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Authority E.Q.10501

*To the Secretary
Gov. Harding*

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FEDERAL RESERVE BANK
OF NEW YORK

June 11/20

FEDERAL RESERVE BANK
460.11
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June 11, 1920.

Dear Mr. Leffingwell:

I have your letter of June 7, accompanied by a clipping from the New York Times of June 4 which states that there is an unwritten understanding pursuant to which call money is not allowed to go below 6%.

As I told you over the telephone, this understanding is not correct. The fact is, the stock exchange call money market is not well organized and not infrequently is a most disturbing factor in the whole financial situation. I made inquiry as to the basis for the article to which you make reference and learned from an authoritative source that on last Friday a certain trust company (which is fiscal agent for the State of New York) appeared in the market with \$8,000,000 at 6%, at about a quarter of three in the afternoon. \$5,000,000 was all that was required, which was rapidly taken, supplying the demand and leaving some \$3,000,000 which could not be loaned. In other words, this one episode technically created an oversupply of call money. On Monday, the next succeeding business day, this \$5,000,000 was promptly called, and as there happened to be but a very limited amount of money offered at that time the rates immediately shot up to 10%, reflecting, of course, a shortage in call money.

As I have previously stated to you, the stock exchange call money situation forms the "missing link" in our financial chain and constitutes a disorder the remedy for which our best banking minds should address themselves to finding. It seems absurd that in dealing with a banking unit that frequently involves a sum of a billion dollars, the matter of lending or calling a comparatively insignificant sum in one day should necessitate an interest change ranging all the way from 4% to 20%. Its effect upon the general credit situation cannot be other than bad. As you know, our member banks have exercised a pretty steady pressure upon their stock exchange loan accounts, with the result that there has been a continued and substantial reduction from the peak which was reached last Autumn. There has, in consequence, been very extensive liquidation in the stock market during the last few months, with a considerable reduction in the price level of securities. The call money market is operated most unscientifically, and I am hoping that as this fact becomes more and more appreciated, some plan may be evolved that will change the present practice of lending money in Wall Street on "sharp call" against more or less unliquid assets.

Very truly yours,

J. H. Case

J. H. CASE,
Acting Governor.

Honorable R. C. Leffingwell,
Assistant Secretary of the Treasury,
Washington, D. C.

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June 7, 1930.

Dear Mr. Cates:

I enclose a clipping from the New York Times of June 4th stating that there is an unwritten understanding pursuant to which call money is not allowed to go below 6%.

It seems to me that if there is any such understanding it should not be tolerated. A year ago last winter the control of call money, so far as it was sanctioned by the Treasury, was withdrawn. One of the reasons urged for the withdrawal of such control at the time was that it was then operating to hold up the call money rate.

It seems to me that any combination among banks to keep the rate for call money from falling below 6% under peace conditions not made for a public purpose or with Government sanction is of doubtful legality and more than doubtful morality. Furthermore, I think that in the long run its effect upon the general credit situation cannot be other than bad. If banks which habitually keep money out on call at the removal rate can be assured a minimum of 6% with the possibility of a much higher rate the consequence is likely to be to attract more money into the call money market, particularly from out of town, and to prevent its investment in bills and in time loans. Everyone realizes that the objective should be to divert as much money

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as possible from the market for call money on stocks and into bills and substitute a market for call money on bills and to finance stock speculation with time money.

I suppose there may be a notion that if the rate should fall below 6% that would stimulate speculation in stocks. I believe, however, that its ultimate effect would be the withdrawal of funds from the call money market and investment of them in Treasury certificates and other time loans and consequently very high rates for call money whenever excessive demands should be made by the stock market.

Very truly yours,

(Signed) R. C. Leffingwell

J. H. Gano, Esq.,
Acting Governor,
Federal Reserve Bank,
New York.

Enclosure.

ROL:WAM

(COPY)

NEW YORK TIMES, FRIDAY, JUNE 4, 1920.

TOPICS IN WALL STREET

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Cheap Call Money.

The quotation for call money which obtained on the Stock Exchange throughout yesterday's session was 6 per cent. But this does not accurately reflect the value of call money, for there was a good deal which could not be loaned at that figure and had it not been for the informal "peg" there is little doubt that the rate would have gone under 6 per cent. This cheapness of call money, when all other kinds are dear, is rather unusual and it shows quite clearly the utter lack of positive relation between the call rate and Reserve Bank re-discount rates at the present time.

Supply and Demand.

The supply of money, as everybody knows, is not great enough just now to meet all the demands which are being made and which would be made if accommodation were freer and less costly. Yet there is an apparent over-abundance of call money. The answer for this is that the stock market is dull and not using as much as usual, while a good many bankers, in the process of playing safe by keeping rather large amounts of liquid money available, find that these amounts exceed the Stock Exchange demand. Thus there is an altogether artificial aspect given to the call money market, where the ordinary laws of supply and demand are more or less suspended by the "6 per cent minimum" which is being adhered to.

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EX OFFICIO ME

D. F. HOUSTON
SECRETARY OF THE TREASURY
CHAIRMAN

JOHN SKELTON WILLIAMS
COMPTROLLER OF THE CURRENCY

ADDRESS REPLY TO
FEDERAL RESERVE BOARD

FEDERAL RESERVE BOARD

WASHINGTON

W. P. G. HARDING, GOVERNOR
ALBERT STRAUSS, VICE GOVERNOR
ADOLPH C. MILLER
CHARLES S. HAMLIN
HENRY M. MOEHLERPAH

W. T. CHAPMAN, SECRETARY
R. G. EMERSON, ASSISTANT SECRETARY
W. M. IMLAY, FISCAL AGENT

ALL ACKNOWLEDGMENTS

RECEIVED

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April 7, 1920

X X-1888

Dear Sir:-

Referring to Governor Harding's letter of March 30th, X-1878, transmitting the reply of the Federal Reserve Board to Senate Resolution No. 328, a limited supply of printed copies of this document has been received by the Board, and I am sending you under separate cover, twenty-five copies for use by your bank.

