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Chairman Martin

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FEDERAL OPEN MARKET COMMITTEE RELATIONSHIP WITH
BROKERS AND DEALERS IN GOVERNMENT SECURITIES

Digest Review from Federal Open Market
Committee Minutes and Files, 1944-1952

Introduction

The steadily mounting volume of System transactions in Government securities during the war period gave rise to a growing concern on the part of the Federal Open Market Committee about the Committee's relationships with brokers and dealers in Government securities. In May 1944 the Committee, after extensive consideration of this problem, decided to *(enacted)* formalize relationships with brokers and dealers transacting business for the System account. This digest reviews the Committee's record with respect to these relationships just prior to and since the formalization action. The record begins with an informal conference of the executive committee on February 21, 1944.

Informal Conference of the Executive Committee, February 21, 1944

At the executive committee's previous meeting, Mr. Rouse had been requested to prepare a memorandum submitting a report and recommendations regarding relationships between the Federal Reserve Bank of New York and dealers in United States Government securities. The main points of the memorandum prepared by Mr. Rouse in response to this request were as follows:

First, the System has no express or implied statutory authority to regulate the Government security market. Second, Government securities

were specifically exempted from regulation by Congress when the Securities and Exchange Commission was established. Third, the System could be accused of price-fixing, and dealers could be accused of violating the anti-trust laws. Fourth, all transactions by the System should be effected in a manner that protects the System and the public without favoritism. Fifth, it is not vital to dealers to comply with requests of the Reserve Bank, since their transactions with the Reserve Bank represent only about 7 per cent of the total business of such dealers. If numerous conditions were imposed upon the dealers, they would probably go a long way to comply, particularly during the war, because they believe that the Reserve Bank, representing the Federal Open Market Committee and the Treasury, is endeavoring in the public interest to exercise a beneficial influence on the market, but it would be primarily for that reason and not because they believe that the business is vital to their continued operation.

It was recommended in the memorandum that the Federal Open Market Committee (1) approve a statement of policy that transactions be effected through or with dealers or brokers who have agreed to requirements prescribed by the Committee, (2) prescribe in broad language certain criteria to be followed in the selection of brokers and dealers, and (3) determine that every broker and dealer enter into certain undertakings with the Reserve Bank. In extending recognition to a dealer, the Bank would take into consideration (1) integrity, knowledge, and capacity and experience of management, (2) willingness to make markets and to take positions, (3) volume and scope of business, (4) cooperation in the maintenance of an orderly market, and (5) financial condition and capital at risk of business. In addition, it was recommended that each dealer furnish the Bank each day with a statement showing the borrowings, position, and volume of

transactions and such other data as in the opinion of the Bank will aid in the execution of transactions for the System. Dealers also would be required to give written notification of whether they executed each transaction with the Bank as a broker or as a dealer, to make deliveries by a specified time, to furnish an annual statement of financial condition, and to refuse to solicit offers or bids for the purpose of selling to or buying from the Bank. Any dealer violating this agreement would be (subject to removal) removed from the recognized list.

The suggestions contained in Mr. Rouse's memorandum, together with a draft statement incorporating these and other staff suggestions prepared by Messrs. Wyatt, Piser, and Kennedy, were discussed at length. At the conclusion of the meeting it was understood that Messrs. Sproul and Rouse would study the matter in the light of this discussion with a view to proposing a statement of the conditions under which the New York Bank, as agent for the Federal Open Market Committee, would deal with brokers and dealers. It was also understood, in studying the matter, that Messrs. Sproul and Rouse would give particular consideration to (1) the desirability of establishing at the Federal Reserve Banks and their branches facilities for the purchase and sale of Government securities, and (2) the advisability of making reference in the Board's annual report to the problem presented to the Federal Open Market Committee in connection with its relationships with dealers in Government securities.

Executive Committee Meeting, February 29, 1944

The proposed statement of terms on which the open market account would transact its business with a Government security dealer as submitted to this meeting was patterned after the suggestions discussed at the executive committee's informal conference. The statement contemplated that

the executive committee's instructions to the New York Bank would include a directive that the Bank would decline to transact any further business with a broker or dealer who willfully violated or failed to perform any of the proposed terms or conditions. An exception was provided in case the Bank was satisfied that the broker or dealer had taken steps to correct the default and prevent its future occurrence. Chairman Eccles suggested that it be understood that, if a broker or dealer were disqualified because of any such violation, he would not again be qualified without the approval of the executive committee.

At the conclusion of the discussion, the committee unanimously voted approval of a statement of terms and conditions under which brokers and dealers would be qualified to transact business for the System open market account. It was understood that the full Open Market Committee would be requested to adopt these terms and to authorize the executive committee to (1) make minor changes in the statement if it appeared desirable following discussion at the full Committee meeting, (2) make the terms effective at such time as in the judgment of the executive committee appeared desirable, and (3) issue such instructions to the New York Bank in connection therewith as might be required. It was agreed that the suggested terms would be applicable to all representatives and agents of qualified brokers and dealers.

The full statement of the terms under which brokers and dealers would be qualified, together with pertinent correspondence on this subject, is attached to this report as Appendix A.

Meeting of the Federal Open Market Committee, February 29, 1944

Chairman Eccles reported that in a meeting just before this meeting the executive committee had approved a recommendation to the full

Committee with respect to the terms under which brokers and dealers would be qualified to transact business for the System open market account. The recommendation of the executive committee was read and discussed by the full Committee. Chairman Eccles stated that other ways which had been discussed of dealing with the problem of the System's relationship with the market included (1) establishment at the Federal Reserve Banks and branches of an organization to handle purchases and sales of Government securities directly with customers, (2) adoption of a policy requiring that transactions handled by dealers for the System account be on a brokerage basis only, and (3) inclusion in the Board's annual report to Congress of a statement of the problem created by the present situation in which there is no express statutory basis upon which dealers in Government securities can be subjected to adequate regulation. He further stated that the executive committee felt that its recommendation was the most satisfactory for the present, although it might be necessary at a later date to consider modification of the procedure or adoption of an alternative.

Mr. McLarin inquired whether dealer banks in cities other than New York and Chicago could qualify under the proposed terms. Mr. Rouse replied affirmatively, but stated that it was not expected that many such banks would be interested in qualifying.

Mr. Davis asked whether it was the intention under the recommendation to qualify all who met the proposed requirements or only brokers or dealers presently having relationships with the New York Bank. Mr. Rouse replied that the former was intended, and the Committee agreed that the final statement should make this point entirely clear.

In discussing the steps to be taken to put the procedure into effect, the Committee unanimously approved Mr. Sproul's suggestion that

the Treasury be informed of the proposed action so that any objections that the Treasury might have could be considered before any such arrangement was put into effect.

At the conclusion of the discussion, the Committee unanimously voted to approve the proposed terms and also to approve the amendatory and enabling suggestions noted at the end of the executive committee meeting on this same date.

Executive Committee Meeting, March 28, 1944

In accordance with the authority granted at the meetings of the full Committee on February 29 and March 1, 1944, the executive committee approved a revised statement of the terms under which brokers and dealers could qualify to do business with the System open market account. It was noted that a copy of the statement of terms had been sent to the Treasury on March 21.

A suggested letter of instructions from the executive committee to the Federal Reserve Bank of New York was considered. The letter of instructions to the New York Bank and the informative letter to the Presidents of the other Federal Reserve Banks are included under Appendix A, together with the terms of dealer qualifications referred to in the meeting of February 29, 1944.

Executive Committee Meeting, May 4, 1944

Chairman Eccles reported that on April 7, 1944, Under Secretary of the Treasury Bell acknowledged receipt of the letter sent by the committee to Secretary Morgenthau on March 21, 1944, transmitting the statement of terms under which the System would transact business with brokers and dealers for the System account. Mr. Bell had stated that the Treasury was vitally interested in some of the proposals and he would like to

withhold comments until his return from a week's vacation, at which time he would discuss the matter with Chairman Eccles. Subsequently, Mr. Bell had stated that he would send a letter to the Federal Open Market Committee regarding the matter, but despite an urgent request by Chairman Eccles that such a letter be submitted promptly nothing had been heard for two weeks. Chairman Eccles was of the opinion that no further comment would be received from the Treasury and that there was no reason for further delay in putting the proposed terms into effect.

The other members of the executive committee agreed with this opinion and unanimously voted to approve and transmit to the New York Bank and the other Federal Reserve Banks the two letters approved at the meeting on March 28, 1944, with the understanding that the terms would be made effective on May 15, 1944.

Letter to Chairman Eccles from the Under Secretary of the Treasury,
May 11, 1944

Subsequent to this action and with informal advice that it had been taken, Mr. Bell addressed a letter, dated May 11, 1944, to Chairman Eccles, expressing the following views on the matter of formalizing System account relations with Government security dealers:

"I have some grave doubts as to the wisdom of formalizing the procedures covering the business transacted between brokers and dealers and the Federal Reserve Bank of New York. I appreciate that this only covers the System's Open Market Account, but the Bank does buy and sell securities in the market involving these same people for account of the Treasury's investment funds. Possibly the Bank can handle your transactions on a formal basis and ours on an informal. We do not feel here in the Treasury that any such formal arrangement is necessary."

"Furthermore, it runs the chance of being severely criticized by newspapers and you may be charged with attempting to control the operations of these firms. I feel that the present system has worked very well and can be explained to anyone interested in the procedure."

Executive Committee Meeting, July 28, 1944

Prior to this meeting there had been an exchange of letters between Secretary Morrill and Mr. Sproul (Appendix A) regarding the matter of putting into effect the terms of conditions under which brokers and dealers would be qualified to do business with the System account.

In discussing the reaction to the formalized procedure, Mr. Rouse stated that the terms had been accepted without question and had worked very well, and that the Bank had received several inquiries from firms which were considering entering the field. He reported that Schroder Rockefeller & Co. had already gone in the business and, in answer to their inquiry, had been informed that when the officers of the firm felt that the terms of qualification could be met they should communicate with the Federal Reserve Bank of New York. He also reported that the officers of the Company felt that the firm should have further experience before undertaking to comply with the terms of qualification.

Executive Committee Meeting, September 21, 1944

Chairman Eccles suggested that consideration be given at some stage as to whether the annual statements of condition submitted by qualified brokers and dealers should be expanded to show holdings of Government securities by issues; Government securities borrowed by issues; borrowings from banks, trust companies, and other financial institutions, and from officers, directors, and others; loans to officers and directors; and net worth. He felt this would provide a better basis for appraisal of the condition of the qualified firms. He further suggested that consideration be given to commissions paid dealers in connection with transactions for the System account. To the latter question, Mr. Sproul suggested that Mr. Rouse study the matter and submit a report to the next meeting of the

executive committee.

Chairman Eccles further suggested that consideration be given to the desirability of having the various Federal Reserve Bank Presidents report on any cases that came to their attention where representatives of any of the qualified dealers violated the terms under which they agreed to transact business for the System account.

Interim Developments

In a letter to Mr. Sproul dated September 11, 1944, Chairman Eccles raised certain questions with respect to brokers and dealers in Government securities, such as: the adequacy of information supplied to the executive committee concerning dealers who failed to qualify; reporting on additions to or removals from the qualified list; the matter of maximum borrowing of any one dealer; and reporting on the volume of transactions for the System account with each qualified dealer.

These questions were discussed at the executive committee meeting on September 21, 1944, and a number of additional points were raised at that time. In the light of Mr. Eccles' letter and this discussion, Mr. Rouse, in a letter dated October 11, 1944, reported on brokers and dealers who had not qualified under the new terms, and, in a further memorandum dated November 1, reported on dealer commissions on transactions for the System account and related matters pertaining to dealer activities.

Mr. Piser addressed a memorandum to the Board of Governors, dated February 8, 1945, bringing to their attention questions which, in the light of this background, seemed to require further consideration. At the February 28, 1945 meeting of the executive committee, reference was made to these questions, but discussion was deferred. At the four succeeding executive committee meetings, the unsettled problems mentioned in Mr. Piser's

memorandum of February 8, 1945, were mentioned, but, owing to the pressure of other business, were not discussed.

Copies of the letters and memoranda pertaining to these questions are included in Appendix B attached.

Executive Committee Meeting, February 28, 1946

A memorandum prepared by Mr. Piser under date of October 15, 1945, restating the substance of his earlier memorandum of February 8, 1945, posed four questions for discussion. These were: (1) whether the executive committee should be advised of any instance in which a qualified dealer's position reached an abnormally high level, of any action taken by the New York Bank regarding that position, and of the dealer's response to this action; (2) whether the executive committee should recognize the present commission of 1/64 of a point in notes and bonds on transactions for the System account and the present limitation to exceptional cases of transactions made on a net basis, and whether the executive committee should establish a commission of 0.01 per cent on transactions in certificates; (3) whether annual statements of condition submitted by qualified dealers and brokers should include certain additional information; and (4) whether Reserve Bank Presidents should be requested to furnish information regarding violations of established terms by recognized dealers.

In regard to the first question, Mr. Rouse stated that difficulties might be involved in establishing a maximum position that an individual dealer might take. Chairman Eccles commented that under present conditions it would be better if the dealers did not take positions and securities were purchased or sold directly to and from the Federal Reserve Banks. Mr. Rouse stated that, with one exception, there had been

no cases of overextended positions that would have been reported to the executive committee, and that in the exceptional case the management of the firm involved had been changed and the situation subsequently corrected. He also feared that if a maximum position were fixed the dealers might take it as an invitation to go to that limit.

Chairman Eccles felt that the Open Market Committee had responsibility for market conditions and that there should be reports of dealers' positions as well as any actions by dealers that would be adverse to the proper discharge of that responsibility. As a guide to the manager of the account, he felt a reasonable limitation on dealers' positions should be established.

Mr. Rouse suggested that it would be possible for him to include comments in a weekly report which might be helpful, and it was agreed that further study should be given to this question and a decision reached at the next meeting.

Mr. Rouse then asked if it was the committee's desire that he encourage dealers to reduce their positions, and Chairman Eccles stated that he felt dealers should sell securities to the extent that they could to keep the market from going higher.

With respect to commissions, Mr. Rouse felt that it would not be wise to tie the hands of the New York Bank beyond the existing general understanding that it would not pay more than 1/32 on System transactions, and that he would desire some over-all instructions that would give more leeway in operation rather than specifying the commission to be paid on any given transaction. Chairman Eccles questioned the need for such leeway and further stated that he would like to consider the matter from the standpoint of the desirability of paying no commissions. To Mr. Williams'

suggestion that the committee's procedure should be such as to keep the dealer mechanism alive, Chairman Eccles replied that he questioned the need for the dealers in the present situation.

At the conclusion of the discussion, it was agreed that further consideration would be given to the matter of commissions as well as to the remaining questions in Mr. Piser's memorandum, so that the four questions could be disposed of at the next meeting of the committee.

Further Developments

In a letter to the executive committee reporting financial data on qualified nonbank dealers, dated April 19, 1946, Mr. Rouse made the following observations with respect to dealer positions and borrowing:

"In general the ratio of dealers' borrowings to net worth appears high. However, we believe that these ratios under the conditions existing at the end of the year (following the close of the Victory Loan drive) do not necessarily indicate an overextended position on the part of any dealer, due to the fact that (1) the dealers' portfolios included large amounts of short term issues; (2) the funds borrowed included large amounts needed temporarily to carry securities sold but not yet delivered (the funds borrowed for the latter purpose represented up to 30 per cent of the total amount of funds borrowed on Government securities by individual dealers); and (3) there was a basis for anticipating that securities would be in demand during January 1946.

