The Papers of Charles Hamlin (mss24661)

365_09_001-	Hamlin, Charles S., Scrap Book – Volume 225, FRBoard Members

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 6, 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 225 of Mr. Hamlin's scrap book and placed in the Board's files:

VOLUME 225

Page 11
Memo to Mr. Hamlin from Mr. Goldenweiser re "The Movement of Commodity and Common Stock Prices".

Page 39
Preliminary Memo for the Open Market Policy Conference, February 24, 1932.

Page 55
Memo to Board from Mr. Smead re Bank Suspensions during 1931.

Page 61
Memo to Mr. Hamlin from Mr. Wyatt re H.R. 10241.

Page 71
Memo to Mr. Hamlin from Mr. Smead re Estimated possible increase in "free gold" under the Glass-Steagall Bill.

Page 73
Letter from Mr. Hamlin to Hon. Chas. Warren re French debt.

Page 87
(X-7115) Advances to member banks under Sections 10(a) and 10(b) of the F.R.Act, as amended February 27, 1932.

Page 109
Memo to Mr. Hamlin from Mr. Smead re Changes in Reserve Bank credit, production index, and member bank loans, during selected periods.

Page 111
Letter to Mr. Platt from Mr. Hamlin re Federal Reserve notes and attached memo to Mr. Hamlin from Mr. Smead.

Page 113
Memo to Mr. Hamlin from Mr. Smead re Federal Reserve notes.

Page 119
Memo to Mr. Morrill from Mr. Smead re Steagall Bill, H.R. 10241.

Page 121
Memo to Mr. Hamlin from Mr. Wyatt re Provisions of the Steagall Bill (H.R. 10241) re par clearance and immediate credit.

Page 128
Memo to Mr. Hamlin from Mr. Smead re classification of bankers acceptances held by F.R. Banks.

Page 129
Memo to Mr. Hamlin from Mr. Goldenweiser re price movements with changes in money in circulation and in Reserve Bank credit.

Page 149
Memo to Mr. Hamlin from Mr. Van Fossen re average amount of Reserve Bank credit.

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Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date March 2, 1932

To Mr. Hamlin

Subject: The Movement of Commodity and Common Stock Prices

From Mr. Goldenweiser

In compliance with your request of February 27, we have prepared the accompanying chart showing the movement of the wholesale price index of the Bureau of Labor Statistics and of the common stock price index of the Standard Statistics Company. The chart shows clearly the comparative steadiness of the commodity price level during the years of the stock market boom.

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Stocks - Standard Statistics - 421 Common Stocks
Commod. - B. of L.S. 784 Price Series

STOCK PRICES & COMMODITY PRICES

1926 = 100

Stock Prices

All Commodities

300
200
100
90
80
70
60
50
40
30
20
10

1921 1922 1923 1924 1925 1926 1927 1928 1929 1930 1931 1932

CODEX BOOK COMPANY, INC. NORWOOD, MASSACHUSETTS
NO. 4135. POLYPURPOSE. 183 DIVISIONS BY 2 4½-INCH CYCLES RATIO RULING.

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CONFIDENTIAL February 23, 1932

PRELIMINARY MEMORANDUM FOR

THE OPEN MARKET POLICY CONFERENCE, FEBRUARY 24, 1932

At the last meeting of the Conference on January 11 and 12, the following program of action either by the Federal Reserve System or by others was considered as a means for dealing with the serious situation existing in the banking and credit situation as evidenced by the heavy bank failures, increasing currency hoarding, and a continued rapid deflation of credit.

(1) Passage of the Reconstruction Finance Corporation Bill

(2) Organized support of the bond market predicated upon railroad wage cuts

(3) Federal reserve and member bank cooperation with the Treasury program

(4) Federal reserve bill purchases when possible

(5) Reduction in discount rates

(6) Buying of Government securities if necessary, facilitated by alleviation of free gold position

The first two of these proposals which were dependent upon action by others have been carried through. The third was at least partially carried through to the extent that the issue of $350,000,000 Treasury certificates on January 25 was well taken after the reserve banks had discussed the matter with the member banks to secure their cooperation. In fact, the issue has sold at a slight premium since that time.

For one reason or another points 4, 5, and 6 of the program have not yet been actively pursued. Continued uncertainties in the domestic situation, as well as a large drain of gold to Europe and particularly to France, stimulated by fear of inflation in this country, have been important factors

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in making it seem undesirable to carry through an aggressive program of reduction in discount rates and purchases of Government securities. The relatively small amount of free gold held by the reserve system was a further major factor in limiting the possibilities of purchases of Government securities.

Partly as a consequence of steps which have been taken, particularly the organization of the Reconstruction Finance Corporation, the number of bank failures has been reduced and in the past two weeks the hoarding of currency has begun to show some slackening, though there has not been as yet any substantial return of currency.

The deflation of bank credit, however, continues at a vigorous pace and shows, in fact, no slackening from the rate of decrease of the last quarter of 1931. Loans and investments of reporting member banks have declined by $800,000,000 in the first 7 weeks of this year, or at the rate of 29 per cent per year. Under this steady deflation of credit business has shown no evidence of recovery but has continued to decline at least until the past two weeks. A major cause for this continued credit deflation has been the heavy borrowing by member banks, particularly outside of a few principal centers. Many member banks are so heavily in debt that their energies are constantly devoted to an effort to liquidate credit and thus repay their indebtedness. The most recent figures show that the discounts of member banks are about $850,000,000, and that the weight of these discounts is falling most heavily on banks outside the principal centers. In fact, the discounts of these groups of banks are considerably larger than they were in 1929 when the reserve system was exerting the maximum of pressure for deflation. The present amount of member bank borrowing has always proved deflationary, except perhaps

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during the war, and with the present sensitive psychology, an interruption to deflation seems unlikely as long as the weight of discounts is as heavy as at present. A steady drain of gold through exports, which may be expected to continue, has the constant tendency to increase these discounts.

The apparent imminence of the passage of the new Glass Bill removes certain of the restraints upon member bank and Federal reserve action. In the first place the emergency discounting provisions should result in less concern by the member banks as to their liquidity and greater willingness to employ their funds freely. In the second place the provision of the Glass Bill relating to collateral for Federal reserve notes makes it possible by action of the Federal Reserve Board to increase the System's free gold from $450,000,000 to $1,200,000,000, and so remove any legal restraint upon whatever purchase of Government securities may appear desirable to offset gold exports or to decrease the pressure of rediscounts. Under the new provision the amount of free gold is not affected by purchases of Government securities unless or until these purchases bring about an increase in the total of Federal reserve credit. Furthermore, the Glass Bill has been important in reviving a general spirit of hopefulness and in some measure dispelling fear. It has started a movement which, if continued and supported, might prove the beginning of recovery.

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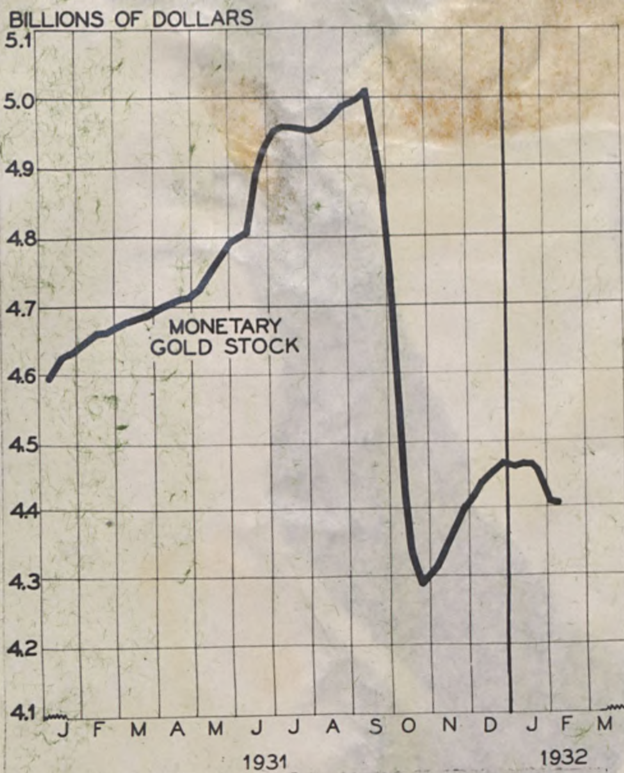
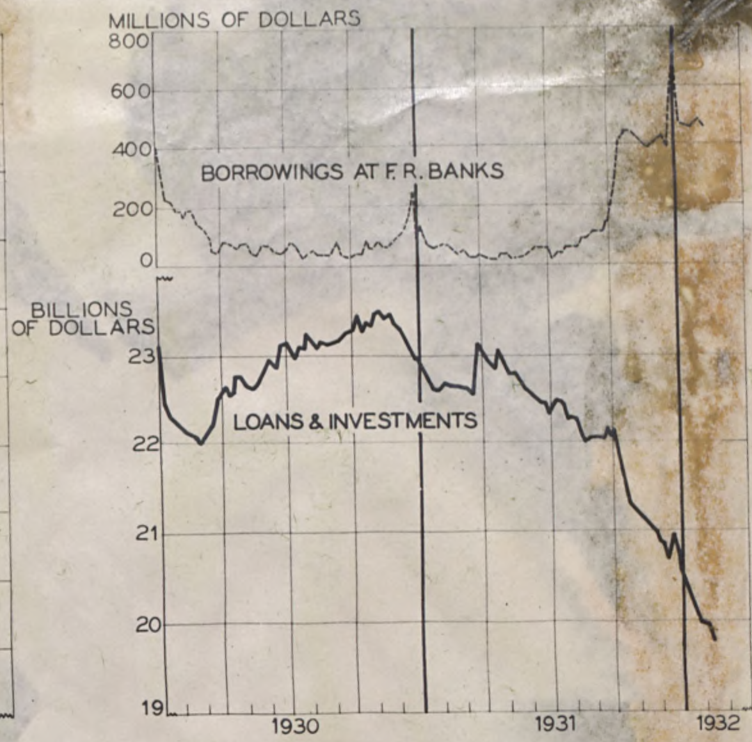
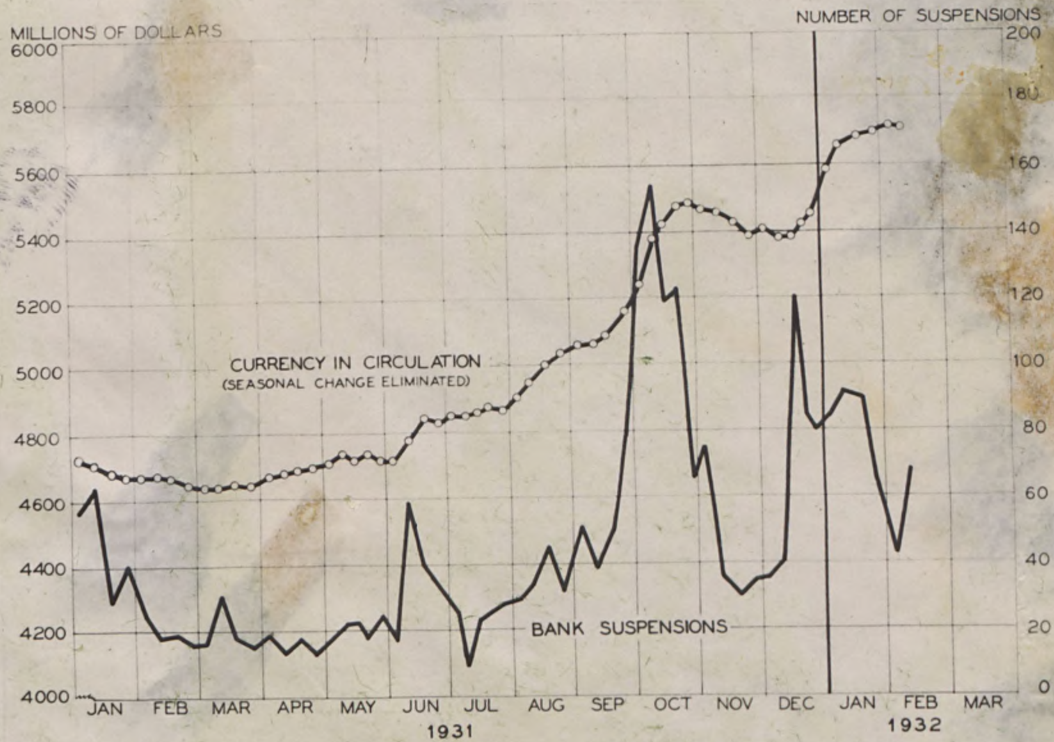
Federal Reserve Bank
of New York
Reports Department
Feb. 21, 1932.
2259



Monetary Gold Stock of the United States
(Weekly averages of daily figures)



Loans and Investments and Indebtedness of
Weekly Reporting Member Banks



Changes in Currency Circulation (Seasonal Variations Eliminated)
Compared with Number of Bank Suspensions

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MR. HAMLIN

March 5, 1932

Federal Reserve Board

Bank Suspensions during 1931

Mr. Smead

CONFIDENTIAL

Our records of bank suspensions for the year 1931 have now been completely reconciled with the Federal reserve agents, and final figures, by districts, states, and classes of banks, were published in the February issue of the Federal Reserve Bulletin (pages 132 and 134).