Very truly yours,

Assistant Secretary.

To Chairman of all F.R. Banks.

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*Rev. Mr. Jay
St. Louis*

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March 9, 1920.

Dear Mr. Jay:-

Referring to our telephone conversation this morning, I hand you herewith copy of a letter which I addressed to Secretary Houston on February 19th, which explains itself. Please return this letter when you have finished with it.

I hope you will be able to send me in the very near future a draft of proposed reply to Senate Resolution which was passed at Senator Owen's instance on yesterday, the text of which was transmitted to you over the telephone this morning.

Very truly yours,

Governor.

Mr. Pierre Jay,
Federal Reserve Agent,
Federal Reserve Bank,
New York City.

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1917 Cont'd

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Preliminary Report of Committee on Term Settlement
of American Acceptance Council.

The undersigned, ~~acting as a committee~~ appointed by the American Acceptance Council for the purpose of studying the advisability, ways and means of modifying the present system of settlements on the New York Stock Exchange and substituting therefor some system of periodical settlement, have held two extended conferences at which the problem was fully discussed both from the point of view of the banks and of the Stock Exchange.

The members of the Committee have unanimously expressed the opinion that the adoption of a Term Settlement by the Exchange would offer advantages in that it would eliminate duplication of the handling of securities and in payments. Inasmuch as it involves, however, changes of great importance both to Banks and to members of the Exchange it will require the most careful study of the subject by the Committee and in any case a term settlement cannot be put in operation until the new system of daily Stock exchange settlements through the Stock Clearing Corporation has been perfected and in practical operation for a reasonable time.

The Committee inspected the new quarters and the machinery of the Stock Clearing Corporation and expressed ^{itself} ~~the~~ greatly impressed by the thoughtfulness and vision with which every detail of the new machinery had been thought out.

The Committee received from one of its members, Mr. Samuel F. Streit, Chairman of the Committee on Clearing House of the Stock Exchange, a detailed report describing the term settlement operations in London and on the European Continent. This report is attached, and the Committee recommends

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that it be printed and widely circulated amongst the members of the American Acceptance Council, the banks and banking and Stock exchange houses. The Committee believes that the study of the report will be very helpful in assuring a more comprehensive grasp of the problem, which will be essential in ultimately passing upon the ~~un~~ question of whether or not active steps should be taken towards the adoption of stock exchange term settlements in the United States.

Respectfully submitted,

WALTER E. FREW
JOHN H. FULTON
DONALD G. GEDDES
GATES MCGARRAH
W. H. PORTER
WM. H. REMICK
JOHN E. ROVENSKY
EDWARD SHEARSON
SAMUEL F. STREIT
E. V. H. THAYER
PAUL M. WARBURG, Chairman.

#9893

Where "elimination" appears
use "settlement" instead

Office of the
AMERICAN ACCEPTANCE COUNCIL
NEW YORK
not final proof

Term Settlements

Trading in securities for the account or periodical settlement dates far back in the history of security transactions; a term settlement having been provided for by the regulations of the Paris Bourse as early as 1724. The first compilation of the Rules and Regulations of the Committee for General Purposes of The Stock Exchange in London became effective on February 12th, 1812, and its recognition of settling days indicated that trading for the account was a well established practice at that time. Clearing houses were not then known.

The first clearing systems practiced were by the exchanges in Glasgow and Manchester in 1848, but were very primitive. The first complete system of clearing intermediate contracts in securities was established in Frankfort in 1867, and from the methods practiced there the principles of clearing were adopted by all of the principal Bourses and Stock Exchanges of Europe within ten years, but it was not until 1892 that the New York Stock Exchange established its clearing house.

As the principal trading in securities on European Bourses and Stock Exchanges is for the periodical or term settlement, most of their clearing systems are adapted thereto and make no provision for cash trades. The definition "term settlement" used herein indicates any settlement for a period that is daily, weekly, fortnightly, or monthly.

The description given in this pamphlet of the operations of term settlements is based on conditions as they existed in Europe prior to 1914, as upon the outbreak of the European war all Bourses were closed and up to the present writing they have only partially resumed. With the exception of the Paris Bourse, trading for the account or settlement has not begun again. In London a resumption is expected as soon as the Defense of the Realm Act is abrogated.

In all markets having term settlements loans on Stock Exchange collateral are generally made for the period of the settlement and substitutions of securities in loans during that period are unusual. In London particularly the purchaser or seller for cash has to pay a higher or receive a lower price, and, as stamp taxes and additional fees contribute to making cash operations more expensive, the volume of cash trading is comparatively small.

The call money market is not based on Stock Exchange collateral but the bulk of the call loans is made on acceptances and special governmental obligations. As in the operations of a term settlement, described hereinafter, the brokers know what their money requirements will be for the ensuing account a day or two in advance of the final settlement day of the current account, they are enabled to make their banking arrangements with the least possible disturbance; the discount market in the final analysis acting as the regulator of excess demand or supply of Stock Exchange money.

