The Papers of Charles Hamlin (mss24661)

361_11_001-	Hamlin, Charles S., Scrap Book – Volume 187, FRBoard Members

205.001 - Hamlin Charles S
Scrap Book - Volume 187
FRBoard Members

Box 361 Folder 11

TRANSFER

CONFIDENTIAL (F.R.)

RETURN TO
FILES SECTION
DO NOT REMOVE ANY
PAPERS FROM THIS FILE

CONFIDENTIAL (F.R.)

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 25, 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 187 of Mr. Hamlin's scrap book and placed in the Board's files:

VOLUME 187

Page 13
Memo to Board from Mr. Goldenweiser re Member Bank Reserve Requirements.

Page 17
Preliminary Memorandum for the Open Market Investment Committee, January 7, 1929.

Page 56
Letter to Mr. Hamlin from Governor Harding re continuous borrowing of member banks - Has Board meeting stamp.

Page 70
Memo to Board from Mr. Smead re Bank Suspensions - Year 1928.

Page 81
(X-6223) Examination of Member Banks.

Page 107
Memo on firming tendencies of the money market by Dr. Miller.

Page 120
Earnings & Expenses of F.R. Banks - December 1928.

Page 131
Letter to Board members and member banks re financial condition in Boston District asking cooperation to avert serious developments signed by Gov. Harding.

Page 137
Discounted bills held by each F.R. Bank.

Sec 61

CONFIDENTIAL November 8, 1928

B. 13

To: FEDERAL RESERVE BOARD

From: Mr. Goldenweiser

Subject: Member Bank Reserve Requirements

Bank reserves are at the heart of our banking structure and their level and incidence are an important factor in the course of bank credit and of trade and industry. They also have a bearing on international gold movements and largely through this channel on economic conditions throughout the world. Reserve requirements as now constituted, however, being an outgrowth of a long historical evolution, do not represent a harmonious, logical plan devised with a clearly defined purpose. In view of the importance of the problem and of the consideration that has been given by the Federal reserve system to plans for revising legal requirements, it is proposed in this memorandum to consider briefly the economic functions of bank reserves and to review existing requirements and proposed changes with reference to the purposes that reserves are designed to accomplish.

Purpose of reserves

In discussions of bank reserves, it is generally taken for granted that their principal purpose has to do with the safety of bank deposits and notes. It is usually not made entirely clear whether that safety should depend primarily on the ability of banks to meet their liabilities on demand, or whether reserves should chiefly aim at maintaining public confidence in the safety of their bank notes and deposits. In this conception of reserves there is implied as an incidental function the limitation of bank expansion, since, to use familiar and inaccurate terms, a bank cannot lend all the money that is deposited with it, but must reserve a part of it to meet current demands. This requirement of law or prudence, as the case may be, limits the amount that the bank can lend. At the time when the Federal reserve system was established there appeared to be recognized a further purpose of member bank reserve requirements, namely, to provide for the use of the reserve banks sufficient funds to insure their ability to meet expenses and to influence credit conditions.

Whatever the validity of the <u>safety</u> principle of reserves may have been in the past, it appears not to be applicable to modern conditions. A bank that has a large amount of eligible paper that can be melted down at any time at the reserve bank is in a better position to meet sudden demands upon it and inspires greater confidence in its depositors than a bank that has ample reserves. The further purpose of reserves under the reserve system of supplying the reserve banks with working funds, though it meets a fundamental requirement of the situation, could be accomplished by other devices, either through provisions in regard to currency issues, through increased capital requirements, through assessments on member banks, or even through taxation. As a test of the equity and validity of existing reserve requirements, this principle of reserves would not be adequate. Under present conditions, it would appear that the principal purpose of bank reserves is that implied incidentally in the safety principle, namely, to set a limit on the expansion of bank credit. It is in the light of this principle that it is proposed in the following pages to review existing reserve requirements and changes that are under consideration.

<u>Differentials between classes of deposits</u>

Existing reserve requirements carry a series of differentials between different classes of deposits and different classes of cities. The principal differential between classes of deposits is that between time and demand deposits. From the point of view of the principle of credit control, an argument can be made for lower reserve requirements against time deposits on the general ground that the growth of time deposits, unlike the growth of demand deposits, does not in general arise directly from an expansion of bank loans, and that such deposits, unlike bank notes and demand deposits, are not generally used as means of payment. The distinction between time and demand deposits in this respect, however, is not clear-cut even in principle. There is a graduated series of different kinds of funds in the hands of the public, the successive steps of which are active demand deposits, inactive demand deposits; active time deposits; inactive time deposits; permanent savings deposits; short-time investments. The line between time and demand deposits, from the point of view of their relationship to the growth of bank credit and of the amount of reserves that should be carried against them, could logically be drawn at various points in this series. Drawing the distinction between deposits requiring 30 days notice of withdrawal and not requiring such notice may be a reasonably satisfactory compromise which has precedent and historical tradition in its favor. It is doubtful, however, whether it is possible as a matter of administration to define time deposits so as to limit them to what actually represents the country's savings. It is the rapid growth of time deposits with their low reserve requirements that has made possible an enormous growth of bank credit since 1922 with little increase in member bank reserve requirements. If the purpose of reserves is to control credit expansion, it is doubtful whether a condition is satisfactory which permits a growth of $2,300,000,000 in member bank loans and investments with only $30,000,000 of increase in reserve requirements, as happened during the year ending in June, 1928. Growth of bank credit without corresponding growth of reserves is in fact one of the important reasons why the question of reserve requirements is under consideration. In the light of existing information, it would seem that revision should be in the direction of diminishing or eliminating altogether the differential between reserve requirements against time and demand deposits, rather than in the direction of attempts to regulate the nature of time deposits through more refined administrative provisions.

Another differential is that which exempts Government deposits from all reserve requirements. This differential is generally defended on the ground that these deposits are secured by Government obligations. From the point of view of credit control, however, the security back of deposits has no bearing on the necessity for reserves. Since funds represented by Government deposits are part of the general volume of bank credit and of the public's aggregate means of payment, these deposits should be treated as to reserve requirements on the same basis as any other demand deposits.

A differential between classes of deposits which does not prevail at present but which has been proposed is a provision of higher reserve requirements for inter-bank deposits, or so-called bankers' balances. The theory underlying this proposal is that bankers' balances are subject to wider fluctuations and to more abrupt withdrawals than other deposits and consequently should be protected by higher reserves. On the principle of credit control, which underlies this memorandum, this argument alone is not adequate to support the proposal. If it is true that bankers' balances should carry higher reserves, the reasons for the differential would have to do with the function of these balances as legal reserves of nonmember banks and as operating reserves of country member banks. It may be that these balances, which themselves are in the nature of reserves, have a peculiar relation to the growth of bank credit, and for that reason may require higher reserves. Before such a decision is reached, however, it would have to be determined in what way these balances function in relation to the growth of bank credit, and whether somewhat higher reserve requirements placed upon them would serve a useful purpose in strengthening the means of control over credit expansion.

Differentials between classes of cities

Another set of differentials in existing reserve requirements is based on the character of the cities in which the banks are located. The basis of these differentials is not clear. It would appear that from the point of view of safety reserve requirements in the larger centers should be lower because they are in a better position to replenish their reserves by borrowing from the reserve banks. It is true that deposits of the banks in the larger cities have a greater velocity than those of country banks, but velocity of circulation has little bearing on the safety of deposits so long as their total volume remains relatively constant. Withdrawals by one group of depositors compensated by deposits by another group result in increased turnover of deposits but cause no strain upon a bank. On the safety principle abruptness and magnitude of withdrawals rather than velocity ought to determine the volume of required reserves. From the point of view of credit control, however, abruptness of withdrawals does not constitute a proper basis for differentials in reserve requirements. When the present differentials were originally determined in pre-Federal reserve days, they were based essentially on the same principle as the proposal now made for higher reserves for bankers' balances. The evident intention was to reach deposits located in the financial centers which constituted a large part of the reserves of other banks and which, as a consequence, were especially important and particularly subject to large and abrupt withdrawals. At the present time and on the principle of control of credit expansion, these reasons for differentials between banks in different cities are no longer conclusive, and no others have been formulated.

Recognizing the lack of essential logic in existing reserve differentials between cities, one of the proposals under consideration by the system provides that higher rates of reserves be required for New York and Chicago as the principal financial centers and intermediate ones for such other cities as have

Federal reserve banks or branches. This proposal apparently is based on the desire to have established equitable apportionment of reserves by making banks in cities with reserve facilities, which require less vault cash, carry larger balances with the reserve banks to offset that advantage. The existing level of reserves, it should be noted, is the result of allowances made for the larger cash holdings carried by country banks. In substance existing reserve requirements count as reserves, not only balances with the reserve banks, but also vault cash, only the amount of vault cash required is left to the judgment of the banks, while the amount of the balances is determined by law.

