. It is even more important for banks in rural communities, which choose to set themselves up as depositaries of other banks, to carry a high reserve on bank deposits, than it is for banks in the large financial centers, since the former usually receive bank deposits from banks in the surrounding territory only, and credit disturbances, which are frequently of a local character, affect them more seriously than they do banks in the larger cities which receive deposits from banks located in various sections of the country.

To require a higher reserve to be carried against bank deposits than on other demand deposits would, of course, necessitate an amendment to the Federal Reserve Act. The desirability of making such a change, however, together with the advisability of simplifying as much as possible the present involved method of computing reserves and of checking the marked tendency on the part of the banks to convert demand deposits into time deposits would seem to warrant the Board in asking Congress to amend the provisions of section 19 of the Act.

Proceeding on the assumption that the present aggregate volume of reserves is satisfactory from both the member bank and the Federal reserve bank standpoint, it is believed that the purposes outlined in the preceding paragraph can be achieved by requiring member banks to maintain reserves with the Federal reserve banks as follows:

1. On total bank deposits - 13 per cent by all member banks
2. On total time deposits - 3 per cent by all member banks
3. On net demand deposits - 13 per cent by member banks in New York City and Chicago, (except banks in outlying territory)
   9 per cent by member banks in all other F. R. bank and branch cities
   7 per cent by member banks located outside F. R. bank and branch cities.
4. U. S. Government deposits - Require all member banks to carry reserves on U. S. Government deposits, the percentage of reserves required to be the same as that required on net demand deposits.

It is also recommended that the Act be amended so as to provide that -

1. A savings account in order to be classified as a time deposit must be subject to the following restrictions: (a) It must be the deposit of an individual or of a religious, charitable or similar corporation and not the deposit of one bank in another or the deposit of a business corporation or firm; (b) a pass book, certificate, or other similar form of receipt issued to and retained by the depositor must be presented to the bank whenever a withdrawal is made; (c) the depositor may at any time be required by the bank to give notice of an intended withdrawal not less than 30 days before the withdrawal is made; and (d) no withdrawal in excess of $500 on any one day shall be made unless the depositor has given notice of such intended withdrawal not less than 30 days before the withdrawal is made.

2. Certificates of deposit payable on a specified date and not within 30 days of maturity shall be classified as time deposits, and all other certificates of deposit payable on a specified date shall be classified as demand deposits.

3. All postal savings deposits shall be classified as time deposits.

4. Other deposits may be classified as time deposits when, in accordance with a written contract entered into with the depositor at the time the deposit is made, they cannot be withdrawn except on a given date more than 30 days after the date of the deposit or on written notice which must be given by the depositor at least 30 days in advance of withdrawal, provided that such deposits shall be classified as demand deposits during the 30 days preceding the withdrawal date.

5. All other deposits shall be classified either as demand deposits or as bank deposits.

6. In determining the amount of net demand deposits on which reserves are to be computed all member banks, wherever located, shall deduct balances due from other banks (except Federal reserve banks and foreign banks), items with Federal reserve banks and other banks in process of collection, exchanges for the clearing house, and checks on other banks in same place, from their <u>gross demand deposits</u> including certified and cashiers' or treasurers' checks outstanding.

The present reserve requirements and the changes suggested are summarized as follows:

PRESENT REQUIREMENTS

	Bank deposits net	Total demand deposits*	Time deposits
Central Reserve Cities (New York City and Chicago)	13	13	3
Other Reserve Cities	10	10	3
Country banks	7	7	3

*Except U. S. Government deposits on which no reserve is now required.

PROPOSED REQUIREMENTS

	Total bank deposits	Net demand deposits	Time deposits
New York City and Chicago	13	13	3
Other F.R. bank & branch cities	13	9	3
Outside F.R. bank & branch cities	13	7	3

Should the proposed changes be adopted, the amount of deposits subject to reserve will be computed in accordance with the following formula:

BANK DEPOSITS

1. Balances due to banks, bankers, and trust companies in the U. S. & foreign countries		$_____

NET DEMAND DEPOSITS

2. Demand deposits	$_____	
3. Cashiers' and certified checks	_____	
4. U. S. Government deposits	_____	
5. Cash letters of credit and travelers' checks	_____	
6. TOTAL DEMAND DEPOSITS (exclusive of bank deposits)		_____
DEDUCT:		
7. Balances due from other banks (except F. R. and foreign banks)	_____	
8. Checks in process of collection with Federal reserve or correspondent banks	_____	
9. Exchanges for clearing house	_____	
10. Checks on other banks in same place	_____	
11. TOTAL DEDUCTIONS		_____
12. NET DEMAND DEPOSITS (exclusive of bank deposits)		_____

TIME DEPOSITS

13. Savings accounts	_____	
14. Time certificates of deposit payable after 30 days	_____	
15. Postal savings deposits	_____	
16. Other deposits payable after 30 days	_____	
17. TOTAL TIME DEPOSITS		_____

The effect of the above changes as compared with present requirements has been calculated for each call date since September 28, 1925, and the changes are summarized as follows:

	Present required reserves	Change resulting from proposed requirements	Change resulting from proposed requirements omitting reserve on U. S. Government deposits
	(In thousands of dollars)		
All banks:			
March 23, 1927	2,219,984	+ 69	- 39,626
Dec. 31, 1926	2,250,367	- 34,334	- 56,714
June 30	2,226,737	- 31,797	- 52,884
April 12	2,167,495	- 17,439	- 52,776
Dec. 31, 1925	2,256,420	- 34,647	- 63,609
Sept. 28	2,140,351	- 11,249	- 37,168
New York City and Chicago:			
March 23, 1927	863,905	+ 9,736	- 5,383
Dec. 31, 1926	898,692	- 5,055	- 12,781
June 30	875,880	- 3,391	- 8,546
April 12	823,290	+ 141	- 8,611
Dec. 31, 1925	897,438	- 11,336	- 20,910
Sept. 28	822,939	+ 2,685	- 4,697
Reserve cities in which a F. R. bank or branch is located:			
March 23, 1927	653,595	+ 11,594	- 7,474
Dec. 31, 1926	647,984	- 2,335	- 13,250
June 30	654,077	- 3,363	- 15,841
April 12	647,405	+ 5,477	- 15,837
Dec. 31, 1925	655,133	+ 401	- 14,240
Sept. 28	633,014	+ 6,667	- 7,002
Reserve cities in which no F. R. bank or branch is located:			
March 23, 1927	107,936	- 10,156	- 11,202
Dec. 31, 1926	102,116	- 9,677	- 10,449
June 30	103,304	- 10,529	- 11,387
April 12	103,578	- 10,197	- 11,393
Dec. 31, 1925	100,576	- 7,867	- 8,904
Sept. 28	98,701	- 7,423	- 8,360
Country banks:			
March 23, 1927	594,548	- 11,105	- 15,567
Dec. 31, 1926	601,575	- 17,267	- 20,234
June 30	593,476	- 14,514	- 17,110
April 12	593,222	- 12,860	- 16,935
Dec. 31, 1925	603,273	- 15,845	- 19,555
Sept. 28	585,697	- 13,178	- 17,109

CHANGE IN AGGREGATE RESERVE REQUIREMENTS. It will be noted from the tabular statement above that the reduction in aggregate reserves which would result from the suggested changes in reserve requirements averages about $33,000,000 on the June and December call dates and about $15,000,000 on the other call dates. Inasmuch as member banks, on the June and December call dates, hold substantial amounts of exchanges for clearing house and other checks in process of collection, for which they have given their depositors credit, a substantial proportion of which cannot be deducted under present laws in calculating net deposits on which reserves are computed, it is evident that the figures for June and December are not representative. It is thought, in fact, that the average reduction in reserve requirements in case the above changes were adopted would not exceed $15,000,000.

GOVERNMENT DEPOSITS. In case the Board should feel it inadvisable to ask Congress to modify the law so as to require member banks to carry a reserve on Government deposits, as they did prior to June 21, 1917, the reduction in reserve requirements which would result from the suggested changes thus modified would probably average in the neighborhood of $40,000,000. A loss of even this much in reserves required could, it would seem, well be afforded if necessary to obtain a more logical method of calculating reserves and more equitable differentials in reserve requirements, especially if, as it is assuméd, the new requirements would be more satisfactory to member banks as a whole.

CASH LETTERS OF CREDIT AND TRAVELERS' CHECKS OUTSTANDING. The Board's present rules covering required reserves of member banks do not require the banks to carry a reserve on letters of credit and travelers' checks sold for cash and outstanding. These letters of credit and travelers' checks are, however, to all intents and purposes, deposits subject to withdrawal on demand, and for this reason they have been included among demand deposits as shown above. The Board apparently has ample authority under the present law to rule that member banks should carry reserves on these items, and it is my understanding that the banks in New York City which issue a substantial volume of cash letters of credit and travelers' checks do carry a reserve against them at the present time.

HIGHER RESERVES FOR BANKS IN NEW YORK CITY AND CHICAGO. The reason for requiring higher reserves to be carried on net demand deposits by member banks in New York City and Chicago than by banks located elsewhere is that these cities are the two largest financial centers in the United States, the banks do practically a world-wide business, they carry large balances both for correspondent banks and for large corporations throughout the United States and in foreign countries as well, with the result that a tremendous volume of working and surplus funds finds its way into the banks of these two cities. Moreover, a large volume of funds are loaned on call in these cities, especially in New York City, and any withdrawal of such funds has to be met by the local banks.

DIFFERENTIAL IN REQUIRED RESERVES ON NET DEMAND DEPOSITS BETWEEN MEMBER BANKS LOCATED IN F. R. BANK AND BRANCH CITIES AND THOSE LOCATED OUTSIDE SUCH CITIES. Banks in Federal reserve bank and branch cities have immediate access to the cash facilities of the Federal reserve banks and branches in their respective cities and consequently can safely operate with a much smaller amount of cash in their vaults than can banks located in other cities and towns.

The ratio of cash in vault to net demand deposits is normally less than 2 per cent for member banks in New York City and Chicago, around 2.4 per cent in other Federal reserve bank and branch cities, and somewhat under 5 per cent for banks located outside such cities. Accordingly, the differential of 2 per cent in reserve requirements on net demand and Government deposits, as between banks in Federal reserve bank and branch cities and elsewhere, is necessary to put the banks, both in and outside of Federal reserve bank and branch cities, on an approximately equal footing with regard to the total of their legal reserves with the Federal reserve bank and vault cash requirements.

REASON FOR MAKING ALL DEDUCTIONS FROM DEMAND DEPOSITS. Under present laws and the rulings of the Federal Reserve Board, member banks are allowed to deduct items in process of collection and balances due from other banks from amounts due to banks in computing their deposits on which reserves are carried. All country banks have substantial amounts due from correspondent banks and of items in process of collection, but they do not as a general rule have any balances due to other banks. Consequently, the country banks cannot deduct their very substantial balances with other banks from their deposit liabilities in determining deposits on which reserves are carried and are, therefore, at a disadvantage in comparison with banks having substantial balances due to other banks. As it is impracticable for a member bank to segregate items in process of collection, which were deposited by customers for credit in their checking accounts, from those received for credit to other banks or to time deposit accounts, some arbitrary rule has to be followed, and as deductions clearly should not be made from time deposits and could not from bank deposits in the case of country banks (which have no such deposits) it follows that the deduction, if it is to be availed of by all member banks, can as a practical matter be made only from demand deposits. In so far as balances due from banks are made up of collected funds, the deduction of such balances from demand deposits is perhaps not entirely logical, but as a real country bank has no bank deposits from which a deduction can be made, the deduction, if made, must be from its demand deposits.

ALLOWANCE FOR CURRENCY IN TRANSIT IN COMPUTING REQUIRED RESERVES. The differential of 2 per cent in the percentage of reserve required on net demand deposits for banks located in Federal reserve bank or branch cities and those located elsewhere, in recognition of the fact that banks in Federal reserve bank and branch cities can carry a smaller vault cash reserve, would seem to be sufficient justification for discontinuing the present practice of some of the Federal reserve banks of allowing for currency in transit in computing required reserves.

EFFECT OF ABOVE CHANGES UPON REQUIRED RESERVES OF INDIVIDUAL BANKS. While the above-suggested changes would result in a slight decrease in the aggregate reserves with the Federal reserve banks, the effect would not be uniform on all member banks. Banks in central reserve cities would not be materially affected. They would have to carry a reserve on Government deposits, but in many of such banks this would be offset by the additional deductions allowed in computing deposit liabilities. In the case of reserve city banks, apart from the increase in reserve arising from the requirement of reserves on Government deposits, the effect will be determined by the proportion of bank deposits to total demand (including bank) deposits. If a bank is located in a Federal reserve bank or branch city, its required reserve will be reduced if the amount of its bank deposits is less than 1/3 of its net demand deposits exclusive of bank deposits, and will be increased if the proportion of bank deposits is larger. In the extreme case, which, of course, would not occur, of a bank all of whose demand deposits were bank deposits, the required reserve would be increased by 30 per cent. Inasmuch, however, as all of the banks carry a substantial amount of demand deposits other than bank deposits, it is apparent that the proposed change would not greatly increase the required reserve of any bank in a reserve city. If a bank is located in a city now designated as a reserve city but in which there is no Federal reserve bank or branch, its required reserve on demand (including bank) deposits would be reduced unless its bank deposits were at least equal to the amount of its net demand deposits exclusive of bank deposits. In the foregoing it is assumed that banks in reserve cities at the present time have a net "due to" banks. In any instance where this does not hold true, there would be a further reduction in the reserve requirement by reason of the fact that the bank would be permitted to deduct all of its "due froms," exchanges, and other items in process of collection from its deposit liability.

When it comes to country banks, the situation is somewhat different. The great majority of country banks would benefit materially by the proposed change as it would permit them to deduct all of their "due froms," exchanges, and other items in process of collection from their deposit liabilities without any offsetting increase in their required reserves as most of them carry practically no bank deposits. In the case of those country banks which carry a substantial amount of bank deposits, however, the effect would be to increase their required reserves. A bank which had all of its demand deposits in the form of bank deposits could theoretically have an increase of 85.7 per cent in the required reserve on such deposits. A bank, however, whose bank deposits did not exceed approximately 55 per cent of its deductible items would have a reduction in its required reserve. There are a number of so-called country banks which do carry very substantial amounts of bank deposits and it is from these banks particularly that opposition to the above-suggested changes would come. If the principle upon which the suggested changes are based is correct, however, it would not seem that the opposition of a number of banks scattered throughout the country which have substantial amounts of bank deposits, but which are not carrying an adequate reserve thereon, should be allowed to prevent a necessary revision of reserve requirements.

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EARNINGS AND EXPENSES OF FEDERAL RESERVE BANKS

June 1927. Total earnings of the Federal reserve banks in June were $206,000 more than in May though earnings were accrued for one day less in June. Earnings from discounted bills declined $196,000 but this decrease was more than offset by an increase of $162,000 in earnings from purchased bills and U. S. securities and of $241,000 in miscellaneous earnings. The increase in miscellaneous earnings was due to the semi-annual distribution of commissions earned on bills and securities purchased for foreign correspondents and to profits on securities sold.

Current expenses (exclusive of cost of currency) aggregated $2,154,000 as compared with $2,148,000 in the month preceding and $2,139,000 in June 1926.

FIRST SIX MONTHS OF 1927. During the first half of the year earnings totaled $20,412,000, or $2,418,000 below the total for the first half of last year. Earnings from discounted bills declined $1,408,000, from purchased bills and U.S. securities $736,000, and from miscellaneous sources $273,000.

Current expenses (exclusive of cost of Federal reserve currency) amounted to $12,874,000 during the first half of this year, an increase of $65,000 from the corresponding period last year.

After providing for all current expense and dividend requirements, the Federal reserve banks on June 30 had a balance of $2,773,000 available for depreciation allowances, surplus and franchise taxes, as compared with a balance of $5,525,000 at the end of June 1926. Earnings of the Federal reserve bank of Richmond on June 30 were $59,454 less than expense and dividend requirements.

St.5439.

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Mr. Hamlin

See Bk

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EARNINGS AND EXPENSES OF FEDERAL RESERVE BANKS, JUNE 1927.

St. 5439.

Federal Reserve Bank	Month of June 1927								Year 1927			
	Earnings				Current expenses						Balance available for depreciation allowances, surplus, franchise tax, etc.	
	From discounted bills	From purchased bills and U. S. securities	From other sources	Total	Exclusive of cost of currency	Total	Current net earnings	Annual rate of current net earnings on average paid-in capital	Current net earnings to June 30	Dividends accrued to June 30	On June 30	On May 31
								Per cent				
Boston	$112,572	$108,767	$13,905	$235,244	$154,267	$159,699	$75,545	10.1	$423,736	$268,343	$155,393	$125,559
New York	302,056	372,913	83,675	758,644	508,358	550,693	207,951	6.5	1,533,959	1,140,026	393,933	380,285
Philadelphia	151,005	117,124	18,827	286,956	160,939	174,040	112,916	10.5	509,723	385,901	123,822	76,089
Cleveland	140,231	185,577	27,761	353,569	196,673	206,043	147,526	13.0	801,279	414,525	386,754	308,509
Richmond	73,570	55,710	11,031	140,311	108,593	111,065	29,246	5.7	125,639	185,093	*59,454	*57,678
Atlanta	107,835	58,208	21,069	187,112	98,223	108,928	78,184	18.6	388,247	151,698	236,549	183,872
Chicago	208,963	260,626	56,259	525,848	313,630	339,814	186,034	13.2	1,063,458	508,731	554,727	454,559
St. Louis	86,309	115,020	10,789	212,118	107,745	108,069	104,049	24.0	391,622	158,645	232,977	155,349
Minneapolis	22,481	80,027	8,640	111,148	84,204	89,913	21,235	8.6	134,168	90,500	43,668	37,457
Kansas City	55,421	119,466	32,933	207,820	131,166	137,801	70,019	20.2	285,927	125,998	159,929	110,985
Dallas	20,636	106,725	11,836	139,197	100,234	104,190	35,007	10.0	171,879	128,266	43,613	29,843
San Francisco	138,008	169,790	22,126	329,924	189,617	211,866	118,058	15.7	770,381	269,368	501,013	428,446
TOTAL:												
June 1927	1,419,087	1,749,953	318,851	3,487,891	2,153,649	2,302,121	1,185,770	11.2	6,600,018	3,827,094	2,772,924	2,233,275
May 1927	1,615,262	1,588,242	78,054	3,281,558	2,147,548	2,304,690	976,567	8.9				
June 1926	1,524,809	1,876,510	360,965	3,762,284	2,139,335	2,296,078	1,466,206	14.5	9,139,448	3,614,093	5,525,355	4,675,810

FEDERAL RESERVE BOARD
DIVISION OF BANK OPERATIONS
JULY 11, 1927

*Deficit

Form No. 131.

Office Correspondence

FEDERAL RESERVE BOARD

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see BH

Date June 23, 1927.

To Mr. Hamlin

Subject: Pacific Southwest Trust and Savings Bank, Los Angeles, California.

From The Committee on Examinations - Gov. Crissinger and Mr. Cunningham

2—8495 G P O

The committee hands you herewith for your personal information a copy of Mr. Gilbert's analysis of the report of examination of the Pacific Southwest Trust and Savings Bank, Los Angeles, California, as at the close of business on February 5th, 1927.

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Form No. 131.

Office Correspondence

FEDERAL RESERVE BOARD

Date June 22, 1927

To Gov. Crissinger and Mr. Cunningham

Subject: Pacific Southwest Trust & Savings Bank, Los Angeles, Calif.

From Mr. Gilbert

2—8495

COPY

The report of the credit investigation of the Pacific Southwest Trust and Savings Bank as of the close of business February 5, 1927, by the examining force of the Federal Reserve Bank of San Francisco, jointly with the California State Banking Department, which contains the latest available information as to this bank in the Board's possession, is incomplete in the following principal particulars:

1. Loans aggregating about $15,000,000 of the 63 branches not inspected by Federal Reserve examiners, are not included in the report. These loans were covered by the State examiners whose report will not be received until after July 1st.

2. Securities held for investment aggregating $31,398,000 (book value) have not yet been appraised.

3. Other real estate owned aggregating $3,225,000 was not appraised independently. The bank's appraisal figures were used by the examiners and they are believed to be too high.

Such facts and figures as were contained in the report, however, indicate, in the opinion of this office, that the bank's capital is imparied at least $1,000,000. This is an estimate, as complete and exact figures as above indicated, are not available. Losses other than those definitely reported as such are believed to exist in the large aggregate of slow, doubtful, and otherwise criticized assets. In view of such potential losses, the figure of capital impairment given is believed to be conservative.

Assuming that an impairment of capital does exist, continuance of this bank's membership in the Federal Reserve System is in violation of Section 5204 R.S.

In granting an excessive loan to the Marine Corporation of $2,452,000 (in excess of the State legal limit by $952,000), the bank violated the first condition under which it was admitted to membership.

In undertaking without the approval of the Federal Reserve Board to assume a contingent liability (which later became a direct liability) of $1,900,000 in connection with the purchase of stock of the Marine Corporation, the bank violated the third condition under which it was admitted to membership.

These violations render the bank liable to expulsion from the System by the Board in its discretion.

GOVERNMENT PRINTING OFFICE

Since the Board may lawfully exercise a discretion in connection with expulsion of members, its action in this matter, it is suggested, could very appropriately follow a constructive course. In view of the violations enumerated, the Board is in a position in which it may terminate the bank's membership, regardless of what corrective measures the bank might later take. In practical effect, this gives the Board the power to require correction, not only of the specific violations set forth above, but correction of any other matters that are not in themselves penalized in any manner by the Federal Reserve Act, under pain of expulsion for the specific violations already committed.

In view of this situation, it is recommended that the Board, through the Federal Reserve Agent at San Francisco, require the bank:

1. To restore itscapital to legal requirements.
2. Remove from the bank doubtful assets.
3. Reduce to the legal limit all excessive loans.
4. Establish a proper control and supervision over its branches.
5. Correct deficiencies in accounting, and
6. Replace dishonest and incompetent officers.

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Form No. 131.

Office Correspondence

FEDERAL RESERVE
BOARD

Pc 41

Date July 7, 1927.

To Mr. Hamlin

Subject:

From Mr. Smead

ES

2—8495
G P O

In accordance with your request I am handing you herewith copies of the statements given to Mr. James under date of July 1, relating to the Havana, Cuba, Agencies of the Federal Reserve Banks of Boston and Atlanta.

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CABLE TRANSFERS SOLD BY THE FEDERAL RESERVE BANK AGENCY IN HAVANA, OR BY THE PARENT BANK IN THE UNITED STATES FOR ITS ACCOUNT, FROM AUGUST 1923 TO MAY 1927, ALSO EXCHANGES OF NEW OR FIT FOR UNFIT CURRENCY SINCE MARCH, 1927.

