The Papers of Charles Hamlin (mss24661)

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Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 12, 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 265 of Mr. Hamlin's scrap book and placed in the Board's files:

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Earnings and Expenses of F.R. Banks, October 1935.

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Preliminary memorandum on money market and credit conditions for the Federal Open Market Committee, October 22, 1935.

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Report of the Open Market Operations to meeting of the Federal Open Market Committee at Washington, D. C., October 22, 1935.

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Memo to Mr. Hamlin from Mr. Carpenter re Governors' Conference, October 23, 1935.

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Business and Credit Conditions - Board of Governors of F.R. System, Division of Research and Statistics - October 18, 1935.

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Memo to Mr. Hamlin from Mr. Owens re Authority of Senate Munitions Committee to Subpoena Witnesses and Compel Production of Documents.

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Memo to Mr. Hamlin from Mr. Smead re Section 13 of the F.R. Act.

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Memo to Mr. Hamlin from Mr. Carpenter attaching recommendations submitted by the Federal Advisory Council.

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Minutes of Governors' Conference, October 23, 1935.

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EARNINGS AND EXPENSES OF FEDERAL RESERVE BANKS, OCTOBER, 1935

Federal Reserve Bank	Month of October 1935											January - October 1935		
	Earnings from -							Current expenses		Current net earnings		Current net earnings		
	Discounted bills	Purchased bills	Industrial advances	U. S. Govt. securities	Commitments to make industrial advances	Other sources	Total	Exclusive of cost of F. R. currency	Total	Total	Rate on paid-in capital	Total	Rate on paid-in capital	Less accrued dividends and net charges (current) to profit and loss*
											Per cent		Per cent	
Boston	$918	$894	$11,881	$205,407	$2,375	$155	$221,630	$164,302	$173,493	$48,137	6.	$552,130	6.3	$42,859
New York	9,059	4,587	34,219	974,681	8,752	5,059	1,036,357	603,223	641,438	394,919	9.1	4,700,200	9.7	2,307,640
Philadelphia	395	1,23[illegible]	31,014	231,602	357	1,261	265,859	188,644	199,292	66,567	6.4	600,563	4.9	-137,357
Cleveland	176	1,176	8,710	282,775	1,558	5,726	300,121	220,642	230,093	70,028	6.7	765,571	7.1	94,362
Richmond	378	458	22,819	151,437	1,318	1,999	178,409	131,876	141,005	37,404	9.6	392,319	9.5	141,761
Atlanta	107	446	5,492	122,199	226	2,612	131,082	106,185	115,722	15,360	4.3	299,969	8.2	155,887
Chicago	4	1,441	8,277	435,705	869	18,841	465,137	246,082	269,756	195,381	19.1	2,399,637	22.7	1,925,461
St. Louis	85	346	1,725	140,376	2,091	5,541	150,164	119,072	128,729	21,435	6.8	349,988	10.6	159,688
Minneapolis	109	276	10,135	108,385	120	461	119,486	105,678	110,176	9,310	3.7	185,114	7.1	55,725
Kansas City	1,030	334	4,2[illegible]8	138,831	1,320	14,392	160,175	138,043	141,931	18,244	5.5	238,805	7.1	45,875
Dallas	647	322	8,[illegible]	114,1[illegible]3	500	1,043	125,515	98,688	101,566	23,949	7.4	298,558	9.	127,012
San Francisco	238	866	3,967	258,52[illegible]	4,969	5,058	273,626	206,622	226,229	47,397	5.5	522,923	5.9	48,982
TOTAL														
October 1935	13,146	12,376	151,367	3,164,069	24,455	62,148	3,427,561	2,329,057	2,479,430	948,131	8.6			
September 1935	15,[illegible]19	947	137,034	3,157,722	22,000	95,437	3,428,259	2,321,606	2,460,219	968,040	8.7			
October 1934	55,560	13,235	16,917	3,888,784	1,691	98,605	4,074,792	2,362,839	2,501,389	1,573,403	12.6			
Jan. to Oct. 1935	135,876	33,975	1,178,642	33,674,674	190,335	820,530	36,034,032	23,516,500	24,728,255	11,305,777	9.4	11,305,777	9.4	4,967,895
" " 1934	1,188,4[illegible]2	137,950	23,524	38,634,809	3,445	1,025,988	41,014,208	23,831,591	24,705,859	16,308,349	13.4	16,308,349	13.4	10,061,482

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM
NOVEMBER 12, 1935

*Exclusive of profits of $4,722,227 on sales of United States Government securities held in Special Investment Account.

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PRELIMINARY MEMORANDUM ON MONEY MARKET AND CREDIT CONDITIONS
FOR THE FEDERAL OPEN MARKET COMMITTEE,
OCTOBER 22, 1935.

Excess Reserves and Federal Reserve Policy

Five months have passed since the last meeting of the Federal Open Market Committee when we discussed Federal Reserve policy with particular reference to the question of excess reserves. During this period the System holdings of government securities and total Reserve Bank credit outstanding have remained virtually unchanged, but excess reserves have increased from $2,180,000,000 on March 6 to $2,910,000,000 on October 16. This increase has been due mainly to further gold inflow, and to a less extent to Treasury disbursements of free gold and an increase in silver certificates in excess of retirements of national bank notes.

In attempting to reappraise our policy with respect to excess reserves at the present time, we must find answers to two questions. First, what evidence is there that our present policy is having desirable results? Second, what dangers are there that a continuance of the present policy may have undesirable results? Having answered these questions, we shall be in a better position to consider whether and when and in what ways our policy might wisely be changed.

As stated in a memorandum presented at a meeting of the Executive Committee on April 17, the theory of creating excess reserves was that in a depression, when the capacity and willingness of banks to lend and of private enterprise to borrow have been impaired, excess reserves would put pressure on the banks to buy government securities, thus forcing down the yield on these securities to the point where bank and other investment funds would flow over into private capital investment. The signs then discernible that this pressure had begun to work have since become clearer. One very favorable indication is the progress of the government war debt conversion program, which has now been entirely completed. There have been converted over $8,000,000,000 of bonds into bonds and long-term

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notes at a saving of over 1% on the bonds and more on the notes. Probably the chief financial development of the last seven months has been the appearance in large volume of private refunding issues bearing interest rate reductions of from 1% to 1 3/4%. During the seven months period ended with September, over \$1,300,000,000 of domestic corporate refunding operations were conducted. In addition, there was \$750,000,000 of state, municipal, and farm loan refunding, exclusive of government guaranteed issues. This is evidence that the reduction of yields on short-time investments and on government securities is having its expected effect upon the yields of corporate and other bonds.

In this period, also, the signs of business revival have become clearer. Perhaps the best evidence is that the decline this year from the spring peak of business activity was markedly less than in any year since the depression began, and was arrested earlier than is usual. From the high point of January, general business activity lost by May only about 25% of the previous advance, since which time the index of production has tended moderately upward. In the three preceding wave movements since the bottom of the depression in 1932, from two-thirds to 100% of each upward movement was lost in the subsequent decline. At present it appears that a number of consumer goods industries are nearly back to their predepression level. The automobile industry has made a notable recovery, although at the moment production is low owing to the early introduction of new models. The heavy goods industries still remain the center of the depression but steel production has now recovered to 50% of capacity and machine tool orders recently have made the best showing since 1929, although they have declined somewhat in the last two months.

There is thus some fairly clear evidence both in interest rates and in the state of business that our long-continued policy of easy money and excess reserves is having the desired results. To what extent these results should be ascribed primarily to credit policy or to other factors is now, as always, problematical. Doubtless, the long duration of depression and the consequent wearout and obsolescence of durable goods has been an important, and perhaps the chief, factor in recovery. Also, the strengthening of the capital structure of the banking system undoubtedly played a large part in stopping the cumulative processes of hoarding and deflation. Another important factor has been the rise of agricultural prices and the consequent increase of farm income. Another factor in all probability, though this has been a much debated question, has been the government spending program. But there can be no doubt that the presence of large excess reserves has played a fundamental role, not only in financing governmental expenditures but also in paving the way for the revival of private capital investment.

As the process continues, we should expect to see its effects in further expansion of bank deposits and bank assets. Already the expansion of bank deposits has proceeded at a pace that has been exceeded only during the World War. Net demand deposits of weekly reporting member banks (91 cities) have increased by $6,400,000,000 since March 1933, and $1,400,000,000 of this increase has occurred in the past seven months. The total of net demand and time deposits of these banks, exclusive of government deposits, now amount to more than $20,000,000,000 and exceed the pre-depression level. Time deposits remain substantially smaller than in 1929-1930, and demand deposits in "country" member banks (which are not largely represented in the weekly reporting member banks) are still considerably below 1928-1929 levels, but have shown a rate of expansion during the past year nearly as rapid as in the city banks.(1) On the other hand, loans and investments of the reporting member banks have made a more moderate recovery, amounting to

(1) The latest figures of deposits of all banks in the country are for December 31, 1934, when the total was $44,800,000,000, exclusive of interbank deposits. This is the highest since the December 1931 call. The peak of deposits of all banks was approximately $56,800,000,000.

$3,315,000,000 (October 9) since March 1933. This change has resulted from an increase of $4,153,000,000 in bank holdings of U. S. government securities, including government guaranteed securities, accompanied by a decline of $807,000,000 in loans, and little change in securities other than governments. Since last March total loans and investments of banks have shown a net increase of $581,000,000. Loans on securities have decreased moderately to the lowest levels of recent years, and all other loans are little changed for the period, a seasonal increase of $200,000,000 in the last two months having offset an earlier decline. On the other hand, an increase of $801,000,000 has occurred in bank investments, of which government securities have accounted for $682,000,000.

These figures indicate, first, that our easy money policy and the monetary and fiscal policy of the government have been followed by an extraordinary expansion of bank deposits, which thus far has come primarily from expansion of bank investments in government securities and from heavy gold inflow (and in the first few months after the bank holiday from return of currency from hoarding); and second, that in the aggregate the recovery of private business has thus far not been financed by private borrowing from banks. It is not unusual in an early stage of recovery from depression for business expansion to be financed out of corporate funds previously idle or invested outside the business. In this connection, refunding issues themselves become a source of funds available for further production, in so far as they release earnings which might otherwise have to be set aside to pay off or reduce maturing capital issues. But this phase of recovery is usually preliminary to borrowing of new money, and before we can accept present indications as conclusive evidence that business revival is firmly established, we must look for an increase both in bank assets other than government securities and in new corporate issues. It is especially important, during this recovery, to watch for these developments because, in the present instance, government borrowing and spending are undoubtedly supplying an important part of the funds which industry is using, and the transition from public to private spending, as recovery proceeds, should be indicated by a transition from government security flotations to new corporate issues and private borrowing from banks.

This brief review of the business and financial situation appears to indicate that our credit policy is now being accompanied, quite definitely, by desirable developments. What are the dangers which may arise from a continuance of this policy, and what are the sign posts which should tell us when and how to change it?

There are two possible dangers from a continuance of our present policy. The first is inflation arising from expansion of public credit through the continued financing by the banks of government budgetary deficits. The second is inflation arising from expansion of private credit. The first danger is that with which we were primarily concerned in the memorandum presented last April. As was then indicated, there is an important difference between the effects of pressure of excess bank reserves against a fixed total of government debt and this same pressure when exerted against a continuously increasing volume of public debt. In the latter case, there is danger that the overflow of bank funds into private channels may not occur, that the banks will become more and more heavily loaded with government securities, and the government do a larger and larger part of the nation's borrowing and spending. In the experience of other nations a long-continued process of governmental deficit financing through the banking system has always led at some point to rapidly rising prices, either through actual monetary expansion or through fear of potential expansion, and at this point the process has always become cumulatively uncontrollable, government deficits rising by reason of the rise of prices and the lag of revenue behind expenditures, the whole process being attended by grave economic and political disruption and disorder terminating in collapse.

The continuance of our present policy, as was pointed out in the earlier memorandum, rests upon the assumption that this danger can be avoided. There is an important economic difference between budgetary deficits arising from extraordinary expenditures of a compelling nature, such as the financing of a war or huge indemnity payments, and budgetary deficits resulting from depression. There is a definite economic basis for the theory that in the latter case a reversal of the forces which in depression produce the deficits should in recovery correct them, for as recovery proceeds the need for extraordinary government expenditure should be reduced and government revenue should be increased through the reemployment of the factors of production. But, on the other hand, it would be both naive and dangerous to suppose that the process is self-operative, and that recovery will now automatically correct the budgetary deficit. If the basis of our present policy of continuance of large excess reserves is correct, namely, that recovery from depression affords an opportunity for transition from public to private spending but that failure to seize this opportunity at the proper time can have only harmful results, it will be necessary from this time forward to keep a close watch upon the course of government revenue and expenditure.

The threat of uncontrollable government inflation now appears to be less than it did to many observers last winter. This is true not only because the recovery appears really to be under way, but also because the deficits themselves are proving to be considerably less than was feared six months or a year ago. The actual deficit for the past fiscal year was \$3,575,000,000, including \$574,000,000 of sinking fund, as compared with the official estimate of \$4,869,000,000. Though the original estimate was doubtless overstated deliberately, the decrease has been due also to the increase of revenue and to the lag of actual expenditure behind the estimates. It has been easier to appropriate money than to devise the means of spending it; the result is that expenditures are still being made to a large extent out of appropriations from the preceding fiscal year and actual expenditures continue to run behind the estimates. In the past 3 months, actual net expenditures have averaged $275,000,000 a month as against the first official estimate for this fiscal year's deficit of $4,529,000,000 which has been revised to $3,282,000,000 in the President's recent budget message. There is also some recent evidence of a desire on the part of the Administration to control extraordinary expenditures.

It would be unsafe, however, to assume that the government's spending program will dry up from either lack of desire or lack of ability to find ways to spend the money. There are still some 19,000,000 people on relief, there is the $4,800,000,000 appropriated by the last Congress, there is every indication of a renewed drive in the next session of Congress for a bonus law which, if enacted, would probably add some $2,000,000,000 of extraordinary expenditure, and a Presidential election is approaching. Probably the most serious problem now bearing upon our policy regarding excess reserves arises from the contemplation of these actual and potential extraordinary appropriations. What will be their effect upon the business recovery which is now under way? If business confidence is not shaken and if the banks continue to absorb government securities, public spending on such a scale as this might well impart an undue stimulus to business activity. It is not impossible that we might find ourselves, much sooner than we now think, facing our second danger, that of undue private business and credit expansion. On the other hand, if such a program of public spending, particularly if the bonus is added, should shake business confidence and impair the ability or willingness of the market to absorb government securities, we might find ourselves facing the first danger outlined above, pure governmental inflation.

The possibilities which have been discussed do not, however, appear to necessitate as yet any change in our policy regarding excess reserves. They merely raise questions for the future and indicate what factors in the current situation should be most closely watched. If this really is the beginning of a genuine recovery, it ought to mean that steps will be taken looking toward, not an immediate balancing of the budget, but some fairly definite schedule of tapering off extraordinary expenditures,the speed with which that is done depending upon the progress of recovery. It may well be that we shall have a permanent problem of relief as England has. The very fact that relief has been organized on a national scale may mean that unemployables previously taken care of informally and privately will become permanently a charge upon the public budget. Passage of the social security legislation, which is desirable in principle, almost certainly means a permanent increase in relief expenditures as compared with the pre-depression period. But the important considerations should be that such expenditures should be kept down to the adequate minimum, and above all that they should be made to find their place in a balanced budget.

If, as recovery proceeds, the effective steps are not taken toward budget balancing, there would certainly be ground for questioning whether the Reserve System is justified in continuing its present policy with respect to its security portfolio and excess reserves. We need not stop to consider anew the difficulties of making a reversal of our policy effective under such circumstances. Some of them have already been discussed in the earlier memorandum, such as the Stabilization Fund and the powers granted in the Thomas Amendment, whereby the Administration could easily override our efforts if it chose to do so. There is the further very practical difficulty that if we should attempt to sell our securities to the market, which at the same time was being offered new government issues to finance budgetary deficits, the result might be such an impairment of the market as might not only give a severe setback to business recovery but force the government along the road toward inconvertible currency inflation, which so far it has avoided. The mere mention of these possibilities indicates how indispensable it is for the Reserve System and the Administration to cooperate in the formulation of a program best suited to recovery and to the transition from public to private spending which should accompany recovery.

If matters proceed satisfactorily in this regard, the larger question for the future will be the relation of our policy to the progress of business recovery. There is the very definite possibility that private credit expansion, once it gets under way, may be difficult to hold within wholesome bounds. Total reserves are now more than double required reserves and interest rates are unprecedentedly low. As has frequently been pointed out in our earlier discussions, we ought not to allow our fears as to how we are to control credit expansion in the future to obscure our realization that in some form and to some extent such expansion is not only inevitable but desirable if we are to have a genuine and complete recovery. What the Reserve System ought now to be considering very seriously is both the methods whereby credit expansion is to be controlled in the future and the timing of this program of control. One previous source of rapid credit expansion peculiarly difficult to control, stock exchange speculation, has received special attention during the depression, and it seems probable that the new powers of the Board of Governors of the Federal Reserve System and of the Securities Exchange Commission to govern not only the supply of such credit,but what is perhaps even more important to regulate the demand for it, will put us in a stronger position in this respect than ever before, particularly as the "loans for the account of others," which were so serious a problem in 1927-29, are now forbidden by law. But it seems inevitable that with excess reserves of such magnitude, undue credit expansion will sooner or later get under way through one channel or another unless appropriately controlled. This is not the place to examine in any detail the criteria by which undue credit and business expansion can be recognized. That is a most difficult and a highly controversial question. It will probably not become a pressing question until the heavy goods industries have recovered and the general index of production has returned to normal. At the present time the Board index stands at 89 as compared with 58 at the bottom of the depression in July, 1932, and with 119 in 1929. Building contracts are still 71% below estimated normal, and steel ingot production 28% below.

The more pressing question is that of the nature of the control program. We have the following major instruments of control: power to alter reserve requirements, discount rates, open market operations, and powers of "direct control" against stock market use of credit. In what order should these powers be used if and when control becomes essential? This is a question of very great magnitude which cannot be discussed fully within the scope of the present memorandum, which is addressed mainly to the question whether there is any immediate ground for a change in our credit policy.

But there is a direct connection between this question of the order in which the instruments of control should be used and the question of our attitude toward the continued growth of excess reserves. During the past two years it has been repeatedly pointed out that excess reserves have gone on increasing, very rapidly and very substantially, not as a result of open market operations or of any deliberate policy of the Federal Reserve System, but in response to recurring inflows of gold following upon devaluation of the dollar. At the time of the passage of the Gold Reserve Act in January, 1934, excess reserves, mainly as the result of open market operations, were $800,000,000; they are now $2,900,000,000. Granting that it has been the Federal Reserve policy ever since February 1932 to maintain pressure for credit expansion through excess reserves, no one supposes that the System would have deliberately created any such volume of reserves as now exists; and the question has been repeatedly raised whether, granting the desirability of large excess reserves, it is desirable to permit them to accumulate indefinitely. It may well be asked whether, at some point, we should not intervene, not to prevent credit expansion but merely to prevent further accumulation of superfluous reserves which will only add to the difficulties of credit control when the time for it arrives?

This question, which is surely very pertinent, reveals the extraordinary nature of our current situation which is without precedent in central banking history. If a central bank creates reserves by open market operations, it can contract them by the same method. But today excess reserves owe their origin, in the main, not to open market operations but to the modification of our monetary standard. So long as gold continues to flow in on such a scale as this year and last, we could not hope to eliminate excess reserves by open market operations alone. As a practical matter, the most that we could do through the sale of government securities would be to reduce them in part and thus psychologically to check their use in credit expansion. It is partly because we fear that the sale of securities at this time would have such a result now when expansion is still necessary for business recovery that we have continued in our present policy. If, on the other hand, a reversal of our open market position did not prevent credit expansion now, our sales would only weaken our power to control such expansion later.

In these circumstances it seems not unlikely that the first step in control may have to be the raising of reserve requirements. Must we not recognize that the modification of our monetary standard in January, 1934, carried with it as one

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REPORT OF OPEN MARKET OPERATIONS
TO MEETING OF THE FEDERAL OPEN MARKET COMMITTEE
AT WASHINGTON, D. C., OCTOBER 22, 1935

The present holdings of Government securities in the System Special Investment Account remain practically unchanged at - - - - - - - - - - $2,223,149,000.

Transactions since May 27, the date of the last meeting of the Federal Open Market Committee, were as follows:

(1) Redemption at maturity of

$374,274,000 miscellaneous Treasury bills

replaced by purchases in the market as follows:

$245,104,000	- Miscellaneous Treasury bills			
3,000,000	- 3 %	T/N	due	2/15/37
310,000	- 3 1/4%	"	"	9/15/37
10,250,000	- 2 5/8%	"	"	2/ 1/38
1,100,000	- 3 %	"	"	3/15/38
900,000	- 2 7/8%	"	"	6/15/38
600,000	- 2 1/2%	"	"	9/15/38
23,950,000	- 1 1/2%	"	"	3/15/39
11,650,000	- 2 1/8%	"	"	6/15/39
75,060,000	- 1 3/8%	"	"	12/15/39
250,000	- 3 1/4%	Tr.	Bds.	1944-46
2,000,000	- 3 %	"	"	1946-48
100,000	- 3 1/8%	"	"	1946-49

The purchases of $2,350,000 of Treasury bonds included above were made during a period of weakness in the market following the first sale of bonds by auction on May 27.

The purchases of $23,950,000 - 1 1/2 per cent Treasury notes due March 15, 1939, dated September 16, 1935, were made in accordance with the agreement of the executive committee to buy up to $50,000,000 of this issue in addition to the amount purchased to replace fourth-called Fourth 4 1/4 per cent Liberty bonds.

The other replacements of bills by notes were made largely at times when Treasury bills were not available in the market or when the note market was weak.

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(2) Redemption at maturity of

$24,645,450 - 2%	Consols		called	7/1/35
1,468,800 - 2%	Panamas	(1936)	called	8/1/35
519,160 - 2%	"	(1938)	"	8/1/35

replaced by purchases in the market as follows:

$10,722,000 -	Miscellaneous Treasury bills			
2,000,000 -	3 %	T/N	due	2/15/37
7,045,000 -	3 %	"	"	4/15/37
600,000 -	3 1/4%	"	"	9/15/37
6,265,900 -	1 3/8%	"	"	12/15/39

(3) Conversions under Treasury offering dated June 10 as follows:

	$62,909,900 -	3 %	T/N	due	6/15/35
	74,223,300 -	1 5/8%	"	"	8/ 1/35
for	137,133,200 -	1 1/2%	"	"	6/15/40

(4) Exchanges in the market as follows:

(a) In anticipation of maturity of

	$31,085,000 -	3 %	T/N	due	6/15/35
	11,500,000 -	1 5/8%	"	"	8/ 1/35
	40,401,000 -	4th 4 1/4's	called		10/15/35
	5,000,000 -	2 1/2%	T/N	due	12/15/35
	2,500,000 -	2 7/8%	"	"	4/15/36
	947,000 -	1 1/8%	"	"	6/15/36
for	47,032,000 -	Miscellaneous Treasury bills			
	2,000,000 -	3 %	T/N	due	2/15/37
	2,000,000 -	3 1/4%	"	"	9/15/37
	40,401,000 -	1 1/2%	"	"	3/15/39

In accordance with the agreement of the executive committee on August 29 to exchange the 4th 4 1/4's in the Account for notes rather than for bonds should the Treasury make an optional offering, total holdings of $40,401,000 of the Fourths were exchanged in the market for the 1 1/2 per cent notes as reflected above. This exchange was effected in the market rather than directly with the Treasury owing to the provision of the Banking Act of 1935 requiring all purchases and sales to be made in the open market, the precise interpretation of which there had not been opportunity to discuss fully.

(b) In accordance with the agreement of the executive committee to purchase up to $50,000,000 of the new issue of 1 1/2 per cent notes due March 15, 1939, dated September 16, 1935, against corresponding reductions in other holdings, $23,300,000 of the new issue was purchased in the market against sales in the market as follows:

$8,000,000	-	Miscellaneous Treasury bills
1,700,000	-	3 1/4% T/N due 9/15/37
600,000	-	3 % " " 3/15/38
1,000,000	-	2 1/2% " " 9/15/38
3,500,000	-	2 1/8% " " 6/15/39
3,250,000	-	1 3/8% " " 12/15/39
5,250,000	-	1 1/2% " " 6/15/40

Together with $23,950,000 of the new note issue acquired as Treasury bill replacements (noted in paragraph 1) purchases under this authorization amounted to $47,250,000.

(c) To improve the maturity distribution in the Account, as follows:

	$28,565,000	-	Miscellaneous Treasury bills
	5,000,000	-	1 1/2% T/N due 9/15/36
	6,500,000	-	2 3/4% " " 12/15/36
	6,400,000	-	3 % " " 4/15/37
	2,000,000	-	3 1/4% " " 9/15/37
	5,000,000	-	3 % " " 3/15/38
	5,000,000	-	2 1/2% " " 9/15/38
	5,000,000	-	1 1/2% " " 3/15/39
	18,700,000	-	2 1/8% " " 6/15/39
	1,000,000	-	1 3/8% " " 12/15/39
	6,500,000	-	1 5/8% " " 3/15/40
	10,000,000	-	1 1/2% " " 6/15/40
	100,000	-	3 1/8% Tr. Bds. 1946-49
	1,350,000	-	3 % " " 1951-55
	3,500,000	-	3 1/4% " " 1943-45
	6,000,000	-	3 1/4% " " 1944-46
	1,300,000	-	3 % " " 1946-48
for	78,165,000	-	Miscellaneous Treasury bills
	1,500,000	-	3 % T/N due 2/15/37
	12,500,000	-	2 1/8% " " 6/15/39
	7,500,000	-	1 5/8% " " 3/15/40
	500,000	-	3 3/8% Tr. Bds. 1941-43
	11,750,000	-	2 3/4% " " 1945-47

$40,600,000 of the above purchases of Treasury bills were made within the past few weeks in exchange principally for four and five-year Treasury note maturities in an effort to partly restore to former levels the proportion of holdings in the Account maturing within two years which it has been increasingly difficult to maintain in the face of recent large-scale refunding by the Treasury of short-term debt into longer maturities. The extent of this operation by the Treasury is reflected in Exhibit "G" attached.