As a means of ironing out differences between banks in different cities in regard to the volume of actual reserves, arising from different vault cash requirements, the proposal has merit. If properly adjusted to conditions it would amount in effect to an abandonment of geographical differentials in reserve requirements. From the point of view of credit control, however, the question still remains whether deposits in different classes of cities may not have a different significance in relation to the general course of bank credit. If a distinction of that sort exists and can be defined, then the classification of cities throughout the country should be reviewed with reference to this characteristic. It may be that such an examination would reveal no sufficient differences between cities to justify differentials, but in any case it is clear that differentials between banks based on geographical locations must be justified by a different character or behavior of bank credit in different localities. A determination of such differences and of their bearing on reserve requirements presents a difficult and complex problem, the solution of which should precede a revision of existing differentials.

Differential against currency

Another differential inherent in the existing system of reserves is the differential against currency. This differential is not generally recognized, but is nevertheless the most powerful differential in the entire reserve structure. Under existing law, when a person borrows money from a bank in order to have a deposit account against which he may draw checks, the bank needs to hold on the average 7.5 per cent reserves against the proceeds of the loan. This means, under normal conditions, since banks usually have no excess reserves, that the bank needs to borrow that amount from the reserve bank. If, however, the person who borrows the money wants to withdraw it in cash, the member bank, since it carries no more vault cash than it requires, has to borrow the full amount of the loan from the reserve bank. In effect, therefore, the present law requires a 100 per cent reserve against loans resulting in cash withdrawals, while it requires only a 7 1/2 per cent reserve against loans resulting in the creation of deposits. When considered in the light of the usual course of economic developments this discrimination against currency is not logical. The predicate for bank inflation is laid at the time when loans are granted for the purpose of creating deposits out of which payments are made by check for an increase of inventories, the purchase of materials, etc. A demand for cash does not develop until after the fabrication of the materials has given rise to larger payrolls, or until the additional purchasing power has resulted in an advance of retail prices causing a need for more pocket money. Furthermore, at the time when a demand for additional currency develops it is usually too late to prevent an inflation of credit. The banks can refuse a loan at the time when it is requested but cannot, without suspending, refuse to pay out cash to those who have deposits previously created. A heavy pressure on banks at the stage of credit developments when cash is wanted is too late to prevent inflation and is likely to make deflation more abrupt and painful. On this ground it may be desirable to raise for consideration the existing differential against that part of purchasing power that is withdrawn in the form of currency, and to canvass the possibility of establishing a system of reserves that would impose more nearly equal reserve requirements on deposit currency and on actual cash.

Reserves of nonmember banks

A picture of the reserve structure in order to be complete must include banks that are not members of the Federal reserve system. These banks control about one-third of the banking resources of the country and this proportion may increase at any time that irksome reserve requirements imposed on member banks result in withdrawals from the system. At the present time reserves of nonmember banks consist chiefly of a small amount of cash in vault and of balances held largely with member banks. Since the cash has to be obtained from the reserve banks and since balances with the member banks require in turn reserves with the reserve banks - the volume of credit of nonmember banks is definitely linked with the reserve system. The link, however, is a slender one, and a large expansion of nonmember bank credit can take place on the basis of a very small increase in the reserves of member banks. It is realized that no immediate solution of this difficulty is possible. The ultimate solution may lie in the direction of a gradual absorption by the system of all the banks in the country, or in the direction of a gradual adoption of standard reserve requirements by state legislatures. It should, in any case, constitute a part of a complete program of revision of reserve requirements that may be adopted by the Federal reserve system.

Deductions

One of the phases of existing reserve requirements which it has been proposed to revise are certain technicalities connected with deductions of amounts due from banks in the computation of net demand deposits. Various plans are under consideration. From the point of view of credit control, it is clear that the total amount of inter-bank deposits should be deducted in arriving at the figure against which reserves must be carried. Deposits by one bank with another do not result in additional loans and investments or in additional purchasing power in the hands of the public. When one bank foregoes the investment of funds and passes it on to another bank, which makes use of the funds, there is no reason, from the point of view of credit control, why this amount should be counted more than once.

Reserves and the gold standard

The ultimate reserves of our banking structure rest with the Federal reserve banks, which must hold a 40 and 35 per cent reserve, respectively, against their liabilities on Federal reserve notes and on deposits. Reserve requirements of the reserve banks, therefore, depend on the demand of the public for currency and the demand of member banks for reserve balances, which in turn depend on the deposit liabilities of the member banks themselves. The larger the reserve requirements of member banks, therefore, the larger will be the demand for reserves by the reserve banks. Through this channel reserve requirements imposed upon member banks are a factor in the gold requirements of the reserve banks and, therefore, of the country as a whole. In planning a revision of reserve requirements it should, therefore, be kept in mind what effects such a revision may have upon the country's demand for gold. This demand should in general not be such as to subject the world supply of gold to a strain that would result in seriously disturbing credit conditions abroad. Too large gold demands by this country would necessitate higher money rates here and would subject the rest of the world to the alternative of either losing gold or raising their money rates. In either case it might act as a serious handicap to the normal course of trade and industry. It is necessary, therefore, to have reserve requirements of commercial banks and of the reserve banks be adjusted to reasonable expectations of such additions to our gold supply as would not seriously disturb financial conditions abroad. A proper level of reserves in this country is an important factor in the maintenance and proper functioning of the international gold standard.

Conclusion

In the preceding pages, an effort has been made to determine the principle on which reserve requirements should be based and to review existing and proposed requirements in the light of that principle. It has been indicated what requirements or proposals appear to be in line with what appears to be the best principle of reserves and what requirements seem to be inconsistent with it. Even such proposals, however, as are in line with the correct principle of reserves may not be advantageous if adopted by themselves without a general revision of the entire reserve structure. For example, deduction of bank balances from gross deposits instead of from amounts due to banks appears to be a move in the right direction. The immediate effect of such a measure by itself, however, would be to diminish the reserve requirements of country banks without materially affecting the reserves of city banks. Such a change would probable not be desirable because country banks appear already to have relatively lower reserve requirements, even when allowance is made for their larger volume of vault cash. This example is cited to indicate that a move which is in itself consistent with a sound reserve principle may nevertheless

R 13

not be desirable, unless it is coupled with a general reexamination of the various differentials now in existence. If an adjustment is to be made, it should be made all along the line and with reference to the cumulative effect of all the elements of adjustment. The credit and economic structure of the country are adjusted to existing reserve requirements and changes in these requirements would inevitably result in readjustment and in disturbance to the country's economic life. A revision of existing reserve requirements should, therefore, be preceded by reexamination of the problem of reserves in its bearing not only on banking developments in the United States, but also on the relation between the growth of credit in this country and the world's supply of monetary gold.

See BK
P. 17

PRELIMINARY MEMORANDUM FOR THE
OPEN MARKET INVESTMENT COMMITTEE
January 7, 1929

The total volume of business in 1928 as compared with 1927, including manufacturing, trade, crop production, building, etc., showed (as nearly as can now be estimated) an increase for the year of approximately 3 per cent.

A comparable figure for the growth in the amount of credit in use is less easy to compute because much of the increase in credit did not take the form of bank loans but rather loans made by individuals and corporations, and was reflected in the banking figures in the increased velocity of bank deposits. If, however, the growth in bank loans and investments from June 1927 to June 1928 (to take the mid-points of each year) is increased by the increase in recorded loans for individuals and corporations made on the New York Stock Exchange, there appears to have been a total increase in credit of more than 8 per cent. An equal rate of growth is shown if the figures are taken from December 1927 to December 1928, as nearly as can now be estimated.

The computation can be made another way by computing the change in bank deposits multiplied by their velocity (M V of the equation of exchange) which would give an indication of the use of credit. These figures show an increase of about 25 per cent from the last quarter of 1927 to the last quarter of 1928. This compares with a 15 per cent increase in 1927.

Thus, the best estimates that we can make indicate that the increase in the use of credit has been quite out of relation to the increase in business. In past years such a lack of relationship has usually been accompanied by changes in prices of different kinds, and often by speculation in commodities or securities. During the past year, as we know from the segregated reports, much of the increase in credit has found its way into loans to brokers on the Stock Exchange.

At a number of times during the year there was some evidence that the expansion of credit had been checked. This was true in February, in June, and again early in December. But on each occasion the expansion was again resumed after a brief pause and while the total loans and investments of reporting member banks are only slightly higher than in May of 1928, nevertheless the total of all credit in use has continued to increase.