A total of 2,298 banks (and approximately 242 branches) suspended during the year with aggregate deposits of $1,691,000,000, as compared with 1,345 banks in 1930 with deposits of $864,715,000, and 956 in 1926 with deposits of $272,488,000, the previous peak years for bank suspensions. During the year, 276 suspended banks with deposits of $158,187,000 resumed operations. The following table shows the number, capital, and deposits of suspended and reopened banks, by years, since 1921:

(Capital and deposits in thousands of dollars)

Year	Banks suspended			Banks reopened		
	Number	Capital	Deposits	Number	Capital	Deposits
1921	501	22,802	196,460	60	1,918	17,493
1922	354	13,743	110,721	65	4,003	35,565
1923	648	21,943	188,701	37	1,516	11,674
1924	776	28,358	213,338	94	2,815	22,462
1925	612	24,441	172,900	62	1,994	16,618
1926	956	32,804	272,488	149	5,134	60,610
1927	662	24,763	193,891	95	3,906	35,729
1928	491	19,715	138,642	39	1,504	15,727
1929	642	32,254	234,532	58	3,052	25,829
1930	1,345	111,643	864,715	147	6,802	61,599
1931	2,298	208,120	1,691,510	276	19,102	158,187
Total	9,285	540,586	4,277,898	1,082	51,746	461,493

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Federal Reserve Bank of St. Louis

More than half the bank suspensions in 1931 took place in the last four months of the year -- 305 in September, 522 in October, 175 in November and 358 in December. Monthly figures of bank suspensions for the last two years are given below:

Month	Number of bank suspensions		Deposits of suspended banks (In thousands of dollars)	
	1931	1930	1931	1930
January	202	99	76,553	28,903
February	77	85	34,616	32,800
March	86	76	34,320	23,769
April	64	96	41,683	33,388
May	91	55	43,493	19,315
June	167	66	190,480	70,566
July	93	65	40,745	32,333
August	158	67	180,028	21,951
September	305	66	233,505	23,666
October	522	72	471,380	24,599
November	175	254	67,656	186,306
December	358	344	277,051	367,119

The ratio of bank suspensions in 1931 to all banks in operation on June 30, 1931 was 10.4 per cent, compared with 5.6 per cent for 1930 and an approximate yearly average of 2.2 per cent for the 9-year period 1921-1929. The ratio of deposits of suspended banks to deposits of active banks, as shown by the following table, was 3.0 per cent as compared with 1.5 per cent in 1930 and an average of only 0.4 per cent for the 9-year period 1921-1929:

Year	Ratio of number of bank suspensions to total number of banks in operation	Ratio of deposits of suspended banks to deposits of all banks in operation
1931	10.4%	3.0%
1930	5.6	1.5
1921-1929 average	2.2	.4

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The average size of banks that suspended in 1931 was larger than in any of the previous 10 years. As brought out in the following table, 23.7 per cent of the banks that suspended in 1931 had a capital stock of $100,000 or more, compared with 15.8 per cent in 1930 and 9.7 per cent during the period 1921-1929:

Banks with a capital of -	Per cent of total number of bank suspensions		
	1931	1930	1921-1929
$100,000 and over	23.7	15.8	9.7
$50,000 and over	43.6	32.2	27.2
$25,000 and over	75.5	64.6	59.0

The increase in the average size of the banks that suspended in 1931 is reflected also in the increased number of suspensions in the larger towns and cities. As shown in the table below, 13.7 per cent of the suspensions during 1931 were in cities with a population of 25,000 or more, as compared with 9.2 per cent in 1930 and 5.2 per cent in the 9-year period 1921-1929:

Banks located in places with population of -	Per cent of total number of bank suspensions		
	1931	1930	1921-1929
25,000 and over	13.7	9.2	5.2
10,000 and over	19.5	13.4	8.4
5,000 and over	25.6	17.9	12.6
1,000 and over	53.5	46.4	39.5
Less than 1,000	46.5	53.6	60.5

While there was no single bank failure during the year approximating in size the Bank of the United States, New York, which suspended in 1930, quite a number of suspended banks were of substantial size. The largest bank failure during the year was the Bank of Pittsburgh, N. A., Pittsburgh, Pa., with deposits of about $44,000,000. In 1931, 32 suspended banks had a capital of

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$1,000,000 or more, as compared with 11 the year before and only 9 in the 9-year period 1921-1929. All of these 52 banks are listed in Table No. 1 submitted herewith.

A geographic distribution of bank suspensions in 1931 shows the greatest proportionate increase in the North Central, Middle Atlantic and New England States. In the Middle Atlantic States the number of bank suspensions in 1931 was 250, as compared with 32 in 1930 and a yearly average of 9 during 1921-1929; in the North Central States, 611 banks suspended in 1931, as compared with 286 in 1930 and a yearly average of 50 during 1921-1929, and in the New England States the number of bank suspensions in 1931 was 33, as compared with 13 the year before and an annual average of 2 for the 9-year period 1921-1929. The following table shows the number of bank suspensions, by geographic divisions, in 1931, in 1930, and in 1921-1929, together with a yearly average for the latter period:

Geographic Division	Number of bank suspensions			
			1921-1929	
	1931	1930	Yearly average	Total for 9 years
New England States	33	13	2	16
Middle Atlantic States	250	32	9	82
North Central States	611	286	50	449
South Mountain States	152	87	21	188
South Eastern States	245	276	103	929
South Western States	174	201	77	694
Western Grain States	717	413	291	2,620
Rocky Mountain States	62	25	59	534
Pacific Coast States	54	12	15	130
Total, United States	2,298	1,345	627	5,642

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While the number of bank suspensions in 1931 was about four times the yearly average for the 9-year period 1921-1929, the deposits of the banks that suspended in 1931 were about nine times the yearly average for that period. As indicated by the table below, the largest relative increases were reported for the New England, Middle Atlantic and North Central States.

Geographic Division	Deposits of suspended banks (In thousands of dollars)			
	1931	1930	1921-1929 Yearly average	1921-1929 Total for 9 years
New England States	117,038	38,841	2,903	26,126
Middle Atlantic States	462,491	242,423	8,826	79,430
North Central States	627,849	145,947	16,777	150,993
South Mountain States	78,339	107,039	6,000	53,999
South Eastern States	93,284	152,589	36,285	326,567
South Western States	69,263	69,248	20,732	186,586
Western Grain States	190,081	89,617	73,423	660,807
Rocky Mountain States	19,909	7,945	17,763	159,871
Pacific Coast States	33,256	11,066	8,588	77,294
Total, United States	1,691,510	864,715	191,297	1,721,673

Of the 2,298 banks that suspended last year, 409 were national banks, 108 state bank members of the Federal Reserve System, and 1,781 nonmember banks. The deposits of suspended national banks aggregated $439,171,000, of state bank members $294,357,000, and of nonmember banks $957,982,000, a total of $1,691,510,000. These figures are shown in detail, by states and Federal reserve districts, in the February issue of the Federal Reserve Bulletin, pages 132 and 134.

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In addition to the list of banks with capital of $1,000,000 or more that suspended during the period 1921-1931 (table No. 1), previously referred to, two tables are submitted herewith as follows:

Table No. 2 -- Number, capital, and deposits of all banks suspended and of reopened banks in 1931, by states.

Table No. 3 -- Distribution of number of bank suspensions in 1931, 1930, and 1921-1929, according to capital stock and according to population.

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Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

see BN

Date March 8, 1932.

To Mr. Hamlin

Subject:

From Mr. Wyatt, General Counsel.

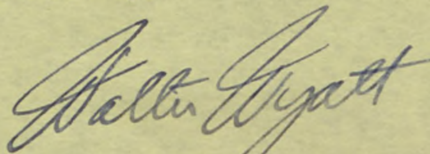
2—8495

There is attached hereto for your information, a copy of H.R. 10,241, the bill which was introduced in the House of Representatives on March 7, 1932, by Congressman Steagall and which was discussed in the newspapers this morning.

Among the important features of this bill affecting the Federal Reserve System are a provision for the guarantee of bank deposits for member banks, authority for member banks to make "exchange charges" on checks and a provision for a distribution to member banks of one-half of the net earnings of Federal reserve banks.

A more detailed analysis will be prepared by this office as soon as possible.

Respectfully,



Walter Wyatt,
General Counsel.

Bill attached.

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Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date March 9, 1932

To Mr. Hamlin

From Mr. Smead

Subject: Estimated possible increase in "free gold" under the Glass-Steagall Bill

In accordance with your request, we have prepared the attached statement showing the amount of free gold held by each Federal reserve bank on February 27, 1932, the date on which the Glass-Steagall Bill was approved, and the amount of free gold which each bank would have had if all United States securities owned had been pledged as collateral security for Federal reserve notes as authorized by the bill.

Two Federal reserve banks, New York and Dallas, had more than enough eligible paper and United States securities to pledge as collateral for Federal reserve notes to bring their free gold up to the amount of their excess reserves. In the case of the other ten Federal reserve banks, the increase in free gold would have been equal to 95 per cent of the amount of their holdings of United States securities. By pledging United States securities against Federal reserve notes an equal amount of gold collateral is released but 5 per cent of the amount so released would have to be added to the gold redemption fund.

If all United States securities held by the Federal reserve banks on February 27 had been pledged with the Federal reserve agents, the free gold would have been increased by $662,104,000. On that date the Federal Reserve Bank of New York held $29,044,000 and the Federal Reserve Bank of Dallas $13,993,000 more United States securities than they needed to pledge with the Agents to bring their free gold up to their excess reserves, and if these securities had been distributed among other Federal reserve banks the free gold of the System could have been increased by $702,990,000, instead of

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$662,104,000, i.e., by 95 per cent of the total amount of United States securities held by the Federal reserve banks on that date.

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"FREE GOLD" HELD BY FEDERAL RESERVE BANKS ON FEBRUARY 27, 1932, ON WHICH DATE THE GLASS-STEAGALL BILL WAS APPROVED

Federal Reserve Bank	Free gold Feb. 27, 1932	Free gold Feb. 27, 1932, if all U. S. securities owned were used as collateral for F. R. notes	Excess reserves, Feb. 27, 1932
Boston	$15,958,000	$69,306,000	$102,640,000
New York	269,442,000	500,739,000	500,739,000
Philadelphia	20,359,000	76,090,000	77,319,000
Cleveland	29,609,000	95,011,000	110,528,000
Richmond	11,427,000	24,804,000	42,670,000
Atlanta	3,799,000	15,787,000	41,587,000
Chicago	25,211,000	127,475,000	339,574,000
St. Louis	8,061,000	34,658,000	45,702,000
Minneapolis	758,000	27,030,000	27,719,000
Kansas City	14,674,000	32,446,000	33,341,000
Dallas	3,834,000	16,536,000	16,536,000
San Francisco	8,059,000	53,413,000	54,563,000
Total	411,191,000	1,073,295,000	1,392,918,000

DIVISION OF BANK OPERATIONS
MARCH 9, 1932

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March 9, 1932.

Dear Charles:

In further answer to your letter of January 28th as regards the French debt, I would put the matter in this way:

The French debt prior to funding, was approximately 4.2 billions, of which 2.6 represented the war debt, and 1.6 the post war debt.

The amount which France will have paid at the end of 62 years on the bonds which she gave, computed at 1.64% interest, the agreed rate, would amount to 6.8 billions.

France has a legal right to pay at once either 4.2 billions, or to pay, spread over 62 years, 6.8 billions, and this is all the right she has.

You state that the present worth of the whole original debt, - 4.2 billions, - plus interest for 62 years at the rate of 1.64% - is 1.6 billions, and this being about the same as the post-war debt, you argue that the war debt has practically been forgiven.

The above figure, however, is not correct. The present worth of 6.8 billions, computed at 1.64%, is 3.4 billions, which is a sum larger than France's original war debt.

The figure you reach of 1.64 billions is obtained by using an interest rate of 5%, and not the agreed rate of 1.64%.

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Secretary Mellon had no authority, of course, to suggest to France that he would accept the present value computed at 5%, nor did he ever make such an offer.

The present worth of any sum payable in the future differs in proportion to the rate of interest used in computing it, and it is an absolutely hypothetical deduction, having nothing to do with the rights of either party. That it is purely hypothetical would appear from the following:

If the United States had charged France 5% interest, instead of 1.64%, on her bond payments, she would have paid, spread over 62 years, 11.4 billions, whereas by charging only 1.64%, the total amount she has to pay is 6.8 billions. The difference between these sums is 4.6 billions, which is larger than the total original war and post-war debt owed by France. On these hypothetical figures, one could say that the United States has forgiven France 4.6 billions, which is more than her original war and post-war debt, and therefore that we have forgiven France her whole debt, - although to that country it looks as if she would have to pay 6.8 billions for a total indebtedness of 4.2 billions.

Let me know how this strikes you.

Sincerely yours,

Hon. Charles Warren,
Mills Building,
Washington, D. C.

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Ser Bds

FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

X-7115

March 10, 1932.

SUBJECT: Advances to member banks under Sections 10(a) and 10(b) of the Federal Reserve Act, as amended February 27, 1932.

Dear Sir:

In view of the fact that advances to member banks under the provisions of Sections 10(a) and 10(b) of the Federal Reserve Act, as amended by the Act of February 27, 1932, will be limited to cases where there are conditions of an unusual and temporary character, the Federal Reserve Board has not prescribed any regulations governing such advances but will consider each case separately and will decide, on the basis of the facts and circumstances in each particular case, whether or not to permit the Federal reserve bank to make the advance applied for.

However, in order that the member banks may be informed of the provisions of these sections and of the procedure contemplated thereunder, a committee of officers of Federal reserve banks appointed pursuant to action taken by the Conference of Governors of Federal reserve banks held in Washington on February 24 and 25, 1932, has prepared, with the assistance of counsel, a circular

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letter to be sent by the Federal reserve banks to all member banks as soon as possible.

While it would seem that the law would permit the Board to grant blanket consent for Federal reserve banks to make loans under the provisions of Section 10(a), the Board prefers for the present at least to consider each case separately; and the law requires separate action by the Board in the case of each specific loan under the terms of Section 10(b). Before making any loan or any renewal or extension thereof under the provisions of either section, therefore, the Federal reserve bank should obtain the Board's consent.

The Board is prepared to give prompt consideration to any application received under these sections. Each request for its permission to make such an advance must include a recommendation of the Federal reserve bank and should contain the following information:

A. Name and location of borrowing bank.

B. Capital stock.

C. Surplus and undivided profits.

D. Whether the bank which is to receive the proceeds of the loan has an adequate amount of eligible and acceptable assets to enable it to obtain sufficient credit accommodations from the Federal reserve bank under other provisions of the Federal Reserve Act.

E. Amount of the loan applied for.

F. Maturity of loan applied for.

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G. Proposed rate.

H. Nature and face amount of security offered.

I. Total deposits of borrowing bank.

J. Total amount of rediscounts and other borrowings (including repurchase agreements) from Federal reserve bank, exclusive of this loan.

K. Amount of rediscounts and borrowings (including repurchase agreements) from others.

L. Concise statement of exceptional and exigent circumstances which occasioned the application, together with any other facts having a bearing upon the case.

M. Whether the application is for a loan under Section 10(a) or Section 10(b).

N. In the case of loans applied for under Section 10(a), name and address of each participating bank and the amount of liability assumed by it, together with the nature and face amount of additional security, if any, required of it.

When the information is transmitted by telegraph, each item listed above may be indicated by using the letter preceding such item, in lieu of stating the text of the question.

The Board has not prescribed any limitation on the aggregate amount of such loans which may be made by any Federal reserve bank; but, in acting upon requests for its permission to make such loans, will give consideration, among other things, to the aggregate amount of such loans which the Federal reserve bank has outstanding.

In making loans to groups of banks under Section 10(a), the Federal reserve bank should require the trustee representing the group of banks to pledge with the Federal reserve bank

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the note of each bank which is to receive the proceeds of the loan and the security therefor. The Federal reserve bank should assure itself that the trustee has been properly authorized to pledge such note and security to the Federal reserve bank. In addition to the note of the borrowing bank and such security as it may provide, the Federal reserve bank may, if it deems it advisable, require the other members of the group to give such other security as the Federal reserve bank may consider necessary for its protection.

In the absence of regulations and in order to insure uniformity of procedure, the Federal Reserve Board has approved the inclosed circular for use by the Federal reserve banks. It will be observed that the Board has made certain modifications in the proposed circular which was transmitted to the Governors with the Committee's report of March 6, 1932. If any Federal reserve bank desires to make any further changes, in order to conform to local conditions or practices, it should communicate with the Federal Reserve Board and obtain its approval before transmitting the circular to member banks. The Board will give prompt consideration to such changes.

This letter is solely for the information and guidance of the Federal reserve banks.

Very truly yours,

Chester Morrill,
Secretary.

Inclosure.

TO GOVERNORS OF ALL F. R. BANKS.

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CIRCULAR LETTER FROM
FEDERAL RESERVE BANKS TO THEIR MEMBER BANKS

Subject: Amendment to Federal Reserve Act by Act of Congress approved February 27, 1932.

The Act of February 27, 1932, adds two new sections to the Federal Reserve Act, Section 10(a) and Section 10(b). Section 10(a) authorizes the making of loans to groups of member banks and is a permanent provision, whereas Section 10(b) authorizes until March 3, 1933, advances to individual member banks having a capital stock not exceeding $5,000,000 each. Under both sections, the banks receiving the proceeds of such advances must be without adequate amounts of eligible and acceptable assets to enable them to obtain sufficient credit accommodations from the Federal Reserve Banks under other provisions of the Federal Reserve Act.