In addition to banks, many banking or semi-banking firms make a practice of carrying brokers over from one settlement to another at an interest charge somewhat higher than current banking rates for the account, as more fully described hereafter in the operation of the Contango in London. On these loans no margin is generally required. On the other hand, banks insist on margins on Stock Exchange loans of about ten points, instead of the usual 20% required by New York institutions. This margin must be kept good.

In a market having a daily settlement as New York, the operations of a Clearing House eliminate on an average 60% of the actual delivery and payment of daily transactions, leaving only 40% to be actually settled for the succeeding day. These figures vary slightly according to the character of the market, but the law of averages from statistics during the twenty-seven and a half years that the Clearing House of the New York Stock Exchange has been established show that the variation is seldom more than 5% above or below the percentages given.

In term settlements of a fortnight as practiced in Europe, the elimination is equivalent to 90% of the total volume of transactions in stocks cleared, which would leave on settlement day of a fortnightly term about two and one-half to three times the amount of securities to be delivered and paid for on final settlement day as is put through in a daily settlement.

For purposes of comparison, and to verify for the New York market, figures were prepared for several periods of a fortnight at the New York Stock Exchange Clearing House which show that the same average percentage of elimination would be effective if a fortnightly settlement were in operation in New York as is now shown in a European term settlement of that period.

The results of this additional elimination of intermediate contracts through the operation of a term settlement indicate its efficiency over a daily settlement in the reduction of unnecessary labor and risk in handling securities.

The custom of London and the Continental Bourses of leaving unprotected contracts for purchase and sale for the period of the settlement presents an element of risk ~~but~~ if a term settlement should be seriously considered in New York could be largely guarded against by the deposit of funds with the Stock Clearing Corporation, on the lines of the margin required by the Syndicat in Paris, from the members of the Coulisse trading for the term settlement, or by a daily clearing, making down contracts to closing prices each day, but deferring the final settlement to the weekly or fortnightly period.

The principles of trading for a term settlement as practiced in all countries of Europe are the outgrowth of experience for a long period of time that has proven its advantages in the saving of labor and waste effort.

As the methods of trading and settlement vary, a description of the principal details of operation of term settlements in London, Paris, Berlin and Vienna are given separately.

London

The settlement in London is fortnightly for all securities except Consols, which are settled monthly.

The Settlement Department of the London Stock Exchange is under the control of a sub-committee of the Committee on General Purposes, with a Manager and subordinates numbering about thirty for the permanent staff, but increased to one hundred and forty more at the time of the settlement, divided into day and night shifts.

There are two classes of settlements: one for the Mining or Registered stocks, which begins the first of the four days of settlement, and the other for Bearer Scrip securities, which include American stocks, and begins on the second day. The number of securities in the Settlement Department in February, 1914, amounted to 243, which is a fair average. The number is increased or decreased, according to the activity of the stocks, by decision of the Settlement Department Committee, acting under suggestions from the Manager of the Department.

Separate sheets are sent for each security, the average number of sheets being about twenty thousand. There are twelve hundred firms members of the Department, of which an average of eight hundred send in sheets at any one settlement. It is not obligatory to be a member of the Settlement Department, and there are still about fifty firms who do not have their stocks cleared.

The number of items at any one clearing varies largely according to the size of the settlement, varying from 75,000 items at the end of January, 1914, to 155,000 items in the middle of February, 1914. Such securities as Canadian Pacific, Union Pacific and United States Steel Common contain anywhere from 12,000 items upward in active markets, but averaging 6,000 to 7,000 in ordinary times.

The average rate for clearing is two pence per item, but there are three charges, Americans being the lowest, Registered stocks next, and Rubbers and Oils the highest. Errors are not fined, but a fine of ten shillings is made for sheets sent to the Settlement Department after the prescribed hour.

Charges received for clearing are used to defray the expenses of the Department. In addition to the charges per item, each firm using the Settlement Department has to deposit £1-10 as an original charge.

As in all clearing systems, the principle of the operation of the Settlement Department is to eliminate intermediate contracts and bring the original seller and the ultimate purchaser together, but, because of the tradition that at all times the continuity of liability must be maintained until the final settlement is made, the method of the London Settlement Department involves cumbersome detail not considered necessary in other clearing systems. This is called the trace system, whereby the Settlement Department furnishes to the ultimate purchaser a memorandum or ticket showing the line of responsibility from the original seller to the final buyer, so that in case of default the liability can be traced back to each individual house concerned. The detail necessary to carry out this condition is very great, and at times makes it almost impossible to bring about a balance in time for the opening of business the next morning.

Liability

The method of the London Settlement Department carries to its extreme limit the theory of the original liability on contracts, but while it thus apparently increases the security in case of a failure, it is placing every house concerned in danger of possible breakdown of the clearing machinery, and in times of very great activity it has so fallen down.

The alternative of this system is the pro rata clearing which is followed by the Continental Bourses and by the Clearing House of the New York Stock Exchange. This system embodies the principles which should be adhered to if a term settlement is ever adopted in New York.

A pro rata clearing was established in London in 1874, but came to an end in 1880; and failed largely because of the fact that there was no proper line of liability, and no authority to enforce it. It was tried in spite of, and almost in defiance of, the Committee at that date, and it has been stated that "the Stock Exchange Committee intended that it never should succeed."

It is unnecessary to describe the complicated present rules of the London Stock Exchange providing for the closing out of securities in case of default or insolvency, except to state that they preserve the liability of the original parties to any contract.