While this credit expansion, does not as yet constitute any considerable drain on the country's basic bank reserves since it has not expanded bank deposits by any large amount, it is a potential drain for the loans made by corporations and individuals, constantly threaten to be converted into bank loans, particularly at times of strain, as was illustrated at the year-end when New York City banks were called upon to put $581,000,000 in the market in the last five days of the year, with the consequence that the reserve ratio of the New York bank was reduced to 55 per cent on December 31. So that, quite aside from any dangers that may be incident to the possibility of a deflation in the present level of stock prices, the continued growth in credit is at least a potential use of bank reserves at a more rapid rate than could be continued indefinitely especially in the face of actual and possible future losses of gold.

The Federal Reserve System thus appears to be facing at the beginning of the year the same general problem which it has faced during the entire year of 1928; that is, the problem of checking any unnecessary expansion of credit without, if possible, seriously penalizing business.

Year End Movement of Funds. The Christmas and year-end requirements for funds called into use a slightly larger additional amount of Federal reserve credit than in preceding years. Total bills and securities in the System were increased from $1,500,000,000 about the middle of November to nearly $1,900,000,000 in the last week of the year. In recent years the retirement of Federal reserve credit during January has been a little over $400,000,000, and the problem this month appears to be to make sure that the seasonal return flow of currency and credit is applied to a reduction of Federal Reserve credit in use so that it will not be made the basis of any unnecessary expansion of bank credit.

The following figures show the changes in Federal reserve credit at reporting dates of January and February in the past two years, taking as a starting point the figures for the last reporting date of the preceding year.

Changes in Supply of Federal Reserve Credit from last reporting date in previous year
(In millions of dollars)
(Cumulative figures)

		Bills		Government Securities		Discounts		Total	
1927	1928	1927	1928	1927	1928	1927	1928	1927	1928
(Dec. 29)	(Dec. 28)								
Jan. 5	Jan. 4	+ 10	+ 1	- 3	+ 24	- 78	- 88	- 70	- 63
12	11	- 41	+ 7	- 6	- 58	-221	-170	-267	-221
19	18	- 42	- 17	- 4	-104	-295	-197	-341	-318
26	25	- 77	- 39	- 14	-162	-346	-224	-438	-425
Feb. 2	Feb. 1	- 50	- 9	- 13	-169	-318	-186	-381	-364
9	8	- 76	- 17	- 12	-202	-332	-150	-421	-369
16	15	- 64	- 31	- 5	-195	-315	-128	-385	-354
23	21	- 99	- 33	- 12	-201	-313	-148	-425	-383
Mar. 2	29	- 90	- 42	- 6	-195	-276	-116	-373	-354

It will be observed from these figures that last year the diminution in the bill portfolio during January was smaller and more gradual than in 1927, thus offsetting somewhat the effectiveness of large sales of government securities. The liquidation of bills will be somewhat difficult this year because of the present relatively low position of bill rates in the market, although recent increases of bill rates should aid in securing a normal reduction of bill holdings.

If we assume a normal reduction of $50,000,000 to $100,000,000 in bill holdings during January, and a withdrawal of funds through gold earmarking of $75,000,000 in the first two weeks of the year, there might be expected to be a reduction of about $250,000,000 or $300,000,000 in bills discounted. This would mean a reduction of rediscounts for the System to $850,000,000 or $900,000,000 during January and February, or about the same amount as was maintained during October and November, a period during which there was a vigorous increase in bank credit, and during which money rates tended to ease somewhat. Already borrowings of New York City banks have been reduced to about $200,000,000 and further reductions are likely.

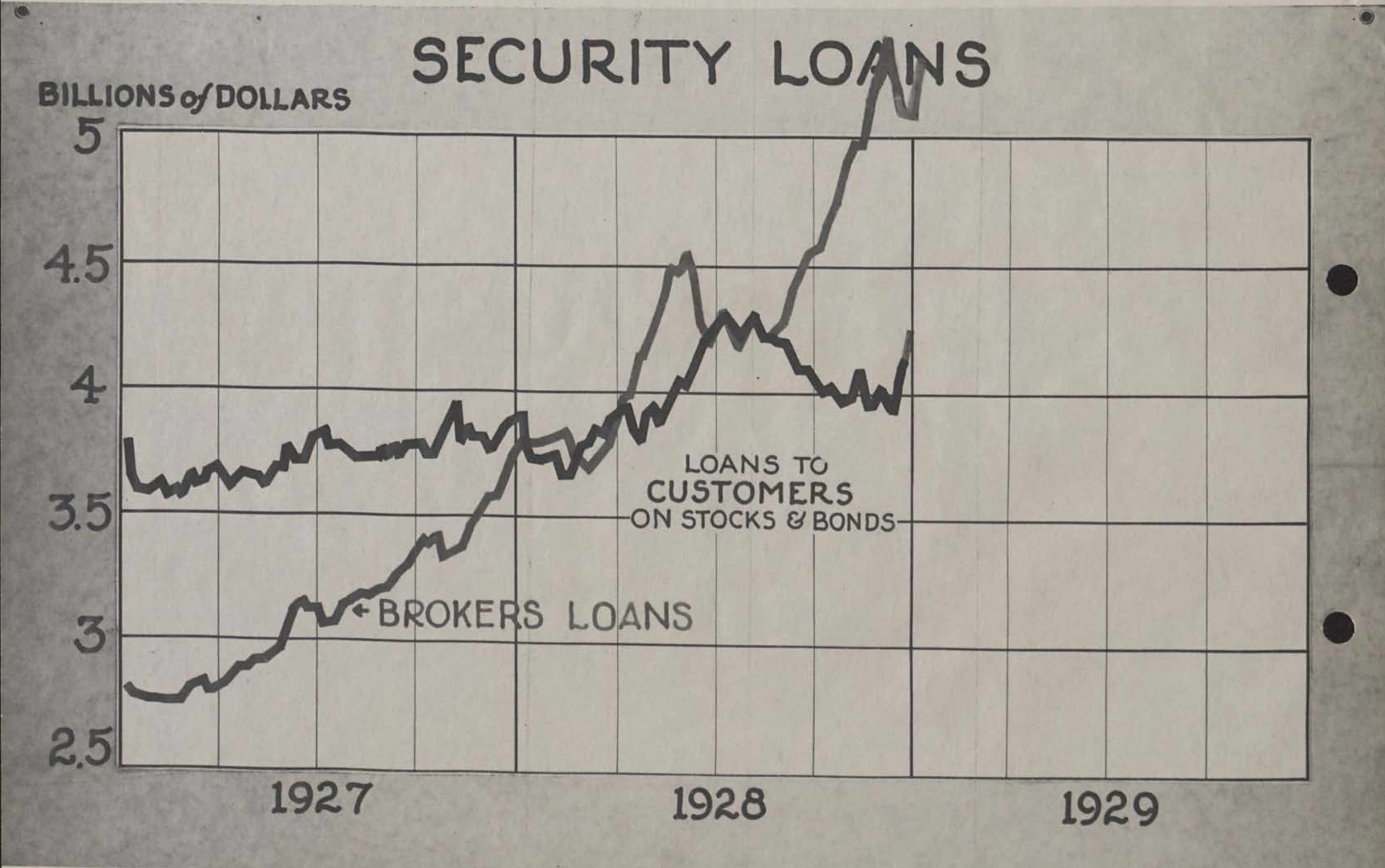
The two possible methods for maintaining the amount of discounts would be the sale of government securities or an additional liquidation of the bill portfolio beyond what normally takes place. The two possible means of making any given amount of member bank indebtedness more effective in its pressure on the credit situation, if this is regarded as necessary, would appear to be increases in discount rates or direct dealing with member banks.

In determining what, if any change in policy, should be adopted, and the methods to be employed to effect it, the three major points for consideration should, of course be