	1923			1924			1925		
	Transfers sold in -			Transfers sold in -			Transfers sold in -		
	Total	Cuba	U. S.	Total	Cuba	U. S.	Total	Cuba	U. S.
January	-	-	-	$1,456,500	$1,405,000	$51,500	$3,535,000	$518,000	$3,017,000
February	-	-	-	3,860,175	360,000	3,500,175	2,837,000	412,000	2,425,000
March	-	-	-	6,534,000	334,000	6,200,000	4,888,000	2,638,000	2,250,000
April	-	-	-	7,956,500	242,500	7,714,000	7,726,000	3,676,000	4,050,000
May	-	-	-	2,787,000	825,000	1,962,000	1,716,000	366,000	1,350,000
June	-	-	-	1,024,000	1,024,000	-	1,311,000	1,011,000	300,000
July	-	-	-	5,561,000	5,561,000	-	5,131,000	4,981,000	150,000
August	$7,800,000	$7,800,000	-	5,547,000	5,547,000	-	3,820,000	3,820,000	-
September	3,385,000	3,385,000	-	4,800,000	4,800,000	-	4,181,000	4,181,000	-
October	1,789,000	1,789,000	-	2,555,000	1,655,000	900,000	3,061,000	2,261,000	800,000
November	10,717,000	3,617,000	$7,100,000	1,627,000	927,000	700,000	2,475,000	1,069,000	1,406,000
December	778,000	678,000	100,000	3,882,000	3,227,000	655,000	3,050,000	2,020,000	1,030,000
Total	24,469,000	17,269,000	7,200,000	47,590,175	25,907,500	21,682,675	43,731,000	26,953,000	16,778,000

	1926			1927			1927	
	Transfers sold in -			Transfers sold in -			Currency exchanges	
	Total	Cuba	U. S.	Total	Cuba	U. S.	Received	Paid out.
January	$1,391,050	$1,111,050	$280,000	$1,221,050	$419,450	$801,600	-	-
February	3,042,000	1,282,000	1,760,000	9,911,430	309,430	9,602,000	-	-
March	3,726,000	1,166,000	2,560,000	3,161,200	1,000,000	2,161,200	$490,000	$490,000
April	54,071,000	12,991,000	41,080,000	6,930,000	250,000	6,680,000	484,000	484,000
May	9,269,200	9,169,200	100,000	4,700,000	4,650,000	50,000	475,000	475,000
June	11,593,000	11,293,000	300,000					
July	6,136,000	5,536,000	600,000					
August	7,432,000	7,432,000	-					
September	6,341,000	5,841,000	500,000					
October	3,300,000	3,300,000	-					
November	2,858,350	2,858,350	-					
December	4,810,000	4,490,000	320,000					
Total	113,969,600	66,469,600	47,500,000	25,923,680	6,628,880	19,294,800	1,449,000	1,449,000

	Currency received	Currency paid out
Cable transfers sold	$143,227,980	$112,455,475
Commissions on transfers sold in Cuba	143,228	-
Currency exchanges	1,449,000	1,449,000
Total	144,820,208	113,904,475

MONTHLY CURRENCY SHIPMENTS TO AND FROM THE HAVANA AGENCY OF THE FEDERAL RESERVE BANK OF ATLANTA
SINCE ESTABLISHMENT IN SEPTEMBER, 1923.

	1923		1924		1925		1926		1927	
	To Cuba	To U. S.	To Cuba	To U. S.	To Cuba	To U. S.	To Cuba	To U. S.	To Cuba	To U. S.
January	-	-	$6,000	$995,000	-	$1,629,000	$80,000	$975,000	-	$1,013,000
February	-	-	3,830,000	623,000	$3,004,000	1,166,500	600,000	739,000	$6,500,000	649,000
March	-	-	5,016,000	1,312,500	1,000,000	580,500	1,840,000	816,000	3,700,000	881,000
April	-	-	6,400,000	1,379,250	2,500,000	1,934,000	47,340,000	(a)9,961,000	8,500,000	320,500
May	-	-	1,000,000	184,000	-	666,500	-	7,146,000	-	2,004,500
June	-	-	-	629,500	-	541,000	-	(b)12,340,500		
July	-	-	-	1,982,000	-	4,721,500	-	5,034,000		
August	$5,000,000	-	-	1,949,500	-	682,000	-	6,096,500		
September	-	$1,862,000	-	3,795,000	-	2,549,500	-	3,751,000		
October	-	2,708,000	-	2,527,500	-	4,366,000	-	3,590,500		
November	3,420,000	1,880,500	-	-	-	3,206,000	-	2,048,000		
December	-	1,741,000	-	2,866,500	2,000,000	1,655,000	-	2,657,500		
Total	8,420,000	8,191,500	16,252,000	18,243,750	8,504,000	23,697,500	49,860,000	55,155,000	18,700,000	4,868,000

(a) Includes $6,000,000 of new and fit notes. (b) Includes $3,000,000 of new and fit notes.

Total currency shipments to Havana Agency, $101,736,000. Total currency shipments to the United States by Agency, $110,155,750.

VOLUME OF OPERATIONS AND EXPENSES OF HAVANA, CUBA, AGENCIES OF THE FEDERAL RESERVE BANKS OF BOSTON AND ATLANTA TO MAY 31, 1927, SUMMARIZED BY CALENDAR YEARS AND BY FISCAL YEARS ENDING JUNE 30

	1923	1924	1925	1926	1927 (to May 31)	Total
BOSTON AGENCY						
Calendar year:						
Transfers sold in Cuba	$17,269,000	$25,907,500	$26,953,000	$66,469,600	-	$136,599,100
Transfers sold in United States	7,200,000	21,682,675	16,778,000	47,500,000	-	93,160,675
Total	24,469,000	47,590,175	43,731,000	113,969,600	-	229,759,775
Current expenses	8,796.40	13,648.23	13,366.43	16,210.52	1,242.12	53,263.70
Fiscal Year:						
Transfers sold in Cuba	-	21,459,500	30,338,000	55,344,250	29,457,350	136,599,100
Transfers sold in United States	-	26,627,675	15,647,000	49,466,000	1,420,000	93,160,675
Total	-	48,087,175	45,985,000	104,810,250	30,877,350	229,759,775
Current expenses	-	14,779.40	13,891.03	13,192.41	11,400.86	53,263.70
ATLANTA AGENCY						
Calendar year:						
Transfers sold in Cuba	-	-	-	-	6,628,880	6,628,880
Transfers sold in United States	-	-	-	-	19,294,800	19,294,800
Total	-	-	-	-	25,923,680	25,923,680
Currency exchanges	-	-	-	-	1,449,000	1,449,000
Currency shipments to Cuba by Atlanta Bank	8,420,000	16,252,000	8,504,000	49,860,000	18,700,000	101,736,000
Currency shipments to U. S. by Agency	8,191,500	18,243,750	23,697,500	55,155,000	4,868,000	110,155,750
Net currency shipments to Cuba	228,500	-	-	-	13,832,000	-
Net currency shipments to United States	-	1,991,750	15,193,500	5,295,000	-	8,419,750
Current expenses	11,264.07	34,995.86	21,914.13	25,716.87	14,253.01	108,143.94
Fiscal Year:						
Transfers sold in Cuba	-	-	-	-	6,628,880	6,628,880
Transfers sold in United States	-	-	-	-	19,294,800	19,294,800
Total	-	-	-	-	25,923,680	25,923,680
Currency exchanges	-	-	-	-	1,449,000	1,449,000
Currency shipments to Cuba by Atlanta Bank	-	24,672,000	6,504,000	51,860,000	18,700,000	101,736,000
Currency shipments to U. S. by Agency	-	13,314,750	19,638,000	*49,157,500	28,045,500	110,155,750
Net currency shipments to Cuba	-	11,357,250	-	2,702,500	-	-
Net currency shipments to United States	-	-	13,134,000	-	9,345,500	8,419,750
Current expenses	-	30,758.95	26,779.78	21,337.98	29,267.23	108,143.94

*Includes $9,000,000 of new and fit notes.

CURRENT EXPENSES OF HAVANA, CUBA, AGENCIES

	1923	1924	1925	1926	1927
BOSTON AGENCY	-				
January	-	$928.04	$916.85	$966.51	$ 39.32
February	-	923.92	921.53	958.55	1,202.80
March	-	950.23	945.12	953.61	-
April	-	923.13	971,95	997.49	-
May	-	1,207.59	968.26	1,137.75	-
June	-	1,050.09	1,502.09	1,037.87	-
July	$722.33	1,047.42	943.61	878.00	-
August	2,099.61	1,186.20	972,17	867.15	-
September	346.54	1,070.67	1,118.42	872.35	-
October	907.22	986.40	971.41	883.40	-
November	1.015.57	1,081.43	963.29	883.70	-
December	3,705.13	2,293.11	2,171.73	5.774.14	-
Total	8,796.40	13,648.23	13,366.43	16,210.52	1,242.12

Total current expenses of agency July 1923 to February 1927 $53,263.70

	1923	1924	1925	1926	1927
ATLANTA AGENCY					
January	-	$3,547.86	2,405.46	845.81	2,338.29
February	-	2,533.83	2,338.84	1,045.20	1,646.19
March	-	2,944.98	2,497.47	1,654.89	3,989.22
April	-	3,950.56	1,321,07	479.58	2,303.03
May	-	3.692.50	1,665.16	2,367.18	3,976.28
June	-	2,825.15	1,050.80	4,309.99	
July	-	2,844.10	2,332.22	4,350.41	
August	-	2,610.29	1,408.21	2,447.87	
September	4,310.40	2,783.91	1,040.00	2,466.56	
October	3,658.57	1,391.14	2,329.51	2,371.91	
November	700.20	3,355.30	720.52	1,650.78	
December	2,594.90	2.516.24	2.804.87	1,726.69	
Total	11,264.07	34,995.86	21,914.13	25,716.87	14,253.01

Total current expenses of agency September 1923 to May 1927
$108,143.94

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Form No. 131.

Office Correspondence

FEDERAL RESERVE BOARD

Date May 10, 1927

To Mr. Hamlin

Subject: H. Parker Willis on speculation

From Mr. Goldenweiser

E.A.G.

2—8495

Your request to write a brief comment on Willis' article in the current number of the Magazine of Wall Street is not easy to comply with. The article is inaccurate and misleading, because it selects its evidence and vaguely intimates that there are perfectly simple methods of combatting speculation at the command of the reserve system. The fact is that the problem is a very difficult one, and one to which the system is giving very careful consideration, as you know. A policy of hard money for the purpose of curbing speculation might have a bad effect on legitimate business without greatly affecting speculation. It would also probably result in an increased inflow of gold which might more than offset the restraining influence of higher rates. To cure speculative activity by handling individual member banks is impracticable. To the extent that certain banks have tried to use funds obtained from the reserve banks for speculative purposes - they have been restrained. Generally, however, this is a disciplinary measure rather than a credit policy, because while it might eliminate abuses in individual banks, it can not have much effect on the general credit situation.

Among Willis' inaccuracies is the assumption that all the money used in the stock market is employed for speculative purposes. A large amount of credit can and must be legitimately used for the purpose of financing the flotation and distribution of securities without any reference to speculation.

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REPORT OF THE PENSION COMMITTEE TO THE GOVERNORS' CONFERENCE, MAY 9, 1927.

Your Committee deems it appropriate at this time to review briefly the history of the Pension Committee and its work.

The Committee was first appointed at the March 1919 Conference of Governors. It was authorized to employ actuaries and other experts and did subsequently employ the following:

Mr. Henry Moir as consulting actuary,
Mr. George B. Buck as working actuary,
Mr. Monell Sayre as pension advisor, and
Mr. James F. Curtis as counsel.

After a careful study of a large number of other pension plans and of the whole pension problem as applied to the Federal Reserve System, a plan was evolved which was outlined and recommended to the Conference of Governors and the Federal Reserve Board in a report, dated February 24, 1921. This report was considered by the Federal Reserve Board and the Governors' Conference in February and April of 1921, with the result that it was decided to endeavor to secure Federal charter for a corporation to operate the fund and Congressional authority to the banks to contribute to such fund.

With a view to securing such legislation a committee of the Conference of April 12, 1921, and the Federal Reserve Board waited on Senator Smoot with the result that he suggested certain modifications of the plan as necessary in his judgment to assure the passage of the enabling act, his principal point being that the banks should assume only one half instead of all of the accrued liability. This condition was met and a bill was accordingly prepared by Mr. Curtis in May of 1921. It was transmitted by the Board to Senator Smoot on June 10, 1921, with the request that it be enacted into law as early as practicable and with a statement that its general details were approved by the Board.

During the summer and autumn of 1921 the plan was accepted and approved by the boards of directors of each of the twelve Federal reserve banks. The bill to incorporate the pension fund was not introduced, however, until March, 1926. On March 22, 1926, it was introduced by Senator George P. McLean, Chairman of the Senate Committee on Banking and Currency and was promptly referred to that Committee. That Committee held two hearings on the bill, on April 13 and April 27, 1926, respectively, both of which were attended by representatives of your Committee. The Senate Committee was favorable to a pension plan for Federal Reserve Banks; its discussion had to do mainly with the fixing of a limit on the amount of any pension that could be paid from the banks' contributions. In order to meet any criticism that might develop on this point, the Senate Committee amended the bill by inserting a clause specifically limiting the amount of pension that could be paid out of the funds contributed by the employer to 30% of the maximum salary paid. Our actuaries and your Committee believe that such limitation would not interfere with the contemplated operation of the proposed plan. The Senate Committee reported the bill favorably but it did not come to a vote in the Senate at the Spring Session.

Simultaneously with the introduction of the bill in the Senate, steps had been taken to secure its introduction in the House, through Representative

Louis T. McFadden. Mr. McFadden, being especially desirous of securing the passage of his banking bill, did not consider it wise to introduce the pension bill until the banking bill was disposed of, so no action on it was had in his Committee or the House during the 1926 Spring Session.

When Congress met in December of 1926 the bill was promptly taken up in the Senate and was passed on December 17, 1926, which automatically referred it to the House.

In the House the bill was referred to the Committee on Banking and Currency of which Mr. McFadden is Chairman. Mr. McFadden was still so much engaged with other legislation, particularly the banking bill, that it was not until February that consideration could be obtained for the pension bill. The House Committee held two hearings on February 11 and 16, 1927, respectively, both of which were attended by representatives of your Committee. Unfortunately, the bill encountered some opposition, largely political, in the House Committee. Notwithstanding, the bill was reported out by the House Committee on February 26, 1927, with recommendation for passage, but there was also an adverse minority report and for this reason it was not possible to obtain a rule from the Rules Committee that would give it opportunity to be voted on in the House prior to adjournment on Mar. 4. It is the view of your Committee that if the bill could have been reported out by the House Committee at an earlier date, there would have been little, if any, difficulty in securing its passage, but in the closing days of the session there were so many important matters to be dealt with that the legislative leaders were unwilling to have brought up measures to which there was considerable political opposition. Mr. McFadden and other members of the House, including some of the signers of the minority report, have advised that the bill can be passed promptly at the next session of Congress.

Your Committee held a meeting on April 20, 1927, for the purpose of reconsidering the bill in the light of experience before the Senate and House Committees, and the steps which should be taken for its reintroduction in the next Congress. While your Committee was informed and believes that much of the opposition that developed was not sincere and was of a petty character and based largely on misunderstanding of the provisions of the bill, nevertheless it was deemed desirable to meet so far as possible the criticisms which have been raised by changes in the language of the bill wherever that can be done without seriously affecting the purpose and operation of a sound and adequate pension plan.

The Committee decided, therefore, to redraft the bill and in the redraft:

(a) To change the name of the fund from the Federal Reserve Pension Fund to Federal Reserve Retirement Fund and to eliminate, so far as possible, the word "pension" from the body of the bill. This was suggested by Mr. McFadden and several other members of his Committee.

(b) To change the language of the amendment made by the Senate Committee to Section 4 of the bill, which established the limit of the amount of any pension that could be paid from employers' contributions at 30% of a maximum salary, substituting the expression of the same limitation by using the language of the Rogers Bill, i. e., a percentage "of the average salary of the last ten years of service."

The words "maximum salary" were the occasion for a good deal of confusion and misunderstanding and one of the principal points raised by an important member of the House Committee who joined in the minority report but has since indicated that with certain amendments the bill should be passed at the next session.

It seemed that a number of the members of the House Committee had difficulty in satisfying themselves that this was a limitation upon the amount of pension that could be paid from employers' contributions and not a method of determining the amount of pension.

(c) To include in the bill a provision requiring return of their contributions to employees leaving the service. This was not mentioned in the original bill but was a provision of the plan. It was one of the points raised in the minority report and there can be no harm in including it in the bill.

It was decided by your Committee to retain the provision that would permit member banks to participate in the pension plan with the approval of the Federal Reserve Board. While it is realized by your Committee that this provision is by no means essential to the success of a retirement system for Federal reserve bank employees, it is deemed by your Committee and its advisors as a most desirable feature for member banks and in the public interest. It is also desirable from the point of view of the administration of the fund in that if used by any considerable number of member banks the administration cost ratio would be materially reduced.

It developed in the discussions of your Committee that quite a number of member banks are much interested in this feature of the bill and that some, at least, are deferring taking some independent action towards establishing pension provisions for their employees, hoping to participate in our system.

Consideration was given also to that portion of the minority report relating to Section 6 of the bill, which is the section that reserves to Congress the right to alter, amend or repeal the act and which further provides that the contractual rights of any individual shall not be affected thereby. Counsel for your Committee advises that from a legal standpoint the section could be omitted without hazard, for the reasons that it is, of course, obvious that Congress may alter, amend or repeal any of its acts and that, in his opinion, the Constitution of the United States guarantees to individuals the necessary protection of their contract rights; nevertheless, he advised that, if possible, the clause should be retained, as in modern times it has become customary to include such a clause in all legislation of this sort. It was, therefore, decided to retain this section for the present at least but with the thought that it could be omitted if it became the subject of serious controversy.

It was also decided to reinstate in more specific language that provision of the bill which was eliminated by amendment on the floor of the Senate, which provided for inclusion within the benefits of the plan of the employees of the fund itself. The provision in the original bill was to include the officers and employees of the Pension Fund, but when the bill was debated on the floor of the Senate, one Senator objected to this provision on the ground that it would provide pensions for the incorporators and trustees of the fund. While this was, of course, a mistaken view, Senator McLean promptly surrendered this minor part to obtain prompt passage of the measure. It is inconsistent, however, in establishing a retirement fund to exclude from participation in it the fund's own salaried officers and employees, as originally provided.

In the hearings before the Committees both in the Senate and the House, it was apparent that some members expected the major provisions of the plan to be stated in the bill and while your Committee had carefully considered this question prior to deciding that the terms of the plan should not be incorporated in the statute, they have again considered it and could only arrive at the same conclusion. It was again emphasized by your Committee's advisors that as pension provisions must look a long way into the future and as pensions cannot become effective until many years after provision for them has been undertaken, it is most unwise and unsound to include terms in the charter. This was formerly the practice, with the result that many of the older pension systems abroad became entirely inadequate with changed economic conditions. For instance, a pension of £10 a year that was ample in the days of Queen Anne would be ridiculous in modern times. The function of modern pensions is to permit orderly retirement of super-annuated employees. This cannot be effected unless the pension is moderately related to the salary enjoyed when the employee comes to pension age. The scheme of working on averages in the plan evolved by your Committee embraces flexibility sufficient to reasonably overcome the effects of changed economic conditions, salary levels, etc., without disadvantage to or discrimination against either the employee or the fund. It provides for the automatic correction with soundness of changes that may take place during the term of employment of the individual for whom retirement provision is made. Therefore, to incorporate terms in the charter provisions of a retirement fund is not only unscientific but also could work grave hardships in individual cases and in the mass unless prompt charter revision were possible and it is deemed by your Committee that it would be both unsafe and undesirable to depend upon prompt action by Congress to amend charter provisions as to the terms of pensions and hence they believe that the terms should not be included in the bill.

Another point made in the minority report deals with the maximum amount of salary that may be considered as a basis for pension and suggests $10,000 instead of $18,000 as that maximum, the argument being that in the bill for the State Department employees $9,000 was the maximum of salary taken as a basis for the calculation of pension benefits. The fact is that $9,000 is the maximum salary that can be paid under the present law to any State Department employee eligible for pension, excepting only an ambassador promoted from the service - there is one such case at present. Your Committee believes that there is no valid argument on that account for the reduction in the maximum salary provided in your bill as a basis for pension calculations. On the contrary, your Committee believes that the fact that Congress adopted the maximum salary paid to State Department employees as the basis for retirement allowance clearly indicates the appreciation by Congress of the necessity for a reasonable relation between terminal salaries and the retirement annuity. While a less than $18,000 basis would provide adequate pension provision for the lower salaried officers and employees of Federal Reserve Banks, the provision would be entirely inadequate in respect of all higher salaried officers, and your Committee believes that it would be a great mistake for any plan to omit provision for the orderly retirement of the higher salaried personnel, and it regards the figure of $18,000 provided in the bill as the minimum that can be considered as permitting reasonable retirement of such personnel at age 65.

Your Committee also considered the problem of accrued liabilities, which has become increasingly difficult with the lapse of time since 1920, and believes that there should be a recalculation made by the actuaries to ascertain exactly the condition of accrued liabilities in order that possible changes or modifications in the plan might be adopted that would permit the older men with years of service to participate when the fund becomes operative.

The accrued liabilities were figured exactly, as of October 1, 1920, at $1,973,519. Without securing complete data the actuaries made an estimate of the accrued liabilities as of October 1, 1924, when by such calculation they were found to be approximately $6,000,000. Your Committee recommends that an exact calculation be made from new data on present employees as of June 30, 1927.

Your Committee believes the passage of the Pension Bill at the next session may be reasonably expected and if so, data collected as of June 30, 1927, can be used in setting up the pension plan more promptly than would be the case if data had to be assembled and the calculations made after the passage of the bill. It is believed that the actual operation of the plan might be begun six months earlier with data as of June 30, 1927, than would be possible if the calculations were deferred until after the passage of the bill.

The original appropriation made in 1920 for the expenses of the Committee amounted to $27,500, of which $20,000 was apportioned for the actuaries and other experts, and $7,500 for counsel fees. The attached statement shows the amounts expended to date against these appropriations. From it will be noted that against the $20,000 appropriation there has been expended $19,105.51. There is payable against this fund $500 to Mr. Henry Moir, being the balance of his stipulated fee of $3,000. There is an unexpended balance of $2,100 in the appropriation for counsel fees, which is insufficient by more than $1,000 to discharge the Committee's debt to counsel for services and expenses incurred.

The unexpectedly long time which has elapsed since the Committee first began its work and the vast amount of detail work which it has been necessary for the actuaries and counsel to do in connection with the restating of the plan and the preparation and presentation of data at the hearings before the Congressional Committees, added materially to the expenses of the Committee.

Your Committee recommends, therefore, that there be appropriated an additional $10,000 for its expenses, which, with the balance remaining from the original appropriation, is believed to be amply sufficient to permit the new actuarial work which is recommended, and to pay such other necessary expenses as will be incurred within one year. Assuming that the bill will pass the next Congress, it is believed that expenses incurred this year will substantially reduce the expenditures that would otherwise have to be made at the time of organization.

Respectfully submitted,

E. R. Fancher,
James B. McDougal,
E. R. Kenzel, Chairman.

Enc.

April 29, 1927.

STATEMENT SHOWING EXPENSES OF PENSION COMMITTEE FROM 1919 TO DATE

	Disbursements	Appropriation
To Mr. George B. Buck for actuarial work and expenses - - - - -	$10,919.53	
To Mr. Henry Moir, consulting actuary - - - -	2,500.00	
To Mr. Monell Sayre, pension advisor - - - - -	5,000.00	
Miscellaneous expenses, traveling, etc. - - -	715.98	
Total -	$19,135.51	$20,000.00
To Mr. James F. Curtis, counsel, for legal fees, expenses, printing, etc.	$ 5,403.71	7,500.00
GRAND TOTAL - - - - - - - - - - - - - - - - -	$24,539.22	$27,500.00

EXTRACT FROM CONGRESSIONAL RECORD OF DECEMBER 17, 1926,
SENATE DEBATE ON FEDERAL RESERVE PENSION BILL.

FEDERAL RESERVE PENSION FUND

The bill (S. 3657) to incorporate the Federal reserve pension fund, to define its functions, and for other purposes, was announced as next in order.