The principle of original liability on the part of contracting parties is carried in London to its extreme, not merely on the part of the Settlement Department, but also to the extent that a customer, having sold a security through a broker to a jobber, and the broker, having become a defaulter being unable to pay his client, the latter can deliver the security directly to the jobber or dealer, whose name the broker has had given to him as the purchaser, and the dealer in that case must pay him therefor, having for his recourse a claim against the broker.

The liability on the one hand for bad stock, on the other for a bad check, or non-payment, rests on the line of the trace given by the Settlement Department, and each individual thereon is liable to his dealer for that particular amount.

Account Days

The Committee on General Purposes in each month fixes the Account days for the second succeeding month. The operation of the settlement occupies four days:

- First, The Mining Contango day.
- Second, The General Contango day.
- Third, The Ticket day.
- Fourth, The Account day.

On the first two days the firms send to the Settlement Department the sheets showing the transactions for the period covered by the settlement, and the transactions are separated as to the classes of securities to avoid congestion. The carrying out of the work of the Settlement Department is entirely separate for each class of securities.

The so-called "Contango day" is when accounts are made up and arrangements are made by the brokers for the carrying (over of stocks) into the new account at prices existing as of twelve o'clock on that day. Contango is freely translated as "carry over," and is used to mean the rate of interest for a time loan upon securities from one settlement day to another, or, in the case of a "bear" or short account, the rate at which stocks are borrowed or loaned for the same period, (exactly in the same manner as is done from day to day in the New York market). The technical bookkeeping operation as between two firms consists in selling for cash and buying for the following account, plus interest, or buying for cash and selling for the following account, ~~with~~ interest. plus

The third day, or Ticket day, is when firms ~~ex~~change among themselves tickets (or what in New York would correspond with comparisons), for the purpose of settling among themselves those contracts in securities traded in for the period of the settlement which are not included in the stocks cleared by the Settlement Department.

The fourth day, the Account day, is "Pay day," when securities are delivered and paid for. These deliveries take place, as in New York, by each seller sending out his deliveries to the ultimate purchaser.

If the holder of Settlement Department orders to deliver securities should allow two clear days to elapse without delivering, he releases his buyer from any loss in consequence of default of a member involved in the contract.

Bank Clearings and Money Payments

Certified checks are not known in London and it is customary for brokers to deliver stocks and have their clerks return later for the check in payment thereof. Under London banking practices there are no priority checks, so that unless a broker's balance with his bank at the time of the bank clearing is sufficient to warrant the bank to pay all of his checks presented for payment, none of his checks is paid. Securities must be delivered not later than 2:30 P. M. on week days and 12 o'clock on Saturdays.

The clearing of each day's business by the banks in London takes place in the afternoon and not the next morning as here.

According to the following sections of Rule 94 of the Rules of the Committee on General Purposes:

- (2) "Cheques must be passed through the Clearing House, unless the Drawer consent to their being otherwise presented.
- (3) "If a Member require Bank Notes in payment for Securities sold, without having made such stipulation at the time of making the bargain, he must give notice to his Buyer to that effect before Half-past Eleven o'clock on the day of delivery, and payment shall be made upon delivery of the Securities, or the Stock receipt."

Section three of Rule 94 is practically never insisted upon.

As to the volume of money transfers on the Pay day of the settlement, the result shows an increase of cash clearing through the banks of about double, so that, where on a daily average of £51,000,000 are cleared, the average on Stock Exchange settlement days would be about £98,000,000. (These figures were secured from the Clearing House of the London banks.)

Settlement Department Statistics

It has always been very difficult to secure any figures as to the volume of securities traded in on the London Stock Exchange, but on two occasions more or less accurate figures were kept, the first being during the panic of May 9, 1901, where the volume on both sides of stocks cleared, including balances, amounted for the ten days of the settlement to \$1,270,000,000. At another time figures were kept of transactions in Union Pacific and Steel Common as follows:

AVERAGE FORTNIGHTLY FIGURES

	Items	Amt. Cleared	Shares— \$100
Un. Pac.	4,389	\$21,368,000	22,800
Steel	7,254	50,864,000	46,640

The unit of trading on The Stock Exchange in London varies in different departments, but in that of American securities the unit is ten shares.

Broker and Dealer

There is considerable confusion in the minds of many unfamiliar with the customs of the London Stock Exchange with regard to the distinction between a broker and a dealer. Stock Exchange members are separated into these two classifications, and the Rules and Regulations state that: "No Member or Authorized Clerk shall carry on business in the double capacity of Broker and Dealer." Also "A Broker shall not make prices or

otherwise carry on the business of a Dealer." Again, "A Broker may not put business through for another Broker"; and, again, "A Dealer shall not deal for or with a Non-member." The nearest analogy for this method of business would be found on the New York Stock Exchange by comparing the dealer in London to the specialist, and the dealer in odd lots on the New York Stock Exchange. The dealer does not come in contact with the public and buys from and sells to brokers who have orders from their customers. The dealer, or so-called jobber, in London is accustomed to buy or sell at close market prices in amounts ranging from ten shares to many thousands, and he changes his position and prices according as to whether the demand or supply is greater. For the business of a dealer as carried on in London term settlements are almost a necessity in order that he may have the opportunity during the interval between two settlements to change his position and even up his contracts without having to settle each day for the preceding day's transactions.

Continental Systems

Paris

The principles of dealing and clearing for the term settlement on the continent of Europe are fundamentally the same as in London, except that with respect to the clearing they follow the New York method in having a pro rata settlement rather than the cumbersome trace system of London.