1. The effectiveness of such action in controlling unnecessary expansion of credit.

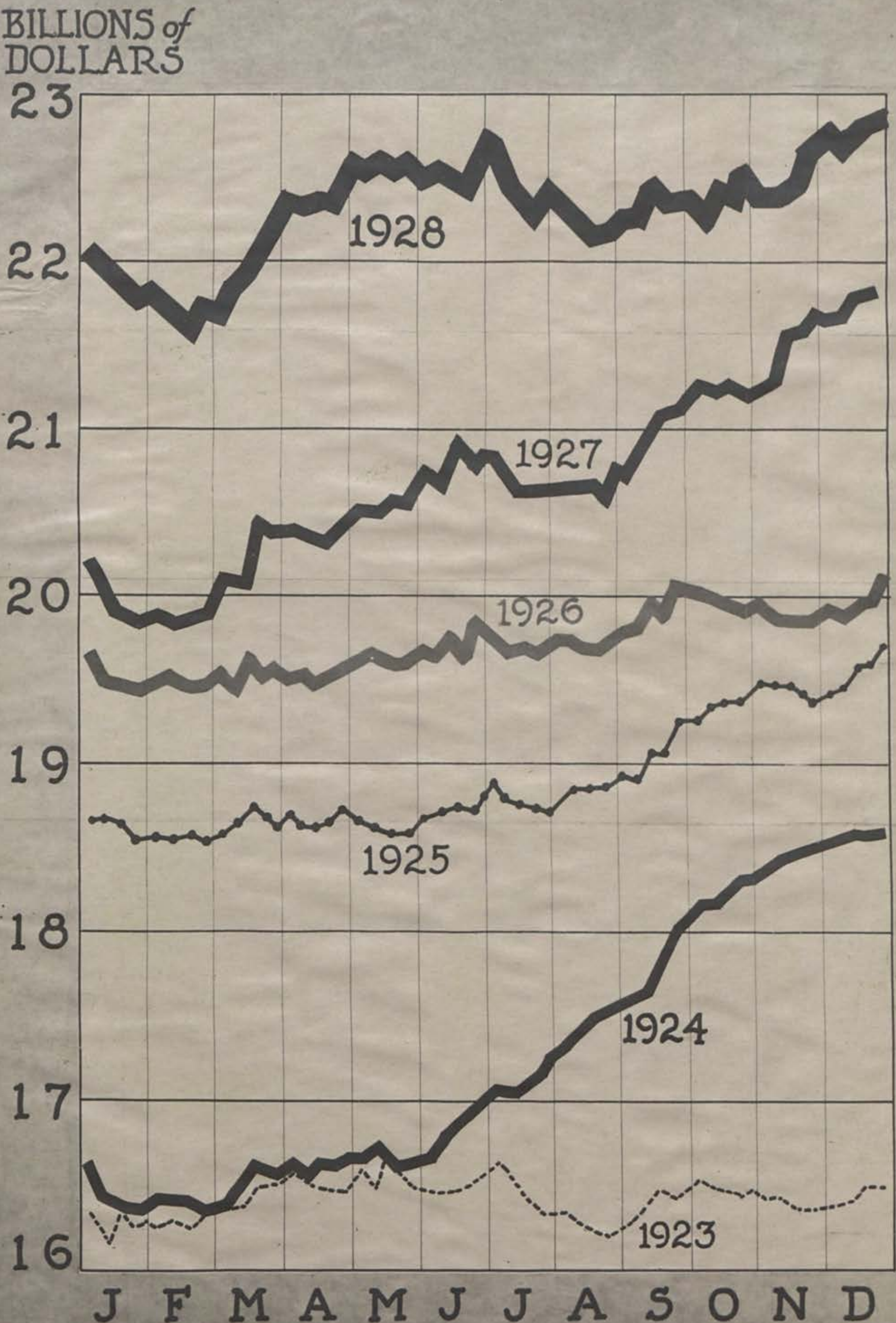
2. The effect of any such action upon domestic business.

3. The effect of such action upon the world monetary situation and indirectly upon world trade.


SECURITY LOANS
BILLIONS of DOLLARS
5
4.5
4
3.5
3
2.5
LOANS TO CUSTOMERS ON STOCKS & BONDS
BROKERS LOANS
1927
1928
1929

TOTAL LOANS & INVESTMENTS

P.17



Sec Bd

P56

FEDERAL RESERVE BANK
OF BOSTON

W. P. G. HARDING
GOVERNOR

January 22, 1929

Dear Mr. Hamlin:

In reply to your letter of January 21, I would say that the resolution which was adopted at the meeting of our Directors on June 20 last, did not refer directly to rediscounts for member banks at any time when the banks had call loans or speculative securities. This resolution referred more directly to continuous borrowings and directed attention particularly to the conditions under which member banks might properly apply for accommodation.

The resolution is as follows:

> "Resolved that in the judgment of this board of directors, the funds of the Federal Reserve Bank are primarily intended to be used in meeting the seasonal, temporary or unusual requirements of member banks and that continuous borrowing by a member bank as a general practice is inconsistent with the spirit and the intent of the Federal Reserve Act, and with the policy of this bank, and that the Governor be and he hereby is authorized and requested to bring the substance of this resolution to the attention of the officers of any member bank which shows a tendency toward making continuous use of reserve bank credit, with a view of having such continuous use terminated."

I may say that the attention of a number of our banks was directed to this resolution, and the responses received have been most gratifying.

Sincerely yours,

WPG Harding
Governor.

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

Noted
AT BOARD MEETING
JAN 24 1929
CSH

J

VOLUME 187
PAGE 56

St. 6050

January 11, 1929

Sec Bk

TO: Federal Reserve Board

Mr. Hamlin

SUBJECT: Bank Suspensions - Year 1928

FROM: Mr. Smead

P. 70

CONFIDENTIAL

There is given below a summary of bank suspensions during the year 1928 with comparative figures for the years 1921-1927. The figures shown for 1928 are, of course, preliminary, and while it is not thought that the number of suspensions will change materially, it is expected that the deposit figures will be reduced somewhat when final information is received.

	All banks			National banks		
	Number	Capital	Deposits	Number	Capital	Deposits
Total: 1921-1928	4,996	$188,296,000	$1,508,021,000	699	$42,270,000	$327,703,000
1928	483	19,292,000	157,418,000	57	4,200,000	40,549,000
1927	662	24,763,000	193,891,000	91	5,415,000	46,581,000
1926	956	32,804,000	272,488,000	125	6,020,000	47,866,000
1925	612	24,441,000	172,900,000	118	7,970,000	58,537,000
1924	777	28,373,000	213,444,000	122	7,660,000	60,889,000
1923	650	21,978,000	188,805,000	90	4,610,000	32,904,000
1922	354	13,743,000	110,721,000	45	3,335,000	19,092,000
1921	502	22,902,000	198,354,000	51	3,060,000	21,285,000
	State member banks			Nonmember banks		
Total: 1921-1928	214	15,903,000	119,439,000	4,083	130,123,000	1,060,879,000
1928	16	975,000	11,738,000	410	14,117,000	105,131,000
1927	33	2,619,000	19,755,000	538	16,729,000	127,555,000
1926	35	2,549,000	20,946,000	796	24,235,000	203,676,000
1925	28	1,950,000	8,727,000	466	14,521,000	105,636,000
1924	37	2,645,000	13,580,000	618	18,068,000	138,975,000
1923	34	2,235,000	18,324,000	526	15,133,000	137,577,000
1922	12	621,000	5,151,000	297	9,787,000	86,478,000
1921	19	2,309,000	21,218,000	432	17,533,000	155,851,000

NUMBER OF BANK SUSPENSIONS BY FEDERAL RESERVE DISTRICTS AND BY STATES

District	Total 1921-1928	1928	1927	1926	1925	1924	1923	1922	1921
Boston	16	1	1	-	2	1	3	2	6
New York	24	3	2	-	-	6	4	3	6
Philadelphia	16	1	-	4	3	2	3	1	2
Cleveland	87	17	29	9	14	6	6	1	5
Richmond	377	42	43	61	68	43	44	36	40
Atlanta	494	66	63	162	44	48	23	22	66
Chicago	734	87	124	182	109	108	53	25	46
St. Louis	404	56	82	77	53	53	24	26	33
Minneapolis	1,398	94	142	283	168	295	279	64	73
Kansas City	820	82	100	112	77	133	137	92	87
Dallas	400	24	44	50	50	53	46	51	82
San Francisco	226	10	32	16	24	29	28	31	56
Total	4,996	483	662	956	612	777	650	354	502
States									
Iowa	494	51	70	135	84	83	35	12	24
North Dakota	394	38	37	59	32	76	106	10	36
South Dakota	381	7	27	115	64	111	45	9	3
Minnesota	380	46	65	92	50	55	45	14	13
Texas	289	23	38	38	39	30	21	31	69
Georgia	287	26	18	102	31	29	11	14	56
Missouri	273	31	48	58	45	43	20	11	17
Oklahoma	246	5	28	21	21	49	54	41	27
Kansas	211	26	36	46	19	16	34	20	14
South Carolina	209	22	21	44	43	24	23	18	14
Montana	202	1	2	8	16	46	77	31	21
Nebraska	184	44	25	18	12	17	17	23	28
Florida	127	35	31	43	1	3	4	5	5
Illinois	108	18	29	20	8	14	5	4	10
North Carolina	107	8	14	11	18	13	19	9	15
Indiana	91	24	25	7	10	4	7	7	7
Colorado	84	3	4	14	15	9	18	8	13
Arkansas	83	13	18	19	8	11	5	4	5
All other states	846	62	126	106	96	144	104	83	125

VOLUME 187
PAGE 70

Sec Bk

FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

P. 81

X-6223

January 26, 1929.

SUBJECT: Examination of Member Banks.

Dear Sir:

The Federal Reserve Act requires that the cost of examinations of member banks made by the Federal reserve banks or the Federal Reserve Board through the Federal reserve agents, be assessed against the member bank examined. Within the last two weeks, bills have been introduced in both the Senate and the House of Representatives, which if enacted will amend the law in such a way as to make the charges for member bank examinations discretionary with the Board.