The PRESIDING OFFICER. Is there objection to the present consideration of the bill?

Mr. KING. I shall not object to the consideration of the bill, but I wish we could have a little more time than the five minute rule permits. The Senator from Connecticut (Mr. McLean) has been very considerate, and I shall not object to its consideration.

The Senate, as in Committee of the Whole, proceeded to consider the bill.

The first amendment of the Committee on Banking and Currency was, on page 5, line 24, after the word "employer," to insert the following additional proviso:

> And provided further, That no pension shall be paid out of the amounts contributed or to be contributed by the Federal reserve banks, the Federal Reserve Board, and the Federal reserve agents at a rate in excess of 30 per cent of the maximum annual salary received by such officer or.

The amendment was agreed to.

Mr. KING. Mr. President, I invite the attention of the Senator from Connecticut to the provision on page 2 and the provision on page 3, which extend the operations of the bill to State banks or trust companies or State institutions if they shall ever become members of the Federal reserve system. I would like to know the theory upon which the Federal Government, if my interpretation of the bill is right, intrudes itself into the State and says to the State institutions, "We have provided a Federal board that shall determine the pensionable status of employees in your various banks and trust companies."

Mr. McLEAN. Yes; they are private institutions the same as national banks. This is merely a voluntary proposition. They can come in if they so desire or remain out.

Mr. KING. It is voluntary in so far as joining the Federal reserve system is concerned, but it is involuntary so far as forcing State banks and State institutions, which may be members of the Federal reserve system, under the provisions and operation of this bill.

Mr. McLEAN. If they become members of the Federal reserve system, then they give it jurisdiction.

Mr. MOSES. Mr. President, may I ask the Senator from Connecticut if this is anything more than an enabling act for banks which wish to establish a pension system?

Mr. McLEAN. That is all.

Mr. MOSES. I am glad to see the junior Senator from Utah so vigorous in defending State rights, because that question is coming up here presently in a much higher form.

Mr. KING. I hope I shall always be a defender of local self-government against the new federalism which tries to destroy the same. But I ask the Senator from Connecticut again if he thinks it is wise or proper to establish a Federal corporation which will project itself into the States and say to State institutions, which may have voluntarily come into the Federal reserve system, "We are going to impose upon you a pension system with respect to your employees, willy-nilly."

Mr. WALSH of Montana. Mr. President, will the Senator kindly call our attention to those provisions of the bill which in his judgment so operate? As I read the bill, it provides pensions or other funds of support for the officers and employees of Federal reserve banks, of the Federal Reserve Board, and Federal reserve agents.

Mr. KING. I was asking the Senator from Connecticut because I have not had time to read the bill. Paragraph (c), on page 2, and paragraph (d), on page 3, indicated to me or at least, as I hastily examined them, led me to the view that the position which I just suggested was right. I will read them:

> (c) To provide pensions or other forms of support for officers and employees (and for persons who may be or who may have been dependent upon such officers or employees) of any bank or trust company that is or shall be a member bank of any Federal reserve bank, and who shall be deemed entitled to the assistance and aid of the corporation, on such terms and conditions, however, as the corporation may from time to time approve and adopt.

In paragraph (d) it is provided:

> (d) In general, to do and perform all things necessary or appropriate to a corporation created for the purpose of providing pensions or other forms of support for officers and employees of Federal reserve banks, Federal Reserve Board, Federal reserve agents, and member banks of Federal reserve banks and for persons who have been or may be dependent upon such officers or employees--

And so forth.

Further on it provides that the--

> corporation may establish and maintain appropriate activities, agencies, and institutions and may aid or make use of such activities, agencies, or institutions as may be now or hereafter established for like or similar purposes--

And so forth.

It is very clear to me that this is for the purpose of reaching State institutions which may be members of the Federal reserve system. I think the Senator ought to agree to strike out those provisions.

Mr. McLEAN. Mr. President--

The PRESIDING OFFICER. Does the Senator from Utah yield to the Senator from Connecticut?

Mr. KING. I yield.

Mr. McLEAN. The important provision of the bill, I will say to the Senator, is to authorize the Federal Reserve Board and the Federal reserve banks to establish pension systems. I think something like 100 systems or more were examined by the experts who were interested in the matter. They recommended this provision, which permits a member bank to come into the incorporation, if it is formed, for the purposes of economy, thinking possibly that it might be an invitation to the State banks to come into the system.

The Senator will realize that the Federal reserve banks now are laboring under a great disadvantage because of the absence of any pension system. Their good men are leaving, and leaving constantly, because of increased salaries offered them by the outside banks. It was felt that this provision would make the Federal reserve system more popular and tend to invite State banks into the system, because a good many of the State banks are not large enough to establish a pension system; that is, it was thought wise that if it could all be managed under one head it would be very much better and very much more satisfactory and inexpensive.

If the provision referred to is going to defeat the bill and carry it over today, I would rather have those provisions taken out; but the bill has not passed the House, and I hope the Senator will let it go through as it is, because I think the provision is a proper one.

Mr. FLETCHER. Mr. President, may I suggest to the Senator that it is purely voluntary?

Mr. McLEAN. That is just what I have suggested.

Mr. FLETCHER. They are simply authorized to consider it and go into the system if they want to do so.

Mr. McLEAN. That is all. There is no compulsion. It does not interfere in any way with the rights of the State banks or State supervision over State banks, but if such a bank comes into the system and desires to join this corporation and come under the provisions of this pension system, it can do so.

Mr. FLETCHER. That is what I understand to be the point which has been made by the Senator from Utah; that if these banks came into the system they would be obliged to become a part of this corporation in a way, and to accept the provisions that might be laid down with reference to the corporation under its rules and regulations.

Mr. McLEAN. That is merely permissive.

The PRESIDING OFFICER. The time of the Senator from Utah has expired.

Mr. KING. It has been used by others, far better, perhaps.

The PRESIDING OFFICER. The Senator from Florida (Mr. Fletcher) has the floor.

Mr. FLETCHER. Mr. President, I wish to call the attention of the Senator from Utah to the provision on page 6, which reads--

> and such banks or trust companies as may be now or hereafter be member banks of a Federal reserve bank are hereby authorized to contribute to the cost of the organization and operation of the corporation and the establishment and maintenance of the said funds.

Such banks are simply authorized to do it; they are not obliged to do it. So I think the point made by the Senator from Utah is answered by that provision of the bill. The particular banks are not compelled to become a part of this system.

Mr. WALSH of Montana. Mr. President, I had noticed the provision of the bill referred to by the Senator from Florida to the effect that the member banks are authorized to contribute to the organization of the corporation. It might be inferred from that provision that any bank will be at liberty to join this corporation or not to join the corporation; but subdivision (c), in section 1, to which our attention has been called by the Senator from Utah, seems to be inconsistent with that. It is perfectly plain from the language that the board is authorized--

> To provide pensions or other forms of support for officers and employees * * * of any bank or trust company that is or shall be a member bank of any Federal reserve bank, and who shall be deemed entitled to the assistance and aid of the corporation on such terms and conditions, however, as the corporation may from time to time approve and adopt.

Mr. McLEAN. That is, provided always that the State bank desires to come in.

Mr. WALSH of Montana. Yes; but the bill does not say so. The board is authorized to provide pensions for the employees of those banks. It is true that that seems rather inconsistent with the provisions which are found in section 4 on page 6; it is equivocal, to say the least. If this be entirely voluntary, I should have no objection to it at all, but I should certainly want to take the advice of the State banks which are members of the Federal reserve system of my State before I could give the measure my approval,provided it was compulsory; and it certainly looks that way from the provisions of subdivision c.

The initial paragraph, paragraph (a), states that the purpose of the corporation is--

> (a) To provide pensions or other forms of support for officers and employees of the Federal reserve banks, Federal Reserve Board, and Federal reserve agents, who by reason of long and meritorious service--

And so forth.

It will be observed that in the purpose of the corporation as indicated in paragraph (a) the employees of the member banks do not come in at all; and yet when we come down to subdivision (c) it is found that the board, in addition to providing a system of retirement pay for employees in the Federal reserve banks and the Federal Reserve Board and the Federal reserve agents, is also empowered to provide pensions for the employees of the other banks. These two sections are inconsistent with each other.

Mr. McLEAN. I would not say they were inconsistent, though the first section referred to may be a little incomplete.

Mr. GLASS. Mr. President--

The PRESIDING OFFICER. Does the Senator from Montana yield; and if so, to whom?

Mr. WALSH of Montana. I yield to the Senator from Virginia.

Mr. GLASS. It occurs to me that that is a pertinent inquiry. What "other banks" are referred to? Such "other banks" as may voluntarily come into the system.

Mr. WALSH of Montana. To what does the Senator now refer?

Mr. GLASS. I think the provision of the bill on page 6, where it states that these banks are authorized to do this, means they are authorized to do it for just such banks as voluntarily come into the system.

Mr. WALSH of Montana. Yes; but observe that under section subdivision (c) the power is given to provide the system, and under section 4 a bank is authorized to take money out of its assets and make contribution to the system provided by the corporation as set forth in subdivision (c) of section 1.

Mr. GLASS. I read subdivision (c) in conjunction with the other provisions of the bill.

Mr. WALSH of Montana. So do I.

Mr. GLASS. And not separated from the other provisions.

Mr. WALSH of Montana. It is in a measure inconsistent. The proposed corporation is empowered to provide the system, but otherwise the bank would say, "We have no power to use our money in this way." Section 4, which is found on page 6, authorizes them to use the money for that purpose.

The PRESIDING OFFICER. The time of the Senator from Montana has expired. The Senator from Virginia has the floor.

Mr. GLASS. The provision would not compel the banks to use their money for that purpose; so that if they do not wish to be the beneficiaries of the system they need not come in.

Mr. KING. The language does not so provide.

Mr. GLASS. The whole purpose of the provision was to create a purely voluntary arrangement.

Mr. REED of Missouri. Mr. President, I should like to have this bill go over until we may have an opportunity to study it. I have never seen it and never heard of it. It is called up here in the morning hour under the five-minute rule, when there is no time to discuss it. I am very certain that it needs some study. I therefore ask the Senator from Connecticut to let the bill go over until tomorrow.

Mr. McLEAN. Mr. President, I will say to the Senator from Missouri that I brought the bill up at the last session and I have tried to do my duty by it at this session. This is the third time I have endeavored to have it considered; but the Senator from Missouri has not happened to be present on the previous occasions. I am very desirous that action shall be had upon it.

As the Senator knows, the Federal reserve system is laboring under a great disadvantage. The board is urging me to press the bill. It is approved by the Secretary of the Treasury, and I think is very carefully drawn and ought to be disposed of. The Senator understands the condition we are in.

Mr. CURTIS. Mr. President--

The PRESIDING OFFICER. Does the Senator from Missouri yield to the Senator from Kansas?

Mr. REED of Missouri. I will yield, but I do not care to have all my time consumed.

Mr. CURTIS. Mr. President, I was going to suggest that if the State small banks were eliminated, perhaps, there would be no objection to the measure.

Mr. REED of Missouri. Mr. President, I have another objection to the bill, and I can not present it and get light on it in five-minutes' time, I presume. Here is a provision empowering the proposed corporation to provide for pensions or means of support not only for the employees but for persons who may be or have been dependent upon such officers or employees. This applies to the Federal Reserve Board and the Federal reserve agents and the Federal reserve branch banks. The Government has an interest in the Federal reserve branch banks, the district banks. It has an interest in the profits which may be made, and I can easily see how this could be employed so that the moneys that are set aside for the benefit of this corporation by the Federal reserve banks--I do not mean the mere member banks, but I mean the district banks--would all come out of that part of the fund in which the Government of the United States is entitled to participate. I wish to know something about this bill.

Mr. McLEAN. Mr. President, the amendment which the Committee offers limits the pensions to 30 per cent of the salary. There are about 10,000 employees, and it is estimated it will cost not to exceed $600,000 a year under the limitations provided. That may give the Senator information which he desires. Such an expenditure would not seriously affect the income of these institutions, and it is believed that it would be an excellent investment, a paying investment.

Mr. REED of Missouri. That may be, but I want time to consider it.

Mr. McLEAN. It will invite willing and efficient service, something greatly to be desired.

Mr. BRUCE. Mr. President, I note the absence of a quorum.

The PRESIDING OFFICER. Does the Senator from Missouri yield for that purpose?

Mr. REED of Missouri. Yes.

The PRESIDING OFFICER. The clerk will call the roll.

The legislative clerk called the roll and the following Senators answered to their names:

Ashurst
Bingham
Blease
Borah
Bratton
Broussard
Bruce
Cameron
Capper
Copeland
Couzens
Curtis
Dale
Deneen
Dill
Edge
Edwards
Ernst
Ferris
Fess
Fletcher
Frazier
George
Gerry
Gillett
Glass
Goff
Gould
Hale
Harris
Harrison
Heflin
Howell
Johnson
Jones, Wash.
Kendrick
Keyes
King
Lenroot
McKellar
McLean
McMaster
McNary
Mayfield
Metcalf
Moses
Neely
Norris
Oddie
Overman
Pine
Pittman
Ransdell
Reed, Mo.
Reed, Pa.
Robinson, Ind.
Sackett
Schall
Sheppard
Shipstead
Simmons
Smith
Smoot
Steck
Stephens
Stewart
Swanson
Trammell
Tyson
Wadsworth
Walsh, Mass.
Walsh, Mont.
Warren
Watson
Weller
Wheeler
Willis

The PRESIDING OFFICER. Seventy-seven Senators having answered to their names, a quorum is present. The question is on the passage of the bill.

Mr. WALSH of Montana. Mr. President, in order to meet some objections which have been made, I offer an amendement, to add an additional section, as follows:

> No member bank shall be required to contribute to any fund, the creation of which is herein provided for, unless it shall elect to participate in the operation and maintenance of the said Federal reserve pension fund.

Mr. McLEAN. I shall be glad to accept that amendment. The amendment was agreed to.

Mr. WALSH of Montana. Another matter, Mr. President: I desire to make an inquiry of the Senator having the bill in charge. Certain persons designated in section 1 of the bill are declared to be, with their successors, a body corporate by the name of the Federal reserve pension fund. I am troubled to know who the successors of these gentlemen shall be and how they shall be selected. I see in the bill no provision whatever looking to the filling of vacancies that may occur.

Mr. FLETCHER. Mr. President, if the Senator will turn to page 4, line 16, he will see that it provides how the trustees are to be elected.

Mr. WALSH of Montana. I find on that page the following:

> The constitution shall prescribe the qualifications of members who may or may not be restricted to the same persons who are trustees of the corporation, the number of members who shall constitute a quorum for the

transaction of business at meetings of the corporation, the number of trustees by whom the business and affairs of the corporation shall be managed, and the qualifications, powers, tenure of office, and manner of selection and of fixing the compensation of the trustees,managers, officers, and employees of the corporation.

Mr. FLETCHER. Beginning in line 16.

Mr. WALSH of Montana (reading)--

> Provided, however, That the trustees of the corporation shall consist of not more than 26 persons, of whom 12 shall be elected, one each by the respective boards of directors of the several Federal reserve banks, and of whom 12 shall be elected, one each by the respective employees of the several Federal reserve banks, and of whom one shall be elected by the Federal Reserve Board, and of whom one shall be elected by the employees of the Federal Reserve Board.

Mr. BRUCE. It does not say anything about the duration of their services.

Mr. FLETCHER. It says that the constitution shall prescribe the manner of selecting and of fixing the compensation of the trustees, managers, officers, and employees of the corporation.

Mr. WALSH of Montana. I suppose probably the words "tenure of office" might cover that. I ask the Senator from Maryland (Mr. Bruce) if he agrees with that.

Mr. BRUCE. Yes.

Mr. KING. What is the tenure of office?

Mr. WALSH of Montana. Line 11, page 4:

> The constitution shall prescribe * * * the number of trustees by whom the business and affairs of the corporation shall be managed, and the qualifications, powers, tenure of office, and manner of selection and of fixing the compensation of the trustees, managers, officers, and employees of the corporation.

I think that is taken care of, then.

The PRESIDING OFFICER. Will the Senator send the amendment to the desk in order that it may be stated for the information of the Senate?

Mr. WALSH of Montana. Certainly.

The PRESIDING OFFICER. The amendment will be stated.

The Legislative Clerk. It is proposed to add as a new paragraph:

> No member bank shall be required to contribute to any fund the creation of which is herein provided for unless it shall elect to participate in the operation and maintenance of the said Federal reserve pension fund.

The amendment was agreed to.

Mr. KING. Mr. President, on page 3, beginning with the word "except," in line 14, I move to strike out lines 14 to 19, both inclusive, in the following words:

> Except that the corporation may provide pensions or other forms of support for its officers and employees and their dependents, under the same terms and conditions as are provided for officers and employees of Federal reserve banks and their dependents.

This bill creates a corporation, and names, as Senators will perceive, in the first section, Mr. Crissinger, who is the chairman of the Federal Reserve Board; Mr. Harding, the former chairman of the Federal Reserve Board; and various other persons who are, I presume, connected with some of the Federal reserve banks throughout the United States. It constitutes them a corporation. Not satisfied, apparently, with providing for pensions for employees of the banks now in existence or those that hereafter shall be organized under the Federal reserve system, we now go further, and provide that the members of this corporation shall be taken care of, and their families and their dependents.

If we are so solicitous for the officials of this corporation, which is created for some quasi-public duty, there is no reason why we should not take care of the members of the Shipping Board and their dependents and their families, and every other Government organization or corporation that may now exist or may hereafter be created for the purpose of aiding in carrying out some alleged or supposed purpose of the Government, or, perhaps, for some legitimate purpose of the Federal Government. While we are taking care of the employees of the banks, I see no reason why Mr. Crissinger and Mr. W. P. G. Harding and others should be taken care of. Most of these men are within or outside of banking circles, and they are all receiving very large salaries.

Mr. McLEAN. Mr. President, the members of the Federal Reserve Board and the governors of the banks are excluded from the bill. None of them, I think, come under the provisions of this bill, and it is limited to salaries of $18,000 a year; so it would apply only to the subordinates.

Mr. KING. I am not sure about that. The language is--

> except that the corporation may provide pensions or other forms of support for its officers and employees.

That would include Mr. Crissinger, certainly. That would include Mr. W. P. G. Harding, certainly.

Mr. McLEAN. If he is a member of the Federal Reserve Board, he is excluded. Under the terms of the bill the members of the board do not come under it.

Mr. KING. I am not sure about that. Then, it is inconsistent, because this has no limitation--

> except that the corporation may provide pensions or other forms of support for its officers--

It does not say "unless they shall be members of the Federal Reserve Board--"

and employees and their dependents, under the same terms and conditions as are provided for officers and employees of Federal reserve banks and their dependents.

It seems to me that too much solicitude has been exhibited for this board; and if we take care of them, and give them and their employees and their families and their dependents all of the benefits that are extended to employees of the Federal reserve banks who are to be pensioned, obviously other boards Federal in character or supposed to be, discharging some Federal or governmental function, will demand that there shall be no discrimination, and that we give them a pension system.

I move to strike out those lines.

The PRESIDING OFFICER. The question is on the motion of the Senator from Utah to strike out, on page 3, lines 14 to 19, both inclusive, beginning with the word "except." (Putting the question.) By the sound the "noes" appear to have it.

Mr. KING. I suggest the absence of a quorum, and shall demand the yeas and nays.

The PRESIDING OFFICER. The absence of a quorum being suggested, the Secretary will call the roll.

The legislative clerk called the roll, and the following Senators answered to their names:

Ashurst	Fletcher	McKellar	Shipstead
Bayard	Frazier	McLean	Shortridge
Bingham	George	McMaster	Smith
Blease	Gerry	McNary	Smoot
Borah	Gillett	Mayfield	Steck
Bratton	Glass	Means	Stephens
Broussard	Goff	Metcalf	Stewart
Bruce	Gooding	Moses	Swanson
Cameron	Gould	Neely	Trammell
Capper	Hale	Norris	Tyson
Copeland	Harris	Oddie	Wadsworth
Couzens	Harrison	Overman	Walsh, Mass.
Curtis	Heflin	Pine	Walsh, Mont.
Dale	Howell	Pittman	Warren
Deneen	Johnson	Ransdell	Watson
Dill	Jones, N. Mex.	Reed, Mo.	Weller
Edge	Jones, Wash.	Reed, Pa.	Wheeler
Edwards	Kendrick	Robinson, Ind.	Willis
Ernst	Keyes	Sackett	
Ferris	King	Schall	
Fess	Lenroot	Sheppard	

The PRESIDING OFFICER. Eighty-one Senators having answered to their names, a quorum is present. The question is on agreeing to the amendment offered by the Senator from Utah.

Mr. McLEAN. Mr. President, I think the proviso on page 3 takes care of the objection offered by the Senator from Utah, but I am very anxious to have this bill acted upon to-day, and I accept his amendment.

The amendment was agreed to.

The bill was reported to the Senate as amended and the amendments were concurred in.

The amendments were ordered to be engrossed, and the bill to be read a third time.

The bill was read the third time and passed.

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CONFIDENTIAL

July 27, 1927.

PRELIMINARY MEMORANDUM RELATIVE TO OPEN MARKET POLICY

The gold movements of the past two months have illustrated the need for preparedness on the part of the Federal Reserve System to deal with either gold exports or imports, which was emphasized in the Chairman's memorandum discussed at the last Governors' Conference. This year's gold movements have included the import of 130 million dollars of gold from abroad, the purchase of 62 million dollars abroad, the sale of 100 million dollars for earmarking here, and the resale of 60 million abroad. There has thus been an import movement, or its equivalent, of 190 million dollars and an export movement, or its equivalent, of 160 million dollars. Fortunately these two movements have largely offset each other in their influence on the domestic credit situation. Otherwise they might have occasioned embarrassment. These movements were largely unforeseen and unforeseeable, although at any time possible under present conditions.

Recent transactions in the special investment account have been largely for the purpose of dealing with these changes in gold. At one time, in May, the account was as low as 136 million dollars, and it has now been restored to 265 million dollars. The increase represents largely purchases to offset the earmarking of 100 million dollars of gold here, but includes in addition the purchase of about 30 million dollars of securities under the authority arranged at the time of the Governors' Conference. The following figures show the changes from week to week in the special investment account. It would appear that this portfolio should be increased from time to time when favorable opportunity offers, if the system is to be in a position to meet future extraordinary gold movements.

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April	27 - - - - -	$201 millions
May	4 - - - - - -	200 "
"	11 - - - - - -	136 "
"	18 - - - - - -	152 "
"	25 - - - - - -	188 "
June	1 - - - - - -	222 "
"	8 - - - - - -	316 "
"	15 - - - - - -	246 "
"	22 - - - - - -	250 "
"	29 - - - - - -	250 "
July	6 - - - - - -	250 "
"	13 - - - - - -	250 "
"	20 - - - - - -	265 "

A temporary increase in the account in ordinary course may be involved in replacing 56 million of maturities in September which includes 30 million taken over from a foreign account in exchange for March certificates. It may be necessary to take over further amounts of securities from foreign correspondents.

The Credit Situation

A number of important changes have taken place in the domestic and foreign credit situation since the Governors' Conference. These may be summarized as follows:

1. Money rates abroad have risen vigorously; open market money rates in London, Berlin, Zurich, and a number of other centers are markedly higher than they were three months ago. The Reichsbank and the Bank of Austria have raised their discount rates. Open market money rates are close to or above the bank rate in London, Berlin, Zurich, Amsterdam, and Milan, as shown in an attached table. These firmer money conditions are undoubtedly exerting continuing pressure upon world trade and world prices, which is liable to react unfavorably upon our own trade and prices.