(5) Transfers of participation within the Account in accordance with the agreement at the meeting of the Federal Open Market Committee on May 27 with respect to the distribution of holdings of government securities among the banks, as follows:

$ 5,000,000 -	to Minneapolis	from	Chicago
3,153,000 -	" Richmond	"	"
5,000,000 -	" Cleveland	"	"
10,000,000 -	" Philadelphia	"	"
5,000,000 -	" Dallas	"	"

On August 5, transfer of $5,000,000 participation from New York to Dallas was made, reversing transaction of last April 30 when New York took over this amount from Dallas to aid their reserve position. Owing to subsequent decline in reserve ratio, this $5,000,000 participation was transferred back to New York on September 4.

As a net result of the transactions since May 22, the amount of holdings in the Account maturing within two years was reduced by $285,570,000. As a partial offset to these transactions, however, a net of $85,660,000 of other issues moved into the two-year classification since May 22, and the actual reduction in two-year maturities amounted to only $199,910,000, which figure may be considered the amount of net shifts under the authority of meeting of the Federal Open Market Committee on May 27 to make shifts between maturities up to $250,000,000. It has not been necessary to make use of the authority obtained informally by letter to make additional shifts between maturities up to $100,000,000 beyond the original authorization of $250,000,000.

Profit realized on sales of government securities in the System Account this year to October 16 amounts to $4,647,393.85. Each bank's pro rata share in this profit as held in Suspense Account on that date was as follows:

Boston	$ 328,161.77	Chicago	$ 670,344.74
New York	1,314,361.98	St. Louis	221,127.65
Philadelphia	351,612.52	Minneapolis	133,691.58
Cleveland	450,058.27	Kansas City	215,806.38
Richmond	236,213.09	Dallas	134,802.31
Atlanta	196,937.96	San Francisco	394,275.60

There were no operations in bankers acceptances for System Account during the period May 22 - October 16.

Attached to this report are the following exhibits:

"A" - Maturity distribution of holdings of government securities in System Account at the end of each month 1932, 1933, 1934 and 1935 to October 16, and net changes since May 22, 1935.

"B" - Classification of issues held in the System Account on May 22 and October 16 and net changes by issues during this period.

"C" - (1) Participation by Federal Reserve banks in System Special Investment Account and (2) total holdings of government securities by Federal Reserve banks close of business October 16 and the amount of (1) and (2) over or short of pro rata share based on ratio of each bank's expenses, dividends and charge-offs for 1934 to total for the System.

"D" - (1) Participation by Federal Reserve banks in System Special Investment Account and (2) total holdings of government securities by Federal Reserve banks close of business October 16, 1935 and the amount of (1) and (2) over or short of pro rata share based on ratio of reserves in excess of amount required for a 55% ratio.

"E" - Earnings of all Federal Reserve banks for the nine months ended September 30, 1935, and estimated annual rate of earnings of all Federal Reserve banks on basis of government security portfolio as of October 15.

"F" - Chart showing average earning rate on holdings of United States Government securities in System Special Investment Account and average yield on outstanding Treasury bonds and Treasury notes, 1934 and 1935 to October 16.

"G" - Interest bearing public debt and System Account holdings maturing within one year and from one to two years on May 22 and October 16, 1935.

MATURITY DISTRIBUTION OF HOLDINGS IN SYSTEM ACCOUNT
END OF EACH MONTH - 1932-33-34-35
(In millions of dollars)

EXHIBIT "A"

1932	Within Six Months	Per-cent	Within One Year	Per-cent	Within Two Years	Per-cent	3-5 Years Inc.	Per-cent	Call-able Bonds	Per-cent	Other Bonds	Per-cent	Totals
Jan.	$165	29	$ 355	63	$ 355	63	$ -	-	$212	37	$ -	-	$ 567
Feb.	191	32	375	64	375	64	-	-	212	36	-	-	587
Mar.	299	44	475	69	475	69	-	-	212	31	-	-	687
Apr.	583	57	778	76	779	76	-	-	239	24	-	-	1,018
May	716	51	1,058	75	1,115	79	-	-	290	21	-	-	1,405
June	744	48	1,106	71	1,173	75	64	4	322	21	-	-	1,559
July	733	45	1,098	67	1,167	71	132	8	336	21	-	-	1,635
Aug.	622	38	1,029	63	1,194	73	110	6	336	21	-	-	1,640
Sept.	606	37	998	61	1,170	71	134	8	336	21	-	-	1,640
Oct.	651	40	1,051	64	1,229	75	75	4	336	21	-	-	1,640
Nov.	765	47	1,046	64	1,227	75	77	4	336	21	-	-	1,640
Dec.	779	48	1,021	62	1,203	73	101	6	336	21	-	-	1,640
1933													
Jan.	644	41	903	58	1,107	71	116	7	336	22	-	-	1,559
Feb.	577	36	856	53	1,090	67	203	12	336	21	-	-	1,629
Mar.	709	44	856	53	1,090	67	203	12	336	21	-	-	1,629
Apr.	570	35	725	45	958	59	335	20	336	21	-	-	1,629
May	543	32	823	49	962	57	384	23	336	20	-	-	1,682
June	656	37	879	49	1,117	62	335	19	336	19	-	-	1,788
July	659	36	903	50	1,143	63	341	19	336	18	-	-	1,820
Aug.	621	32	1,025	53	1,191	62	394	21	336	17	-	-	1,921
Sept.	706	34	1,102	53	1,278	62	452	22	336	16	-	-	2,066
Oct.	860(A)	39	1,257	57	1,443	66	498(B)	23	252	11	-	-	2,193
Nov.	845(A)	43	1,235	56	1,435	65	511(B)	23	252	11	25	1	2,223
Dec.	887(A)	40	1,216	55	1,426	64	520(B)	24	252	11	25	1	2,223
1934													
Jan.	887(A)	40	1,216	55	1,426	64	520(B)	24	252	11	25	1	2,223
Feb.	987(A)	44	1,190	54	1,415	64	531(B)	24	252	11	25	1	2,223
Mar.	799(A)	36	1,034	47	1,287	58	659(B)	30	252	11	25	1	2,223
Apr.	730(A)	33	1,008	45	1,476	67	488(B)	21	195	9	64	3	2,223
May	717(A)	32	991	44	1,475	66	489(B)	22	195	9	64	3	2,223
June	765(A)	34	972	44	1,354	61	550(B)	24	195	9	124	6	2,223
July	732(A)	33	939	42	1,321	59	583(B)	26	195	9	124	6	2,223
Aug.	705(A)	32	1,018	46	1,365	61	539(B)	24	195	9	124	6	2,223
Sept.	654	29	868	39	1,258	56	646(B)	29	195	9	124	6	2,223
Oct.	749(A)	34	964	43	1,342	60	647(B)	29	110	5	124	6	2,223
Nov.	752(A)	34	968	43	1,349	60	640(B)	29	110	5	124	6	2,223
Dec.	794(A)	36	953	43	1,405	63	584(B)	26	110	5	124	6	2,223
1935													
Jan.	790(A)	35	950	43	1,394	62	595(B)	27	110	5	124	6	2,223
Feb.	863(A)	39	950	43	1,460	65	529(B)	24	110	5	124	6	2,223
Mar.	747(C)	33	889	40	1,379	62	603(B)	27	56	3	185	8	2,223
Apr.	727(D)	33	1,087	49	1,524	69	519	23	0	0	180	8	2,223
May	584(E)	26	976	44	1,416	64	615	27	0	0	192	9	2,223
June	525(E)	23	887	40	1,281	58	748	33	0	0	194	9	2,223
July	494(E)	22	829	37	1,233	55	796(F)	36	0	0	194	9	2,223
Aug.	454(A)	20	856	38	1,181	53	848(F)	38	0	0	194	9	2,223
Sept.	425	19	850	38	1,193	53	836(F)	38	0	0	194	9	2,223
Oct.16	566	25	874	39	1,213	54	816	37	0	0	194	9	2,223
Net Change since May 22	-12		-102		-200		+216		0		-16		0

(A) Includes Fourth Liberties "called"
(B) Does not include Fourth Liberties "uncalled" maturing October 1938.
(C) Includes First Liberties, Panama's and Consols "called"
(D) Includes First and Fourth Liberties, Panama's and Consols "called"
(E) Includes Fourth Liberties and Panama's "called"
(F) Does not include 3 3/8% T. B. 1940/43, callable 6/15/40

EXHIBIT "B"

CLASSIFICATION OF ISSUES HELD IN THE SYSTEM ACCOUNT ON MAY 22 AND OCTOBER 16, 1935
AND NET CHANGES BY ISSUES DURING THIS PERIOD
(000 Omitted)

	Holdings May 22	Holdings Oct. 16	Increase	Decrease
Total Holdings of Treasury Bills	$ 525,235	$ 495,419	$ -	$29,816 Net
TREASURY NOTES				
3 % Treas.Notes due June 15, 1935	93,995	-	-	93,995
1 5/8% " " " Aug. 1, 1935	85,723	-	-	85,723
2 1/2% " " " Dec. 15, 1935	67,621	62,621	-	5,000
2 7/8% " " " Apr. 15, 1936	136,886	134,386	-	2,500
1 1/8% " " " June 15, 1936	50,000	49,053	-	947
3 1/4% " " " Aug. 1, 1936	79,042	79,042	-	-
1 1/2% " " " Sept.15, 1936	58,967	53,967	-	5,000
2 3/4% " " " Dec. 15, 1936	98,868	92,368	-	6,500
3 % " " " Feb. 15, 1937	65,685	75,685	10,000	-
3 % " " " Apr. 15, 1937	84,175	86,820	2,645	-
3 1/4% " " " Sept.15, 1937	84,750	83,960	-	790
2 5/8% " " " Feb. 1, 1938	60,205	70,455	10,250	-
3 % " " " Mar. 15, 1938	97,099	94,849	-	2,250
2 7/8% " " " June 15, 1938	65,924	74,324	8,400	-
2 1/2% " " " Sept.15, 1938	81,981	76,831	-	5,150
1 1/2% " " " Mar. 15, 1939	-	82,651	82,651	-
2 1/8% " " " June 15, 1939	81,485	87,935	6,450	-
1 3/8% " " " Dec. 15, 1939	-	77,076	77,076	-
1 5/8% " " " Mar. 15, 1940	128,375	129,375	1,000	-
1 1/2% " " " June 15, 1940	-	121,883	121,883	-
TOTALS	$1,420,781	$1,533,281	$112,500 Net	-
LIBERTY LOAN AND TREASURY BONDS				
4 1/4% 4th L/L Bds.called 10/15/35	$ 40,401	$ -	$ -	$40,401
3 1/4% Treasury Bonds of 1941	42,700	44,300	1,600	-
3 3/8% " " " 1940-43	2,000	2,400	400	-
3 3/8% " " " 1941-43	2,000	4,500	2,500	-
3 1/4% " " " 1943-45	25,000	21,500	-	3,500
3 1/4% " " " 1944-46	39,000	33,250	-	5,750
3 3/8% " " " 1943-47	3,000	3,000	-	-
2 3/4% " " " 1945-47	-	11,750	11,750	-
3 % " " " 1946-48	40,000	40,700	700	-
3 1/8% " " " 1949-52	2,015	2,015	-	-
3 % " " " 1951-55	1,350	-	-	1,350
2 7/8% " " " 1955-60	53,034	31,034	-	22,000
2 % Consols 1930 called 7/1/35	24,645	-	-	24,645
2 % Panamas 1936 " 8/1/35	1,469	-	-	1,469
2 % " 1938 " 8/1/35	519	-	-	519
TOTALS	$ 277,133	$ 194,449	-	$82,684 Net
GRAND TOTALS	$2,223,149	$2,223,149	-	-

EXHIBIT "C"

(1) PARTICIPATION BY FEDERAL RESERVE BANKS IN THE SYSTEM SPECIAL INVESTMENT ACCOUNT AND (2) TOTAL HOLDINGS OF GOVERNMENT SECURITIES BY FEDERAL RESERVE BANKS CLOSE OF BUSINESS OCTOBER 16, 1935 AND THE AMOUNT OF (1) AND (2) OVER OR SHORT OF PRO RATA SHARE BASED ON RATIO OF EACH BANK'S EXPENSES, DIVIDENDS AND CHARGE-OFFS FOR 1934 TO THE TOTAL FOR THE SYSTEM

(000 Omitted)

	Participations in System Account (A)	Ratio of Holdings in System Account (B)	Ratio of Expenses, Dividends & Charge-offs Year 1934 (C)	Participations (+) Over or (-) Short of Pro Rata Share Based on Ratios in Col. C (D)	Total Holdings (Portfolio and Participation in System Account) (E)	Ratio of Total Holdings (F)	Total Holdings (+) Over or (-) Short of Pro Rata Share Based on Ratios in Col. C (G)
Boston	$ 156,982	7.06%	6 3/4%	$ 6,919+	$ 157,677	6.49%	$ 6,205-
New York	622,318	27.99%	28 %	164-	742,614	30.59%	62,807+
Philadelphia	173,734	7.81%	9 %	26,349-	177,120	7.29%	41,389-
Cleveland	218,024	9.81%	9 3/4%	1,267+	218,024	8.98%	18,694-
Richmond	116,715	5.25%	5 1/4%	0	116,716	4.81%	10,748-
Atlanta	94,209	4.24%	4 %	5,283+	94,213	3.88%	2,902-
Chicago	292,948	13.18%	11 1/2%	37,286+	355,689	14.65%	76,483+
St. Louis	107,700	4.84%	4 3/4%	2,100+	108,200	4.46%	7,124-
Minneapolis	68,054	3.06%	3 3/4%	15,314-	75,081	3.09%	15,965-
Kansas City	106,659	4.80%	5 1/4%	10,056-	106,741	4.40%	20,723-
Dallas	66,475	2.99%	3 3/4%	16,893-	76,475	3.15%	14,571-
San Francisco	199,331	8.97%	8 1/4%	15,921+	199,331	8.21%	969-
TOTALS	$2,223,149	100 %	100 %	$68,776 Adj.	$2,427,881	100 %	$139,290 Adj.

NOTE: Charge-offs do not include reserves for possible losses, Self Insurance or abnormal real estate depreciation.

EXHIBIT "D"

(1) PARTICIPATION BY FEDERAL RESERVE BANKS IN THE SYSTEM SPECIAL INVESTMENT ACCOUNT AND (2) TOTAL HOLDINGS OF GOVERNMENT SECURITIES BY FEDERAL RESERVE BANKS CLOSE OF BUSINESS OCTOBER 16, 1935 AND THE AMOUNT OF (1) AND (2) OVER OR SHORT OF PRO RATA SHARE BASED ON RATIO OF RESERVES IN EXCESS OF AMOUNT REQUIRED FOR A 55% RATIO

	(A) Ratio of Reserves in Excess of Amount Required For a 55% Ratio	(B) Partici-pations in System Account	(C) Participations (+) Over or (-) Short of Pro Rata Share Based on Ratios in Column A	(D) Total Holdings (Portfolio and Participation in System Acct.)	(E) Total Holdings (+) Over or (-) Short of Pro Rata Share Based on Ratios in Column A
Boston	6 3/4%	$ 156,982	$ 6,919+	$ 157,677	$ 6,205-
New York	47 %	622,318	422,562-	742,614	398,490-
Philadelphia	5 1/4%	173,734	57,019+	177,120	49,656+
Cleveland	5 1/4%	218,024	101,309+	218,024	90,560+
Richmond	2 %	116,715	72,252+	116,716	68,158+
Atlanta	1 1/2%	94,209	60,862+	94,213	57,795+
Chicago	20 3/4%	292,948	168,355-	355,689	148,096-
St. Louis	2 1/2%	107,700	52,121+	108,200	47,503+
Minneapolis	1 1/2%	68,054	34,707+	75,081	38,663+
Kansas City	1 3/4%	106,659	67,754+	106,741	64,253+
Dallas	3/4%	66,475	49,801+	76,475	58,266+
San Francisco	5 %	199,331	88,173+	199,331	77,937+
TOTALS	100 %	$2,223,149	$590,917 Adj.	$2,427,881	$552,791 Adj.

EXHIBIT "E"

EARNINGS OF ALL FEDERAL RESERVE BANKS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 1935

Earnings do not include $4,647,393.85 profits (as of Oct. 16, 1935) on security sales, now held in Suspense Account.

	Gross Earnings	Current Expenses and Net Deductions from Current Net Earnings	Available for Depreciation Allowances, Reserves and Surplus
Boston	$ 2,071,117	$ 2,028,183	$ 42,934
New York	10,147,184	8,241,390	1,905,794
Philadelphia	2,326,575	2,468,005	141,430 (A)
Cleveland	2,787,966	2,701,547	86,419
Richmond	1,635,926	1,507,306	128,620
Atlanta	1,285,040	1,124,126	160,914
Chicago	4,808,660	3,018,043	1,790,617
St. Louis	1,406,561	1,249,106	157,455
Minneapolis	1,095,901	1,031,597	64,304
Kansas City	1,470,156	1,423,771	46,385
Dallas	1,130,672	1,008,506	122,166
San Francisco	2,440,713	2,387,733	52,980
TOTALS	$32,606,471	$28,189,313	$4,417,158

(A) Deficit

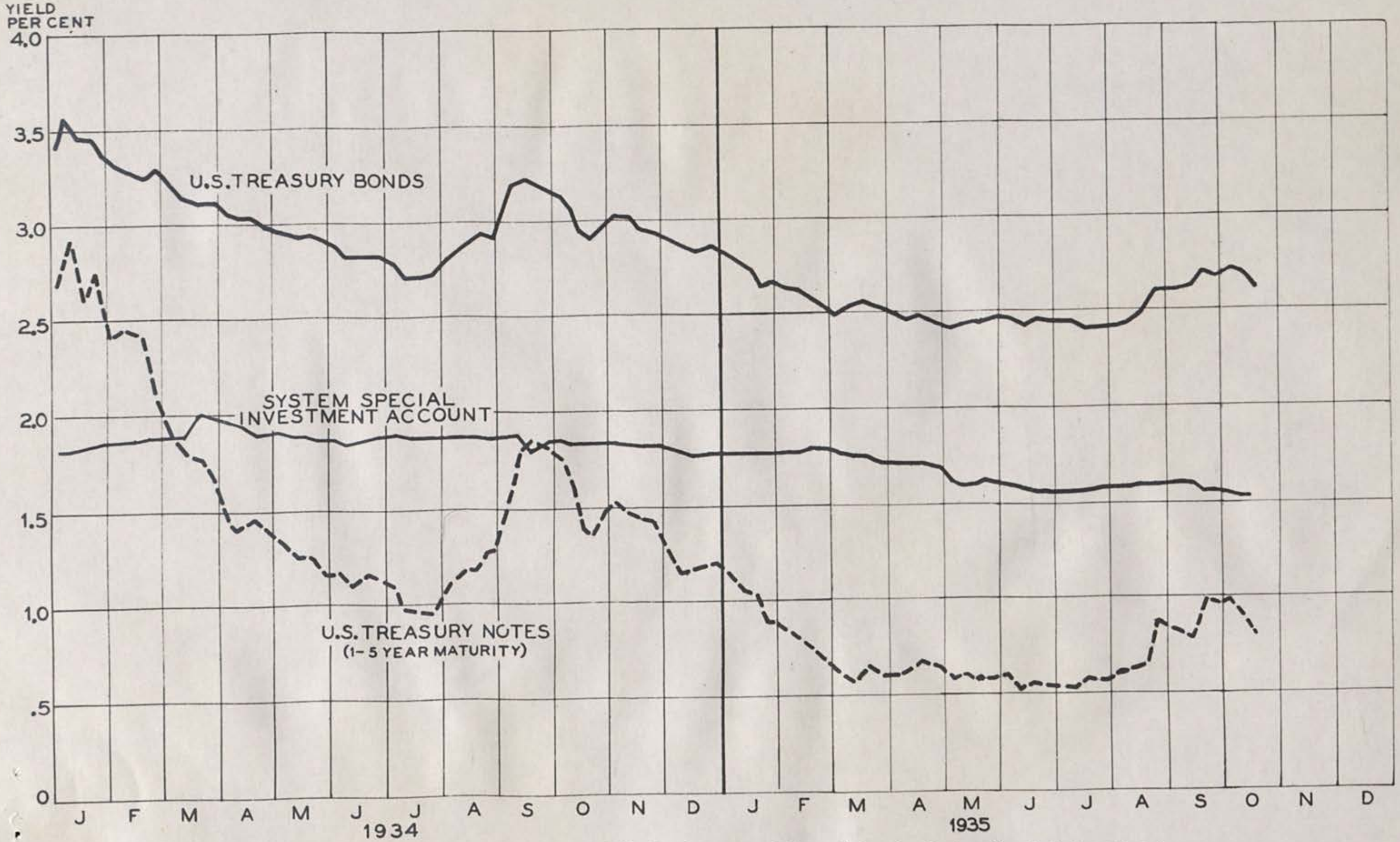
ESTIMATED ANNUAL RATE OF EARNINGS OF ALL FEDERAL RESERVE BANKS ON BASIS OF GOVERNMENT SECURITY PORTFOLIO AS OF OCTOBER 15
(Exclusive of Profits on Sales of Government Securities and Year-end Charge-offs)

Total Earnings		$40,500,000
Total Current Expense		29,500,000
Current Net Earnings		$11,000,000
Net Charges (current) to profit and loss	$ 600,000	
Dividends	7,800,000	
Total Deductions		8,400,000
*Available for Surplus		$ 2,600,000

*This amount would be increased if profits on sales of Government securities exceed year-end charge-offs, or decreased if year-end charge-offs exceed profits on sales of Government securities.

Federal Reserve Bank
of New York
Reports Department
FEB 2, 1935.
2826

EXHIBIT "F"



Average Earning Rate on Holdings of U. S. Government Securities in System Special Investment Account and Average Yield on Outstanding U. S. Treasury Bonds and Treasury Notes of the necessary conditions of its continued operation the necessity of some fundamental readjustment of our whole system of reserve requirements?

But whatever program of control may be chosen, it seems certain that co-ordination of Federal Reserve policy and the Administration's fiscal policy is the first and the fundamental prerequisite to its success. Upon the achievement of this coordination depends fundamentally the timing of any control program, for whether we employed open market operations or an alteration of reserve requirements as our first measure of control, we would be facing the definite risk of a stoppage in the government bond market, with all of the undesirable consequences which might follow therefrom, unless our policy were closely timed and coordinated with a Treasury program of budgetary economy and control.

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EXHIBIT "G"

INTEREST BEARING PUBLIC DEBT AND SYSTEM ACCOUNT HOLDINGS MATURING WITHIN ONE YEAR AND FROM ONE TO TWO YEARS ON MAY 22 AND OCTOBER 16, 1935

(Dollars in millions)

May 22, 1935	Interest Bearing Public Debt	System Account Holdings	Percentage Held in System Account
Maturing Within 1 year	$6,538	$ 976	14.93
" 1-2 years	2,854	437	15.31
Totals	$9,392	$1,413	15.04

October 16, 1935			
Maturing Within 1 year	$4,644	$ 874	18.82
" 1-2 years	2,106	339	16.10
Totals	$6,750	$1,213	17.97

P9

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date October 25, 1935.

To Mr. Hamlin

Subject:

From Mr. Carpenter

GPO 16—852

For your information there is attached a copy of the digest, which was read by Governor Calkins at the meeting yesterday, of the actions taken by the Governors' Conference on October 23, 1935.

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Governors' Conference
October 23, 1935

I. - Requirement of Board of Governors that reports of indebtedness of employees in the Federal Reserve Agent's Department be made semi-annually.

This topic, which was not on the program, was submitted by Governor Young, with the explanation that the Boston Reserve bank directors asked for an annual report of indebtedness from employees of the bank and that it was confusing to have different policies in effect in the two divisions of the staff.

Voted to ask the Board of Governors to revise its request for information regarding indebtedness of employees of the Federal Reserve Agents' departments to provide for annual reports in conformity with the general practice of the Federal Reserve banks.

II. - Report of Leased Wire Committee.

Voted that the report be accepted and the committee's recommendation approved.

III. - Report of Standing Committee on Collections.

Voted that the report of the Standing Committee on Collections, and its recommendation that each Federal Reserve bank determine for itself a method of handling drafts drawn on non-banking institutions, received on Saturday, and whether the float arising therefrom should be absorbed, be approved.

IV. - Report of Committee on Reimbursable Expenses.

Governor Fleming, Chairman of the Committee, reported informally on the progress made.