The full text of these two sections of the Federal Reserve Act is printed at the end of this circular.

In view of the fact that it is contemplated that applications for such advances will be made only in unusual circumstances, the Federal Reserve Board has not prescribed any regulations governing such advances, but, for the information of all member banks, the principal requirements of the law are analyzed and the general procedure contemplated thereunder is outlined below.

SECTION 10(a)
ADVANCES TO GROUPS OF MEMBER BANKS

This section provides in effect that, upon receiving the consent of not less than five members of the Federal Reserve Board, any Federal Reserve Bank may make advances, in such amount as the board of

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directors of such Federal Reserve Bank may determine, upon the following conditions:

(a) Advances may be made on the promissory notes of groups of five or more member banks within the district of the loaning Federal Reserve Bank, a majority of them independently owned and controlled; except that advances may be made to a lesser number of such member banks (but not less than two) if the aggregate amount of their deposit liability constitutes at least 10 per centum of the entire deposit liability of the member banks within such district.

(b) Advances may be made only if the bank or banks which receive the proceeds thereof have no adequate amounts of eligible and acceptable assets available to enable such bank or banks to obtain sufficient credit accommodations from the Federal Reserve Bank through rediscounts or advances other than as provided in Section 10(b) of the Act.

(c) The liability of the individual banks in each group must be limited to such proportion of the total amount advanced to such group as the deposit liability of the respective banks bears to the aggregate deposit liability of all banks in such group. (The liability of each individual bank on the note of a group under this provision of the law should be determined on the basis of its gross deposit liabilities at the opening of business on the date of the written application by the group to the Federal reserve bank for the advance, computed by adding together, (1) in the case of national banks, the figures corresponding to those called for by items 21, 22, 23 and 24 on the Comptroller of the Currency's call report form No. 2130, as revised in November, 1931, or, (2) in the case of State member banks, the figures corresponding to those called for by items 19, 20, 21 and 22 on the Federal Reserve Board's call report form No. 105, as revised in November, 1931.)

(d) The proceeds of an advance to a group may be distributed only to banks which are members of such group, and before receiving such proceeds such banks must deposit with a suitable trustee, designated by and representing the entire group, their individual notes made in favor of the group protected by such collateral security as may be agreed upon.

(e) No obligations of any foreign government, individual, partnership, association or corporation organized under the laws thereof shall be eligible as collateral security for advances under this section.

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(f) No note upon which such advances are made will be eligible as collateral security for Federal Reserve notes.

The rate at which advances may be made under the provisions of this section will be fixed from time to time, subject to the approval of the Federal Reserve Board and the condition specified in the law.

The maturities of notes accepted under this section must be satisfactory to the Federal Reserve Bank. There must be deposited and pledged with the Federal Reserve Bank, as security for any advance made by the Federal Reserve Bank to a group of banks under the provisions of Section 10(a), the note or notes of the bank or banks to which the proceeds of such advance are distributed by the group, together with all the security for such note or notes. Such security must, of course, be acceptable to the Federal Reserve Bank, which may require the group or any member thereof to provide such additional security as may be deemed necessary.

For the convenience of member banks desiring to apply for loans under Section 10(a), the following suggested forms are being prepared.

1. Resolution to be adopted by board of directors of each of the banks desiring to form a group, authorizing their officers to sign an agreement with other banks for this purpose.

2. Agreement to be entered into by banks desiring to form a group. This form of agreement includes the designation of a trustee for the group.

3. Resolution to be adopted by board of directors of individual borrowing bank authorizing it to borrow from the group and to pledge security therefor.

4. Application to be used by individual borrowing bank in requesting loan from the group. This must include a certificate to the effect that such bank has no adequate amount of eligible and acceptable assets available to enable it to obtain sufficient credit accommodations from the Federal Reserve Bank through rediscounts or advances other than as provided in Section 10(b).

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5. Note to be used by the individual borrowing bank in borrowing from the group.

6. Resolution to be adopted by the board of directors of each of the banks in the group, authorizing the group to borrow from the Federal Reserve Bank upon the note of the group and to pledge the note or notes of the individual borrowing bank or banks and the security therefor.

7. Application to be used by group in requesting advance from the Federal Reserve Bank.

8. Note to be used by the group in borrowing from the Federal Reserve Bank. This form contemplates that the group shall give to the Federal Reserve Bank a single note for the full amount of the advance, such note, or counterparts thereof, being signed by all members of the group and stating on the face thereof the dollar amount of the proportion of the principal of such note for which each bank in the group is liable.

Banks desiring to form groups, or contemplating the possibility of forming groups at some future time, should so advise this bank, which will be glad to furnish them with copies of the suggested forms. It is suggested that each group be formed under the name "Member Bank Loan Group No. _____ of the _____ Federal Reserve District." In order to prevent possible duplication of numbers in the names of groups this bank will assign numbers when advised of the desire to form groups.

The forms used in different cases may vary to some extent to meet the needs and desires of the banks forming the particular group, but all forms used in connection with any advance made by this bank must, of course, be satisfactory to it.

SECTION 10(b)
ADVANCES TO INDIVIDUAL MEMBER BANKS

Under the terms of this section Federal Reserve Banks may, until March 3, 1933, and in exceptional and exigent circumstances, and subject in each case to affirmative action by not less than five members of the Federal Reserve Board, make advances to individual member banks upon the following conditions:

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(a) Advances may be made only to member banks having capital stock of not exceeding $5,000,000 each.

(b) Advances may be made only to banks which have no further eligible and acceptable assets available to enable them to obtain adequate credit accommodations through rediscounting at the Federal Reserve Bank or any other method provided by the Federal Reserve Act other than that provided by Section 10(a).

(c) No obligations of any foreign government, individual, partnership, association, or corporation organized under the laws thereof shall be eligible as collateral security for advances under this section.

(d) Advances under this section may be made only upon the promissory notes of member banks secured to the satisfaction of the lending Federal Reserve Bank.

(e) No note accepted for any such advance shall be eligible as collateral security for Federal reserve notes.

The rate at which advances may be made under the provisions of this section will be fixed from time to time, subject to the approval of the Federal Reserve Board and the condition specified in the law.

A special form of application is being prepared for the use of member banks desiring to apply for loans under Section 10(b). Copies will be provided upon request.

Each such application must include a certificate to the effect that the applying bank has no further eligible and acceptable assets available to enable it to obtain adequate credit accommodations through rediscounting at the Federal Reserve Bank or any other method provided by the Federal Reserve Act other than that provided by Section 10(a); and it must also be supported by a statement of facts sufficient to satisfy the Federal Reserve Bank and the Federal Reserve Board that there are exceptional and exigent circumstances which would justify the making of such loan under the provisions of Section 10(b).

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The regular form of member bank promissory note may be used for advances made under this section. Maturities must be satisfactory to the Federal Reserve Bank.

GENERAL

In conformity with the purposes of this legislation, advances under Sections 10(a) and 10(b) of the Federal Reserve Act will be limited to cases where there are conditions of an unusual and temporary character which appear to justify such action and when the member banks receiving the proceeds lack adequate amounts of eligible and acceptable assets with which to secure sufficient credit accommodations from the Federal Reserve Bank under other provisions of the Federal Reserve Act. When and if such circumstances exist it is hoped that this bank may be able to render helpful service for temporary periods. It is suggested, however, that before making applications for such advances member banks should communicate with this bank and ascertain its views as to the collateral or other security which should be offered and as to the other conditions upon which this bank would be disposed to give favorable consideration to the application.

APPENDIX

(Here print title and first two sections of Act.)

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Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date February 20, 1932

To Mr. Hamlin

From Mr. Smead

Subject: Changes in reserve bank credit, production index, and member bank loans, during selected periods.

GPO 2—8495

In response to your telephone request, we have prepared and are handing you herewith --

(1) A table showing the index of industrial production, the amount of reserve bank credit, of security loans and of "All other" loans of weekly reporting member banks, on July 13, 1927, January 4, 1928, July 11, 1928, February 6, 1929, June 5, 1929, and October 23, 1929;

(2) A similar table showing the change, in each of the items, that took place between the consecutive selected dates.

We included figures for January 1928, in addition to figures for the dates mentioned by you, for the reason that in January 1928 the Federal reserve banks began to reduce their holdings of United States Government securities and to increase discount rates.

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RESERVE BANK CREDIT, PRODUCTION INDEX, AND LOANS OF WEEKLY REPORTING MEMBER BANKS, ON SELECTED DATES
(Amounts in millions of dollars)

	July 13, 1927	Jan. 4, 1928	July 11, 1928	February 6, 1929	June 5, 1929	October 23, 1929
Reserve bank credit	1,102	1,604	1,542	1,500	1,303	1,374
United States securities in Special Investment Account	251	423	85	76	33	23
Index of industrial production (monthly)*	106	105	109	118	127	118
Loans of all weekly reporting member banks:						
On securities - total	6,152	7,022	7,003	7,558	7,197	7,920
To brokers and dealers in New York	(a)	(a)	(a)	1,771	1,122	1,480
To others	(a)	(a)	(a)	5,787	6,074	6,440
All other loans	8,590	8,652	8,889	8,696	9,140	9,580
Loans of weekly reporting member banks in New York City:						
On securities - total	2,249	2,915	2,666	2,857	2,678	3,005
To brokers and dealers	991	1,511	942	1,116	837	1,077
To others	1,258	1,404	1,724	1,741	1,841	1,928
All other loans	2,400	2,489	2,605	2,464	2,731	2,894
Brokers' loans by weekly reporting member banks in New York City:						
Total (for all accounts)	3,059	3,810	4,243	5,669	5,284	6,634
For own account	991	1,511	942	1,116	837	1,077
For out-of-town banks	1,204	1,371	1,554	1,931	1,513	1,733
For others	863	928	1,747	2,621	2,934	3,823

*Adjusted for seasonal variation; 1923 - 1925 = 100

(a)Not reported separately.

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CHANGES IN RESERVE BANK CREDIT, PRODUCTION INDEX, AND LOANS OF WEEKLY REPORTING MEMBER BANKS DURING SELECTED PERIODS

(Amounts in millions of dollars)

	July 13, 1927 to Jan. 4 1928	Jan. 4 to July 11, 1928	July 11, 1928 to Feb. 6, 1929	Feb. 6 to June 5, 1929	June 5 to Oct. 23, 1929
Reserve bank credit	+ 502	- 62	- 42	- 197	+ 71
United States securities in Special Investment Account	+ 172	-338	- 9	- 43	- 10
Index of industrial production (monthly)*	- 1	+ 4	+ 8	+ 9	- 9
Loans of all weekly reporting member banks:					
On securities - total	+ 870	- 19	+555	- 361	+723
To brokers and dealers in New York	(a)	(a)	(a)	- 649	+358
To others	(a)	(a)	(a)	+ 287	+366
All other loans	+ 62	+237	-193	+ 444	+440
Loans of weekly reporting member banks in New York City:					
On securities - total	+ 666	-249	+191	+179	+327
To brokers and dealers	+ 520	-569	+174	-279	+240
To others	+ 146	+320	+ 17	+100	+ 87
All other loans	+ 89	+116	-141	+267	+163
Brokers' loans by weekly reporting member banks in New York City - total	+ 751	+433	+1,426	-385	+1,350
For own account	+ 520	-569	+174	-279	+ 240
For out-of-town banks	+ 167	+183	+377	-418	+ 220
For others	+ 65	+819	+874	+313	+ 889

*Adjusted for seasonal variation; 1923 - 1925 = 100.

(a) Not reported separately.

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Sec. + Com. Loans

1922 - 1928

Secur. Loans

1922	1928	Incr.	% Incr.
3.6 billion	7.5 billion	3.9 billion	100% +

Com. loans

7.4 "	8.7 "	1.3 "	18%

1 ~~9~~

% av. of loans to total loans + investments.

1922 - 29. June.

Sec. Loans

1922	1929. June
25%	34%

Com. notes

51%	39%

Goldenweiser
June 19. 29
194 - 115

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Secur & Com loans

Jan 1.927 - Feb 13.29

All rep. M bks

~~Secur. loans incr. 1610 million~~

Secur. loans incrd from 5915 to

7525 millions. Incr = 1610 million (27%)

Com. loans incrd from 8623 - 8708 million

= 85 million (1%)

N Y City rep. Bks

Secur. loans incrd from 2168 to

2817 million = 649 million (29%)

Com. loans incr. 103 million

Rep M bks Chicago

Secur. loans incr 152 million

Com. loans incr. 52 .

Snead.

Feb 19.29

189 - 123

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1922 – 1927

[illegible] Res. Bk. Cr.

Sec loans inc. 3.9 billion. 100%

Com " " 1.3 " 18%

Gold stk inc. 782 million

Res Bk Cr. " 500 "

Res. Bk. inv. about 12 to 1

Expansion = chiefly in
security market
only relatively caused by
Member.

In 1928 yearly avge. of
Member amt = 79
million less than in
1922
while Res Bk credit
incr 500 m. gold
stock incr. 750 m.

3 Periods of [illegible] in
Member [illegible] 1922-28

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F

1. 1922. Feb – June

Gold imp. incr. 237

Re disc .. 132

2. 1924

April – Dec.

Similar movt.

3. 1927. Last quarter

1. + 2. Credit was eased off.

3. New credit to carry off

Gold exports in early

part of year used

to take down disc

309

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March 16, 1932.

Personal and Confidential.

Dear Mr. Platt:

I have your note of March 7th. I agree with you in principle, that Federal reserve notes should be Federal reserve bank notes, and that there is no necessity for any collateral other than the 40% of gold reserve.

I used to think that collateral was required in order to protect the Government which is liable on the Federal reserve notes, as well as the Federal reserve bank through which they are issued. I am satisfied, however, that this is a mistake; that the real reason for requiring collateral was to tie down Federal reserve notes and limit them to the amount of eligible paper. This certainly was a very stringent limitation on their issue.

The amendment of 1917, however, making gold acceptable as collateral, removed to a very great degree any limitation on Federal reserve notes. It does, however, impose a limitation on the power of a Federal reserve bank, for example, to engage in open market operations, for the necessity of keeping gold as collateral necessarily lowers the amount of gold which can be used for other purposes.

This limitation, however, works exactly opposite to what we at first sight would suppose, - that is to say, it does not effectively limit credit

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expansion when such limit is desired, nor does it permit adequate steps being taken to prevent disastrous credit deflation when an easy money policy is desired.

For example, just before the Glass-Steagall bill was enacted, the free gold of the System was reduced to slightly over 400 millions, due to the fact that member banks had little eligible paper to deposit as collateral for Federal reserve notes, and therefore had to substitute gold. With this relatively limited amount of free gold, the System could not safely purchase many Government securities for the purpose of easing the credit situation and checking the contraction taking place in member bank credit.

On the other hand, in 1929, when credit was expanding at a very rapid rate, and at a time when a firming policy was in effect, the free gold of the System rose to over 1 billion dollars, owing to the fact that there was plenty of eligible paper to cover Federal reserve notes. At that time the Federal reserve banks held only 200 millions of Government securities, and could easily have purchased several hundred millions more without risk of any shortage in the gold collateral behind Federal reserve notes, but at that time such purchases were undesirable.