2. There has been some reduction in business activity in this country, not serious, but indicating a spirit of great caution in business.

3. There has been some congestion of the bond market, due largely to undigested new issues. This situation has been partially corrected.

4. Due largely to reduced industrial payrolls there has been

a slight reduction in the past few weeks in the credit and currency demand, and total bills and securities of the Reserve System have dipped below one billion dollars. The New York Reserve Bank gained 50 million last week in transfers from the interior and New York City member bank borrowing was correspondingly reduced.

5. There is growing ease in money conditions, although some rates are still slightly higher than a year ago, due probably to a higher discount rate at the New York Reserve Bank. Current quotations for money are as follows compared with last year.

	A Year Ago	July 23, 1927
Call money	4	3 3/4
90-day time money	4 1/2	4 3/8
Commercial paper	4	4 1/4
90-day bills	3 3/8	3 1/2
Treasury Issues		
Dec. maturity (notes)	3.03	2.87
Mar. " (C of I)	3.31	3.19
Discount Rate N.Y. F.R.B.	3 1/2	4

The Prospect for Autumn

Normally the approaching seasonal demand for funds might be expected to tighten money conditions somewhat. If this takes place it would have the result (1) of increasing the pressure on world money markets and perhaps forcing up the Bank of England discount rate, and certain of the Continental discount rates, with consequent unfavorable reaction upon world trade and prices; (2) of accentuating the existing tendency towards some reduction in business activity.

If on the other hand steps should be taken which would prevent any seasonal increase in money rates, and tend rather towards somewhat easier money conditions, the following results might be anticipated:

1. An easing of the pressure upon world money markets, which would react favorably upon world trade. The results would be felt partly through the tendency for balances to move in the direction of the highest rate, and partly as lower bill rates here would attract financing to our bill market which might otherwise go to

London and require funds there.

2. Coming at the crop moving season easier money conditions would tend to facilitate the marketing of the crops at favorable prices.

3. It would tend to remove any credit pressure which may now be exerted upon business, and would encourage business enterprise.

4. There would on the other hand be danger that easier money might encourage speculation. The spirit of business is so cautious that it seems doubtful whether speculative tendencies in business would easily arise, but it is probable that easier money would stimulate speculation in securities.

If under these circumstances it should seem wise to follow a policy favoring easier money conditions, the immediate problems would be (1) to localize the effects of easier money conditions, where they would be most beneficial; and (2) to prevent excessive speculation or excessive growth in the volume of credit.

In this connection the attached table shows the total bills discounted at Federal Reserve Banks in the 12 districts. The total is nearly 100 million smaller than it was a year ago and the decreases in bills discounted exceed 25 per cent in the New York, Richmond, Minneapolis, Kansas City, and Dallas districts.

Total Bills Discounted by Federal Reserve Banks

(in millions of dollars)

	Week Ended	
	July 21, 1926	July 20, 1927
Boston	24	32
New York	126	87
Philadelphia	44	42
Cleveland	35	28
Richmond	43	19
Atlanta	44	37
Chicago	56	55
St. Louis	35	33
Minneapolis	8	6
Kansas City	17	11
Dallas	18	8
San Francisco	45	45
Total	495	403

Money Rates in World Markets

		July 1926	May 1927	July 1927
London	- Market Rate	4.25	3.69	4.31
	Discount Rate	5	4.5	4.5
Berlin	- Market Rate	4.5	4.88	5.88
	Discount Rate	6	5	6
Paris	- Market Rate	6	2.25	2.13
	Discount Rate	6	5	5
Amsterdam	- Market Rate	2.76	3.5	3.5
	Discount Rate	3.5	3.5	3.5
Brussels	- Market Rate	6.70	4.25	3.75
	Discount Rate	7	5.5	5
Zurich	- Market Rate	2.31	3.13	3.81
	Discount Rate	3.5	3.5	3.5
Milan	- Market Rate	8.5	9.25	8
	Discount Rate	7	7	7
Vienna	- Market Rate	6	5.38	5.75
	Discount Rate	7.5	6	7
New York	- Bill Rate	3 3/8	3 5/8	3 1/2
	Discount Rate	3 1/2	4	4

CONFIDENTIAL

REPORT OF OPEN MARKET INVESTMENT COMMITTEE WEEK ENDED JULY 20, 1927

Holdings of Earning Assets of Federal Reserve Banks from June 30, 1926 to Date
(000 Omitted)

	TOTAL EARNING ASSETS	GOVERNMENT SECURITIES Outright Purchases	GOVERNMENT SECURITIES Sales Contracts	BANKERS ACCEPTANCES Outright Purchases	BANKERS ACCEPTANCES Sales Contracts	BILLS DISCOUNTED
-1926-						
June 30	$1,158,406	$372,868	$12,411	$214,664	$34,750	$515,031
July 28	1,106,302	368,591	647	196,009	15,164	521,319
Aug. 25	1,150,171	318,912	2,305	244,019	10,507	570,638
Sept. 29	1,297,994	286,951	15,090	247,431	28,192	716,630
Oct. 27	1,242,138	297,592	3,582	290,696	16,845	631,923
Nov. 24	1,270,681	298,269	1,635	303,220	37,409	627,604
Dec. 29	1,409,529	310,725	6,479	307,372	71,426	710,931
-1927-						
Jan. 26	972,249	301,851	914	269,362	32,465	365,157
Feb. 23	985,326	304,880	428	243,934	36,255	397,929
Mar. 30	1,049,034	311,587	41,516	184,755	52,654	456,023
Apr. 27	1,005,577	314,332	3,993	194,007	47,892	443,553
May 25	988,510	302,349	19,571	171,907	64,263	428,620
June 29	1,071,130	367,140	9,262	183,163	32,955	477,311
July 13	998,512	371,456	6,347	179,374	13,833	426,202
" 20	975,770	379,037	6,732	172,795	12,584	403,322

CHANGES IN EARNING ASSET HOLDINGS (EXCLUSIVE OF SALES CONTRACTS)
DURING WEEK ENDED JULY 20, 1927
(000 Omitted)

	GOVERNMENT SECURITIES Balance July 20	GOVERNMENT SECURITIES Net Change	BANKERS ACCEPTANCES Balance July 20	BANKERS ACCEPTANCES Net Change	BILLS DISCOUNTED Balance July 20	BILLS DISCOUNTED Net Change
Boston	$ 15,423	$1,153+	$ 11,204	$ 421-	$ 31,670	$ 9,256+
New York	64,548	817+	26,000	2,369-	87,092	47,398-
Philadelphia	27,943	1,158+	13,636	465-	41,858	2,137-
Cleveland	45,681	682+	15,913	480-	28,282	9,003-
Richmond	16,746	1,152+	8,902	288+	19,429	4,500-
Atlanta	10,368	773+	8,505	930-	37,346	2,514+
Chicago	56,855	3,141+	24,911	214-	55,208	10,901+
St. Louis	26,360	3,504-	9,256	1,233-	32,662	9,397+
Minneapolis	18,721	418+	5,568	614-	5,807	1,342+
Kansas City	29,777	546+	8,673	830-	10,926	2,771-
Dallas	25,936	427+	8,397	315-	7,537	1,239+
San Francisco	40,679	817+	12,866	1,404-	45,505	8,280+
N.Y. holdovers and other bills			18,964	2,408+		
Totals	$379,037	$7,580+	$172,795	$6,579-	$403,322	$22,880-

COMMENT ON CHANGES WEEK ENDED JULY 20, 1927

The total earning assets of the System showed a decrease of $22,742,000 for the current statement week. The approximate changes by classification consisted of an increase in outright purchases of Government securities of $7,600,000 and decrease of $6,600,000 in outright purchases of bankers acceptances, $22,900,000 in bills discounted and $900,000 net in investments held under sales contract. The latter item was made up of a decrease of $1,250,000 bankers acceptances and an increase of $350,000 Government securities.

Money Market

The flow of funds from other districts continued during the past week, and added to the already large supply of funds in the New York money market. As a result, a considerable amount of Reserve bank credit was retired, and money rates eased slightly further. The call loan rate held at 4 per cent early in the week, but declined to 3 3/4 on Wednesday and 3 1/2 per cent on Thursday, but held at 3 3/4 per cent on Friday accompanying some increase in borrowing by New York City banks to bring their average reserves above requirements at the close of the reserve week.

Time money eased slightly further during the week; 30 and 60-day loans were quoted at 4 1/4 to 4 3/8 per cent; 90-day loans 4 3/8 to 4 1/2 per cent; 4 and 5 months' loans 4 1/2 per cent; 6 months' loans 4 1/2 to 4 5/8 per cent.

The commercial paper market remained quiet in New York, but was reported to be moderately active in New England and the Middle West. The supply of paper coming into the market was small, and some reduction in dealers' portfolios was reported. The 4 1/4 per cent rate continued to prevail, only occasional sales being reported at 4 per cent.

Government Security Market

Trading in United States securities continued to be in normal volume. Accompanying easier money conditions prices were fractionally higher than at the previous week's close with dealers' offerings at levels to yield from 3 to 3.55 per cent for Liberty Loan bonds, 3.33 to 3.36 per cent for Treasury bonds and 3 to 3.50 per cent for the certificates of indebtedness and Treasury notes. The Second Liberty Loan bonds, certificates of indebtedness maturing next September and Treasury bonds were in best demand with offerings of the first two mentioned issues very scarce.

Bankers Acceptances

Dealers' portfolios of bills were further reduced this week and with a view to replenishment almost all of the dealers lowered their rates 1/8 per cent on all maturities except 30s. Their offering rates for unindorsed bankers acceptances, according to maturities, were as follows: 3 1/2 per cent for 30, 60 and 90s, and 3 5/8 per cent for 120-day bills. At the end of the week some of the dealers lowered their 30-day rate 1/8 per cent, bidding 3 1/2 per cent and offering at 3 3/8 per cent.

Boston reports their bill market continued dull with offerings even smaller than the past few weeks and the demand poor. Short maturities continued to be in best demand. In the New York market new bills were scarce and considerably less than during the previous week. Dealers found it difficult to satisfy the very substantial inquiries from abroad and also the good domestic demand which recently developed as a result probably of easier money. Philadelphia reports their bill market quiet with the demand fair and preference for 90-day bills. Chicago reports a fair demand for bills of short maturities with the supply smaller than the demand.

OPERATIONS ACCOUNT UNITED STATES TREASURY

Under authority from the Treasury purchases were made during the week of $250,000 March 15, 1928 - 3 1/4 per cent certificates of indebtedness for account of the Alien Property Custodian, and $5,000,000 Second 4 1/4s for delivery July 22 for account of the Cumulative Sinking Fund. The latter purchase was made in the New York and Chicago markets.

SYSTEM PURCHASES OF BANKERS ACCEPTANCES

Purchases of bankers acceptances since the beginning of the year, and amount each bank now holds in excess or short of its pro rata share under the apportionment plan put into effect in the early part of the year and revised on July 8:

	Bills Acquired	Bills Entitled to Acquire	Bills Over Pro Rata Share	Bills Short Pro Rata Share
Boston	$ 64,224,000	$ 62,093,000	$2,131,000	$ 0
New York	208,353,000	212,499,000	0	4,146,000
Philadelphia	73,127,000	70,106,000	3,021,000	0
Cleveland	86,276,000	86,674,000	0	398,000
Richmond	44,117,000	45,252,000	0	1,135,000
Atlanta	43,191,000	43,817,000	0	626,000
Chicago	124,345,000	123,436,000	909,000	0
St. Louis	52,044,000	52,400,000	0	356,000
Minneapolis	34,231,000	34,571,000	0	340,000
Kansas City	51,179,000	51,618,000	0	439,000
Dallas	34,964,000	34,844,000	120,000	0
San Francisco	70,682,000	69,423,000	1,259,000	0
Totals	$886,733,000	$886,733,000	$7,440,000	$7,440,000

The overages shown in the above statement are being adjusted in the usual manner.

SPECIAL INVESTMENT ACCOUNT - GOVERNMENT SECURITIES

Deliveries were completed during the statement week of $14,215,500 of the $15,000,000 short-term Government securities purchased under authorization of the Committee as mentioned in the last report. Sales of $3,755,000 were made to foreign accounts which were replaced by purchases in the market of a like amount of short-term Governments and an exchange was effected with the Federal Reserve Bank of Cleveland whereby they sold to the System Account from their outright holdings $8,220,000 Dec. 15, 1927 - 4 1/2 per cent Treasury notes for a like amount of third 4 1/4s. These transactions left the total holdings in the System Account, at close of business July 20, at $265,213,800. The participation by Federal reserve banks and the classification of issues were as follows:

PARTICIPATION BY FEDERAL RESERVE BANKS

Boston	$ 14,716,500
New York	62,891,300
Philadelphia	12,758,500
Cleveland	21,035,500
Richmond	15,504,500
Atlanta	5,628,000
Chicago	35,928,000
St. Louis	15,958,000
Minneapolis	11,163,500
Kansas City	20,193,500
Dallas	18,450,500
San Francisco	30,986,000
Totals	$265,213,800

RECAPITULATION OF HOLDINGS BY MATURITIES

Sept. 15, 1927	3 1/8%	C/I	$ 17,220,000
Sept. 15, 1927	3 1/4%	"	8,535,000
Nov. 15, 1927	4 1/4%	2nd L/L	9,000,000
Dec. 15, 1927	4 1/2%	T/N	31,924,500
Mar. 15, 1928	3 1/4%	C/I	81,178,000
Sept. 15, 1928	4 1/4%	3rd L/L	67,106,500
Mar. 15, 1932	3 1/2%	T/N	30,249,800
June 15, 1947	3 3/8%	T/B	20,000,000
			$265,213,800

With the approval of the Open Market Investment Committee after the close of the statement week, sales were made to foreign correspondents of $30,000,000 aggregate amount of 3 1/4 per cent certificates due March 15, 1928 in exchange for a like amount of 3 1/4 per cent certificates due Sept. 15, 1927, both at the market price. These exchanges make a better distribution of maturities in the System Account and will assist in the replacement of September maturities for foreign correspondents.

ITEMIZED STATEM[illegible] OF TRANSACTIONS A[illegible]NG THE [illegible]STMEN[illegible] ACCOUNT OF ALL FEDERAL RESERVE BANKS FROM JULY 14 TO JULY 20, 1927

GOVERNMENT SECURITIES - SYSTEM INVESTMENT ACCOUNT

	Purchases	Sales	Net Increase
Boston	$ 1,805,500	$ 652,500	$ 1,153,000
New York	6,826,000	2,818,500	4,007,500
Philadelphia	1,718,000	560,000	1,158,000
Cleveland	2,087,000	949,500	1,137,500
Richmond	1,841,000	689,500	1,151,500
Atlanta	969,500	240,000	729,500
Chicago	3,756,000	1,614,500	2,141,500
St. Louis	1,286,000	730,500	555,500
Minneapolis	928,500	510,500	418,000
Kansas City	1,475,500	930,000	545,500
Dallas	1,253,500	852,500	401,000
San Francisco	2,244,000	1,427,000	817,000
Totals	$26,190,500	$11,975,000	$14,215,500

OTHER TRANSACTIONS IN GOVERNMENT SECURITIES

	Purchases	Issue	Sales	Issue
New York	$ 300,000	Second L/L.[xxx]	$ 3,491,000	Second L/L.[xxx]
Cleveland	8,220,000	3rd L/L.[xx]	8,220,000	A-1927 Treas.Notes[xx]
			456,000	Second L/L.
			165,350	Misc. Gov't Sec.
Atlanta	208,800	Misc. Gov't Sec.	0	-
Chicago	1,000,000	Second L/L.[xxx]	4,060,000	A-1927 Treas.Notes[x]
St. Louis	0	-		
Kansas City	500	A-1927 Treas.Notes	0	-
Dallas	26,450	Misc. Gov't Sec.	0	-
Totals	$ 9,755,750		$16,392,350	

x Sold to System Account.
xx Exchange effected with System Account.
xxx Sold to Treasury Department before and after close of statement week.

BANKERS ACCEPTANCES
(000 Omitted)

	Holdings July 13	Purchased Own Mkt.	Rec'd by Allotment from N.Y.	Maturities & Sales	Holdings July 20	Other Holdings Close July 20/27 Sales Contracts	Other Bills
Boston	$ 11,625	$ 1,760 R	0	$ 2,181	$ 11,204	$ 4,185	$ 876
New York	28,369	4,425 " / 7,100 A	0	6,794	26,000	262	3,428
Phila.	14,101	2,509 R	0	2,974	13,636	0	1,122
Cleveland	16,393	0	1,078	1,558	15,913	0	3,053
Richmond	8,614	63 "	1,257	1,032	8,902	0	608
Atlanta	9,435	21 "	735	1,686	8,505	0	1,357
Chicago	25,125	1,549 "	2,078	3,841	24,911	1,824	1,613
St. Louis	10,489	0	558	1,791	9,256	0	502
Minn.	6,182	0	454	1,068	5,568	0	351
Kan. City	9,503	0	569	1,399	8,673	0	432
Dallas	8,712	356 "	371	1,042	8,397	518	409
San Fran.	14,270	643 "	0	2,047	12,866	5,795	818
Totals	$162,818	$18,426	$7,100	$27,413	$153,831	$12,584	$14,569
Bills held overnight by N.Y. for distribution to other F.R.banks							4,395
							$18,964

NOTE: R. indicates Retained and A. indicates Allotted in the above statement.

MATURITIES AND RATES ON BILLS PURCHASED WEEK ENDED JULY 20, 1927.
(000 Omitted)

	1-30 days 3 1/2 - 3 5/8%	31-60 days 3 1/2 - 3 3/4%	61-90 days 3 3/4%	Over 90 days 3 3/4 - 3 7/8%	Total
Boston	$ 309	$1,442	$ 9	0	$ 1,760
New York	6,721	3,025	1,000	779	11,525
Philadelphia	1,220	1,289	0	0	2,509
Richmond	30	33	0	0	63
Atlanta	0	3	18	0	21
Chicago	435	1,114	0	0	1,549
Dallas	153	17	5	181	356
San Francisco	30	550	47	16	643
Totals	$8,898	$7,473	$1,079	$976	$18,426

RECAPITULATION OF PURCHASES AND SALES OF GOVERNMENT SECURITIES AND BANKERS ACCEPTANCES DURING WEEK ENDING JULY 20, 1927
(000 Omitted)

(Excluding Sales Contracts)

	Government Securities	Bankers Acceptances		Total	
Purchased	$35,946	$18,426		$54,372	
Sold	28,366	0		28,366	
Matured	0	27,413		27,413	
		$ 8,987-		$ 1,407-	
		2,408+	(Net Change 1-day holdover and other bills)	2,408+	(Net Change 1-day holdover and other bills)
Totals	$ 7,580+	$6,579-		$1,001+	

(Including Sales Contracts)

Holdings July 20, 1927	Within 15 days	16-30 days	31-60 days	61-90 days	91-days-6 months	Over 6 months	Total
Gov't Securities	$ 6,732	0	$29,884	0	$44,127	$305,025	$385,768
Bills Purchased	81,641	48,940	37,402	12,681	4,715	0	185,329
Totals	$88,373	$48,940	$67,286	$12,681	$48,842	$305,025	$571,147

See Bk

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REPORT OF THE CHAIRMAN TO THE OPEN MARKET INVESTMENT COMMITTEE AT WASHINGTON, MARCH 21, 1927.

The secretary's report gives the details of operations in the special investment account since the last meeting of the committee. Beyond the shifting of securities, in order to accommodate the Treasury and foreign correspondents, the principal change in the account has been a decrease of $25,000,000 in the open market account and a decrease of $50,000,000 in the volume of Government securities held for foreign correspondents due to maturities of March 15 certificates which, has had the effect of withdrawing about $75,000,000 from the market. It will be desirable at this meeting to determine whether or not these securities should be replaced.

Before discussing this question, however, it may be well to review briefly the December and March money market situations and the open market policies related thereto.

End of the Year Situation

In view of the experience at the end of 1925, careful consideration was given to the avoiding of such a period of stringent money as appeared at that time, and such large borrowing by a few member banks. The principal steps taken were to discuss the problem thoroughly with a number of the large member banks in New York City and to make every effort to invest the Treasury balance after the tax day, so that no large Treasury balance would be built up. For a time it was feared that it would not be possible to avoid a large Treasury balance and open market purchases were contemplated. It proved, however, possible to reach the end of the year with only a normal Treasury balance, and as a consequence of this and the cooperation of the member banks in showing willingness to appear in debt at the Reserve Bank at the end of the year, there was no marked stringency of money.

March 15, Tax Period.

The March 15 tax period was extraordinary in the very large amount of maturities to be redeemed in cash. Maturities of approximately 660 million dollars plus interest payments of approximately 95 million dollars, resulted in a large immediate net gain to the market, which was only partly offset by a Treasury call of 123 million and income tax check collections. The consequence was a larger Treasury overdraft and a larger gain to the market than has taken place for several years. The gain to the New York market on March 15 through these transactions was over $300,000,000.

The taking up in some way of this large volume of surplus funds in the market was an acute problem. A number of the banks in New York City fortunately anticipated this situation and allowed their reserves to remain about 23 million in deficit for the Saturday, Sunday, and Monday preceding March 15. Thus they entered the tax day with an accumulated deficit in their reserves of 69 million dollars. The following methods were then used to offset large Treasury payments by the liquidation of Federal Reserve assets:

(1) $ 75,000,000 of United States securities in the System and foreign accounts were allowed to run off. Those held in foreign accounts were replaced by bills from our portfolio.

(2) $ 25,000,000 of sales contracts were taken out by dealers.

(3) $ 65,000,000 of ~~investments~~ discounts were ~~taken out~~ paid by member banks.

(4) $ 10,000,000 of securities were sold temporatily for one day on March 14th from the special investment account.

(5) $ 63,000,000 of participations in the Treasury one-day certificates were sold to member banks.

al $238,000,000.

The sale of participations in the one day certificate was a new method of withdrawing funds from the market. It avoided taking away earning assets from the other Federal Reserve Banks, even temporarily, as sales from the special investment account would have done; it avoided the complicated bookkeeping which that transaction involves; and constituted a simple and logical means of offsetting Treasury payments into the market.

As a consequence of the use of these different methods for removing surplus funds from the market, money remained reasonably steady all week and call money only dipped under 4 per cent on the exchange for a few hours. By Friday the banks were deficient in their reserves and found it necessary to increase their borrowing from the Reserve Bank to $150,000,000. Thus at the close of the week the money situation was restored to approximately the same position as before the tax period, but the Treasury still had an overdraft of $70,000,000 which is still to come out of the market.

Replacement of March 15 Maturities

The present outlook is for moderately firm money conditions, as the market settles down after the tax period. Business is active. The security markets are using more credit. Further large gold imports seem unlikely for the present.

If this anticipation is correct, the country will require currently, as in early March, over one billion dollars of Federal Reserve credit. But there will be a difference in the makeup of this credit, because foreign correspondents replaced about 50 million dollars of securities matured on March 15 with bills, and the bill holdings of the system will probably be reduced to something about that amount and the borrowings by member banks increased. The effect of this operation will be the same as a sale of securities.

Under these conditions borrowing by member banks throughout the country ... e around 400 to 500 million dollars and by member banks in New York City

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upwards of 100 million dollars, and the call rate will be a firm 4 per cent, or possibly higher even if the 75 million of securities in the system and foreign accounts, which matured March 15, are replaced. If, however, these are not replaced, about 75 million dollars additional of member bank borrowing will be required and call rates will be nearer 4-1/2 or 5 than 4 per cent.