Voted that Governor Fleming's report be accepted as an interim report of the Committee. The Committee was instructed to continue its studies and report to the next conference. It was the sense of the

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Conference that the Committee should take reasonably prompt steps to ascertain from the Treasury and the various Governmental agencies the extent to which they will agree to reimburse the Federal Reserve banks for expenses chargeable to them under the instructions contained in the Expense Manual.

V. - Shipments of currency and coin to nonmember banks within the district and to points beyond district limits.

Voted that this is a reasonable accommodation to accord to nonmember banks within the district provided the shipping charges are reimbursed to the Federal Reserve banks and that there was no objection to performing the same service for nonmember banks in adjoining districts provided the nonmember bank is located in a city or town adjacent to the district boundary, upon the same basis.

VI. - Desirability of Reserve banks adopting a time schedule for direct sendings by Air Mail.

Voted to refer this to the Standing Committee on Collections for study and report to the next conference.

VII. - Meeting days of Directors.

Voted that it is desirable that meetings of the Boards of Directors of the twelve Federal Reserve banks be held on the same day and that the Board of Governors be asked to arrange with the several Reserve banks for uniformity in this regard to become effective after February 1, 1936.

VIII. - Postage surcharge on currency and securities.

Voted that the Board of Governors be requested to consult with the Postal authorities with a view to bringing about a discontinuance of the surcharge applying to such shipments made by the Federal Reserve banks.

IX. - Acceptance of deposits of uninvested trust funds by Federal Reserve banks (Board letter, X-9253 of July 1, 1935)

Voted to recommend that:

1. A member bank operating a separate trust department, or
2. A trust company engaged exclusively in conducting a trust business and owned by a member bank,

be permitted to carry, at the option of the Federal Reserve bank, an account on the books of the Federal Reserve bank representing trust funds awaiting investment or distribution.

Transactions in such trust account must be confined to transfers to and from the reserve account of the member bank.

Governors Seay, Schaller, Norris and Fleming voted in the negative.

X. - Board of Governors' Building Account.

Revision of accounting procedure to permit charge-off of entire amount of assessments or establishment of appropriate reserves.

Voted that assessments levied by the Board of Governors of the Federal Reserve System, to purchase a site and construct a building to house the Board, be charged to Profit and Loss by the Federal Reserve banks.

XI. - Publicity requested by member banks including newspaper copy to be prepared by the System featuring at times par check clearance.

Voted that the furnishing of such publicity material be left to the discretion of the individual Federal Reserve banks.

XII. - System interest in threatened litigation with trustees of Fletcher-American National Bank.

Voted that if a suit is filed against the Federal Reserve Bank of Chicago it

Seen [illegible]

Goldenweiser
Oct 1935

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
Division of Research and Statistics

BUSINESS AND CREDIT CONDITIONS

CONFIDENTIAL

October 18, 1935
Cr. 10

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Page 19

BUSINESS AND CREDIT CONDITIONS

BUSINESS AND CREDIT CONDITIONS

General summary

Sustained activity of business at a level near the high point reached at the beginning of the year is the outstanding fact in the current economic situation.

The increase over last year has been chiefly in industries producing durable goods, the low level of activity of which has been the principal characteristic of the depression. Residential building has shown a marked and sustained increase this year, for the first time since the decline which began early in 1928, but the volume of construction is still relatively small.

Greater activity in industry has been accompanied by an advance in the income both of industrial workers and of farmers, and the distribution of commodities to consumers has also increased. There has been no evidence of accumulation of stocks of commodities. Wholesale prices of farm products and foods have continued to advance, but at a slower rate than in 1933 and 1934. Prices of most industrial products have shown little change in the past two years.

Notwithstanding the improvement in business, there is still a large volume of unemployment and the burden of relief continues to be heavy.

Continued ease in the money market and the accumulation of a vast amount of idle funds in the hands of investors have been reflected in a revival in the capital market. Security flotations have been in larger volume than in any year since 1931. For the most part they have been refunding issues reducing the debt service, but there has also been an increase in the amount of new money raised in the capital market to be used in part in liquidation of bank debt and in part for productive purposes.

Industrial profits have increased, and there has been a sustained advance in security prices--representing the effect of cash buying by investors. Bank loans to brokers have not increased and security loans to other borrowers have declined.

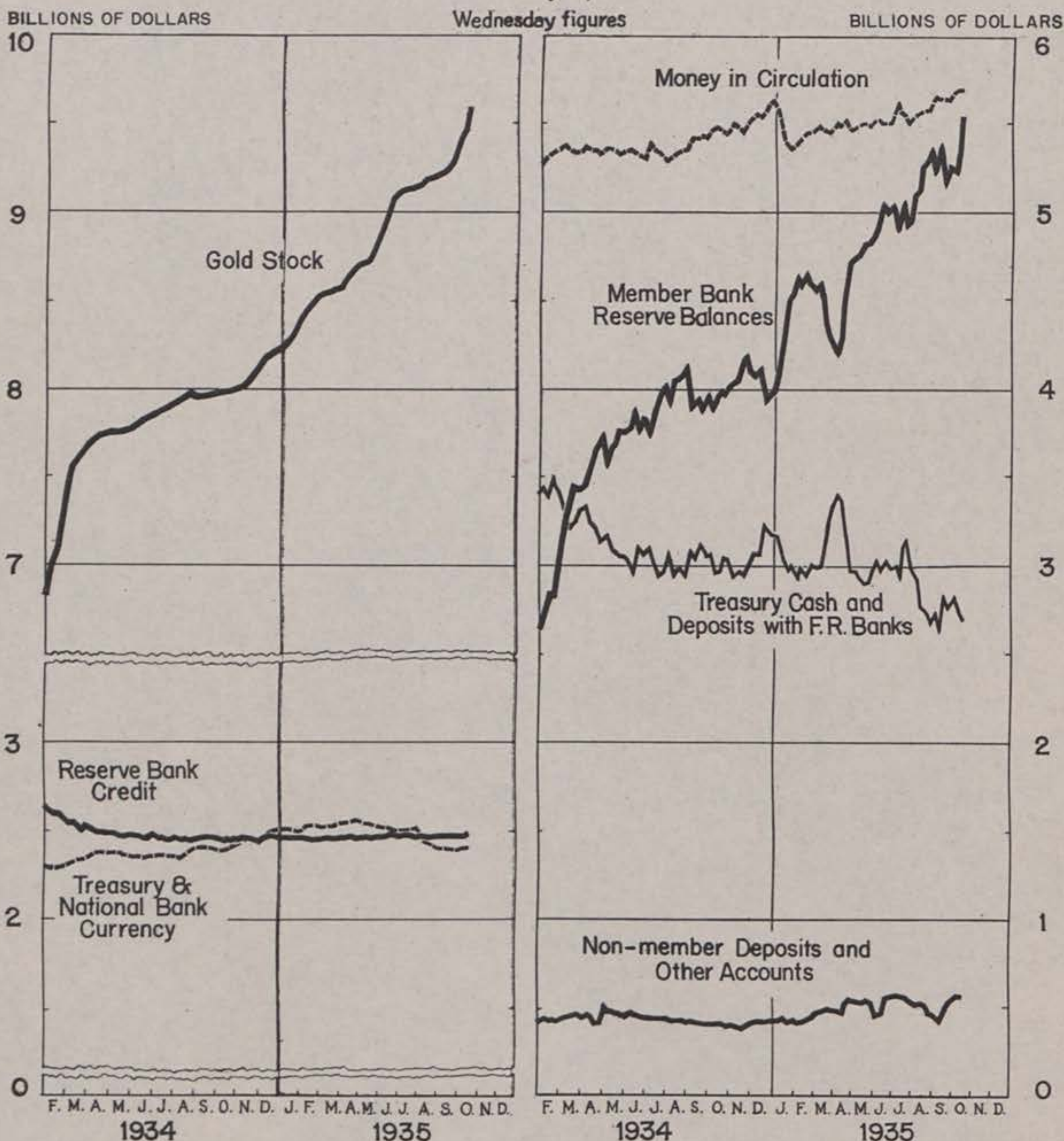
Expansion of total bank loans and investments has been continuous during the year and has reflected for the most part additional purchases by banks of United States Government obligations and of securities guaranteed by the Government. Bank deposits have grown as the result chiefly of gold imports and disbursements by the Government, and demand deposits of member banks are at a higher level than at any previous time.

In recent months disturbed conditions abroad and expectations of a rise in security prices have resulted in a large flow of capital to this country and consequent imports of gold. These imports have been the chief factor in carrying member bank reserves to a new high level, as shown in the accompanying chart. Notwithstanding a considerable increase in legal reserve requirements, consequent upon the increase in deposits, and a more than seasonal growth in the demand for currency, arising from the greater volume of trade, excess reserves of member banks increased further and at $2,900,000,000 are at the highest point on record.

Immediate prospects in the business situation taken as a whole appear to be favorable.

MEMBER BANK RESERVE FUNDS AND FACTORS OF CHANGE IN THEIR VOLUME

Since January 31, 1934



Business Conditions

During the first three quarters of 1935 industrial activity and employment have been maintained at a level higher than in any of the four preceding years and about half way between the lowest point of the depression and the 1929 level. The increase in production over last year, amounting to about 10 percent, has been largely in durable manufactures, particularly automobiles, machinery, and steel, while output of non-durable manufactures in the aggregate has shown a relatively small increase.

Since the beginning of the year, industrial activity has shown less change than in the corresponding period of any other recent year. In September the Board's seasonally adjusted index was at 88 percent of the 1923-1925 average as compared with a high point of 91 percent in January and a low point of 85 percent in May. Industrial prices also have fluctuated within a narrow range and there has been no general accumulation of stocks of industrial products such as occurred in the rapid speculative advance in prices and production during the summer of 1933.

The volume of residential building, which had remained unchanged at exceptionally low levels in 1932, 1933, and 1934, has shown an increase this year, reflecting improvement both in the real estate situation and in the mortgage market. The current level is approximately twice that of last year and one-fifth that of the peak years 1925 to 1928. Commercial and factory building has continued at a low level. There has been less public construction in recent months than a year ago; currently, however, a considerable amount of new public work is being undertaken.

Incomes in industrial communities have increased somewhat, as compared with a year ago, reflecting primarily increased industrial activity. Relief expenditures by the government have continued at a high level. Factory payrolls for the first three quarters were 10 percent larger, and there was also an increase in wage payments on the railroads, where employment declined somewhat but wage rates advanced.

Industrial profits have also been larger than in the corresponding period of 1934. The largest increases have been in the automobile, building materials, machinery, and electrical equipment industries, while the profits of public utilities, which had shown a relatively small decline during the depression, have decreased somewhat further this year.

Agricultural income has been above that of a year ago by about 7 percent, chiefly as a consequence of higher prices for livestock and livestock products. Marketings of livestock have been sharply reduced while crop production has shown a considerable increase over last year, when drought conditions prevailed.

The volume of domestic trade has been somewhat larger than a year ago, particularly in rural areas. Purchases of household equipment and automobiles have shown a substantial growth, and the dollar volume of sales by department stores has been larger, with the most marked increases over last year reported in recent months.

Although economic activity has increased substantially from the low levels of the depression, the current level is considerably below that in 1929 and the volume of unemployment continues high.

The accompanying table shows a comparison of business conditions in September and the first three quarters of 1935 with conditions in the years 1929, 1932, 1933 and 1934.

BUSINESS CONDITIONS

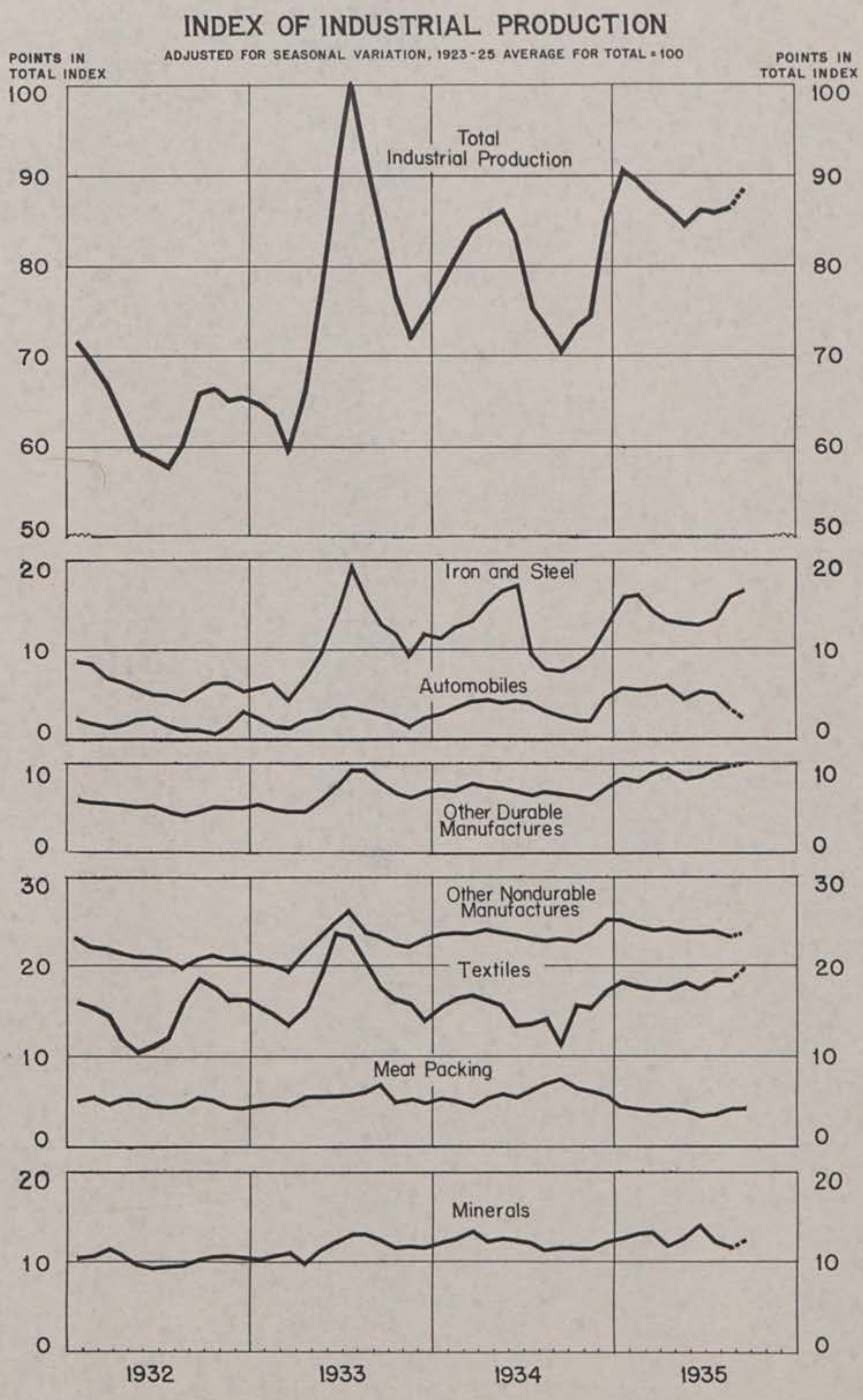
Index numbers, 1923-1925 = 100

	Industrial production	Construction contracts awarded (value)	Factory employment	Factory payrolls	Department store sales	Wholesale prices 1/	Retail food prices 2/
1929	119	117	105	109	111	95	157
1932	64	28	64	46	69	65	102
1933	76	25	69	49	67	66	100
1934	79	32	79	62	75	75	111
1935							
Jan.-Sept.3/	87	31	81	68	78	80	122
Aug.3/	87	38	82	70	79	81	122
Sept.3/	p88	p41	p82	p71	p82	81	124

p--Preliminary.
1/ 1926 = 100; index of Bureau of Labor Statistics.
2/ 1913 = 100; index of Bureau of Labor Statistics.
3/ Indexes for periods less than a year, except those for wholesale and retail prices, adjusted for seasonal variation.

Industrial production

Since the middle of 1932 there have been four periods of increased industrial output, each quite different from the others. Some of the differences are evident on the accompanying chart, which shows the Board's seasonally adjusted index of industrial production and the production of iron and steel, automobiles, other durable manufactures, textiles, meatpacking, other non-durable manufactures, and minerals, all expressed in terms of points in the total index, so that it is possible to see just how much of any movement in the total index is accounted for directly by changes in activity in any of these industries. The indirect effects, such as an increase in the output of materials owing to an increase in output of finished goods, are not shown separately.


INDEX OF INDUSTRIAL PRODUCTION
ADJUSTED FOR SEASONAL VARIATION, 1923-25 AVERAGE FOR TOTAL = 100
POINTS IN TOTAL INDEX
POINTS IN TOTAL INDEX
100
90
80
70
60
50
Total Industrial Production
20
10
0
Iron and Steel
Automobiles
10
0
Other Durable Manufactures
30
20
10
0
Other Nondurable Manufactures
Textiles
Meat Packing
20
10
0
Minerals
1932
1933
1934
1935

The first of the four advances was in the summer of 1932. It was small in amount and reflected largely an increase in textile output from an unusually low level. By the following March, at the time of the banking crisis, production had declined to about the same level as in the middle of 1932.

The second advance, stimulated by the reopening of banks, the low level of stocks of certain commodities, and the prospect of higher costs and higher prices in many lines, was widespread and exceptionally rapid. Output of semi-finished products showed the most rapid expansion in this period, and the index, which is based in large part on output of such products, advanced 41 points in four months, from 59 percent of the 1923-1925 average in March to 100 percent in July. This advance, partly of a speculative character, was not sustained, however, and beginning in August there was a general, rapid decline in output, which by November had brought the index down to 72 percent.

The third advance in the index, to a high of 86 percent in May 1934, reflected primarily increased output of steel, part of which was purchased for stock in anticipation of price advances announced for the third quarter. Increased automobile production was also a factor in this advance. After May the index declined rapidly, reflecting chiefly an abrupt decline in steel production which continued at an exceptionally low level for several months. There was also a decline in activity at textile mills while meatpacking showed a marked increase, largely as a consequence of the drought. The low point of this downward movement in the index of industrial production was reached in September 1934, partly owing to the textile strike in that month.

The fourth advance, from this low point of 71 percent in September 1934 to 91 percent in January 1935, was general for the industries shown on the chart, except that in the meatpacking industry activity showed a rapid decline during this period. The level of industrial output reached in January was somewhat higher than that reached in the spring of 1934 and has been largely maintained. This is the first advance that has not been followed in the immediately succeeding months by a sharp decline. The lowest index reported so far this year is 85 percent for May. The most recent index, for September, is 88 percent, and there is no indication of a decline in the immediate future.

Steel production has been maintained generally at a level of between 40 and 50 percent of capacity and currently is at 52 percent, reflecting sustained demand from many sources, especially the automobile and machinery and miscellaneous industries; orders from the railroad and building industries have continued to be in limited volume. Automobile production, which had increased from a low level of 1,400,000 cars for the whole year of 1932 to 2,800,000 for 1934, has totaled 2,900,000 during the first nine months of 1935. Output was sharply reduced in September as preparation was made for new models which are now being produced in increasing volume.

Lumber output has increased considerably, accompanying an advance in residential building and increased activity in the furniture industry. Textile production as a whole has been unusually stable at a level somewhat higher than was reached at any time during 1934. This higher level, however, has been due chiefly to unusually large production by the wool industry, partly offset in the total by a relatively small volume of output in the cotton textile industry.

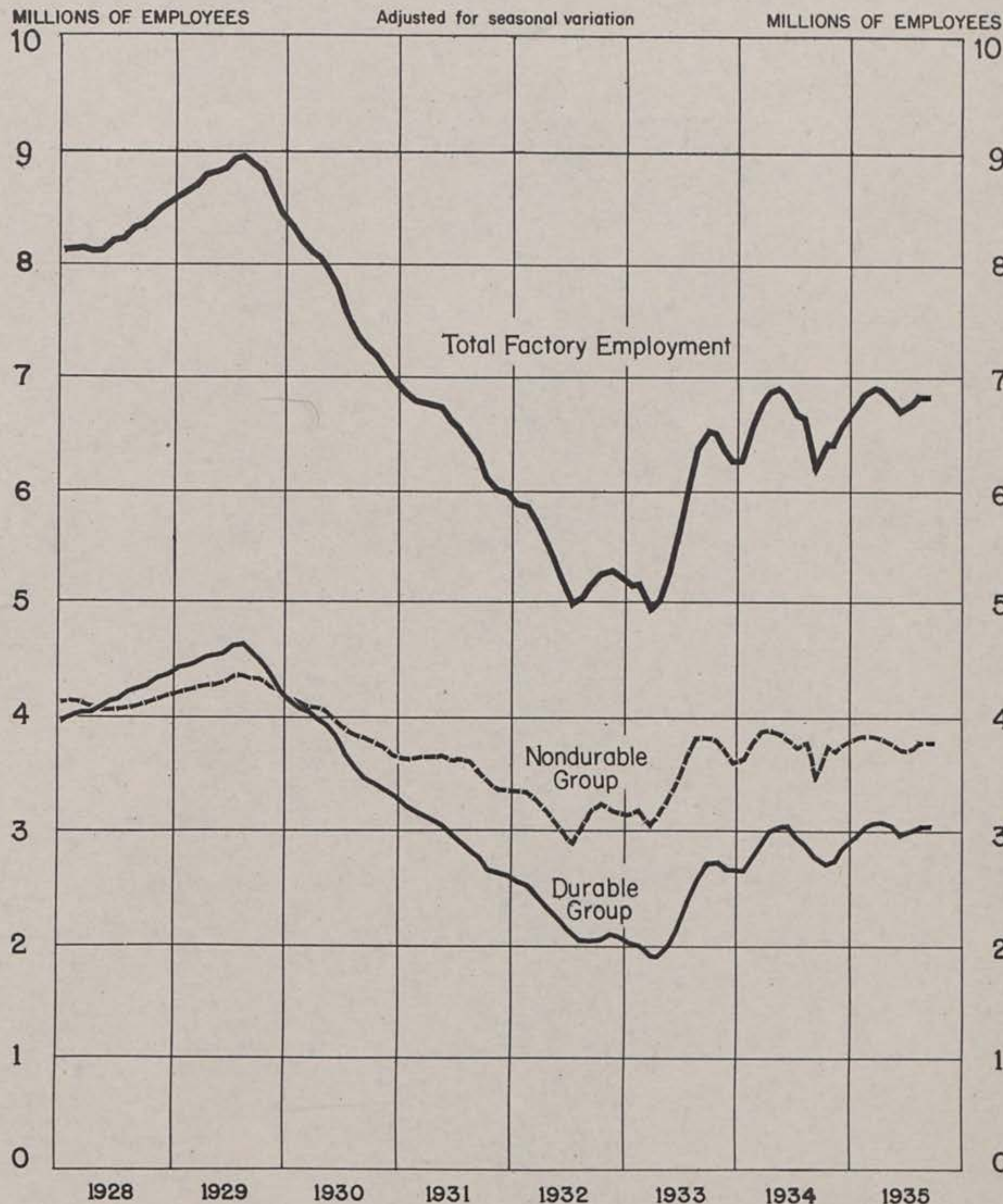
At mines output has fluctuated more from month to month this year than in other recent years on account of uncertainties concerning a possible coal strike, which finally occurred in September and was settled after a few days.

Employment and payrolls

Total volume of employment is slightly higher than a year ago and substantially above the lowest level of the depression. It is, however, considerably below the 1929 level and, with a growing number of persons of working age, the volume of unemployment continues at an unusually high level.

The course of factory employment since 1928 is shown on the accompanying chart with separate lines for employment in the industries producing durable manufactures, such as iron and steel, automobiles, machinery, lumber, and furniture, and for employment in the industries producing non-durable manufactures, such as foods, textiles, and leather products. The figures are adjusted for seasonal variation.

FACTORY EMPLOYMENT



The total number of wage-earners employed at factories in August was about 6,800,000 as compared with 6,600,000 a year ago, a low of 4,900,000 in the spring of 1933, and a high of 9,000,000 in the middle of 1929. Preliminary figures indicate that in September the number employed showed a seasonal increase.

In 1929, as in most of the earlier post-war years, the number employed in the durable group was slightly larger than in other manufacturing industries. From the high in 1929 to the low point of the depression, the decline in the non-durable group was about 1,500,000 persons, while in the durable group it was about 2,700,000 persons. The subsequent increase reported for the durable group has been larger than for the non-durable group, amounting to about 1,100,000 persons as compared with 900,000. This year employment in both groups has been maintained with little change, with the durable group generally higher than a year ago. Detailed comparisons for leading groups of industries are shown in the following table.

FACTORY EMPLOYMENT

January-August 1935

	Average number of employees	Change from year ago	
		Number of employees	Percent
Total	6,774,700	+111,100	+1.7
Durable group	3,024,000	+119,300	+4.1
Automobiles and parts	445,100	+35,900	+8.8
Machinery	738,100	+57,500	+8.4
Non-ferrous metals and products	224,100	+15,500	+7.4
Lumber and products	465,900	+18,800	+4.2
Iron and steel and products	613,400	+8,600	+1.4
Transportation equipment, other than automobiles	96,400	+1,400	+1.4
Stone, clay, and glass products	185,100	-1,700	-0.9
Railroad repair shops	255,900	-16,700	-6.1
Non-durable group 1/	3,750,700	- 8,200	-0.2
Textile wearing apparel	446,700	+15,200	+3.5
Paper and printing	510,900	+11,600	+2.3
Chemical group, except petroleum refining	292,100	+2,700	+0.9
Textile fabrics	1,023,400	+2,900	+0.3
Leather and products	287,600	-2,700	-0.9
Petroleum refining	70,900	-800	-1.1
Food products	653,900	-29,700	-4.3
Rubber products	108,600	-6,000	-5.3
Tobacco products	79,300	-6,500	-7.5

1/ Includes a few miscellaneous industries not shown separately.