"We were not greatly concerned over the turn of the year with the large amount of short term issues which the dealers were carrying as it represented primarily an aid to the market. Ordinarily dealers, selfishly perhaps, do not care to tie up capital in carrying excessive amounts of such issues. However, a problem which has caused us concern has been the substantial amount of dealers' holdings of restricted Treasury bonds, not only for the interest carry, but also the likelihood of capital appreciation. Notwithstanding a number of discussions we have had with dealers in an attempt to have them supply such holdings of long bonds to the market at the time of steadily advancing prices, their positions were not materially reduced until a period subsequent to the statement date. As a matter of fact, in some instances dealers' positions in long bonds have continued to remain relatively large,

approximately one half of their holdings at the beginning of April were in 2 1/4 per cent bonds and the balance was comprised generally of small amounts of the various issues of 2 1/2 per cent bonds. We have not made an issue in the matter beyond exerting pressure on the dealers to supply their holdings of bonds to the market, inasmuch as those with whom we do business for the System Open Market account were in competition with unqualified security houses. In addition, there has been the difficulty of criticizing a condition (almost riskless) brought about by Treasury and System policy. Actually the dealers who are not qualified to act for System account have been in a preferred position as far as profits are concerned. If it came to a choice, it seems entirely possible that some of the qualified dealers would have preferred, under existing conditions, to disregard requests to reduce positions and forego our existing relationship in which event their profits would have been greater."

Executive Committee Meeting, June 10, 1946

The four questions referred to in the executive committee meeting of February 28 were discussed, and the following suggested solutions were unanimously approved:

"1. Whether the executive committee should be advised of any instance in which the position of a dealer reaches an abnormally high level, of any action taken by the New York Bank regarding the position of a dealer, and of the response by the dealer to this action.

"The Federal Reserve Bank of New York should include in its regular weekly report a statement that, during the period covered by the report, the position and borrowings of individual dealers or of all dealers combined, in its opinion, had or had not been excessive as the case might be. In the event the position and borrowings of an individual dealer or of all dealers taken together were believed to be excessive, the statement should include a report of any action considered by the New York Bank, the action taken by the Bank, and the response by the dealer or dealers thereto.

"2. Whether the committee should recognize, at least informally, the present commission of 1/64 of a point on transactions with dealers for the System account in notes and bonds and the present limitation to exceptional cases of transactions in these securities on a net basis, and whether the committee should establish a commission of perhaps 0.01 per cent on transactions in certificates.

"Transactions in notes and bonds on an agency basis for the System account with qualified dealers should be handled in such a manner as to permit the dealers a spread of not more than 1/64 of a point, and such transactions where the dealers act as principal should be limited to exceptional cases and the transactions together with the reasons therefor should be reported separately by the New York Bank in the weekly report. Transactions in certificates should be handled in such a manner as to permit the dealers a spread of not more than 0.01 per cent (in relation to the price to the customer when on an agency basis and in relation to the current market price when the dealers act as principal) on the longest maturity of certificates and the equivalent in dollars on shorter maturities.

"3. Whether the statements of condition of qualified dealers should be required to include certain additional information.

"The New York Bank should send to the members of the Federal Open Market Committee information similar to that contained in Mr. Rouse's letter of April 19, 1946, with respect to the financial condition of the qualified dealers, at least once each year or oftener if statements of condition are received from the dealers at more frequent intervals.

"4. Whether the Reserve Bank Presidents should be requested to furnish the executive committee any information they may obtain regarding violations by dealers of the terms upon which the New York Bank will transact business with dealers in Government securities.

"Each Federal Reserve Bank should report to the manager of the account any information, which in its judgment is pertinent and comes from reliable sources, in connection with the operations of any dealer that would be in violation of the established terms. For example, a report should be made of instances in which dealers in violation of the established terms have influenced customers to sell when the System has been buying, have made recommendations to customers that had the effect of disturbing the market, or have manipulated quotations in order to increase transactions."

Mr. Rouse reported that the New York Bank probably would receive two or three applications for qualification from dealers in the near future. One application was expected from Blair and Company which he stated now had adequate capital, did a national business, and now had satisfactory management. He reported that this firm had been on the approved list at one time

but had been removed for cause; he felt, however, that the matters which had been subject to criticism previously were now corrected and that the firm was entitled to restoration as a qualified dealer. He indicated that if this application were received it would be sent with a full report to the committee for its approval. The two other applications expected were from Briggs, Schaadle and Company, and J. B. Roll and Company, and he thought that they would be satisfactory.

Executive Committee Meeting, October 3, 1946

Reference was made to Mr. Rouse's statement to the executive committee on June 10, 1946, with respect to a possible application for reinstatement as a qualified dealer from Blair and Company, Inc. Under date of July 30, 1946, a letter was sent to Mr. Morrill by Mr. Rouse stating that the application and a signed copy of the terms of agreement had been received from this firm. A report on the firm was enclosed with the letter, and it was recommended that reinstatement be approved by the executive committee.

At this meeting, members of the committee reviewed the information contained in Mr. Rouse's report, and, after further discussion, the committee unanimously voted to reinstate Blair and Company as a qualified dealer, with the understanding that the New York Bank would follow the firm's operations closely and report to the committee any instance of violation of the terms of agreement.

Mr. Rouse further reported that D. W. Rich & Co., Inc., a qualified dealer, and Chas. E. Quincey Co., a qualified broker, had continued to carry what in the opinion of the New York Bank were unduly large positions in Government securities despite frequent suggestions by the Bank that these positions be reduced. Consideration of further action

to be taken led to the suggestion by the committee that the firms should be advised that they would be disqualified for further transactions with the System account. Mr. Rouse suggested that both firms first be put on notice that unless corrective action were taken they would be disqualified, and Mr. Vest stated that under the terms of the Administrative Procedure Act such notice should be given in writing and an opportunity afforded the offenders to make necessary corrections before committee action was taken. It was understood that this procedure would be followed.

Following this discussion, the committee unanimously voted that in future situations of this kind, where it appeared that a broker or dealer was acting in violation of the terms of agreement, the manager of the System account would forward a statement of facts in the case to the Secretary of the Federal Open Market Committee and, in the absence of advice to the contrary from the executive committee within a reasonable time, the manager would notify the broker or dealer in writing that unless the necessary corrections were made within a stated time he would be dropped from the list of qualified dealers.

Mr. Rouse then reviewed conversations with representatives of Harriman, Ripley & Co., a qualified dealer, in August and September 1946, during which the question was discussed whether the firm should continue as a recognized dealer. Mr. Rouse reported the firm's representatives felt that they should not develop the Government securities end of their business beyond its present level due to their preoccupation with corporate financing, the difficulty of obtaining necessary personnel, and the absence of a senior partner who thoroughly understood the business. In view of these circumstances, the representatives had informed Mr. Rouse

that the company felt it should withdraw from its position as a qualified dealer. The committee unanimously agreed that it was desirable for this firm to withdraw and that upon receipt of a written request from the company the New York Bank should advise the firm that its position as a qualified dealer had been discontinued.

Executive Committee Meeting, December 11, 1946

Mr. Rouse referred to the understanding reached at the last meeting of the executive committee that he would give notice in writing to D. W. Rich & Co. and Chas. E. Quincey Co. that unless the extended positions which they were carrying were reduced they would be discontinued as qualified concerns for doing business with the open market account. He reported that the letters had been sent, that the final response from D. W. Rich & Co. had not been received, but that a representative of Chas. E. Quincey Co. had stated that his firm would be glad to cooperate and that the necessary correction would be made within 30 days.

Mr. Rouse also stated that, in accordance with the executive committee's instructions of June 10, 1946, he had been including in the weekly report statements with respect to the large positions of the two concerns referred to above. He noted that a report had been circulating in the market that the Federal Reserve Bank of New York was "after" two of the qualified dealers. It was his suggestion that the committee's instructions in this connection be changed to require that information with respect to the position and borrowings of individual dealers be not included in the weekly report but that such information be reported to the members and secretary of the executive committee in a separate weekly report. The committee unanimously approved this suggestion and amended

its instructions of June 10.

Mr. Rouse then reported that an application for qualification had been received from the Manufacturers Trust Company of New York, but that, after having reviewed the statement of terms and conditions, the Trust Company had concluded that it did not wish to become a qualified dealer at this time.

Executive Committee Meeting, February 27, 1947

Mr. Rouse reported that, in the past, weekly meetings with a committee representing the Government securities dealer group had been scheduled but that regular meetings were no longer being held. An informal meeting had been held on February 21, 1947, he said, at which he had told the members of the committee that he did not see any further need of frequent regular meetings, but that the Federal Open Market Committee would continue to have, with the dealers, a common interest in the market and in the effort to improve trading practices. He reported that it was then decided that meetings of the dealer group committee would be held at least quarterly.

Interim Developments

In a letter to Chairman Eccles, dated April 21, 1947, Mr. Rouse reported on developments in the case of D. W. Rich & Company, Inc., as follows:

"As we have indicated from time to time in the supplements to the weekly reports of open market operations and money market conditions, the positions and borrowings of the individual dealers have been within reasonable limits except in the case of D. W. Rich & Company, Inc., which discloses that condition in its balance sheet of October 31, 1946. We, of course, were cognizant of the situation prior to the receipt of the balance sheet and the matter was reported to and acted upon by the Federal Open Market Committee at its meeting on October 3, 1946. Subsequently, the Company was informed of the action of the Federal Open Market Committee in

a letter dated November 29, 1946, which letter stated, in effect, that 30 days after the date thereof unless the Company's position in United States Government securities was reduced to an amount which, in the opinion of the Federal Reserve Bank of New York, was not unduly large in relation to capital at the risk of the business, the Company would no longer be included among the qualified dealers with which the Reserve Bank is authorized to transact business for the System open market account. The net positions and borrowings of the Company as of the date of our notice to it (November 29, 1946), 30 days from the date of such notice (December 28, 1946), and as of January 3, 1947, were as follows:

	(000 omitted)		
	<u>11/29/46</u>	<u>12/28/46</u>	<u>1/3/47</u>
Certificates of Indebtedness	\$44.5	\$41.5	\$42.9
Restricted Bonds	16.1	7.9	.8*
Other Bonds 5 Years and over	12.6	8.7	15.3*
All Other Notes and Bonds	8.2	4.8	2.3
Total	\$81.4	\$63.0	\$59.7
Borrowings	85.0	66.6	60.4

*(Evidencing correction on January 3, 1947 of error in former reports of \$7,100,000, 2 1/4s of 1956-59 as "restricted bonds").

In view of the action of the Company in reducing to reasonable amounts its net position of bonds over five years in compliance with our notice, the Company's classification as a qualified dealer has been continued without interruption."

A memorandum, dated November 6, 1947, from Mr. Rouse for the Federal Open Market Committee files and sent to members of the executive committee, reported the final disposition of the D. W. Rich & Company case:

"I advised the Securities Department on Monday that I would speak to Mr. Rich and in the interim that we should do no further business with him. After seeing his figures today, as of Monday night, I telephoned Mr. Rich, referring to our conversation and my letter of about a year ago and our conversation of last spring, and said that I had concluded that he had decided that our way was not his way, and that, under these circumstances, I had instructed the Securities Department not to do business with him. Mr. Rich said in connection with the reduction of his holdings over his statement date that he had taken a loss and then repurchased his securities. He indicated no intention of reducing this holding in the near future.

"Mr. Rich asked if despite this situation we would like to see him occasionally and see his figures and I told him that if he cared to do so we would be glad to have them and any information with respect to the market that he thought would add to our knowledge of the condition of the Government securities market.

"I discussed this matter this morning with Mr. George Vest, General Counsel of the Federal Open Market Committee, and we felt that this should be treated as a continuation of the situation as it developed on November 29, 1946, and that no formal communication to D. W. Rich & Company, Inc. was necessary at this time."

Executive Committee Meeting, February 26, 1948

Mr. Rouse notified the committee that, because the System had been the principal market for Government securities in the recent past, due to its support policy, some dealers not qualified to do business with the System had complained that they were being forced out of business. He stated that these dealers were not a national factor in the market and therefore could not be qualified to do business with the System account. He reported that some of the dealers had suggested that they be allowed to split commissions with recognized dealers as a partial offset to the discrimination being exercised against them and that this question had been given careful consideration by legal representatives of the New York Bank and the Board. The counsel had come up with no solution to the problem and had raised the question of possible problems which might arise under the Clayton Antitrust Act.

Mr. Rouse felt that the situation in his opinion was not serious, that he was much less concerned about the problem than he had been because many issues of Government securities were moving above support levels and therefore the nonrecognized dealers were again able to do business competitively. He felt that the situation had already righted itself and that dealers not able to do business with the System were not

suffering serious loss of earnings.

Mr. Rouse further reported that an application had been received from the Northern Trust Company of Chicago to qualify as a dealer but their business was not national in scope and therefore recognition was denied. A similar application had been received from the Chemical Bank and Trust Company of New York, and this application was being studied and would probably be acted upon favorably.*

Chairman Eccles suggested that the New York Bank submit a memorandum of the consideration which it had given to the nonrecognized dealer problem, with a recommendation as to any action which might be taken. It was his thought that, in the event of further complaint by any dealers, it could be shown that the position of the committee had been taken only after complete consideration of all the questions involved.

Mr. Rouse reported that sometime ago it had been ascertained that there had been periods when the reserve position of dealer banks in New York was affecting their ability to act as Government security dealers, but that in all other respects they had been discharging their dealer functions as effectively and in some respects more effectively than the nonbank dealers. To meet that situation, he had asked for written assurance from each of the New York dealer banks that a stated amount of funds would be available at all times for use in the bank's business as a dealer. He added that such assurances had been given and that it was proposed to get the same assurances from dealer banks in Chicago as soon as convenient.

*On March 5, 1948, this application was approved by the officers of the Federal Reserve Bank of New York.

Meeting of the Federal Open Market Committee, March 1, 1948

At Chairman Eccles' request, Mr. Rouse reviewed the discussion in the executive committee concerning complaints of small dealers. Views were expressed to the effect that a careful study of the situation should be made, particularly with respect to the position of the smaller dealers, to determine whether the present rules should be modified to enable additional dealers to qualify to transact business directly with the System account.

Mr. Sproul stated that the New York Federal Reserve Bank had been asked to make a comprehensive report to the executive committee, which would re-examine the matter and report to the full Committee.

Executive Committee Meeting, April 21, 1948

Prior to this meeting a memorandum prepared at the Federal Reserve Bank of New York under date of April 15, 1948, on the subject of dealer relationships, had been sent to members of the executive committee. A copy of this memorandum, together with correspondence related to it, is attached to this report as Appendix C.

In response to a question from Chairman McCabe, Mr. Rouse stated that three or four nonqualified dealers continued to request recognition but they did not do a national business and, in some cases, did not have the required capital to qualify as dealers for the System account.

Mr. Rouse further reported that none of the nonrecognized dealers had followed up a suggestion previously made in regard to splitting commissions and that apparently that idea had been forgotten when the market moved above support levels.

By unanimous vote the executive committee concurred in the conclusion reached in the memorandum submitted by the New York Bank and

agreed to recommend to the full Committee that no change be made at that time in the terms of agreement with dealers or in the interpretation of those terms.*

Executive Committee Meeting, May 20, 1948

Mr. Rouse submitted a memorandum concerning the executive committee's instructions to the manager of the open market account regarding transactions with dealers on an agency vs. a principal basis. The burden of the memorandum and ensuing discussion concerned the desire of the open market account manager to limit dealers' profits on transactions with the System account to a maximum of $1/64$ of a point on notes and bonds and 0.01 per cent on long certificates and the dollar equivalent on shorter certificates. While this was easy enough when dealing on an agency basis, it was somewhat more difficult on occasions when the System desired to have the dealers act as principal. Transacting business with dealers as principals was felt to be desirable in order to conceal the fact that securities were being offered from the System account.

As a result, a motion amending the instructions to the New York Bank was unanimously passed, as follows:

"Transactions in notes and bonds on an agency basis for the System account with qualified dealers should be handled in such a manner as to permit the dealers a spread of not more than $1/64$ of a point, and such transactions where the dealers act as principal should be limited to exceptional cases and the transactions together with the reasons therefor should be reported separately by the New York Bank in the weekly report. If, however, it appears desirable in the interest of maintaining an orderly market to avoid the identification by the market of System operations, transactions in Treasury bonds may be confirmed to the Federal

*On May 20, 1948, the Federal Open Market Committee approved this recommendation.