Upon several occasions in the past the Board has attempted, by circular letter, to define a credit investigation, but after several years experience it has arrived at the conclusion that a far too liberal interpretation has been placed upon credit investigations by the agents.

The Board has had this matter under review for some time and on October 10, passed the following resolutions which deal with the responsibility of the Federal Reserve Board in reference to member banks as it interprets the law:

> "BE IT RESOLVED, That the Federal Reserve Board recognizes its duty under the Federal Reserve Act to keep itself informed as to the condition of all member banks;
>
> "BE IT FURTHER RESOLVED, That the Board is of the opinion that it is justified in relying upon the Comptroller of the Currency for such information as to National banks;
>
> "BE IT FURTHER RESOLVED, That whenever the reports of examination of State member banks furnished by the State authorities are not deemed satisfactory either to the Federal reserve bank of the district concerned or to the Federal Reserve Board, the Federal reserve bank or the Board shall cause to be made at least one examination or investigation each year of such character as to furnish satisfactory information, the cost of such examinations to be assessed against the member banks examined."

In order to avoid duplications and unnecessary expense of operation, which now exist, the Board has voted that the Department of State Bank Examination, now in operation in the Board's quarters in Washington, be abolished, effective February 1, 1929, and that you be charged with the duty of seeing to it that the Board's views, as covered in the above resolutions, are carried out in your district. This does not mean that the Board is attempting to relieve itself of all responsibility, and you are advised that through its examining force, it will check carefully your bank examination department.

The following instructions will serve as a guide to you in performing your duties:

1. The Comptroller of the Currency is a member of the Federal Reserve Board and under the law is charged with the responsibility of enforcing the terms of the National Bank Act and also of the Federal Reserve Act. The Board therefore relies upon the Comptroller of the Currency to perform his duties and it will not be necessary for the Federal reserve agents to duplicate the work.

2. In the opinion of the Board, State reports of examination can be relied upon in the great majority of cases to furnish the necessary information to the agents.

3. If a State examination is unsatisfactory, a credit investigation will not give sufficient information for the agents to act intelligently upon and a complete examination should be made for which the member bank should be charged. This does not prohibit investigations of member banks by Federal reserve banks or Federal reserve agents without cost, because the Board realizes that unusual situations require unusual action. Therefore, the Board will act promptly by approving or disapproving the request of any Federal reserve bank or any Federal reserve agent for permission to make an investigation without cost. The Federal reserve banks, however, and the Federal reserve agents, in making such request for investigation without cost must bear in mind that if the investigation contemplates anything covered by the following language, which appears in Section 21 of the Federal Reserve Act, the Board cannot waive the cost: "The expense of such examinations shall be borne by the bank examined. Such examinations shall be so conducted as to inform the Federal reserve bank of <u>the condition of its member banks and of the lines of credit which are being extended by them.</u>"

4. If Federal reserve agents have evidence in the form of letters or otherwise, that officers and directors of State member

banks have had their attention called to violations of the law and unsound banking practices by State authorities, it is not necessary for agents to duplicate this work.

5. If this supervision is not conducted by State authorities Federal reserve agents are directed to take such action, as in their opinion, will discharge the responsibilities of the Board.

6. When a State member bank fails to show any disposition whatever to correct these irregularities within a reasonable time so as to show improvement in its condition, the Federal reserve agent will be expected to lay the information before the directors of his bank and ask them to make a formal recommendation to the Federal Reserve Board, with reasons, as to whether or not the State member bank should continue as a member.

7. Federal reserve agents are instructed to discontinue their present practice of furnishing the Federal Reserve Board with reports of examination of State member banks, except in extreme cases where they may wish to ask for advice or request the Board to cancel membership. In lieu of these reports, agents will furnish the Board with an analysis of each report received or made by them, using the enclosed analysis form. A supply of this form is being forwarded under separate cover.

The Federal reserve agents are advised that the Board thoroughly realizes that it is utterly impossible to lay down uniform, detailed procedure in each and every district because of the local conditions which exist in the 48 states. It does believe, however, that certain fundamental policies can be laid down and asks your cooperation toward that end.

Yours very truly,

R. A. Young,
Governor.

TO ALL FEDERAL RESERVE AGENTS.

C O P Y

ac b

Dr. Miller's Original draft

P.107

January 21, 1929.

The firming tendencies of the money market, which have been in evidence since the opening of the year contrary to the usual trend of money rates at this season, make it incumbent upon the Federal Reserve System to give constant and vigilant attention to the situation in order that no influence adverse to the trade and industry of the country shall be exercised by the trend of money conditions, if it is unavoidable, beyond what may develop as inevitable.

During the year 1928 through the combined influence of member banks and the Federal Reserve banks commercial rates were successfully maintained at levels appreciably lower than the trend of money market changes about mid-year indicated as probable. The problem of exerting the influence of the Federal Reserve System as a moderating influence in the movement of commercial money rates is still with us at the opening of the new year.

The extraordinary absorption of funds in speculative security loans which has characterized the credit movement in the past year or more in the judgment of the Federal Reserve Board deserves particular attention lest it become a decisive factor working toward a still further firming of money rates to the prejudice of the country's commercial interests.

The resources of the Federal Reserve System are ample for meeting any probable commercial needs of credit without difficulty or strain provided the credit facilities of the Federal Reserve System are vigilantly and efficiently administered and restricted to such uses as are proper.

The Federal Reserve Board has on different occasions and in different places, notably in its annual reports, stated its position with regard to uses of the rediscount privilege by member banks for purposes that are proper. Broadly speaking, the purposes are proper when the credit accommodation obtained from the Federal Reserve bank is for productive and distributive operations. In brief, agriculture, industry and trade. They are not proper when occasioned by extensions of speculative loans by member banks. While such loans are not prohibited either by the National Bank Act or by the Federal Reserve Act, the whole tenor of the Federal Reserve Act makes it clear that a member bank is not within its reasonable claims for rediscount facilities at a Federal Reserve bank when the occasion of its borrowing is

(a) Speculative loans that it contemplates making; or

(2) Speculative loans that it has made and which it desires not to liquidate.

There would be no difference of opinion as regards the impropriety of seeking Federal Reserve credit for the purpose of making security loans

It is the opinion of the Federal Reserve Board that the objections that lie against the use of Federal Reserve credit for the making of speculative loans also lie against the use of Federal Reserve credit for the maintaining of speculative loans.

The Federal Reserve Board has no disposition to assume authority to interfere with the loan operations of member banks so long as they do not involve the Federal Reserve banks. It has, however, a grave responsibility whenever there is evidence that member banks are maintaining a given volume of speculative security loans with the aid of Federal Reserve credit. When such is the case the Federal Reserve bank becomes either a contributing or a sustaining factor in the existing volume of security loans. And such is contrary to the intent of the Federal Reserve Act and the wholesome operation of the Federal Reserve banking system.

It is the opinion of the Federal Reserve Board that when member banks which have substantial investments of their resources in speculative security loans are called upon by their commercial customers to provide commercial accommodation, the proper course for them to pursue is to reduce their call loans and thus put themselves into a position to take care of the requirements of their commercial borrowers. The Federal Reserve Board has no disposition to question the propriety of investments by banks of surplus funds in the call loan market. The call loan market is capable of performing a useful service if investments by banks in it are treated as a secondary reserve to be availed of as occasion arises. It may become a source of mischief, if the banks are permitted to regard such investments as something not to be disturbed except under the pressure of exigent circumstances.

You are desired to bring this letter to the attention of the directors of your bank in order that they may be advised of the attitude of the Federal Reserve Board with respect to a situation and a problem confronting the administration of the Federal Reserve banks which for more than a year has been exciting widespread interest and concern.

After your directors have fully considered it the Board desires to be advised of their attitude and their views on (a) how they keep themselves fully informed as to the occasion of borrowing by their member banks: (b) what

2

methods they employ to protect their institution against improper use of its credit facilities by member banks; and (c) what other steps they propose to take in working out a further procedure where existing methods are not proving fully effective.

The Board realizes that the problem of adequate control against misuse of the credit facilities of the Federal Reserve banks of the kind that have given rise to this letter is not free of difficulties. It also appreciates that no one method of procedure would be equally effective in all districts and in all circumstances. It is, therefore, not disposed to be dogmatic in its own attitude. It is, however, firm in the opinion that a more effective control is needed if the Federal Reserve System is to function satisfactorily and that methods of control suitable to the situation and not invasive of the privacy of member bank operation can be worked out by each Federal Reserve bank that will have the approval and support of the majority of the member banks of the Federal Reserve System and the general body of public opinion.

The Federal Reserve Board will await with deep interest the reply of your directors to this letter and bespeaks their prompt attention in order that it may have their reply at an early date.

A. C. M.

Chairman and Board of Directors
of each Federal Reserve Bank.