Employment at mines has fluctuated considerably in recent months, reflecting the threat of a strike in the bituminous coal industry; the average for the year to date, however, is about the same as last year. On railroads employment has shown a seasonal increase since the beginning of the year, while in public utilities little change has been reported.

Payrolls at factories for the period from January to September this year have been about 10 percent larger than a year ago and on the railroads payrolls have also been larger, partly on account of higher wage rates. Payrolls at mines and public utilities have shown little change. The figures for these four groups of industries are given below; for other groups, such as trade, construction, professional and government service, no satisfactory data are available.

AVERAGE WEEKLY PAYROLLS IN FOUR GROUPS OF INDUSTRIES

(In millions of dollars per week)

	Jan.-Sept. 1934	Jan.-Sept. 1935	Change
Total--factories, mines, railroads, public utilities*	183.9	199.0	+15.1
Factories	126.5	138.8	+12.3
Durable group	58.3	66.4	+8.1
Non-durable group	68.2	72.4	+4.2
Mines	12.7	12.4	-.3
Railroads	28.0	30.0	+2.0
Public utilities	22.9	23.8	+.9

*Steam railroad repair shops are included in factories and also in railroads, but the duplication has been eliminated in this total.

Domestic trade

The total amount of domestic trade has been larger during the first three quarters of 1935 than it was a year ago. Sales of general merchandise in rural areas, as reported to the Department of Commerce by mail-order houses and chain stores, have been substantially larger than in any other year since 1930. Department store sales, as measured by the Board's seasonally adjusted index, have shown an increase during this year and the average for the third quarter was 80 percent of the 1923-1925 average, as compared with 75 percent in the third quarter of 1934. Sales of automobiles showed a considerable advance in the early part of the year and were well maintained until September when they declined prior to the introduction of new models. There has been an increase over a year ago in the sales of chain grocery stores, owing in part to higher food prices, while in chain variety stores sales have been in about the same amount as last year.

Foreign trade

In the first 8 months of this year the value of exports was about the same as in the corresponding period last year while the value of imports was one-fifth larger. The excess of exports amounted to $28,000,000 as compared with $259,000,000 a year ago.

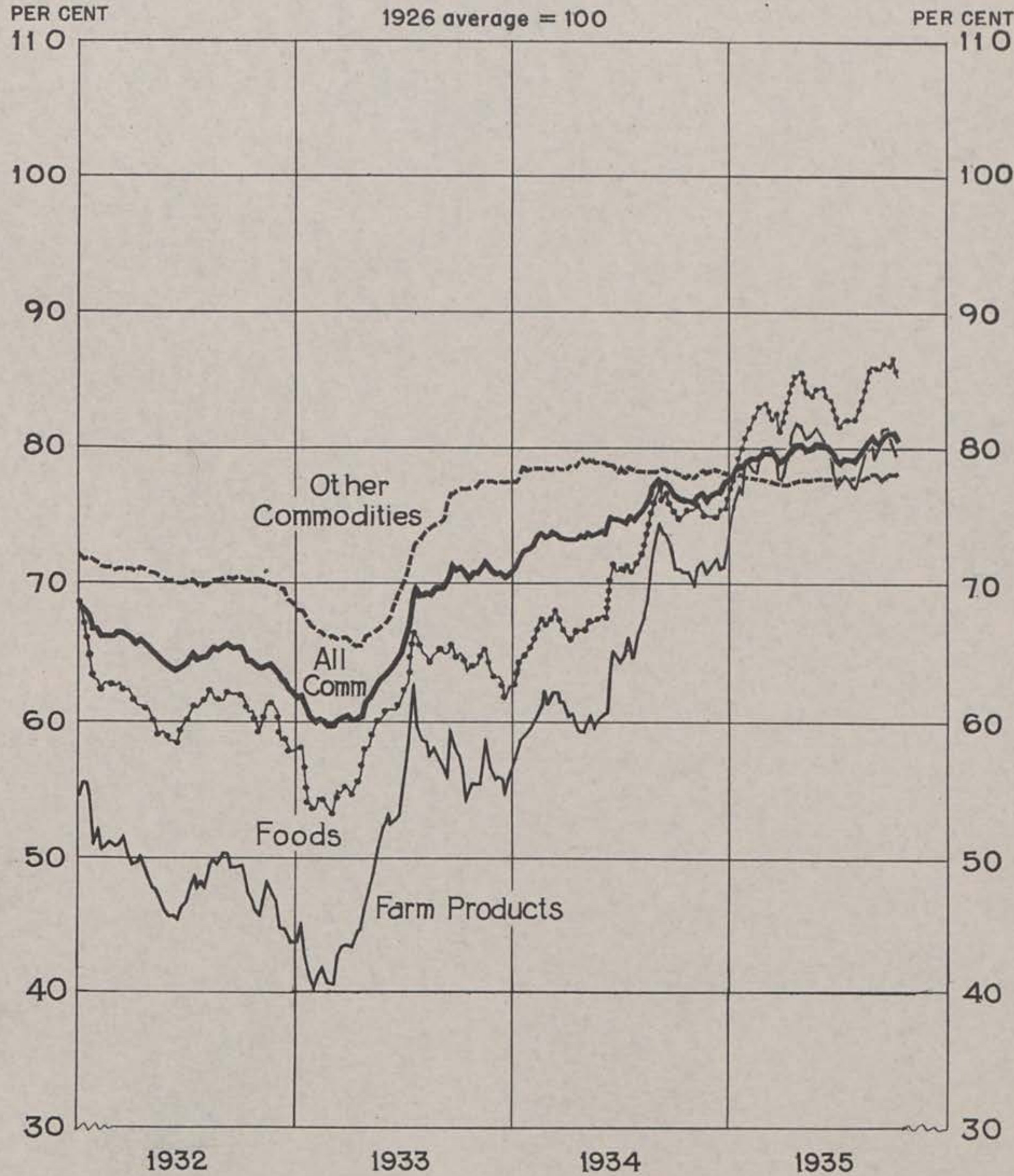
Reflecting chiefly the effects of last summer's drought, exports of meats, lard, and grains showed a marked decline from last year and imports of livestock products, grains, and feeds increased. Exports of cotton showed a marked decrease and the quantity of tobacco exported was also considerably smaller. Exports of automobiles, machinery, and crude petroleum, however, have been in larger volume than last year.

The increase in imports this year has been general, with marked increases over a year ago reported for sugar and tin, as well as for meats and grains. Imports of crude rubber have been larger in value but slightly smaller in volume.

Prices

Since the beginning of the year the general level of wholesale prices has shown less change than in the corresponding period of any other year since 1929. The course of the index has been gradually upward, with an irregular advance from 78 percent of the 1926 average in the early part of January to 81 percent currently. As is indicated on the accompanying chart, movements in the index have been largely dominated by changes in the prices of farm products and foods, while prices of other commodities as a group have shown little change from the level reached in the autumn of 1933 and maintained throughout 1934.

WHOLESALE PRICES



The principal changes in prices of farm products and foods have been marked increases in the prices of livestock and livestock products, a rapid decline in the prices of grains other than wheat, and a smaller decrease in the price of cotton. Wheat prices declined in the early part of the year but from the end of June to the first week of October they advanced rapidly, and although they have declined somewhat since then, they are now higher than at the beginning of the year. Prices of sugar have also shown a considerable increase.

While other commodities as a group have shown little change, there have been marked movements in the prices of several individual commodities. Since last spring prices of hides and leather, silk, textile products, and scrap steel have advanced, and since summer nonferrous metals have also increased. Prices of tires and tubes and crude petroleum have shown declines during the year.

Retail prices of foods advanced considerably during the early months of the year, reflecting chiefly a sharp rise in meat prices. Since April there has been little net change in food prices and at the present time they are approximately 6 percent higher than they were a year ago.

Profits and dividends

Industrial profits, as indicated by reports of large corporations, were somewhat larger in both the first and second quarters of 1935 than in the corresponding periods of last year. Automobiles, building materials, machinery, and electrical equipment were among the industries showing the most marked increases. Results for the third quarter are not yet available, but known developments indicate that profits were above those of the previous year. Since 1932, when industrial corporations were generally operating at a loss, profits have recovered substantially, but their current volume is still only about one-third of that attained in 1929.

During the first half of 1935 profits reported by public utility companies were somewhat below those of the previous year. Since the recession in this field, however, was much less than for industry generally, profits of utilities are almost two-thirds as high as the best levels reached a few years ago. Railroad companies as a group failed to earn their fixed charges during the first half of 1935, as in other recent years.

Dividend declarations for a large group of corporations during the first nine months of the year as compiled by the New York Times aggregated $2,000,000,000, an increase of about $100,000,000 over the previous year. Several of the largest banks in New York City have recently reduced dividends because of low average yields on available funds.

Credit Conditions

Member bank deposits

Deposits at member banks have continued to show a rapid growth during 1935, reflecting principally the influence of gold imports and of disbursements by the Government of funds raised through the sale of obligations to the banks. The following table shows for recent years the various types of deposits at all member banks.

DEPOSITS AT ALL MEMBER BANKS
ON SELECTED CALL DATES

(In millions of dollars)

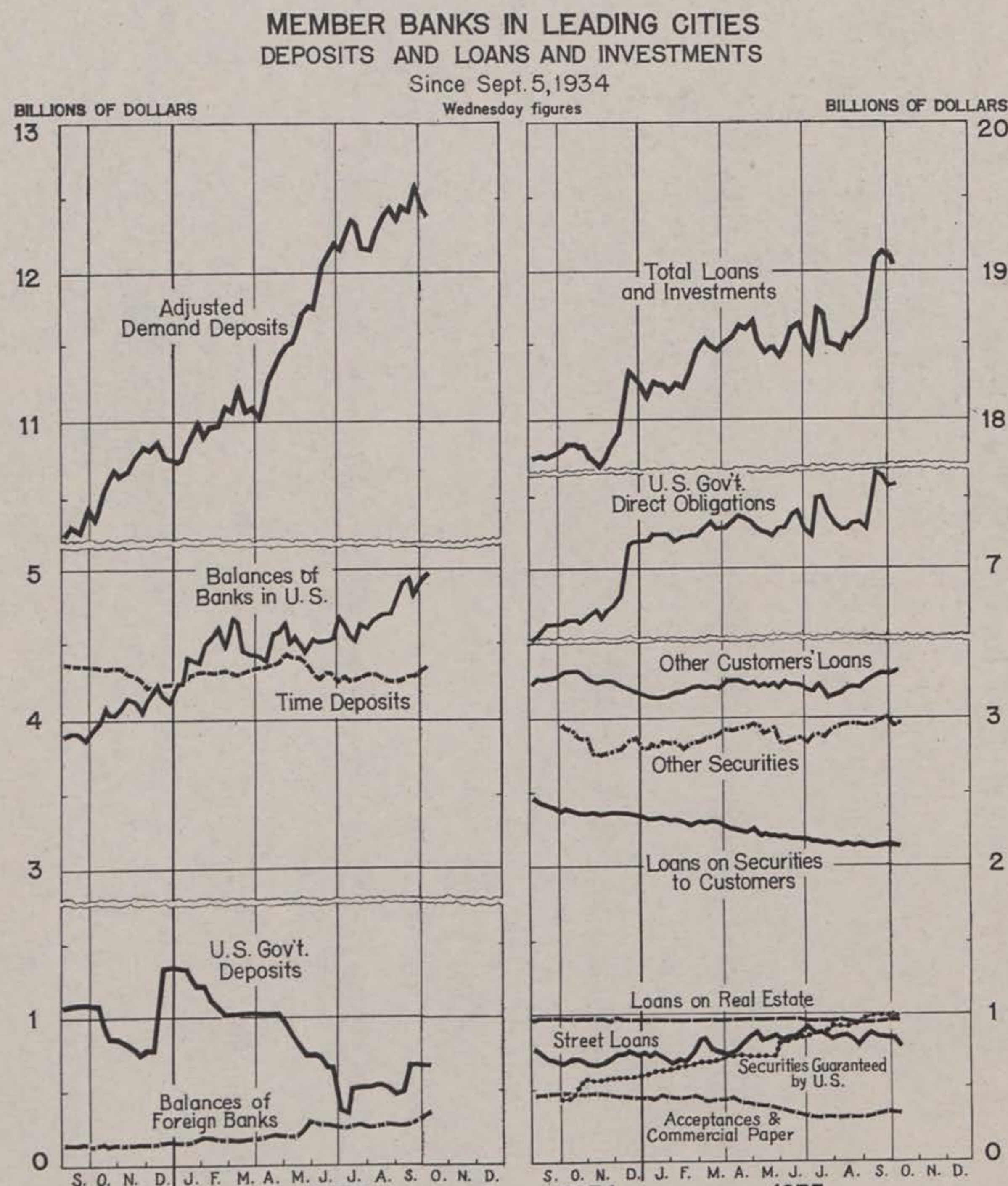
	Adjusted demand*	Time (excluding interbank and Postal Savings)	United States Government	Postal Savings	Interbank
1929 June 29	16,324	13,053	348	115	3,766
1933 June 30	12,089	8,102	806	788	3,340
1934 June 30	14,261	9,096	1,658	585	4,397
Dec. 31	15,686	9,315	1,636	452	4,905
1935 June 29	17,530	9,747	779	307	5,442

* Demand deposits, other than those of banks and the United States Government, plus certified and officers' checks, cash letters of credit and travelers' checks, and due to Federal Reserve banks (deferred credits), minus cash items reported as on hand and in process of collection.

On June 29, 1935, adjusted demand deposits, which exclude United States Government deposits, interbank balances, and reported "float," amounted to $17,530,000,000. This is the largest amount ever reported for member banks, but demand deposits at nonmember banks and at all banks continued below their previous peak. Time deposits at member banks, excluding interbank and Postal Savings deposits, increased in the first half of this year and at $9,750,000,000 were $1,650,000,000 larger than two years earlier, but considerably smaller than in the period from 1928 to 1931.

The recent decline in Postal Savings deposits at banks reflects the direct investment of funds by the Postal Savings System; the amount of deposits held by the public in Postal Savings accounts has shown little change since 1933. The continuous growth in interbank balances, which are now the largest on record, reflects an increase in idle funds held by banks.

That the growth of deposits has continued since June, although at a somewhat slower rate than in the second quarter of this year, is indicated by figures for weekly reporting member banks in 91 leading cities, shown on the chart. Adjusted demand deposits at these banks increased by over $200,000,000 between June 26 and October 9, while time deposits showed a small increase, notwithstanding a decrease in Postal Savings deposits, which are included in the figures shown on the chart. Balances of domestic banks continued to increase, and there has also been some growth in recent weeks in deposits of foreign banks, reflecting the movement of short-term funds from abroad.


MEMBER BANKS IN LEADING CITIES
DEPOSITS AND LOANS AND INVESTMENTS
Since Sept. 5, 1934
Wednesday figures
BILLIONS OF DOLLARS
BILLIONS OF DOLLARS
Adjusted Demand Deposits
Balances of Banks in U.S.
Time Deposits
U.S. Gov't. Deposits
Balances of Foreign Banks
Total Loans and Investments
U.S. Gov't. Direct Obligations
Other Customers' Loans
Other Securities
Loans on Securities to Customers
Loans on Real Estate
Street Loans
Securities Guaranteed by U.S.
Acceptances & Commercial Paper
S. O. N. D. J. F. M. A. M. J. J. A. S. O. N. D.
1934
1935
13
12
11
5
4
3
1
0
20
19
18
7
3
2
1
0

Bank debits and turnover of deposits

Reflecting an increased volume of financial and other business transactions, the amount of debits to depositors' accounts at banks has been larger in 1935 than in any of the three previous years. At banks in 140 cities outside of New York debits in the first three quarters of this year were 13 percent larger than in the same period last year. In New York City, where debits are to a considerable extent affected by speculative stock-market activity, the increase amounted to 6 percent.

The increase in debits for the country as a whole has been somewhat slower than the growth of deposits, and therefore the rate of deposit turnover has decreased slightly.

Member bank loans and investments

Loans and investments of member banks have increased this year by a somewhat smaller amount than in the same period last year. This difference has reflected in large part the smaller volume of borrowing by the United States Government and its agencies this year as compared with last. Another factor has been the retirement in July and August of bonds bearing the circulation privilege. Holdings of direct obligations of the United States Government by all member banks showed little change in the first half of the year, while those of weekly reporting member banks in leading cities, as indicated on the chart previously shown, have increased by about $200,000,000 since June. Additional securities purchased have exceeded in amount the circulation bonds retired.

Obligations fully guaranteed by the United States Government increased by $570,000,000 at all member banks in the first half of the year, reflecting in part an exchange of partially guaranteed for fully guaranteed securities. Since June weekly reporting banks have shown a further increase. Holdings of other securities also increased during the year.

Total loans of member banks declined in the first half of the year, but since the end of July loans of weekly reporting banks have increased somewhat. Loans on securities to customers continued to decline, while other customers' loans showed seasonal increases in the spring and again in recent weeks. Loans to brokers and dealers in securities, which are discussed more fully in a subsequent section, fluctuated within a relatively small range, reflecting principally operations of dealers in Government securities.

Money rates and bond yields

Short-term money rates have continued at low levels during 1935, with rates on open-market commercial paper at 3/4 of one percent since January, those on call and time loans on the New York Stock Exchange at 1/4 of one percent since April, and rates on acceptances at 1/8 of one percent throughout the year. Yields on 9-month Treasury bills, which declined in the first half of the year to .05 of one percent in July, have recently been between .20 and .25 of one percent.

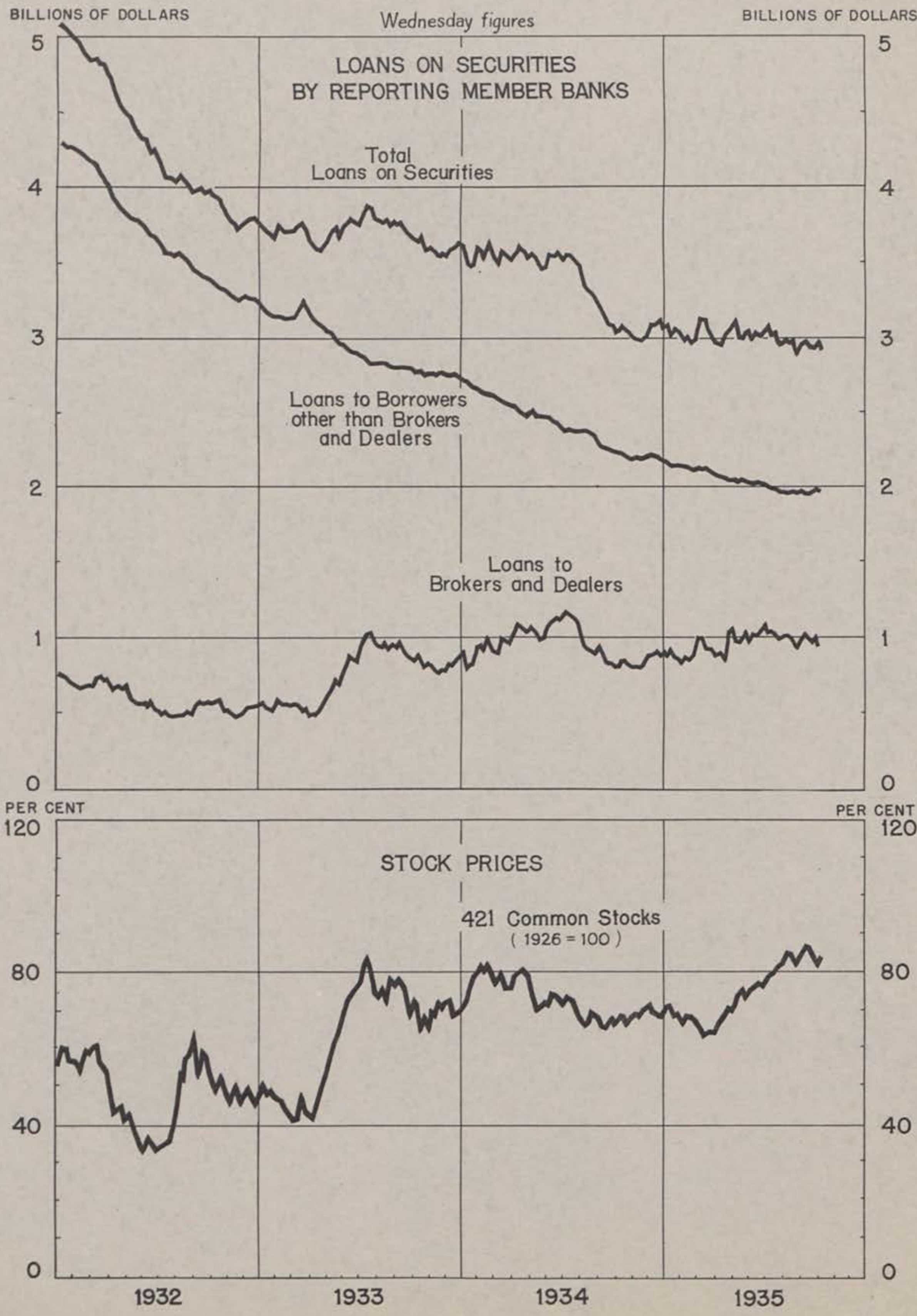
Rates charged on prime loans to customers by banks have shown a further slow decline during the year. Rates at New York City banks now average less than 2 3/4 percent; those in other northern and eastern cities, 3 3/4 percent; and those in southern and western cities, about 4 1/2 percent.

Yields on outstanding Treasury bonds continued to decline during the first half of the year but rose somewhat in August and September as a consequence of declines in prices. Yields on high-grade corporate bonds have been relatively stable at a low level since early in the year.

Security prices and security loans

There has been a substantial increase in security prices and in stock market activity during recent months, reflecting for the most part cash purchases by investors. The following chart brings out the fact that this rise in prices of securities has not been accompanied by an increase in security loans.

SECURITY LOANS AND STOCK PRICES



The average increase in stock prices since last March has exceeded 30 percent, according to the most comprehensive available index, while the security loans of the weekly reporting member banks have shown little change. A small increase in their loans to brokers and dealers in securities has been offset by a decrease in their security loans to other customers.

It is an unusual development for a rise of 30 percent in stock prices in a short period of time not to be accompanied by an increase in the amount of bank credit used for carrying securities. This unusual condition is due in part to the abundance of funds in the hands of investors and in part to the effects of the Board's Regulation T, which limits withdrawals of cash from margin accounts for the purpose of realizing profits from a rise in stock prices, and thereby reduces the need of borrowing by brokers.

A somewhat paradoxical situation arises out of the nature of the formula for determining margin requirements stated (but not prescribed) in the law and adopted by the Board. The formula provides that a loan on a security must not be greater than whichever is the higher of:

> (1) 55 per centum of the current market price of the security, or
>
> (2) 100 per centum of the lowest market price of the security during the preceding thirty-six calendar months, but not more than 75 per centum of the current market price.

The theory on which this formula was based was to provide for a constant increase of restraining influences as the prices of stocks advanced further and further above their lows. The way the formula works out in practice is not entirely consistent with this theory. Up to the point when the price of a stock rises to 133 percent of its three-year low it is permissible to borrow as much as 75 percent of its market price and an increase in price can result in pyramiding of profits. From that point until the price reaches 182 percent of its low, the amount that can be borrowed remains constant at 100 percent of the low price. During that period the percentage of the margin to the permissible loan increases, but the actual amount that can be borrowed remains unchanged and, therefore, no pyramiding is possible. When the price of the security gets above 182 percent of its low, the formula results in a constant 45 percent margin requirement. This is the highest proportionate margin provided for in the formula, but since every increase of $1.00 in the price of the stock from that point permits an increase of 55 cents in the amount that can be borrowed on it, it becomes possible once more to pyramid profits arising from price advances. In this way the formula, though providing a higher margin requirement for stocks that have advanced rapidly, results in removal of the anti-pyramiding restraint when the stocks have advanced beyond 182 percent of their lows.

At the present time stocks in which two-thirds of the trading is done, including many market leaders, have emerged from the anti-pyramiding zone and, though subject to the 45 percent margin requirement, will afford opportunities for pyramiding profits in the event of further advances in prices.

The course of the market in the immediate future requires close observation to determine whether and when a change in the formula or in the level of required margins shall become desirable.

Capital issues

The supply of funds seeking investment and the low level of money rates brought about a revival of the capital markets beginning early in 1935. New issues, particularly for refunding purposes, were offered in increased volume in March and have continued to come into the market in a volume substantially above that of recent years. Total issues increased from $140,-000,000 in January and $100,000,000 in February to $290,000,000 in March. Since then they have averaged about $500,000,000 a month. This compares with average issues of $140,000,000 a month during the years 1932-1934 and of $740,000,000 a month during the period 1925-1930.

Capital issues for the period January 1--September 30, 1935, totaled $3,530,000,000, including $2,560,000,000 for refunding existing securities and $970,000,000 for raising new capital to be used in part in liquidation of bank loans and in part to improve or expand plant and equipment.