Reserve Bank of New York by dealers as principals rather than as agents, provided the dealers' confirmations to the Bank state that the bonds were bought from or sold to another at a price spread of not more than 1/64 of a point. Transactions in certificates should be handled in such a manner as to permit the dealers a spread of not more than 0.01 per cent (in relation to the price to the customer when on an agency basis and in relation to the current market price when the dealers act as principal) on the longest maturity of certificates and the equivalent in dollars on shorter maturities."

Executive Committee Meeting, November 30, 1948

Mr. Rouse reviewed in detail some information which had come to him regarding a proposed reorganization of Blair & Co., Inc., one of the dealers recognized to do business with the System account. Because developments in this reorganization raised questions as to the future management of the Company and the capital that would be available for its Government security business, he had informed the management of the Company that until these and other questions were cleared up the System would transact no further business with the Company. The executive committee expressed concurrence in the action that Mr. Rouse had taken.

Meeting of the Federal Open Market Committee, February 28, 1949

Mr. Rouse referred to the terms upon which the System account would transact business with brokers and dealers in Government securities and reviewed briefly the complaints made by certain nonrecognized dealers during the previous year. He also reviewed the consideration given to these complaints by the Federal Open Market Committee and the reasons for the conclusion reached the previous year that no change should be made in the statement of terms. He added that there was nothing in the present situation that would warrant a change in the terms.

Executive Committee Meeting, November 18, 1949

Mr. Rouse reported that, with two or three exceptions, all of the recognized dealers were living up to the terms of the agreements under which

they were qualified. These exceptions involved the fact that these dealers were not doing a sufficient volume of their business in Treasury bonds and, as a result, their business was not sufficiently wide in scope to discharge their responsibility for making a national market in these securities under all conditions. He reported that he had urged them to broaden their activities and if there was no objection from the committee he would require that this be done. He further suggested that if satisfactory results were not obtained promptly he would bring the matter to the attention of the executive committee again. No disagreement was expressed by the committee members to this procedure.

Meeting of the Federal Open Market Committee, March 1, 1950

Mr. Rouse reviewed the terms of agreement under which dealers were qualified to do business with the System account, reported that there had been no complaints from nonrecognized dealers, and suggested that no changes be made in the terms of agreement or in the interpretation thereof.

Meeting of the Federal Open Market Committee, March 8, 1951

With respect to the published terms on which the Federal Reserve Bank of New York transacts business with qualified dealers in United States Government securities for the System open market account, Mr. Sproul stated that from time to time nonqualified dealers had questioned the arrangement; that these questions arose only during periods when the System was actively supporting the market and was the principal purchaser of a particular issue or issues of securities; that this problem should tend to disappear with the freer market now anticipated; and that since the existing terms had worked well in the past he felt it would be desirable to continue them.

Chairman McCabe suggested the desirability of having a formal report submitted to the Federal Open Market Committee on this matter

inasmuch as the most recent study submitted had been made in 1948, and Mr. Sproul responded that he felt it would be appropriate to ask the Federal Reserve Bank of New York to make such a report to the executive committee at an early meeting of that committee.

Upon motion duly made and seconded, and by unanimous vote, it was agreed that no change in the statement of terms would be made at this time, with the understanding that the Federal Reserve Bank of New York would submit a report with respect to the arrangement for consideration at an early meeting of the executive committee.

Executive Committee Meeting, April 5, 1951

Mr. Szymczak referred to an amended motion which he prepared for consideration by the executive committee, copies of which had been sent to each member of the committee on April 2, 1951, in which he recommended that the whole subject of qualified and unqualified dealers in Government securities be studied by a committee of three members of the executive committee. He stated that he contemplated that such a study would differ from the report which the full Committee, at its meeting on March 8, requested that the executive committee arrange for, and that perhaps the study he suggested should come as a result of a request by the full Committee. He went on to suggest that, since the matter was not urgent, it be referred to Mr. Martin with the understanding that he would look into it and, if he felt it desirable to do so, he might ask some of the members of the executive committee to make an informal study with a view to determining what if any recommendation should be made to the full Committee. No objection to this procedure was indicated.

Meeting of the Federal Open Market Committee, May 17, 1951

Chairman Martin suggested that the Committee authorize him to appoint a committee to consist of himself as chairman and not less than two or more than four other members of the Federal Open Market Committee to make a study of the scope and adequacy of the Government securities market during the coming months with the understanding that the committee would be authorized to call on outside assistance if that should be considered to be necessary and that it would report to the executive committee and to the full Committee. Chairman Martin emphasized that his suggestion for a study of this type was in no sense a criticism of the operations of the System account. In response to questions, he indicated that there was a need for a broader market for Government securities, that perhaps there would be value in studying the British Government securities market, that the time may come when the Federal Open Market Committee might find it necessary to change the procedure whereby it did business with only a small number of qualified dealers, and that he hoped the study proposed would make some worth-while suggestions along these and other lines.

Several other members of the Committee expressed the view that it would be desirable to have a study such as that proposed by Chairman Martin.

Chairman Martin was then authorized by unanimous vote to appoint a committee to make a study of the Government securities market along the lines he suggested.

Meeting of the Federal Open Market Committee, March 1, 1952

Chairman Martin referred to the published terms on which the Federal Reserve Bank of New York transacts business with qualified dealers

in United States Government securities for the System open market account, stating that he had no suggestions for a change in the terms at this time.

Upon motion, it was unanimously agreed that no change in the statement of terms should be made at this time.

STRICTLY CONFIDENTIAL

(For use of the ad hoc Subcommittee on
Study of the Government Securities
Market, Federal Open Market Committee)

Copy 27

FEDERAL OPEN MARKET COMMITTEE RELATIONSHIP WITH
BROKERS AND DEALERS IN GOVERNMENT SECURITIES

Appendix A

Correspondence making effective the formalization of terms under which the Federal Reserve Bank of New York would transact business for the open market account with brokers and dealers in Government securities:

- (1) Letter, May 6, 1944, from Secretary Morrill to all Federal Reserve Bank Presidents enclosing a copy of the statement of terms.
- (2) Letter, May 6, 1944, from Secretary Morrill to Mr. Sproul containing instructions from the executive committee of the Federal Open Market Committee relative to putting the adopted procedure in effect.
- (3) Letter, May 31, 1944, from Mr. Sproul to Mr. Eccles concerning action taken by the New York Federal Reserve Bank in compliance with the executive committee's directive.
Attached is a list of comments on each broker and dealer qualified.

Appendix A

C O P Y

May 6, 1944

Dear Sir:

You will recall that at the meeting of the Federal Open Market Committee on February 29, 1944, the Committee approved in substance a statement of proposed terms upon which the Federal Reserve Bank of New York would transact business with brokers and dealers in United States Government securities for the System open market account. This action was taken with the understanding (1) that the executive committee was authorized to make such changes in the form of the statement of terms as appeared to be desirable, (2) that the procedure would be put into effect at such time as in the judgment of the executive committee such action appeared to be desirable after having informed the Treasury of the proposed arrangement, and (3) that the executive committee was authorized to issue such instructions to the Federal Reserve Bank of New York as agent for the System account in connection with the proposed procedure as appeared to the executive committee to be desirable, including the manner in which advice of the arrangement was to be sent to dealers who might qualify thereunder.

A copy of the statement of terms is enclosed in the form approved by the executive committee. A copy of the letter containing the instructions of the executive committee to the Federal Reserve Bank of New York in connection with the statement is also attached.

When the statement has been presented to the brokers and dealers with whom the Federal Reserve Bank of New York now does business for the System account, it will be handed by the Bank informally to representatives of the press as a formalization of existing procedure.

If any broker or dealer in your district evidences an interest in qualifying under the terms of the statement as a broker or dealer with whom the Federal Reserve Bank of New York would do business for the System account, and in your opinion such broker or dealer would have a reasonable chance of qualifying, it is requested that you furnish him a copy of the statement, and, in the event he desires to pursue the matter further, that you so inform the manager

C O P Y

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of the System account, giving him such information with respect to the broker or dealer as you think would be of value in determining whether he should be qualified. It is assumed that if a broker or dealer in your district should take up the matter of qualifying directly with the New York Bank, the Bank would request your views before reaching a decision.

Very truly yours,

Chester Morrill,
Secretary.

Enclosures 2.

TO THE PRESIDENTS OF ALL THE FEDERAL RESERVE BANKS EXCEPT NEW YORK.

C O P YTERMS ON WHICH FEDERAL RESERVE BANK OF NEW YORK WILL
TRANSACT BUSINESS WITH BROKERS AND DEALERS IN UNITED STATES
GOVERNMENT SECURITIES FOR THE SYSTEM OPEN MARKET ACCOUNT

The Federal Open Market Committee has directed the Federal Reserve Bank of New York (hereinafter referred to as the Bank) to transact business in United States Government securities for the System open market account with reputable brokers and dealers in such securities who meet the qualifications and agree in writing to comply with the terms and conditions set forth below.

1. In determining whether a person (individual, partnership or corporation, including a bank) is a qualified broker or dealer with whom the Bank will transact business, and the extent to which business will be transacted with such person, the following factors will be taken into consideration:

- (a) Integrity, knowledge, and capacity and experience of management;
- (b) Observance of high standards of commercial honor and just and equitable principles of trade;
- (c) Willingness (in the case of a dealer) to make markets under all ordinary conditions;
- (d) The volume and scope of business and the contacts such business provides;
- (e) Financial condition and capital at risk of business; and
- (f) The reliance that can be placed on such person to cooperate with the Bank and the Federal Open Market Committee in maintaining an orderly market for Government securities; to refrain from making any recommendations or statements or engaging in any activity which would encourage or stimulate undue activity in the market for Government securities; and to refrain from disclosing any confidential information which he obtains from the Bank or through his transactions with the Bank.

2. The Bank will obtain from such person an agreement in writing to comply with the following terms and conditions:

C O P Y

-2-

- (a) He will furnish the Bank with a statement for the confidential information of the Bank and the Open Market Committee showing as of the close of business each business day:
 - (1) The total amount of money borrowed (directly and indirectly);
 - (2) The par value of all Government securities borrowed;
 - (3) His position, both long and short, in Government securities, classified by classes of securities and maturity groups (or by issues, if so requested by the Bank);
 - (4) The volume of transactions during the day in Government securities, classified by classes of securities and maturity groups (or by issues, if so requested by the Bank); and
 - (5) Such other statistical data as in the opinion of the Bank will aid in the execution of transactions for the System open market account.
- (b) At or before the completion of each transaction with the Bank, he will furnish the Bank with a written notification disclosing whether he is acting as a broker for the Bank, as a dealer for his own account, as a broker for some other person, or as a broker for both the Bank and some other person. In the absence of a special agreement to the contrary with the Bank with respect to a particular transaction, he will not act as broker for any other person in connection with any transaction with the Bank, and he will receive no compensation or profit of any kind in connection with the transaction other than the specified commission paid him by the Bank.
- (c) In the absence of special arrangements with the Bank, delivery of securities will be made at the office of the Bank before 2:15 p.m. on the next full business day following the day of the contract and all payments by the broker or dealer will be in immediately available funds.
- (d) He will furnish the Bank not less frequently than once during each calendar year with a report of his financial condition as of a date not more than 45 days prior to

C O P Y

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the delivery of the report to the Bank in form acceptable to the Bank and prepared or certified by a public accountant acceptable to the Bank; and, upon the request of the Bank, he will furnish it with a statement of condition as shown by his books as of a date specified by the Bank.

- (e) Unless the Bank shall have informed him of its desire to purchase or sell a particular issue of Government securities, he will not solicit from any other person offerings of or bids for any issue of Government securities for the purpose of placing himself in a position to offer to sell to or buy from the Bank securities of such issue.

The Federal Open Market Committee has further directed that the Bank decline to transact any further business with a broker or dealer in any case in which the Bank has concluded that the broker or dealer no longer meets the qualifications set forth above or has willfully violated or failed to perform any of the terms and conditions set forth in the agreement.

To the Federal Reserve Bank of New York:

The undersigned hereby agrees to meet the qualifications and to comply with the terms and conditions set forth above.

Dated: _____

(Signature)

Appendix A

C O P Y

May 6, 1944

Mr. Allan Sproul, President,
Federal Reserve Bank of New York,
New York 7, New York.

Dear Mr. Sproul:

At its meeting on February 29, 1944, the Federal Open Market Committee approved in substance a statement of proposed terms upon which the Federal Reserve Bank of New York would transact business with brokers and dealers in United States Government securities for the System open market account. This action was taken with the understanding (1) that the executive committee was authorized to make such changes in the form of the statement of terms as appeared to be desirable, (2) that the procedure would be put into effect at such time as in the judgment of the executive committee such action appeared to be desirable after having informed the Treasury of the proposed arrangement, and (3) that the executive committee was authorized to issue such instructions to the Federal Reserve Bank of New York as agent for the System account in connection with the proposed procedure as appeared to the executive committee to be desirable, including the manner in which advice of the arrangement was to be sent to dealers who might qualify thereunder.

A copy of the statement of terms as prepared in consultation with you and Mr. Rouse and as approved by the members of the executive committee is enclosed, and there are set forth below the instructions issued to the New York Bank in connection with the statement pursuant to the authority granted by the full Committee on February 29, 1944:

1. The Federal Reserve Bank of New York shall furnish copies of the statement of terms to each broker or dealer in Government securities with whom the Bank has been transacting business on behalf of the System open market account, and to such other brokers and dealers as evidence to the Bank an interest in qualifying and in the opinion of the Bank would have a reasonable chance of qualifying. On and after May 15, 1944, the New York Bank will transact business on behalf of the System open market account only with the brokers and dealers who meet the qualifications, have executed the agreement, and comply with the terms set forth in the statement.

2. When the statement has been presented to the brokers and dealers with whom transactions are now conducted for the System open market account, the Bank shall give copies to representatives of the press informally as a formalization of existing procedure.

C O P Y

Mr. Allan Sproul

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3. The Bank shall keep the executive committee of the Federal Open Market Committee informed of each broker and dealer with whom it ordinarily transacts business and of each addition to, or removal from, the list of qualified brokers and dealers.

4. The Bank shall encourage the observance of high standards of commercial honor and just and equitable principles of trade by the brokers and dealers in Government securities, through the medium of the Bank's contacts with the brokers and dealers and the Government Security Dealer Group or any other similar organization that may exist or develop.

5. When any broker or dealer has been removed from the list of qualified brokers and dealers for failure to meet the qualifications set forth in the statement of terms or for willful violation of or failure to perform any of the terms and conditions set forth in the agreement, and the Bank is satisfied that he has taken appropriate steps to correct any default and to prevent the occurrence of similar defaults in the future, the Bank may restore him to the list of qualified brokers and dealers and resume the transaction of business with him, after obtaining the consent of the executive committee of the Federal Open Market Committee.

A copy of the letter being sent today to the Presidents of the other Federal Reserve Banks in connection with this matter is also enclosed.

Very truly yours,

Chester Morrill,
Secretary.

Enclosures 2

Appendix A

C O P Y

FEDERAL RESERVE BANK
OF NEW YORK

May 31, 1944.