See B4

(2)

January 22, 1929.

CSH.

Sent to each Member

Dr. Miller's Memorandum of January 21, 1929.

Suggestions for Changes.

On Page 1, line 25, substitute for the word "proper", the phrase "consistent with the terms or spirit of the Federal Reserve Act", and change the following sentence so it will read, "broadly speaking, such consistency exists when the credit accommodation, etc."

Line 28. Substitute for the word "proper" the word "consistent."

Line 28. Substitute for the word "occasioned" the word "necessitated."

On Page 2, line 20. Substitute for the word "investments" the words "secondary reserves."

Line 21. Substitute for the phrase "something not to be disturbed, etc." the following: "as something not to be used to meet the necessities of agriculture, business, and commerce."

Line 21. Insert between lines 21 and 22 a new paragraph as follows:

"The Federal Reserve Board does not intend, by this circular, to advocate any sudden, drastic ~~deflation~~ liquidation of existing speculative loans. It simply lays down a procedure primarily for the future, with the feeling, however, that a gradual conservative liquidation of present speculative loans may be brought about without injury, ~~to speculative borrowers,~~ thus releasing Federal Reserve credit for normal purposes.

D

"The Board further realizes that the policy herein expressed has, in effect, been carried out in the past by some of the Federal Reserve banks, and, in other Federal Reserve banks, has been attempted with varying degrees of success."

January 23, 1929.

Sent to each Member

Dr. Miller's Memorandum of January 21, 1929.

Additional Suggestions.

To my mind, this whole question involves a determination of what is good banking. There is a great distinction between good banking and doubtful banking, even when the latter is within the limits of the law.

I do not believe we can lay down, as a matter of law, that a Federal Reserve Bank can not lawfully discount paper for a member bank, even though the use of the funds is made to make up reserve deficiencies caused, in part, by speculative loans. For example, a bank which is not a regular discounter presents eligible paper to secure funds to make good its reserves which are depleted in part by speculative loans. These loans are lawful for the member bank to make, and the Act provides that the reserves against deposits arising out of these loans must be deposited and maintained in the Federal Reserve Bank, and a penalty is provided if the reserves are not promptly made good when a deficiency occurs. I do not think it can be claimed that, under the Act as a matter of law, we are bound to decline to discount paper to be used for this purpose, for a bank might be in the position where it would have no other means of making good its reserves than the discounting of eligible paper. Where a bank is a continuous borrower, it seems to me that it is really obtaining capital from the Federal Reserve Banks, and this, except in extraordinary crises, can not be considered good and proper banking. I believe today many banks in the United States are really obtaining capital through rediscounting, and under present conditions this would seem objectionable, whether that capital is used for speculative loans or even for ordinary commercial transactions.

As stated above, I believe a bank legally may rediscount commercial paper, although its ultimate use is to replenish reserves depleted by speculative loans, but I further believe that it is the duty of the bank to inquire into the operations of its member banks and to use direct pressure to see that a proper proportion is maintained between its speculative loans and its ordinary commercial loans, especially in the situation which now confronts us where business is threatened by a continuation of the speculative activity now going on throughout the country.

----

(4)

See BM

January 30, 29.

cctt.
submitted to other Bd Members

Dr. Miller's Letter.

Substitute for the 5th paragraph, the following:

A "Broadly speaking, borrowing by a member bank from its Federal Reserve bank is proper when confined primarily to productive and distributive operations, in agriculture, industry, or trade."

Substitute for the 6th paragraph, the following:

B "The Federal Reserve Act does not contemplate the frequent or continuous use of the resources of the Federal Reserve banks for the creation or extension of speculative credit. A member bank is not within its reasonable claims for rediscount facilities at its Federal Reserve bank when it borrows frequently or continuously either for the purpose of making speculative loans, or for the purpose of maintaining such loans."

(For example, - if a member bank which is not a frequent or continuous borrower, presents eligible paper for rediscount in order to replenish a deficiency in its reserves caused, in part, by speculative loans, it surely would not be contended that the Federal Reserve bank should refuse such discount.)

Mr. Hamlin (5) (1) See BH

LETTER SUBMITTED BY MR. MILLER JANUARY 29th, AS SUBSTITUTE FOR LETTER APPROVED JANUARY 24th.

The firming tendencies of the money market which have been in evidence since the beginning of the year - contrary to the usual trend of money rates at this season - make it incumbent upon the Federal reserve banks to give constant and close attention to the situation in order that no influence adverse to the trade and industry of the country shall be exercised by the trend of money conditions, beyond what may develop as inevitable.

The extraordinary absorption of funds in speculative security loans which has characterized the credit movement during the past year or more in the judgment of the Federal Reserve Board deserves particular attention lest it become a decisive factor working toward a still further firming of money rates to the prejudice of the country's commercial interests.

The resources of the Federal Reserve System are ample for meeting the growth of the country's commercial needs for credit, provided they are competently administered and protected against seepage into uses not contemplated by the Federal Reserve Act.

The Federal Reserve Board has on different occasions, notably in its Annual Reports, stated its position with regard to the use of the rediscount privilege by member banks for purposes that come within the intent of the Federal Reserve Act and, therefore, are to be regarded as proper.

Broadly speaking, borrowing by a member bank from its Federal reserve bank is proper when the credit accommodation sought and obtained is for productive and distributive operations - in agriculture, industry or trade.

The Federal Reserve Act does not, however, contemplate the use of the resources of the Federal reserve banks for the creation or extension of speculative credit. A member bank is not within its reasonable claims for rediscount facilities at its Federal reserve bank when it borrows either for the purpose of making speculative loans or for the purpose of maintaining speculative loans.

The Federal Reserve Board has no disposition to assume authority to interfere with the loan practices of member banks so long as they do not involve the Federal reserve banks. It has, however, a grave responsibility whenever there is evidence that member banks are maintaining speculative security loans with the aid of Federal reserve credit. When such is the case the Federal reserve bank becomes either a contributing or a sustaining factor in the current volume of speculative security credit. This is not in harmony with the intent of the Federal Reserve Act nor is it conducive to the wholesome operation of the banking and credit system of the country.

You are desired to bring this letter to the attention of the directors of your bank in order that they may be advised of the attitude of the Federal Reserve Board with respect to a situation and a problem confronting the administration of the Federal reserve banks, which for more than a year has been exciting widespread interest and concern.

The Board realizes that the problem of adequate control against misuse of the credit facilities of the Federal reserve banks of the kind that have given rise to this letter is not free of administrative difficulties. It views the matter primarily as one of good operating practice. It also appreciates that no one method of procedure would be equally effective in all districts and in all circumstances. It is, therefore, not disposed to be dogmatic in its own attitude. It is, however, of the opinion that, taking the Federal reserve banks as a whole, the problem has not yet been completely met and that the situation admits of improvement. It is also of the opinion that methods of handling the problem suitable to the situation and not invasive of the privacy of member bank operation can be worked out by each Federal reserve bank that will have the approval and support of the majority of the member banks of the Federal Reserve System and the general body of public opinion.

The Federal Reserve Board will await with deep interest the reply of your directors to this letter and bespeaks their prompt attention in order that it may have their reply at an early date.

By direction of the Federal Reserve Board.

Very truly yours,

Walter L. Eddy,
Secretary.

Chairman and Board of Directors
of each Federal Reserve Bank.

6

See BM

LETTER SUBMITTED BY DR. MILLER JANUARY 29th, AS SUBSTITUTE FOR LETTER APPROVED JANUARY 24th.

(Suggestions for amendment by C. S. Hamlin and E. H. Cunningham)
Submitted only to Miller who made slight changes in original draft

The firming tendencies of the money market which have been in evidence since the beginning of the year - contrary to the usual trend of money rates at this season - make it incumbent upon the Federal Reserve banks to give constant and close attention to the situation in order that no influence adverse to the trade and industry of the country shall be exercised by the trend of money conditions, beyond what may develop as inevitable.

The extraordinary absorption of funds in speculative security loans which has characterized the credit movement during the past year or more in the judgment of the Federal Reserve Board deserves particular attention lest it become a decisive factor working toward a still further firming of money rates to the prejudice of the country's commercial interests.

The resources of the Federal Reserve System are ample for meeting the growth of the country's commercial needs for credit, provided they are competently administered and protected against seepage into uses not contemplated by the Federal Reserve Act.

The Federal Reserve Board has on different occasions, notably in its Annual Reports, stated its position with regard to the use of the rediscount privilege by member banks for purposes that come within the intent of the Federal Reserve Act and, therefore, are to be regarded as proper.

Broadly speaking, borrowing by a member bank from its Federal Reserve bank is proper when the credit accommodation sought and obtained is for productive and distributive operations - in agriculture, industry or trade.