The increased flow of new securities into the capital market during 1935 has been chiefly for the purpose of reducing interest charges on existing debt. Nearly three-fourths of the securities were offered to refund outstanding securities into issues bearing lower coupon rates. In fact the total issued for refunding purposes during this nine-month period exceeds the amount of such issues during any post-war year. Refunding issues of the farm loan and Government credit agencies totaled $865,000,000, including offerings to redeem $400,000,000 of Federal land bank bonds and $325,000,000 of Home Owners' Loan Corporation bonds guaranteed by the United States as to interest. Public utility companies were the next most important group participating in refunding operations. They issued $760,000,000 for refunding purposes, including twelve issues varying in amount from $30,000,000 to $70,000,000 each and aggregating $530,000,000.

Corporate issues have become a more important factor in the capital market in 1935 than in any year since 1931. Total issues by corporations in the period January 1--September 30 were $1,600,000,000, including $1,370,000,000 for refunding purposes and $230,000,000 for new capital. In addition to the refunding issues offered by public utility companies, which have already been mentioned, $120,000,000 were offered for this purpose by railroads, $340,000,000 by various manufacturing companies, and $110,000,000 by companies producing and refining oil. Corporate issues to raise new capital averaged $35,000,000 a month during the period April 1--September 30, which is in excess of average monthly issues for such purposes in any year since 1931. Stocks, preferred and common, have been issued to only a small degree. Nearly three-fourths of the issues for new capital have been in the form of long-term bonds and notes.

Treasury finance

During the period July 1 to September 30, 1935, Treasury expenditures, excluding debt retirement, were $1,700,000,000, receipts totaled $1,000,000,000, and the public debt increased by $700,000,000.

On the basis of revised budget estimates, included in a recent statement by the President, the deficit (excluding debt retirement) for the fiscal year ending June 30, 1936, is expected to be about $2,700,000,000, as compared with a deficit of $3,000,000,000 in the fiscal year 1935. Whereas during the fiscal year 1935 the Treasury met a large portion of its deficit by drawing on its previously accumulated general fund balance and the public debt showed an increase of only $1,650,000,000, it is anticipated that during the current fiscal year the deficit will be met principally by borrowing and the public debt will increase by $2,600,000,000.

During the current calendar year the Treasury's refunding program has included about $5,700,000,000 of its bonded debt called for redemption. The retired issues include $1,870,000,000 of 4th Liberty Loan bonds on April 15, the remaining $1,250,000,000 of 4th Liberty bonds on October 15, $1,930,000,000 of 1st Liberty bonds on June 15, $600,000,000 of Consols on July 1 and $75,000,000 of Panama Canal bonds on August 1. About $4,200,000,000 of this bonded debt was retired by exchange offerings; the new issues included $2,310,000,000 of 2 7/8 percent 20-25 year bonds, $570,000,000 of 2 3/4 percent 10-12 year bonds, $860,000,000 of 1 5/8 percent 5-year Treasury notes, and $430,000,000 of 1 1/2 percent 3 1/2 year Treasury notes.

With the redemption of the remaining 4th Liberties on October 15 the Treasury completed the refunding program which was begun in October 1933 with the first call of the 4th Liberties. Under this program about $8,875,000,000 of bonds have been retired, including all remaining war bonds and practically all pre-war bonds. Redemption of about $6,900,000,000 of these bonds was made through exchange offerings of notes and bonds carrying lower interest rates and with varying periods to maturity and about $1,900,000,000 have been redeemed in cash or are subject to cash redemption. The effect of the exchanges was to reduce the interest charges on that part of the redeemed debt by about $100,000,000 per annum.

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Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

File

Date July 24, 1935

To Mr. Hamlin

From Mr. Owens

Subject: Authority of Senate Munitions Committee to Subpena Witnesses and Compel Production of Documents.

O.K. G.W.

At Mr. Wyatt's request I have investigated the authority of the Senate Munitions Committee to subpena witnesses and to require the production of books, papers and documents. As a result of such investigation I have reached the following conclusions:

1. The Committee has the authority to require you to appear before it as a witness and to testify regarding any matter pertinent to its investigation.

2. Although the Committee has no general power to require the production of your private papers or correspondence, it may require the production of such private papers and correspondence as are pertinent to a matter into which it has authority to inquire for the purpose of carrying out its legislative functions.

3. The Committee has the authority to require the Federal Reserve Board to produce such of its minutes, correspondence, and other records as may be pertinent to a matter into which the Committee has authority to inquire for the purpose of carrying out its legislative functions.

4. A witness before the Committee would not have the right to refuse to answer a question on the ground that the testimony sought to be elicited by the question would constitute hearsay evidence.

5. Refusal to appear before the Committee or to produce

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documents in response to a subpena would be punishable by the Senate as a contempt and would also be punishable as a misdemeanor under the provisions of 2 U.S.C.A. Secs. 192, 193, 194.

DISCUSSION

The Senate special committee to investigate the munitions industry was created by Senate Resolution 206 adopted March 28, 1934. Among other things this resolution provides:

> "For the purposes of this resolution the committee or any subcommittee thereof is authorized to hold hearings, to sit and act at such times and places during the sessions and recesses of the Congress until the final report is submitted, to require by subpena or otherwise the attendance of such witnesses and the production of such books, papers, and documents, to administer such oaths, to take such testimony, and to make such expenditures, as it deems advisable."

The above quoted provision is essentially the same as that contained in Senate Resolution 349 creating a Senate committee to investigage ocean and air mail contracts. The comparable provision of S. Res. 349 is as follows:

> "For the purposes of this resolution the committee, or any duly authorized subcommittee thereof, is authorized to hold such hearings, to sit and act at such times and places during the sessions and recesses of the Senate in the Seventy-second and succeeding Congresses, to employ such clerical and other assistants, to require by subpoena or otherwise the attendance of such witnesses and the production of such books, papers, and documents, to administer such oaths, to take such testimony, and to make such expenditures, as it deems advisable."

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The above quoted provision of S. Res. 349 was involved in the case of Jurney v. MacCracken 293 U.S. 543, 55 S.Ct. 375, 79 L. Ed. 89 (1935). In that case an attorney named MacCracken received a subpena to produce before the Committee certain correspondence with his clients regarding air mail contracts. After receiving the subpena he permitted a client named Brittin to remove and destroy certain correspondence which he had been ordered to produce. The Senate ordered MacCracken, Brittin and others to appear before it to show cause why they should not be punished for contempt of the Senate on account of destroying and removing the correspondence in question. MacCracken failed to appear before the Senate, was arrested and taken into custody, and petitioned for a writ of habeas corpus which was denied by the Supreme Court of the District of Columbia. The action of the Supreme Court of the District of Columbia was reversed by the Court of Appeals and after granting certioria the Supreme Court of the United States reversed the decision of the Court of Appeals and held that the Senate had authority to punish MacCracken for contempt of the Senate even though the act which constituted the contempt had been completed. In discussing the authority of the Committee investigating ocean and air mail contracts to require the production of papers, the Supreme Court of the United States stated:

> "It is conceded that the Senate was engaged in an inquiry which it had the constitutional power to make; that the committee had authority to require the production of papers as a necessary incident of the power of legislation; and that the Senate had the power to coerce their production by means of arrest. McGrain v. Daugherty, 273 U.S. 135, 47 S.Ct. 319, 71 L. Ed. 580, 50 A.L.R. 1."

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Refusal of a witness to appear and testify before a Congressional Committee not only subjects the witness to punishment for contempt but also renders him liable to punishment under the provisions of Secs. 192 and 194 of 2 U.S.C.A. These Sections provide as follows:

> §192. Refusal of witness to testify. Every person who having been summoned as a witness by the authority of either House of Congress, to give testimony or to produce papers upon any matter under inquiry before either House, or any committee of either House of Congress, willfully makes default, or who, having appeared, refuses to answer any question pertinent to the question under inquiry, shall be deemed guilty of a misdemeanor, punishable by a fine of not more than $1,000 nor less than $100, and imprisonment in a common jail for not less than one month nor more than twelve months.
>
> §194. Witnesses failing to testify. Whenever a witness summoned as mentioned in section 192 of this title fails to testify, and the facts are reported to either House, the President of the Senate or the Speaker of the House, as the case may be, shall certify the fact under the seal of the Senate or House to the district attorney for the District of Columbia, whose duty it shall be to bring the matter before the grand jury for their action.

Another Section dealing with the privileges of witnesses to refuse to testify before a Congressional Committee is Section 193 of 2 U.S.C.A. which provides as follows:

> §193. Privilege of witnesses. No witness is privileged to refuse to testify to any fact, or to produce any paper, respecting which he shall be examined by either House of Congress, or by any committee of either House, upon the ground that his testimony to such fact or his production of such paper may tend to disgrace him or otherwise render him infamous.

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Section 192 of 2 U.S.C.A. was held constitutional in the case of In Re Chapman, 166 U. S. 661, 17 S. Ct. 677, 41 L. Ed. 1154 (1897). To the same effect is Sinclair v. United States, 279 U. S. 262, 49 S. Ct. 268, 73 L. Ed. 692 (1929), which upheld the conviction of Harry F. Sinclair for refusing to answer a question pertinent to an inquiry before the Senate Committee on Public Lands and Surveys in its investigation of the Navy oil leases.

In the above case it was contended that the question asked Mr. Sinclair was not pertinent to the investigation and also that it involved a private matter into which the Congressional Committee had no authority to inquire. The question was related to a contract between Mr. Bonfils and Mr. Sinclair regarding the Teapot Dome oil fields. The Supreme Court of the District of Columbia ruled that the pertinency of the question was a matter of law and decided that the question was pertinent. On appeal to the Court of Appeals of the District of Columbia, Mr. Sinclair contended that the question of the pertinency should have been submitted to a jury. Certain questions of law were certified to the Supreme Court of the United States which held that the question of pertinency was a matter of law to be decided by the Court and was properly withheld from the jury. The matter of whether a question is pertinent to the Congressional investigation is a

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matter of law because Congress has no general power or even any express power granted by the Constitution to conduct investigations. Its authority to investigate and to subpoena witnesses is purely an incidental function and extends only so far as is necessary to enable Congress to carry out its legislative functions. In view of the fact that Congress has authority to legislate regarding the control of the munitions industry, it would seem that it has authority to require testimony and the production of any correspondence, books, records, or documents which would have a bearing upon the conduct of the munitions industry or on the financing of sales of munitions.

The leading case holding that Congress has no authority to examine into purely private matters except insofar as it may be necessary to do so in order to perform its legislative functions is Kilbourne v. Thompson, 103 U. S. 168, 26 L. Ed. 377 (1880). In that case the Supreme Court held that a Congressional Committee had no authority to examine into the history and character of a real estate pool in the District of Columbia since the affairs of the pool were involved in litigation before a bankruptcy court and thus the investigation had become judicial rather than legislative. The Supreme Court traced the historical development of the power of Congress to conduct investigations and to subpoena witnesses before

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it and held that there was no general power to inquire into private affairs of witnesses except to the extent necessary to enable the Congress to carry out its legislative functions. Later cases have cited Kilbourne v. Thompson with approval but have made it clear that if a matter is pertinent to a subject which Congress is investigating in order to legislate thereon, an exemption is not obtained by the witness because of the fact that the matter would otherwise be a private matter. See McGrain v. Daugherty, 273 U. S. 135, 47 S. Ct. 319, 71 L. Ed. 580 (1927).

In view of the fact that the rules regarding hearsay evidence are primarily for the purpose of preventing unreliable evidence from reaching the ears of the jury who are considered to be untrained in evaluating evidence, it is my opinion that a witness before a Congressional Committee could not refuse to answer a question on the ground that the answer would constitute hearsay evidence. The Committee is not a court and it seems to me that judicial rules of evidence would not apply. Although the rules as to pertinency and relevancy are applicable to Congressional Committee investigations, they are not made applicable in order to save the time of the court, jury, and litigants and to prevent confusion of the jury, as is the case in a judicial proceeding, but because the Congressional Committee has no power to examine into a matter which is not pertinent to the performance of its legislative functions. Thus the rules as to pertinency and relevancy relate to the scope of the inquiry and the power of the Committee rather

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than to the quality of the evidence as is true of the hearsay rule in judicial proceedings.

Furthermore, the rule against hearsay is not a matter of privilege which may be invoked by the witness but instead is a matter which may be raised by the opposing attorney by way of objection or by the Court on its own motion in order to prevent the introduction of hearsay evidence.

Respectfully,

Joseph T. Owens
Joseph T. Owens,
Assistant Counsel.

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FEDERAL RESERVE BOARD

WASHINGTON

December 27, 1916.

Dear Governor Strong:

I duly received your Christmas card and want to thank you for your kind thought of me. While I have not troubled you with many letters inquiring as to your health, yet you can be sure I have kept myself informed almost day by day from those who hear from you, and the news I hear is certainly delightful. However, do bear in mind that you must take time, but how ever long that time is before you can come back absolutely cured we shall rest content, so I trust you will not worry about it.

Governor Harding tells me that he has written you about our announcement the other day of authority to the New York bank to appoint the Bank of England its foreign correspondent and agent, so I will not bother you with any of the details. I feel, however, that the news was received with great favor throughout the country as evidencing an indication of the Board to take up the matter of foreign exchange in a practical way.

With best wishes for the New Year, believe me,

Very sincerely yours,

(Signed) C. S. Hamlin

Hon. Benj. Strong, Jr.,
41 Montview Boulevard,
Denver, Colorado.

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Denver, Colorado,
January 2, 1917.

Dear Governor Hamlin:

It was good to hear from you and I appreciated your writing me very much indeed. My progress is satisfactory but slow just now, but, as you realize, my temperament does not fit in very easily with this irksome inactivity.

Governor Harding's letter about that announcement has not yet reached me and I await it with interest. It is, of course, most satisfactory to feel that we are now going to be in position to link up our Federal Reserve System with the Bank of England and ultimately I hope with the Bank of France and with the other great central banks of Europe. It would seem to me that the supreme importance of this relationship had not been fully appreciated, not as to present conditions, but as to the great advantages which will result from such alliances in future years. The only fly in the ointment is the fact that the Board's announcement really violated a very sacred pledge which I had entered into with Lord Cunliffe and having been made as it was might discredit me abroad and worse than that cause him a good deal of embarrassment with his own directors. Concerning all of that, however, I will be able to write more fully a little later.

With warmest regards and every good wish for the New Year, believe me,

Faithfully yours,

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

BS/CC

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FEDERAL RESERVE BOARD

CONFIDENTIAL WASHINGTON

January 9, 1917.

Dear Governor Strong:

I duly received your note of January 2nd and cannot tell you how glad I am that your progress is satisfactory, even though slow. The main thing to achieve is progress and a slow steady gain in the long run is much better than a sudden change which may later give way to further set-backs.

I fully share your gratification at the authorization of the Board to the Federal Reserve Bank of New York to appoint the Bank of England as its foreign agent and to open reciprocal accounts with it, and I hope, with you, that similar action may speedily be taken with the other great central banks of the world.

I cannot, however, quite comprehend your further statement "that the Board's announcement realy violated a very sacred pledge which I (you) had entered into with Lord Cunliffe and having been made as it was might discredit me (you) abroad and worse than that cause him a good deal of embarrassment with his own directors."

I think, on reflection, you will see that the vote which our Board passed and published was really an authorization to the Bank of New York to take up the matter of the appointment of a foreign agent with the Bank of England. The vote contained no reference to any preliminary conversation or understanding which had been had with the Bank of England. On the contrary, the vote clearly relates to future action and not to past understandings. As a matter of fact, the memorandum of your talk with the directors was never read officially at a meeting of the Board. On the contrary, the Board felt that if, acting under its authorization, you were to proceed to enter into any arrangement with the Bank of England, the arrangement itself would be formally submitted to us for our approval.

Speaking confidentially, I would say that the warning the Board felt impelled to give to the banks of the United States as to keeping their affairs liquid and avoiding investments in securities which though nominally short time may ultimately develop into long time bonds, was resented at the first, and some intimation even was given that it revealed a Pro-German inclination on the part of the Federal Reserve Board. It is hardly necessary to say to you that this was a pure banking matter and that the Board in giving its warning simply performed what it deemed to be its duty in warning the banks of the United States as to the necessity of keeping their assets in a liquid condition. When, however, the Board had voted to permit your Bank to appoint the Bank of England as its foreign agent the Board felt that it would be plainly improper to keep such a vote from the public. It was perfectly clear to us that it was our duty to mention the fact in our forthcoming annual report and we felt that the only proper way was to take the public into our confidence and state what the vote was.

So far as any action of the Board is concerned, it would, of course, be open for the Bank of England to decline to enter into any arrangement as to an agency, so far as our vote at least is concerned.

Speaking personally, I do not believe that you will be placed in any embarrassment through the publication of this vote of the Board. It was received with enthusiasm by the press of England and also universally by the press in this country. I only hope, as I have said, that it may be the beginning of many other arrangements with the various great central banks.

With my very best wishes for the New Year, believe me

Very sincerely yours,

(Signed) C. S. Hamlin

Honorable Benjamin Strong,
4100 Montview Boulevard,
Denver, Colorado.

Denver, Colorado,
January 15, 1917.

CONFIDENTIAL.

My dear Governor Hamlin:

I was delighted to receive your confidential letter of the 9th. As you may imagine, it is only my correspondence that prevents the development of a mental stagnation out here - that would be about the worst fate that I could contemplate. I am making good progress, although at this stage it is rather slow, particularly as I am disbarred as yet from much active exercise, partly on account of the weather and partly due to the excessive caution of my doctor, but I have added a total of 18 lbs. to my weight by some mysterious process, and that of course indicates progress, if nothing else does.

5 * In reply to what you say about the foreign arrangements, I am much tempted to write an elaborate account of the situation, but, having already done so to the office, possibly it is better for me not to repeat now. Had the Board's intention to make the announcement been communicated to me, I could have pointed out many reasons why it was unwise as could have been done also from the office in New York, but little good can come from worrying over spilt milk, and I am now hoping that my health and arrangements at the bank will permit me making another trip to Europe this summer and make these foreign arrangements complete and effecting and as comprehensive as present conditions justify.

In conclusion, let me suggest that the establishment of these relations between the System and the great banks of Europe is to my mind the most important development which can now be undertaken for the purpose of regulating after war developments, and I know that that view is shared by some of the most important bankers both in New York and aborad. I hope that no consideration will interfere with their prompt conclusion.

With kindest regards and again many thanks for your letter, I am,

Very truly yours,

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

BS/CC

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COPY

FEDERAL RESERVE BOARD

WASHINGTON

January 19, 1917.

CONFIDENTIAL:

Dear Governor Strong:-

I was very glad to receive your note of January 15th. If you have added eighteen pounds to your weight, I am sure you ought to feel that you have made splendid progress.

You say that if the Board's intention to make the announcement had been communicated to you, you could have pointed out many reasons why it was unwise. When I see you I think I can whisper a few words into your ear which will satisfy you, that it was not only not unwise, but was the highest part of wisdom.

By the way, I notice in the Journal of the American Bankers' Association for January, 1917, an interview with the Governor of the Bank of France to the effect that he hopes a similar authority can be given to the Federal Reserve Bank to enter into negotiations with the Bank of France.

I have read many editorials in European papers and every one welcomes the authority to enter into the proposed arrangements as most wise and beneficial both to the United States and Great Britain. I earnestly hope that we can now go farther and make similar arrangements with the other great European and Asiatic banks.

Trusting soon to hear from you again and with the kindest personal regards of my colleagues, believe me,

Very sincerely yours,

(Signed) C. S. Hamlin

Hon. Benjamin Strong,
Denver, Colorado.

Denver, Colorado,
January 26, 1917.

Dear Governor Hamlin:

It was very good of you to write me again and I do not want to seem unresponsive to the needs of any important situation, particularly when I am so far away and out of touch with things, but that announcement, as I wrote you, did give me a great shock.

I am now corresponding with Governor Pallain of the Bank of France and feel quite sure that we can conclude negotiations with that institution, but in Paris much more than in London many difficulties arise in dealing with so important and technical a matter by correspondence. Were I on the ground right now, I am sure the matter could be promptly concluded.

This situation as to foreign correspondents better than any other in my experience illustrates the truth of the saying that a man with money is always popular.

If I live and keep my health, you will see our bank in a close and important relationship with all the great central banks of Europe where such relationships can be of value, and it is one of the matters which has been uppermost in my mind ever since we started our organization. When that part of the work is done maybe I will retire and grow potatoes.

Again thanking you for your letter and your good wishes, I am,

Very sincerely yours,

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

Ser. Bn

FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

X-9360
November 9, 1935.

SUBJECT: Issuance of General Voting Permits.

Dear Sir:

The Board of Governors has for some time been giving consideration to the determination of the conditions under which general voting permits may be issued to holding company affiliates of member banks pursuant to section 5144 of the Revised Statutes and section 9 of the Federal Reserve Act. Much thought and effort have been devoted to this subject. Special consideration has been given to the intent of Congress in placing upon the Board the responsibility with respect to the issuance of voting permits and in providing that the Board shall consider the financial condition of the applicant, the general character of its management and the probable effect of the granting of such permit upon the affairs of its subsidiary member banks and that it may, in its discretion, grant or withhold such permit as the public interest may require.

In this connection, the Board has had an examination made of the history of this legislation, including the debates and other relevant matters; and there is attached a memorandum summarizing in a concise manner material which it is believed throws considerable light upon the purpose that Congress had in view.

In the endeavor to carry out what appears to have been the intent of Congress, it has been proposed that the following standard

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conditions be prescribed in connection with the issuance of general voting permits, in addition to such special conditions as may be warranted by the facts of individual cases:

1. That, as soon as practicable and, in any event, within two years from the date such voting permit is granted, the undersigned will charge off or otherwise eliminate from its assets, (a) the part of the carrying value on its books of its investments in stocks of subsidiary and/or affiliated organizations which is in excess of the adjusted value of such stocks, after effect shall have been given to the deduction of all estimated losses of such subsidiary and/or affiliated organizations, all depreciation in stocks and defaulted securities, and all depreciation in all other securities not of the four highest grades, as classified by a recognized investment service organization regularly engaged in the business of rating or grading securities, as shown by the latest available reports of examination of such organizations by the appropriate supervisory authorities and/or as shown by the latest appraisal of their assets by other examiners, auditors or appraisers satisfactory to the Federal Reserve Agent, (b) all depreciation in securities not of the four highest grades, as classified by a recognized investment service organization regularly engaged in the business of rating or grading securities, (c) all losses in all other assets as shown by such reports of examination and/or appraisals, (d) all other known losses;

2. That the undersigned will take such action within its power as may be necessary to cause each of its subsidiary State banking institutions to charge off or otherwise eliminate from its assets as soon as practicable and, in any event, within two years from the date such voting permit is granted, (a) all estimated losses in loans and discounts, (b) all depreciation in stocks and defaulted securities, (c) all depreciation in securities not of the four highest grades, as classified by a recognized investment service organization regularly engaged in the business of rating or grading securities, (d) all other losses, all such charge-offs or eliminations to be based upon the latest available reports of examination of the banks by the appropriate supervisory authorities;

3. That the undersigned will take such action within its power as may be necessary to cause each of its subsidiary banking institutions to maintain a sound financial condition and to cause the net capital and surplus funds of each such subsidiary banking institution to be adequate in relation to the character and condition of its assets and to the deposit liabilities and other corporate responsibilities of such subsidiary banking institution;

4. That the undersigned will take such action within its power as may be necessary to cause each subsidiary national bank or affiliate thereof to comply with the recommendations or suggestions of the Comptroller of the Currency based upon any report of examination of such bank or affiliate made to him pursuant to authority conferred by law and to comply with the regulations or requirements of the Board of Governors of the Federal Reserve System made pursuant to authority vested in it by law;

5. That the undersigned will take such action within its power as may be necessary to cause each subsidiary State banking institution or affiliate thereof to comply with the recommendations or suggestions of the Board of Governors of the Federal Reserve System or its designated representative in the district in which the institution is located based upon any report of examination of such institution or affiliate made pursuant to authority conferred by law and to comply with the regulations or requirements of the Board of Governors of the Federal Reserve System made pursuant to authority vested in it by law;

6. That the undersigned will not make, and will take all necessary action within its power to prevent any of its subsidiaries and any other organizations with which the undersigned or any of its subsidiaries is affiliated from making, any loans or extensions of credit to, or purchases of securities under repurchase agreements from, the undersigned or any of its subsidiaries or any other organizations with which the undersigned or any of its subsidiaries is affiliated, or any investments in, or advances against, securities of the undersigned or any of its subsidiaries or any other organizations with which the undersigned or any of its subsidiaries is affiliated, except within the

same limitations and subject to the same conditions and provisions as are applicable under section 23A of the Federal Reserve Act to such transactions involving member banks and their affiliates; except that this paragraph shall not apply to loans or extensions of credit by any organization to its own subsidiaries, or the purchase of securities under repurchase agreements by any organization from its own subsidiaries, or the investment by any organization in the securities of its own subisdiaries, where such transactions would not otherwise be subject to the limitations, conditions and provisions of section 23A of the Federal Reserve Act;

7. That the management of the undersigned and its subsidiaries will be conducted under sound policies governing their financial and other operations, including statements issued relating thereto; that the undersigned will maintain a sound financial condition; that its net capital and surplus funds shall be adequate in relation to the character and condition of its assets and to its liabilities and other corporate responsibilities; and that, except with the permission of the Board of Governors of the Federal Reserve System, it shall not cause or permit any change to be made in the general character of its business or investments.

Before taking final action upon the proposed standard conditions, the Board desires to give the applicants an opportunity to present their views in writing. You are, therefore, requested to transmit to each holding company affiliate in your district whose application is still pending a copy of this letter and a copy of the inclosed memorandum, in order that it may have an opportunity to submit to you in writing such constructive criticisms and suggestions as it may desire to have considered by the Board. Please transmit such criticisms and suggestions to the Board as promptly as possible, and in all events not later than fifteen days from the date of this letter, together with your own comments.