Dear Mr. Eccles:

Referring to Secretary Morrill's letter of May 6, transmitting to this bank the instructions of the executive committee of the Federal Open Market Committee concerning the formalization of the terms on which this bank transacts business with brokers and dealers for System Open Market Account, I wish to advise you that:

(1) This bank has furnished each broker and dealer in United States Government securities, with whom this bank has been transacting business, a copy of the statement of terms on which this bank will transact business with brokers and dealers in United States Government securities for the System Open Market Account. At the opening of business on May 15, 1944, executed agreements and oral acceptances of the statement of terms had been received from the principal dealers so that beginning on that day there was no question of this bank's ability to function under the instructions issued to it by the executive committee of the Federal Open Market Committee. Since that time executed agreements have been received from all of the dealers and brokers who in our opinion meet the qualifications set forth. The bank-dealers generally signed the statement on the understanding that requirement 2(d) was not applicable to member banks, and two of the brokers whose business in United States Government securities is primarily as brokers on the New York Stock Exchange signed on the understanding that the requirements listed in 2(a) 1 to 4 were not applicable in their case. In addition, one of the dealer-banks, acting under advice of its counsel, substituted the words "buy and sell" for "make markets" in paragraph 1(c) owing to a feeling that the term "make markets" has the connotation of pegging the market, and deleted the words "both long and short" in paragraph 2(a) (3) inasmuch as a bank legally could not go short. All these exceptions appear reasonable to us. The dealers, without exception, accepted the terms as being a fair presentation of their oral understanding with this bank, although a number expressed the view that the formalization of this understanding was unnecessary.

C O P Y

Federal Reserve Bank of New York

-2- Honorable Marriner S. Eccles 5/31/44

(2) On May 16, I met with representatives of the press and made the statement of terms available for their reading and inspection, and discussed with them the reasons for their formalization. So far the press has handled the matter well.

(3) There is enclosed data descriptive of each qualified broker and dealer with whom this bank is prepared to transact business on behalf of the System Open Market Account. These contain a summarization of the information on which this bank based its qualification of such dealers and brokers. The list of dealers and brokers covered is as follows:

(a) For over-the-counter business

Govt. Bond Dept. - Bankers Trust Company - New York City
C. F. Childs and Company - Chicago, Ill.
Govt. Bond Dept. - Continental Illinois National Bank and
Trust Company of Chicago - Chicago, Ill.
C. J. Devine and Company - New York City
Discount Corporation of New York -
New York City
The First Boston Corporation -
New York City
Govt. Bond Dept. - The First National Bank of Chicago -
Chicago, Ill.
Govt. Bond Dept. - Guaranty Trust Company of New York -
New York City
Harriman Ripley & Co., Incorporated -
New York City
D. W. Rich & Company, Incorporated -
New York City
Salomon Brothers & Hutzler -
New York City

(b) Brokers on New York Stock Exchange

Asiel & Co. - New York City
Mabon & Co. - New York City
Chas. E. Quincey & Co. - New York City
Salomon Brothers and Hutzler - New York City

There are five other dealers with whom this bank has done business, occasionally and in limited volume, who do not clearly qualify because of the relatively small volume and restricted scope of their business and the limited amount of capital at the risk of their business. They have been advised that they do not qualify, although there may be situations in the future when, with the knowledge

C O P Y

Federal Reserve Bank of New York -3- Honorable Marriner S. Eccles 5/31/44

of the executive committee, we shall find it to the advantage of the System Open Market Account to deal with them. These dealers are:

Briggs, Schaedle and Company, Inc.
Harvey Fisk and Sons, Inc.
R. W. Pressprich and Company
Chas. E. Quincey and Company
J. B. Roll and Company, Inc.

The firm of Charles E. Quincey and Company, however, does qualify for the transaction of business as a broker on the New York Stock Exchange and has executed the required agreement as indicated above. The only other dealer in United States Government securities with whom this bank had occasionally done business is Blair and Company, Inc. (Blair Securities Corporation). However, there have been no transactions since December 1943 with this concern, other than the purchase of Treasury bills at the 3/8 per cent rate, as in the opinion of the officers of this bank, its portfolio consistently has been too large in relation to its capital, and it failed to report promptly a large contingent liability that appeared in its annual statement.

It was considered undesirable to include even dealers with whom some business has been transacted at times in the past, if they do not clearly qualify under the written terms and conditions now effective. The line of demarcation must be as clearly defined as possible, if our practice is to be understood and defensible, and if future requests for qualification are to be capable of determination.

We believe it is important that the names of the qualified dealers and brokers be held in strict confidence, in order that our action may not adversely affect the business or reflect in any way upon the integrity, knowledge, and capacity and experience of management of the firms that do not qualify.

Yours sincerely,

Allan Sproul,
President.

Honorable Marriner S. Eccles,
Chairman, Executive Committee,
Federal Open Market Committee,
Washington 25, D. C.

CONFIDENTIAL

C O P Y

DISCOUNT CORPORATION OF NEW YORK

Incorporated under New York laws in 1918. An investment company operating under Article XII of the New York Banking Law.

NATURE OF BUSINESS

Dealers in Bankers' acceptances and U. S. Government securities.

OFFICERS

Dudley H. Mills, Chairman of the Board - Herbert N. Repp, President - Edward E. Anderson, Vice President - Charles W. Belmer, Vice President - Robert M. Coon, Vice President and Treasurer - Francis D. Bartow, Jr., Secretary - Walden H. Leverich, Donald D. Leeds and Wingate Bixby, Assistant Vice Presidents - Charles E. Dunbar, Charles F. Lang, Albert R. Fegan and William Ewing, Assistant Treasurers.

MAIN OFFICE

58 Pine Street, New York, N. Y.

BRANCHES

None

NET WORTH

\$5,722,000 - (12/31/43), not including \$1,263,000 reserve for premiums, discount, taxes and contingencies.

CREDIT REPORT

Because its interests are identified with the leading New York City banks, no investigation with its banks of account has been made.

SCOPE OF BUSINESS AND CONTACTS

Does business on both a dealer and order basis and the greater part of it comes from large corporations, from commercial banks in the larger cities, and from savings banks in the New York area. Due to its close contact with most of the large commercial banks and corporations, the firm is especially active in short term securities. It also has a large volume of business with security houses, particularly those located in New York City.

THE FIRST BOSTON CORPORATION

Chartered under Massachusetts laws in 1932. The Company's name was originally First of Boston Corporation and the stock was controlled by the First National Bank of Boston under a beneficiary trust agreement. Under the Federal Banking Act of 1933 it became necessary to separate the business entirely from that of the bank. Since 1934 the capital stock has been privately owned, although many of the stockholders and depositors of the First National Bank of Boston are shareholders in this corporation.

NATURE OF BUSINESS

Underwriters and distributors, dealers in U. S. Government securities, bankers' acceptances, State, Municipal, Canadian, public utility, industrial and railroad issues and bank, insurance and other investment stocks.

O F F I C E R S

John R. Macomber, Chairman of Board - Allan M. Pope, President - H. M. Addinsell, Chairman of Executive Committee - J. C. Montgomery, Vice-President and Treasurer - Francis A. Cannon, James Coggeshall, Jr., Eugene I. Cowell, Nevil Ford, Col. R. Parket Kuhn, Edward H. Ladd, 3rd, Aubrey G. Lanston*, Duncan R. Linsley, Philip Lockwood, James A. Lyles, L. Meredith Maxson, Louis G. Mudge, Theodore S. Mead, William H. Potter, Jr., Frank M. Stanton, Winthrop E. Sullivan, Adolphe H. Wenzell, Herbert T. C. Wilson, George D. Woods, Vice Presidents - Alfred A. Gerade, Vice President and Comptroller - Arthur B. Kenney, Honorary Secretary - Allen E. Burns, Secretary and Assistant Treasurer.

*Trading Department - Government Securities.

E X E C U T I V E O F F I C E S

100 Broadway, New York, N. Y. and One Federal Street, Boston, Mass.

B R A N C H E S

Buffalo; Chicago; Cleveland; Hartford; Philadelphia, Providence; Rutland, Vt.; San Francisco; Springfield, Mass.

R E P R E S E N T A T I V E S

Albany, New York.

N E T W O R T H

\$11,945,000 - (12/31/43)

C R E D I T R E P O R T

The last investigation with the banks of account was made in May 1943, at which time it was learned that ample facilities were available

CONFIDENTIAL

-2-

C O P Y

THE FIRST BOSTON CORPORATION

to the corporation on both a secured and unsecured basis. The usual expressions of high regard for the management were received.

SCOPE OF BUSINESS AND CONTACTS

Transacts business on both a dealer and order basis and its numerous branches and representatives provide the firm with an active contact with investors in all sections of the country, although its business in the South Atlantic, East South Central and West South Central states is not believed to be large. All types of investors, both small and large, are included among its customers. It also does a substantial business with other security houses.

CONFIDENTIAL

C O P Y

D. W. RICH & COMPANY, INCORPORATED

Incorporated under New York laws in October 1940. It was formed for the purpose of acquiring the domestic government securities and bankers acceptance departments of the New York Hanseatic Corporation.

NATURE OF BUSINESS

Dealers in U. S. Government Obligations and Bankers Acceptances.

OFFICERS

Dominic W. Rich, President - D. William O'Kolski, Vice President and Secretary - Edward J. O'Connell and Harold M. Leinbach, Vice Presidents - Henry Scherpding, Treasurer - Marshall H. Montgomery, Director - Reginald Luhr, Assistant Vice President.

MAIN OFFICE

31 Nassau Street, New York, N. Y.

BRANCHES

None

NET WORTH

\$636,000 - (4/30/44)

CREDIT REPORT

A completed investigation in May 1944, with the banks of account, indicates that the company enjoys a good reputation. Ample credit is available to it and in the bankers' opinion the management is capable and deserving of confidence.

SCOPE OF BUSINESS AND CONTACTS

Its business is principally with commercial banks in the larger cities of the United States, particularly those in the Mid-Atlantic and East North Central states. It also does a moderate volume of business in short-term securities with a few large corporations. Its business, except in short-term securities, is largely on an order basis.

CONFIDENTIAL

C O P Y

BANKERS TRUST COMPANY - NEW YORK CITY

Dealers in U. S. Government, State and Municipal Securities.

BOND DEPARTMENT

B. A. Tompkins, E. F. Dunstan and Robert C. Morris*, Vice Presidents - W. Laud-Brown, Arthur S. Schlichting*, and George F. Trefcar, Assistant Vice Presidents - H. F. Dobbins and F. R. Began*, Assistant Treasurers.

*U. S. Government Trading Division

SCOPE OF BUSINESS AND CONTACTS

A large part of its business is with commercial banks, many of which use the Bankers Trust Company as their New York correspondent. It appears to be particularly active with banks in the Mid-Atlantic and South Atlantic states. It also has a moderate amount of business with other types of investors, but many of these may be depositors of the Bankers Trust Company. It transacts business on both an order and dealer basis.

CONFIDENTIAL

C O P Y

C. F. CHILDS & COMPANY

A Delaware corporation chartered in 1930. A Maine corporation of this name, handling mostly municipal and Government securities, had been chartered by Mr. C. F. Childs in 1911. In 1928, Mr. Childs sold his interests therein to Goldman Sachs interests, but repurchased his name and re-entered this business in 1930.

NATURE OF BUSINESS

Dealers in U. S. Government Securities, Instrumentalities, Territorial and Municipal Obligations.

OFFICERS

C. Frederick Childs, President - E. N. Childs, Vice President - F. N. Childs, Vice President and Assistant Treasurer - A. G. Pickard, Malon S. Andrus and C. C. Scholefield, Vice Presidents - M. A. Partridge, Secretary and Treasurer - Russel T. Williams, William M. Fletcher, Byron R. Mitchell, Davis Kales, William H. Gray and Murray F. Brown, Assistant Vice Presidents - C. R. Ekman, J. D. McNally, Charles Giamondi, Luke Nebhan, J. D. Robinson, C. W. Steinman, Herman Golin & Thomas Keys, Assistant Treasurers - Dorothy McVeigh, Assistant Secretary.

MAIN OFFICE

141 W. Jackson Blvd., Chicago, Ill.

BRANCHES

Boston; Cleveland; New York; Pittsburgh; St. Louis.

NET WORTH

\$4,730,000 - (12/31/43)

CREDIT REPORT

When last investigated in April 1943, ample facilities were available on both day loan and secured basis and we received favorable expressions concerning the responsibility of the house and the ability of the management.

SCOPE OF BUSINESS AND CONTACTS

Carries on an active dealer and order business in all sections of the country with the possible exception of the South Atlantic states. Its branch offices are very active and the percentage of its business coming through its branches is probably the largest for any dealer in U. S. Government securities. On the other hand, its volume of business with investors in the New York area is probably the smallest of any of the large private dealers in U. S. Government securities. Most of its customers may be termed "small to medium" sized investors. A moderate volume of business also flows to the firm from other security houses.

CONFIDENTIAL

C O P Y

CONTINENTAL ILLINOIS NATIONAL BANK AND TRUST COMPANY
OF CHICAGO

Dealers in U. S. Government and Municipal Issues.

U. S. GOVERNMENT SECURITIES DEPARTMENT

F. M. Knight and Robert S. Drew, Vice Presidents -
Merle G. Glanville, Second Vice President - Magnus I. Ronning
and Orion Morris, Assistant Cashiers.

SCOPE OF BUSINESS AND CONTACTS

Its business is largely on an order basis with customers of the bank and with commercial banks in the East North Central and West North Central states with which it maintains an active contact.

CONFIDENTIAL

C O P Y

HARRIMAN RIPLEY & CO., INCORPORATED

Incorporated in 1934 under New York laws as Brown, Harriman and Company. The present corporate name was adopted on January 1, 1939. The company was formed to take over the securities business of Brown Bros. Harriman and Company, which, in order to conform with the requirements of the Banking Act of 1933, was required to separate its investment banking from its deposit banking business. Some of the officers of the subject company were formerly partners of Brown Bros. Harriman and Company or executives of the National City Company of New York, Inc., security affiliate of the National City Bank of New York, which was liquidated in 1934 in order to conform with the requirements of the Banking Act of 1933.

NATURE OF BUSINESS

Underwriters and Distributors, Dealers in U. S. Government, State and Municipal Bonds, in Canadian Government, Provincial and Municipal Bonds, and in Public Utility, Railroad, Industrial and other investment securities.

OFFICERS

Joseph P. Ripley, Chairman - Pierpont V. Davis, President - Harry W. Beebe, Milton C. Cross, R. McLean Steward, Elwood D. Smith, Frederick A. Krayer, George E. Abbot, Nathan D. McClure, Frederick M. Thayer, Harding C. Woodall, Walter V. Millette, David L. Skinner and Franklin T. McClintonck, Vice Presidents - Willet C. Roper, Secretary and Treasurer - Reginald Martine, Comptroller and Assistant Secretary - William R. Eppel, Assistant Secretary and Assistant Treasurer.

U. S. Government Bond Department - James S. Baker, Manager.

MAIN OFFICE

63 Wall Street, New York, N. Y.

PRINCIPAL OFFICES

New York; Boston; Philadelphia; Chicago.

REPRESENTATIVES

Albany; Cleveland; Detroit; Indianapolis; Reading, Pa.

NET WORTH

\$ 7,412,000 - (12/31/43)

CREDIT REPORT

Our last investigation was conducted in April 1943 when the company was readily obtaining its requirements on both day loan and

HARRIMAN RIPLEY & CO., INCORPORATED (Cont'd)

collateral basis. Favorable opinions regarding the standing of the house and the ability and integrity of the management were expressed in all quarters.

SCOPE OF BUSINESS AND CONTACTS

Does a substantial business in corporate and municipal securities, but its Government security business is small and believed to be a "sideline" in order to accommodate its corporate and banking customers. Most of its business is on an order basis and in short term securities. Their capital, contacts, out-of-town offices and representatives provide basis for substantial growth. The manager of the Government Bond Department is the current chairman of the Government Security Dealer Group.

CONFIDENTIAL

C O P Y

THE FIRST NATIONAL BANK OF CHICAGO

Dealers in U. S. Government and Municipal Bonds.

BOND DEPARTMENT

Irvin L. Porter, Austin Jenner, James P. Feeley,
J. H. C. Templeton, and John H. Grier, Vice Presidents* -
Lewis Miller, Assistant Vice President.

*U. S. Government Bond Dept.