The principal argument for reducing our security portfolio, by not replacing the maturities, is that the security market is very active and using more credit, and firmer money conditions will tend to keep speculation within bounds.

The principal arguments for maintaining our security portfolio by replacing the maturities are:

1. A portfolio of securities is a protection against inflation, and its size should not be reduced without good cause.

2. Higher rates here would tend to attract foreign balances and gold from countries which need them to us who do not want them.

3. Higher rates here would force higher rates abroad and contimue the pressure on world commodity prices.

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Form No. 131.

Office Correspondence

FEDERAL RESERVE BOARD

Date April 1, 1927.

To

Subject:

From

2—8495

In your letter of March 22nd you have asked for an expression from the Board with reference to a summary of general principles, guiding your policy in dealing with badly managed banks, or banks in an extended condition, as given in your letter of February 10th. The Board in asking the Federal reserve agents whether any set of definite principles could be formulated for dealing with such cases was well aware of the difficulties involved and appreciates your full and frank statements with the illustrations showing both the application of the principles, as summarized in your letter of February 10th, and the occasional necessity of departing from them in individual cases.

It is impossible at this distance to express a definite opinion upon all the statements of your letter, but the Board is confident that you are doing a valuable work in seeking to promote better and safer banking, and in seeking to curb the recklessness of the few managers who conduct their banks without sufficient regard for the safety of deposits entrusted to their care.

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Misc 37

Form No. 131.

Office Correspondence

FEDERAL RESERVE BOARD

Date March 31, 1927.

To

Subject:

From

2—8495

Replying to your letter of February 10th, members of the Board have each read, and some of them have given considerable study to the principles outlined on pages 24, 25 and 26 and to the cases used as illustrations of the way the officers of the Federal Reserve Bank of Dallas seek to prevent banks from getting into dangerous conditions, and to correct serious errors in management. The Board believes the principles well stated and sound, and appreciates the difficulties you have had in applying them. It is impossible at this distance to discuss or to express a definite opinion upon all the details covered in your letter, but, in general, the Board is confident that you are doing a valuable work in the District in seeking to curb the recklessness of some few bankers who operate their banks without sufficient regard for the safety of the deposits entrusted to their care.

Misc. 37

Form No. 131.

Office Correspondence

FEDERAL RESERVE
BOARD

Date March 30, 1927.

To Mr. Platt

Subject:

From Mr. Eddy.

2—8495
G P O

At the meeting of the Board yesterday, the Governor called attention to a request of the Federal Reserve Agent at Dallas made on behalf of several of his directors for an expression of the views of the members of the Board as to the credit policies of the Dallas bank as set forth in detail in a letter addressed to the Board by the Federal Reserve Agent under date of February 10, 1927. The Board voted to consider this matter at its meeting on Friday, April 1st. A copy of the Federal Reserve Agent's letter is attached hereto.

There is also attached copy of an address by Governor Talley.

(COPY)
FEDERAL RESERVE BANK OF DALLAS.

February, 10, 1927

Federal Reserve Board
Washington, D. C.

Gentlemen:

In reply to Mr. Eddy's telegram of February 5, I am writing you today to give you certain requested information concerning the credit policies of the Federal Reserve Bank of Dallas.

For several years prior to 1923, the credit policies of this bank had been framed with the thought in mind that a Federal reserve bank could best assist a weak and overextended member by liberal advances of credit in the hope that improved conditions would enable the member to recover a position of soundness and strength. It subsequently developed, however, that our attempts to serve the banks involved in this way merely had the effect of further overextending them. This was due to the fact that the additional credit granted brought about no change in the managerial policies which had originally caused the overextension, but on the contrary operated to widen the scope of those policies and aggravate the evil consequences following therefrom. Your records will show that we have paid the price of our mistakes of judgment and for our responsibility in abetting unsound credit practices on the part of a number of our members - our responsibility being definitely measured by the amount of losses we have sustained. This bank has charged off losses during the past five years amounting to $2,146,000. Of this sum $1,014,000 represents contributions or compositions in the cases of the indebtedness of the following banks, now closed or reorganized:

Federal Reserve Board #2.

Name of banks	Amounts
First National Bank, Hugo, Okla.	$570,000
Ennis National Bank, Ennis, Texas.	282,000
City National Bank, El Paso, Texas.	100,000
First National Bank, Annona, Texas.	18,000
Miles National Bank, Miles, Texas.	44,000

Without exception the foregoing banks were operating on the theory that a bank's chief responsibility was to make loans so long as its community could absorb the credit and so long as the loans could be cashed at the Federal Reserve Bank. It became apparent ultimately that the banks had been saturating their communities with credit, causing a serious inflation of local values, and had been making loans largely against expectancies and prospects of an uncertain and hazardous nature (e.g. future crops) rather than against existing values and a present ability to pay. In short, the banks were subsidizing their communities and were able to do so largely because of the liberal credit policies of this institution.

We were not long in recognizing the fact that we must have misconceived the proper use to be made of reserve bank credit, and therefore several years ago we set about changing in a gradual manner the policies previously followed. I think you will recognize the necessity for this change, not only from the circumstances already recited in this letter, but also from a consideration of several cases which will be set out in some detail in accordance with Mr. Eddy's telegram.

Federal Reserve Board #3.

1. The Avery State Bank, Avery, Texas
(Capital $25,000, Surplus and Profits $581)

	1922	1923	1924	1925	1926
Maximum line with Fed.Res.Bk.	$102,000	$ 83,000	$ 48,000	$ 18,000	$ 10,000
Maximum total borrowings from all sources	116,000	99,000	66,000	38,000	35,000
High point loans	170,000	169,000	125,000	107,000	91,000
Low point deposits	36,000	47,000	56,000	59,000	43,000
Low point loans	137,000	102,000	72,000	54,000	60,000
High point deposits	58,000	70,000	71,000	81,000	55,000

You understand, of course, that the loans of this bank represent advances made locally and principally to tenant farmers. There is a large element of hazard in them at best, and especially so when their collectibility is made to depend almost exclusively upon future crops. Therefore a bank makes a mistake if at any time it has invested in such loans more than an amount equal to its local deposits at their normal low point. This is true because the deposits at the low point represent what might be termed the normal saved and permanent working capital accumulated by the community and deposited in the bank. It is these deposits which may with some reason be subjected to the hazards of ordinary crop loans. Other deposits, being likely to be withdrawn, should be invested in such a manner as to become available during the spring and summer. They will not be available if they have been invested in crop loans, because such loans will not be paid until the following fall, and may not and probably will not be paid then unless a crop is made.

You will see that the subject bank has during each year loaned locally far in excess of the deposits at the low point and has borrowed heavily as a consequence. As a matter of fact, not only have loans at the high point been far in excess of deposits at the low point, but they have been, even at their low point, higher than the deposits when the latter were at the high point. The fundamental unsoundness of the situation is obvious. The bank has borrowed in excess of its capital investment each year.

The figures show some apparent improvement as you come forward from 1922, but this has been a sort of enforced improvement occasioned by an inability to borrow quite as heavily in recent years as before.

The better proportion apparently existing between the loans and deposits is somewhat deceptive because much of the reduction in the loans is represented by charge-offs. Over the period, examiners have estimated losses amounting to $60,000 and $30,000 of losses have actually been charged off. The bank was examined on January 15, 1927 and losses were estimated in an amount in excess of the entire capital investment. It can hardly be said that the heavy advances of credit obtained from the Federal Reserve Bank and correspondents have been of benefit, either to the bank or to its community. This is true, because the trouble in the case is not an inability to get credit but rather an incompetent management and unsound credit policies - defects which, unfortunately, cannot be corrected by indulgence on the part of creditors. The community evidently senses this fact, because it is not supporting the bank, if we may judge from the amount of the bank's deposits.

The managing officers of this bank have not yet asked us for a line of credit for the season of 1927, but they have informed us that they will pay us a visit soon.

2. The First National Bank, Wellington, Texas
(Capital $25,000, Surplus and Profits $36,000)

	1922	1923	1924	1925	1926
Maximum line with Fed.Res.Bk	$ 57,000	$ 43,000	$ 42,000	$ 14,000	$ 25,000
Maximum total borrowings from all sources	73,000	63,000	72,000	104,000	120,000
High point loans	264,000	224,000	319,000	447,000	349,000
Low point deposits	162,000	113,000	197,000	298,000	188,000
Low point loans	185,000	171,000	221,000	299,000	274,000
High point deposits	225,000	401,000	653,000	450,000	318,000

The foregoing figures show quite clearly an expansion of the loan account for crop making purposes unwarranted by the bank's normal line of deposits. Consequently, excessive credit advances were sought and obtained from creditors. Instead of credit helping the situation in the early years of the period, it apparently had the reverse effect, since the bank borrowed more heavily in 1925 and especially in 1926 than in previous years - and this, too, in spite of an excellent crop in 1924 and a fair crop in 1925. The exceptional increase in deposits in the fall of 1924 led the bank into an unwarranted expansion of loans in 1925. The deposits melted away at the same time and the loss was by no means regained the next fall.

This case clearly illustrates how many banks increase the loan account disproportionately on the theory that a good crop will restore the deposits lost the preceding spring and summer - which loss had to be met by borrowing money since the proceeds of the deposits had already been loaned out. In a year when crops are only fair, plans miscarry, deposits fail to increase, loans are slow of liquidation and the bank is consequently forced into a very extended condition the following season. That was the case with the subject bank during the 1925-6 season.

In fact the bank owed $122,000 at the peak in 1926, or nearly three times the capital and surplus. While in that condition it approached us for an increase in its line (then amounting to $24,000). We declined to grant further credit and suggested that some attempt be made to obtain relief from its own resources. Tomthis end we volunteeaed the services of one of our men free of charge to analyze the position of the bank on the ground. He visited the bank and pointed out a way by which it might help itself. As a result, the management collected over $40,000 during the remainder of the summer (when it would otherwise have been increasing its loans) and did not borrow any more money from any source. Our sending a representative was at the bank's request.

3. State National Bank, Lamesa, Texas.
(Capital $60,000, Surplus $20,000, Profits $22,000)

	1922	1923	1924	1925	1926
Maximum line with Fed.Res.Bk.	$75,000	$74,000	$49,715	$64,639	$ 50,000
Maximum total borrowings from all sources	88,000	94,000	119,715	164,639	266,000
High point loans	386,000	362,000	426,200	592,358	613,000
Low point deposits	259,000	268,000	297,341	441,412	341,000
Low point loans	318,000	321,000	306,900	490,921	485,000
High point deposits	527,000	733,000	1265,375	765,043	461,000

It will be seen from an examination of the above figures that this bank has substantially expanded its loan account each year since 1923 - and this in the face of severe shrinkages in deposits since 1924. As a consequence borrowed money has gone up steadily since 1922 and in 1926 amounted to over two and one half times the capital and surplus.

If reliance can be placed upon the reports of examination of this bank, the institution would appear to be solvent, but the trouble lies in the fact that the management has lost all sense of proportion and has so extended the institution and has invested so heavily in crop loans that the poor yields of 1925 and the low prices of 1926 have placed it in a precarious position indeed. The management was warned by us against just such an eventuality early last year. We have already been approached for a line for the season of 1927 but have refused to make a commitment until the management shows some disposition and ability to adjust the situation of the bank from the inside. We have refused to become a party for another season to the kind of banking typified by this case.

4. First National Bank, Blossom, Texas.
(Capital $60,000, Surplus and Profits $6,000)

	1922	1923	1924	1925	1926
Maximum line with Fed.Res.Bk.	$175,000	$ 74,000	$ 80,000	$ 60,000	$ 52,000
Maximum total borrowings from all sources	188,000	107,000	102,000	77,000	75,000
High point loans	392,000	305,000	275,000	237,000	225,000
Low point deposits	134,000	140,000	150,000	153,000	125,000
Low point loans	323,000	237,000	178,000	164,000	181,000
High point deposits	231,000	236,000	230,000	273,000	141,000

It will be observed that this bank has borrowed in excess of its capital investment each year of the period covered by the above figures. It borrowed considerably less in 1925 and 1926 than in previous years. This is accounted for in 1925 by the good crop raised in 1924 and the substantial collectinns affected that fall. It is accounted for in 1926 by the exceptionally good crop raised in 1925 and the fair reduction in loans and large increase in deposits resulting therefrom. Another reason why borrowings were held to a more reasonable figure in 1925 and 1926 than in previous seasons was the fact that creditors were not disposed to contimue to advance excessive amounts of credit to the institution.

The liberal loan policies of the bank are clearly illustrated by comparing the high point in loans (eighty percent of which, according to Cashier Black, were made to tenant farmers and were solely dependent upon a satisfactory crop out-turn for liquidation) with the low point in individual deposits. With the exception of 1924-5 when exceptionally good crops were raised, the loans at the <u>low</u> point were never in any single year during the period below deposits at the high point. When it is understood that a bank in a "one-crop" country has eighty per cent of its loans made to tenant farmers against crop prospects almost exclusively, the importance of reducing them to a very low figure in the fall of the year is apparent. The failure of the bank to do this is the best evidence, not only of the liberal credit policies of the management, but also of the unsafe and uncollectible chatacter of a large part of its note case. This observation is borne out by a consideration of the loss record of the institution. From the beginning of 1922 to the end of 1926 losses aggregating about $125,000 were estimated by examiners and losses aggregating about $90,000 were charged out by the management. When National Bank Examiner Hutt visited the institution in December 1926 he estimated sufficient losses to impair the capital stock fifty per cent. Cashier Black visited us on January 5 for the purpose of obtaining a commitment for 1927. The discussion of his situation revealed the fact that he saw nothing exceptionally wrong in the policies which the bank had been following and he gave us no reason to believe that those policies would be changed - this, too, in the face of the fact that we had each season for several seasons in the past warned him against a continuance of such policies and told him that we were not going to be willing to continue indefinitely to subscribe to those policies by extending his bank a large line of credit.

On this particular occasion we told Mr. Black that his case could not be remedied by an extension of credit but that it could only be helped by a complete reversal of his attitude and a radical change in policy. Not only would that be necessary, but it would also be necessary that the owners of the bank recapitalize it since in its then condition the capital investment was represented entirely by losses and by investment in real estate, banking house, furniture and fixtures. We did state, however, that we would be willing to continue td carry the unliquidated portion of the 1926 line for a time until the management could work on its situation and see what could be accomplished toward remedying it. The carry-over portion of the line amounted to $27,000.

We were later informed of the closing of the bank on January 7, 1927. Examiner Whitehurst then made a classification of the bank's assets and classified losses in an amount sufficient to eliminate the bank's capital investment. On January 21 we conferred with Examiner Whitehurst, Cashier Black and his associates in connection with the proposed reorganization of the bank. We told our visitors that we would be willing to carry over the $27,000 of indebtedness to us but that since the paper securing it represented carry-over lines of the bank's customers it could not be regarded as very satisfactory collateral, because the borrowers had manifested no ability to pay. Moreover, the proposed organization called for more than a fifty per cent reduction in the bank's capital investment and represented a set-up which indicated that the new institution would not begin its career under very good auspices. We, therefore, said that we not only could not make any commitment regarding an increase in the line to the bank but that we must insist that the existing indebtedness be placed in more satisfactory form by obtaining satisfactory endorsements from among the board of directors.

The same matter was discussed again with Examiner Whitehurst and a proposed new management for the reorganized institution on February 8. The condition of the reorganized institution, if it is opened, will be somewhat as follows:

Resources		Liabilities	
Loans and discounts	$114,000	Capital stock	$30,000
Circulation bonds	15,000	Surplus and profits	none
Banking house	10,000	Deposits	116,000 #
Other real estate	9,000	Circulation	15,000
Cash and Exchange	43,000	Bills payable Fed.Res.Bk.	27,000
		Other bills payable	5,500
	$191,000		$191,000

$110,000 of the deposits to be tied up by contract for one year.

Since the new management gave us no reason to believe that substantially different policies would be followed by the new bank, we did not see where there was any ground for our changing the position we took in the previous conference with reference to the carry-over indebtedness to us and with reference to any additional advances to the bank.

I believe that the Board will be interested in knowing why the Examiner, in looking over the bank's assets on January 7, estimated just enough losses to exactly absorb the bank's capital investment. It was apparent to us that the Examiner must have made some adjustment in the classification he made of the loans when he first went through the note case. Upon inquiry we found that the Examiner had really found losses of about $77,000 instead of $67,000, but that he had been induced to scale down his original estimates after talking the situation over with the directors - the reduction being sufficient to lower his total estimate to a figure equal to or nearly equal to the bank's capital investment. A circumstance of this kind leads us to wonder whether the examination was motivated by the desire to make a true appraisal of the bank's assets or simply by a desire to reopen the institution.

5. First National Bank, Haworth, Oklahoma
(Capital $25,000, Surplus and Profits $4,000)

	1922	1923	1924	1925	1926
Maximum line with Fed.Res.Bk.	$85,000	$ 76,000	$ 42,000	$ 27,000	$ 26,000
Maximum total borrowings from all sources	102,000	84,000	70,000	52,000	36,000
High point loans	184,000	165,000	199,000	139,000	91,000
Low point deposits	79,000	72,000	101,000	92,000	79,000
Low point loans	134,000	137,000	99,400	59,000	70,000
High Point deposits	123,000	124,000	166,000	146,000	82,000

This bank closed its doors for the first time on November 19, 1923. The bank was examined in June 1923, at which time it had loans of $163,000 as compared with deposits of $78,000 and it owned the Federal Reserve Bank $66,000 and correspondents $8,000 as compared with capital stock of $25,000, surplus $5,000 and profits $5,700. The Examiner in his comments made the following statement: "Another very badly extended bank - transacting a borrowing business with the Federal Reserve Bank of Dallas now about two and one-half times its capital stock, with applications pending for additional accommodation necessary to restore depleted reserve". This bank's loans were made largely to tenant farmers against prospective crops, and not against existing tangible values. The bank was literally in the farming business.

The bank was examined again on February 1, 1924, for the purpose of finding out whether or not it could be reopened. As in the case of the Blossom bank just discussed the examiner set up just enough losses to eliminate the capital investment. In this case the amount of losses set up was $29,000. The bank was reopened eight days after the examination had been completed with a new capital of $25,000. Hardly more than four months elapsed when the bank was examined again and sufficient losses were estimated by the examiner to impair the new capital nearly fifty per cent. Six months later the bank was again examined and sufficient losses were estimated to impair the capital more than twenty-five per cent. We are unable to understand how the bank acquired such a substantial amount of fresh losses so soon after it was supposed to have been cleaned out through reorganization. The explanation may lie in the possibility that examiners approach the credit position of a bank for reorganization purposes from a point of view different from ours when we are called upon to make an advance of credit.

The figures given in the foregoing table show that the bank was a heavy borrower in each of the years covered. The loan account was too heavy for the deppsits, particularly in the earlier years, because the new management since 1924 showed a willingness and an ability to pursue a strong collection policy. The bank closed for the second time on October 28, 1926, and this was occasioned by the fact that it had worked itself into such a position that it was no longer able to function as a bank. The management had collected the liquid and really desirable notes in the case and the paper which was left could not be made to respond to the bank's pressing need of funds to meet steadily declining deposits. Moreover, the cummunity had lost confidence in the institution as shown by the fact that deposits, exclusive of those placed in the bank by Vice President Shafter, amounted to only $51,000. The best evidence that the community had abandoned the bank is seen from the fact that the good cotton crop of 1925 brought between $500,000 and $550,000 into the Haworth trade territoty but the bank's deposits increased during the fall only up to $146,000 - or by $54,000.

On October 27, the day before the bank closed, the managing officers called upon us for the purpose of obtaining credit to meet outstanding cash letters. We told them that we saw no hope for their institution because the community had apparently definitely decided not to support it, and this, in spite of the fact that the shareholders had paid into the bank nearly $57,000 of new money since it was closed in 1923.

The bank was no longer able to function as such, not only because of the circumstances just mentioned, but also because of the fact that the capital and such deposits as it had were apparently frozen up in unresponsive tenant farmer loans and immovable real estate.

6. Security State Bank, Cooper, Texas

(Capital $100,000, Surplus and Profits nominal)

This bank was a reorganization of the old Farmers National Bank of Cooper which closed its doors for the second time on June 10, 1921 as a result of frozen and inflated credits and inability to meet a withdrawal of public funds. These public funds (amounting to about $400,000 in the aggregate) had been tied up under a contract against withdrawal when the Farmers National Bank reopened on June 15, 1920 after having previsouly closed on January 17, 1920, as a result of defalcations on the part of one of its managing officers. When the time limit against withdrawals of the public money expired in 1921 the bank found itself unable to meet the first withdrawal and had to close its doors. We decided to help the situation in every way we could and consequently we gave our consent to the subsequent organization of the Security State Bank of Cooper which took over the assets and assumed the liabilities of the old Farmers National Bank. The fact that we had been very prodigal in our extension of credit to the old bank did not prevent its failure. At the high point of 1920 the bank owed us $136,500, at the high point of 1921, $110,500, and on the date of closing, over $51,000.

Within a short time after the closing of the Farmers National Bank, Cooper, the Security State Bank was opened as a reorganization of the old institution. It applied for and was granted membership in the Federal Reserve System. The figures appearing below will show that we made substantial advances to the new institution and that its total borrowed money each year up to the date of closing was substantially in excess of its capital investment. Notwithstanding this liberal use of credit the bank was unable to continue to operate and closed its doors for the third time on January 23, 1925.

	1922	1923	1924	1925	1926
Maximum line with Fed.Res.Bk.	$151,500	$118,000	$76,000	-	-
Maximum total borrowings from all sources	166,500	168,000	123,000	Closed 1-23-25	
High point loans	587,000	458,000	320,000	-	-
Low point deposits	357,000	291,000	220,000	-	-
Low point loans	439,000	362,000	243,000	-	-
High point deposits	475,000	340,000	229,000	-	-

It should be stated that the inability to obtain credit was not the reason why this bank closed in 1925, just as it was not the reason for its having closed in 1921. The reason why the bank closed was that it had been following unsound loan policies, operating with the idea that its first duty was to help its borrowing customers make a crop by extending to them additional advances on the theory that that ewas the only way it could protect the loans already made. Thus the bank's policies and practices were dictated by a concern for the interests of its borrowers rather than by a concern for the interests of its depositors.

Reference need only be made to the foregoing figures to see quite clearly that the reorganization of the bank did not effectually alter its policies, because at no time was it able to reduce its local loans much below the high point of deposits. It has been previously stated that owing to the large element of hazard in typical crop loans they should be liquidated in the fall of the year to the lowest possible point and should certainly be reduced far below the high point of deposits reached at the same time, because of the fact that those deposits at that time are composed largely of a seasonal and, therefore, temporary increase resulting from crop production - which increase cannot safely be invested in local crop loans. This bank could not, with safety, run its local loans at the high point above its local deposits at the low point, but this principle went unobserved just as it went unobserved in most of the other cases which have been discussed in this letter. This whole situation simply resolves itself into the proposition that errors of judgment and unsound policies on the part of the management of amember bank cannot be corrected by continuous extensions of credit by a Federal Reserve Bank or any other creditor. Those extensions of credit simply serve to create further opportunities to make the same mistakes of judgment and to further prosecute the same unsound policies with consequences usually vicious for the bank receiving the credit, for the community which it serves, and for the bank extending the credit.

Aside from the patent disproportion existing between the loans and deposits of the Security State Bank and between its borrowed money and capital investment, a further factor entered into the situation which made the closing of the institution inevitable. The policies which it followed naturally led to the "freezing up" of a large amount of its credits. On October 28, 1924 the bank was examined. This was four months before it closed. On the date of examination the bank had total loans of $261,000; of that amount the Examiners criticized $237,000 - estimating $164,000 slow, $45,000 doubtful, and $28,000 losses, the losses being sufficient to create more than a twenty-five per cent impairment of the capital stock. The bank had simply worked itself into such a hopelessly frozen condition that it was no longer able to function as a bank.