The Bourses of Paris, Berlin and Vienna are under government regulation and control, and they can make no change in their rules and regulations without the approval of the Minister of Finance in France, or a similar government official in the other countries.

The best illustration of a Stock Exchange completely controlled by the government, and regulated and restricted, by most rigid rules is offered by the organization known as the Agents de Change of Paris, whose regulations, although revised in 1890 and 1898, have not been altered materially since 1724. In 1898 the number of its members was increased from sixty to seventy, where it now stands. The Agents de Change have enjoyed special privileges for trading in securities since the fourteenth century. The value of the privilege of being an Agent de Change has been as high as 2,000,000 francs, but in 1914, prior to the war, was placed at about 1,700,000 francs. Besides this cost of his seat, each member must furnish a cash bond of 250,000 francs, and in view of the large investment thus required members generally associate with themselves other capitalists who are known as "silent partners." These special partners have no rights or obligations toward third parties except with and through the Agents de Change.

Coulisse

The so-called Coulisse, or outside brokers, who trade on the floor of the Bourse not reserved for the Agents de Change and also on the porch of the building, are divided into two bodies; one dealing only in securities for the term settlement, and one dealing for cash or immediate settlement. In 1914, of the former there were 113 members and of the latter about 150, but most of the members of the first are also members of the second.

The Syndicat de Banquiers a la Feuille des Valeurs au Terme, or Coulisse brokers trading for the settlement, admits to membership only such persons or firms as have assets equivalent in cash or proper securities equal to no less than 1,000,000 francs. Corresponding to our Governing Committee, there is a Board of Direction, (Chambre Syndicale), which exercises a very rigid control over the members. This organization provides for the term settlement a protection not enjoyed in London through the enforcement of a requirement obligating the deposit with the Syndicat the sum of 100,000 francs to be held for the benefit of all members concerned as a margin guaranty on trades.

In times of active fluctuations, the Syndicat has the right to increase the amount of this required deposit. No interest is allowed on this money, such return as is received therefrom forming one of the sources of income from which the expenses of the Chambre Syndicale are paid. This guaranty fund is kept on deposit in the Bank of France.

As in London it is a weak spot in the settlement methods of the *Coulisse* that members under the rules of the *Syndicat* are not obliged to deliver security balances to any member designated by the Settlement Department unless they have actually traded with such member during the month. This defect is overcome by certain members voluntarily, in the interest of the organization, agreeing to act as intermediary, receiving the security from objecting members, assuming all responsibility, including payment, and delivering it to the receiver named by the Settlement Department, or *Bureau de Compensation*.

Certified checks are also unknown in Paris, but by requiring the *Agents de Change* and both organizations of the *Coulisse* to keep their accounts with the Bank of France this difficulty—one of the greatest of the New York system—is overcome.

The volume of money transferred on settlement days through the Bank of France for the monthly settlement of both the *Agents de Change* and the *Coulisse* is about three to four times that of any other intermediate day. (More complicated than in London, the operations take five days instead of four days.)

The settlements in Paris among the *Agents de Change* are both monthly and semi-monthly, with the exception of *Rentes*, which are only settled monthly, as well as traded in for cash. The term settlement of the *Coulisse* is monthly only for all classes. Through the *Syndicat de Banquiers au Comptant*, or those trading for cash, a very considerable market for immediate settlement has grown up, although immediate settlement by this organization does not mean necessarily the next business day as in New York, as the rules for demanding delivery are very elastic and so-called cash transactions generally run from two to five days before being settled.

The centralization and delivery of securities in Paris is simpler and avoids a great deal of the congestion on settlement day occurring in London.

The loans by banks, both to the *Agents de Change* and to the members of the *Coulisse* trading for the term settlement, are made for the period of the settlement and as settlement day approaches and when the Settlement Department has issued its orders for the receipt and delivery of securities on final settlement day, the brokers know what their requirements will be in the money market and make their arrangements accordingly with the banks. There is also a money market for so-called call money to take care of the cash transactions, but it is very limited as most of the transactions for cash are for investment purposes.

The unit of trading varies according to the value and character of stock from ten to fifty shares.

Berlin

On the Berlin Bourse dealings in securities are both for daily settlement and for the term settlement, which in this case is monthly. All securities can be and are traded in for the daily settlement, but only active and well established securities are admitted to the trading for the monthly settlement. This corresponds with the admission to the Clearing House of the New York Stock Exchange of only active securities, as a clearing is not effective or useful unless there is sufficient activity to bring about elimination of intermediate transactions, whether in a daily settlement or in a monthly settlement, and experience in London corresponds with that in Berlin where the securities admitted to the clearing account for about 90% of the total trading.

In Berlin the Bourse makes no provision for clearing securities except for those included in the monthly settlement. The Berlin Bourse as well as that of Vienna differs from Paris, London and New York in allowing banks to be members thereof. The Clearing is carried on on the pro rata principal as in Paris and New York.

The unit of trading varies according to the value of the stock, the higher price stock being the smaller unit, varying from five to one hundred shares.

Vienna

Vienna not only has a considerable market for cash but also has three additional settlements, each involving a clearing, namely, weekly, fortnightly, and monthly.

The unit of trading is twenty-five shares, except in securities that are quoted at very high figures where the unit is five shares, and in the weekly clearing the unit is sometimes as low as one share.

The principal settlements are monthly and weekly, the monthly being used for the better class of active stocks on which it is not considered the liability for such a long period of time is as great as it would be on the more speculative type, which are confined to the weekly clearing, but all securities can also be traded in for cash.