SCOPE OF BUSINESS AND CONTACTS

Its business is on both a dealer and an order basis
with customers of the bank and with commercial banks in the
East North Central, West North Central and South Central states
with which it maintains an active contact, although it extends
its business on a less active basis to both coasts.

CONFIDENTIAL

C O P Y

GUARANTY TRUST COMPANY OF NEW YORK

Dealers in U. S. Government and Municipal Bonds and Home Owners Loan, Federal Farm Mortgage, R. F. C., C. C. C., Federal Intermediate Credit, Federal Home Loan and Federal Land Bank Securities and U. S. Housing Authority Notes.

U. S. GOVERNMENT BOND DEPARTMENT

Arthur A. Kiendl, Second Vice President, John D. C. Towne, Jr., William W. Pevear and J. V. Hendricks, Assistant Treasurers.

SCOPE OF BUSINESS AND CONTACTS

Its business appears to be largely with investors who, in one way or another, deal with the Guaranty Trust Company. The greater part of its volume of business arises in transactions in short term securities, reflecting, in part, the activity of the Guaranty Trust Company and many of its corporate accounts. Business is transacted both on a dealer and order basis.

CONFIDENTIAL

C O P Y

C. J. DEVINE & CO. - (PARTNERSHIP)

The trade style "C. J. Devine & Co." was registered December 27, 1940 by the partners. The firm was formed to purchase the assets and assume the liabilities of C. J. Devine and Co., Incorporated, a New York Corporation organized June 1, 1933.

NATURE OF BUSINESS

Dealers in U. S. Government, Territorial, Federal Land Bank and Municipal securities.

PARTNERS

Christopher J. Devine, David J. Garvin, Vincent H. Herrmann, Frank T. Kennedy, Matthew F. Reilly, William J. Stoutenburgh.

MAIN OFFICE

48 Wall Street, New York, N. Y.

BRANCHES

Chicago; Boston; Philadelphia; Pittsburgh; Cleveland; Cincinnati; St. Louis; San Francisco.

NET WORTH

\$5,221,000 - (12/31/43)

CREDIT REPORT

An investigation with its banks of account was completed April 12, 1944 and the information obtained was of a highly complimentary nature.

SCOPE OF BUSINESS AND CONTACTS

Transacts business with investors, both small and large, in all parts of the country, on both an order and dealer basis, and its volume of business has consistently been the largest of any reporting dealer in U. S. Government securities. Its extensive wire service and numerous branches are a means for active contact with investors. The firm also does a substantial business with security houses in all parts of the country.

CONFIDENTIAL

C O P Y

CHAS. E. QUINCEY & CO. - (PARTNERSHIP)

Chas. E. Quincey & Co. is a trade name registered by the partners February 3, 1941.

The firm was formed in January 1887, by the late Charles E. Quincey who died in 1924.

NATURE OF BUSINESS

Dealers in U. S. Government Obligations, Home Owners Loan Corporation, Federal Farm Mortgage, Federal Land Bank, Federal Home Loan Bank, Federal Intermediate Credit Corporation, and U. S. Territorial Issues, Brokers in Railroad, Public Utility, Industrial and Foreign Government issues. Member of the New York Stock Exchange.

PARTNERS

Maurice A. Gilmartin, James Edmund Orr, Maurice A. Gilmartin, Jr., John A. Cashman, Robert A. Love, and Edmund J. Leonard.

MAIN OFFICE

25 Broad Street, New York, N. Y.

BRANCHES

None

NET WORTH

\$437,000 - (6/30/43)

CREDIT REPORT

An investigation with the firm's banks of account was completed in May 1944. The institution at which the principal account is carried reported that they hold a very high regard for the firm and believe that it is entitled to full confidence. In other quarters, we were told that the partners are well regarded, that operations have been fairly conservative and that the house is considered responsible.

SCOPE OF BUSINESS AND CONTACTS

It is felt that the firm's business is largely on an order basis and confined to a few corporate and bank customers in the New York area, some of which have dealt with the firm for many years. In recent years, the business on the Stock Exchange has declined to nominal amounts and this firm has not endeavored to build up an active over-the-counter business.

CONFIDENTIAL

C O P Y

SALOMON BROS. & HUTZLER

A partnership established in 1910 although there have been several changes in the personnel since its inception.

NATURE OF BUSINESS

Dealers and brokers in U. S. Government securities, direct and guaranteed; Federal Land Bank bonds; Municipal, Canadian Dollar, Public Utility, Industrial and Railroad Securities and Railroad Equipment Trust certificates; Industrial and Public Utility Preferred Stocks. Member of the New York Stock Exchange.

PARTNERS

Herbert Salomon, Percy F. Salomon, B. J. Levy, Henry L. Rosenfeld, Jr., Rudolf Smutny, Edward L. Holsten, Herbert I. Losee, Bertram F. Brummer, Jonas H. Ottens, Franklin J. Grieder, James H. Carson, L. Eugene Marx, Miles D. Perrin, Lloyd S. Miller, Theodore A. VonGlahn, Jr., Henry F. Ludeman, Girard L. Spencer, William R. Salomon, Maurice Levy, Morton D. Hutzler (Special) and Louis B. Tim (Special).

MAIN OFFICE

60 Wall Street, New York, N. Y.

BRANCHES

Boston; Chicago; Cleveland.

NET WORTH

\$4,183,000 - (12/31/43)

CREDIT REPORT

At the time of our last investigation in June 1943, full confidence was expressed in the ability and integrity of the management.

SCOPE OF BUSINESS AND CONTACTS

Transacts business on both a dealer and order basis. Most of the firm's business stems from the New England, Mid-Atlantic, East North Central and Far Western states and its customers are, for the most part, of "long standing". It does, however, carry on a fairly active business with investors in most other sections of the country, including security houses.

CONFIDENTIAL

C O P Y

ASIEL & CO. (PARTNERSHIP)

This business was established January 1, 1879, although, since inception, numerous changes have occurred in the personnel.

NATURE OF BUSINESS

Brokers in Railroad, Public Utility, Industrial and Foreign Bonds. Member of the New York Stock Exchange and the New York Curb Exchange.

PARTNERS

Nelson I. Asiel, Robert H. White, Arthur Marx, Jacob C. Stone, Mark C. Meltzer, Jr., Morris Weil, Solomon Litt, Jesse Boehm, David S. Cooper, Gabriel Litt, John Wasserman, Samuel H. Rosenberg, Joseph D. Croll, and Louis J. Werner.

MAIN OFFICE

11 Wall Street, New York, N. Y.

BRANCHES

Jersey City, N. J.

NET WORTH

\$2,731,000 - (10/31/43)

CREDIT REPORT

No investigation with the firm's banks of account has been made since February 1942. At that time we were told that the firm has always had an excellent reputation and is considered one of the outstanding houses in its line.

SCOPE OF BUSINESS AND CONTACTS

Their business in U. S. Government securities is strictly on a brokerage basis.

CONFIDENTIAL

C O P Y

MABON & CO. (PARTNERSHIP)

This partnership was formed July 2, 1906, at which time it succeeded Kingsley, Mabon & Co., in which the late James S. Mabon and S. Clifton Mabon were the partners. Since that time there have been various changes in the partners of this firm.

NATURE OF BUSINESS

Bond brokers, specializing in Railroad, Public Utility, Industrial, Foreign and Government issues. Members of the New York Stock Exchange and the New York Curb Exchange.

PARTNERS

S. Clifton Mabon, Roland L. DeHaan, Charles A. Greenfield, Rudolph Nadel, Mabon Kingsley, John M. Maurer and Joseph C. Nugent, and James B. Mabon, Jr.

MAIN OFFICE

115 Broadway, New York, N. Y.

BRANCHES

None.

NET WORTH

\$788,000 - (5/31/43)

CREDIT REPORT

An investigation with the banks of account in April 1943, elicited uniformly favorable comments. The opinion was expressed that it is a conservative and eminently respectable house.

SCOPE OF BUSINESS AND CONTACTS

Their business in U. S. Government securities is strictly on a brokerage basis.

STRICTLY CONFIDENTIAL

(For use of the ad hoc Subcommittee on
Study of the Government Securities
Market, Federal Open Market Committee)

Copy 27

FEDERAL OPEN MARKET COMMITTEE RELATIONSHIP WITH
BROKERS AND DEALERS IN GOVERNMENT SECURITIES

Appendix B

- (1) Letter, September 11, 1944, from Chairman Eccles to Mr. Sproul regarding nonqualifying dealers, maximum borrowing by recognized dealers which should be countenanced, and other matters.
- (2) Letter, October 11, 1944, from Mr. Rouse to Chairman Eccles enclosing comments on dealers who did not qualify under the May 15, 1944, terms.
- (3) Memorandum, November 1, 1944, from Mr. Rouse to the executive committee of the Federal Open Market Committee on dealer borrowings and positions and certain other matters pertaining to dealers' activities.
- (4) Addendum, May 9, 1946, to the above memorandum regarding dealers' commissions.
- (5) Memorandum, February 8, 1945, from Mr. Piser to the Board of Governors of the Federal Reserve System listing matters concerning relations between the System open market account and dealers in Government securities which had been raised since May 15, 1944, and were still unsettled.

C O P Y

September 11, 1944

Mr. Allan Sproul, President,
Federal Reserve Bank of New York,
New York, New York.

Dear Allan:

I have again been looking over the letter dated May 31, 1944, that you sent to me regarding the qualification of brokers and dealers by your bank as agent for the System account. It seems to me that the report concerning the brokers and dealers who were qualified is entirely adequate but that the information given concerning the dealers who failed to qualify is a little sketchy. I believe, therefore, that the Executive Committee should receive an analysis of the dealers who failed to qualify, along the same lines as the analysis of those who were qualified. I presume that if any broker or dealer is added to or removed from the qualified list the Executive Committee will be informed not only of that fact but of the reasons for the addition or removal and will continue to receive a full report of each meeting with the dealer group.

In thinking further about the relationship between your bank and the dealers, it occurred to me that some additional information would be helpful to the Executive Committee in discharging its responsibilities in this matter. You will recall that the earlier drafts of the dealer terms included a provision that the amount of borrowings by any one dealer should not exceed ten times the net worth of such dealer. This suggestion was subsequently discarded on the grounds that the objective could better be attained by continuing the existing informal supervision over the position of dealers. It seems to me that the Executive Committee should be informed of any action that is taken regarding the position of any dealer and the response of the dealer to this action and should also be advised of any instances when the position of a dealer reaches an abnormally high level. Perhaps ten times the net worth of a dealer would not be a satisfactory measure, but I believe that some maximum should be set and that any amounts above that maximum should be reported.

Finally, I think that it would be helpful if the Executive Committee were informed as to the amount of transactions for the System account with each qualified broker and dealer. Recognizing that some dealers are particularly active in certain types of securities, I suggest that this information include the amount of transactions by types of securities. Probably one report a month showing monthly totals would be adequate for this purpose.

I should appreciate it, therefore, if you would ask Bob Rouse to send me the above reports. I think that copies should be sent to the other members of the Executive Committee, if they desire them, and a copy each to Mr. Morrill and Mr. Piser.

Sincerely yours,

M. S. Eccles, Chairman,
Federal Open Market Committee.

STRICTLY CONFIDENTIAL

C O P Y

Appendix B

FEDERAL RESERVE BANK
OF NEW YORK

October 11, 1944.

Dear Mr. Eccles:

In response to the suggestion in your letter dated September 11 to Mr. Sproul, I am enclosing reports covering those brokers and dealers with whom we had been doing some business occasionally prior to May 15, but who did not qualify under the new terms. These reports are along lines similar to those sent with Mr. Sproul's letter of May 31 covering the qualified group. It is my understanding that the executive committee shall be fully informed of the circumstances if any broker or dealer is added to or removed from the qualified list by this Bank, as agent. As I reported to the last meeting of the Federal Open Market Committee, there has been no change in the original list of qualified dealers.

There has been no occasion recently for a meeting with representatives of the Government Security Dealer Group, the last meeting with this group since May 15 having occurred on July 6, 1944. Matters discussed at that meeting are covered in the weekly report of open market operations and money market conditions for the week ended July 12, 1944, under the heading "Dealers' Subscriptions". As you know, we do not keep minutes of such meetings but the substance of the discussions, when they occur, will continue to be reported in our weekly report of open market operations.

There are also enclosed statements showing the volume of transactions by classes of securities for the System open market account with each qualified broker and dealer by months since May 15, 1944. In regard to the distribution of the business, you have in mind, of course, that it is related to the flow of business at the time and to the objectives to be accomplished by the transactions. Copies of these statements are being sent to the other members of the executive committee and regular monthly reports will be furnished the members of the executive committee hereafter.

The subject of borrowings by dealers and their positions in U. S. Government securities will be discussed in the memorandum which we are preparing on the subjects pertaining to the Government security dealers brought up by you at the last meeting of the executive committee.

Copies of the reports and statements attached are being mailed to Mr. Morrill.

Yours faithfully,

Encs.

Robert G. Rouse, Manager,
System Open Market Account.

Honorable M. S. Eccles, Chairman, Executive Committee,
Federal Open Market Committee,
Board of Governors of the
Federal Reserve System,
Washington 25, D. C.

C O P Y

STRICTLY CONFIDENTIAL

R. W. PRESSPRICH & CO. - (PARTNERSHIP)

The firm as at present constituted was formed as of August 1, 1940. The business was originally established in January 1909 but that partnership was dissolved as of July 31, 1940.

NATURE OF BUSINESS

Underwriters, Distributors and Dealers in U. S. Government, Municipal, Railroad and Public Utility Bonds and Preferred Stocks. Also does a general brokerage business as members of New York Stock and Curb Exchanges.

PARTNERS:

Clinton S. Lutkins, Barrett Brown, Samuel G. Adams, Reginald W. Pressprich, Jr., Norman K. Karn, Charles L. Bergmann, John J. Clapp, Jr., and Reginald W. Pressprich (Limited).

MAIN OFFICE

68 William Street, New York, N. Y.

BRANCHES

Boston; Newark, N. J.

NET WORTH

\$1,278,000 - (8/31/43)

CREDIT REPORT

The last investigation was made in February 1942. At that time the partners were well regarded by the banks of account which stated that they regarded it as responsible for its engagements.

SCOPE OF BUSINESS AND CONTACTS

Business is very small and on an order basis. Most of its customers are believed to be small commercial and savings banks within the immediate vicinity of New York.

C O P Y

STRICTLY CONFIDENTIAL

BLAIR & CO., INC.

Blair & Co., Inc. was incorporated under New York laws April 20, 1948 as Bancamerica - Blair Corporation. This company was formed as the result of a merger in May 1929 of Bancamerica Corporation and Blair American Securities Corporation. The Bancamerica Corporation was originally organized in April 1928 as the investment affiliate of the Bank of America National Association. The Company became a separate organization after the acquisition of the Bank of America by the National City Bank of New York in November 1931, at which time the shareholders of the bank were given certificates representing the shares formerly held pro rata with the shares of the bank.

NATURE OF BUSINESS

Underwriters, distributors and dealers in U. S. Government, State, Municipal and Corporate Securities.

OFFICERS

Ashby O. Stewart, Chairman of the Board - John R. Montgomery, President - J. Edwards Baker, George J. Gillies, C. Marshall Wood*, George B. Seager*, James J. Sullivan, and Frank B. Bateman, Vice Presidents - John J. de Boisaubin, Secretary and Treasurer - C. Courtney Keller, Jr., John M. Whitbeck and Walter B. Henricksen, Assistant Vice Presidents - Joseph F. Hughes, Assistant Secretary and Assistant Treasurer.

*U. S. Government Bond Department.

MAIN OFFICE

44 Wall Street, New York, N. Y.

BRANCHES

Buffalo; Chicago; Philadelphia; Pittsburgh.

NET WORTH

\$1,528,000 - (12/31/43), not including \$168,000 reserve for contingencies.