I feel that the collateral requirement should certainly be changed so as to include any paper or securities which the Federal reserve banks can acquire under the Federal Reserve Act, or better still, that the requirement for collateral be entirely eliminated.

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It may well be that in such case the power of the System to expand credit on its own initiative should be controlled, but this control should be brought about through some other limitation, e.g. by a limitation on the authority to purchase securities in the open market.

I have written this very hurriedly, and perhaps have not fully thought it out. Please regard it as confidential, and let me know how it strikes you.

Sincerely yours,

Hon. Edmund Platt, Vice President,
The Marine Midland Corporation,
120 Broadway,
New York City, N. Y.

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Federal Reserve Bank of St. Louis

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date March 9, 1932

To Mr. Hamlin

Subject:

From Mr. Smead

GPO 2—8495

I have read with much interest your correspondence with Mr. Platt which is returned herewith. The question as to whether of nor Federal reserve notes should be issued against specific collateral pledged with the Federal reserve agent or against the general assets of the bank is one of fundamental importance and involves the basic theory upon which the Federal Reserve Act was written.

The real purpose in requiring specific kinds of collateral to be pledged with the Federal reserve agents against issues of Federal reserve notes, as I understand it, was not so much to protect the government's liability on the notes as the notes are prior lien on all the assets of the banks, but to limit note issues to the demands of commerce, industry and agriculture as evidenced by the amount of commercial and agricultural paper held by the Federal reserve banks. To permit Federal reserve notes to be issued against the general assets of the banks would give the System an opportunity through large purchases of Government securities to take the initiative in expanding the currency instead of requiring the initiative to come from the member banks. This, of course, is possible now to some extent through purchases of acceptances in the open market.

The real bases on which credit expansion takes place in this country are the reserve balances maintained by the member banks with the Federal reserve banks and it is the volume of these deposits that need to be controlled rather than the volume of Federal reserve notes in circulation.

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The basic question involved is, it seems to me, whether or not some limitation should be placed upon the System's right to engage in open market operations, particularly the purchase of United States securities. To attempt to limit such operations through collateral requirements against Federal reserve notes is tantamount to locking the barn after the horse is stolen since once a substantial volume of credit is outstanding and member banks' deposit liabilities are expanding on the basis of such reserve balances, the member banks will of necessity borrow from the Federal reserve banks, to obtain such volume of currency as is needed to carry on their general operations. In other words, the volume of member bank reserve balances upon which credit expansion is based should be controlled by a sould credit policy with such legal limitations on open market operations as Congress may see fit to impose and the volume of currency in use should be automatically adjusted to current requirements.

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Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date March 8, 1932.

To Mr. Smead

Subject:

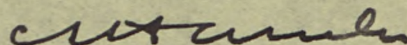
From Mr. Hamlin

2—8495

Dear Mr. Smead:

I enclose copy of a note I sent to Mr. Platt, and his reply. I also enclose copy of a proposed reply to him. Will you kindly look them over, and make any criticisms you desire?

Sincerely yours,



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MARINE MIDLAND GROUP, INC.

EDMUND PLATT
VICE-PRESIDENT

ROOM 820
120 BROADWAY
NEW YORK, N.Y.

March 7, 1932.

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

Dear Mr. Hamlin:

Yours of the 5th has just come in and I was very much interested in your statement that Federal reserve notes "should be made a straight asset currency." There certainly isn't any real necessity for collateral for the notes with the 40 per cent gold reserve, and the only question it seems to me is whether it is wise to allow notes to be issued on assets accumulated by the Federal reserve banks on their initiative, with the Board's approval, or whether they should always be issued on the initiative of the member banks. If issued on the initiative of the Federal reserve banks that, of course, is contrary to the whole original theory of the Federal reserve currency but in such an emergency through which we have passed and are still passing I see no reason why member banks should be required to pay for currency either at the regular rediscount rate or at one per cent penalty rate, when the currency is used to pay off deposits, simply changing one form of purchasing power into another. No inflation can possibly result, as the National City Bank points out in its March Bulletin, and the member banks lose money instead of gaining by the process.

We are gloating a little over the statement in the newspapers this morning that you had several inches of wet snow yesterday, while we in New York and on Long Island had merely a high wind and heavy rain, with a few flakes of snow not enough to show on the ground. However, spring is doubtless further advanced with you than it is with us and better weather is coming.

With best regards,

Yours very sincerely,

Edmund Platt

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March 5, 1932.

Dear Mr. Platt:

I have your note of March 4th. I agree with you that the Federal reserve note should be made a straight asset currency, but of course with some limitation upon the amount which may be issued. I do not see any necessity for collateral for these notes other than the 40% gold reserve, as they are prior lien on all the assets of the bank.

I do not know that any loans have yet been made under the Glass Steagall emergency act, but I presume there soon will be some.

With best wishes,

Sincerely yours,

Hon. Edmund Platt, Vice-President,
Marine Midland Corporation,
120 Broadway,
New York City, N. Y.

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MARINE MIDLAND GROUP, INC.

EDMUND PLATT
VICE-PRESIDENT

ROOM 820
120 BROADWAY
NEW YORK, N.Y.

March 4, 1932.

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

Dear Mr. Hamlin:

When I last saw you in Washington I had the idea that I should probably be coming down again before many weeks but the Glass Banking Reform bill seems to be held up and I heard it said, of the Federal Reserve Banks, that it is quite possibly dead for the session. In the course of the debate on the Glass-Steagall Act Senator Glass and one or two others constantly referred to the Banking Reform bill and promised it would be brought in again within a few weeks and I have no doubt that Glass at least meant what he said.

One question I have heard discussed more or less and that is whether the third section of the Glass-Steagall Act, permitting government bonds to be used as collateral for currency, should be made permanent law. My present feeling is that it should not be but, on the other hand, it seems to me that there ought to be some means of calling it back into action without waiting for its re-enactment by Congress in case the System should ever be caught again with its pants down as it was in October and November last, with gold going out at an unprecedented rate and currency being demanded at an unprecedented rate at the same time. Furthermore I think there is something to be said for a straight asset currency. How do you feel about this?

I understand that loans are being made under the first or perhaps the second section of the Glass-Steagall Act, although they don't show in the statement of March 3rd which, however, does show that U. S. securities are again being purchased, a policy which I think may be all right at such a time as this if it merely serves to hold down rediscounts a little and offsets gold exports.

With best regards,

Yours very sincerely,

Edmund Platt

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Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date March 9, 1932

To Mr. Hamlin

Subject:

From Mr. Smead

2—8495

Experience in operating the Federal Reserve System has demonstrated that as a practical matter the only real purpose served by requiring Federal reserve banks to pledge eligible paper with the Federal reserve agents against outstanding Federal reserve notes is to limit the amount of United States securities which the Federal reserve banks may purchase. Strangely enough experience has shown this to work directly opposite from the manner in which it was intended, i.e., it has not been an effective means of limiting credit expansion but on the contrary has operated to prevent adequate steps being taken to limit credit deflation.

For example, just before the Glass-Steagall Bill was enacted the free gold of the System was down to slightly over $400,000,000 at a time when member banks were in debt to the Federal reserve banks over $800,000,000 and member bank credit had been declining at perhaps the most rapid rate since the System was inaugurated. Owing to the small amount of free gold held, the System could not safely purchase any material amount of United States securities for the purpose of checking the contraction taking place in member bank credit. In 1929, however, when credit was expanding at a rapid rate, the free gold of the Federal reserve banks amounted to more than twice what it is now, or over $1,000,000,000. At that time the Federal reserve banks held less than $200,000,000 of United States securities and on the basis of the amount of free gold available could readily have purchased several hundred millions of United States securities without running any

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risk of a shortage of collateral for Federal reserve notes.

It seems to me that the requirement of the Federal Reserve Act that certain specified collateral be pledged with the Federal reserve agents against Federal reserve notes issued to the Federal reserve banks has not served the purpose intended, and that the collateral requirement should either be eliminated or changed so as to include any paper or securities the banks are permitted to acquire under Sections 13, 13-a and 14 of the Federal Reserve Act. If a check is desired on the power of the System to expand credit on its own initiative it should be obtained through some limitation on the authority to purchase securities in the open market.

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Mr. Hamlin

See BM

To Mr. Morrill March 11, 1932.

From Mr. Smead Subject: Steagall Bill, H. R. 10241

In accordance with your telephone request of yesterday, there is attached hereto a statement showing the earnings, expenses, losses, etc., of member banks during the year ended June 30, 1931, from which you will note that the net additions to profits of National banks for the year amounted to $52,385,000, of State bank members to $109,640,000, and of all member banks to $162,025,000.

The earnings, expense and dividend reports of state bank members for the last half of 1931 have not yet been completely edited, but net profits as reported by the banks amounted to only $1,278,000, as compared with $67,275,000 in the first half of 1931. Corresponding figures for each Federal reserve district are shown in the second table submitted herewith. The figures for the last six months of 1931 may be changed slightly when the reports have been completely edited and tabulated.

We also find that during the last half of 1931, 427 State bank members of the total of 878 reported a net loss for the period. This is shown, by Federal reserve districts, in a third table.

You may also be interested in a table prepared by the Committee on Branch, Group and Chain Banking, a copy of which is attached, showing the percentage of National banks, in various size groups, that reported annual net losses or no net earnings for the years 1926 - 1930, both inclusive.

The Steagall bill does not state specifically, in Section 202 (a), how average deposits, other than time deposits, are to be determined. The only average daily figures of deposits which we have are those of "net demand deposits on which reserves are computed" and "time deposits." For the calendar year 1931 net demand deposits on which reserves are computed averaged $17,745,000,000 and time deposits $13,072,000,000.

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EARNINGS AND EXPENSES OF MEMBER BANKS DURING THE YEAR ENDED JUNE 30, 1931

(In thousands of dollars)

	All member banks	National banks (1)	State bank members
Gross earnings:			
Interest received-			
On loans (2)	1,216,518	760,371	456,147
On investments (3)	490,950	319,546	171,404
On balances with other banks	37,905	28,247	9,658
Domestic exchange and collection charges	18,460	15,058	3,402
Foreign exchange department	23,931	15,250	8,681
Commissions received	24,139	730	23,409
Trust Department	79,730	26,687	53,043
Profits on securities sold	83,727	50,306	33,421
Other earnings	132,569	90,120	42,449
Total earnings	2,107,929	1,306,315	801,614
Expenses:			
Salaries and wages	441,797	275,028	166,769
Interest paid-			
On borrowed money (2)	15,457	9,018	6,439
On deposits-			
Time	437,323	287,420	149,903
Demand	189,882	106,095	83,787
Bank	69,634	46,101	23,533
Taxes	105,392	64,069	41,323
Other expenses	251,026	158,453	92,573
Total expenses	1,510,511	946,184	564,327
Net earnings	597,418	360,131	237,287
Recoveries on charged-off assets:			
Loans and discounts	23,006	16,582	6,424
Bonds, securities, etc.	12,926	9,295	3,631
All other	13,088	9,355	3,733
Total net earnings and recoveries	646,438	395,363	251,075
Losses charged off:			
On loans and discounts	258,807	186,589	72,218
On bonds, securities, etc.	168,654	119,085	49,569
On banking house, furniture and fixtures	30,318	18,408	11,910
All other losses	26,634	18,896	7,738
Total losses charged off	484,413	342,978	141,435
Net addition to profits	162,025	52,385	109,640
Number of banks, June, 1931	7,781	6,800	981

(1) Member banks only, i.e., exclusive of national banks in Alaska and Hawaii.
(2) Includes discount.
(3) Includes dividends.

FEDERAL RESERVE BOARD
DIVISION OF BANK OPERATIONS
MARCH 11, 1932

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NET PROFITS OF STATE BANK MEMBERS OF THE FEDERAL RESERVE SYSTEM
DURING 1931, BY DISTRICTS

(In thousands of dollars)

Federal Reserve District	First half of 1931	Second half of 1931**	Calendar year 1931**
Boston	4,597	1,598	6,195
New York	31,430	-3,305*	28,125
Philadelphia	6,034	-1,375*	4,659
Cleveland	7,915	7,813	15,728
Richmond	1,345	-732*	613
Atlanta	-3,670*	-465*	-4,135*
Chicago	14,689	-2,960*	11,729
St. Louis	2,041	-325*	1,716
Minneapolis	118	-31*	87
Kansas City	511	288	799
Dallas	321	-286*	35
San Francisco	1,944	1,058	3,002
Total	67,275	1,278	68,553

*Net loss
**Figures covering the last six months of 1931 are preliminary and may be changed upon completion of the examination of the reports of individual banks.

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DIVISION OF BANK OPERATIONS

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TOTAL NUMBER OF STATE BANK MEMBERS OF THE FEDERAL RESERVE SYSTEM AND NUMBER THAT REPORTED A NET LOSS FOR THE LAST HALF OF 1931, BY FEDERAL RESERVE DISTRICTS

(Preliminary figures -- subject to correction)

Federal Reserve District	Total number of state bank members	Number that reported a net loss for last half of 1931
Boston	30	9
New York	142	79
Philadelphia	73	31
Cleveland	70	26
Richmond	32	12
Atlanta	* 44	29
Chicago	175	95
St. Louis	* 86	34
Minneapolis	40	19
Kansas City	23	12
Dallas	67	44
San Francisco	96	57
Total	878	427

*Includes one bank for which no report has been received.

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PERCENTAGE OF NATIONAL BANKS SHOWING
ANNUAL NET LOSSES OR NO NET EARNINGS
DURING 1926-1930

Banks Grouped According to Size of Loans and Investments

Size Groups Loans and investments	Percentage of banks showing losses
Under $150,000	35.0
150,000 to 250,000	28.0
250,000 to 500,000	20.6
500,000 to 750,000	14.6
750,000 to 1,000,000	15.2
1,000,000 to 2,000,000	10.5
2,000,000 to 5,000,000	8.4
5,000,000 to 10,000,000	6.3
10,000,000 to 50,000,000	5.2
50,000,000 and over	2.5
All groups	15.8

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date March 16, 1932.

To Mr. Hamlin.

From Mr. Wyatt.

Subject: The provisions of the Steagall Bill (H. R. 10241) re par clearance and immediate credit.

2—8495

In addition to providing for the guaranty of bank deposits (on which I understand that the Division of Analysis and Research and the Division of Bank Operations are preparing material) the Steagall Bill (H. R. 10241), on which hearings are now being held, contains:

1. A provision (Section 6) abolishing the par clearance of checks and specifically authorizing the member banks to charge "exchange" at a rate not exceeding 10¢ per $100 in remitting for checks drawn on themselves; and

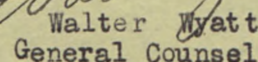
2. A provision (Section 7) requiring the Federal reserve banks to give their member banks <u>immediate credit</u> for checks sent by the member banks to the Federal reserve bank for collection.

For your information on these two points, I am handing you herewith the following documents:

1. A memorandum prepared in this office under date of October 5, 1926 (X-4919) containing a non-technical statement of the merits of par clearance; and

2. A memorandum containing excerpts from briefs filed in the Supreme Court of the United States by Honorable Newton D. Baker and Honorable John W. Davis in two of the most famous par clearance cases, both on the question of par clearance and on the question of giving immediate credit for uncollected checks.

