

The Papers of Charles Hamlin (mss24661)

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Hamlin, Charles S., Scrap Book – Volume 226, FRBoard Members

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Scrap Book - Volume 226
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 226 of Mr. Hamlin's scrap book and placed in the Board's files:

VOLUME 226

Page 43

Proposed Amendment to the Federal Reserve Act with Regard to Advances to Member Banks on their Promissory Notes. (Draft--Wyatt)

Page 59

Letter to Senator Walsh re Purchase of Municipal Obligations by F.R.Bk. of Boston.

Page 85

Memo to Mr. Hamlin from Mr. Goldenweiser re banking developments between 1922 and 1929.

Page 125

Memo sent to Sen. Norbeck April 6, 1932, in response to an inquiry from Senator Glass as to whether the Proposed Amendment suggested by the Board to Section 14 of the Act would "abrogate the right of a Federal Reserve Bank to initiate the discount rate and transfer it to the F.R. Board".

Page 137

Memo to Mr. Hamlin from Mr. Smead re Commercial paper held by member banks.

Pages 132, 134, 136, 138, and 139

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PROPOSED AMENDMENT TO THE FEDERAL RESERVE
ACT WITH REGARD TO ADVANCES TO MEMBER
BANKS ON THEIR PROMISSORY NOTES.

The original Federal Reserve Act authorized Federal reserve banks to rediscount commercial and agricultural paper for their member banks, but did not permit them to make direct loans to the member banks on the promissory notes of the latter. Because of the inconvenience of rediscounting many separate pieces of commercial or agricultural paper, however, many member banks preferred to borrow from their correspondent banks on their own promissory notes, as they had been accustomed to do before the enactment of the Federal Reserve Act, rather than to change their method of borrowing so as to avail themselves of the rediscount facilities of the Federal Reserve System.

The amendment of September 7, 1916, was accordingly adopted authorizing Federal reserve banks to make direct loans to their member banks on their promissory notes secured by paper eligible for rediscount or for purchase by Federal reserve banks or secured by bonds or notes of the United States, but the maturity of such notes was limited to fifteen days. The effect of this amendment was to provide another and simpler form of borrowing from Federal reserve banks, without in any respect departing from the fundamental purposes of the Federal Reserve Act or broadening the character or class of paper or securities which might be legally acquired by Federal reserve banks; and the amendment now proposed to increase the maximum

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maturity of such direct advances to member banks to ninety days would be merely an extension of the principle of the 1916 amendment.

There is no logical reason why Federal Reserve Banks should not have the same latitude in making advances to their member banks against the pledge of commercial, industrial and agricultural paper which is eligible for rediscount as they have with respect to rediscounting such paper; since the underlying transactions giving rise to the credit are the same; the substance of the transaction remains the same; and only the form is changed. On the other hand, there are important reasons why this more convenient and practical method of extending credit should not be limited to advances for fifteen days.

The privilege of borrowing on their own notes from Federal reserve banks afforded by the 1916 amendment has been used extensively by member banks which are located in the same cities with Federal reserve banks or their branches or in nearby cities; but country banks generally have found it impractical to avail themselves of the privilege to any great extent, because it is inconvenient for them to renew their notes every fifteen days. Rediscounting, therefore, is still the only practical method available to many country banks of obtaining credit from the Federal reserve banks, and many country banks continue to borrow from their city correspondents on their own promissory notes, instead of rediscounting with the

Federal reserve banks. This probably is one of the reasons why many country banks have not joined the Federal Reserve System.

The banks consider rediscounting unnecessarily troublesome and inconvenient. In order to obtain any substantial amount of credit through rediscounting, a member bank usually finds it necessary to offer a number of separate notes or bills of varying amounts and of different maturities; and the amount of discount must be calculated separately for each of these notes or bills. For example, if a member bank wishes to rediscount with its Federal reserve bank paper in the amount of \$100,000, it may be necessary for it to offer as many as twenty or thirty notes of its customers, of different amounts, and maturing on different dates; and the discount must be separately computed as to each of these notes. If for any reason other notes are later substituted for some of those first rediscounted, the amount of discount on each of the substituted notes must also be calculated. When a member bank borrows on its own promissory note secured by collateral, however, it is only necessary to compute the interest on one note for the full amount of the loan and, in cases of substitution of collateral, no additional computation of interest is required.