CREDIT REPORT

When the last investigation was conducted in April 1943, the organization was readily obtaining its requirements on both a day loan and collateral loan basis. At least one bank reported the parent company to be a very substantial steady borrower on a secured basis. All the banks expressed a high regard for the organization and its management.

C O P Y

STRICTLY CONFIDENTIAL

Note: From December 7, 1943 to March 17, 1944, the Federal Reserve Bank of New York did not transact any business with Blair Securities Corporation, except in Treasury bills, due to a continued over-extended long position in U. S. Government securities about which we had expressed concern to their management on several occasions. On March 17, 1944, the Federal Reserve Bank of New York informed the Blair Securities Corporation that, due to its unsatisfactory financial condition and its failure to report promptly the very large contingent liability that appeared in its annual statement, the bank would transact no further business with it, at least until they had for a period of time - some months - corrected their extended financial position.

BLAIR SECURITIES CORPORATION

Blair Securities Corporation was organized in 1939 under Maryland laws. Although it was formerly a wholly owned subsidiary of Blair & Company, Incorporated, a minority interest has been sold to several of its officers.

NATURE OF BUSINESS

Dealers in U. S. Government, municipal and corporate securities.

OFFICERS

John R. Montgomery, Chairman and President - Benjamin R. Brindley, J. R. Leininger, George B. Seager, George J. Gillies, James J. Sullivan, C. Marshall Wood and Robert J. Tyson, Jr., Vice Presidents - John J. de Foisaubin, Secretary and Treasurer - Winslow M. Lowe, Assistant Treasurer and Assistant Secretary.

MAIN OFFICE

44 Wall Street, New York, N. Y.

BRANCHES

Chicago; Cleveland; San Francisco.

NET WORTH

\$897,000 - (12/31/43)

CREDIT REPORT

(See Blair & Company, Inc.)

SCOPE OF BUSINESS AND CONTACTS

The firm has built up a moderate volume of business which is believed to come largely from investors in the middle Atlantic, East North Central, and Pacific states. The officers in charge were formerly associated with other firms dealing in U. S. Government securities which provided them an entree with many investors when the business was formed; also the business of Blair & Company, Inc. in other securities probably provides them with contacts. Transacts business on both a dealer and order basis.

C O P Y

STRICTLY CONFIDENTIAL

J. B. ROLL & CO., INC.

Incorporated in September 1939 under New York laws.

NATURE OF BUSINESS

Dealers in U. S. Government Securities.

OFFICERS

John B. Roll, President - Stewart C. Morton, Vice President and Secretary - Edward M. Fitzpatrick, Treasurer.

MAIN OFFICE

One Wall Street, New York, N. Y.

BRANCHES

None

NET WORTH

\$149,000 (9/30/43)

CREDIT REPORT

A checking was completed on June 6, 1944, with this company's bank of account which, apparently, has handled all clearings for the company since the account was opened in September 1939. Full confidence was expressed in the company and its management and we were advised that the business is under capable, conservative and experienced supervision. No day loans are requested by the firm.

SCOPE OF BUSINESS AND CONTACTS

Business believed to be confined to the Eastern Seaboard states, largely the Second Federal Reserve District, with activity centering in Treasury bonds, as most of its customers are savings banks, small commercial banks, savings associations of various kinds, and trust accounts. With the exception of odd lots, a good deal of its business is on an order basis.

C O P Y

STRICTLY CONFIDENTIAL

BRIGGS, SCHAEDLE & CO., INC.

Incorporated in November 1940, under New York laws.

NATURE OF BUSINESS

Dealers in Government Securities and Bankers Acceptances.

OFFICERS

M. Grescan Briggs, President - Thomas G. Schaedle, Vice President and Treasurer - John L. MacFarlane, Secretary - Le Roy Roome and Walter E. Suttmeier, Assistant Treasurers. The principals are former officers of Discount Corporation.

MAIN OFFICE

44 Wall Street, New York, N. Y.

BRANCHES

None

NET WORTH

\$131,000 - (11/30/43)

CREDIT REPORT

An investigation was completed June 2, 1944, with the company's bank of account which clears all transactions for the company. The investigation revealed that the management is considered experienced, capable and conservative in its operations. The bankers say that the management is meticulous in its dealings and all transactions are cleanly handled and that they have full confidence in the company and believe it to be responsible for whatever it undertakes. Inasmuch as the firm does no underwriting, there is no occasion for granting it day loans.

SCOPE OF BUSINESS AND CONTACTS

Business small and largely confined to the New York area but it appears to be steadily growing on a sound basis. Its customers include commercial banks, scattered nationally, a few savings banks and several large corporations. Some of its larger customers, undoubtedly, deal with this firm for the reason that they were contacted by the officers when they were associated with Discount Corporation. Its business, with the exception of moderate transactions in short term securities, is primarily on an order basis.

C O P Y

STRICTLY CONFIDENTIAL

HARVEY FISK & SONS, INC.

Incorporated in New York in January 1937.

NATURE OF BUSINESS

Dealers in U. S. Government, Territorial and Federal Land Bank Securities. Underwriters and Dealers in State, Municipal and Housing Authority Bonds.

OFFICERS

Martin C. Grunwald, President and Treasurer - William E. Pollock, Executive Vice President - H. Albert Ascher and Max E. Pollock, Vice Presidents - Edward F. Wrightsman, Paul J. Mahoney, Karl J. Panke and Theodore P. Dixon, Assistant Vice Presidents - Ashmore L. L. Mitchell, Secretary - Herbert E. Jordan, Assistant Secretary and Assistant Treasurer.

MAIN OFFICE

40 Wall Street, New York, N. Y.

BRANCHES

None

NET WORTH

\$220,000 - (12/31/43)

CREDIT REPORT

The company's banks of account, with which we completed an investigation in June 1944, speak favorably regarding its reputation and management. The business is said to be conservatively operated and the company is looked upon as responsible for its engagements.

SCOPE OF BUSINESS AND CONTACTS

Several of the officers of this firm have been connected with the Government Security Market for many years and it is felt that the majority of its customers are those who have dealt consistently with these men over a period of years. A large part of its business appears to be with savings banks in New York State and the New England States, although it occasionally gets a moderate volume of business from several of the larger commercial banks in New York. The bulk of its business is on an order basis.

COPY OF MEMORANDUM

To: Executive Committee of the Federal Open Market Committee

November 1, 1944

From: R. G. Rouse

MEMORANDUM ON DEALER BORROWINGS AND POSITIONS IN UNITED STATES GOVERNMENT SECURITIES, COMMISSIONS PAID THE DEALERS ON TRANSACTIONS FOR THE SYSTEM ACCOUNT, AND CERTAIN OTHER MATTERS PERTAINING TO DEALER ACTIVITIES, CONSIDERATION OF WHICH WAS SUGGESTED BY CHAIRMAN ECCLES AT THE MEETING OF THE EXECUTIVE COMMITTEE OF THE FEDERAL OPEN MARKET COMMITTEE HELD IN WASHINGTON ON SEPTEMBER 21, 1944 AND IN HIS LETTER TO MR. SPROUL DATED SEPTEMBER 11, 1944

- (1) Formal or informal recognition by the executive committee of commissions paid on transactions on an agency basis for the System Open Market Account.

In the past year or more, all transactions on an agency basis for the System Open Market Account in Treasury bonds and notes have been at a 1/64 commission (\$156.25 per \$1,000,000). On transactions in certificates with dealers for the account of their customers, we have followed the practice of buying from or selling to the dealer the longer maturities of certificates at a yield which permits the dealer to make a price differential of 0.01 per cent in yield. This has not always been true in the case of the shorter maturities of certificates, as an 0.01 per cent in such cases does not permit the dealer to make a reasonable profit. As can be seen from the following table, the value of 0.01 per cent per \$1,000,000 varies with the maturity and price of the certificate.

<u>Issue</u>	<u>Yield</u>	Approximate dollar value of 0.01% per \$1,000,000 on outstanding certificates
	<u>Bid</u>	
	<u>9/28</u>	
7/8% C/I due 12/1/44	.45%	\$17.53
" " " 2/1/45	.69	33.98
" " " 4/1/45	.74	50.68
" " " 5/1/45	.74	59.09
" " " 6/1/45	.77	67.29
" " " 8/1/45	.79	83.92
" " " 9/1/45	.81	92.09
" " " 10/1/45	.82	99.43

A day loan costs the dealers about \$27.77 per \$1,000,000 which must be deducted before the profit realized can be determined as well as the cost of Federal funds if they are involved which amounts to about \$10.42 per \$1,000,000. These charges are in addition to telephone charge tolls, salaries and overhead.

As you know, one of the uniform trading practices which the dealer group has adopted is that they shall trade only at the quoted market. Inasmuch as we, at all times, are informed on the quoted markets, we have not been concerned about the dealers making more than an 0.01 per cent on the longer maturities since our purchases and sales are usually made at the in-between prices. As an average, we would say dealers make between \$50 and \$70 per \$1,000,000 on transactions with us in certificates from which they must deduct any charges.

The matter of commissions paid on transactions for the System Open Market Account has been reported to the committee on several occasions and we have assumed that it met with the approval of the committee. However, if it is the judgment of the executive committee that it should formally instruct us on this point, we would prefer that the instructions be broad enough to permit us to operate within the range of a maximum commission, rather than at set commissions for each type of security. For example, the committee might instruct this Bank, as agent, that on transactions for the System Open Market Account the commission paid dealers shall not exceed 1/32.

- (2) The annual statements of condition of qualified brokers and dealers might include (1) holdings of Government securities by issues, (2) Government securities borrowed by issues, (3) borrowing from banks, trust companies, and other financial institutions, (4) borrowings from officers and directors, (5) borrowings from others, (6) loans to officers, and (7) net worth.

With the exception of the detailed lists of securities owned and securities borrowed, all of the above information is ordinarily obtainable from

annual statements such as the dealers have been in the habit of submitting to us. The statements are prepared or certified by public accountants acceptable to the Bank and we have confidence that the figures are presented in accordance with sound accounting principles. Dealers' long and short positions in U. S. Government securities by groups of issues are reported to us on a daily basis.

Accordingly, we do not feel that it is necessary to request specific information as listed above, although under the terms of the signed agreements we feel that we may ask for and obtain clarification of items appearing in the statements or additional details as to holdings and borrowings by issues when there is occasion for it. It is our practice to refer the financial statements received from the dealers to our Credit Department which prepares an analysis of them for the confidential use of the interested officers of this Bank. This analysis usually includes a comparison of the principal balance sheet items with figures of previous years as well as comments on any items which appear unusual or for which there is not sufficient information.

We shall be glad to forward copies of these analyses as well as the financial statements of the dealers to the Committee if it so desires.

(3) The Bank might encourage the dealer group to adopt rules of conduct.

As previously reported, the "dealer group" is an informal organization. It gave consideration to the advisability of formally organizing early in 1943* for the purpose of controlling practices which might result in criticism. With the aid of counsel, it arrived at the conclusion that such a step would be of no benefit to either the Treasury, this Bank, the market or itself

* See summary of the discussion which took place on May 28, 1943, with the executive committee of the dealer group attached to the statement regarding the relationship between the Bank and the dealers in U. S. Government securities submitted to the meeting of the Federal Open Market Committee held October 18, 1943.

and that to put teeth into such an organization it would be necessary to adopt policies and rules resulting in price fixing and other practices which would run afoul of the anti-trust and other laws. The dealers felt that the same objectives could be accomplished by each member of the group refraining from any practices that would be bad for the market or that might bring criticism on the group.

In the report dated February 1, 1944, we reviewed various requirements, suggested by Chairman Eccles in a memorandum dated October 6, 1943, many of which were rules of conduct, including the rule that, "recommendations to any client to buy, sell or swap shall be made only on the request of the client, shall be made only by a senior member of the firm, and shall be on an investment basis and not on a speculative basis." It was concluded, after consultation with counsel, that, although this rule is unquestionably a desirable rule of conduct, it is not now imposed by law regarding transactions not involving U. S. Government securities, where abuse is much more possible, presumably because of impossibility of enforcement and, therefore, it seems inappropriate for the Federal Reserve System to try to impose such a requirement regarding transactions of brokers and dealers with persons other than the Reserve Bank.

As pointed out, both in the report submitted to the meeting of the Federal Open Market Committee on October 18, 1943 and in the report dated February 1, 1944,* we have not only encouraged the dealers individually to adopt desirable rules of conduct, but have encouraged the dealer group to strengthen its organization and to endeavor to eliminate market practices which might bring about results that rightfully or wrongfully cause criticism. It was also pointed out in these reports that various trading practices and rules of conduct have

* Report and Recommendations regarding Relationship between the Federal Reserve Bank of New York and dealers in U. S. Government Securities.

been informally adopted by the group. Up to this time, the dealer group has policed itself and appears to have handled effectively all violations that have been reported to its policing committee whether the violators were small or large dealers.

Under the existing circumstances and in view of the fact that the dealers who have been recognized by us have carried on a large and successful business over a number of years without any specific charge of malpractice against them, we feel no further action is necessary or warranted at this time.

- (4) It might be advisable for the executive committee to have on hand specific examples of any abuses by dealers, including names and dates.

We could have no objection to the executive committee requesting the Reserve Bank Presidents to furnish it with a report of any abuses, the facts of which are brought to their attention, and which may be harmful to the market or violate the terms of the agreements signed by the recognized dealers. However, it would be undesirable to give credence to every rumor which develops in the market and to launch charges or make investigations based on flimsy evidence. This Bank would assume that if the committee solicits reports of abuses they will be authenticated in so far as possible and forwarded to this Bank for further investigation.

- (5) The establishment of maximum levels for dealers' positions in U. S. Government Securities.

Dealers' borrowings and long positions are closely interrelated. To the extent that borrowings are against U. S. Government securities, a limit on borrowings limits positions, and vice versa, a limit on positions limits borrowings. The suggested requirement that "the amount of borrowings by each dealer shall at no time exceed ten times the net worth of such dealer" was discussed in the report dated February 1, 1944 (pages 8 and 9) titled "Report and Recommendations Regarding Relationship between Federal Reserve Bank of

New York and Dealers in U. S. Government Securities." As you know, the Executive Committee decided not to include this requirement in the signed agreements formalizing our dealer relationship but instructed this Bank, as agent, to continue its informal supervision over borrowing. We firmly believe that this action was the correct one and that we should not include among our requirements any rule or regulation which would interfere with the normal business relations of the dealers with others. The reasons set forth in the report dated February 1, 1944, as to why a ceiling on dealers' borrowings is inadvisable are equally as valid as regards a ceiling on positions.

A summary of our opinion in this matter follows:

1. Inasmuch as our contracts with dealers are completed by physical deliveries against Federal Reserve funds, our risks, other than the possibility of receiving counterfeit or altered securities, are market risks incident to the failure of the dealers to accept or to deliver securities pursuant to their contracts.
2. If positions were to be limited, it would tend to restrict the floating supply of securities and might very well have an adverse market influence under changing conditions. There are times when it is helpful to the market, the Treasury and the System for the dealers to take very large positions and any limit imposed would have to allow for such occasions. For example, the dealers were helpful in absorbing a very large part of the supply that preceded and accompanied the Fifth War Loan Drive by increasing their positions which they were able to reduce in a very short period following the issue date of the

market issues offered in the Drive. A considerable percentage of the securities taken by dealers at that time consisted of securities which we normally do not purchase for the purpose of supplying reserves or which could not have been bought in the interest of a pattern of rates.

3. A position ceiling established high enough to permit dealers to meet the situations mentioned above, would probably be too high to be continuously effective and might expose us to situations that we would rather avoid. For example, the dealers might consider that such a limit was safe and that we would have no objection to their reaching it at any time.
4. Commercial banks making loans to dealers of the type with which we are doing business do not in most cases know the dealers' total position at the time. Nor do they usually know the amount of their aggregate borrowings except on the date of their annual financial statement which they receive. At the present time, we understand that commercial banks generally are willing to lend the dealers at 3/4 per cent with a 2 point margin for securities in excess of 1 year and at 3/8 to 1/2 per cent on the one-year-and-under group, frequently with no margin requirement other than the interest accrued on the securities. The present margin requirements permit a dealer to carry a far larger position than would be considered reasonable and, after making allowance for

working balances and physical assets, provides a borrowing capacity in excess of 40 times capital.