It is the Board's desire to issue general voting permits before the next annual meetings of stockholders in all cases where the circumstances warrant such action; and the Board will do everything in its power to accomplish this result. If it be found that in some instances it is not possible to do so, the Board contemplates that, in the absence of exceptional circumstances, it will issue limited voting permits to enable the applicants to vote upon the election of directors and routine matters at such meetings.

In order that this work may be expedited, your cooperation in obtaining the views of the applicants and transmitting them to the Board with your comments at the earliest possible date will be greatly appreciated.

Very truly yours,

Chester Morrill

Chester Morrill,
Secretary.

Inclosure.

TO ALL FEDERAL RESERVE AGENTS.

RESPONSIBILITIES OF BOARD IN GRANTING
GENERAL VOTING PERMITS TO HOLDING COMPANY AFFILIATES

The Banking Act of 1933 provided for the regulation of holding company affiliates of member banks and made it necessary for such organizations to obtain voting permits from the Federal Reserve Board (now Board of Governors of the Federal Reserve System and hereinafter referred to as the "Board") in order to vote stock which they own or control of member banks. This was an entirely new field of legislation and numerous questions have arisen concerning the Board's powers, duties and responsibilities in administering the law and in acting upon applications for voting permits. In order to clarify this matter, this memorandum will review the legislative history of the pertinent statutory provisions and discuss the Board's powers, duties and responsibilities in the light thereof.

The Banking Act of 1933 contained the pertinent provisions of law in substantially their present form. Such provisions, except certain minor amendments made by the Banking Act of 1935, are set out in full in the Board's Regulation P, a copy of which has been furnished to each holding company affiliate. However, at the outset, attention is directed to the following provision:

"Any such holding company affiliate may make application to the Board of Governors of the Federal Reserve System for a voting permit entitling it to vote the stock controlled by it at any or all meetings of shareholders of such bank or authorizing the trustee or trustees holding the stock for its benefit or for the benefit of its shareholders so to vote the same. <u>The Board of Governors of the Federal Reserve System may, in its discretion, grant or withhold such permit as the public interest may require</u>.

In acting upon such application, the Board shall consider the financial condition of the applicant, the general character of its management, and the probable effect of the granting of such permit upon the affairs of such bank, but no such permit shall be granted except upon the following conditions:" (Section 5144, Revised Statutes, as amended by Banking Acts of 1933 and 1935.)

EARLY LEGISLATIVE HISTORY

Agitation for banking legislation had resulted in the introduction of a number of bills in Congress and an investigation by the House of Representatives prior to 1930. The original Glass Bill (S.4723), introduced on June 17, 1930, during the Second session of the 71st Congress, became the basis for an extensive investigation of the national and Federal reserve banking systems by a sub-committee of the Senate Committee on Banking and Currency (pursuant to Senate Resolution 71 of that Congress). One of the subjects of the investigation was group and chain banking and in this connection several representatives of large bank holding companies appeared before the Committee. This bill and the investigation by the Senate Committee was the basis of the Banking Act of 1933.

The original Glass Bill contained a provision that no corporation, association or partnership should vote the stock of a national bank but did not contain a similar provision with regard to stock of State member banks. During the investigation it developed that it was impractical to terminate the holding company affiliate relationships immediately and that the then proposed legislation probably would result in holding companies terminating the charters of their national banks and reorganizing them as State banks in order to avoid the effect of such legislation. The representatives of the holding companies themselves suggested various forms of regulation to which their companies might properly be subjected. (See Report of Hearings Pursuant to Senate Resolution 71.)

On January 21, 1932, Senator Glass introduced a revised draft of his bill (S.3215) which incorporated new provisions suggested by the information secured by the investigation. This bill provided that no affiliate or corporation, association or partnership owning more than 10 per cent of the stock of any national bank should vote the stock of such bank. However, in another section it provided for the issuance of voting permits to such organizations by the Comptroller of the Currency. This section provided that the Comptroller might, in his discretion, grant or withhold such permits as the public interest might require but that no permit should be granted except upon certain specific conditions. Under this bill the Board would have had no connection whatsoever with the issuance or revocation of such permits. Neither this draft nor the next contained provisions relating to the voting of stock of State member banks.

On March 14, 1932, Senator Glass introduced a further revision of his bill (S.4115) which became the basis for further hearings by the Senate Committee on Banking and Currency. Under this bill the actual issuance and revocation of voting permits was to be handled by the Board but all other functions in connection with voting permits (relating to examinations and the filing of agreements) were placed in the hands of the Comptroller of the Currency.

In testifying before the Senate Committee, the Comptroller of the Currency objected to the regulation of holding company affiliates of national banks without similar regulation of holding company affiliates of State banks on the ground that such regulation would force banks out of the national bank system. During the hearings some objection was also made to the provisions giving the Board the right to grant or withhold and to revoke voting permits at its discretion. (See Report of Hearings on S.4115.)

SUBSTITUTE PROPOSAL OFFERED BY THE BOARD

During the hearings on this bill the Board unanimously recommended to the Senate Committee two entirely new sections as substitutes for those then in the bill relating to the regulation of holding company affiliates. The outstanding features of this proposal were as follows:

1. Holding company affiliates of State member banks as well as those of national banks were to be regulated.

2. The regulation of holding company affiliates of national banks was to be placed solely in the hands of the Comptroller

of the Currency and the regulation of holding company affiliates of State member banks was to be handled by the Board.

3. The issuance of voting permits was to be eliminated, the right to vote bank stock was to be made solely dependent upon the filing of certain agreements with the Comptroller or the Board as the case might be, and the Comptroller and the Board were to be given no right to use their discretion in granting or withholding the right to vote bank stock.

This substitute proposal offered by the Board is of particular significance because the Senate Committee rejected it and incorporated in the next draft of the bill only the first of the above listed features of the proposal.

PROVISIONS AS ENACTED.

On April 18, 1932, Senator Glass introduced a new draft of his bill (S.4412) in which the provisions with reference to the issuance of voting permits were in substantially the same form as the provisions of the Banking Act of 1933. Holding company affiliates of State member banks were made subject to the same provisions as holding company affiliates of national banks and the issuance and revocation of all voting permits was placed solely in the hands of the Board. Despite the objections made at the hearings, the Board was directed to issue or withhold voting permits as the public interest might require.

For the first time the following language appeared in the bill:

"In acting upon such application, the Board shall consider the financial condition of the applicant, the general character of its management, and the probable effect of the granting of such permit upon the affairs of such bank * * * *"

This provision was obviously inserted to supply the Board with a guiding principle to follow in exercising its discretion in the issuance of permits. As more fully discussed hereinafter, this provision was very similar to the provision in section 9 of the Federal Reserve Act relating to applications of banks for membership in the Federal Reserve System, the references to financial condition and management being almost identical.

In this draft of the bill, the agency granting the voting permit was for the first time limited in the exercise of its discretion in revoking such permit by the provision that a permit might be revoked "if at any time it shall appear to the Board that any holding company affiliate has violated any of the provisions of the Banking Act of 1933 or of any agreement made pursuant to this section." A marked similarity may be noted between this provision and the provision in section 9 of the Federal Reserve Act relating to forfeiture of membership in the Federal Reserve System.

This bill also contained the definition of holding company affiliate which appears in the Banking Act of 1933 and provided that voting permits should be required only of such organizations. There were copied into the bill the provisions contained in the previous drafts to the effect that no voting permit should be issued except upon certain conditions relating principally to examinations, building up of reserves for stock liability and divorcement of security affiliates.

This draft of the Glass bill underwent many further revisions and was debated at length in Congress; but the provisions concerning holding company affiliates and the issuance of voting permits were not substantially modified. They passed virtually unmentioned during the debates, and the Committee Reports supply little information concerning their intended interpretation. Group banking was discussed on the floors of Congress primarily in connection with the proposed provisions relating to branch banking. Regulation of holding company affiliates was not a controversial question since group banking systems apparently had no friends in Congress and the bill prepared by the Committee was apparently accepted by Congress without any substantial questions being raised.

ATTITUDE OF CONGRESS TOWARDS REGULATION OF HOLDING COMPANY AFFILIATES

As previously noted, the regulation of bank holding companies was an entirely new field for legislation. Congress was dealing with a subject about which it had little familiarity and Congressional leaders fully realized this fact. They apparently felt that there were evils to be corrected but that to a considerable extent they were groping in the dark in preparing legislation on the subject. This is demonstrated by the extensive investigation undertaken and the numerous revisions of the proposed bill. It is further shown by the fact that these provisions were the subject of virtually no discussion on the floors of Congress. Congress was apparently willing to leave this problem to the committees and its technical advisers and to the sound judgment of the members of the Board who were to have charge of the regulation of such companies. As stated by Senator Norbeck, a member of the Committee on Banking and Currency (Congressional Record, Vol. 75, p. 10332, daily publication):

> "The new system of banking in the Northwest, commonly referred to as chain, is, of course, the group system of banking, controlled by the holding companies. It has been quite a problem with this committee to know what to do with this new system of banking, which had no foundation in law or in experience. The committee was of the view that strict regulations should be enforced, but reached the conclusion that it was impossible then to enforce very strict regulations. They did not want to assume the responsibility for important changes in times like these."

However, there is no doubt that Congress desired as strict regulation of bank holding companies as might prove practicable. Congressional leaders started out with the idea that such companies should be completely abolished. The majority report of the Senate Committee filed in connection with Senate bill 4412 criticised the group banking system but said that practical considerations made control preferable to complete abolition. The minority report filed by Senator Norbeck referred to group banking as an evasion if not a violation of the law.

On the floor of the Senate, Senator Glass stated that it was hoped that the strict regulation of the bank holding companies would cause them to go out of business. During the debates on Senate bill 4412, he said:

> "Somewhat akin to investment bank affiliates, we undertake to deal with the question of holding companies, the system of holding companies being one species of what is known as chain banking. It is a species of chain banking that is largely devoid of responsibility. * * * * But the committee was convinced that they needed pretty severe supervision, restraint, and examination, and I want to say for those officials that they were cheerfully willing that that should be provided. We have incorporated in that provision of the bill many of the suggestions made by them not because they were made by them, but in spite of the fact, because all of us were very suspicious when we entered upon the consideration of that phase of banking. * * * * Therefore we have undertaken to encompass them with such restrictions and restraints and requirements of examination and report as, we hope, may induce them perhaps to go out of that sort of banking at their convenience."
>
> (Congressional Record, Vol. 75, p. 10202 - 10203, daily publication.)

Later during the debates in May, 1933, he said:

> "We deal with holding companies, and we deal with them so severely -- but, I am frank to say, with their consent -- that they expect to dissolve within the 5-year period given them; * * *"
>
> (Congressional Record, 73rd Cong., 1st Session, p. 3819 - daily publication.)

Senator Wheeler's attitude was shown by the following reference to one holding company during debates on branch banking provisions:

> "It might be called to the attention of the Senate that this corporation, as a matter of fact, was nothing more nor less than a promotion scheme by a few men in the Northwest who went out and took a lot of sound, safe banks in the Northwest and poured into their corporation a tremendous lot of watered stock and unloaded it

upon the directors, stockholders, and other citizens of the Northwest.

"The reason why some of those banking institutions are not in the shape that they should be today is not because they have not been part of a branch-banking system but because of poor management and because they are loaded up with stocks and bonds which have little or no value today, if ever."

(Congressional Record, Vol. 76, p. 2154 - daily publication.)

In supporting the branch banking provisions Senator Vandenberg expressed his views regarding group banking:

"All of the vices, if there be vices, that are conjured against branch banking already exist in the theory of group and chain banking. The alleged vices exist without the offsetting advantages of common, open, and mobile responsibility which exists in branch banking."

(Congressional Record, Vol. 76, p. 1495 - daily publication.)

CONGRESS INTENDED BOARD TO EXERCISE ITS DISCRETION

There can be no question but that Congress intended the issuance and revocation of voting permits to be a discretionary matter. Every draft of the bill providing for voting permits contained express provisions to this effect and stated that voting permits were to be granted or withheld as the "public interest" might require. The Board urged the adoption of its substitute proposal which would have entirely eliminated the elements of discretion and would have given the holding company affiliates the power to vote bank stock as a matter of right upon filing agreements to comply with certain requirements written into the Act, but this proposal was rejected by the Senate Committee. The Board did not want this discretionary power and representatives of some of the holding companies objected to the Board being given such power; but Congress insisted upon granting it.

CONGRESS WAS CONCERNED WITH FUTURE OPERATIONS OF HOLDING COMPANY AFFILIATES

Congressional leaders were not only interested in the present operations of the various bank holding companies but were also interested in future operations. Representatives of some of the companies went to considerable length to show that the operations of their companies were not harmful to the public interest. Senator Glass and Mr. Willis, technical adviser to the committee, on several occasions suggested by their questions that the high character of the present management was no guarantee or protection against future mismanagement. (See Record of

Hearings Pursuant to Senate Resolution 71.) The representative of one of the large holding companies, in admitting that such was the case, stated that that was one reason why his company desired regulation. During the debates, Senator Glass said:

> "Some of these holding companies have been admirably managed, managed by bankers of character, long experience, and great skill. Many of them have done no great harm. In fact, they will tell you that they have done great good. * * * * <u>There is this to be said, that if one of those holding companies -- as some of them have -- should come under the administration of unscrupulous persons, the amount of harm that might ensue is hard to conceive</u>."

(Cong. Record, Vol. 75, p. 10202-10203, daily publication.)

INTENT OF CONGRESS REGARDING THE PRESCRIBING OF CONDITIONS

Certain conditions to the granting of voting permits were prescribed in the Act, but the language indicates that they are only basic or minimum requirements designed to correct evils definitely established and known to Congress, and it is apparent that Congress intended that the Board should further regulate holding company affiliates of member banks. The Congressional investigation extended into many features of holding company affiliate relationships and it is indicated that members of the Senate Committee felt that there were other evils inherent in the group banking system with which they were not specifically dealing but with which they expected the Board to deal in acting upon applications for voting permits. As indicated by Senator Norbeck's comments quoted above, the Senate Committee in drafting the bill did not deem it practical in the circumstances to write into the bill as strict regulations as many desired and insisted on vesting the Board with discretionary power in order that it might make such further requirements as circumstances should justify or demand.

As previously noted, the draft of the Glass Bill which, for the first time vested in the Board complete jurisdiction over and sole responsibility for the regulation of holding company affiliates of member banks, provided that the Board, in acting upon applications for voting permits, should:

> "* * * consider the financial condition of the applicant, the general character of its management, and the probable effect of the granting of such permit upon the affairs of such bank, * * *".

The obvious purpose of this provision was to give the Board a guiding principle to follow in exercising its discretion with reference to the issuance of voting permits. It is very significant that this guiding principle is very similar to, and apparently was copied from, the following guiding principle contained in section 9 of the Federal Reserve Act with reference to the admission of State banks to membership:

> "In acting upon such application the Board of Governors of the Federal Reserve System shall consider the financial condition of the applying bank, the general character of its management, and whether or not the corporate powers exercised are consistent with the purposes of this act."

In adopting a similar guiding principle governing the issuance of voting permits, Congress knew that for many years it had been the practice of the Board in admitting State banks to membership in the Federal Reserve System to prescribe conditions of membership designed to require such banks to create and maintain a sound financial condition and good management, and not to change the general character of their business without the prior approval of the Board. These conditions of membership included both conditions precedent and conditions of a continuing nature. As recently as 1927 this practice of the Board had been the subject of much discussion in Congress; the practice and the reasons for it had been explained at length, and Congress had specifically rejected a proposal which would have taken away from the Board the power to prescribe conditions of membership for State banks. At the time of the enactment of the Banking Act of 1933 the Board was following the policy of prescribing a dozen or more standard conditions in connection with all applications for membership.

In view of its knowledge of the Board's practice with respect to the admission of State member banks and in view of its action in prescribing a guiding principle with respect to the issuance of voting permits very similar to that previously prescribed with respect to admission of State banks to membership, it seems reasonable to assume that Congress intended the Board to follow with respect to the issuance of voting permits practices and policies very similar to those which it had followed for many years with respect to the admission of State banks to membership.

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date November 15, 1935

To Mr. Hamlin

Subject:

From Mr. Smead

16—852

In accordance with your telephone request, there is attached a statement showing by Federal Reserve districts the number and amount of loans to individuals, partnerships and corporations made under the third paragraph of Section 13 of the Federal Reserve Act from the date that paragraph was added to the Federal Reserve Act, July 21, 1932, to November 8, 1935.

The figures in the attached statement do not include loans to individuals, partnerships and corporations secured by United States Government obligations made under the last paragraph of Section 13 of the Federal Reserve Act. Under this paragraph the Federal Reserve banks made 82 loans amounting to $4,845,136.

Attachment.

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LOANS TO INDIVIDUALS, PARTNERSHIPS AND CORPORATIONS

MADE UNDER PARAGRAPH 3, SECTION 13, OF THE FEDERAL RESERVE ACT,

JULY 21, 1932 TO NOVEMBER 8, 1935.

Federal Reserve Bank	Number of Individuals, Partnerships and Corporations accommodated.	Amount
Boston	2	$35,000
New York	38	806,500
Philadelphia	20	117,202
Cleveland	---	---
Richmond	---	---
Atlanta	6	122,650
Chicago	---	---
St. Louis	---	---
Minneapolis	26	113,922
Kansas City	31	256,298
Dallas	---	---
San Francisco	---	---
	123	1,451,572

To Hamlin Sec Bk

Confidential
R. and S.
November 20, 1935.

MEMORANDUM ON PROPOSED REQUEST FOR INFORMATION RE LARGE DEPOSITS

Purpose

The Board of Governors in formulating its general policies is interested not only in the volume of deposits but also in the turnover, now and in the future. One factor that has a bearing on the turnover is the distribution of deposits among different economic groups, about which almost no current information is available. Since 1933 over $5½ billion of new demand deposits have come into existence. What has happened to this purchasing power? Has it been distributed among all economic groups or has the bulk of it come to rest temporarily in large corporate accounts? It is known that deposits in New York and Chicago are far in excess of their 1929 peak. It is also known that demand deposits in the central reserve city and reserve city member banks have increased over $4 billion since 1933. If this represents a growth of large corporate balances what bearing will this have on the probable future demand for bank credit and on the volume of new capital issues?

As there are over fifty million separate accounts a complete coverage and classified distribution of deposits would be a large task. It is known, however, that in 1933 about 45 percent of total deposits were in 47,000 accounts of over $50,000 each. It appears, therefore, that information on the larger accounts in the larger banks would throw considerable light on what has happened to the deposits created in the past two years while involving a minimum of trouble to collect.

P101

Procedure

The original suggestion was to obtain information on identical accounts at intervals during the past six years. If, however, the inquiry were confined to a few accounts in a few banks it would be impossible to determine whether the changes shown were actual changes in corporate accounts or merely represented shifts between banks. If the inquiry were limited to the period since the bank holiday it is believed that changes due to shifts of deposits would be minimized. It is now proposed, therefore, to investigate the feasibility of obtaining information on all accounts above a certain amount, classified by manufacturing, trade, public utility and railroad, financial, personal, and other, as of a recent date, and the same accounts as of June 30, 1933. The broad classifications would preclude the possibility of identifying the ownership of any deposit. If the information here suggested were obtained it would throw light upon the present distribution of the larger deposits and would aid in determining what has happened to the deposits created by Government financing and by inflows of gold.

Questions

The specific questions on which assistance is solicited from the Advisory Council are as follows:

1. Accounts above what size in New York and Chicago banks would include some 30 or 40 percent of their deposits?

2. Accounts above what size in the 76 largest banks outside of New York and Chicago would include some 25 percent of their deposits?

3. Would the tabulation and classification of such accounts involve much inconvenience?

Before proceeding with the inquiry the answers to these questions would be sought from the individual bankers affected. In the meantime the Board will appreciate any assistance the Advisory Council may give it in this matter.

B,01

November 21, 1935.

Mr. Hamlin:

At the request of Mr. J. H. Frost, Member of the Federal Advisory Council, I am sending you herewith a copy of a letter of this date from Mr. Frost to Chairman Eccles and a copy of the statement referred to therein for your personal information.

C. M.

See Bk

November 21, 1935.

Honorable Marriner S. Eccles, Chairman,
Board of Governors of Federal Reserve System,
Washington, D. C.

Dear Governor Eccles:

In view of the difficulties involved in a general discussion in which twenty men are taking part, I feel that I would like the privilege of presenting to you a copy of the statement which I made to the Advisory Council in support of the resolution authorizing the statement made by the Council to the Board today, and which latter statement I prepared and recommended to the Council for adoption. As stated to Dr. Miller in the joint meeting, there was neither a dissenting vote nor an unfavorable comment from any member of the Council. My desire, purely unofficially, [illegible]t this statement to you has been submitted to the Co[illegible] they have unanimously approved although Mr. Perkins had al[illegible] left the meeting and had no opportunity of expressing himself.

Naturally I do not request that you make any comment or reply although this, of course, is not inten[illegible]d to indicate that I should not be glad for you to complete[illegible] follow your own inclination and desire in that respect.

I only want you to have my personal views in more comprehensive and intelligible form than they could be expressed at the meeting this morning, and I am sending a copy to each member of the Board of Governors. I am also sending a copy to Dr. Goldenweiser so that he may possibly understand my point of view. Of course, I am not trying to convert him to my views and am sorry that what I said this morning could have been understood as being equivalent to such harsh criticism as charging a "defilement" of the System.

Very truly yours,

J. H. Frost

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Since the last meeting of the Federal Advisory Council, when the Council presented to the Federal Reserve Board a resolution bearing upon the static condition of the holdings of Government obligations by the System, I understand that a considerable amount of discussion has taken place over the Country, and some expressions by people of importance have been made, recommending that something be done to eliminate or reduce the present volume of excess reserves, in order to lessen the probability of a wild orgy of credit inflation by the banks of the Country.

It is my personal conviction that the danger referred to is a very real one, and that prevention is much more feasible and desirable than correction after the movement is well under way. In the interest of brevity, I shall not discuss the many reasons why the danger is imminent, or all of the many advantages of preventive over corrective measures.

I shall merely call your attention to the fact that more than two years ago, after a season of run-away purchases of Government obligations, which reached the almost incredible total of $2,430,000,000.00, and created excess reserves of more than $800,000,000.00, the management of the Federal Reserve System discontinued these purchases on the grounds, either, that they had created enough excess reserves to arrest a deflation which, to some people, seemed to be a necessary and natural phenomenon of readjustment, or that additional excess reserves would not accomplish the purpose. Since that time somewhere between two and three billion dollars (nearer the latter amount) of gold imports have come into the Country, thus enabling member banks to completely eliminate rediscounts, to increase excess reserves to more than three billion dollars, and at the same time to purchase I know not how many additional Government Bonds. In the face of these momentous phenomena, the managers of the Federal Reserve System have allowed matters to drift with no action whatever designed to affect the course of events, and it seems clear to me that we have now reached a point where the Federal Advisory Council can no longer postpone the giving of constructive advice to the Board of Governors of the Federal Reserve System without being guilty of neglect in the performance of an obligation clearly imposed upon them by law.

It is my further understanding that the matter has had the earnest consideration of the Board of Governors of the Federal Reserve System, and that also the Open Market Committee of the System have been considering what action, if any, should be taken by the System at this time with respect to the matter. Also, the Council has received a communication from the Board, commenting upon the Resolution of the Council previously referred to, and suggesting that, "If the Council has any proposals to make with respect to the operation of the Open Market Account of the Federal Reserve System, which it believes to be pertinent in the existing situation, all factors considered, the Board will, as in the past, be glad to receive them and consider them."

In view of this suggestion or invitation it is my belief that the Council, if it wishes to maintain a proper relationship with the Federal Reserve Board and perform its statutory function, should take a clear and well defined position and make carefully considered recommendations which will be for the best interest of the Country as a whole, and which can be justified by sound logic and sound economic theory.

I have understood, correctly or not, that, in most discussions by those who have spoken publicly, and by the Open Market Committee as well, there has been considered the advisability of action upon two distinct lines: 1. The selling or "permitting to run off" of a portion or all of the holdings of Government securities now held by the Federal Reserve System; 2. The raising of Reserve requirements, as now permitted to the Federal Reserve Board under the Banking Act of 1935. And I have further understood, correctly or not, that the second method has generally been recommended, and that in fact the Open Market Committee have so expressed themselves.

I shall assume, for the purpose of discussing and comparing the merits of these two plans, that the Council agrees with me that the use of one or the other is desirable at the present time. Even if the Council should conclude, after consideration, that no action whatever is desirable at this time, the question of which method to use first, will some day be up for decision, and a discussion now of which will be the correct procedure will certainly not be out of place or entirely wasted.

It is, of course, apparent to everyone that selling Governments or increasing reserve requirements will decrease the amount of <u>excess</u> reserves, but there is a vast difference between the <u>other</u> effects of the two actions, and to me the distinction seems to be of paramount importance. The first method would <u>reduce</u> reserves previously created by arbitrary and artificial action (this language should not be construed as a condemnation of that action at the time that it was taken, although I personally disapproved), whereas, the second method would not change the <u>amount</u> of reserves in the slightest degree. It would simply change the <u>name</u> of a part of these artifically created reserves from "excess" to "required", although, of course, it is true that either action would have the immediate effect of lessening the amount of bank credit which could be built upon reserves as now carried.