Not long after the closing of the Security State Bank of Cooper a successor bank was organized, known as the Cooper State Bank. This bank did not apply for membership in the Federal Reserve Bank of Dallas, and since it was not a member we do not have any first-hand information as to the policies which it followed. The bank closed, however, a few weeks ago and this would indicate that its management had perhaps been true to tradition and had been trying to operate on the theory that it would succeed on a policy of subsidizing its community and putting out more credit to save that previously extended.

This Cooper case is perhaps one of the clearest examples in this district, of the futility of trying to strengthen a weak bank through themere expedient of lending it a large amount of money. Credit must have harmful results if it is place at the disposal of an incompetent bank management, or if the management pursues, and continues to pursue, policies which are fundamentally unsound.

In passing, it might be mentioned that the Delta National Bank of Cooper faced the same conditions that confronted the Security State, Cooper, yet while the latter was struggling vainly and wasting its substance in trying to solve problems which its own policies continuously created, the Delta was pursuing an undisturbed and profitable business. The distinction between the two institutions is, of course, the fact that one was in the farming business whereas the other was in the banking business.

Incidentally it may be remarked that the First National Bank of Cooper closed the day following that on which the Cooper State Bank closed, and it closed for very much the same reasons. In accordance with the practice followed by us in other similar cases, we wrote the Delta National Bank, after the failure of the other two banks at Cooper, and volunteered to extend credit to the institution should it need it because we felt that the conservatism of the management and the soundness of its policies and practices justified such an overture on our part. It is hardly necessary to say that the bank has had no occasion to take advantage of our proffer of accommodation.

7. First National Bank, Killeen, Texas

(Capital $50,000, Surplus and Profits $12,000)

	1922	1923	1924	1925	1926
Maximum line with Fed.Res.Bk.	$ 13,000	$ 9,000	$ 21,000	$ 10,000	$ 31,000
Maximum total borrowings from all sources	19,500	23,000	34,000	10,000	43,000
High point loans	39,000	57,000	71,000	92,000	90,000
Low point deposits	49,000	77,000	72,000	101,000	57,000
Low point loans	33,000	33,000	40,000	69,000	47,000
High point deposits	76,000	186,000	132,000	183,000	95,000

On January 10, 1921 this bank was reopened after having been closed on October 8, 1920 because of an overextension of credit and frozen loans. A large part of the frozen loans had been converted into real estate by the time the old institution went out of business. The reopened bank has never been able to make any progress since its organization, because all of the new capital paid in at that time was in effect invested in the real estate of the old bank. The amount of real estate acquired and carried on the books at the present time amounts to about $58,000.

We have extended credit to this institution from year to year, not so much because credit will assist it in working out its fundamental problem, but because we have confidence in the Cashier and in the policies which he is trying to follow. We feel that sooner or later the shareholders will recognize the necessity of taking out the real estate or of liquidating the bank, because its present volume of business would hardly justify its continuance as a going institution.

8. The First National Bank, Ennis, Texas

(Capital $200,000, Surplus and Profits $10,000)

	1923	1924	1925	1926
Maximum line with Fed.Res.Bk.	$115,000	$110,000	-	$ 60,000
Maximum borrowings from all sources	150,000	230,000	50,000	221,000
High point loans	850,000	792,000	631,000	681,000
Low point deposits	696,000	617,000	600,000	572,000
Low point loans	508,000	669,000	424,000	533,000
High point deposits	1077,000	1010,000	831,000	668,000

This bank was organized February 9, 1922 as a successor to the Ennis National Bank which closed its doors on November 14, 1921. Because of our desire to assist the new institution we agreed in effect to contribute $282,000 to it by agreeing to accept that amount of the poorest loans of the old Ennis National Bank and to release the new bank from any liability on that amount of the indebtedness of the old bank which it took over. It might be remarked in passing that the Ennis National Bank closed for the same reason that the other banks closed which have been discussed in this letter.

A review of the foregoing figures does not indicate that our liberality has been of any material assistance to the new institution insofar as its being able to function as a bank is concerned. The bank continues to borrow heavily and its loans have been continuously disproportionate to its normal line of deposits. Its note case is heavily burdened with slow and frozen loans. Moreover, it has almost all of its capital stock invested in real estate, banking house, furniture and fixtures.

The probabilities are that the bank will attempt to borrow heavily in 1927 because it failed by over $100,000 to reduce its loans this past fall as low as they were at the beginning of the 1926 season, and its deposits have failed by $160,000 to recover to the high point at the beginning of the season. In other words the loan account of the bank will not respond to its requirements which means that the owners of the institution should be required to remove the unresponsive assets and relieve the bank from calling upon creditors to carry them. It may be said that this bank has reached an impasse which is sufficient proof that our donation of $282,000 has amounted to little more than a mere temporizing with the situation.

The substantial number of bank failures which this district has had during the past four or five months might give an erroneous idea of just what the banking position of ~~xxxx~~ the district is. The cases which have been discussed in this letter are typical of the class of banks in which most of the failures have occurred and it is, of course, with banks of this kind that most of our problems arise. The Board should remember, however, that only a comparatively small percentage of our membership falls within this class and that such credit problems as we have to face with the great majority of member banks borrowing from us are comparatively easy of solution. The reason why member banks, other than of the class discussed, do not give us very much concern is because they follow policies and practices that are conservative. They do not have exaggerated ideas about their duty to the communities which they serve, nor do they attempt to borrow sums of money disproportionate to their own resources and capital investment.

With respect to your request for a statement of the fundamental principles followed by our bank in granting or refusing credit to member banks in a weakened condition, I desire to preface my reply to this question by the observation that the mere incidence of weakness in the financial position of a member bank or group of member banks does not, of course, present a condition that permits us to call into play any arbitrary rule or rules that can be applied to all weakened banks alike. Our treatment of individual cases must necessarily be individualistic, because no two cases are exactly alike; and since it follows that "circumstances alter cases", we find that the problem of granting an over-extended bank a large line of credit, or a small one, or no line at all, resolves itself largely into a matter of personal judgment - based, of course, upon experience.

Nevertheless, there are certain broad fundamentals that form the background of our dealings with weak or distressed banks, which may be summarized as follows:

1. A line of credit should be granted or refused, accordingl to whether it would be helpful, rather than harmful, to the applying bank and its community; and, if granted, it should be upon such terms as may reasonably be expected to produce beneficial rather than hurtful results.

(a) If the line applied for is considerably in excess of the bank's capital and surplus, and is granted, the stockholders' investment becomes a minority interest, which is likely to reflect itself in the interest which they subsequently take in the bank's ultimate fate.

(b) We cannot prevent a member bank from borrowing excessively in proportion to its capital funds, if such borrowings can be obtained from its correspondents, but we can and do decline to be a party to borrowing programs that experience teaches are suicidal. Therefore we are as much concerned in knowing the total amount a bank intends to borrow as in knowing the amount it desires to borrow from us.

(c) Granted that a line of credit in certain cases is an appropriate relief measure, the terms of the accommodation often play an important part in determining whether the loan proves helpful or injurious to the member bank. If the bank's difficulties happen to be due to excessive loaning and excessive borrowing, such restrictions as a scaling down of the amount applied for, or the requirement of directors' endorsement, or a substantial margin of "additional collateral," necessarily tend to cure the bank's habitual abuse of its loan function.

2. Credit is the wrong remedy for a weakened bank whose distress is due - either mainly or entirely - to internal causes, unless satisfactory assurances can be given that such causes will be promptly eliminated.

(a) Frozen assets and accumulated losses due to incompetent management or erroneous policies are examples of internal disorders that call for internal remedial measures.

3. Reserve bank credit cannot be permitted to be used to supply capital deficiencies of member banks or their communities.

(a) But we can and do extend temporary aid to member banks that are in process of eliminating capital deficiencies and reversing the policies that brought them about.

4. Rediscount advances should be made against existing values, rather than prospective values, and, like the advances made by the member banks, should be made without undue dependence upon the success or failure of the enterprise which they are used to finance.

(a) We recognize this principle as an essential element in the safety of our own institution.

(b) We apply it also because of its exemplary effect upon our member banks.

Passing from the discussion of the broader principles involved in our loan policies with respect to weak banks, it may be of interest to the Board to know something of the methods and practices we follow in the practical application of these fundamentals, as well as a few illustrations of the conditions in this district which seem to make these methods appropriate.

Our procedure may be said to be based almost entirely upon "case history." Many member banks, after operating for years in the "non-borrowing" class, undergo a change in management and fall into the hands of bankers who assume that the bank's first duty is to its borrowing customers, and that the practice of loaning money mainly against the security of unplanted crops is correct and economically necessary. Very shortly thereafter the bank begins its rediscount relations with us, and a careful record of its annual borrowings is kept in our files. When this record, as it usually does, shows a steady increase each year in the bank's rediscount needs, we endeavor to point out to its officers what is likely to be the ultimate destination to which such a borrowing and loaning program leads, and try to convince them that the limits of their loaning power are not to be found in the reserve position of the Federal Reserve Bank, but in the operating ratios of their own institution.

A fine case in point is that of the Forney State Bank, of Forney, Texas. This bank, for several years past, has been operating in utter disregard of its ratios of loans to deposits, and while its condition has been growing steadily more extended, it has been able thus far to avoid actual disaster by reason of an unusually fertile soil in its trade territory, a wealthy board of directors, and a resourceful managing officer who has been able heretofore to borrow such funds as the bank's extravagant loan policy made necessary. The following figures reflect the trend of this policy:

In 1925 the ratio of loans to deposits was 181% (at the peak)

In 1926 the ratio of loans to deposits was 251% (at the peak)

In 1927 the bank estimates the ratio will reach a peak of 280%. Its managing officer, when recently applying to us for an increase in the bank's line from $30,000 to $50,000, admitted for the first time that his policies had been wrong, and said he believed as we did that the liberal loan policy of his bank was reflected in the low level of his deposits, which, he stated, had been getting lower each year. He said the bank had made money, and that his customers had made money too, but had spent it, knowing that they could go to the bank and in all probability get whatever money they wanted. He, in turn, had evidently been laboring under the impression that he could contimue to borrow from the Federal Reserve indefinitely and without reference to the steadily growing spread in his ratio of loans to deposits. We were able to consider his application for the additional advance entirely in the light of how the advance would affect the borrowing bank, as we endeavor to keep our loan portfolio in such shape that when we receive an application for a loan the fact that the applicant is already indebted to us is a circumstance of minor importance so far as our independence of action on the new application is concerned. In this case, we told the Forney State Bank that we would increase their line from $30,000 to $50,000, against the bank's own note, endorsed by its directors, the line to be carried by renewals until fall, at which time it is to be paid in full. We left the matter of pledging marginal collateral to the discretion of the endorsing directors.

Thus we are, in effect, financing the directors themselves by obviating the necessity of their realizing on their own assets in behalf of their bank. We deliberately chose this method because our experience in similar cases provides good reason to expect that the arrangement will have a most salutary effect in awakening the directors of this institution to their duty in shaping the bank's policies along sounder lines and with a greater regard for such fundamentals as correct operating ratios, the conservation of deposits, and the education of their community generally.

The "case histories" that we keep on file, showing not only the borrowing record of member banks but also the long-term trend of their loans and deposits, are a valuable aid to us in analyzing the plea that is frequently made by weakened banks to the effect that their distorted operating ratios were caused by reverses suffered by their customers - such as crop failures - rather than by causes under the bank's control. In many cases we are able to confront them with unanswerable proof that their explanation is untenable - - this proof being in the form of the sound ratios exhibited by other banks competing with them in the same community, operating "under the same rain and sunshine", and yet carrying along their share of the community financing without having to borrow a dollar. Outstanding examples of the many banks in this district whose records have demonstrated the supremacy of prudent management over outside conditions are the Bartlett National Bank of Bartlett, Texas, the First National Bank of Commerce, Texas, and the Delta National Bank of Cooper, Texas. I could extend the list almost indefinitely, but the three banks cited are of special interest because they have successfully withstood the cumulative effects of short crops and low cotton prices, while some of their local competitors, operating under the same conditions, were closing their doors and ascribing their downfall to agricultural reverses.

The case of the Bartlett National Bank is especially illuminating. This bank, located in a farming community in the heart of the 1925 drought zone, with a capital of $100,000 (of which $65,000 has been set up from earnings) ran its loans up in 1926 to a peak of $311,000, as against deposits at that time of $154,000. In the light of these figures, the bank could certainly not be accused of not doing its part to meet the emergency brought on by the 1925 drought and crop failure. Yet it was able to do this without abusing its credit, and showed that it had made its advances on the right basis by collecting its loans down to $147,000 at the close of the crop season, despite the low price received for the 1926 crop. It recently sent us an order for the purchase of $50,000 of bankers' acceptances. The record of this institution thoroughly demonstrates that a well managed bank can operate on sound banking principles and at a profit, and at the same time take care of its customers, in spite of two unsatisfactory crop years in succession.

The phenoménon of bank failures is too frequently attributed to extraneous causes, and the prevention of these failures is too frequently supposed to be possible through the intervention of extraneous measures of relief. Where we are convinced that a weak bank is in trouble by reason of internal instead of external conditions, there is little that we can do to relieve the situation except to use our influence and our loan function in such a way as to induce a change in the policies that were responsible for the bank's plight. Oftentimes the embarrassed banks wait so long before coming to us that it is too late for credit or anything else to do any good. Some resistance to the demands of over-extended banks upon our loan facilities is essential to their salvation, for the reason that they invariable follow the lines of least resistance in their attempts to find a way out of their difficulties, and, unless we commit the mistake of making it easier for them to borrow from us than to obtain long neglected liquidation from their own loan portfolio, they will usually solve their difficulty by attacking it at its source.

Illustrative of the effects of the conservative credit policy in times of agricultural depressions is the situation at this time in the 65 Texas counties in the "drought zone" of 1925. While we met the credit demands of the banks in that section in such a manner as to bring us no complaints, we made it clear to them, through our loan policy, that the year 1926 would be no time for a general expansion of credit in their section. Had we made loans in large amounts to these 65 counties following the drought of 1925, their member banks would now be caught by the price situation in a seriously over-extended condition. As it is, these banks (as illustrated above by the case of the Bartlett National) have their situation well in hand, in sharp contrast with the banks of Northeast Texas, where most of the recent failures occurred, despite ~~of~~ a most profitable cotton crop in 1925.

I believe that the foregoing sketch of our experiences with weakened banks during the past few years will suffice to give the Board a fair understanding of the policies we have tried to develop along constructive lines. We realize that our progress in attempting to build a sounder credit structure in this district must necessarily be slow, in the face of an archaic and wasteful farm credit system that has been the bane of the South since the Civil War, the principal phases of which have been ably outlined by Governor Talley in one of the exhibits which accompany this letter. We also realize that our dispensation of credit in the present cotton emergency has not coincided with the extremely liberal policy that our bank unfortunately pursued during the last previous depression some years ago. Slow progress and occasional adverse criticisms, however, are perhaps necessary concomitants of our efforts to reach the goal we have set for ourselves, namely; without swinging from one extreme to another in credit administration, to bring our bank and its membership to a position where both can function properly as dispensers of credit.

I think that the proper functioning of Federal reserve banks and their members has been defined nowhere more clearly or forcefully than in the following excerpt from the Board's discussion of "Federal Reserve Credit Policy", as contained in its Annual Report for 1925:

"The reserve banks in the districts outside of the financial centers, therefore, in passing upon the loan applications of member banks consider not only the legal eligibility and soundness from the credit point of view of the paper presented for rediscount or as collateral for an advance, but also the general position of the borrowing bank, the volume and character of its outstanding loans and investments, and to some extent the character of its management." * * * * "The reserve banks further realize that while protecting the depositors of a member bank by refusing to assist it in extending unsafe loans they are also protecting the bank's borrowers from incurring obligations which they may not be able to repay. A bank loan obtained under such circumstances is in most cases of no real assistance to the borrower, but on the contrary is likely to make it more difficult for him to regain a sound financial condition."

Summed up, the practices of a constructive character that we have developed as a means to this end may be described as follows:

1. The inauguration of more frequent conferences with officers and directors of weak banks, holding them in an unhurried manner and permitting the member banks' representatives to indicate the termination of the conference instead of doing so ourselves.

2. The application of pressure for a closer study and analysis by them of the internal causes of their troubles.

3. The assignment of specially trained analysts from our own staff to visit these banks and assist them to analyze their situation with a view of determining remedial measures, and the best uses of their assets.

4. The policy of volunteering the use of our rediscount facility to assist well-managed member banks in local emergencies arising from suspensions of banks in their community or immediate vicinity. (Acceptances of these proffers have been veryffew indeed, if any.)

5. A careful and sympathetic consideration of all applications for lines of credit with a view of confining advances to such banks and to such amounts as will safeguard the best interests of both the lending and borrowing institutions.

As brought out in the earlier paragraphs of this letter, our files contain the history of many cases of distressed banks that came to us for so-called assistance during the depression of 1920-21, with the result that the lavish advances we made them not only failed to save them from the receiver's hands but definitely made receivership inevitable by stripping these banks of both the ability and inclination to work out their own salvation. Although the last rites of receivership have long since been performed for most of these "chloroformed" institutions, their communities in some respects still feel the effects of our mistaken policy. On the other hand, although we have extended accommodations to innumerable weak banks, under a wide variety of circumstances and under varying degrees of hazard to ourselves, we cannot recall or find record of a single instance where liberal use of our credit facilities was alone the means of saving a bank.

Neither can we recall an instance where an indulgence or forbearance on our part has been responsible for the rehabilitation of a member bank weakened by heavy losses and slow assets. In a few cases we can trace beneficial results to the use of our credit facilities, but, as I have already pointed out, these were cases in which even the amount of our accommodation was confined within fixed limits and provision was made for a fundamental change in the administrative policies previously pursued by the borrowing member, and for the application of new policies with sufficient promptness and vigor to avert the accumulation of heavy losses. The Farmers National Bank of Brenham, Texas, is a notable example of such treatment.

Attached you will find a number of exhibits that will complete the picture I have endeavordd to draw of the situation inquired about. If any further details are desired, we shall be very glad to furnish them.

Yours very truly,

(signed) C. C. Walsh,

Federal Reserve Agent.

COPY

S U B S I D I Z I N G   A G R I C U L T U R E

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

When it is considered that cotton is the leading wealth-producer among American agricultural products, it is not surprising that people who live in the non-cotton states find it hard to understand why the purchasing power of the South should be seriously crippled by a single unprofitable cotton season like that of 1926. The plight in which the Southern cotton farmers find themselves at this time, as the result of a heavy over-production and consequent low price of their product, has attracted nation-wide attention and comment. Among the questions that are being asked by those who are not familiar with conditions in the South are the following:

Why should one bad year put the cotton industry in a state of depression or distress?

Why haven't the cotton growers accumulated a sufficient amount of savings from previous profitable years to tide them over such an emergency as this?

There is a well defined belief among those who are asking these questions that there must be something radically wrong with the habits or business methods of the cotton farmer, either in the form of a lack of thrift or a lack of efficient productive effort. Unfortunately, this belief is well-founded. But the cotton farmer's failure to make his farm pay the maximum possible returns, as well as his inaptitude for saving his money, cannot be laid entirely at the door of his own weaknesses as an individual. The environments, traditions and customs which have surrounded him for the past sixty years have had much to do with the fact that he has made so little progress in improving his economic condition.

Above all, the agricultural credit system of the South is, in my opinion,primarily responsible for the deplorable condition in which he finds himself today -- a condition but little better than serfdom, so far as the tenant farmer is concerned. And because the same evils which beset the financing of agriculture in the South, are prevalent, on a somewhat smaller scale perhaps, in other sections of the United States, as for example the wheat belt of the Northwest and the corn belt of the Middle West, a discussion of some of the factors which underlie the agricultural credit system of the South will serve to illustrate some of the reasons why there is so much public agitation on the subject of farm relief, and perhaps point the direction in which the solution or remedy lies.

HISTORY OF PRESENT FARM CREDIT SYSTEM:

In the reconstruction days followingthe Civil War a peculiar credit system sprang up in the South. It was an outgrowth of the chaotic situation caused by the War, and very possibly was the only system that would have fitted such a situation. The farmer - without money or equipment - bought his supplies from the country merchant, who "carried" him from one harvest season to another, and who, in turn, was "carried" in like manner by the local country bank.

From that day until this the farmer has been trained and taught to believe that being in debt is nothing to be ashamed of - is in fact a normal and inevitable thing - a natural and necessary part of the business of farming. After sixty years of this kind of training, is it surprising that ninety per cent of our farmers are still in debt about nine months out of the year and accept it as a matter of course? The debt habit remained, although time has brought about a significant change in the system of agricultural credit upon which the debt habit is based. No longer is the burden of crop financing carried by the country merchant. It has been transferred almost in its entirety to the country banker, who thus became the source of the credit supply for both the merchant and the farmer. The farmer was shrewd enough to see that by using bank credit instead of store credit he could satisfy certain wants that cash alone could supply. The merchant was shrewd enough to see that he could use the bank as a means of converting the farmer into a cash customer and, at the same time, unload on the bank the risks incident to the hazards of a growing crop. One observer has pointed out that this risk was so great as to make the farmer's account unprofitable to the merchant even when margined by a 40% merchandise profit and a 10% interest charge, and yet the bank was willing to take over the function on a straight 10% margin. The reason this 10% rate has never been reduced by the country banks, even to this good day, can be best understood by a perusal of the statistics of earnings and losses of country banks, which show that even this high rate is not high enough, because it does not represent, as it should, simply an interest charge arising out of the extension of true credit, but represents mainly an insurance premium intended to cover the risk involved in extending a capital loan to an exceedingly hazardous enterprize. Even this premium does not afford the banker the full protection of the rate it represents, because instead of being collected in advance it is usually added to the face of the note and is subject to the same fate as the principal of the loan.

The extension of capital loans to farmers, in the guise of so-called credit, has become so chronic and has continued so many years that the farmers themselves do not realize or understand the injustice they suffer from the present system, which in reality constitutes a most pernicious form of subsidy, undermining the farmer's independence, his self-reliance, and his will to produce and save.

The cotton industry has been on a subsidized basis for sixty years, largely because the country banker lacks either the desire or the incentive to help the farmer to get out of debt and stay out. A false emphasis placed upon crop financing at high interest rates as a factor in bank earnings has built up a relationship between banking and agriculture that has been hurtful to both sides. Less selfish, but equally as unsound, is the false conception that some banks entertain as to a bank's duty to its community. These banks seem to regard themselves as an essential factor in agricultural production, even to the extent of permitting the entire amount of their own capital assets and credit to be absorbed by loans to tenant farmers against chattel mortgage security, the bank assuming all the attendant risks of such loans upon the theory that since the landlords will not assume these risks the banks must do so. Until the responsibility for agricultural production is forced back where it blongs, upon the <u>landowner</u>, and credit (for crop production purposes) is extended to tenants only upon the landlord's endorsement, we will always have unstable agricultural conditions in the South. False notions as to a bank's duty to an agricultural community have caused both the banks and their constituency to lose sight of the community's duty to the bank, which is to conserve and safeguard the bank's ability to equitable vitalize and distribute the resources of the community upon the proper credit basis.