As in Paris, the borrowing arrangements of the brokers are made with the banks as soon as they know their position as the result of the settlement, although in Vienna, contrary to London, the loans, although made for the period of the settlement, can be called on any day; however, in practice this privilege is never used.

* * * * *

As previously stated, the term settlement system avoids unnecessary duplication of the handling of securities and payments therefor as well as the disarrangement of money markets. It also provides adequate time for the procuring of the funds required. This paper in describing term settlements does so only from the viewpoint of the practical operation thereof. It is not within its limits to discuss the wisdom of the adoption of term settlement which is largely dependent upon the time when it is to be applied. a

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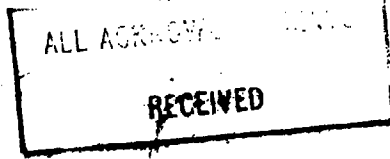
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HENRY SKELTON WILLIAMS
COMPTROLLER OF THE CURRENCY
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FEDERAL RESERVE BOARD

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W. T. CHAPMAN, SECRETARY
R. G. EMERSON, ASSISTANT SECRETARY
W. M. IMLAY, FISCAL AGENT

WASHINGTON



March 30, 1920.

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CARDED

SUBJECT: Board's reply to Senate Resolution 328.

Dear Sir:

There is enclosed herewith, for your information,
copy of the Board's reply to the following resolution adopted
by the Senate on March 8, 1920:

"RESOLVED that the Federal Reserve Board be and is hereby directed to advise the Senate what is the cause and justification for the usurious rates of interest on collateral call loans in the financial centers, under what law authorized, and what steps, if any, are required to abate this condition!"

Very truly yours,

Governor.

To all Agents and Governors of the F. R. Banks.

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Authority E.Q 10501

RESERVE BOARD FILE

FEDERAL RESERVE BOARD

WASHINGTON

OFFICE OF THE GOVERNOR

March 30, 1920

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SUBJECT: Board's reply to Senate Resolution 328.

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[Handwritten mark]

[Handwritten signature]
Governor

To Federal Reserve Agents and Governors of all F. R. Banks

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FEDERAL RESERVE BOARD

March 27, 1920.

Subject: Reply to Senate Resolution No. 328.

CARDED

Sir:

On March 8, 1920, the Senate adopted the following resolution

"RESOLVED that the Federal Reserve Board be and is hereby directed to advise the Senate what is the cause and justification for the usurious rates of interest on collateral call loans in the financial centers, under what law authorized, and what stops, if any, are required to abate this condition."

In reply the Board desires first to invite attention to the following tables showing discount and interest rates prevailing in various centers in all Federal reserve districts during the two thirty-day periods ended January 15, 1920, and February 15, 1920. It will be seen from these tables that the maximum and minimum rates on demand loans secured by collateral are approximately the same as those for commercial paper in all cities except Boston and New York. While the legal rate of interest in Massachusetts is 6%, higher contract rates are authorized, and consequently the 6% limitation is occasionally exceeded.

(Tables referred to appear on pages 286 and 287 of Federal Reserve Bulletin for March 1920.)

The only financial center in this country in which there is maintained a call money market of national importance is New York City, and while the rates charged there on call loans are frequently in excess of the legal rates allowed for commercial paper, they are not "usurious" under the laws of the State of New York, which specifically exempt collateral call loans from the 6% limitation which lenders must observe on other loans on pain of incurring the penalty prescribed for usury. Section 115 of the Banking Law (L. 1914, Ch. 369; Consol. L. Ch. 2) provides that upon advances of money repayable on demand to an amount not less than \$5,000 made upon warehouse receipts, bills of lading, certificates of stock, etc., or other negotiable instruments as collateral, any bank may receive and collect as compensation any sum which may be agreed upon by the parties to such transaction. The section reads:

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"Sec. 115. Interest on collateral demand loans of not less than five thousand dollars.

"Upon advances of money repayable on demand to an amount not less than five thousand dollars made upon warehouse receipts, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds or other negotiable instruments, pledged as collateral security for such repayment, any bank may receive or contract to receive and collect as compensation for making such advances any sum which may be agreed upon by the parties to such transaction."

Section 201 of the Banking Law, identical in language with Section 115 above quoted, makes the same provision in the case of collateral loans by trust companies. In the General Business Law (L. 1909, Ch. 25; Consol. L. Ch. 20) there is the following general provision of a like character:

"Sec. 379. Interest ^{permitted} on advances on collateral security.

In any case hereafter in which advances of money, repayable on demand, to any amount not less than five thousand dollars, are made upon warehouse receipts, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds or other negotiable instruments pledged as collateral security for such repayment, it shall be lawful to receive or to contract to receive and collect, as compensation for making such advances, any sum to be agreed upon in writing, by the parties to such transaction."

National Bank Act.

The National Bank Act provides that national banks may receive and charge on any loan or discount interest at the rate allowed by the law of the State, territory or district where the bank is located. The applicable provision reads:

"Limitation upon rate of interest which may be taken.

422. Sec. 5197.- Any association may take, receive, reserve and charge on any loan or discount made, or upon any note, bill of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory or District where the bank is located, and no more, except that where by the laws of any State a different rate is limited for banks of issue organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this Title. When no rate is fixed by the laws of the State or Territory or District, the bank may take, receive, reserve, or charge a rate not exceeding seven per centum, and such interest may be taken in advance, reckoning the days for which the note, bill or other evidence of debt has to run. And the purchase discount, or sale of a bona fide bill of

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exchange, payable at another place than the place of such purchase, discount, or sale, at not more than the current rate of exchange for sight drafts in addition to the interest, shall not be considered as taking or receiving a greater rate of interest."