Respectfully,



Walter Wyatt
General Counsel

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Papers attached

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October 5, 1926.

THE MERITS OF PAR CLEARANCE.

The par clearance of checks by Federal reserve banks is conducted pursuant to the express provisions of the Federal Reserve Act, which have been construed by the Supreme Court of the United States to mean that -

(1) Federal reserve banks are required by law to receive and collect at par all checks drawn upon member banks of the Federal Reserve System;

(2) Federal reserve banks are authorized to receive and collect checks drawn upon nonmember banks, if such checks can be collected at par;

(3) Member banks are required by law to remit at par for checks drawn upon themselves and presented to them for payment by Federal reserve banks;

(4) If nonmember banks remit at all for checks forwarded to them by Federal reserve banks they must remit at par; and

(5) Federal reserve banks are prohibited by law from paying exchange.

The above principles are definitely established by the decisions in the cases of American Bank & Trust Co. v. Federal Reserve Bank of Atlanta, 262 U. S. 643; Farmers & Merchants Bank v. Federal Reserve Bank of Richmond, 262 U. S. 649, and Pascagoula National Bank v. Federal Reserve Bank of Atlanta, 3 Fed. (2nd) 465, 11 Fed. (2nd) 866, 46 Sup. Ct. 637. Neither the Federal Reserve Board nor the Federal reserve banks, therefore, have any option in the matter and cannot permit banks to deduct exchange when remitting for checks presented by Federal Reserve banks.

TRADITIONAL POLICY OF THE UNITED STATES.

When Congress passed the Federal Reserve Act and amendments thereto authorizing Federal reserve banks to collect checks at par, its action was based upon a policy of the United States government which had been thoroughly tested by experience and had been found to be sound, namely,

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the policy of the Government to secure at all times acceptability at par for all forms of money or recognized substitutes therefor.

This policy had its inception at the time of the formation of the United States and has been adhered to since that time. Owing to the confusion arising from the various kinds of currency in use and the varying discount at which many of them circulated at the time the Union was formed by the several States, the States surrendered to the United States under the Constitution the sole right to coin money and to provide a uniform standard of value. By appropriate legislation United States coinage was created and immediately became everywhere acceptable at face value.

Again, in 1863 the confusion that had long prevailed in our bank note currency, then an important medium of exchange, caused Congress to legislate on the subject. One of the difficulties with this currency was that most notes issued by country banks did not circulate at par because the issuing banks deducted exchange in paying them when sent for redemption by city banks. The National Bank Acts of 1863-65 cured this difficulty by taxing out of existence notes of the State banks and by creating national bank notes which every national bank was required to receive at par and which were, therefore, everywhere accepted at face value.

Fifty years later, in 1913, when the Federal Reserve Act was under consideration, the use of checks as a medium of exchange had increased enormously. Indeed, the ease and economy with which funds can be transferred and debts settled by checks has been a large factor in the rapid growth of American business and banking. Congress, therefore, in establishing a new and country-wide banking organization followed the traditional policy of the United States and made provisions whereby checks might be paid at par, thereby insuring a wider acceptability for such checks.

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Ninety-seven per cent of all payments in this country are now made with checks and the demands of a small number of banks in the smaller cities and towns that they be permitted to maintain their "toll gates on the highways of commerce" through the charging of exchange on checks sent them for collection by Federal reserve banks, is diametrically opposed to the national policy of securing the free circulation at par of all forms of money or recognized substitutes therefor. If heeded, it would greatly discourage the maintenance of deposits in banks which persist in making such charges.

BENEFITS OF PAR CLEARANCE TO THE PUBLIC.

The benefits which accrue to business men and to the public generally under the par clearance system as conducted by the Federal reserve banks may be summarized briefly as follows:

(1) It enables the business man to get 100 per cent payment of his invoices in the most convenient and expeditious manner. This means that when he receives a $100 check for a $100 invoice he gets $100 for it, not less.

(2) It has made the check of the business man, be he merchant, manufacturer, or farmer, a much more satisfactory and acceptable means of payment for all purchases, even in distant cities. It has relieved him from having to purchase drafts or carry bank balances at distant places in order to make distant payments.

(3) It has reduced to a minimum the time required to collect checks, thereby making the proceeds of a check available to its owner much sooner than formerly.

(4) It results in a much more expeditious handling of checks, thus providing prompt advice and return of dishonored checks, and minimizing the chance of loss through bank failures.

EVOLUTION OF THE USE OF CHECKS.

In the earlier and more primitive days, commercial transactions were conducted through barter or the exchange of one kind of goods for another. When money came into use it was necessary for a purchaser of goods to transport the money with which to settle his obligations

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to the place of payment or to have it transported by the primitive methods then available. Later, owing to the hazard and expense of the physical shipment of money by an individual, banking institutions undertook, for a consideration, to provide the purchaser of goods with a draft drawn upon a banking institution in a financial center which would be acceptable to the seller of the goods in lieu of cash. To compensate his bank or banker for the expense and hazard of establishing a credit balance in New York or some other financial center the purchaser paid a stipulated sum of money for the draft in addition to its face value.

At this stage of banking practice checks were practically worthless as media for settlement of obligations except within the community where the drawee bank was located, because there was no satisfactory means of collecting such checks.

Banks and bankers made some profit from the sale of drafts to be used in payment of debts; but they observed that, in order to avoid the expense of purchasing exchange drafts, the public continued in a large measure to pay its debts in cash, and that this practice caused large amounts of money to be hoarded and not deposited in banks. Banks and bankers also observed that if the use of checks became general they could greatly increase their own deposits and, through the use of checks drawn on banks in other places, could build up balances in such places without the expense of shipping currency. The banks, throughout the country, therefore, undertook to encourage the public to deposit its money in banks and to use bank checks in payment of debts. They taught the public that checks of individuals, firms, and corporations could be used as a means of discharging their obligations everywhere in a manner convenient to themselves and satisfactory to their creditors. Bank checks, therefore, originated, as instruments

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designed for the benefit of banks; since their use enabled banks to facilitate their own operations, to escape the cost of currency transfers, and to obtain vast amounts of deposits which had hitherto been hoarded.

Finally, under the encouragement of banks and bankers, the practice developed of using checks upon the local bank in settlement of transactions with non-residents. At first this practice was confined to settlements with residents of nearby communities; but gradually the practice spread until the check became the almost universal medium of settlement, regardless of the distance between the parties to the transaction. At the present time, in this country, 97% of all payments are made by means of bank checks.

ORIGIN OF "EXCHANGE CHARGES."

Up to the time when the use of bank drafts was in most instances abandoned for the use of checks, the cost of the draft was borne by the purchaser of the draft and not by the person to whom it was sent. When checks came into general use, banking institutions which had formerly secured revenue from the sale of drafts to their customers, reversed the process and deducted so-called "exchange charges" when remitting to out of town banks for checks drawn on themselves. And they did this in spite of the fact that they had the use of their depositor's money during the additional time when his check was travelling to the payee in a distance place and back to the drawee bank for payment.

When a bank receives a general deposit from one of its customers it receives a loan, either without interest or at a very low rate of interest; and, if the purpose of the deposit is to create or maintain a checking account, the bank, in return for the use of its customer's money, undertakes to honor checks drawn against such deposit as and when presented. Under the common

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law it is obligated to pay such checks in cash when presented at the bank, but not to remit the proceeds to distant places. When checks were sent in through the mails from distant places, therefore, the banks claimed that in remitting the proceeds to such places they performed a service which they were not obligated to perform and that they were entitled to compensation therefor. It was for this alleged service that they deducted the so-called "exchange charge."

In the old and more primitive days of banking there was some justification for this charge, because it was sometimes necessary for banks to ship cash in payment of such checks. As the banking business developed, however, this necessity was avoided through the maintenance of accounts in correspondent banks against which drafts could be drawn in payment of such checks. The banks, however, continued to impose exchange charges, attempting to justify this practice on the theory that it was still necessary for the paying bank to incur expense in shipping currency from its vaults to maintain its balance with its correspondent banks. At one time this was true, but a means was soon found to avoid this necessity. The rural banks adopted the practice of establishing credit balances in recognized financial centers by depositing drafts on other institutions in which they had credit balances or by sending to the financial center the checks which had come to them on banks in the financial centers or nearby places. The banks in the financial centers became in effect clearing houses for the country banks, and their transactions with the country banks were largely, if not wholly, confined to paper items in lieu of currency.

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"EXCHANGE CHARGES" NO LONGER JUSTIFIED

At this stage of the development, practically the only necessity for shipment of currency was between banks in the financial centers, and the cost of these shipments was not charged to the country banks as such, but was absorbed as part of the operating expense of the banking institutions in the financial centers. As the practice existed even prior to the passage of the Federal Reserve Act, therefore, the necessity for a country bank to make currency shipments had practically disappeared, and if its operations resulted in its correspondents in financial centers being required to make currency shipments, no part of the expense incurred by such correspondents was charged as such to the country bank.

After these improvements and economies were adopted it was actually less expensive for a bank to remit by draft for checks drawn on it than it was to pay such checks in cash over the counter. They were required to maintain less idle cash on hand, and the writing and mailing of remittance drafts involved much less actual labor than the counting out and paying of cash over the counter, especially since a number of checks could be remitted for with a single draft.

The exchange charge was, therefore, no longer justified but it still persisted as a sort of petty graft based upon an obsolete practice.

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CHECK COLLECTIONS UNDER FEDERAL RESERVE SYSTEM.

Upon the establishment of the Federal reserve banks, even the necessity of currency shipments by the banks in financial centers at their own expense was eliminated, for the reason that most of the banking institutions located in the financial centers became members of the Federal Reserve System and were entitled to make settlement through the Federal reserve bank in their district with any banking institution in the United States wherever located by means of what is known as the Gold Settlement Fund. This fund was created by having each Federal reserve bank deposit gold at the Treasury Department in Washington, receiving therefor a book credit to which is debited or credited at the close of each day's business, upon telegraphic advice from the Federal reserve banks, the net balances due to or from each other Federal reserve bank. By this means the daily transactions between Federal reserve banks, both on their own account and for the account of their member banks, are settled by a mere book transfer of title to gold, without the physical shipment thereof.

It is not overstating the fact, therefore, to say that all expense and hazard formerly incurred by private banking institutions in remitting to distant points for checks drawn on themselves have been virtually eliminated. Even the expense of making remittances to the Federal reserve bank is largely, if not wholly, absorbed by the Federal reserve bank, which furnishes drawee banks with stamped, self-addressed envelopes in which to remit exchange drafts. Where drawee banks elect to remit in cash, rather than by exchange draft, the Federal reserve banks assume all risk and pay all expenses of such shipments.

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LESS EXPENSIVE TO REMIT FOR OUT OF TOWN CHECKS THAN TO PAY CHECKS ACROSS COUNTER.

Not only has the expense of making remittances been eliminated, but, through the centralization of the collecting functions in the Federal reserve banks, certain further economies have been effected. Under the old system each bank received every day numerous cash letters from other banks containing checks on it sent for payment. For each cash letter the drawee bank had to write a separate remittance draft and mail same to the sending bank. Since the establishment of the Federal Reserve Collection System practically all of the checks coming to a bank which remits at par come through the Federal reserve bank in a single cash letter and can be paid with a single remittance draft drawn either against funds which the bank is required by law to maintain on deposit with the Federal reserve bank as reserves or against funds which it maintains with other banks for other purposes. In this way the actual labor of paying checks received through the mails has been reduced to an absolute minimum and is much less than the labor and expense of paying them in cash across the counter, as the bank contracts to do when it opens a checking account for one of its customers.

It is perfectly obvious, therefore, that banks no longer incur expenses or perform valuable services when they remit for checks sent to them through the mails, but they actually discharge their obligations to their customers with less labor and less expense to themselves than when they pay such checks across the counter.

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BETTER TO REMIT THROUGH FEDERAL RESERVE SYSTEM THAN THROUGH OTHER CHANNELS.

That it is better from the bank's own standpoint to remit at par through the Federal Reserve System than to remit through other channels has been recognized and frankly admitted by some nonmember country banks which have tried both systems, as appears from letters received by Federal reserve banks.

One such country bank, having a capital of $30,000 and a surplus of $20,000 and located in a town with a population of 1075 people, wrote to its Federal reserve bank requesting that its name be restored to the par list, saying:

> "Beginning this date, we will par all items on our bank and will ask you to place us on the par list again, as we find the extra trouble we have is worth more than the exchange we have been getting."

Another small bank with a capital of $25,000 and a surplus of $33,720, and located in a town with a population of 516 people, wrote as follows, to its Federal reserve bank requesting that it again be placed on the par list:

> "We are again taking up the matter with you in reference to handling at par items received by you drawn on this bank, and in that connection we find that the change we made has created quite an additional amount of work on the employees of our bank, and in view of the fact that our business is rapidly increasing we have decided to par all items sent us by you drawn on this bank, and until further notified by us we will remit at par to you for all items sent us from the Federal Reserve Bank."

Still another small bank with a capital of $25,000 and a surplus of $14,000 and located in a town with a population of 500 in requesting that it again be placed on the par list says:

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"Please place us back on the par list. After trying out the par proposition and receiving so many cash letters from all over the country, I think the par system much better."

These letters were unsolicited and were taken from the routine correspondence of Federal reserve banks. Further illustrations could be produced in great numbers; but the above are sufficient to indicate the trend of enlightened banking thought.

NO NET PROFIT IN EXCHANGE CHARGES.

In order that a profit might be made out of exchange charges under the old system of collecting checks it was necessary for country banks to avoid the payment of exchange on checks deposited with them for collection by their customers, for if the country bank had to pay exchange on these items the amount they would have to pay would offset the amount they would collect. Country banks could not ordinarily charge back to a customer exchange charges which they had to pay, because when they endeavored to gain his account they assured him that he could deposit his checks for collection and that the bank would replace them to his credit without any charge for making the collection.

In order, therefore, to effect a system whereby they could charge exchange but would be relieved from paying exchange, country banks entered into agreements with banks located in the financial centers under which the country banks were permitted to charge exchange on all checks drawn on them and the banks in the financial center agreed to collect all checks sent to them by the country banks without charging the country banks exchange. The country banks were able to effect such an arrangement with

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banks in financial centers only by agreeing to maintain with their city correspondent balances sufficiently large to compensate the city banks for the following items:

1. Interest allowed to the country banks on the account.
2. Exchange paid on the checks collected by the city banks.
3. The actual expense of handling the account and collecting the checks.
4. A profit sufficient to make the business worth while to the city correspondent.

It is very doubtful, therefore, whether the country banks ever derived a net profit from such an arrangement. The exchange charges appeared as a profit on their books; but this was offset by the loss of the use of the funds maintained on deposit with the city correspondent. True, the city correspondent paid interest on this deposit at a low rate - say 2% - but by investing or lending this money themselves the country banks could have earned much more than the exchange charges plus the interest paid by the city correspondent. Otherwise there would have been no profit in the transaction for the city correspondent.

CIRCUITOUS ROUTING AND DELAY IN MAKING COLLECTIONS.

In order to collect checks which country banks sent them the city banks had to pay exchange charges in some instances; but they endeavored by every possible means to avoid the payment of such charges.