5. Generally the aggregate position except from money market considerations does not concern us as much as the dealers' position in certain classes or maturities of securities. For example, we might be more concerned if a dealer had a position of 25 million in long partially tax-exempt bonds than if he had a position of 100 million in certificates. An over-all ceiling on positions would put us at a disadvantage in correcting undesirable positions in certain classes or maturities of securities.

Although we are opposed to including a ceiling on borrowings or positions among our requirements, we recognize that the executive committee and this Bank, as agent, have a responsibility to see that no dealer gets into a position so extended as to impair his effectiveness or to cause him to become a disturbing market influence. In our opinion it is on matters of general policy, such as this, that the committee should express its views and that the details of the application of such policy should be made the responsibility of this Bank.

COPY OF MEMORANDUM

May 9, 1946.

TO: Executive Committee of the Federal Open Market Committee

FROM: R. G. Rouse, Manager, System Open Market Account

(ADDENDUM TO MY MEMORANDUM TO YOU
DATED NOVEMBER 1, 1944.)

At the meeting of the executive committee of the Federal Open Market Committee on February 28, 1946, Chairman Eccles suggested that the executive committee consider the desirability of paying no commissions on System Open Market Account transactions with dealers in Government securities. The reasons stated by the Chairman were substantially as follows:

This whole matter should be considered in the light of the changed conditions existing at the present time. The question cannot be settled today but it should be studied, along with the position that the dealers now occupy, so that the committee would have before it the reasons why the Federal Reserve Banks should pay commissions and why they should not. The Federal Reserve Banks are not in the position of purchasers or sellers of securities in the usual sense. If the market can take the securities offered, the Federal Reserve Banks do not want them. If the Reserve Banks buy securities the dealer should get his commission from the person who sells, and if the Banks sell the dealer should get his commission from his purchaser. The Federal Reserve Banks should be a place of last resort when securities are offered on the market. Securities are sold to the Reserve Banks because the System is supporting the market in accordance with a known general policy and when the broker comes to the Federal Reserve Banks it is more in his interest to sell to the Banks than to someone else. There should be no incentive to the dealer to go out and purchase securities for the purpose of selling them to the Reserve Banks and if no commissions were paid that would be the case. We must realize that under present conditions there is not a natural market and the position of the dealers must be analyzed in that light.

In discussing Chairman Eccles' suggestion it might first be said that transactions in Government securities consummated in the market for the System Open Market Account fall into two categories, i.e., those initiated by the System and those initiated by others. In the case of transactions initiated by the System in the practical administration of the Account or for the purpose of expanding or contracting bank reserves or of stabilizing prices, the System could not rightfully expect dealers to buy or sell securities for it and at the same time receive their remuneration for this service by charging the third party a commission. As a matter of fact, the System would have little choice on such transactions as to the basis on which the third party would prefer to do business. Furthermore, if the System permitted the dealers to act as principal on such transactions, it would have no control over the amount of profit which might accrue to the dealer. On the assumption that the System will continue to pay the commission on transactions initiated by it, the following comments relate to the transactions initiated by others.

May 9, 1946.

TO: Executive Committee of the Federal Open Market Committee

FROM: R. G. Rouse, Manager, System Open Market Account

The question of whether the System pays the commission or requires the dealer to obtain his commission from the third party on transactions initiated by the third party depends upon the objectives desired by the System. For example, if the System paid the dealer 100 plus a commission of 1/64, the customer would receive 100 for the securities sold and the market would be quoted 100 bid. If the System paid 100 net (no commission) the dealer in order to obtain his remuneration of, say 1/64 of a point, would pay the seller 100 less 1/64 commission and would quote his market at 99 63/64 bid. In both cases, the dealer would make 1/64 but the effect of the System purchase in the first instance is a higher price to the seller and a higher market quotation than in the second instance. Consequently, if the System wished to have a par bid maintained in the market it would have to pay either 100 plus 1/64 commission or 100 1/64 net. In either case, the cost to the System would be the same. However, if the dealer collects his commission from a third party, the System's control over the amount of profit which the dealer makes would have to be in the form of an agreement with the dealer. Normally in such cases the dealer, acting as principal, would be free to charge whatever commission he felt desirable from the third party and the System would have no knowledge of the amount charged. Both of these factors appear to be good reasons for the System to continue its present practice of paying the dealers' commission.

The incentive for the dealers to solicit from their customers business which could be reversed with the Reserve Banks would be restricted generally to the dealers being able to recommend to their customers specific market operations likely to prove profitable rather than to the willingness of the System to pay the dealers' commission. The area for such solicitation is greatly circumscribed by the fact that most of our operations are in Treasury bills and certificates. Furthermore, unless a dealer's recommendations proved profitable to his customers, at least over a period of time, he would have no influence over his customers' operations in the market. On other occasions, when the dealers' customers initiate the business, it is merely a question of the dealers' willingness or ability to consummate transactions at quoted prices. In such cases the open market policy of the System, rather than the payment of dealers' commissions by the System determines whether the transaction will take place with us or not. It should be remembered, also, that the terms and conditions to which the qualified dealers have agreed in writing restrict, in effect, the dealers from soliciting transactions with their customers for the purpose of reversing the transactions with the System, unless otherwise requested by the System.

Although in one sense the present government security market is not a natural market, but one which we support and maintain, it is to our advantage to have it preserve as much of its free characteristics as possible so that we shall be called upon only as residual buyers. Efficient, effective market machinery is required and is supplied by the government security dealers. So long as we wish to make use of this machinery, and so long as the commissions we pay are neither extravagant nor excessive, there would seem to be nothing to be gained by transferring the cost of all of our operations, not to the dealer, but to his customers.

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COPY OF MEMORANDUM

Appendix B

February 8, 1945

To: Board of Governors

Subject: Government security dealers

From: L. M. Piser

Several matters relating to Government security dealers were discussed in a letter dated September 11, 1944, from Chairman Eccles to Mr. Sproul and at the meeting of the Executive Committee on September 21. Three of these matters have been settled since that time. First, the members of the Executive Committee have received an analysis of the dealers who failed to qualify.^{1/} Second, they have received each month a report showing the amount of transactions for the System Account with each dealer and broker. Third, Mr. Rouse reported that the New York Reserve Bank has encouraged the dealers individually to adopt desirable rules of conduct and has encouraged the dealer group to strengthen its organization and to endeavor to eliminate market practices that cause criticism.

The remaining four matters, however, have not been settled. First, the Chairman suggested that the Executive Committee should be advised of any instances when the position of a dealer reaches an abnormally high level and also should be advised of any action that is taken by the New York Bank regarding the position of a dealer and the response of the dealer to this action. The Chairman also mentioned that the earlier draft of the dealer terms included a provision that the amount of borrowings by any dealer should not exceed ten times his net worth, that this provision subsequently was discarded on the grounds that the objective could better be attained by continuing the existing informal supervision over the position of dealers, and that, although ten times the net worth of a dealer might not be a satisfactory measure, some maximum should be established and any instances when that maximum is exceeded should be reported to the Executive Committee. Mr. Rouse's reply to this suggestion was that the amount of dealer borrowings should not be limited by any rule or regulation and that, on matters of general policy such as this, the Executive Committee, in his opinion, should express its views and should make the details of the application of such policy a responsibility of the Bank.

Second, the Chairman suggested that the Executive Committee should recognize at least informally the present commission of 1/64 of a point on transactions with dealers for the System Account in notes and bonds and the present limitation to exceptional cases of transactions in these securities on a net basis and that the Executive Committee should establish a commission of perhaps 0.01 per cent on transactions in certificates. Regarding the latter part of this suggestion, Mr. Rouse felt that a differential of 0.01 per cent, while reasonable on the longer maturities of certificates, would not permit the dealers to make a reasonable profit on the shorter maturities. He suggested that, if the Executive Committee wishes to issue formal instructions, the instructions should be sufficiently broad to permit the Bank to operate within the range of a maximum commission rather than at set commissions for each type

^{1/} See letter from Mr. Rouse to Chairman Eccles dated October 11, 1944, attached.

STRICTLY CONFIDENTIAL

To: Board of Governors

From: L. M. Piser

-2-

February 8, 1945

of security and that the instructions might limit the commission to no more than 1/32 of a point.

Third, the Chairman suggested that the annual statements of condition of qualified dealers and brokers should include the following items: (1) holdings of Government securities, by issues, (2) Government securities borrowed, by issues, (3) borrowings from banks, trust companies, and other financial institutions, (4) borrowings from officers and directors, (5) borrowings from others, (6) loans to officers and directors, and (7) net worth. In reply, Mr. Rouse said that, with the exception of the detailed lists of securities owned and securities borrowed, all of the suggested information ordinarily is obtainable from the annual statements and that the dealers' long and short positions by groups of issues are reported to the Bank on a daily basis. He suggested that, if the Executive Committee so desires, he would be glad to forward copies of the financial statements and of the analyses prepared by the Credit Department of the Bank.

Finally, the Chairman suggested that the Reserve Bank Presidents should be requested to furnish to the Executive Committee a record of any information that they may obtain in the future regarding violation by dealers of the terms. Such a record would include information that dealers have induced customers to sell when purchases are being made for the System Account, that dealers have made recommendations to customers that had the effect of disturbing the market, and that dealers have manipulated quotations in order to increase their transactions. In reply, Mr. Rouse suggested that, if such reports are made, they should be authenticated in so far as possible and forwarded to the Bank for further investigation.

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(For use of the ad hoc Subcommittee on
Study of the Government Securities
Market, Federal Open Market Committee)

Copy 37

FEDERAL OPEN MARKET COMMITTEE RELATIONSHIP WITH
BROKERS AND DEALERS IN GOVERNMENT SECURITIES

Appendix C

- (1) Letter, April 2, 1948, from Governor Szymczak to Mr. Rouse containing a digest of letters and discussions with representatives of Wm. E. Pollock and Co., Inc., a nonqualified dealer.
- (2) Memorandum, April 16, 1948, from Mr. Rouse to Confidential Federal Open Market Committee Files concerning discussion held with Mr. Pollock of Wm. E. Pollock and Co., Inc.
- (3) Memorandum, April 15, 1948, from Mr. Rouse to the Federal Open Market Committee summarizing developments in the relationship of the Federal Reserve Bank of New York with dealers in Government securities between 1939 and 1948.

C O P Y

April 2, 1948.

Mr. Robert G. Rouse, Vice President,
Federal Reserve Bank of New York,
New York 45, New York.

Dear Bob:

At the last meeting of the Federal Open Market Committee, there was some discussion of the rules relating to the qualification of dealers in Government securities with whom your Bank transacts business for the System account, and I understand that you are preparing a memorandum on this subject for consideration at the next meeting.

At my request Bill Pollock wrote me what he had been telling me for some time, and I quote several paragraphs from his letter:

"At a dinner sponsored by a few of the larger dealers in the early part of 1941, a government bond group was created, consisting of two New York Banks and all New York firms who, at the same time, dealt in government bond issues. No rules or regulations were prescribed at the time of organization. Dealings with the Federal Reserve Bank were had by any and all houses, based on their individual contacts and knowledge of the U. S. Government Bond business.

"Since formation of the group, trading activity began to show various changes - competitive and initiative spirit was being supplanted by personalities involving contact with the Federal Reserve Bank.

"Step number one was established through the repurchase of Treasury Bills by the Federal Reserve Bank at a prescribed commission instead of at a price against average established by weekly sales and therefore making it a riskless business for those dealers and banks who either were not equipped to bid properly or who did not have the ability to exercise judgment in auction bidding and thereby were guaranteed against any possible losses caused by faulty bidding. With the seed planted through this operation, it wasn't long before contact instead of knowledge of the U. S. Government business seemed to find favor with the Federal and made Government Bond trading quite riskless and encouraged numerous houses to start Government Bond Departments. Because of increased activity through war financing and the growing number of government dealers, new devices had to be developed by the Federal Reserve Bank and an Open Market group was formed and designated as the only body of dealers who might henceforth do business with the Federal.

"Various regulations were imposed which would serve to keep out many dealers and at the same time, two out-of-town banks were

requested to join to give balance to a Dealer-Banker group comprising the Open Market group. Though these regulations were quite specific, some of the rules were not strictly enforced and two of the banks disclaimed any intention to carry out some technical terms of their agreements. It soon became a habit not to make or maintain markets in all Government Bond issues but only when it suited individual dealers in relation to their positions in the market. Independent brokers gained prominence and were used to manipulate quotations, so that dealers themselves could not be accused of being unnecessarily aggressive or disturbing to an orderly market such as was desired by the Federal Reserve Bank.

"In due course, one Government Bond house was dropped from the Open Market group because it refused to comply with a request made by the Federal Reserve Bank to cut down its portfolio.

"Just very recently, another New York Bank was requested to join the Open Market group to further balance the Banker-Dealer set-up.

"Since the inception of the U. S. Government Bond Dealer group, a detailed report to the Federal embodying all positions, the type and character of consummated business and all particulars that may reflect all our markets and give the Federal a clear cut picture of all these important factors, was our daily function and our firm was most diligent in this service without any question on our part or without seeking any special favors. Even when the group within the group was formed, known as the Open Market group, we continued to maintain our relations with our customers, as well as the Federal Reserve Bank, to the best of our ability under those circumstances.

"When the emergency period arrived and peg prices were resorted to, those of us who were not in the inner circle found the door to the Federal completely closed, the latter not only failing to help us through that period but actually creating new regulations for their Open Market group which made it almost impossible for us to be of service to our clientele which we have spent a business life-time to build up.

"If the period of emergency continued for a longer stretch of time, the Federal Reserve Bank would have been instrumental in putting several government bond dealers out of business. If that had been the ambition of those in charge, they came close to achieving it. As the bond market improved and the avalanche of selling subsided, a few of us were finally told that once again we may do business for agency accounts in a moderate form."

Referring to the provision of the Committee's rules concerning qualified dealers which relates to willingness to make markets, the letter goes on to recommend, in effect, that willingness and ability to make and maintain markets be made a determinative factor in the qualification of dealers. The opinion is expressed that the application of this test would solve the problem of possible additional administrative work resulting from an increase in the number of qualified dealers, because 90 per cent of the would-be Government bond departments would not and could not maintain adequate trading markets. As a means of applying this test, the letter suggests "an agreed unit of at least \$100,000 throughout the list and possibly some formula as to the number of minimum personnel required in a bona fide Government bond department."

A subsequent letter states that, of the eleven members of the Open Market Group, actually only six dealers try to maintain markets in restricted Government issues. It also mentions that there are at least 500 municipal bond dealers against a total municipal indebtedness of twenty billion dollars, that over 1300 dealers engaged in floating a 250 million dollar issue of World Bank bonds, and that there are only two men at the Federal Intermediate Credit Bank office who handle over 400 dealers in connection with monthly F. I. C. issues.

I am bringing this to your attention because I am sure that you will want to consider it, if you have not already done so, in connection with the preparation of your memorandum. When you are next in Washington, I will be glad of an opportunity to discuss this matter with you; or better yet, why not have Bill Pollock amplify his statements by coming in to see you at the Bank.

Kindest personal regards.