Furthermore, in the event of the failure of a member bank which has rediscounted notes with a Federal reserve bank, it is necessary for the Federal reserve bank to prove a separate claim against the insolvent institution for each note under rediscount;

whereas, in a case where a Federal reserve bank holds a member bank's own note secured by any number of notes as collateral, it may, in the event of the failure of the member bank, prove one claim for the entire amount.

It is evident, therefore, that an amendment to the law increasing the maximum maturity of advances to member banks on their promissory notes secured by paper eligible for rediscount or for purchase from fifteen to ninety days would be of material benefit both to member banks and to Federal reserve banks. The reasons for such an amendment, which have been discussed above, may be summarized briefly as follows:

1. Under existing law, rediscounting is the only practical method available to many country banks of obtaining credit from Federal reserve banks.

2. Rediscounting is necessarily troublesome and inconvenient to member banks because of the necessity for calculating separately the amount of discount on each note offered for the purpose, and because in cases of substitution of notes interest must be calculated separately on each substituted note.

3. Borrowing by member banks on their promissory notes does not involve the difficulties which are present in rediscounting.

4. The proposed amendment would eliminate the necessity and inconvenience of frequent renewals of member banks' promissory

notes and would thus render this method of obtaining credit from Federal reserve banks practical for use by country banks.

5. A cause of dissatisfaction among country member banks and one of the reasons why many country banks have not joined the Federal Reserve System would be removed.

6. In the event of insolvency of a member bank, each note under rediscount for such bank must be proved by the Federal reserve bank as a separate claim, but the entire amount of an insolvent member bank's promissory note secured by collateral may be proved as one claim.

7. The amendment would not involve any departure from the fundamental purposes of the Federal Reserve Act but would be merely an extension of the principle of the amendment adopted in 1916.

The Federal Reserve Board feels that the increase in maturity of advances on member banks' promissory notes should be limited to notes which are secured by paper eligible for rediscount or purchase by Federal reserve banks and that it should not be made applicable to advances secured by bonds or notes of the United States. It is believed that the proposed increase in maturity of notes secured by paper eligible for rediscount or purchase is adequate to meet the difficulties mentioned above.

Under the existing law, Federal reserve banks are au-

thorized to purchase debentures and other such obligations of Federal Intermediate Credit Banks which have a maturity at the time of the purchase of not more than six months. Such obligations of Federal Intermediate Credit Banks are secured by agricultural paper which, when of proper maturities, is eligible for rediscount by Federal reserve banks. In these circumstances the Board believes that it is desirable that the law should be amended so as to permit debentures and other such obligations of Federal Intermediate Credit Banks, when complying with the requirements for purchase by Federal reserve banks, to be used as security for advances by Federal reserve banks to member banks on their promissory notes for periods not exceeding fifteen days.

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March 10, 1932

Hon. David I. Walsh,
United States Senate,
Washington, D. C.

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My dear Senator Walsh:

This will acknowledge receipt of your letter of March 3 enclosing copy of your letter of February 11 to Hon. Eugene Meyer, Governor of the Federal Reserve Board, and copy of his reply to you dated February 18, 1932, all in reference to the purchase of municipal obligations by the Federal Reserve Bank of Boston. In replying to your specific inquiry, I am going somewhat into detail in order that you may fully appreciate our position and any action we have taken.

Section 14 of the Federal Reserve Act permits us to buy certain municipal obligations under rules and regulations of the Federal Reserve Board. I am sending herewith copy of the Board's regulations regarding the purchase of warrants either with or without the endorsement of a member bank. The regulations of the Federal Reserve Board are such that no doubt many municipal obligations in New England would be eligible for purchase.