It is not my purpose to decry the use of credit, <u>per se</u>, for crop production purposes. There is not a more legitimate or attractive field in which a bank may extend credit, in the true sense of the term, than the agricultural industry. But there is a fundamental difference between a credit extension and a subsidy. The former may be defined as a loan made against existing assets whose value and character are such as to guarantee the repayment of the loan regardless of the success or failure of the enterprise in which the proceeds of the loan are used. The furnishing of funds against a prospective crop obviously does not fit this definition, and to the extent that such loans are secured only by the borrower's crop prospects the advance is not an extension of credit but a mere subsidy. The Southern cotton farmer's practice of giving a mortgage on workstock, implements and an unplanted crop is hardly more than an evidence of good faith on the part of the borrower. Aside from that feature, this form of collateral is of little value because the crop must be looked to as the real means of extinguishing the debt, and when crops fail to yield an adequate return the same conditions which force recourse to the collateral at the same time destroy the market for it.

GOOD YEARS VS. BAD YEARS

One of the chief weaknesses of the Southern agricultural credit system is the fact that in the constant effort of the borrower and lender to discount the future, too much reliance is placed by both parties upon the efficacy of the so-called "good crop year" to rectify the reverses suffered in a bad year or a series of bad years. When the average farmer, in a so-called good year, makes more than enough money to pay his indebtedness he retires his note at the bank and leaves the rest of his money in the bank in the form of a temporary deposit. Does he regard his deposit as working capital to be used in financing the production of his next crop? He does not. Consciously or unconsciously, the bank subsidy habit - now grown to the proportions of an addition - smothers any desire he might otherwise have to own a money equity (instead of a mere labor equity) in his next crop, and makes him an easy prey to the temptation to use his ready money to buy certain luxuries or non-essentials that he wouldn't think of buying except for the certanty that his bank would continue to finance his farm operations exactly as it had done in the past.

Take the banker's side of the situation. When he sees the farmer come in voluntarily and pay his note in full, leaving a handsome sume on deposit to his credit, does it occur to him to have a heart-to-heart talk with the farmer and suggest that after setting aside a portion of the deposit to live on until planting time that he salt away the balance in the form of a cashier's check, to be used to reduce his borrowing needs for the next season's crop purposes? Not at all. In the first place, the average banker is reluctant to thrust his advice upon the farmer as to what he should or should not do with his surplus funds. In the next place, the banker reasons that this farmer is entitled to enjoy some of the good things of life, even though in effect he buys them with borrowed money, and if he happens to have another good year he will pay up his debts, while if the next crop should be a failure he will "work out" his indebtedness when he does have a good year. A curious thing about the banker's mental processes on this subject is the fact that he invariably picks out "next year" as being the propitious time to rectify any mistakes or misfortunes of past years or the present year. It never occurs to him that credit extended upon the strength of what is expected to happen in 1927, for example, might just as well be predicated on what might happen in 1930 or 1940, so far as the regular recurrence of "good years" can be depended upon.

In lean or bad years, both the banker and the farmer usually reverse their respective policies. Each foresees that crop returns will be insufficient to extinguish the farmer's note at the bank. The banker resolves upon two courses of action, both of which are in conflict with his policy in a "good year." First, he will take a sharp interest in what the farmer does with the proceeds from the sale of his crops, will make an effort to obtain as large a payment on his bank debt as possible, and will keep a sharp eye on the farmer's standards of living to see that he is not spending money that should be paid to the bank. Second, he resolves to cut down the farmer's line of credit for the coming year.

The farmer also takes a different attitude. He foresees a curtailment in his line of credit for the next season, and feels that it is to his interest to put as little money in the bank as possible, either on his maturing note or on deposit.

Thus the community's resources, after being heavily impaired by crop losses, are still further weakened by being demobilized in the form of money in hiding. In such a stiuation, the average banker feels it incumbent upon him to act early in the matter of notifying his customers what their line of credit will be, if any, for the next year. If this same promptness in fixing lines of credit in the fall liquidating season were used in prosperous years as well as lean years, it would redound immensely to the conservation of community resources, because the banker would be in a position to influence depositors to husband a portion of their deposits for use in financing at least a portion of the cost of the next crop.

THE BANKER MUST THINK STRAIGHT

In agricultural communities the seasonal movement of deposits is oftentimes apt to be deceptive, even to the bankers themselves. There are certain bankers who for some reason fall into the habit of thinking of their deposits in terms of X assets. In other words, they attempt to operate their bank on its deposits. For example, in the spring season, while there is still a fairly substantial residue of deposits representing returns from the previous season's crops, the deposit account is temporarily swelled by crediting the accounts of farmer depositors with the proceeds of new loans extended to them. Surprisingly few bankers take the trouble to keep in close touch with the composition of their deposits at this season of the year, and when the borrowers begin to check out proceeds of loans the rapid shift in the ownership of deposits, as well as the rapid drain upon the bank's cash resources, produces a situation that invariably embarrasses the banker who has committed himself to an extravagant loan policy, and his only recourse is to divide his earnings with his correspondent or the Federal Reserve Bank in the form of interest on borrowed money.

Inter-bank borrowing, like individual borrowing, easily becomes a habit. A country bank that borrows habitually is apt to be one that is managed by the type of banker who from the outset of his career has assumed that the present agricultural credit system is correct. His bank would not be a habitual borrower if his farmer customers were not habitual borrowers, The latter would not borrow habitually if their banker had done a little straight thinking at the start and refused to subscribe to the existing methods of crop financing as being correct. The influence of majority opinion in leading each successive generation of country bankers abjectly to accept the subsidy system as a matter of course has caused more farm distress and wrecked more banks than has intrinsic incompetency on the part of the men who have been operating our country banking system. The same chains of hereditary customs and traditions that have bound the farmers to the bank credit habit have shackkled and nullified the native ability of many a country banker who otherwise was perfectly competent to conduct a successful banking business. These straight-thinking country bankers who do extend credit in the true sense of the term - against existing values, rather than against expectancies, - are able successfully to compete in the country banking field only because they exercise such an effective supervision over the use made of the credit they extend that their farmer customers form the habit of living within their income, depend upon low crop <u>costs</u>, rather than upon high crop <u>prices</u> for their profits, and never experience the need of having their productive efforts subsidized under the present day system of so-called farm credit.

It is a system that is basically wrong because it is full of anomalies. The same banker who solemnly advises a farmer to raise his own food and feedstuffs will, the next minute, nullify this good advice by loaning him the money to buy these things. A slight variation of this type of banker is the one who will become as enthusiastic over the economic value of the sow, the cow, and the hen that he will insist on loaning the farmer the money to buy these productive barnyard assets, on the theory that if the farmer has not been sufficiently provident to buy them out of his own earnings somebody must force him, via the credit route, into the experiment of producing his own meat, butter and eggs. The supposition seesm to be that the results of the experiment will more than offset the debt by which it was initiated. Despite the fact that such experiments sometimes justify themselves by the results obtained, broadly speaking, they represent an anomalous banking practice, because, although meant to assist the farmer to get out of debt, they violate the rule, based upon many decades of experience, that a farmer will never get out of debt so long as he knows he can depend upon borrowed money as a substitute for self-earned capital and spending money.

Another noticeable inconsistency that is characteristic of the agricultural credit system is the average bank's attitude on the subject of the distribution of credit risks. Many banks that constantly insist upon the farmer's diversifying his crops, in order to minimize crop risks through the process of distribution, make it a practice to tie up all of their loanable funds in agricultural loans. As a rule, they do not realize the value of practicing what they preach until a period of agricultural depression comes along and finds them with no reasources available for succoring a distressed agriculture at a time when it needs aid most.

Disintegration of Community Assets

What is happening in many parts of the South today, as a result of periodical agricultural depressions, coupled with the steady degeneration of farm credit, is that certain communities are gradually sinking into bankruptcy. Community assets are steadily wasting away under the annual erosion of debit trade balances. The settlement of a trade balance is inexorable. It must be met in one of four ways. First, by production of goods at least equal in value to the goods purchased outside of the community, with a sufficient margin for reserve and a return of invested capital. Second, if there is a debit balance against the community it is paid in the first instance of bank credit, and if the adverse trade balances continue the bank credit becomes frozen, because sooner rather than later, it comes to depend upon capital assets for repayment. The third phase is the settlement by compositions; that is to say, a compromise of debts such as might be illustrated by a country bank collecting $400 on a $1,000 line of credit and charging off the remaining $600. The fourth step in the sequence is bankruptcy. In this connection, there is a marked tendency, which has become more pronounced in the last two years, for landowners to be forced into a definite impairment of their capital assets by reason of having to borrow on their land to liquidate frozen bank lines. This, of course, is just another step toward compositions or bankruptcies. It is interesting to note just here that certain statistics recently compiled indicate that in the year 1925 the population of the Eleventh Federal Reserve District lacked approximately $97,000,000 of having enough ready funds to pay its bills for that year.

Because the gradual attrition of community assets. such as I have just described, is a slow process, and because it is confined largely to the smaller communities dependent almost entirely upon agriculture, it represents a disintegration that attracts but little notice or study until some sweeping catastrophe overtakes the country, such as the drastic decline in the price of the South's 1926 cotton crop. But, as a rule, when such a misfortune occurs, there is a tendency to over-emphasize the immediate or precipitating factors, and a great deal of laudable sympathy and assistance are wasted in the form of remedial schemes devised for and applied to surface factors, which are merely symptoms mistaken for the disease itself.

COST AND PRICE

In the glib discussion of remedies, the question of crop prices assumes such an exaggerated importance as completely to eclipse the subject of crop costs, which is the cardinal issue of the emergency. Valorization schemes, fostered either in the form of legislative panaceas or a mass attack upon the legal reservoirs of bank credit, are brought forward in almost infinite number and variety, with the result that the legislative department of the government and the Federal Reserve System are regarded as the country's ultimate hope of salvation for a distressed agricultural industry. Intervention of these agencies is claimed to be necessary because of the continued disparity between the price level of the things the farmer has to buy and the prices of the things he sells. Somehow sight is lost of three fundamental reasons for this disparity, all of which have a direct bearing upon the problem of eliminating the differential complained of.

(1) The production of fabricated articles has for its base the law of supply and demand, and production is therefore kept somewhere near a proper level. Agriculture must take its cue from the example thus set.

(2) Fabricated articles are distributed under a highly trained system of organization and salesmanship.

(3) In recent years the farmer's purchases have consisted to an increasing extent of certain fabricated articles that are relatively high in price, not only as compared ~~wit~~ to farm products, but also as compared to other classes of fabricated articles.

If there does exist such a thing as a remedy for the unsatisfactory condition of agriculture in this country, it seems to me that it lies in the hands of those who control the administration of agricultural credit, particularly the primary dispensers of that credit. That the exercise of a greater degree of intelligent bank supervision over the expenditure of funds loaned for agricultural purposes would go far towards lifting the industry above the vicissitudes of violent fluctuations in world prices of famproducts and in placing it on a permanently profitable basis, is a conclusion that seems inescapable in the light of the present-day conditions under which the farmers operate and which may be summarized as follows:

> Crop production costs are the one definitely determinable and controllable factor of crop profits; are inseparably related to the yield per acre; and in the final analysis depend upon the producer's operating and living methods, which in turn are largely right or wrong according to the influence exerted upon them by the banker to whom he looks for credit and counsel.

When such a system of bank supervision over the use of agricultural credit is established, the farmer - like the merchant and the manufacturer - will predicate his expenditures upon the inflexible rule that costs must always be held to a minimum, instead of predicating them upon the price received for the previous year's output. An enlightened control of crop costs will largely solve the problems intermittently presented, by low crop prices, because it will increase the profits derived in "good years" sufficiently to enable the farmers to accumulate a reserve for "lean years".

With such an agricultural system as its base, a new and sounder credit structure can be erected by the rural bankers of this country. The control of agricultural credit lies in their hands, and upon the use which they make of this control depends the solution of the ills that agriculture has suffered for the past sixty years from the lethal and pernicious system of subsidy which has been inflicted upon it in the guise of credit. The Federal Reserve Banks are ready to do their part. They possess no supervisory powers whatever. While they may be deeply concerned over or about the policies of their member banks rather than with them, a control can be exercised only in the amount of credit which a Federal Reserve Bank may extend to any member bank or to the group as a whole. This is a matter of discretion, and therein, coupled with a wise credit policy on the part of city and country banks, lies a solution of the problem which has been accumulated.

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THE DALLAS REDUCTION

I am unwilling to approve the reduction of the rediscount rate in the Dallas district from 4 to 3 1/2 per cent at this time; first, because it was not made in response to any local demand or because of any local condition but because of the Board's request for uniformity at a lower rate; and, second and chiefly, because in reducing its rate the Dallas reserve bank, in my opinion, surrenders one of the greatest advantages of the regional system - namely, the opportunity of attracting funds from the east by maintaining a rate higher than the eastern rates. I think the Board's request for uniformity is a mistake. It cannot be denied, I think, that a higher rate does attract funds. Certainly that is true of international rates, and no one doubts the efficiency of the higher rate in London in attracting funds from New York. If it is not also true to some extent as to Federal reserve districts, then there is little or no advantage in the regional plan of the Federal Reserve System as compared with the discarded Aldrich plan which provided for uniform rates. I believe its truth can be demonstrated through a study of the movements of gold from week to week through the Gold Settlement Fund. Several of the leading financial writers, when the reduction of the Kansas City rate was announced, stated that the result would be to promote a flow of funds to New York so long as the NewYork rate remained higher. Certainly that was not what the Board was seeking to accomplish.

When rates are uniform throughout the Federal Reserve System it is clear, I think, that the New York rate is relatively high and serves to attract funds from most of the other districts, particularly from the western and southern districts. The tremendous accumulation of funds in New York at the present time, as shown by the Brokers' Loan figures, took place

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I am unwilling to approve the reduction of the rediscount rate in the Dallas district from 4 to 3 1/2 per cent at this time; first, because it was not made in response to any local demand or because of any local condition but because of the Board's request for uniformity at a lower rate; and, second and chiefly, because in reducing its rate the Dallas reserve bank, in my opinion, surrenders one of the greatest advantages of the regional system - namely, the opportunity of attracting funds from the east by maintaining a rate higher than the eastern rates. I think the Board's request for uniformity is a mistake. It cannot be denied, I think, that a higher rate does attract funds. Certainly that is true of international rates, and no one doubts the efficiency of the higher rate in London in attracting funds from New York. If it is not also true to some extent as to Federal reserve districts, then there is little or no advantage in the regional plan of the Federal Reserve System as compared with the discarded Aldrich plan which provided for uniform rates. I believe its truth can be demonstrated through a study of the movements of gold from week to week through the Gold Settlement Fund. Several of the leading financial writers, when the reduction of the Kansas City rate was announced, stated that the result would be to promote a flow of funds to New York so long as the NewYork rate remained higher. Certainly that was not what the Board was seeking to accomplish.

When rates are uniform throughout the Federal Reserve System it is clear, I think, that the New York rate is relatively high and serves to attract funds from most of the other districts, particularly from the western and southern districts. The tremendous accumulation of funds in New York at the present time, as shown by the Brokers' Loan figures, took place under uniform rediscount rates maintained for a considerable period, and, in my opinion, such an accumulation could not have been made so easily if western reserve rates had been maintained somewhat above the New York and other eastern rates. Four per cent at a time of fairly abundant supplies of funds and of softening interest rates is not a low rate for New York, Boston or Philadelphia, but it is a low rediscount rate for Dallas, and for several other western districts.

Conditions in the New York and Boston districts (disregarding the speculation in the stock markets) had for several weeks pretty clearly indicated the wisdom of reduction, quite apart from the international financial situation which provided an additional reason. Everything that we sought to accomplish was accomplished by the reduction of the New York and Boston rates. The lowering of rates in the agricultural districts which at this time need money for crop moving is a mere gesture, possibly harmless but also possibly dangerous. It has been acclaimed by a few writers as an effort to help the farmers but every farmer who borrows money must know that it does not lower the interest that he pays.

It has been said the lowered local rediscount rate compels big banks in the large cities of the west to grant lower rates to their country correspondent banks, particularly to the non-member banks whose officers have been told that they can obtain from their city correspondents every service the Federal Reserve can give them. This may be true, but we are generally not interested in non-member banks and I have never seen any evidence that these small banks, whether members or non-members, pass on a reduction of rates to their customers. Furthermore, there is plenty of evidence that a low borrowing rate, with a high spread of profit, tempts

Ser

the small banks into unsound advances or investments which get both themselves and their customers into difficulties.

It may be said that I should have expressed disapproval of the first reduction made - the reduction at Kansas City.- That reduction, however, was determined upon by Governor Bailey and his directors during my absence abroad and came through before I had opportunity to study the local situations. I had also sufficiently expressed my disagreement with the plan for a new uniformity at a lower rate beginning with the western districts at the Open Market Committee Meeting of July 27th, the day after my return.

If the reduction to 3 1/2 per cent already made by Kansas City, St. Louis and Dallas, as well as by Boston, New York and Cleveland, is made also by the remaining banks in the System, or by most of them, then uniformity will have been restored but on a lower level. The New York rate will then again become relatively the highest and will continue to attract funds to New York from other districts.

E.P.

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EARNINGS AND EXPENSES OF FEDERAL RESERVE BANKS

JULY 1927. Total earnings of the Federal reserve banks were $26,000 less than in June though earnings were accrued for one day more in July. Earnings from discounted bills increased $126,000 but this increase was more than offset by a decrease of $47,000 in earnings from purchased bills and U. S. securities and of $105,000 in miscellaneous earnings.

Current expenses (exclusive of cost of currency) aggregated $2,144,000 as compared with $2,154,000 in the month preceding and $2,170,000 in July 1926.

FIRST SEVEN MONTHS OF 1927. During the first seven months of the year earnings totaled $23,874,000, as compared with $26,666,000 for the corresponding period last year and $22,388,000 for the first seven months of 1925.

Current expenses (exclusive of cost of Federal reserve currency) amounted to $15,017,000 during the seven-month period, an increase of about $40,000 over the corresponding period last year.

After providing for all current expense and dividend requirements, the Federal reserve banks on July 31 had a balance of $3,308,000 available for depreciation allowances, surplus and franchise taxes, as compared with a balance of $6,447,000 at the end of July 1926.

On June 30 earnings of the Federal Reserve Bank of Richmond were $59,500 less than expense and dividend requirements, but this deficit was reduced to $38,800 on July 31, largely as the result of a transfer of $5,000,000 of securities to it by the Open Market Investment Committee.

St. 5467a

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Mr. Hamlin

See Bk

CONFIDENTIAL
Not for publication

EARNINGS AND EXPENSES OF FEDERAL RESERVE BANKS, JULY 1927.

St. 5467

Federal Reserve Bank	Month of July 1927 — Earnings — From discounted bills	From purchased bills and U. S. securities	From other sources	Total	Current expenses — Exclusive of cost of currency	Total	Current net earnings	Annual rate of current net earnings on average paid-in capital	Year 1927 — Current net earnings to July 31	Dividends accrued to July 31	Balance available for depreciation allowances, surplus, franchise tax, etc. — On July 31	On June 30
								Per cent				
Boston	$96,990	$95,333	$7,628	$199,951	$149,064	$154,718	$45,233	5.8	$468,969	$313,091	$155,878	$155,393
New York	416,479	304,955	34,315	755,749	501,906	544,226	211,523	6.4	1,745,482	1,334,704	410,778	393,933
Philadelphia	161,193	121,711	10,958	293,862	168,282	187,913	105,949	9.6	615,672	451,065	164,607	123,822
Cleveland	122,196	188,888	29,208	340,292	197,639	219,617	120,675	10.2	921,953	481,704	440,249	386,754
Richmond	74,986	74,816	7,442	157,244	104,608	105,547	51,697	9.8	177,335	216,107	*38,772	*59,454
Atlanta	122,030	61,873	15,670	199,573	95,915	96,586	102,987	23.7	491,234	177,295	313,939	236,549
Chicago	203,794	263,345	48,457	515,596	296,689	313,953	201,643	13.8	1,265,101	595,023	670,078	554,727
St. Louis	101,263	102,591	9,937	213,791	105,527	109,687	104,104	23.3	495,726	184,990	310,736	232,977
Minneapolis	20,308	76,574	4,605	101,487	83,717	87,638	13,849	5.4	148,017	105,043	42,974	43,668
Kansas City	42,903	124,306	25,378	192,587	136,519	144,215	48,372	13.5	334,298	147,101	187,197	159,929
Dallas	25,027	113,284	5,756	144,067	105,861	106,368	37,699	10.5	209,578	149,496	60,082	43,613
San Francisco	157,388	175,706	14,495	347,589	198,251	212,501	135,088	17.4	905,469	315,130	590,339	501,013
TOTAL:												
July 1927	1,544,557	1,703,382	213,849	3,461,788	2,143,978	2,282,969	1,178,819	10.7	7,778,834	4,470,749	3,308,085	2,772,924
June 1927	1,419,087	1,749,953	318,851	3,487,891	2,153,649	2,302,121	1,185,770	11.2				
July 1926	1,794,805	1,798,994	242,668	3,836,467	2,169,502	2,301,394	1,535,073	14.7	10,674,520	4,227,575	6,446,945	5,525,355

*Deficit.

FEDERAL RESERVE BOARD
DIVISION OF BANK OPERATIONS
AUGUST 10, 1927.

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Page 123

November 3, 1921.

Dear Sir:

Referring to your telegram of this date I would state that the records here show that the rate of 5% for the Federal Reserve Bank of Chicago was requested by the Executive Committee of your bank and was approved by the Board in accordance with this request. Please explain to any of your directors who may be interested, that the Board had no intention of determining a rate in opposition to their wishes.

Very truly yours,

Governor.

Mr. W. A. Heath, Chairman,
Federal Reserve Bank,
Chicago, Illinois.

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C O P Y

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Chicago Nov 2 316p

Harding

Washington

Resolution adopted by our Board instructed executive committee to act to reduce rates. McDougal is absent today but I have called up one outside member of the committee and he has authorized special meeting of the committee and authorized me to vote him for 5% rate as instructed by the Board. I think it better to have your own records show that our executive committee itself voted the 5% rate before you have declared it.

Heath.

420p

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November 2, 1921.

Dear Mr. Heath:

Following the meeting of the Federal Reserve Board today, at which your telegram of yesterday on the subject of rates was considered, I wired you as quoted below (deciphered) which I now desire to confirm:

"Your telegram yesterday regarding rates. As New York and Philadelphia have established 4½% rate, San Francisco, St. Louis and Kansas City 5% rate, Richmond and Atlanta 5½% rate and as Cleveland will undoubtedly act favorably on Governor Fancher's recommendation for 5% rate, Board construes your telegram as indicating desire on part of your directors to establish 5% rate for Chicago and has accordingly approved that rate effective at once."

Very truly yours,

Governor.

Mr. W. A. Heath, Chairman,
Federal Reserve Bank,
Chicago, Illinois.

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TELEGRAM

FEDERAL RESERVE SYSTEM

Chicago 258p Nov 1

Board

Washn

Our Board of directors today passed the following resolution: Resolved that in the opinion of this board from the viewpoint of this district, alone, the rediscount scale should not be reduced more than 1/2%, viz to 5½% at this time. However if a majority of the other F.R. Banks approve the rate scale suggested at the recent joint conference of agents and governors this institution should also conform to that scale and reduce its rate to 5%. Resolved that the executive committee be empowered and instructed to reduce our rate to 5%, concurrently with action by other F. R. Banks, in putting the proposed new scale into effect, or to 5½% in case the new scale is not adopted

McLallen

406p

Board Meeting Nov. 1, 1921.

Sec Bk

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July 29, 1927.