In endeavoring to avoid the payment of exchange charges the city banks entered into reciprocal relations with other banks whereby they remitted to each other at par without charging exchange; but such relations were not universal and banks were constantly getting checks on

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other banks with which they had no such relations. When they received such checks they did not send them direct to the drawee banks but sent them to other banks with which they had reciprocal relations, hoping that such other banks would be able to find a means whereby the checks could be collected without the payment of exchange charges. This led to the circuitous routing of checks with all of its attendant evils, including the risk and delay resulting from the fact that such checks often would float about the country for weeks before they were finally presented for payment. It was partly to eliminate these evils that Congress authorized Federal reserve banks to institute the Federal reserve check collection system, the benefits of which have been recognized by the overwhelming majority of banks.

It is not probable that there is any country bank which desires to return to the old circuitous routing of checks, to the resulting delay in the collection of checks, and to the necessity of maintaining large balances with city correspondents in order that it may not have to pay exchange. It is now universally recognized by informed country bankers that these old methods and devices of avoiding the payment of exchange are more costly to the country bank than the loss of the amount which it derives from charging exchange.

If, on the other hand, exchange charges were permitted and checks continued to be collected through the Federal reserve banks, all banks would charge exchange on checks drawn upon themselves and would be forced to pay exchange on checks which they receive for collection. The result in general would be that no bank would make any profit out of exchange charges, since the amount a bank would have to pay in exchange charges would approximately balance the amount which it received from such charges. The banks might attempt to pass the exchange charges back to

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their depositors; but if they did they would soon hear from their depositors, who have greatly benefited by the par collection of checks and have strongly resisted every attempt to go back to the old practice.

CONCLUSION.

There are in operation in this country at the present time 27,485 banks exclusive of mutual savings bank. Out of this number 23,584 remit at par and without the deduction of an exchange charge for checks drawn upon themselves. Of the 23,584 banks which now remit at par, 14,207 are not members of the Federal Reserve System and they remit at par voluntarily and not under compulsion of law. This is ample evidence of the extent to which enlightened bankers have recognized the advantages of the Federal Reserve Par Collection System.

The practical question whether nonmember country banks should charge exchange on checks really comes to this: Do the country banks prefer to cling to an antiquated banking practice which seems to produce a small revenue, but actually results in a net operating loss, or are they among the forward-looking bankers of the country who recognize that the par clearance system is efficient, economical and profitable, and for the best interests of the country as a whole? One path leads backward to the old conditions of chaos, delay and expense in check clearances. The other steps along with progress and modern banking conditions and provides a means whereby checks, which play such a predominant part in paying the accounts and adjusting the balances of the whole country, may be collected quickly, safely and economically, with a resultant benefit to every user of checks of incalculable value and a corresponding benefit to banks.

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PAR CLEARANCE AND IMMEDIATE CREDIT.

(Excerpts from briefs filed in Supreme Court of the United States by Honorable Newton D. Baker and Messrs. Hollins N. Randolph, Robert S. Parker, Montgomery B. Angell and Walter Wyatt in case of Pascagoula National Bank v. Federal Reserve Bank of Atlanta.)

LEGISLATIVE HISTORY OF PAR CLEARANCE.

Under the Act as it originally stood, the Federal Reserve Banks construed the language of Section 16 to the effect that they were required to receive checks and drafts from member banks at par, as the equivalent of a prohibition upon them from paying exchange charges or allowing deduction of exchange charges, by drawee banks, upon checks presented through the Federal Reserve Bank. The further language of section 16, authorizing the Federal Reserve Board to exercise the functions of a clearing house for theFederal Reserve Banks, and to require such banks to exercise the functions of clearing houses for their member banks, were construed to be a direction to establish a system of universal par clearance so far as the operations of Federal Reserve Banks were concerned.

Even prior to the enactment of the Federal Reserve Act clearance at par had become practically universal throughout the New England District. In the rest of the country, the incidence of exchange charges was casual. Banks had built up reciprocal arrangements with one another by private understandings. Banks in the large reserve and central reserve cities, as a means of inviting the deposit of country bank reserves, undertook to secure par payment of checks transmitted by regular correspondents. As a consequence, each bank was associated with some other

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banks in an effort to secure par clearance, but there was no universal relation and the resulting practice was that banks ordinarily routed directly only those checks that were drawn upon banks with which they had, by private understanding, a par payment arrangement. The bulk of checks drawn upon other banks were routed indirectly, going from one bank to another, until they finally reached a bank which had reciprocal par clearance arrangements both with the bank from which it received the check and with the bank upon which the check was drawn. Checks deposited in a bank within fifty miles of the bank upon which the check was drawn would often travel hundreds of miles back and forth from one bank to another, seeking to escape exchange charges. The evils of this practice are obvious. A large volume of checks was kept in transit, with multiplied opportunities for loss. The rights and equities of the drawer and payee, as well as the several banks involved, were suspended and confused. An unjust delay was interposed between the receipt of a check and the receipt of its proceeds by the owner, and drawee banks were enabled to have possession and use of funds long after the depositors had attempted to withdraw them and to pay them to their creditors.

So far as the actual payment of exchange charges is concerned, this roundabout, indirect, private arrangement often avoided their payment, but it was cumbersome, costly, both of money and time, and lacked uniformity in its application.

The Federal Reserve Board, accordingly, undertook the establishment of a universal par clearance system, believing that to be the mandate of the law.

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So far as the operations of member banks were concerned, the statute compelled their compliance. Member banks consisted of all national banks and such state banks and trust companies as might voluntarily become members of the System. It was a matter of surprise to discover that State banks and trust companies were reluctant to become members. This being called to the attention of Congress, an effort was made to make the intitation more attractive, and Section 13 was amended, in the particulars above described, with the express purpose of widening the scope of the clearing house and collection features of the Federal Reserve System, so as to make the services of the System more attracttive to state banks and trust companies, thus inducing a larger membership of them in the System and making the collection and clearing function more useful to the general business of the country.

By 1917 there had already grown up in some parts of the country a disposition to resist the attempt of the Federal Reserve Banks to make par clearance universal. The reason for that resistance is immaterial. In general, however, it may be said that many banks had established private arrangements which gave them competitive advantages, which would be lost should the par clearance system become universal. Accordingly, when the matter came to be considered in Congress in 1917, there were, in both the Senate and House, members who desired so to amend the Act as expressly to authorize exchange charges. This disposition was both for the purpose of enabling the country banks to preserve exchange charges as sources of revenue, and also for the purpose of making membership in the Federal Reserve System unattractive to State Banks.

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From this point the matter can be best followed in the debates in the Congressional Record on the Report of the Conferees on the bill containing the Hardwick Amendment which indicate very clearly that both Houses of Congress fully understood that a vote to approve the Report of the Conferees was a vote to reverse the policy incorporated in the original Hardwick Amendment and was a vote against exchange charges and not for exchange charges. They also show clearly that the amendment, as finally adopted, was intended to prohibit making exchange charges on any checks collected through Federal Reserve Banks regardless of whether such checks were owned outright by the Federal Reserve Banks or were being collected for other banks, pursuant to the enlarged powers then and thereafter granted to Federal Reserve Banks. For authority so to use the Journals of Congress see Blake vs. National Bank, 90 U. S. 307.

When the bill was first pending in the House, Congressman McFadden offered an amendment, the purpose of which was to authorize all banks, both member and nonmember, to make charges, commonly known as "collection charges" for collecting checks drawn on others and also charges, commonly known as "exchange charges" for remitting to out-of-town banks for checks drawn on themselves. On a point of order the House refused to vote on this amendment on the ground that it was not germane to the principal purpose of the bill. In the Senate, however, Senator Hardwick offered the same amendment and succeeded in having it attached to the bill.

The House voted to disagree with the Senate amendments and sent the bill to conference. Mr. McFadden offered a resolution instructing the conferees on the part of the House to "agree in substance" to the Hardwick Amendment. That motion was adopted by the House, but it afterward

developed that many members of the House did not know for what they were voting.

At this stage of the proceeding President Wilson addressed the following letter to Senator Owen, who later read it to the Senate. (Cong. Rec. Vol 55 p. 3761):

> "My dear Senator: I have been a good deal disturbed to learn of the proposed amendment to the Federal reserve act which seems to contemplate charging Federal reserve banks for payment of checks cleared by them, or charging the payee of such checks, passing through the reserve banks with a commission. I should regard such a provision as most unfortunate and as almost destructive of the function of the Federal reserve banks as a clearing house for member banks, a function which they have performed with so much benefit to the business of the country.
>
> "I hope most sincerely that this matter may be adjusted without interfering with this indispensable clearing function of the banks."
>
> Sincerely yours,
>
> WOODROW WILSON."

The conferees on the part of the House were opposed to the Hardwick Amendment, but under the resolution adopted by the House they were unable to insist that the amendment be stricken out. The conferees on the part of both the House and the Senate, therefore, agreed to leave the amendment in the bill with certain modifications which they frankly hoped would nullify its original purposes. After the words "reasonable charges" they inserted the words "to be determined and regulated by the Federal Reserve Board" and at the end of the amendment they added the provision "but no such charges shall be made against the Federal Reserve Banks."

When the conference report was submitted to the House and Senate these modifications of the Hardwick Amendment were the subject of much bitter debate, and the conferees were charged with an act of bad faith, and a motion was made to recommit the bill to conference with instruc-

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Both Mr. Glass and Senator Owen admitted frankly that they were opposed to the Hardwick Amendment and that the changes were intended to nullify its original purposes.

The following extracts from the Congressional Record will throw much light on this subject. All references are to Volume 55 of the Congressional Record, 65th Congress, First Session.

On page 3618 Mr. Glass said :

> "The gentleman from Ohio (Mr. Switzer) asked me a while ago why the conference report does not omit the Senate amendment altogether, if the practice which it proposes to sanction is so indefensible. The only reason we did not discard the provision was the instruction given by the House. While we felt that the House did not act with full knowledge of the facts, and knew that scores of members had voted under misapprehension, the conferees did not feel at liberty to 'contemptuously' disregard the instructions of the House, as the gentleman from Wyoming (Mr. Mondell) suggests we have done. In the circumstances the best we could do was to retain the phraseology of the Senate 'rider' *and apply an antidote, which, we feel confident, will correct its evil effects in large degree if not entirely*. * * * For these and other reasons, which I have not the time to present, I urge the House to vote down the motion to recommit the bill with instructions." (Italics ours)

And the House did not vote down the motion. (Cong. Rec. p. 3620) and adopted the action of the conferees to preserve par collection. (Cong. Rec. 3621)

The following remarks by Senator Page, on pages 3762 and 3763, clearly indicate that he knew that in voting to approve the conference report he was voting to reverse the policy adopted by the Senate when it passed the Hardwick Amendment:

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"The national banks of my section of the country have finally decided that it is best, all things considered, to enter the clearing house system provided by the Federal reserve banks. We did not like to do it, for it took from us a little profit to whichwe thought we were legitimately entitled. But, Mr. President, here is a great system, which is endeavoring to clear at par the checks of the whole country, and while I fear it means a loss to the little national banks scattered throughout the country, yet I believe that, in view of the conditions which surround us today, they had better yield to the extent asked for by this measure, and so while I have in the past sustained my good friend the Senator from Georgia in his contention I think the time has come when I ought to reverse myself on this matter, and I am going to vote to sustain the conference report."

That Senator Hardwick himself understood that the modifications agreed upon by the conferees nullified the purpose of his amendment is indicated by the following remarks (pages 3764 and 3765) as well as by the fact that he voted against the adoption of the conference report:

"Mr. Hardwick. Of course the Senator from Vermont must be the judge of his own conduct about that, but as far as I am concerned I do not want anyone in this body or outside to think that I believe for one minute that there is anything left in this amendment by the confrence report.

* * * * * * * * * *

"Of course the Senator from Massachusetts (Mr. Weeks) is satisfied with this amendment as reported by the conferees. He opposed the original amendment before, and every Senator who opposed it before ought to be satisfied now with the conference report; there is no reason why he should not be. Of course, the Senator from Massachusetts is willing to vote for the conference report; but I am a little surprised that my friend from Vermont (Mr. Page) is willing to do so.

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Now let us see what they did. They went to conference. The Senate has adopted this amendment adding to Section 3 (sic 13) a proviso which reads as follows:

> "Provided Further, That nothing in this or any other section of this act shall be construed as prohibiting a member or nonmember bank from making reasonable charges, in no case to exceed 10 cents per $100 or fraction thereof, based on the total of checks and drafts presented at any one time, for collection or payment of checks and drafts and remission therefor by exchange or otherwise."

" When the conferees, * * * finally thought they had waited long enough to risk a vote, * * * and asked the two Houses of Congress to reverse their position in this matter. The house of Representatives has done it by a very narrow margin; the Senate may do it if a majority of its members want to do it; but I am determined that they shall not do it without knowing exactly what they are doing, exactly what it means, and certainly not with my vote, even if my distinguished friend from Vermont does favor such a course.

* * * * * * * * * * *

" Mr. Norris. As I heard it read, I thought the only material change was in the clause that was added at the end.

Mr. Hardwick. That is the most material change, because I say frankly that, while I do not like the words I have just quoted, I would not resist theconference report ifit were not for the fact that the conferees added at the end of it, as the Senator evidently caught it, this provision:

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" But no such charges shall be made against the Federal Reserve Banks."

That destroys the whole amendment; and the President's letter proves that it was intended to destroy the whole business, and that it will be construed so as to destroy the amendment, because he says he does not want any amendment allowing a commission to be charged the payee of such checks passing through the Federal Reserve Banks."

"Mr. Owen. Mr. President, I call the attention of the Senator to the date of the letter, showing that it was written before the conference met, and that the language which was added related only to charging the Federal reserve banks with the items. It says nothing about the payee.

"Mr. Hardwick. Yes; while the language does not means that, if it were given the construction that I should like to see given to it, and that I think the Senate ought to force to be given to it, if it is in its power to do so, yet I think, in view of the President's letter which the Senator has brought to us, that it is perfectly plain that the President's object is not only that they shall not have this exchange out of the pockets of the Federal reserve banks, which none of them wanted, but that they shall also not have this exchange on checks passing through the Federal reserve banks, which was exactly what they did not want to accomplish. "(Italics ours.)

The fact that Senator Hardwick recognized that the bill as agreed upon by the conferees would prohibit exchange charges on checks collected by FederalReserve Banks as agents for others as well ason those owned by the Federal Reserve Banks themselves is further indicated by the fact that he tried to have the Senate amend the Glass Proviso to read as follows:

"But no such charge shall be made against the Federal reserve banks, to be absorbed or finally paid by them."

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On page 3767 he said:

> " * * * If the senate will take that position, and we ask these conferees to put on this bill at the end of it, leaving this thing like they reported it, this language -
>
> 'But no such charge shall be made against the Federal Reserve Banks, to be absorbed or finally paid by them - '

We will have this amendment like we ought to have it and like they ought to accept it."

* * * * * * * * * * * * * * *

> "So that if all these people want is to see that the Federal reserve banks themselves shall not pay this exchange out of their own pocket, we will write it double-riveted into this bill; but if they mean to use that language to destroy this amendment and to defeat the will of the Senate; then the better way to do would be to wipe it out entirely and not leave it in the bill the ghost of what it was, a mere remnant of what it was intended to be - something that appears and purports to mean something and yet means nothing. "

This new Hardwick proposal was defeated (page 3771) and both Houses of Congress accepted the Conference Committee report (pages 3621, 3771) and passed the bill, with the distinct understanding that the amendment to Section 13, as passed, left the member banks and nonmember banks perfectly free to make charges for remittances, within limits prescribed by the Federal Reserve Board, in transactions <u>inter sese</u>, but that whenever a check was presented through a Federal Reserve bank, whether as agent for collection or for deposit, to the credit of the reserve account of a member bank, under any of these circumstances, the check was required to be paid by the bank upon which it was drawn, without the deduction of exchange charges.