It will be observed that the effect of the foregoing provisions is to authorize in the State of New York on collateral call loans of not less than \$5,000 rates of interest which may be in excess of those permitted for loans of other character, and that such higher rates are not prohibited as usurious.

As to the "cause and justification" of the high rates of interest which it thus appears may legally be charged on collateral call loans in New York, and as to the "steps *** required to abate this condition", there is, as is well known, a wide difference of opinion among persons who have given thought and study to the question. Indeed, broad and fundamental questions of general economic and social policy are involved in the last analysis, the whole question of the utility of speculative dealings in securities and commodities on organized exchanges is involved; and more immediately, the question of the methods and practices of the leading speculative markets of the country, margining, stock manipulation, and kindred matters also susceptible of abuse. As to these the Board has never had occasion officially to form an opinion; the Federal Reserve Act specifically precludes the purchase or discount by Federal reserve banks of "notes, drafts or bills covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States". The Board could not undertake to form a judgment upon the matters above referred to without study and investigation of such a comprehensive nature as would seriously interfere with the conduct of its regular work and which, had the Board the requisite authority, would require the services of experts and assistants for the employment of which the Board does not feel authorized to expend funds accruing from statutory assessments on the Federal reserve banks for the purpose of defraying the ordinary expenses contemplated by the Federal Reserve Act.

There is submitted as an appendix hereto a memorandum prepared for the information of the Board by the Federal Reserve Agent in New York, explaining in general the nature and operation of the New York call money market and causes of high and fluctuating rates for call money in that center.

Respectfully,

W.P.G. Harding

Governor.

The President of the Senate.

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THE NEW YORK CALL MONEY MARKETDefinition of Call Loans.

Collateral call loans, in the general acceptance of the term, are made chiefly in New York City, which is practically the only important call money market in the United States. They are loans which are payable on demand of the lender without previous notice, secured by the pledge of investment securities, i.e. stocks and bonds, generally those which are listed on the New York Stock Exchange. The interest rates on these loans, as on other classes of loans, are on the basis of a rate per annum.

The Borrowers.

The loans are made for the most part to houses which are members of the Stock Exchange and the money so borrowed constitutes a portion of the funds employed ordinarily in purchasing and carrying securities for their customers and securities for themselves.

The Lenders.

The principal supplies of money for collateral call loans are loanable funds of banks and bankers located both in and out-

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side of New York City, including foreign banks and agencies of foreign banks; and similarly the loanable funds of firms, individuals and corporations seeking temporary investment. The proportion of the whole fund loaned by these ~~several~~ interests varies seasonally and in accordance with the attractiveness of other opportunities for investment, either locally or in other markets. The bulk of call money is lent on the floor of the New York Stock Exchange at "the money post" where through various brokers loanable funds are offered and bids for funds are received. Most of the business is done between the hours of 12 noon and 2:45 p.m. The important relation to the money market of the present system of daily settlement of balances resulting from the purchases and sales of securities on the Stock Exchange will be discussed more fully hereafter.

Commercial Requirements have the Prior Claim.

In the matter of the supply or attraction of funds to the call money market, there is generally a definite and well understood obligation on the part of banks to accommodate first their own commercial clients, so that it is only the excess of loanable funds which they may have from time to time that is available for the collateral call money market or for the purchase of commercial paper in the open market. This excess of loanable funds available for employment in the securities market varies, therefore, according to the commercial requirements of the country. It has long been

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recognized that for assurance of sufficient amount of money to finance the volume of business in securities, reliance cannot be placed on a rate of interest limited to the rates which obtain or are permitted in commercial transactions whose prior claim on banking accommodations is universally conceded.

CAUSES AFFECTING PRESENT CALL MONEY RATES.

The reference in the resolution to the present high rates for call money in the financial centers and the inquiry as to their causes require, it is felt, a survey of the operations of the money markets and the reflection therein of the underlying economic conditions which govern, in varying degrees, all money rates, including those for call money.

Present Changed Conditions of Supply.

In former times, and specifically prior to the institution of the Federal Reserve System, bankers, especially in reserve centers, were accustomed to look upon call loans as their principal secondary reserve on the theory that inasmuch as those loans were payable upon demand, funds so invested could always be promptly obtained on short notice to meet withdrawals of deposits or for other use. In these circumstances there was ordinarily available for collateral call loans a supply of funds sufficient

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for ordinary market requirements and at low rates, although at times the rates rose to high levels as the supply of funds diminished, or the demands increased.

This attitude of the banks toward call loans as their chief secondary reserve has been greatly modified by two causes. The first was the closing of the Stock Exchange at the outbreak of the European War in the summer of 1914, when it became practically impossible to realize on call loans secured by investment securities, which became, therefore, "frozen loans". This resulted in a more or less permanent prejudice against dependence upon call loans as secondary reserves. The second and more important factor was the creation of the Federal Reserve System. Under the terms of the Federal Reserve Act provision is made for the rediscount of commercial paper, but the rediscount of loans for the purpose of carrying investment securities, other than United States Government obligations, is excluded. Consequently, in order to maintain maximum liquidity, with suitable provision for secondary reserves that can be immediately availed of, banks, including foreign agency banks, now invest a greater proportion of their resources in assets that can be realized upon at the Federal Reserve Bank. Another changed factor in the present situation grows out of the fact that the war and post-war conditions have rendered unavailable supplies of money which formerly came from foreign banks. Since the summer of 1914, while total banking resources have largely in-

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creased, the volume of bank money available to the securities market at low or normal rates has not increased proportionately, but on the contrary has probably decreased. All of these circumstances explain in some measure, the increased rates which have often been required during the past year for money loaned in the securities market.