Dear Senator Blaine:

Permit me to make further acknowledgement of your letter of July 15, which raises a number of interesting questions concerning which you are in doubt with regard to the operation of the Federal Reserve System. I am very glad that you have brought these questions to my attention and given me an opportunity to answer them directly. It is of course difficult, within the compass of a single letter, to deal fully with these problems and I am not sure that upon all points I fully understand the questions you have in mind. I trust, therefore, that you will feel free to make further inquiry upon any points this reply does not make entirely clear.

As a preliminary to dealing with the specific issues which you have raised, I should like to refer briefly if I may to the purpose and operation of the note-issuing function of Federal reserve banks.

Prior to the establishment of the Federal Reserve System in 1914, the banks of the country frequently found it difficult if not impossible to supply the currency required by commerce, industry and agriculture, while at other times the amount of cash available was in excess of actual needs. This situation arose because the monetary stock of the United States was determined not by the need for cash but by the amount of the following four principal kinds of money then in circulation: (1) gold and gold certificates, changes in which depend on gold production and on gold imports and exports; (2) United States notes or greenbacks, fixed by law in 1878 at $346,681,016; (3) silver dollars and certificates, which remained practically constant; and (4) national bank notes, the volume of which was dependent on the amount of United States bonds bearing the circulation privilege outstanding, nearly all of which bonds had been acquired by national banks and pledged as security for such currency.

To remedy this situation - to provide an elastic currency, which would automatically expand and contract with the country's needs, was, as is stated in the preamble to the Federal Reserve Act, one of the primary purposes to be accomplished through the establishment of the Federal Reserve System. The Act provided, therefore, for a new form of currency to be issued against the security of commercial and agricultural paper. This was done on the theory that as the need for additional currency arose commercial and agricultural paper would be presented for rediscount at the Federal reserve banks, and as the need for currency abated the paper would be paid off with the notes and the latter retired.

The way in which this new currency, the Federal reserve note, is issued and retired may be briefly described as follows: Federal reserve notes are printed at the Bureau of Engraving and Printing and delivered by the Comptroller of the Currency to the Federal reserve agents, who hold such notes as official representatives of the Federal Reserve Board, a unit of the Federal Government. When a Federal reserve bank needs Federal reserve notes in order to meet the demands of member banks, it applies to the Federal reserve agent, who is authorized by the Board to issue the notes requested against the pledge by the bank of at least 100 per cent collateral satisfactory to the agent, such collateral to consist of eligible paper or of gold. The eligible paper may be commercial and agricultural paper and paper secured by U. S. Government obligations discounted for member banks, or bankers acceptances bought in the open market.

Federal reserve notes are paid out by the Federal reserve banks only when there is an actual demand for additional currency by the member banks to enable them to take care of the cash requirements of their customers. Taking the most simple situation, where the amount of currency in circulation at a given moment corresponds with actual requirements, any additional need for currency is met essentially as follows: (1) the customer, for example, a business man or farmer, draws a note, discounts it at his bank and requests cash; (2) the bank rediscounts the note with the Federal reserve bank and receives credit therefor in its deposit account; (3) the Federal reserve bank pledges the paper with the Federal reserve agent and receives Federal reserve notes; (4) the Federal reserve bank sends the Federal reserve notes to the member bank and charges its account; (5) the member bank delivers the notes to its customer and charges his account. In actual practice, of course, the member banks keep a sufficient amount of cash on hand to take care of current requirements and obtain cash from the Federal reserve banks whenever their supply falls below the level which experience shows to be necessary. When the need for the additional currency is over the process described is reversed and the Federal reserve notes are returned to the Federal reserve banks and by them to the Federal reserve agents for retirement.

The Federal Reserve Board through its agents may refuse to issue notes requested by the Federal reserve banks, but this option thus far has not been exercised, as it has been found that the distribution of credit as between currency and deposits adjusts itself automatically to suit the needs of business and agriculture. Any attempt on the part of the Federal Reserve Board to restrict note issues would, as a matter of fact, be ineffective unless the total volume of credit granted to member banks were restricted, as otherwise member banks would call upon the reserve banks for such currency as they required and the reserve banks, in default of a supply of Federal reserve notes, would be obliged to pay out in lieu thereof gold and other lawful money. The inevitable consequence would be to dissipate the reserves of the reserve banks, and if continued long enough would compel them to restrict the total amount of credit granted in order to avoid incurring a deficiency in reserves. Accordingly, nothing would be gained by the restriction of Federal reserve note issues that could not be better accomplished by proper supervision over the total volume of reserve bank credit granted. Such influence upon the total volume of credit as the Board is able to exercise is made effective through changes in discount rates and in rates on acceptances bought in the open market, and through purchases and sales of United States Government securities.

That banks and commerce and agriculture have adjusted their cash holdings to actual credit requirements is clearly evidenced by the fact that during the fall movement of crops and the Christmas and other holiday periods the volume of currency in circulation rises substantially but immediately declines thereafter, the decline in a period of about four weeks around the turn of the year usually amounting to approximately $400,000,000. It is further illustrated by the increases which take place in the currency circulation around the monthly and weekly pay-roll periods and the declines which follow during the subsequent few days. It is evident that neither the member banks nor the public keep on hand any more cash than is necessary to take care of their current requirements, partly because of the risk involved and partly because of the loss of income on idle funds. This creates a strong incentive for the prompt return of surplus cash to the Federal reserve banks for retirement and constitutes the real reason why the distribution of reserve bank credit in use between currency and deposits can be safely left to the discretion of the commercial and agricultural interests of the country.

The deposit of gold with Federal reserve agents as collateral security for Federal reserve notes, above referred to, amounting as it does merely to an exchange of one form of currency for another, does not affect the total volume of currency in use. The only object to be gained by issuing Federal reserve notes against gold is to conserve the gold reserves of the Federal reserve banks and thus enable them to adequately take care of the credit requirements of commerce and agriculture and to meet demands for gold for export purposes. In this connection I may state that on July 20 there were $1,676,000,000 of Federal reserve notes in actual circulation and on the same date the Federal reserve banks had deposited with the agents as collateral for notes issued to the banks $1,664,000,000 in gold.

For a more complete discussion of the note issue function I would refer you to an article printed on pages 467-478 of the July 1926 Federal Reserve Bulletin, a copy of which is being mailed to you under separate cover.

Taking up your specific inquiries as nearly as practicable in the order they appear in your letter, I note your understanding that during the first year's operation of the Federal reserve banks they received from the Government more than $4,000,000,000 of circulating notes without return of anything of any value, even without the payment of interest, and that with these notes the banks discounted commercial notes at a net profit of about $200,000,000. By referring to page 84 of the Board's 1926 annual report, a copy of which is being mailed to you under separate cover, you will note that the total amount of Federal reserve notes outstanding, i.e., issued to the Federal reserve banks by the Federal reserve agents, at the end of 1915, a little more than a year after the Federal reserve banks opened, was $214,125,000. Of this amount $189,026,000 had been paid into circulation, the remainder being held by the Federal reserve banks for the purpose of meeting future demands. On the same date, the Federal reserve agents held $197,450,000 of gold pledged by the Federal reserve banks as security against the notes, so that all of the Federal reserve notes in circulation were more than covered by gold held by the Federal reserve agents, who represent the Federal Reserve Board and therefore the Government. In other words the Federal reserve banks had merely delivered Federal reserve notes to their member banks in exchange for gold. The Federal reserve banks at this time held $83,398,000 of bills and securities discounted and purchased, of which $16,740,000 represented eligible paper pledged with the Federal reserve agents against the notes issued to the Federal reserve banks.

Earnings of the Federal reserve banks from the date of their opening, November 16, 1914, to the end of 1915 aggregated $2,173,252, as may be noted by reference to page 128 of the annual report for the year 1926, this amount being $141,459 less than current expenses, not including accrued dividends payable to member banks.

The United States Treasury usually carries between one and two million dollars of Federal reserve notes in its general fund, also a supply of other forms of currency, in order to take care of its daily cash requirements. This cash is obtained partly through ordinary receipts at Washington, but the Treasury can obtain Federal reserve notes, gold, or any other form of currency from the Federal reserve banks, the same as member banks can, by having the amount charged to its deposit account. As already explained in the discussion of the note-issue function, the law does not permit Federal reserve notes to be issued directly against Government securities. While the Federal reserve banks may discount eligible paper secured by obligations of the United States Government and pledge such paper with the Federal reserve agents as collateral security for Federal reserve notes, such eligible paper must consist of notes of customers of member banks maturing within 90 days, in which case the Government obligations belong to the customers of the member banks, or of promissory notes of the member banks themselves maturing within 15 days, in which case the Government securities belong to the member banks. It is thus seen that the Government securities used as collateral for member bank borrowings are owned by the member banks or their customers and not by the Federal reserve banks or the Government. Such use of Government securities does not, of course, affect the Government's obligation to pay interest thereon. It sould be noted, however, that the amount of paper secured by Government obligations pledged as collateral to Federal reserve notes is less than $250,000,000, interest on which at 4 per cent would be $10,000,000 per annum. An annual payment of $350,000,000 quoted in your letter would be equal to interest at 4 per cent on nearly $9,000,000,000 of securities.

Regarding the statement that between April 7, 1917, and August 1, 1919, over a billion and a half dollars in gold was taken out of the

Treasury by the Federal reserve banks by the presentation of gold certificates which the Government had previously given to the Federal reserve banks in exchange for Federal reserve notes, you will note from the following tabular statement that gold holdings of the Treasury showed a slight increase between these two dates:

GOLD HELD BY UNITED STATES TREASURY

	Apr.7, 1917	Aug. 1, 1919
Gold reserve against U. S. Notes	$152,979,025.63	$152,979,025.63
Other gold in the general fund	51,589,429.77	196,482,454.80
Gold held for the account of Federal reserve banks and agents	326,520,000.00	1,418,073,166.60
Gold held against gold certificates outstanding	1,914,011,589.00	693,408,404.00
Total	2,445,100,044.40	2,460,943,051.03

Prior to June 29, 1917, it was the practice of the Treasury to issue certificates to the Federal Reserve Board covering gold deposited with the treasury by the Federal reserve banks and agents and in order to put the figures on a comparable basis for the two dates the above table shows gold held for the account of the Federal reserve banks and agents separately in both instances.

It will be seen from the above statement that while there was an increase of about $16,000,000 in the gold holdings of the Treasury between April 7, 1917, and August 1, 1919, the proportion of such gold held for the account of the Federal reserve banks and agents increased something over a billion dollars. The reason for this is that during the above period the Federal reserve banks withdrew something over a billion dollars of gold certificates from circulation in exchange for Federal reserve notes, and deposited these gold certificates with the Treasury as a part of the gold funds maintained by them with the United States Treasury. This gold which in April 1917 was held by the Treasury in trust against gold certificates in the hands of the public, including member and non-member banks, was therefore held in August 1919 in trust for the Federal reserve banks. It is thus apparent that the gold added to the holdings of the Federal reserve banks came out of circulation and did not represent any withdrawal of gold from the Treasury. This withdrawal of gold from circulation by the Federal reserve banks resulted in building up their gold reserves and enabled them to take care of the credit requirements of member banks during the war and post-war periods.

The cost of printing, shipping and redeeming Federal reserve notes is paid by the Federal reserve banks, but the Federal Reserve Board thus far has not required the banks to pay interest on Federal reserve notes, though it may require the payment of interest on the amount of outstanding notes not secured by gold deposited with the Federal reserve agents. While the Federal Reserve Act provides that Federal reserve notes shall be obligations of the U. S. Government, it also provides that any such notes issued to a Federal reserve bank shall become a first and paramount lien on all the assets of the bank. All Federal reserve notes paid out by the Federal reserve banks are redeemable in gold or lawful money at any Federal reserve bank, or at the Treasury of the United States out of a gold redemption fund maintained by the Federal reserve banks for that purpose. It will thus be seen that the notes issued by the Federal reserve banks are in effect bank notes the same as are notes issued by other central banks. Moreover, should a Federal reserve bank be dissolved or go into liquidation, all of the assets remaining after the payment of its debts, accrued dividends and the par value of the stock would become the property of the United States. At the present timetthe gold holdings alone of the Federal reserve banks are more than 80 per cent in excess of their Federal reserve note circulation. It should also be noted, in this connection, that if interest were paid on notes issued to the Federal reserve banks, it would automatically reduce the franchise tax which the Federal reserve banks are required to pay to the Government, since the tax is based on their net profits. The franchise tax paid to the Government by the Federal reserve banks to the end of 1926 amounted to $139,992,093.

All of the Federal reserve banks act as fiscal agents of the Government, and in this capacity they issue and redeem bonds, Treasury notes and certificates, pay Government checks and coupons, receive on deposit checks in payment of income and other taxes, etc. They also perform most of the functions previously handled by the sub-treasuries, such as the issue, exchange, and redemption of United States currency and coin, but they do not have custody of the gold and silver held in trust by the Treasury or as a reserve against United States notes.

To enable the Federal Reserve banks to perform their fiscal agency functions, the Treasury maintains a deposit balance averaging around $30,000,000 with the Federal reserve banks. The account is, of course, a very active one, as may be realized when it is considered that during 1926 the Federal reserve banks paid for Government account 68,883,000 checks and coupons aggregating $4,746,602,000, and issued, redeemed and exchanged 4,691,000 securities having a face value of $4,971,442,000. No interest is paid by the Federal reserve banks on the balance maintained by the Treasury, but on the other hand the Federal reserve banks are not reimbursed at present for services performed as fiscal agents, except for expenses incurred in issuing new securities.

Besides the current deposit account maintained at the Federal reserve banks, the Treasury keeps a larger balance on deposit with member banks (averaging about $300,000,000 on recent quarterly call dates), on which it receives interest at the rate of 2 per cent per annum. From time to time the Treasury transfers funds from member banks to the Federal reserve banks in order to enable the latter to make current disbursements for Government account.

Your understanding is correct that the Federal Reserve Act exempts the Federal reserve banks from all Federal, state, and local taxation, except taxes upon real estate. The reason for this exemption is that, after the Federal reserve banks have accumulated a surplus account equivalent to their subscribed capital, 90 per cent of all net earnings remaining after the payment of dividends is paid to the Government as a franchise tax. As previously stated, the Federal reserve banks have thus far paid $139,992,093 to the Government as a franchise tax.

In the last question in your letter you ask what provision there is in the Federal Reserve Act to prevent currency inflation. As previously indicated, currency paid out to member banks by the Federal reserve banks is charged to their deposit accounts. In order, therefore, to control the volume of currency that can be issued it is necessary to control the volume of funds placed to the credit of member banks on the books of the Federal reserve banks. These deposit accounts may be built up through (1) the rediscount of eligible paper with the Federal reserve banks, (2) the deposit of funds paid out by Federal reserve banks for acceptances and securities purchased by them, and (3) the deposit of any surplus funds that may accumulate at member banks by reason of gold imports or otherwise.

The volume of paper rediscounted is dependent on member banks as the initiative in such transactions is always taken by them and not by the Federal reserve banks. The Federal Reserve Board and the Federal reserve banks do, however, exercise some control over the volume of member bank rediscounts through changes in discount rates which, in accordance with the Federal Reserve Act, are fixed "with a view of accommodating commerce and business." In the purchase of acceptances by Federal reserve banks, the initiative is also taken by the sellers of the acceptances and not by the Federal reserve banks, and the rates which the Federal reserve banks quote on acceptances offered to them are based on the same principles as discount rates on eligible paper. With regard to Government security purchases, these likewise are made with a view of accommodating commerce and business, as expressed in a resolution adopted by the Board in 1923, appearing on page 16 of its annual report for that year, to the effect "That the time, manner, character, and volume of open-market investments purchased by Federal reserve banks be governed with primary regard to the accommodation of commerce and business and to the effect of such purchases or sales on the general credit situation."

The factors taken into consideration by the Board in formulating the credit policies followed by it are discussed in some detail in its 1923 annual report, pages 29-39, a copy of which is being mailed to you under separate cover.

Let me summarize briefly if I may the replies to the two major questions which you raise, namely: the relation of the Federal reserve banks to the United States Treasury and the influence of the Federal reserve banks on expansion and contraction of credit.

As to our relationships with the Treasury, instead of being an expense to the Government, the Federal Reserve System has, during its existence, paid into the United States Treasury over $139,000,000, and, in addition is performing each year for the Treasury, free of charge, services which result in a substantial annual saving to the Government. Moreover, as fiscal agents for the Treasury, the reserve banks have been able to provide a means for greatly facilitating the Treasury financing program and the ordinary handling of Treasury receipts and disbursements. The Federal Reserve System costs the Treasury nothing but, on the contrary, benefits the Treasury both financially and otherwise.

As to the effect of the Federal Reserve System on the expansion or contraction of credit, the situation may be summarized by saying that the System's influence on the credit situation is exerted, not through the regulation of Federal reserve note issues, but primarily through its discount rate and open market operations. Its influence in this field has been directed toward the accommodation of commerce and agriculture. Under our banking organization before the inauguration of the Federal Reserve System there was no means by which there could be a national credit policy and we were subject to the unrestrained influence of every chance event such as gold exports and imports, speculation, business panics, etc. There was no means by which our banking operations could be systematically directed toward the common good. The Federal Reserve System makes possible, for the first time, an American banking policy for the service of American business and agriculture.

We shall be glad to answer any further inquiries that you may care to make or, if you can arrange it, we would be most happy to have you visit our offices in the Treasury Building, and also any of the Federal reserve banks, for such further information regarding the operation of the System as you may wish.

Very truly yours,

D. R. Crissinger,
Governor.

Honorable John J. Blaine,
Boscobel, Wisc.

C O P Y

John J. Blaine

Wisconsin

UNITED STATES SENATE

WASHINGTON, D.C.

Boscobel, Wis.,
July 15, 1927.

Mr. Walter L. Eddy, Secretary,
Federal Reserve Board,
Washington, D. C.

Dear Sir:

I would like to get some information regarding the Federal Reserve Board in operation.

I understand that during the first year's operation of the Federal Reserve Banks they received from the Government more than $4,000,000,000 of its circulating notes without return of anything of any value, even without payment of interest, and that with these notes the banks discounted commercial notes at a net profit of about $200,000,000. I also understand that the Government in its own daily business requires vast sums of these circulating notes issued by the Federal Reserve Banks and that the banks issue such notes upon depositing certain securities with the Government, and where such securities are Government bonds then the Government pays interest on such bonds so deposited with it as security for the privilege of issuing Federal Reserve circulating notes, and that on such bonds so deposited the Government pays about $350,000,000 per annum.

It is also charged that in 1917 the Federal Reserve Banks took advantage of their power to exchange Federal Reserve notes for gold and gold certificates and that between April 7, 1917, and August 1, 1919 over a billion and a half in gold was taken out of the United States Treasury by the presentation of gold certificates which the Government had previously given to the banks in exchange for Federal Reserve notes.

Am I misinformed as to the foregoing, and if I am, will you kindly outline the system in vogue relating to the foregoing matters?

I also gain the impression from the Federal Reserve Act that the Federal Reserve Banks are authorized to receive from the Government its circulating notes without interest and at the discretion of the bank as to the amount; also to discount and rediscount commercial notes, cashing them with Government notes, issued, however, by the Federal Reserve Banks as Federal Reserve notes, and to exchange Federal Reserve notes for gold, gold coin or gold certificates, and to act as the fiscal agents of the United States.

Is my information correct that as fiscal agents the Federal Reserve Banks hold all Government money other than the daily cash, the various sub-treasuries having been discontinued?

Is the interpretation of the Federal Reserve Law correct with respect to the Federal Reserve Banks with their capital stock and surplus and the increase derived therefrom being exempt from Federal, state and local taxation, except real estate holdings?

If the Federal Reserve Banks may operate as above indicated, doesn't it mean that there can be a complete inflation of money or such an increase in circulating notes as to bring about an inflation which, of course, would operate in the depreciation of the value of a dollar in purchasing power? What is there in the Federal Reserve Law to prevent such circumstance?

While, of course, the law is at hand before me, I have presented these various suggestions in order to get a comprehensive view of the practical working of the Federal Reserve system.

I would thank you to advise me fully.

Yours very truly,

(s) JOHN J. BLAINE

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Minutes of meeting of the Open Market Investment Committee for the Federal Reserve System in Washington on July 27, 1927 at 11:00 a.m.

PRESENT: Messrs. Crissinger, Platt, Hamlin, James and McIntosh, Members of the Federal Reserve Board.

Governors Strong, Harding, Morris, Fancher and McDougal, Members of the Open Market Investment Committee.

Governor Young, Federal Reserve Bank of Minneapolis.
Governor Biggs and Chairman Martin, Federal Reserve Bank of St. Louis
Mr. Harrison, Deputy Governor, Federal Reserve Bank of New York.
Mr. Mills, Undersecretary of the Treasury.
Mr. Burgess, Acting Secretary, Open Market Investment Committee.
Messrs. Noell and McClelland, Assistant Secretaries, Federal Reserve Board.

The meeting was called as a meeting of the Open Market Investment Committee with the Federal Reserve Board and representatives of two of the mid-western banks were present. The Chairman presented his report reviewing open market operations and credit conditions. The credit policy of the System was thereupon fully discussed.

Consideration was given to the continued fall in commodity prices, to the fact that there was a diminution of borrowing fromthe reserve banks due apparently to some slackening in business, and especially to the relation of money rates in the United States to money rates in Europe. It was reported that because of heavy foreign payments which are likely to increase with the fall movement of commodities to Europe, there was a continued drain on European central bank gold reserves, which made it more than likely that central bank rates in Europe would need to be further advanced this fall. The German and Austrian rates have already been once advanced and there is some probability of a one per cent advance in the rate of the Bank of England.

All present at the meeting recognized that these developments would necessarily have a depressing effect upon business abroad and might tend to restrict the freedom of purchases of goods in this country at the usual season. It was also brought out that it is the duty of the central banks to keep money rates at as low a level as may be attained with safety, and that at this time rates could be reduced not only without harm but with reasonable expectations of beneficial results. It was felt that the only possible adverse development resulting from a general lowering of discount rates would be in the speculative security markets, but that this possibility should not stand in the way of the execution of an otherwise desirable policy.

There was no exception to the view that the time had arrived, or was approaching, when the discount rate in New York should be reduced, and with one or two exceptions there was no ~~discount~~ dissent from the view that a System policy of lower discount rates should in general prevail. It was pointed out, however, that local conditions in some of the interior reserve districts did not indicate any demand for rate reductions in those districts and that the small borrowings from the reserve banks indicate an adequate supply of credit for all needs at the present rates. Officers of some of the larger member banks were quoted as opposed to rate reductions. On the other hand, it was pointed out that reductions now, which would result in no harm and considerable possible benefit, would place the reserve banks in position to make increases later which might serve as warnings without penalizing business with high rates.

It was also suggested that in order to make a three and one-half per cent discount rate effective some further purchases of securities might be desirable up to say $50,000,000.

The most important consideration at the meeting was undoubtedly the fact that the differential between the rates in New York and the rates in London was not today sufficient to enable London, and therefore the rest of Eruope, to avoid general advances in rates this autumn unless rates here were lowered, and that the consequence of such high rates as would result in Europe would be the freedom of purchases of goods in this country at the usual season. It was also brought out that it is the duty of the central banks to keep money rates at as low a level as may be attained with safety, and that at this time rates could be reduced not only without harm but with reasonable expect-

unfavorable to the marketing of our export produce abroad and would have an adverse effect generally on world trade.

Before adjournment of the meeting, the foregoing portion of these minutes was read to the meeting and adopted without objection. Thereupon, upon motion the members of the Federal Reserve Board present voted that the authority of the Open Market Investment Committee be extended for the purchase, as and when conditions warrent, of not to exceed an additional $50,000,000. of investments.

(Signed) W. R. Burgess, Acting Secretary
Open Market Investment Committee.