We, however, have not been purchasers of such obligations for several years because up to last Fall these obligations always found a ready outside market at very favorable rates, except in some of the smaller communities where the issues were handled by the local banks. Late last Fall the outside market practically disappeared, with the result that we had several inquiries as to what we could do to relieve the situation. As stated above, Section 14 of the Federal Reserve Act and the Regulations of the Federal Reserve Board give us plenty of latitude to purchase such obligations but the difficulty arises in Section 16 which you will observe by reading, does not permit us to pledge such warrants as collateral security for Federal reserve notes. Therefore, our capacity to buy is governed largely by our free gold position. The free gold position of the Federal Reserve Bank of Boston varies from day to day - during the past six months it has been as low as 8 million dollars and at the present time it is approximately 24 million dollars. In December of last year when the strain seemed to be most severe, we made a rough canvass of the probable needs of New England for the coming year and we arrived at the figure of approximately 200 million dollars. Had we entered the market at that time with the free gold that was available, obviously our assistance by direct purchases would not have proved sufficient. We, therefore, were compelled to approach the problem from an entirely different angle, and in

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Hon. David I. Walsh

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March 10, 1932

answer to inquiries from our member banks we reminded them that our rediscount facilities were open to them and if they cared to render the necessary assistance to the municipalities they could secure the credit needed by discounting eligible paper with us and carry the municipal obligations in their own portfolio until such time as their eligible paper was exhausted, then we would give them assistance on their municipal obligations if our free gold position permitted such action. In this way, we could use the eligible paper as collateral security for Federal reserve notes and not affect our free gold position in any appreciable amount. In other words, we can expand many times further if we acquire eligible paper than we would be able to if we purchase municipal obligations.

We believe that we pursued the right course in the circumstances and that this program was helpful to the situation is evidenced I think by the fact that certain municipalities that were unable to negotiate their obligations at 8 per cent or better thirty days ago, have had their needs taken care of and have withdrawn offerings. In fact, one municipality was successful in raising the funds needed at a rate of 5 per cent. I do not want you to arrive at the conclusion that our action alone brought about this situation because other factors such as the Reconstruction Finance Corporation and an easing of the tension in the banking situation of New England also contributed.

The recent amendment to the Federal Reserve Act contained in the Glass Steagall Bill offers further opportunities for relief in emergencies insofar as our free gold is concerned, but regardless of whether we acquire municipal obligations under Section 14 of the Federal Reserve Act or under the Glass Steagall amendments 10a or 10b to Section 10 of the Federal Reserve Act, we cannot pledge such obligations as collateral security for Federal reserve notes and, therefore, our free gold problem is still with us insofar as a municipal obligation is concerned.

I have attempted to make this letter concise, but if there are other inquiries or suggestions that you may wish to make I will greatly appreciate your writing me again.

Yours respectfully,

R. A. Young,
Governor.

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Office Correspondence

FEDERAL RESERVE
BOARD

See 24

Date April 1, 1932

To Mr. Haglin

Subject:

From Mr. Goldenweiser

... 2-8495

In reply to your inquiry of March 24, I enclose a table which gives the fundamental figures bearing on banking developments between 1922 and 1929. You can see from this table that monetary gold stock increased during the period by \$481,000,000, and in addition there was an increase of \$233,000,000 in reserve bank credit and an increase of \$181,000,000 in Treasury currency adjusted, which represented silver purchases and issue of silver certificates by the Treasury. Of the funds put into the market from these three sources, increase in money in circulation absorbed \$228,000,000, capital and surplus of the Federal reserve banks absorbed \$90,000,000, and \$577,000,000 went into member bank reserve balances. It is a fair statement, therefore, to say that all of the gold received during that period, and even more, went into member bank reserve balances, where it constituted a basis of credit expansion. Member bank credit, as a matter of fact, increased by \$11,500,000,000 during this period, or at an approximate rate of \$20 of member bank credit for \$1 of member bank reserves. The facts are clear enough, but the question whether Federal reserve policy could have prevented these developments is one we have often discussed and one that is debatable.