Cordially yours,

M. S. Szymczak.

Appendix C

C O P Y

OFFICE CORRESPONDENCE

Federal Reserve Bank
of New York

To Confidential Federal Open
Market Committee Files

April 16, 1948

From R. G. Rouse

Referring to the attached letter from Governor Szymczak quoting excerpts and summarizing letters which he had received from William Pollock of William E. Pollock and Company, Inc., I followed the suggestion made therein and asked Mr. Pollock to come in and amplify his statements which were not clear to us. Mr. Miller and I spent an hour and a half going over with him his statements to Governor Szymczak and discussing each point as set forth in the letter. Mr. Pollock disclaimed any idea of intimating that we had any special friends among the dealers with whom we do business, for other than justifiable reasons, for System Open Market Account, and stated that his sole purpose in taking up this matter with Governor Szymczak was not to embarrass us but rather to try to have the rules amended so that his firm would have direct access to us as a qualified firm. Mr. Pollock's letter contains many statements which, as far as Mr. Miller and I are concerned, are not true and represent either a twisting of the truth or a lack of understanding on his part as to the real facts.

However, I made it clear to Mr. Pollock that the situation with respect to certain unqualified dealers, including his firm, is now under consideration by this Bank and by the Federal Open Market Committee but that, as far as this Bank is concerned, it believes one of the basic requisites of a qualified dealer is the making of primary markets on a nationwide basis. This I told him is impossible unless the dealer has adequate available capital. I explained that I thought the making of primary markets under conditions as they exist today requires considerably greater capital than was the case four years ago at which time I told him I thought the minimum amount of capital that would be necessary was \$500,000. In making that statement in 1944, I did not commit ourselves to that specific figure but expressed the view that under the then existing conditions, there would be no use considering an application of a dealer to qualify unless at least that amount of capital were pledged to the business. I also remarked to Mr. Pollock that it would be possible for him to raise sufficient capital and to develop national scope of business; that he knew the requirements and is free to work toward that goal.

C O P Y

RECENT DEVELOPMENTS IN THE RELATIONSHIP OF
FEDERAL RESERVE BANK OF NEW YORK WITH
DEALERS IN UNITED STATES GOVERNMENT SECURITIES

Review of Policy in the
Relationship of the Federal Reserve Bank of New York
with Dealers in United States Government Securities

Procedure Developed by Federal Reserve Bank
of New York in 1939

Late in 1939 this Bank made a careful review of its relationships with the United States Government security dealers. On the basis of the recommendations made by the officers at that time, this Bank's Board of Directors passed a resolution on November 2, 1939 laying down a specific policy governing certain phases of the relations of the officers of this Bank with the market, that is to say, with the Government security dealers. This resolution provided a policy requiring this Bank to execute orders for the purchase and sale of United States Government securities, through ordinary market channels, with or through "recognized dealers" -- an internal designation. Such a dealer was defined for this purpose as "a firm or corporation, including a bank, which is a specific dealer or broker in United States Government securities, or bills of exchange and bankers acceptances, or other securities, and which has furnished to this Bank a recent statement of assets and liabilities showing to the satisfaction of this Bank that such firm or corporation is a substantial dealer and has, in the judgment of this Bank, adequate capital and is otherwise in satisfactory financial condition." The principal factors which this Bank considered in extending such recognition were the following:

- 1) Reputation for integrity, experience, and knowledge,
- 2) capital at the risk of business,

- 3) willingness to make markets under all ordinary conditions and to take positions, both long and short, and
- 4) a large volume of national scope with the contacts which such trading provides.

The designation of recognized dealers was left to the discretion of the President and/or First Vice President of this Bank, and five dealers and two dealer-banks were designated as recognized dealers, in accordance with the stated policy.

Within certain limits, the resolution referred to above permitted this Bank to effect transactions in United States Government securities through responsible concerns, including banks, other than those recognized dealers when in the judgment of the President, the First Vice President, or the Vice President in charge of the Open Market Function of this Bank, such a course would properly aid in the execution of System Open Market policy or Fiscal Agency transactions. Under this authority there were at that time eight such dealers and two out-of-town dealer-banks with which this Bank might transact business. Some of these dealers functioned as did recognized dealers, in that they carried some portfolio, while others with slight capital resources, conducted for the most part an order business.

Prior to our entry into the war in December 1941, our contact with the unrecognized dealer group was an informal one, maintained because the volume of business done by those firms was, in the aggregate, such that we felt it advisable to keep in touch with them. In return for information supplied by them as to important transactions and general market conditions, which they believed would help to keep us informed on the day-to-day factors at work in the market, we reciprocated at times by giving them a small amount of business directly when we were in the market and when their bids or offers were satisfactory, keeping such business within the limits dictated by the

capital position of the respective firms.

There followed a period of change in personnel and organization in some of the dealer firms, both recognized and unrecognized, with several of the smaller houses, to which recognition had not been extended, doing a somewhat larger volume of business. No changes, however, were made in the number or names of recognized dealers.

Action by Federal Open Market Committee in 1944

With the increase in Government debt in the earlier years of the war, trading volume in United States Government securities increased substantially and the volume of System transactions also expanded. The Federal Open Market Committee recognized that operations for the System Open Market Account were becoming, and promised to continue, so large and so important in their effect upon the market that it should be prepared, as a matter of record, to justify the procedures followed in dealing with the market. In meeting its responsibility for the determination of the relationships between the System and the United States Government security dealers, the Federal Open Market Committee undertook a thorough study of the System-dealer relationships with a view to establishing a procedure for the New York Bank to follow in acting as its agent, having in mind:

- 1) The growing importance and function of the dealers in United States Government securities,
- 2) the degree of influence exercised over the dealers, and
- 3) the possible need for regulation and for additional information.

In May 1944 the Federal Open Market Committee, after prolonged consideration, approved a statement of terms on which this Bank, as agent, would transact business with brokers and dealers in United States Government securities for the System Open Market Account. This statement, in its final form,

represented a formalization of the relationship which this Bank had previously had with the principal dealers in United States Government securities. In taking this action, the Federal Open Market Committee delegated to the executive committee, the authority to make such changes in the form of the statement of terms as appeared to be desirable, to make the terms effective at such time as, in the judgment of the executive committee appeared to be desirable, and to issue such instructions to the New York Bank in connection therewith as might be required. On May 6, 1944, the executive committee instructed the Federal Reserve Bank of New York in detail with respect to the new procedure. A statement of these instructions and the terms on which the Federal Reserve Bank of New York will transact business with brokers and dealers in United States Government securities for System Open Market Account are given in an attachment. Pursuant to the instructions issued on May 6, 1944, the Federal Reserve Bank of New York concluded by May 15, 1944 agreements with all brokers and dealers who, in the opinion of this Bank, met the qualifications developed by the committee. These firms consisted at that time of the following:

For Over-the-Counter Business

Bankers Trust Company
C. F. Childs & Company, Inc.
Continental Illinois National Bank
and Trust Company of Chicago
C. J. Devine and Company, Inc.*
Discount Corporation
The First Boston Corporation
The First National Bank of Chicago
Guaranty Trust Company of New York
Harriman Ripley and Company, Inc.
D. W. Rich and Company, Inc.
Salomon Brothers and Hutzler

* Incorporated January 1, 1945 after earlier reverting to a partnership

Brokers on the New York Stock Exchange

Asiel and Company
Charles E. Quincey and Company
Mabon and Company
Salomon Brothers and Hutzler

Since that time Blair and Company, Incorporated and Chemical Bank and Trust Company were accepted as a qualified dealer and dealer-bank, respectively; Harriman Ripley and Company, Incorporated has withdrawn from the Government securities business and D. W. Rich and Company, Incorporated has been removed from the list of qualified dealers.

There were, at that time, five other dealers with whom this Bank had done business occasionally in limited volume but who did not clearly qualify because of the relatively small volume and restricted scope of their business and the limited amount of capital at the risk of their business. These dealers were:

Briggs, Schaedle and Company, Inc.
Harvey Fisk and Sons, Inc.
R. W. Pressprich and Company
C. E. Quincey and Company
J. B. Roll and Company, Inc.

The Federal Reserve Bank of New York took the position at that time that "it was considered inadvisable to include even dealers with whom some business has been transacted at times in the past if they did not clearly qualify under the written terms and conditions now effective." It believed that the line of demarcation must be as clearly defined as possible if System practice is to be understood and defensible and if future requests for qualification are to be capable of determination. We continued, however, to do a small amount of business with these five firms on purchase and sale orders this Bank received for accounts other than the System Open Market Account. Since 1944 Harvey Fisk and Sons, Inc. was dropped from that list for cause, R. W. Pressprich and Company was removed from the list when that

firm retired as a dealer in United States Government securities, and William E. Pollock and Company, Inc., a new firm organized January 2, 1945, was added to the list.

Recent Experience

We have now had some four years experience with the procedure set up by the Federal Open Market Committee. On the whole, it has operated smoothly under most market conditions. At the time the whole subject was reviewed in 1943-44, the committee endeavored to prescribe terms which would define the limit within which this Bank, as its agent, might qualify dealers and dealer-banks, so that the committee would always be in a position to answer questions concerning the method, as well as the purpose of our open market transactions. At that time it was anticipated that an important problem might be the number of banks (as well as others) which might wish to become dealers in Government securities, thus creating an administrative and operating problem. This problem has been a minor one. The failure of the situation to develop to the extent anticipated may perhaps be attributed in large part to (a) the relative ability of commercial banks with trading departments to operate independently of "qualification" in the kind of Government securities markets which have prevailed up until the last six months, and (b) recognition of a sound and consistent basis in the committee's terms and qualifications.

There has been a certain pressure to qualify smaller firms and a determined effort on the part of some of them to bring their organizations within the scope of the committee's terms. These firms, however, do not make primary markets in Government securities on a national basis and this bank has not transacted business with them for System Account under the existing rules and regulations. These rules, growing out of experience, are based on the principle that operations for System Open

Market Account should be concentrated upon the residual supply of, or demand for, securities which cannot be cleared by the market. That means dealing only with those firms which are national factors in the market, since these provide the central point of activity through which the major portion of the operations of buyers and sellers are cleared, and at which most of the residual transactions come to rest. In this way, it is possible to maximize the System Open Market Account operations with a minimum of transactions since they are directed at the gap between market demand and supply rather than at the full magnitude of the market on both sides.

The unusual market conditions which developed late in 1947, the System policy of buying and selling Treasury bonds only on an agency (commission) basis, and the established procedure of dealing only with qualified firms, all created a situation, new in degree if not in kind, in our relationship with the market.

This situation was most severe at the end of 1947 and in the early weeks of 1948 when System intervention on an extraordinary scale was required to clear the market of offerings of Treasury bonds and when Treasury investment accounts withdrew from the market as buyers. In order to obtain our full support price, sellers tended to channel their business through those dealers who, by the reason of their qualification to deal with the System Open Market Account, were in a position to give immediate execution to orders. In this circumstance, firms which did not have access to the System Open Market Account were able to function with the usual profit margin only to the extent that outside buyers could be found who were willing to pay better than the support price.

This resulted in some protests, voiced mainly by the smaller firms, against the competitive effect of the procedures in force. The protests included the assertion that current credit and debt management policies of the

Federal Reserve System and the Treasury had created a situation in which the System was the primary factor in matching demand and supply in all issue classifications of Government securities. It was further claimed that a dealer who had no recourse to the System Open Market Account, was at an increasing disadvantage in his daily operations, especially with respect to Treasury bonds which are the chief source of his income. Unable to wash their business through the System Open Market Account, these dealers asserted that they were faced with a declining volume of business and a possible impairment of long standing customer relationships. Dealer protests against the competitive effect of procedures in force deserved a hearing.

The position this Bank has taken is that present System policy clearly implies that open market transactions for the System will be restricted to those dealers in the market having a large volume of business of national scope, and is calculated to preserve a private market in Government securities, in which brokers and dealers, both large and small, will normally participate, and in which the System's participation will be kept to a minimum consistent with its objectives in the field of credit policy and in support of the Government security market.

It remains to be determined whether any convincing basis exists at this time for widening the group of qualified dealers, either through a relaxation of this Bank's interpretation of the committee's terms or through a revision of those terms. This Bank believes that some of these small firms have been a constructive influence in the market, with a sense of responsibility to the market, and that they have striven to establish a representative business in United States Government securities. Some of them conform generally to one or more of the standards laid down by the committee, but fail to measure up to all of them, and particularly to the requirement that

their business be national in scope, and to the requirement with respect to the amount of capital employed. Although not unmindful of the difficulties which these firms have experienced in recent months (difficulties which are already tending to disappear), this Bank is of the opinion that, in the broadest sense, neither the interest of the market nor the needs of policy would be served by a relaxation of the qualifications established by the Federal Open Market Committee nor of their interpretation by this Bank. The System through those dealers now qualified is dealing with firms which handle upwards of 90 per cent of the daily volume of business transacted in Government securities in the market and considers its contact with the market to be as broad and inclusive as the efficient and practical administration of the Account requires. Of course, if any dealer not now qualified should meet the Federal Open Market Committee's conditions, this Bank would qualify it. But to qualify any large number of small dealers by relaxing the conditions precedent to qualification or the interpretation of them would create a difficult administrative problem of determining qualification and maintaining performance, and eventually might well destroy the principle governing present procedure. This would carry in its train the risk that the total volume of offerings to the System would be larger in periods of support because a heterogeneous group of dealers would probably include some who might actively solicit business against the System's supporting bids. Under the present set-up, if such solicitation of business arose, it could readily be stopped in dealing with a compact group of responsible dealers.

This Bank has also, at the request of the dealers, recently studied in some detail, with benefit of counsel at this Bank and at the Board of Governors, a related suggestion that the System give tacit, if not express consent, to the splitting of commissions paid by the System

to qualified dealers where the transaction in question has originated with "unqualified firms." This study indicates that the splitting of commissions by dealers would not provide a feasible solution to the problem. The more technical objections to this arrangement include the following:

1. Under existing agreements the qualified dealer would be under compulsion to see that a non-qualified dealer refrains from any solicitation of offerings of United States Government securities and, in so doing, the former would in all cases find it very difficult to prevent the disclosure of confidential information with respect to his transactions with the Bank.
2. A question is involved as to whether such an arrangement would violate certain provisions of the Clayton Antitrust Act as amended by the Robinson-Patman Act of 1936.
3. It would appear that the splitting of fees would contravene the New York Stock Exchange rules with respect to transactions engaged in by dealers who are members of the Exchange.

Conclusions

The problems of the small dealers, outlined in this report, appear to be less formidable and more temporary than some have suggested. There is no doubt that their operations have been circumscribed, in the recent past, when market quotations corresponded closely to the support levels. Early in February, however, two of the unqualified firms, which did not associate themselves with the others in claiming discrimination by the System, reported that they were able to function at a reasonable profit during January without a significant increase in their positions. More recently, pressure on the Treasury bond market has eased in response to a better demand and a contracting supply, and a fair amount of two-way trading has taken place without reference to the System Account. The Federal Reserve Bank of New York has also, in its capacity as fiscal agent for the Treasury, purchased limited amounts of restricted bonds from unqualified dealers, from time to time, on market orders for Treasury investment accounts.

After reviewing the terms and conditions of qualification requirements established by the Federal Open Market Committee in 1944, and examining the market situation which has recently developed, this Bank has no changes to recommend either with respect to the substance of the conditions or their interpretation. From the standpoint of keeping the System's market operations as nearly in line with its credit policies as possible, a large increase in the number of qualified dealers might easily weaken rather than strengthen the System's position. A relaxation of the interpretation of the terms and conditions might easily result in such an increase and in an administrative problem. The principal danger in this regard would arise from lowering the standards with respect to the requirements regarding (1) "volume and scope of business and the contacts which such business provides", and (2) "capital at risk of business". It would seem as important now as it was in May 1944 that the line of demarcation between qualified and unqualified firms be as clearly defined as possible, if the System's practice is to be understood and defensible and if future requests for qualification are to be capable of determination.

It is the opinion of this Bank that the System's standards and requirements should be responsive to the needs of the national economy and of credit policy and public debt management, not to the desire of all those who find it profitable to engage in the business of dealing in Government securities.

Att.

FEDERAL RESERVE BANK OF NEW YORK
April 15, 1948.