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The intention of Congress to exclude exchange charges upon all checks presented by the Federal Reserve Banks and not merely those presented by such banks as owners, is further shown by the fact that the Conference Committee amendment to the Hardwick Amendment was partly induced by a letter from the Federal Reserve Board to Mr. Glass, calling attention to the posibility of the government having to pay $1,000,000 exchange charges in connection with the subscriptions to the Liberty loans. Checks of subscribers to these bonds would be collected by the Federal Reserve banks as agent for the government of the United States, one of the regular, authorized depositors in such banks, with no other interest in the proceeds of the checks than to collect them for the account of the government.

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LEGAL AND PRACTICAL ARGUMENTS AGAINST IMMEDIATE CREDIT.

The plaintiff contends that the question of the soundness of allowing immediate credit and availability for checks deposited in the reserve accounts of member banks is wholly irrelevant to any issue in this case.

On the contrary, it is a well established rule of statutory construction that,

> "It is always to be presumed that the legislature intends the most reasonable and beneficial constructions of its enactments when their design is obscure or not explicitly expressed, and such as will avoid inconvenience, hardship, or public injuries." (Black, Interpretation of Laws, p. 126.)

If, therefore, the statute is susceptible of two constructions it should be given that which is in accordance with sound economic policies and which will be beneficial rather than harmful to the public; and if the construction conyended for by the plaintiff would be harmful to the public it is appropriate for defendant to point this out to the Court.

A comprehensive reading of the Federal Reserve Act shows that all of its provisions are harmonized around the central thoughts of real reserves and a sound and elastic currency. Reserves of member banks must be "actual net balances," nothing more or less will satisfy the Act. But given an "actual net balance" to the credit of a member bank, the member bank is authorized to check against this balance as freely as it wishes; provided only that in the event such "actual net balance" falls below the reserve requirements, progressively heavier penalties are im-

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posed and member banks are forbidden to make additional loans or pay any dividends during the existence of such deficiency. Against these reserve balances the Federal Reserve Banks are required by Section 16 to maintain reserves in gold or lawful money to the extent of 35%. They are also required to maintain reserves in gold of not less than 40% against their reserve notes in actual circulation. Beyond these percentages of 35 and 40, respectively, which must be in gold or lawful money, Federal Reserve Banks employ their available funds only by rediscounting the particular kind of paper or purchasing the limited class of securities listed in Sections 13, 13(a) and 14 of the Act.

So long as the reserve balances of the member banks arise out of the deposit of cash or its equivalent, the system of a sound reserve policy based upon actual balances in cash or its equivalent is maintained, and the 35% gold and lawful money reserve requirement imposed on the Federal Reserve Banks is limited to the actual minimum needed for reserve security, leaving their remaining available resources for current operations. But if member banks are entitled to count uncollected checks as part of their own prescribed reserves with the Federal Reserve Banks, as the plaintiff contends should be required by injunction, thus transferring to the Federal Reserve Banks the burden of carrying the "float"

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it would mean that the sound reserve policy of the Act would be abrogated, and that the ultimate reserves against the country's bank deposits would contain a large volume of checks of unproved soundness and doubtful liquidity.

Required reserve balances of all member banks against their deposits are on the average about 10 per cent of their aggregate deposit liabilities. What this means is that when a person deposits $100 in his bank, the bank must keep $10 of this amount on deposit at the reserve bank as reserves against the $100 deposit, and is free to loan or invest the remaining $90. The reserve bank in turn on receiving the $10 must keep $3.50 of it in cash as reserve against the $10 deposit and is free to extend additional credit on the remaining $6.50. Thus the actual cash reserves required to be maintained against a bank deposit of $100 amount to only $3.50. This very low percentage of reserve is adequate because reserves of member banks have been concentrated at the reserve banks and thus have been made very much more efficient, and because the remaining $6.50 in the possession of the reserve banks can be invested only in paper and securities whose soundness and liquidity is scrupulously provided for by Congress. When it reduced the actual cash required to be held back of deposits to the very low level of $3.50 per $100, Congress relied upon the fact that the remaining funds entrusted to the reserve banks would be kept not only in a sound but also in an extremely liquid position, and would in fact be convertible into cash at practically any time. To introduce into this very

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carefully guarded field of reserve bank assets a large volume of uncollected checks of untested validity, would reduce the reserves below the point of safety as determined by Congress. Uncollected checks are considerably more than one-fourth as large in volume as the total of member bank reserve balances, sothat the counting of uncollected checks as reserves would reduce the member banks' actual collected balances by more than 25 per cent. With our required bank reserves reduced to the lowest possible minimum, it is a matter of the greatest public importance to keep these reserves absolutely inviolate.

The Federal Reserve System has by no means superseded inter-bank collection relations. A vast volume, both in number of checks and in amount of money represented by them, is cleared daily by direct correspondence of banks. The rule here contended for would convert every check in the country into currency upon its mere presentation to a Federal Reserve Bank and the "float" now existing would be increased probably many fold. The taking over of the "float" by the reserve banks, as contended for by the plaintiff, would be an inducement to member banks to relax their efforts in reducing the volume of float and to send to the Reserve Banks a large volume of checks which are now collected through other channels; with the consequence that the Reserve Banks would have to give credit in the member banks' reserve accounts not merely for the $500,000,000 of float now in existence, but for a

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much larger amount. In effect every Federal Reserve Bank would be required to cash all checks on member banks, wherever located, without any opportunity to ascertain whether or not they are genuine and drawn against sufficient funds in a sound and solvent bank.

Let us get clearly in mind just what the plaintiff seeks to have established as a mandatory rule upon the Federal Reserve Banks. It is that each Federal Reserve Bank shall receive every check or draft tendered to it which is drawn on any of its depositors as though it were currency, pass the amount of all such checks at once upon their receipt to the credit of the reserve accounts of member banks, and make such credit immediately available for withdrawal in cash or, what is more important, immediately available as legal reserves of the member banks which may be used as the basis for the extension of additional credit in an amount equal to approximately ten times the amount of such reserve. Obviously, in a country like ours, of vast territorial extent and with business relations established from and to all parts, so that the major part of the business of each day is done by checks, and these checks go by mail across the continent and must recross it for collection, a very substantial part of the checks outstanding at any particular moment represents funds hundres or thousands of miles away from the place where they must be finally brought to accomplish the payment for which the checks were given. The time factor in

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the collection of checks varies from hours to days, even when the swiftest means of transportation are used, and the most direct relations established between the bank of deposit by the payee and the drawee bank.

The money or credit which is to pay all these "floating" checks is in various banks, properly to the credit of the persons who deposited it there, earning interest on daily balances, available for the use of the banks holding it, subject to be withdrawn by checks which anticipate those in "float" and subject to equities on behalf of the bank against the depositor. It is not in the hands of the Federal Reserve Bank or available to it for any use until it has been actually collected. Yet this great aggregate sum is by this prayer sought to be doubled by the creation of a fictitious equivalent, credited and made available as cash by the Federal Reserve Banks.

<u>The net result would be, in substantial effect, that any time anybody in the United States deposited with a commercial bank a check, payable at a point where there is no office of a Federal Reserve Bank, a Federal Reserve Bank would make a loan in the amount of that check, without any opportunity to ascertain whether it is, in fact, genuinely drawn against funds in a solvent bank, and without any interest on the loan for the time between the receipt of the check and the collection of the proceeds.</u>

Such a use of reserve bank funds would be contrary to the letter, the spirit, and the purpose of the Federal Re-

serve Act, which throughout shows the solicitude of Congress for safety, soundness, and liqidity of the paper or securities acquired by the reserve banks. The funds available for investment by the reserve banks are the ultimate banking reserves of the country, upon which rests the safety of the deposits of all commercial banks. It is a sacred trust placed upon the reserve banks by Congress to protect the reserves of member banks, so that the deposits of the people at their banks may be available when the occasion arises to use them. To invest funds of this character, the reserves of the nationb banks, in checks, whose soundness has in no way been tested and whose collection may require an indefinite amount of time, would be at variance with the purpose of the Federal Reserve Act, and contrary to the public interest.

Not only would the counting of checks in process of collection as reserves introduce an element of uncertainty and speciousness into the reserves held by member banks against the people's money deposited with them but it would also bring about a danger of credit inflation.

It is difficult to describe in any concise way, the effects growing out of the assumption of the $500,000,000 "float" by the Federal Reserve Banks. The immediate effect of course, would be that this enormous sum would be carried to the reserve accounts of the member banks, thus placing those accounts greatly in excess of the reserve required

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for their then existing deposit liabilities. Now, in these circumstances what would happen ? Theoretically, there are a number of possibilities:

1. The member banks might withdraw the amount in excess of their legal reserve requirements in gold or currency; or

2. They might use some or all of the excess reserves to pay off rediscounts, if they happen to owe any; or

3. They might leave the entire amount to their credit as reserve and use it as the basis for additional credit expansion.

As will be shown below in some detail, the last alternative is the one that would be most profitable to them. To withdraw the amount in gold or currency would simply place them in the possession of idle cash for which there would be no demand and which would earn them no interest; to pay off their rediscounts would be to use the credit only once, that is, dollar for dollar; but to leave it on deposit as reserves with the Federal Reserve Banks and use it as the basis for additional credit expansion would enable them to employ at a profit approximately ten times the amount.

A commercial bank is a business enterprise conducted for profit and its board of directors is under obligation to the stockholders to keep its available funds profitably invested. Commercial banks, therefore, do not keep idle funds on hand so long as they have the opportunity of lending these funds or of making

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investments consistent with banking prudence. Member banks of the Federal reserve system are, however, obliged to keep a certain amount of funds idle: (1) as legally required reserves in the form of balances with the Federal reserve banks, and (2) as cash in vault to meet day-to-day requirements of customers. The proportion of reserves that member banks are required by law to hold against their deposits varies for different classes of cities and different classes of deposits, but on the average for all member banks required reserves are about 10 per cent of the member banks' combined liabilities on demand and time deposits. The proportion of cash to be carried in vault is left to the discretion of the banks themselves, and on the average for all member banks it amounts to two per cent of their deposit liabilities. Since this cash in their own vaults does not count as legal reserves under the law and is unproductive of earnings, the banks endeavor to keep the amount of this cash down to the minimum necessary to meet the demands of their customers. Banking statistics show in fact that both classes of unproductive funds, legal reserve balances at the reserve banks and necessary cash holdings, remain consistently at the lowest level that the law and banking prudence permit. To keep funds idle that could legitimately and safely be employed in a profitable manner would be considered poor management by a commercial bank.

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Under these circumstances, any change in the law or the regulations that would have the effect of adding to the existing reserves of member banks, would lead to increased extension of credit by these banks, for the purpose of employing these surplus reserves. The addition of $500,000,000 of uncollected checks to the reserve balances of member banks, as is proposed by the plaintiff, would result, as the banks used these additional funds, in a large growth in the aggregate volume of bank credit in use. This growth in the amount of credit in use would not arise out of an increase in the credit requirements of trade and industry, but out of an arbitrary change in legal requirements. Such a growth in credit, without a corresponding growth in business activity, constitutes inflation. An addition of $500,000,000 to the reserve balances of member banks will tend inevitably to increase the volume of bank credit in use by several times this amount. The reason for this is that as the banks use the additional funds in granting loans or purchasing investments, most of the borrowers or sellers will leave the proceeds of the transaction on deposit with their bank, so that the net result will be a growth in deposits, without a withdrawal of funds from the banks taken as a whole. But a growth in deposits, as was pointed out above, increases reserve requirements of member banks by only about one-tenth of the amount added to deposits, so that a growth in deposits of $500,000,000 will tie up as reserves only about $50,000,000, leaving an additional $450,000,000 at the disposal of the

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member banks. In the absence of an increased demand for currency accompanying this growth in deposits the banks will be in a position to increase their loans and investments by about $5,000,000,000 before the entire addition to their reserve funds will have been absorbed. In practice the growth in member bank credit on the basis of $500,000,000 added to their reserve funds is not likely to be as large as $5,000,000,000, because experience shows that a large growth in deposits is ultimately followed by a growth in the demand for currency. As customers of member banks would begin to withdraw a part of their deposits in cash the banks would have to use a corresponding proportion of their funds to meet this demand, and their surplus reserve balances available for a ten-fold extension of credit would thus be diminished. The extent of the growth in the currency demand brought about by a growth of $500,000,000 in member bank reserve balances would depend on the prevailing business situation. Under our banking system and with the banking habits of our people such as they are, the volume of actual cash outside of the Federal reserve banks continually adjusts itself to the public's requirements, at the prevailing level of prices, for pocket and till money and to the volume of payrolls of industrial and commercial entërprises. Since the credit arising from the counting of uncollected checks as reserves will have been brought about by a change in interpretation of law and not by an in-

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creased demand for credit through a growth in the country's industry and trade, it would not be likely to be accompanied immediately by a large growth in the demand for currency, and a large part of the addition of $500,000,000 to the reserves of member banks would continue to be available as reserves, which under the law are capable of supporting a ten-fold growth in deposits. The extent of growth in bank credit that would result from an addition of $500,000,000 to bank reserves, unrelated to a growth in commercial credit demand, cannot be predicted with precision, but it is certain from past experiences, such as gold imports, that such an addition to bank reserves, even when considering the resulting increase in the demand for currency, will lead to a growth in the total volume of bank credit of several times that amount. Such a growth in credit would be pure inflation and an artificial disturbance to the course of business.

/ The economic ills of credit inflation are too well known to need extended comment. Prices and the cost of living advance under the stimulus of inflation, and this results in a grave social injustice in that the <u>real</u> wages of the laboring man are reduced through the reduction in the purchasing power of his money. A day's wages buys less bread and meat. Moreover, the bases upon which the industrial and commercial business of the country is done are immediately altered. The process of credit inflation, by its

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very nature, induces and encourages speculation. Unsound business ventures flourish when banks are eager to make loans and their eagerness is induced not by normal and proper business demands, but by the fact that their reserve position has been abnormally enlarged and they are in a position to make profits by expanding credit. It is fundamentally unsound that the banks should thus be tempted to encourage credit inflation by creating for them reserves which are, in fact, fictitious - built up in whole or in large part by the crediting of unrealized funds, and not based on gold, lawful money, or the equivalent in actually collected funds.

Moreover, the financial history of the United States, prior to the passage of the Federal Reserve Act, shows that exactly this kind of unregulated credit inflation was an evil influence causing depressions, crises and panics. It is, therefore, inconceivable that after the exhaustive studies which revealed the causes of our financial instability and after twenty years of legislative effort to remedy these causes resulting in the Federal Reserve Act, aimed directly at them, the court should now reverse the Federal Reserve Act upon itself and through its decision place the reserve banks in a position of being factors in increasing rather than moderating the fluctuations in the course of business.