You will notice that, taking this particular period, there was a decrease of \$247,000,000 in Government security holdings of the reserve banks and an increase of \$380,000,000 in discounts, so that the Federal

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Mr. Hamlin, - #2

reserve system did to some extent offset the inflow of gold and member banks increased their borrowings. As I think I have had occasion to say before, I believe that taking the period as a whole there is little that one can criticize in the conduct of the Federal reserve system. If, however, particular briefer periods are considered, it would seem that in 1924 the Federal reserve bought too many securities and forced too much credit on the market and in 1927 it did the same thing to a minor extent. I think that in the light of what we have learned more recently it is clear that the country would have been better off if Federal reserve policy throughout the period had been somewhat more conservative. To be sure, we would probably have not had some of the years of extraordinary prosperity, but it is possible that we would not now be in so deep a depression.

In view of all the disturbing factors that were operating during the period, and the newness of the problems, I do not believe that the system can be criticized legitimately for its course of action. I do think, however, that it is important that the lessons of the period be clearly worked out and indicated so that they will be helpful in shaping future policy.

CHANGE IN RESERVE BANK CREDIT, GOLD STOCK, ETC.
 COMPARED WITH CHANGE IN MEMBER BANK LOANS
 AND INVESTMENTS, 1922-1929

(In millions of dollars)

	Averages of daily figures		
	1922	1929	Change
Bills discounted.....	571	951	+380
Bills bought.....	159	241	+ 82
United States securities.....	455	208	-247
Other reserve bank credit.....	41	59	+ 18
 Total reserve bank credit.....	 1,226	 1,459	 +233
Monetary gold stock.....	3,802	4,283	+481
Treasury currency adjusted....	1,604	1,785	+181
 Money in circulation.....	 4,535	 4,763	 +228
Member bank reserve balances..	1,781	2,358	+577
Nonmember deposits, etc.....	30	30	0
Unexpended capital funds.....	286	376	+ 90
 Member bank loans and invest- ments.....	 <u>1/24,130</u>	 <u>1/35,727</u>	 +11,597

1/ Figures for all member banks; averages of call dates.

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See P. 125

Memorandum Sent to Senator Norbeck April 6, 1932, in reponse to an Inquiry from Senator Glass as to whether the Proposed Amendment Suggested by the Board to Section 14 of the Act would "abrogate the Right of a Federal Reserve Bank to Initiate the Discount Rate and Transfer it to the Federal Reserve Board."

(There is another question answered in the letter which is not material to this matter)

The question has been raised whether the proposed amendment to Section 14 of the Federal Reserve Act suggested on page 21 of the comments and recommendations of the Federal Reserve Board regarding Senate Bill 4115 would "abrogate the right of a Federal reserve bank to initiate the discount rate and transfer it to the Federal Reserve Board."

The answer is that the proposed amendment was not intended in any respect to increase or add to the powers of the Federal Reserve Board over discount rates of Federal reserve banks, and that it does not do so.

On this subject, Section 14 of the Federal Reserve Act now provides as follows:

"Every Federal reserve bank shall have power:

" * * * * *

"(d) To establish from time to time, subject to review and determination of the Federal Reserve Board, rates of discount to be charged by the Federal reserve bank for each class of paper, which shall be fixed with a view of accommodating commerce and business."

By administrative interpretation, acquiesced in by all Federal reserve banks since the earliest days of the Federal Reserve System, it is definitely settled that any discount rate established by

P. 125

any Federal reserve bank cannot become effective until it has been reviewed and determined --i.e., put into effect, by the Federal Reserve Board.

The proposed amendment, which was intended to clarify the Board's power over purchases and sales by the Federal reserve banks in the open market, would insert in Section 14 of the Federal Reserve Act before the words, "Every Federal reserve bank shall have power", the words, "Subject to such regulations, limitations, restrictions and procedure as the Federal Reserve Board may prescribe."