(Mr. Hamlin) (Broadly speaking, borrowing by a member bank from its Federal Reserve bank is proper when confined <u>primarily</u> to productive and distributive operations, in agriculture, industry, or trade.)

The Federal Reserve Act does not, however, contemplate the use of the resources of the Federal Reserve banks for the creation or extension of speculative credit. A member bank is not within its reasonable claims for rediscount facilities at its Federal Reserve bank when it borrows either for the purpose of making speculative loans or for the purpose of maintaining speculative loans.

(Mr. Hamlin) (The Federal Reserve Act does not contemplate the <u>frequent or continuous use</u> of the resources of the Federal Reserve banks for the creation or extension of speculative credit.

A member bank is not within its reasonable claims for rediscount facilities at its Federal Reserve bank when it borrows frequently or continuously either for the purpose of making speculative loans, or for the purpose of maintaining such loans.)

The Federal Reserve Board has no disposition to assume authority to interfere with the loan practices of member banks so long as they do not involve the Federal Reserve banks. It has, however, a grave responsibility whenever there is evidence that member banks are maintaining speculative security loans with the aid of Federal Reserve credit. When such is the case the Federal Reserve bank becomes either a contributing or a sustaining factor in the current volume of speculative security credit. This is not in harmony with the intent of the Federal Reserve Act nor is it conducive to the wholesome operation of the banking and credit system of the country.

You are desired to bring this letter to the attention of the directors of your bank in order that they may be advised of the attitude of the Federal Reserve Board with respect to a situation and a problem confronting the administration of the Federal Reserve banks, which for more than a year has been exciting widespread interest and concern.

(Mr. Cunningham) (You are desired to bring this letter to the attention of the directors of your bank in order that they may be advised of the attitude of the Federal Reserve Board with respect to this situation and problem confronting the administration of the Federal Reserve banks, and the Board would like to have from them an expression of (a) how they keep themselves fully informed of the use made of borrowing by their member banks, (b) what methods they employ to protect their institution against the improper use of its credit facilities by member banks, and (c) how effective their policy has been.)

The Board realizes that the problem of adequate control against misuse of the credit facilities of the Federal Reserve banks of the kind that have given rise to this letter is not free of administrative difficulties. It views the matter primarily as one of good operating practice. It also appreciates that no one method of procedure would be equally effective in all districts and in all circumstances. It is, therefore, not disposed to be dogmatic in its own attitude. It is, however, of the opinion that, taking the Federal Reserve banks as a whole, the problem has not yet been completely met and that the situation admits of improvement. It is also of the opinion that methods of handling the problem suitable to the situation and not invasive of the privacy of member bank operation can be worked out by each Federal Reserve bank that will have the approval and support of the majority of the member banks of the Federal Reserve System and the general body of public opinion.

(It should be understood that the Federal Reserve Board is not suggesting or advocating any sudden, drastic liquidation of existing speculative loans. On the contrary, it is simply laying down a procedure primarily for the future, with the feeling and hope, however, that a gradual conservative liquidation of present speculative loans (Mr. Hamlin) may be brought about or may occur naturally without injury, thus releasing Federal Reserve credit for business and agricultural purposes.

The Federal Reserve Board will await with deep interest the reply of your directors to this letter and bespeaks their prompt attention in order that it may have their reply at an early date.

By direction of the Federal Reserve Board,

Very truly yours,

Walter L. Eddy,
Secretary.

Chairman and Board of Directors
of each Federal Reserve Bank.

Form No. 131 (7)

Office Correspondence

FEDERAL RESERVE BOARD

Date January 31, 1929.

See Bk

To Mr. Hamlin

Subject:

From Mr. McClelland

2—8495

adopted by Board

There is quoted below the amendment to the letter under consideration by the Board which Mr. Cunningham submitted yesterday:

C "You are desired to bring this letter to the attention of the directors of your bank in order that they may be advised of the attitude of the Federal Reserve Board with respect to this situation and problem confronting the administration of the Federal Reserve Banks, and the Board would like to have from them an expression of (a) how they keep themselves fully informed of the use made of borrowing by their member banks, (b) what methods they employ to protect their institution against the improper use of its credit facilities by member banks, and (c) how effective their policy has been."

(8)

Miller Resolution

as issued Feb 2.'29

February 2, 1929.

Dear Mr. Curtiss:

The firming tendencies of the money market which have been in evidence since the beginning of the year - contrary to the usual trend at this season - make it incumbent upon the Federal reserve banks to give constant and close attention to the situation in order that no influence adverse to the trade and industry of the country shall be exercised by the trend of money conditions, beyond what may develop as inevitable.

The extraordinary absorption of funds in speculative security loans which has characterized the credit movement during the past year or more, in the judgment of the Federal Reserve Board, deserves particular attention lest it become a decisive factor working toward a still further firming of money rates to the prejudice of the country's commercial interests.

The resources of the Federal Reserve System are ample for meeting the growth of the country's commercial needs for credit, provided they are competently administered and protected against seepage into uses not contemplated by the Federal Reserve Act.

The Federal Reserve Act does not, in the opinion of the Federal Reserve Board, contemplate the use of the resources of the Federal reserve banks for the creation or extension of speculative credit. A member bank is not within its reasonable claims for rediscount facilities at its Federal reserve bank when it borrows either for the purpose of making speculative loans or for the purpose of maintaining speculative loans.

The Board has no disposition to assume authority to interfere with the loan practices of member banks so long as they do not involve the Federal reserve banks. It has, however, a grave responsibility whenever there is evidence that member banks are maintaining speculative security loans with the aid of Federal reserve credit. When such is the case the Federal reserve bank becomes either a contributing or a sustaining factor in the current volume of speculative security credit. This is not in harmony with the intent of the Federal Reserve Act nor is it conducive to the wholesome operation of the banking and credit system of the country.

You are desired to bring this letter to the attention of the directors of your bank in order that they may be advised of the attitude of the Federal Reserve Board with respect to this situation and the problem confronting the administration of Federal Reserve banks. The Board would like to have from them an expression as to (a) how they keep themselves fully informed of the use made of borrowingsby their member banks, (b) what methods they employ to protect their institution against the improper use of its credit facilities by member banks, and (c) how effective these methods have been.

The Board realizes that the problem of protecting the credit situation from strain because of excessive absorption of credit in speculative security loans is attended with difficulties. It also realizes that there are elements in the situation which are not readily amenable to recognized methods of banking control. The Board nevertheless believes that, however difficult, the problem can be more completely met and that the existing situation admits of improvement.

The Federal Reserve Board awaits the reply of your directors to this letter and bespeaks their prompt attention in order that it may have their reply at an early date.

By direction of the Federal Reserve Board.

Very truly yours,

E. M. McClelland,
Assistant Secretary.

Mr. Frederic H. Curtiss, Chairman,
Federal Reserve Bank,
Boston, Massachusetts.

P 120

Sec Bk

CONFIDENTIAL
Not for publication

EARNINGS AND EXPENSES OF FEDERAL RESERVE BANKS, DECEMBER 1928.

St. 6089

Federal Reserve Bank	Month of December 1928 — Earnings from — Discounted bills	Purchased bills	U. S. securities	Other sources	Total	Current expenses — Exclusive of cost of F.R. currency	Total	Current net earnings — Amount	Ratio to paid-in capital	January - December 1928 — Current net earnings	Dividends accrued	Available for reserves, surplus and franchise tax.*
									Per cent			
Boston	$276,947	$187,854	$27,150	$8,736	$500,687	$158,977	$160,576	$340,111	39.5	$2,595,339	$590,830	$1,863,961
New York	1,252,368	580,217	292,041	121,812	2,246,438	511,903	555,616	1,690,822	39.9	12,038,777	2,743,725	8,885,563
Philadelphia	393,000	62,605	68,420	14,306	538,331	154,896	156,844	381,487	31.0	3,408,304	843,755	2,438,244
Cleveland	464,506	208,464	104,860	24,577	802,407	220,034	222,980	579,427	47.4	3,653,739	856,843	2,667,203
Richmond	174,456	102,970	10,191	10,878	298,495	116,205	117,363	181,132	35.0	1,455,256	370,683	977,428
Atlanta	248,636	119,413	17,695	12,791	398,535	115,932	117,382	281,153	63.5	2,325,022	312,259	1,941,146
Chicago	762,770	161,739	132,057	56,110	1,112,676	299,755	304,116	808,560	51.7	5,239,739	1,099,761	3,880,660
St. Louis	168,114	43,298	74,903	7,087	293,402	117,152	117,925	175,477	38.3	1,565,131	321,855	799,954
Minneapolis	42,139	81,762	39,476	15,940	179,317	91,490	92,212	87,105	34.2	709,830	181,203	486,989
Kansas City	172,539	19,436	34,628	6,443	233,046	122,431	123,632	109,414	30.6	935,988	253,254	574,815
Dallas	69,692	98,366	47,540	25,859	241,457	111,849	112,143	129,314	35.3	874,187	258,544	497,636
San Francisco	230,633	204,303	55,257	14,213	504,406	195,162	197,564	306,842	33.3	2,346,738	625,751	1,595,976
TOTAL												
Dec. 1928	4,255,800	1,870,427	904,218	318,752	7,349,197	2,215,786	2,278,353	5,070,844	40.8			
Nov. 1928	3,615,684	1,759,800	793,790	131,336	6,300,610	2,181,348	2,222,864	4,077,746	34.0			
Dec. 1927	1,569,894	1,026,409	1,686,625	242,819	4,525,747	2,121,307	2,267,966	2,257,781	20.1			
Jan.-Dec. 1928	38,334,141	13,020,535	10,827,702	1,870,482	64,052,860	26,098,910	26,904,810	37,148,050	26.4	37,148,050	8,458,463	26,609,575
1927	17,010,778	9,206,675	14,206,172	2,600,859	43,024,484	25,673,603	27,518,443	15,506,041	12.0	15,506,041	7,754,538	7,113,387

*After adjustment for current profit and loss entries, purchases of furniture and equipment, etc.