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Nothing could be more certain than that Congress intended to impose a wholesome regulation upon credit inflation. The requirement that reserves shall be actual net balances is one evidence of this. Reserve balances which could be increased by the banks through the simple process of depositing uncollected checks, would give the banks the power to bring about an enormous credit expansion beyond the needs of our business life and entirely beyond the control of the Federal Reserve System. This would be contrary to the intention of Congress in creating the Federal Reserve System for the purpose of preventing excessive expansion and contraction in the volume of bank credit.

* * * * *

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It is obvious that the credit to the reserve account of the petitioner of all checks taken from it for deposit by the Federal Reserve Bank, under conditions which would render such check immediately available as cash, would result practically in a situation where the reserve balance of the petitioner might consist in large part, or even in whole, or uncollected checks. Although we shall not consider the economic aspects of the question, it should be pointed out to the Court that this situation would constitute a positive violation of Section 19 of the Federal Reserve Act which, as now amended, reads in part as follows:

> "Every bank, banking association, or trust company which is or which becomes a member of any Federal reserve bank shall establish and maintain reserve balances with its Federal reserve bank as follows:
>
> "(a) If not in a reserve or central reserve city, * * * it shall hold and maintain with the Federal Reserve bank of its district an *actual net balance* equal to not less than seven per centum of the aggregate amount of its demand deposits and three per centum of its time deposits." (Italics supplied.)

The words "*actual net balance*" were put into the Act by the amendment of June 21, 1917, (40 Stat. 232), and are designed to execute one of the primary and fundamental purposes of the Federal Reserve Act, namely the creation of *real* reserves as contrasted with the *fictitious* reserves which constituted one of the perilous weaknesses of the old system.

It is manifest that a balance made up, in whole or in part, of items in transit, or in process of collection, would be neither

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actual nor net within the meaning of the statute, and that the demands of the petitioner, if acceded to, would be destructive of the reserve requirements which Congress has imposed upon all member banks. The Act of 1917 is, of course, later in point of time than the original Federal Reserve Act, in which was embodied Section 16, which has never been amended. While we see no conflict of any kind between Section 16 and Section 19 as now amended, were there any such conflict between the requirement for credit at par of checks and drafts, etc., and the requirement for the maintenance by member banks of "actual net balances" for reserve purposes, the later enactment would prevail.

With regard to this amendment it is important to note that Congress, in making it, responded to a recommendation of the Federal Reserve Board which in express terms stated that these words "actual" and "net" would require each bank to "carry its own float." For this reason, since the "reserves" would all be collected balances, the Federal Reserve Board further recommended a reduction in the amount of reserves to be required. The legislative history of the Amendment of June 21, 1917, shows that Congress acted with exactly this understanding and purpose. (Third Annual Report of the Federal Reserve Board, 1916, pp. 22-29; Federal Reserve Bulletin, February 1917, pp. 99 and 104. Congressional Record 65th Congress, 1st Session, Vol. 55, Part 2, page 1588). We thus have a long and consistent administrative interpretation of this language which would be persuasive with the Court. United States v. Alabama Great Southern Railroad Company, 142 U.S. 615-621. Schell's Executor v. Fauche, 138 U.S. 562-572. We have the language in question actually suggested by

the Federal Reserve Board for the express purpose of requiring the member banks to carry their own float, and the language adopted by the Congress and enacted after a debate showing that it not only desired to effect this purpose but made a reduction in the amount of reserve required to be carried, because of the fact that when the reserve consisted entirely of collected items less reserve would be necessary than under the practice of counting as a part of the reserve uncollected items in process of collection.

Further it should be observed that the Federal Reserve Act imposes rigid limitations upon the investment, by Federal Reserve Banks, of their funds. (See Federal Reserve Act, §§ 13, 13a, 14.) To require the Federal Reserve Banks to buy the great volume of checks floating about the country in the process of collection, or any substantial part of them, would obviously violate these limitations and defeat their purpose by requiring the Federal Reserve Banks to invest their funds in "uncollected items," a form of investment not authorized and incompatible with the kinds of investment which are prescribed.

The suggestion made by counsel for petitioner (Brief pp. 36 and 37) that member banks be permitted to have two accounts, one consisting of uncollected items immediately available to check and the other the reserve account consisting only of an actual net balance of collected items, obviously does not advance the argument. Such a bank would immediately check out of its float account and into its reserve account, and its reserve account would thus rest upon the same uncollected items and be neither actual nor net.

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EXCERPTS FROM BRIEF OF HONORABLE JOHN W. DAVIS

American Bank and Trust Company

v.

Federal Reserve Bank of Atlanta

Some time in June, 1916, the Federal Reserve Board at Washington, in accordance with the directions contained in the provisions of the Federal Reserve Act * * * * * inaugurated a policy of universal par clearance of checks, that is, it directed the several Federal Reserve Banks to act as clearing houses for their member banks and to undertake the collection at par of all checks received for collection (R., 75, 211). The policy of universal par clearance was inaugurated by the Federal Reserve Board at Washington, but the methods by which the plan was to be carried into effect in each districtwere left entirely to the respective Federal Reserve Bank of that district (R., 205,209,296,301).

* * * * * * * * * * *

The Attitude of Plaintiffs.

The real reason for the institution of this suit is the reluctance on the part of the plaintiff banks to forego the exchange charges (R., 93)/ In order to retain this revenue, they have charged all manner of illegal acts on the part of the defendant bank, apparently with no other purpose than so to tie the hands of the defendant bank that the plaintiffs may be permitted to continue to exact exchange charges. The plaintiffs have refused to agree to remit by mail at par and have elected to stand on their bare legal rights. Having taken that position,

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they now complain that the Federal Reserve Bank of Atlanta intends to show them no consideration but to go the limit in collecting checks across the counter in order to do them out of a few dollars a year. On the contrary, the evidence discloses that the Federal Reserve Bank of Atlanta has in the past, and proposes in the future, to show them every consideration and even now is prepared to give them the alternative of paying in exchange at par or in cash, rather than stand on its own bare legal rights as holder of checks payable on presentation and demand cash only, a medium which along can discharge the obligation arising out of a negotiable instrument. In the last analysis, this is what the evidence of record discloses. It is admitted that the exchange charges are borne by the ultimate consumer, the people at large (R., 152). Nevertheless, the plaintiffs insist upon the right to retain such charges in much the same way as the spinners of old clung to their alleged right to employment when the cotton gin first came into being. It is a policy of obstruction, pure and simple; an attempt to exact a charge for a service which in reality is no longer rendered, as shown by numerous letters written by Governor Harding and introduced in evidence by the plaintiffs themselves. (See particularly letter to a United States Senator, dated April 1, 1920, R., 122.)

* * * * * * * *

<u>The dictates of sound banking require that if the several Federal Reserve Banks, in undertaking the collection of checks</u>

payable on presentation at par, are to render satisfactory and efficient service to their member banks, they must be prepared to accept for collection and to collect at par any and all checks deposited with them for collection.

Having the necessary authority, it is of course open to the Federal Reserve Banks to exercise such authority at will. There are, however, cogent considerations of policy which impel the Federal Reserve Banks to undertake the universal par collection of checks.

In the United States, the use of the check as a medium of exchange, both locally and at distant points, has grown enormously in recent years on account of its convenience and safety in settling business transactions. By the use of the check, debts may be readily settled at distant points expeditiously and without the danger and expense incident to the shipment of currency. Yet unless the check is universally freed from the imposition of exchange charges, which are in effect nothing more than an unwarranted tax upon its free circulation, the full usefulness of the check as a medium of exchange cannot be attained. With certain banks insisting upon an exchange charge while others will remit for the full amount of a check, a merchant who receives an out of town check in payment for goods sold must face the risk of undergoing a loss in the form of exchange charges, which are often impossible to foresee and which are certainly very inconvenient and annoying when imposed. On the other hand, if all checks are universally collectible at par, the commercial interests of the country may rest assured that a check for $1,000 is worth $1,000 and not $999, or some lesser amount.

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Uniformity in the value of a circulating medium is essential to its full usefulness as such.

Universal par clearance will insure to the check a ready acceptance everywhere. Checks on small towns will be just as available as checks on large centers. Every check, irrespective of the bank or locality upon which it is drawn, should, in the interest of the entire country, represent available funds in the full amount of its face value. If the check collection system set up by Congress under the Federal Reserve Act is to meet properly the needs for which it was created, each Federal Reserve Bank must be prepared to accept for collection and to collect at par checks drawn upon all banks within its district. The value of the collection service rendered by any clearing-house is directly proportionate to the number of banks, checks on which may be collected through it. Even among the protesting non-member banks themselves, the desirability of universal par clearance is recognized. In a letter dated December 30, 1919, to the Federal Reserve Bank of Atlanta, offered in evidence by the plaintiffs (R., 88), Mr. E. M. Moore, President of the Merchants and Farmers Bank of Roanoke, Ala., said:

> "To get down to real facts, we are ready to remit at par for our checks when we can clear everything at par, * * *. There is no doubt but that every check in this country should be remitted at par, and I trust to see this in effect soon."

Moreover, the imposition of exchange charges constitutes a serious and unwarrantable burden upon the commerce of the country as such. It has been estimated that the amount of exchange charges

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which the commerce of the country would have to bear in case the usual exchange charges were assessed upon all out of town checks would amount in a year, in round figures, to some $135,000,000 (R., 124-5). The dictates of sound banking and far seeing policy clearly require that such a condition as this should not be allowed to continue, as it most assuredly will unless the par clearance plan of the Federal Reserve Bank is upheld.

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Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date March 17, 1932

To Mr. Hamlin

Subject:

From Mr. Smead

In accordance with your telephone request, I am giving below a classification of bankers acceptances held by the Federal reserve banks on the last day of January, 1932.

Bankers acceptances, payable in dollars, based on -		
Imports	$16,478,000	
Exports	18,919,000	
Domestic transactions	32,470,000	
Dollar exchange bills	2,239,000	2.2
Shipments between or storage of goods in foreign countries	47,466,000	47.4
Transactions involving shipment of goods between the United States and two or more other countries	1,917,000	
Bankers acceptances payable in foreign currencies	33,444,000	33.4
Total	152,933,000	83.1

The latest information we have as to the amount of real estate loans held by member banks is for December 31, 1931. On that date, as you will note from the Member Bank Call Report attached hereto, national banks held $291,787,000 of loans based on farm land and $1,388,000/000 of loans on other real estate. All member banks on that date held $359,065,000 of loans based on farm land and $2,678,494,000 of loans based on other real estate.

291.7
1388.0

1,679.7

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Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

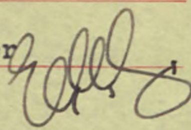
Date March 19, 1932

Se BK

To Mr. Hamlin

Subject:

From Mr. Goldenweiser



GPO 2—8495

Complying with the request contained in your note of March 17, the attached table has been prepared comparing price movements with changes in money in circulation and in reserve bank credit.

In selecting the periods for which to show the changes in each series, the movement of prices has been used as a guide. If either of the other two series were used as a base for periodizing different data would have to be presented.

In using these figures it should be borne in mind that there is a marked seasonal movement of money in circulation and some seasonal movement in reserve bank credit, but no seasonal movement in prices. The correlations shown in the table are in a good many cases substantially affected by these circumstances. Between December 25, for example, and June 27, the larger part of the decline shown for money in circulation reflects only the fact that there is always more money in circulation at Christmas time than there is in the middle of the year.

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Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date March 21, 1932

To Mr. Hamlin

Subject:

From Mr. Van Fossen

2—8495

In accordance with your request of March 17, we have prepared the attached statement showing the average amount of reserve bank credit outstanding and of related items during the first week in January 1922 and 1929, the week ending October 26, 1929 and the week ending March 12, 1932.

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AVERAGE RESERVE BANK CREDIT OUTSTANDING AND RELATED ITEMS DURING THE FIRST WEEK IN JANUARY IN 1922 AND 1929, THE WEEK ENDING OCTOBER 26, 1929, AND THE WEEK ENDING MARCH 12, 1932

(In millions of dollars)

	Week ending Jan. 7,1922	Week ending Jan. 5,1929	Week ending Oct.26,1929	Week ending Mar.12,1932
Bills discounted	1,106	1,048	843	757
Bills bought	126	491	355	136
United States securities	234	239	140	786
Other reserve bank credit	39	54	71	26
Total reserve bank credit	1,505	1,832	1,409	1,705
*Monetary gold stock	3,663	4,126	4,386	4,363
*Treasury currency adjusted	1,553	1,785	1,793	1,778
#Money in circulation	4,665	4,932	4,791	5,563
#Member bank reserve balances	1,741	2,429	2,378	1,901
#Unexpended capital funds, non-member deposits, etc.	315	382	419	382

*Factors of decrease
#Factors of increase

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Mendel
1922-29

add Oct 23, 29
and
Mar - 1932

AVERAGE RESERVE BANK CREDIT OUTSTANDING AND RELATED ITEMS DURING THE FIRST WEEK IN JANUARY IN 1922 AND 1929

(In millions of dollars)

	Week ending Jan. 5, 1929	Week ending Jan. 7, 1922	[handwritten: Jan 5, 29]
Bills discounted	1,048	1,106	
Bills bought	491	126	
United States securities	239	234	
Other reserve bank credit	54	39	
Total reserve bank credit	1,832	1,505	+237
*Monetary gold stock	4,126	3,663	
*Treasury currency adjusted	1,785	1,553	
#Money in circulation	4,932	4,665	
#Member bank reserve balances	2,429	1,741	
#Unexpended capital funds, nonmember deposits, etc.	382	315	

*Factors of decrease
#Factors of increase

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PRICE MOVEMENTS COMPARED WITH

CHANGES IN MONEY IN CIRCULATION AND RESERVE BANK CREDIT

Period	Price Change	Change in money in circulation	Change in reserve bank credit
	(Per cent)	(In millions of dollars)	
May, 1920 - January, 1922	-45	-887	-2,059
February, 1922 - March, 1923	+15	+186	- 98
April, 1923 - June, 1924	- 9	+117	- 342
July, 1924 - February, 1925	+10	- 25	+ 208
March, 1925 - November, 1925	0	+155	+ 258
December, 1925 - June, 1927	-10	-129	- 271
July, 1927 - October, 1927	+ 3	+103	+ 173
November, 1927 - October, 1928	0	- 98	+ 367
November, 1928 - February, 1932	-31	+791	+ 164

Periods shown have been determined by reference to movements of the United States Bureau of Labor Statistics' index of wholesale prices.

Changes in money in circulation and reserve bank credit based on monthly averages of daily figures.

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CHANGES IN AVERAGE RESERVE BANK CREDIT AND RELATED ITEMS BETWEEN THE WEEK ENDING JANUARY 7, 1922, AND THE WEEK ENDING JANUARY 5, 1929.

(In millions of dollars)

	Increase or decrease
Bills discounted	- 58
Bills bought	+ 365
U. S. securities	+ 5
Other reserve bank credit	+ 15
Total reserve bank credit	+ 327
FACTORS RESPONSIBLE FOR INCREASES IN RESERVE BANK CREDIT -	
Member bank reserve balances	+ 688
Money in circulation	+ 267
Unexpended capital funds, nonmember deposits, etc.	+ 67
Total	+1022
FACTORS RESPONSIBLE FOR DECREASES IN RESERVE BANK CREDIT -	
Monetary gold stock	+ 463
Treasury currency, adjusted	+ 232
Total	+ 695
NET CHANGE	327

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