If applied to the power of the Federal reserve banks to establish discount rates "subject to review and determination of the Federal Reserve Board, "the power to prescribe regulations, limitations, restrictions and procedure governing the establishment of such rates would not enable the Board to do anything which it cannot already do in the exercise of its powers in connection with the review and determination of such rates.

In this connection, attention is invited to the fact that Section 11 of the Federal Reserve Act now authorizes the Federal Reserve Board to "exercise general supervision over said Federal reserve banks" and to "make all rules and regulations necessary to enable said board effectively to perform" its duties and functions under the Act; and Section 13 provides that:

"The discount and rediscount and the purchase and sale by any Federal reserve bank of any bills receivable and of domestic and foreign bills of exchange, and of acceptances authorized by this Act, shall be subject to such restrictions, limitations, and regulations as may be imposed by the Federal Reserve Board."

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Office Correspondence

FEDERAL RESERVE
BOARDDate April 11, 1932

See Bu

To Mr. HamlinSubject: Commercial paper held byFrom Mr. Smeadmember banks

2-8495

In accordance with your telephone request of last week, we have prepared and are handing you herewith a statement giving certain figures of paper eligible for rediscount with Federal reserve banks, United States Government securities, etc., in comparison with total loans and investments of national banks and of all member banks, at the end of December 1931 as compared with June 1915, June 1918 and June 1926.

June 1915 is the first time that separate figures of loans on securities and of "all other" loans became available; June 1918 is the first date for which eligible paper figures are available, though for national banks only; and June 1926 is the first date for which figures of eligible paper are available for both national and state member banks.

Since June 1926 there has been a decline in the amount of eligible paper as well as in the amount of eligible paper plus Government securities reported by both national banks and all member banks, also in the ratios of such paper and securities to total loans and investments. On the other hand, there has been a steady rise in the ratio of loans on securities plus securities owned, to total loans and investments.

CLASSIFICATION OF LOANS AND INVESTMENTS OF NATIONAL BANKS
AND OF MEMBER BANKS, 1915, 1918, 1926 AND 1931

(In millions of dollars)

	June 1915	June 1918	June 1926	December 1931
<u>NATIONAL BANKS</u>				
Loans and investments	8,688	13,914	19,159	19,094
Loans - total	6,663	10,078	13,322	11,905
On securities	1,750	2,577	4,034	4,116
All other	4,913	7,500	9,288	7,789
Investments- total	2,025	3,835	5,837	7,189
U.S. Government securities	749	2,025	2,466	3,171
Other securities	1,276	1,810	3,371	4,018
Eligible paper	*	3,218	3,497	1,827
Eligible paper plus U.S. securities	*	5,243	5,963	4,998
<u>ALL MEMBER BANKS</u>				
Loans and investments	8,764	18,507	31,184	30,575
Loans - total	6,720	13,233	22,060	19,261
On securities	*	*	7,321	7,320
All other	*	*	14,739	11,940
Investments - total	2,044	5,274	9,123	11,314
U.S. Government securities	749	2,465	3,745	5,319
Other securities	1,295	2,809	5,378	5,996
Eligible paper	*	*	4,925	2,573
Eligible paper plus U. S. securities	*	*	8,670	7,892
<u>RATIO TO TOTAL LOANS AND INVESTMENTS</u>				
National banks:				
Of eligible paper	*	23.1	18.3	9.6
Of "All other" loans	56.5	53.9	48.5	40.8
Of eligible paper plus U. S. securities	*	37.7	31.1	26.2
Of loans on securities plus investments	43.5	46.1	51.5	59.2
Member banks:				
Of eligible paper	*	*	15.8	8.4
Of "All other" loans	*	*	47.3	39.1
Of eligible paper plus U. S. securities	*	*	27.8	25.8
Of loans on securities plus investments	*	*	52.7	60.9

*Not available.

FEDERAL RESERVE BOARD
DIVISION OF BANK OPERATIONS
APRIL 11, 1932