FEDERAL RESERVE BOARD
DIVISION OF BANK OPERATIONS
FEBRUARY 6, 1929.

C.

COPY

Sec Bd

FEDERAL RESERVE BANK

OF BOSTON

P. 131

February 6, 1929.

PERSONAL AND CONFIDENTIAL

TO THE MEMBER BANK ADDRESSED:

The financial situation in this district is such that we feel we are justified in discussing it frankly with you and to request your cooperation in averting the development of conditions which might be serious. For several months past, taking the district as a whole, there has been a decline in the volume of deposits in member banks, and during the year 1928 savings deposits in New England showed a decline for the first time in many years, due probably to investments made by depositors.

An analysis made of the statements of our member banks shows that several of them who are borrowing from the Federal reserve bank have outstanding call loans which, if paid or reduced, would avert the necessity of their borrowing from us, and in many cases their loans to customers on collateral have increased very materially during the past year and are, from information received in certain specific cases, still increasing. Ordinarily loans and advances by this bank to member banks reach a high point during the month of December due to a seasonal demand, and these advances are liquidated during the month of January. In 1927, our loans to member banks reached their high point on December 15 - \$42, 104,000, and by January 27, 1928, this amount was reduced to \$19,511,000. In 1928, our loans and advances to member banks reached their high point on December 26, the amount being nearly 92 million dollars. By January 9, 1929, this amount had been reduced to approximately 47 million dollars, and up to February 2, there was a steady increase until on that date our total loans and advances to member banks stood at \$83,366,000, being distributed among 169 borrowing banks as compared with \$34,680,000 on February 2, 1928 to 95 banks. During this period, our advances to member banks showed an increase in the City of Boston, in Massachusttts outside of Boston and in each of the other five states in the district.

The amount of our Federal reserve notes outstanding, however, has decreased from \$167,759,000 on December 24, 1928 to \$132,831,000 on February 4. This represents the decrease usually noted at this season of the year and indicates that the demand upon us has not been caused by currency requirements. Just now we are between seasons, agricultural operations have not begun, textile and other industries are not heavy buyers of material for the time being, and the increase in our loans to member banks at a time when ordinarily they are well liquidated, indicates that the demand upon us is occasioned either by a decline in deposits, loans in the call money market, or by collateral loans to customers.

As you know, Boston is an important acceptance market both as to the creation and distribution of bills. It ranks next to New York in this respect. Because of the fact that many dealers have offices both in New York and Boston, we are compelled in the matter of our bill purchases to follow the Federal Reserve Bank of New York very closely both as to policy and as to rates. Partly because of the attitude of other Federal reserve banks with respect to bills and partly because of our large advances to member banks, we have recently been obliged to restrict our purchases of bills although we continue to do what we can to protect the local acceptance market in a legitimate way by giving preference to short term bills and to bills created in this district. On Friday, January 11, our bill portfolio reached its high mark, $76,432,000, but because of our restriction of purchases, the amount of bills we are now carrying in our portfolio has been reduced to about 58 million dollars.

Looking back for many years past, we find that there has always been a seasonal demand on us from member banks about the first of March and we see no reason why we should not anticipate such a demand this year. We wish to put ourselves in position to meet all legitimate demands when they are made upon us and the object of this letter is to request all of our present or prospective borrowers to assist us as far as possible in building up a strong reserve before the Spring demand arises. It is rather mortifying to the officers and directors of the Federal Reserve Bank of Boston and we are sure that it is also to our member banks, that this Federal reserve bank should have the lowest reserve of any of the twelve banks in the System, especially at a time when we know that such a condition is not caused by commercial, agricultural or industrial activities. A few days ago our reserve percentage was under 52%, although we are glad to say that there has been a considerable improvement since the low point was reached. We feel, however, that we are justified in bringing to your attention the matters touched upon in this letter lest there should be a renewal of the unseasonable demand upon us.

Our situation in this district has attracted the attention of the Federal Reserve Board which has addressed a letter to us calling attention to the fact that the only paper eligible for rediscount at a Federal reserve bank is paper the proceeds ofwhich have been used or are to be used for commercial, agricultural or industrial purposes, and that it is the view of the Board that member banks should not use their eligible paper in order to obtain funds for call loans or for loans on collateral, for under the terms of the Federal Reserve Act, loans made for the purpose of carrying investments are not eligilbe for rediscount at a Federal reserve bank. We appreciate the fact that it is very difficult for a bank to decline to make a collateral loan to a good customer, and we are not asking that you refuse to make such loans, nor do we ask that "loans on call" be called by banks which are only occasional and temporary borrowers from us, but those banks which have been borrowers from us for weeks or months at a time and which have call loans outstanding should reduce them for the purpose of liquidating their indebt-

P. 131

edness to us; and we urge the banks to do what they can, as far as they feel that they can do so without prejudice to their business, to discourage their customers in the matter of collateral loans in order to relieve the pressure upon the Federal reserve bank.

This letter is not written with any view of dictating to a member bank how it should conduct its credit policy, but rather to bring the situation to the attention of the banks and to invite their cooperation in carrying out what we believe to be a sound policy. It will be remembered that conditions in January 1920 were such that the Federal reserve banks, with the approval of the Federal Reserve Board, were compelled to adopt a very drastic policy and we are sure that we are all anxious to avert the necessity of adopting such a policy at the present time.

This letter is not being sent to all of our member banks and we are sure that you realize the importance of treating it as confidential.

Very truly yours,

(S) W. P. G. Harding,
Governor.

P. 137

See BA

CONFIDENTIAL
For use of Federal
Reserve Board only

DISCOUNTED BILLS HELD BY EACH FEDERAL RESERVE BANK AND TOTAL BILLS AND SECURITIES HELD BY THE SYSTEM
(In millions of dollars)

St. 3438

	Boston	N.Y.	Phila.	Cleve.	Rich.	Atla.	Chicago	St. Louis	Minn.	K.C.	Dallas	S.Fran.	System: Discounted bills	System: Purchased bills	System: U. S. securities	System: Total bills and securities #
Daily average holdings																
1928																
January	23	153	44	51	*27	29	*59	17	4	13	4	41	465	373	512	1,350
February	*45	*119	*53	51	27	*28	51	*24	*4	*11	*4	*52	471	360	406	1,237
March	49	130	49	*57	28	25	68	26	3	11	4	63	513	343	415	1,272
April	*44	211	53	61	*35	39	*88	*33	*10	19	8	61	661	358	351	1,371
May	60	*295	*60	*68	43	*52	110	39	11	23	*9	64	836	349	257	1,442
June	85	376	80	89	48	60	136	53	9	*22	11	*49	1,019	244	232	1,495
July	*68	*383	*94	101	*55	*68	*157	*55	12	24	17	57	1,090	185	213	1,488
August	61	321	99	*80	57	77	159	59	18	23	30	77	1,061	178	210	1,449
September	51	352	106	78	57	83	114	65	18	24	30	87	1,064	226	240	1,534
October	46	300	94	75	48	79	134	50	18	31	25	74	975	368	237	1,584
November	51	238	79	86	42	69	139	44	16	43	21	70	897	471	238	1,610
December	65	299	91	108	41	58	179	40	10	44	18	60	1,013	483	263	1,766
1929																
January	60	246	73	80	41	59	143	37	12	33	21	55	859	473	229	1,570
Holdings on Feb. 6	**62**	**195**	**70**	**81**	**39**	**59**	**151**	**39**	**13**	**37**	**23**	**82**	**852**	**411**	**200**	**1,472**

*Discount rate changed. #Includes "other securities".

FEDERAL RESERVE BOARD, DIVISION OF BANK OPERATIONS.

VOLUME 187
PAGE 137