I fully agree that over expansion of bank credit is the danger most apparent to all of us, but I do not agree to the proposition that it is the only danger or the most serious one, - simply the most apparent to those who have not thought the problem through to a correct conclusion.

A question of much greater importance is that of the purity and soundness of our currency, and of the reserves of Member Banks, which are potential currency, and on which, as a base, all bank credit is superimposed.

Of course, we all know that Silver Certificates and United States notes or greenbacks are unsound elements in our currency structure, but since the Federal Reserve System can have no direct control over those forms of currency, I shall leave them out of this discussion.

Reserves of Member Banks and Federal Reserve Notes, when they are represented by gold holdings or gold certificate holdings of the System up to a full one hundred percent, are, of course, free from all impurity, but the moment that either Federal Reserve Notes or Member Bank Reserves are issued or created against anything other than gold or gold certificates, it is my opinion that, precisely to a corresponding extent, the purity ~~or soundness~~ of the circulating medium, or of Member Bank reserves (the basis of bank credit) has been impaired. This impairment ~~injury~~, when Federal Reserve Notes are issued, or Member Bank reserves are created against re-discounts or bankers' acceptances, is not a serious one ~~in reasonable amounts~~, for the reason that the underlying security is of a self-liquidating nature, and, as the need decreases, the amount of such secured notes or such created reserves will automatically and correspondingly decrease. In fact, this fluctuating dilution of the purity of both Federal Reserve Notes and Member Bank Reserves is the basic underlying theory, and the most desirable feature, of the Federal Reserve System, since it supplies the elasticity necessary for expansion to meet emergencies or unusual demands, and then to automatically contract after the need or emergency has disappeared.

When, however, Federal Reserve Notes are issued or Member Bank Reserves are created against Government Bonds owned by the System, the ~~injury~~ impairment is a serious one, and much more so than when against other assets, for the most excellent reason that Government Bonds are not self-liquidating instruments, and currency secured by them or bank reserves created by them are absolutely "fiat", and just as dependent on the unsecured promise of the Government as if no Bonds whatever had been issued or pledged. Just as if the Government had paid its expenses with "printing press money", which would immediately come into the hands of the banks, and be deposited in turn with the Federal Reserve Banks, thus creating Member Bank Reserves, or potential currency to be withdrawn at will. Likewise the supply is not automatically elastic, but is dependent upon the judgment of a small group of human beings to be known as the "Open Market Committee". It is, therefore, my reasoned opinion that holdings of Government Bonds by the System should be of a very modest amount (from two to three hundred millions) which can be increased and diminished from time to time for the purpose of moderating seasonal fluctuations in the money market, and also to alleviate to a degree the effects of non-seasonal and unusual imports and exports of gold. Certainly, today, without fear of successful demonstration to the contrary, we can make the statement that this Country, or the banking system, is operating on the basis of "fiat" currency or "fiat" reserves - one or the other, to the extent of $2,430,000,000.00, dependent for soundness upon absolutely no other single thing than an unsecured promise of the Government. Unquestionably, this condition should never be permitted to occur, even in the case of a poverty-stricken people, and certainly not in a Country of the power, resources, and gold holdings of the United States of America.

If my reasoning up to this point is sound, and if excess reserves should be reduced or eliminated, would it not be far sounder policy to reduce or eliminate them by following the first method (selling or permitting Governments to run off) and thus, at the same time, to purify both the circulating medium and the holdings of the System, representing Member Bank reserves.

I fully realize that, even after the Federal Reserve System may have disposed of its entire holding of Government obligations, the Treasury Department might release the so-called "gold profit" of two billion dollars in one way or another; by the purchase of a corresponding amount of Government Bonds for cancellation, or to be held by the Treasury, by the payment of a Soldiers' bonus, or by using it to defray the general expenses of the Government; although I understand that, under either of the last two mentioned methods, new legislation would probably be necessary. Assuming that the Treasury Department should follow any one of these courses, two billion dollars of new excess reserve would be immediately created, and, in such case, in order to curb an undue expansion of bank deposits by the extension of bank credit on the base of reserves so created, there would only be left as a method, the invoking of the power of the Federal Reserve Board to increase reserve requirements, which, to my mind, might be a most desirable or even urgently necessary course to pursue.

I appreciate the truth of the published statement of at least one of the very prominent economists of the country to the effect that the vast over expansion of credit between 1922 and 1928 was largely due to the very low reserve requirements which we had inaugurated during the War, and that a raising of the reserve requirements would diminish the potential effect of a given volume of reserves, insofar as future expansion of credit is concerned. However, the first thing to do, and the thing of the greatest importance, to the soundness of the banking structure, is to purify the currency, and to purify the composition of member bank reserves, by the elimination of Government obligations from Federal Reserve holdings, or by reducing such holdings to a small amount; no larger than necessary for their proper function outlined above. Then, if further curbs should be necessary to check unsound expansion of bank credit, will be the time to begin to increase reserve requirements.

Now, as to the practical working of the two plans -
It has been urged that reduction of the amount of Government Bond holdings would cause selling by banks, and a depreciation in the market price of bonds. Naturally, this is literally and necessarily true, but isn't it equally true that increasing reserve requirements will have the same effect? I am keenly conscious of the fact that

an action by the System, either by one method or the other, will drastically affect the market price for Government Bonds, of which we and most good banks hold an inordinate and disproportionate amount, but, at the same time, I believe that any fair-minded and sound thinking banker, if he thinks the matter through, will inescapably reach the conclusion that we had all of us better face the fact that our Government Bond holdings are only worth present market prices, due to the fact that the Federal Reserve System has created $2,430,000,000.00 of "fiat" reserves by the purchase of Government obligations on the open market to a corresponding amount. Beyond question, this is an artificial situation, and one which was never contemplated by the original framers of the Federal Reserve Act, or by the sound economists who, during the life of the Federal Reserve System, have defended it as a sound agency for holding the reserves of Member Banks, and for furnishing to the country a safe and, at the same time, elastic circulating medium. Some day the System must be purged of this impurity, and never will we see a time so favorable for its elimination as when excess reserves are sufficient in volume to permit the entire operation without forcing rediscounts by Member Banks. What a ghastly mistake it would be to increase reserve requirements, and at a later date attempt to eliminate Government Bond holdings which then could only be accomplished with the accompaniment of the acquisition of an equal amount of rediscounts, by drastic credit deflation, or by a reversal of policy, and a reduction of reserve requirements previously established.

The longer we put off the necessary correction, the more devastating will be the effects. Suppose we wait until the banks of the country have loaded up with a few billion more bonds at still higher prices, and then still longer, until there may have arisen an appreciable demand for the use of bank credit for commerce, industry or agriculture, or for all three of them; or let us suppose that we wait until gold is moving outwardly instead of inwardly, as will surely happen one of these days - is it not all too apparent that a reduction of the System holdings at that time would create a condition in the bank capital structure too horrible to contemplate? Without any qualifications whatever, I state that, if the Federal Reserve System does not at once begin the process of purification of the currency and their investments representing the reserves of member banks, there will never be a time when any political administration, including the Congress, will permit, or could afford to permit, any reduction whatever in the bond holdings of the System. If the System intends to allow to pass by, the present opportunity to reduce or eliminate fiat reserves, would it not be fairer to everyone to make it entirely clear by legislative action that the United States intends permanently to operate with a currency or Member Bank reserve structure built upon a minimum government bond holding by the System of $2,430,000,000.00? Is it fair, or even honest, for the Government to sell bonds to its citizens on a market absolutely created by the System holdings of such bonds, unless its citizens are assured by legislation that these holdings will in perpetuity be maintained? And is there a member of this Council, or a member of the Board of Governors of the Federal Reserve System, or a reputable economist in the country, who would be willing to recommend or sponsor such legislation? Why should a nation capable of maintaining the soundest currency in the world and a banking system capable of operating on the soundest reserve structure in the world deliberately resolve to permanently have the most artificial and unsound base for its currency or bank reserve structure (a Government promise) which has ever been conceived in all the hundreds of years of currency and credit manipulation and experimentation? Would any one have the temerity to recommend the return to a currency redeemable in specie with this mountain of sand for a foundation?

Now, let us see how changes in reserve requirements would actually function.

Is it not true that, if they should be frequent, they would make it utterly impossible for banks to intelligently lay out and follow a credit policy without constant fear of an arbitrary action by the Board? This desirability of avoidance of frequent changes in reserve requirements means that, if reserve requirements are to be increased at all, it should be done by a substantial increase at one stroke, say 25, 33-1/3 or 50%. A 25% increase would be equivalent to the sale in a single day of approximately $625,000,000.00 bonds, and a 50% increase would correspond to a sale of $1,250,000,000.00 bonds. How much safer and more reasonable would it be to allow the Government Bond holdings to run off a reasonable amount per week, and then to gradually increase the "run off" as, in the judgment of the Open Market Committee, might seem to be feasible and advisable. Think of the advantage of being able, if the effects seem to be too severe, to reverse the policy from time to time and buy back a part or all of the amount which had been permitted to run off. In other words, the first plan is flexible, while the second plan is rigid, and a step once taken can be retraced or modified only with great difficulty, and with the inevitable result of dangerous confusion to the planning of Member Banks. These reasons seem to me to make it clear that, from an administrative standpoint, the first plan is so much more workable that there should be no hesitation as to choice, but the basic and soundest reasons for preferring it are those given in the earlier part of this discussion: purification of the currency, and of the Member Bank reserves. Let us not eliminate excess reserves by any procedure whatsoever which will leave the impurity untouched, and thus make permanent a "fiat" element in the currency or the bank reserve structure.

Bankers and the general public, as well, are enjoying the seductively pleasant sensations which uniformly accompany an inflation of the currency.

True it is, beyond peradventure, that its elimination will lower the market price of government bonds, but the loss and suffering which would occur as a result of corrective measures at this time will be as nothing in comparison with what the people of this country will have to bear if the correction be much longer delayed.

Let us not fail to recommend fearlessly and wisely -

6107

Form No. 131

Office Correspondence

FEDERAL RESERVE BOARD

Date November 25, 1935.

Sec Du

To Mr. Hamlin

Subject:

From Mr. Carpenter

CONFIDENTIAL

gpo 16—852

There are attached for your information copies of the statement and recommendations submitted to the Board by the Federal Advisory Council at the meeting on November 21, and copies of three letters received from the Secretary of the Council under date of November 23, 1935.

Copy

FEDERAL ADVISORY COUNCIL

38 South Dearborn Street

Chicago, November 23, 1935.

Dear Mr. Morrill:

I beg to acknowledge receipt of your letter of October 30 in which you state that the Board of Governors of the Federal Reserve System would be interested in receiving any proposal which the Federal Advisory Council might wish to make in respect to the statement which it handed to the Board on September 24, 1935, in which attention was called to the large amounts of government bond holdings in the System and which have not varied for a long time.

I am instructed to inform you that the Council adopted at its meeting on November 20, 1935, a recommendation which it handed to the Board of Governors of the Federal Reserve System at the joint meeting of November 21. In view of the fact that the Federal Advisory Council was advised by the Chairman of the Board of Governors of the Federal Reserve System that the Board does not have the authority to initiate open market operations, the Council requests the Board to submit the recommendation to the Open Market Committee and it wishes that the Board would submit this recommendation to said Committee at an early date, if necessary calling a special meeting of the Committee for that purpose.

Very truly yours,

(Signed) Walter Lichtenstein

Secretary

Mr. Chester Morrill, Secretary
Board of Governors of the
Federal Reserve System,
Washington, D. C.

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Copy

FEDERAL ADVISORY COUNCIL

38 South Dearborn Street

Chicago, November 23, 1935.

Dear Mr. Morrill:

I beg to acknowledge receipt of your communication of November 12, 1935, in which you convey the information to the Federal Advisory Council that the Board of Governors of the Federal Reserve System is desirous "of asking a small group of the larger member banks to fill out a schedule showing in each case the deposits of the bank's fifty or one hundred largest depositors on four dates in each year for the past six years, classified by a broad classification, etc." I am instructed to inform you that the members of the Council as individuals see no reason why banks should not be willing to give the information requested by the Board. They feel certain that the banks which they themselves represent would be willing to do so. On the other hand, the Council as such did not feel that it was advisable for it to take any action in this matter and believed that the Board should approach member banks entirely on its own responsibility.

Very truly yours,

(Signed) Walter Lichtenstein

Secretary

Mr. Chester Morrill, Secretary,
Board of Governors of the
Federal Reserve System,
Washington, D. C.

Copy

FEDERAL ADVISORY COUNCIL

38 South Dearborn Street

Chicago, November 23, 1935.

Dear Mr. Morrill:

You will recall that at the joint meeting of the Board of Governors of the Federal Reserve System and the Federal Advisory Council which adjourned at 1:05 P. M. on Thursday, November 21, there was considerable discussion regarding the question of publication of Recommendation No. 1 of the Council dealing with the question of open market operations and excess reserves. After the adjournment of the joint meeting, the Council met alone and authorized the President of the Council to hand a memorandum to the Chairman of the Board of Governors to read as follows:

"The Council believes that its recommendation numbered I of November 21, 1935, dealing with open market operations and excess reserves of member banks should be published on or before December 20, 1935, which will give ample time for consideration of this recommendation by the Open Market Committee of the Federal Reserve System."

Very truly yours,

(Signed) Walter Lichtenstein

Secretary

Mr. Chester Morrill, Secretary,
Board of Governors of the
Federal Reserve System,
Washington, D. C.

RECOMMENDATIONS OF THE FEDERAL ADVISORY COUNCIL TO
THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

November 21, 1935.

Topic No. 1. Open Market Operations.

RECOMMENDATION: The Federal Advisory Council, in view of the fact that it has been advised by the Chairman of the Board of Governors of the Federal Reserve System that the Board does not have the authority to initiate open market operations, requests the Board to submit the following recommendation to the Open Market Committee and to call for that purpose a special meeting of said Committee at an early date.

The Federal Advisory Council of the Federal Reserve System has received the communication of the Board of Governors of the System, wherein reference is made to the statement of the Council made to the Board at its meeting of September 24, 1935, concerning the amount of Government securities held by the System, which has not varied for a long time, and calling the attention of the Board to the basic theory of open market operations: that there should at all times prevail sufficient flexibility to prevent undue expansion and contraction in the credit structure of the country. The Council enquired whether the Board agreed with the principle enunciated.

The present communication of the Board recognizes "the necessity for the consideration of the factors referred to in the statement as elements in the determination of open market policy" and closes with the statement that "if the Council has any proposals to make with respect to the operation of the open market account of the Federal Reserve System, which it believes to be pertinent in the existing situation, all factors considered, the Board will, as in the past, be glad to receive them and consider them".

The Council is fully cognizant of and thoroughly appreciates the importance and significance of the obligation imposed upon it by law "to confer directly with the Federal Reserve Board" and "to make recommendations in regard to discount rates, rediscount business, note issues, reserve conditions in the various districts, the purchase and sale of gold or securities by reserve banks, <u>open market operations by said banks</u>, and the general affairs of the reserve banking System", and it has given its most careful and earnest consideration to the suggestion by the Board that it will be glad to receive from the Council such proposals as it may make with respect to the open market account of the System.

As a result of this consideration the Council desires to call the attention of the Board to the fact that, since the discontinuance, more than two years ago, of open market purchases by the System, excess reserves of member banks held by the System have now reached the unprecedented total of more than three billion dollars, which may well be considered as a base upon which additional bank credit can be extended to the extent of at least thirty billion dollars with a corresponding increase of bank deposit liabilities.

The Council believes that there have now been some considerable evidences of recovery in business, of an increase in prices generally, and particularly in the security markets of the country, with the possibility, at least, that a too rapid advance of security prices could easily develop into a new wave of speculation such as preceded the market collapse of 1929. The constant pressure of the very large excess reserves of the member banks creating a plethora of the available supply of bank credit has a very distinct tendency to foster and encourage speculative activity, increase prices, and raise the living cost of the population. The Council believes that, even with the practically complete elimination of excess reserves, the banking system of the country would still be prepared and ardently desirous of meeting any and all legitimate and proper demands for bank credit, and it is strongly of the opinion that, in order to obviate the probability of an undue and dangerous credit inflation, it is desirable from every point of view to eliminate or at least greatly reduce the excess reserves now being carried in the System.

Since the enactment of the Banking Act of 1935, there exist two methods by which this can be accomplished. 1. The selling or "permitting to run off" of a portion or all of the System holdings of Government securities. 2. Raising of reserve requirements.

The Council has most earnestly considered the question as to which of these two methods might be the more desirable under the present circumstances and has determined to recommend as strongly as possible the first method.

The controlling reason for this is the indisputable fact that so long as Government bonds are held under the ownership of the System, either the currency of the country or the reserves of member banks, to a corresponding extent, are dependent entirely upon a Government obligation. The world history of currency and banking has demonstrated the dangers inherent in such a system or policy too many times to make it necessary for them to be elaborated upon in this communication.

There is, however, another reason for preferring the first method, namely, the ease and flexibility with which it may be administered. Under that method, Government security holdings may be permitted to run off or may be sold, rapidly or gradually, as in the judgment of the Open Market Committee, may seem to be feasible or advisable. If at any time, the effects seem to be too severe, it is possible to suspend or even temporarily to reverse the policy.

Under the second method, namely, increase of reserve requirements, rigidity is substituted for flexibility, since it must be entirely apparent to any one that frequent changes in reserve requirements would create a chaotic condition in planning for the future by member bank management.

Finally, the Council wishes to make perfectly clear to the Board that, after Government security holdings of the System have been eliminated or greatly reduced, and if, then, further curbs upon speculation should seem to be desirable, there would certainly be no possible objection to an increase in reserve requirements. On the contrary, it would become the clear and plain duty of the Board fearlessly and promptly to take such action.

RECOMMENDATIONS OF THE FEDERAL ADVISORY COUNCIL TO
THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

November 21, 1935.

Topic No. 2. Regulations in Respect to Margin Requirements on Collateral Loans of Banks

RECOMMENDATION: The Federal Advisory Council understands that the Board of Governors of the Federal Reserve System is contemplating issuing regulations to deal with the control of collateral loans to be made by banks. The Council, therefore, reaffirms herewith its recommendation of May 15, 1934, reading as follows:

"The members of the Federal Advisory Council are of the opinion that the Federal Reserve Board before issuing regulations under this bill, provided it is enacted into law, should make a careful study as regards the needs of the situation. It should be pointed out that the power conferred on the Board is to be permissive and not mandatory. Consequently, there is no need for the Board to issue any regulations until there is evidence that there is necessity for them. In general the members of the Council feel that if the Board conscientiously can refrain from adding unnecessarily to the innumerable regulations, orders, and laws of all kinds under which banks are at present compelled to operate it will be doing a distinct service.

"If and when the Federal Reserve Board deems it necessary and advisable to issue regulations under this provision of the proposed law then it is to be hoped that the Board will bear in mind the need for maintaining adequate markets not merely for securities listed on the more important exchanges of the country but also for securities which have merely a restricted local market and those which are sold over the counter and not listed. Stringent regulations may result in destroying the market for the securities of small worthy industries and thereby possibly destroy these industries themselves by making it impossible for them to obtain needed capital"

The Federal Advisory Council acknowledges receipt of the letter of the Secretary of the Board of Governors of the Federal Reserve System dated November 12, 1935 in which the Board asks the advice of the Council in reference to "the desirability of asking a small group of the larger member banks to fill out a schedule showing in each case the deposits of the bank's fifty or one hundred largest depositors on four dates in each year for the past six years, classified by a broad classification", etc.

The members of the Council as individuals see no objection to banks giving the information, but the Council as such does not desire to express an opinion on this subject.

B109

Mr. Hamlin

Sec/Ba

G O V E R N O R S' C O N F E R E N C E

Washington, D. C.

October 23, 1935

The meeting was called to order at 12:00 o'clock noon.

PRESENT: Governor Calkins, Chairman, and Governors Young, Harrison, Norris, Fleming, Seay, Newton, Schaller, Martin, Geery, Hamilton, and Deputy Governor Gilbert. Also Deputy Governor Burgess.

Mr. Strater, Secretary.

TOPIC - <u>REQUIREMENT OF BOARD OF GOVERNORS THAT REPORTS OF INDEBTEDNESS OF EMPLOYEES IN THE FEDERAL RESERVE AGENTS' DEPARTMENTS BE MADE SEMI-ANNUALLY.</u> BOSTON

Under date of April 29, 1933, the Federal Reserve Board addressed letter X-7425 to all Federal Reserve Agents requiring that reports of indebtedness of all employees of the Federal Reserve Agents' Departments, as of July 1, 1933, be furnished to the Federal Reserve Board, and suggesting that the Boards of Directors of the several Federal Reserve banks give consideration to the adoption of a similar policy with respect to indebtedness of bank officers and bank employees. Subsequently, in its letter of December 20, 1934 (X-9052), the Board requested that reports of indebtedness of members of the staff of the Federal Reserve Agent be submitted semi-annually as of January 1 and July 1 each year.

Governor Young explained that the Board of Directors of the Boston reserve bank requires an annual report of indebtedness from each officer and employee of the banking departments, and that it was somewhat inconsistent to have different policies in effect in

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the two divisions of the staff of the bank.

The discussion developed that for the most part the reserve banks are now requiring only annual reports from bank officers and bank employees, as experience indicates much more time is consumed in obtaining reports from the larger staff in the banking departments and in comparing reports with those previously made, as well as in compiling a resume for consideration by the Board of Directors of the bank. It was the consensus of opinion that the practice in this regard should be uniform in its application to both classes of employees. It was therefore

VOTED to ask the Board of Governors to revise its request for semi-annual information regarding indebtedness of employees of the Federal Reserve Agents' Departments and to provide instead annual reports in conformity to the general practice of the Federal Reserve banks.

TOPIC - REPORT OF LEASED WIRE COMMITTEE

A copy of the report of the Leased Wire Committee dated October 21, 1935, was furnished to each of the Governors and, after a general discussion of the committee's recommendations, it was

VOTED that the report be accepted and the committee's recommendations approved.

TOPIC - REPORTS OF STANDING COMMITTEE ON COLLECTIONS

The report of the Standing Committee on Collections dated July 12, 1935, at the request of Governor Calkins, Chairman of the Governors' Conference, was submitted to each of the Governors directly by the Chairman of the committee. This report deals with the desirability of uniform procedure in handling telegraphic transfers of bank balances, in round amounts, for the account of nonmember clearing banks over the commercial wires, at the expense of such banks. After discussion, it was

VOTED that the report of the Standing Committee on Collections, dated July 12, 1935, be accepted, and its recommendations with respect to telegraphic transfers of funds for the account of nonmember clearing banks be approved.

The report of the Standing Committee on Collections dated September 23, 1935, which was submitted previously to each of the Governors at the request of Governor Calkins, Chairman of the Governors' Conference, was also considered. This report deals with the handling of drafts, as cash items, by Federal Reserve banks received on Saturday drawn on nonbanking institutions which are closed on Saturday, and reviewed its recommendations made in previous reports. After discussion, it was

VOTED that the report of the Standing Committee on Collections, dated September 23, 1935, and its recommendations that each Federal Reserve bank determine for itself a method of handling drafts drawn on nonbanking institutions received on Saturday and whether the float arising therefrom should be absorbed, be approved.

TOPIC - <u>REPORT OF COMMITTEE ON REIMBURSABLE EXPENSES</u>

Governor Fleming, Chairman of the committee, submitted an informal report on the progress made by the committee since the last Governors' Conference, and explained that the committee had deferred taking up the subject of reimbursement for actual expenses with the Treasury and various governmental agencies, because of the fact that major banking legislation was under consideration and no opportune time for doing so had presented itself. After discussion, it was

VOTED that Governor Fleming's report be accepted as an interim report of the committee, and the committee was instructed to continue its studies and report to the next conference. It was the sense of the conference that the committee should take reasonably prompt steps to ascertain from the Treasury and the various Government agencies, the extent to which they will agree to reimburse the Federal Reserve banks for expenses chargeable to those agencies under the instructions contained in the Expense Manual.

TOPIC - SHIPMENTS OF CURRENCY AND COIN TO NONMEMBER BANKS WITHIN THE DISTRICT AND TO POINTS BEYOND DISTRICT LIMITS — Kansas City

The discussion which followed developed the fact that most of the Federal Reserve banks were making shipments of currency or coin, or both, to nonmember banks within the district upon the request of their member banks, and the shipping charges were collected from the member bank making the request. It also developed that shipments to points beyond district limits were made in some cases but only to a limited extent. It was

VOTED that this is a reasonable service to extend to nonmember banks within the district, provided the shipment is ordered by a member bank from its Federal Reserve bank; and, provided further, that the shipping charges are reimbursed to the Federal Reserve bank. It was also

VOTED that there is no objection to performing the same service, upon the same basis, for nonmember banks in adjoining districts at the request of a member bank to its Federal Reserve bank, provided the nonmember bank is located in a city or town adjacent to the district boundary; and, provided, that such a service may be performed more expeditiously and conveniently than would be the case if it were initiated by a member bank in the adjoining district.

TOPIC - DESIRABILITY OF RESERVE BANKS ADOPTING A TIME SCHEDULE FOR DIRECT SENDINGS BY AIR MAIL — CLEVELAND

After discussion, it was

VOTED to refer this topic to the Standing Committee on Collections for study and report to the next conference.

TOPIC - REPLACEMENT OF OLD FORM FEDERAL RESERVE NOTES — NEW YORK

It developed during the discussion that a large volume of new undelivered Federal Reserve notes, of the old series, are held for the account of the Federal Reserve banks. It appeared to be the desire of the Treasury to avoid, if possible, the further distribution of Federal Reserve notes bearing the gold redemption clause, and that it would be desirable to print a sufficient quantity of the new form, without the gold clause, for distribution to the Federal Reserve banks. The expense of making this change is estimated at approximately $2,000,000 for the System, and there was some question as to whether the cost of the change should be borne by the Federal Roserbo banks or by the Treasury. While no action was taken, the hope was expressed that the Treasury might arrange to assume this expense.

TOPIC - MEETING DAYS OF DIRECTORS RICHMOND

This topic was discussed in the light of the amendment to the Federal Reserve Act embodied in the Banking Act of 1935, which requires each Federal Reserve bank to establish rates of discount and purchases, subject to the review and determination of the Board of Governors of the Federal Reserve System, every fourteen days, or oftener if deemed necessary by the Board of Governors. It was

VOTED that it is desirable that meetings of the Boards of Directors of the twelve Federal Reserve banks be held on the same day, and that the Board of Governors be asked to arrange with the several Federal Reserve banks for uniformity in this regard to become effective after February 1, 1936.

TOPIC - PAYMENT OF CHARGES ON INCOMING CURRENCY SHIPMENTS RICHMOND

It was the consensus of opinion that if, as, and when a further reduction in the expenses of the several Federal Reserve banks was deemed necessary or desirable, consideration should be given to a discontinuance of absorption of transportation expenses in connection with shipments of incoming or outgoing currency, or both.

TOPIC - POSTAGE SURCHARGE ON CURRENCY AND SECURITIES RICHMOND

Governor Seay expressed the opinion that the heavy surcharge imposed by the postal authorities on shipments of currency and securities was out of proportion to the service performed, particularly as the charge covered transportation only and Federal Reserve banks are obliged to effect insurance at additional cost to them. It was his conviction that the Federal Reserve banks should be exempt from the application of the surcharge. After discussion, it was

VOTED that the Board of Governors be requested to consult with the postal authorities with a view to bringing about a discontinuance of the surcharge applying to such shipments made by the Federal Reserve banks.

TOPIC - ACCEPTANCE OF DEPOSITS OF UNINVESTED TRUST FUNDS BY FEDERAL RESERVE BANKS (Board letter X-9253 of July 1, 1935)

The Board's letter was discussed in detail, and it was

VOTED to recommend that a member bank operating a separate trust department, or a trust company engaged exclusively in conducting a trust business and owned by a member bank, be permitted to carry, at the option of the Federal Reserve bank, an account on the books of the Federal Reserve bank representing trust funds awaiting investment or distribution. Transactions in such trust account must be confined to transfers to and from the reserve account of the member bank.

Governors Seay, Schaller, Norris, and Fleming voted in the negative.

Adjourned at 12:50 o'clock p. m. to reconvene immediately as the Federal Open Market Committee.

At 2:30 o'clock p. m. the conference reconvened with the same attendance as at the previous session.

TOPIC - BOARD OF GOVERNORS BUILDING ACCOUNT
1. REVISION OF ACCOUNTING PROCEDURE TO PERMIT CHARGE-OFF OF ENTIRE AMOUNT OF ASSESSMENTS OR ESTABLISHMENT OF APPROPRIATE RESERVES — SAN FRANCISCO

The setting up of an asset account on the books of each of the several Federal Reserve banks, representing assessments paid to the Board of Governors of the Federal Reserve System, to provide for the acquisition by the Board, in its own name, of a site in the District of Columbia for the purpose of providing suitable and adequate quarters for the performance of its functions, was considered to be undesirable because of the involved character of the transaction and, after discussion, it was

VOTED that amounts levied by the Board of Governors of the Federal Reserve System to purchase a site and erect a building to house the Board, be charged to Profit and Loss by the Federal Reserve banks.

TOPIC - PUBLICITY REQUESTED BY MEMBER BANKS INCLUDING NEWSPAPER COPY TO BE PREPARED BY THE SYSTEM FEATURING AT TIMES PAR CHECK CLEARANCE — CHICAGO

After a general discussion, it was

VOTED that the furnishing of such publicity material be left to the discretion of the individual Federal Reserve banks.

TOPIC - SYSTEM INTEREST IN THREATENED LITIGATION WITH TRUSTEES OF FLETCHER-AMERICAN NATIONAL BANK — CHICAGO

Governor Schaller explained that the liquidating trustees of the Fletcher-American National Bank of Indianapolis, Indiana, were seriously considering filing a suit against the Federal Reserve

Bank of Chicago to recover the amount of drafts drawn by the Fletcher-American National Bank on its reserve account prior to the declaration of a banking holiday in the State of Indiana, and which were subsequently paid by the Federal Reserve Bank of Chicago. Due to the involved situations created by the declaration of banking holidays in numerous states, and restrictions imposed upon the withdrawal of deposits in various localities, it was felt that serious complications might arise if the threatened suit was actually filed and successfully prosecuted. After discussion, it was

VOTED that if such a suit is filed against the Federal Reserve Bank of Chicago, it shall be deemed a matter of System interest and that general counsel for the Board of Governors may, in his discretion, call upon counsel for one or more of the Federal Reserve banks for assistance, or with the approval of the Board of Governors employ special counsel to defend the suit.

TOPIC - GRANTING OF SICK LEAVE TO EMPLOYEES IN EXCESS OF THIRTY DAYS — KANSAS CITY

Governor Hamilton referred to the Federal Reserve Board's letter X-7303 of December 5, 1932, which contemplates that individual consideration of each leave of absence, on account of sickness, be considered and the payment of salary approved by the Board of Directors of each Federal Reserve bank. It was the general opinion that consideration of such cases by the Board of Directors each month involves a discussion of many minor details, and that, in any event, the Board of Directors depends very largely upon the executive officers of the bank to determine if such salary payments are justified. After discussion, it was

VOTED that a definite procedure for the approval of the payment of salaries to employees absent on account of sickness be adopted by the Board of Directors of each Federal Reserve bank, and that such procedure be submitted to the Board of Governors for approval. It was further

VOTED that Governors Hamilton and Martin be appointed a committee to discuss this matter with the Board of Governors.

TOPIC - RESPONSIBILITY OF CHAIRMEN AND PRESIDENTS OF FEDERAL RESERVE BANKS UNDER BANKING ACT OF 1935 — PHILADELPHIA

After a brief discussion, this topic was passed without action.

TOPIC - REVISED REGULATIONS OF BOARD OF GOVERNORS — NEW YORK

It was understood that the Board's regulations were being tentatively revised by the Board's staff preparatory to consideration by the Board, and that copies of the tentative revisions were being sent to each of the Federal Reserve banks for consideration and suggestions. This topic was therefore passed without action.

TOPIC - DISCOUNT RATES RATE ON 10b LOANS — NEW YORK

The Governors discussed the whole matter of rates under this provision of the Act, and it was the general opinion that the establishment of an abnormally low rate at this time was of no particular importance; nevertheless, it was felt the fact that most of the reserve banks had established 10b rates at the minimum figure stated in the Banking Act of 1935 should not be construed as a precedent which would prevent appropriate increases in the rate commensurate with the character of the collateral and the earnings therefrom accruing to the member bank.

TOPIC - <u>FOREIGN EXCHANGES</u> NEW YORK

TOPIC - <u>GOLD AND SILVER MOVEMENTS AND MONETARY STABILIZATION</u> NEW YORK

Governor Harrison left the meeting at 3:30 o'clock p. m., and advised the Governors that he would send to each of them a memorandum covering the above topics.

TOPIC - <u>REOPENING OF PRIVATE CAPITAL MARKET</u>
<u>1. REFUNDING AND NEW ISSUES</u>
<u>2. MORTGAGE MONEY MARKET COOPERATION WITH FEDERAL HOUSING ADMINISTRATION</u> NEW YORK

Deputy Governor Burgess discussed these topics informally, but no action was taken.

Adjourned at 4:00 o'clock p. m, to meet with the Board of Governors at 10:00 o'clock a. m. on Thursday, October 24.

H. F. STRATER

Secretary.

REPORT OF STANDING COMMITTEE ON COLLECTIONS

TO

GOVERNOR J. U. CALKINS, CHAIRMAN OF GOVERNORS' CONFERENCE

July 12, 1935

The following topic was submitted to the Standing Committee on Collections by the Governors' Conference of May 27 and 28, 1935, with the request that the Committee's report and recommendations be presented to the Chairman of the Conference:

> DESIRABILITY OF UNIFORM PROCEDURE IN HANDLING TELEGRAPHIC TRANSFERS OF BANK BALANCES IN ROUND AMOUNTS FOR ACCOUNT OF NONMEMBER CLEARING BANKS OVER COMMERCIAL WIRES AT EXPENSE OF SUCH BANKS.

In its letter of February 21, 1922 (X-3337), the Federal Reserve Board adopted certain rules and regulations for the guidance of Federal reserve banks in connection with wire transfers of funds. These regulations provided that telegraphic transfers should be accepted from and paid to member banks only but stated "as some of the Federal reserve banks are under obligation to accept telegraphic transfers from their nonmember clearing banks, they may for the present continue to make such transfers." It appears that under these regulations Federal reserve banks were temporarily permitted to make telegraphic transfers for nonmember clearing banks over the leased wires. In its letter of June 21, 1924 (X-4099) the Federal Reserve Board issued revised regulations governing the use of the Federal reserve leased wires and the making of telegraphic transfers both over the leased wires and the commercial wires. These regulations, which were adopted uniformly by all Federal reserve banks, provided that telegraphic transfers of funds should be accepted from and paid to member banks only, whether such transfers were made over the Federal reserve leased wires or over the commercial telegraph wires, and since July 1, 1924, the effective date of the regulations, there has existed no provision for making telegraphic transfers for nonmember clearing banks.

The Standing Committee on Collections in its report to the Governors' Conference of April 1, 1929, covered very fully (pages 3-9) the whole subject of transfers requested by nonmember banks and recommended (page 4) that the Board's regulations as set forth in its letter of June 21, 1924 (X-4099) be amended to permit telegraphic transfers of funds to be made for nonmember clearing banks under the same conditions as they were made for member banks. This recommendation was not approved by the Governors' Conference, it having been felt that nonmember clearing banks should not be furnished the same transfer service as member banks, and the Board's regulations were not changed.

The Committee has given further consideration to this subject and feels that, since nonmember clearing banks are permitted to carry clearing accounts with Federal reserve banks, and since reserve banks collect checks drawn on them, some provision, however restricted, should be made which will permit them to transfer funds both to and from such accounts.

The Committee recommends, therefore, that the Federal Reserve Board be requested to amend its regulations to provide that telegraphic transfers of bank balances in round amounts, i. e. multiples of $100 be accepted from and paid to nonmember clearing banks and that such transfers be made only over the commercial telegraph wires at the expense of such banks.

If this recommendation be approved by the Governors and accepted by the Federal Reserve Board, it is further recommended that the semi-annual par list issued by the Board include a list of nonmember clearing banks by districts in the same manner that state member banks are now shown, and that the monthly supplements to the par list record the changes in the list of nonmember clearing banks, in order that the operations of the Federal reserve banks under the revised regulations may be facilitated.

The Committee suggests for the consideration of the Federal Reserve Board the following paragraphs of revised rules and regulations for uniform use by all Federal reserve banks in their circulars relating to wire transfers:

TRANSFERS OVER LEASED WIRES

1. Only transfers of bank balances in round amounts, that is multiples of $100, will be made over the Federal reserve leased wires. The term "bank balance" shall be construed to mean an accumulation of funds comprising an established account maintained by a member bank with its Federal reserve bank or with another member bank.

2. Telegraphic transfers of funds over the leased wires will be made for and paid to member banks only. Such transfers will be made without cost to member banks.

3. The descriptive data in telegrams transferring bank balances over the leased wires must be limited to the amount to be transferred, name of the member bank to receive credit and, when necessary, name of its correspondent member bank, and name of member bank with which request originated.

4. Transfers of the proceeds of individual collection items will not be made over the leased wires.

5. The Federal reserve banks maintain, at large expense, a leased wire system over which it is necessary to transmit a heavy volume of important communications. Member banks are requested to cooperate with us in attempting to avoid overcrowding the leased wires by not making requests for telegraphic transfers of

small amounts, or those which can be made as well through the mails.

TRANSFERS OVER COMMERCIAL WIRES

1. Telegraphic transfers of funds for any purpose and in any amount and without limitation as to descriptive data will be made over the commercial telegraph wires for member banks. While such transfers will be accepted from and paid to member banks only, they may be for the use of any bank, individual, firm or corporation.

2. Telegraphic transfers of bank balances in round amounts, that is multiples of $100, will be made over the commercial telegraph wires for nonmember clearing banks. Such transfers will be accepted from any member bank for the credit of any nonmember clearing bank, and from any nonmember clearing bank for the credit of any member bank or any other nonmember clearing bank.

3. The cost of all telegrams between Federal reserve banks transferring funds over the commercial telegraph wires will be charged to the member and nonmember clearing banks for which the transfers are made. Member and nonmember clearing banks should prepay the cost of telegrams requesting such transfers, and telegrams to member and nonmember clearing banks advising credit will be sent "collect."

LIABILITY OF THE FEDERAL RESERVE BANK

The Federal Reserve Bank of ____________ will use due diligence and care in the transfer of funds by telegraph to the receiving Federal reserve bank for credit to the account of the payee bank, but will not be responsible for errors or delays caused by circumstances beyond its control.

Respectfully submitted,

Standing Committee on Collections.

O. M. Attebery
C. H. Coe
H. F. Strater
J. M. Toy
J. S. Walden, Jr., Chairman

October 21, 1935

REPORT OF THE LEASED WIRE COMMITTEE

To the Conference of the Governors

of the Federal Reserve Banks:

At the May 1935 Conference of Governors, the Leased Wire Committee submitted a letter received from the Federal Reserve Board under date of May 7, 1935, commenting upon the recommendations of the Leased Wire Committee contained in its report dated November 30, 1934, and approved by the Governors' Conference at its meeting in Washington on February 5, 1935. The Leased Wire Committee had recommended certain changes in the accounting procedure and had also suggested changing from Morse to Teletype service. The Federal Reserve Board reviewed the report and suggested (1) that further consideration be given to the advisability of the Federal reserve banks' billing direct to various Governmental agencies for the cost of business sent over the main line wires; (2) that with respect to Teletype equipment, the committee make a further study with a view to determining whether the page machine or the tape machine is preferable, as uniformity in the type of machine to be adopted is desirable, and (3) that the Leased Wire Committee make some recommendation as to the policy to be pursued by the Federal reserve banks in connection with personnel in the event Teletype service should be installed throughout the System. After conferring with the various Federal reserve banks, the committee makes recommendations as follows:

1. In view of the fact that it will be necessary in order to secure reimbursement to furnish copies of telegrams sent over the leased wires for the account of Governmental agencies, whether the billing is made direct or through the Federal Reserve Board, it is recommended that all such agencies be billed direct by the respective bank and the Board for the cost of messages sent over the main line wires.

2. Six banks have indicated a preference for the tape machine and four banks for the page; one can adapt itself to either, and one, while stating that it is not in favor of changing from Morse to Teletype service, stated that it felt the page machine was less desirable than the tape machine. Teletype tape equipment service is now in effect on the following main-line circuits:

Chicago-San Francisco
Chicago-Kansas City
Chicago-Dallas
Chicago-St. Louis
Chicago-Minneapolis

The committee will give further study to this subject before making a recommendation.

3. The committee recognizes that the personnel problem is a difficult one and feels that to a large extent this is something that each bank will want to work out for itself. The committee recommends, however, that in the event the change is made from Morse to Teletype each bank should make every effort to adjust this problem as soon as possible in order that the System is not charged with salaries in excess of those that should reasonably be paid to competent teletype operators. This might be effected by finding other positions for their present Morse operators in the bank or elsewhere, or in lieu of this by giving them ample notice so that they may adjust their affairs accordingly.

The suggestion was recently made by one of the Federal reserve banks that a considerable saving in cost could be effected if certain main-line wires were re-routed. Accordingly, the Leased Wire Committee requested the American Telephone & Telegraph Company to make a survey of the traffic handled on the wires which would be affected by the proposed change with a view to determining whether or not such re-routing would be practical or advantageous. This survey has just been completed and the representatives of the telephone company state that while the proposed re-routing as originally submitted would not be advisable, it appears that certain changes in the present setup may be possible which will result in some reduction in cost. The committee will give this matter further study and when conclusions have been reached will take the matter up with the offices concerned.

In view of the foregoing, the committee suggests that the recommendations with respect to accounting procedure be put into effect as soon as practicable without awaiting further developments on the Teletype or re-routing the wires. These recommendations which follow are the result of questions which have previously been raised, and with the exception of Recommendation No. 9 are substantially, those contained in the Committee's report which was approved by the Governors' Conference in February 1935:

1. Is the expense of operating the Leased Wire System properly allocated?
   It is the sense of the committee that a more accurate record would be reflected if the leased wire operations of the Federal Reserve Board were set up as a direct expense incurred by it and if in the monthly reports showing classification and number of words transmitted such operations of the Federal Reserve Board were included in that portion of the report which has heretofore been confined to the various Federal reserve banks.

2. Is the cost of reimbursable business handled over the leased wire system properly allocated?

   It is believed that the present plan for allocating reimbursable expense in connection with messages transmitted over the main lines of the Leased Wire System, namely, in proportion to the total number of words handled, is satisfactory. (For proposed change in the method of securing reimbursement, see Recommendation No. 9)

3. Should messenger service be charged to leased wire operations?

   It is felt in view of the varied practices among the Federal reserve banks that messenger service should not be charged to the Leased Wire System, except possibly in the case of the Federal Reserve Board, if it develops that in its case it is necessary to maintain a messenger service to make delivery of telegrams to the Treasury Department.

4. Printing and Stationery.

   The cost incident to printing and stationery appears to be comparatively small, and it would seem that the expense of maintaining records incident to determining such cost would offset any savings that might accrue by charging the cost to leased wire operations. It is therefore, recommended that such cost be abosrbed by each individual bank.

5. Cost of counting the number of words in messages.

   It is believed that the expense incident to counting the number of words is an appropriate item to be charged against leased wire operations; also other clerical help which is assigned exclusively to work on main line business.

6. Expense in connection with branch wires.

The branch wires are essential for communication between the head office and the branches, and insofar as such operations are concerned it is felt that branch wire expense should not be charged to the Leased Wire System. However, it is suggested that each Federal reserve bank ask for reimbursement from the Governmental agency concerned for the cost of branch wire messages if the volume, in the opinion of the bank, warrants reimbursement.

7. Salaries.

As indicated in the Board's letter, operators' salaries, operators' overtime, retirement contributions, and wire rental are now being charged to the Leased Wire System and we believe such charges should be continued. In addition to such items, we believe that supper money should be considered as a proper charge.

8. Salaries of Washington operators.

While such salaries are carried on the payroll of the Federal Reserve Bank of Chicago at present, we believe in view of the practice outlined under Recommendation No. 1 that salaries, overtime, supper money, workmen's compensation insurance premiums, contributions to the retirement fund, et cetera, incurred in the Washington Leased Wire Office should be paid by the Federal Reserve Board.

9. Advisability of having each reserve bank bill the various Governmental agencies for the cost of messages sent over the main line leased wires by the banks for the account of such agencies, rather than to follow the present practice of reporting reimbursable business to the Board, which in turn charges the respective agencies.

The committee recommends that each Federal reserve bank bill the various Governmental agencies direct for the cost of messages sent over the main line leased wires by the banks for the account of such agencies.

Respectfully submitted,

George J. Schaller, Chairman

George H. Hamilton

REPORT OF STANDING COMMITTEE ON COLLECTIONS

TO

CONFERENCE OF GOVERNORS

September 23, 1935

At the request of the Federal Reserve Board the following topic was referred to the Standing Committee on Collections by Governor J. U. Calkins, Chairman of the Governors' Conference, in a letter dated August 16, 1935, in which he asked the Committee to make its report and recommendations to the next Governors' Conference:

> HANDLING OF DRAFTS (as Cash Items) BY FEDERAL RESERVE BANKS RECEIVED ON SATURDAYS DRAWN ON NON-BANKING INSTITUTIONS WHICH ARE CLOSED ON SATURDAYS.

The Board's letter requesting Governor Calkins to refer the question to the Standing Committee on Collections contained the following paragraphs:

> "The Federal Reserve bank in writing to the Board stated that the question for determination is whether such items received in cash letters for presentation on Saturdays should be handled by the Reserve bank as cash items with the Federal Reserve bank absorbing the float until Monday or whether they should be treated as non-cash collections for credit to the bank's endorsers when paid.
>
> "It is assumed that similar situations may exist in other districts and for this reason it is felt desirable to have the Standing Committee on Collections of the Federal Reserve System look into the question and submit a report and recommendation at an early date with respect to the policy it feels should be followed by the Federal Reserve banks in the handling of such drafts."

For a long time it has been the practice of certain large non-banking institutions to draw drafts on themselves, usually payable through banks. These items as a rule are collectable at par and serve the purpose of checks although they are technically non-cash items. The method of handling by Federal Reserve banks in the different districts has always varied and when the uniform circular regarding "Collection of Cash Items" which was adopted by all Federal Reserve banks effective September 2, 1930, was being drafted by the Standing Committee on Collections and a sub-committee of counsel for the Reserve banks, including Mr. Wyatt of the Federal

Reserve Board, the question was raised as to whether Reserve banks should be permitted to handle such items as cash items. It was finally agreed that, inasmuch as such items were collectable at par and could be handled very easily as cash items while it would be burdensome and impracticable to handle them in large volume as non-cash items, the Reserve banks should be permitted at their option to receive and handle them as cash items, and the following paragraph was included in the uniform circular under the caption "Items which will be accepted as cash items":

> Such other items, collectable at par in funds acceptable to the Federal Reserve bank of the district in which such items are payable, as we may be willing to accept as cash items. When any such item is accepted as a cash item, we will give credit therefor in accordance with the provisions of this circular and our time schedules; but with respect to such item the "Terms of Collection" set forth in our current circular on the subject "Collection of Maturing Notes and Bills, or other Non-Cash Items" will apply.

It will be seen from this paragraph that when such items are collectable at par they may be handled as cash items and credited in accordance with the published time schedules but are subject to the same terms of collection as non-cash items. It was not intended that such items should be considered as checks or that they should necessarily be handled as cash items but simply that a Reserve bank be permitted to receive and handle them as cash items if it desired to do so as a matter of convenience subject to the uniform terms of collection applicable to non-cash items.

On July 14, 1932, the Standing Committee on Collections rendered a report to the Chairman of the Governors' Conference regarding the questions involved at that time in the receiving and handling by Reserve banks of items which were formerly drawn directly on or payable at banks but which were then being drawn by the makers on themselves payable through banks or on themselves directly to avoid the payment of the tax on checks. As stated above it was the purpose of the uniform Check Collection circular of September 2, 1930, to permit Federal Reserve banks in the districts where such items were payable to determine whether they would receive and handle such items as cash items or as non-cash items. Upon the passage of the Revenue Act of 1932 and the imposition of the check tax, however, the practice became very general for business concerns, which formerly had drawn checks on their commercial banks, to draw drafts on themselves. It was realized that such items were taking the place of checks and it would be exceedingly impracticable, expensive and disrupting to the departmental organizations of the Reserve banks to suddenly begin handling as non-cash collections such a large volume of items which were formerly checks. It was also thought that it would be very confusing unless all of them were handled uniformly either as cash items or as non-cash items. The Committee recommended therefore that such items when collectable at par be handled only as cash items, and if the bank through which they were payable would not pay them as cash items without the deduction of exchange, the Reserve banks should decline to handle them at all. The report stated that, inasmuch as the number of depositors drawing items on themselves payable through banks or on themselves directly was increasing and the practice was becoming general because of the tax on checks, great confusion would exist in the Reserve banks unless they adopted a uniform policy with respect to handling and receiving such items, and in view of the conditions in the Reserve banks the Committee felt that they should not be handled except as cash items. This recommendation was made in the then existing emergency, but since the tax on checks is no longer in effect and no occasion exists now for depositors to draw drafts on themselves to avoid the tax, the Committee can see no reason why Federal Reserve banks, in the handling of such items, should not revert to the practices in effect under the uniform circular prior to the passage of the 1932 Revenue Act and so recommends.

With respect to the handling of such items received on Saturdays which are drawn on institutions which are not open for business on Saturdays, the Committee is of the opinion that, since conditions in the various districts are so entirely different, it is not practicable, and probably not desirable, for the practices of the Reserve banks to be uniform, but that each Reserve bank should decide for itself how such items will be handled according to the merits of each case, the volume of items, the conditions existing in the locality in which they are payable, and its own experience under the laws of the states within its district. It seems to the Committee that under the Negotiable Instruments law the Reserve banks would be safe in holding such items when received as cash items on Saturday for presentation on the following business day (Monday), and in doing so they are further protected by reason of the fact that while such items are received and handled as cash items they are, according to the terms of the Check Collection circular under which they are accepted, subject to the terms of collection applicable to non-cash items. The Committee feels that there should be no objection to the absorption of the float resulting from the hold-over of such items for one business day, which in the vast majority of cases would be of little consequence. The question of whether such float will be absorbed, however, should be left to the determination of each Reserve bank in deciding how it will handle such items.

Respectfully submitted,

Standing Committee on Collections

O. M. Attebery
C. H. Coe
H. F. Strater
J. M. Toy
J. S. Walden, Jr., Chairman