Present Changed Conditions of Demand.

Changed conditions are also present in the factors governing the demand for money. Prior to the armistice agencies of Government were employed to restrict the issue of new securities for purposes other than those which were deemed essential for carrying on the war. At the same time, as the Treasury undertook to sell large amounts of certificates of indebtedness and Liberty Bonds bearing low rates of interest, the question arose as to whether the competition of the general investment markets might not prejudice the success of the Government issues. In these circumstances, with full understanding on the part of the Treasury Department, the officers and members of the New York Stock Exchange undertook to limit transactions which would involve the increased use of money for other purposes in consideration of which the principal banks of New York City endeavored to provide a stable amount of money for the requirements of the security market.

After the armistice these restrictions were removed and ordinary market forces reasserted themselves. The issuance of new securities was resumed in unprecedented volume and consumed a vast amount of

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capital and credit, when bank credit was already expanded by the necessity of carrying large amounts of Government securities which the investment market was not prepared to absorb. Thus arose further cause for the increased cost at times of accommodation or collateral call loans.

Since the armistice these causes have been augmented by the increased volume and velocity of transactions in securities generally. Before examining the figures, it should be explained that the amount of call money employed by the securities market fluctuates according to the amount of other funds available for this purpose, i.e. customers' money invested and time money borrowed, and also as the volume of business varies.

Volume.

The volume of money outstanding on call is more or less constant, fluctuating only over relatively long periods, and the amount which is loaned from day to day is but a small proportion of this constant volume. The constant volume of outstanding call loans bears a rate of interest which is determined daily and is known as the renewal rate. The daily borrowings, either in replacement of loans called for payment or representing new money borrowed, are made at rates which may or may not be the same as the renewal rate and which frequently vary during the same day.

Turning to the figures, it appears that over a period of years during the pre-war period the volume of all money, both time and call, employed in the securities market was estimated at about

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\$1,000,000,000., of which the average on call was about 60% and the average on time about 40%, or a normal volume of call money, say of \$600,000,000. The daily turnover in call money, i.e. old loans called for payment, loans made in replacement thereof, and new money borrowed, ranged from \$15,000,000 to \$30,000,000., and averaged about \$20,000,000. The daily turnover during the year 1919, however, ordinarily ranged from \$25,000,000 to \$40,000,000, and averaged about \$30,000,000. Moreover it is important to notice there has been a disproportionate increase in the amount of call loans, as distinguished from time money, with the consequence that the former, as now estimated, constitute about 75% of the total money employed in the securities market. At a time of such heavy credit requirements as the present the greater volume of borrowings, not only in the aggregate but in the day to day demands, naturally often results in high rates for the money loaned. Indeed, so reluctant have the bankers been during the past few months to supply the large demand for credit based on securities that the occasional loaning of relatively small amounts of money at very high rates often represents a desire not to secure the high rate quoted but to prevent the rate from going very much higher with the consequent demoralization which might result.

Intermittent Factors.

There are certain other factors, the influence of which is principally manifested in intermittent wide fluctuations in the daily rates or in the rates which apply for brief periods. The increased

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volume of demand loans called daily for payment noted above, coupled with the decreased amount of time money loaned on securities, produces more or less apprehension on the part of borrowers as to their ability to re-borrow money called for payment. This apprehension, quickened by the number of insistent borrowers bidding at times when momentarily loanable funds are exhausted or are offered in small quantity, frequently results in competitive bidding for funds which advances the rates for a day or part of a day beyond the actual necessities of the situation.

Another active and important influence which has recently affected the supply of funds available for collateral loans and precipitated at times a rise in the rates, has been the periodic transfers of Government deposits from depositary banks to the Federal Reserve Banks in connection with the fiscal operations of the Treasury. Such withdrawals result in the depositary banks calling money from the securities market, which causes sharp advances in the rate bid for call money in replacement of the loans called for payment.

RATES ARE DETERMINED BY THE OPERATION
OF THE LAW OF SUPPLY AND DEMAND.

The underlying cause of fluctuations and, especially of increases in call money rates is the operation of the law of supply and demand. In other words, it is the supply of loanable

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funds diminishes in proportion to the volume of the demand, the rate for collateral demand loans advances. However, in the case of the daily borrowings of call money to which the abnormal high and low rates apply and which represent but a comparatively small proportion of the total outstanding loans -- other factors, incidental to the temporary circumstances and conditions of the market, tend in times of stress to greater fluctuations in rates than result from the more normal operation of the law which is reflected in the renewal rate for the greater volume of the outstanding call loans. The renewal rate is regarded as the real barometer of market conditions and its fluctuations throughout the longer periods more nearly reflect the relation between the amount of the loanable funds and the amount of the demand. In other words, high renewal rates are mainly due to other demands for credit, resulting in part from the increased requirements of the commercial community and in part from other temporary factors, such as depletion of bank reserves resulting either or both from credit expansion or loss of reserves through gold export, speculation in commodities and real estate, and congestion of commercial transactions incidental to slow or interrupted transportation.

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Commercial Rates are Similarly and Independently Determined.

The operation of the law of supply and demand is equally effective in determining the rate for commercial loans and all other borrowings. In fact, rates for commercial loans and rates for collateral call loans have a common root in the law of supply and demand, and the conditions which affect one, in the main affect the other, although not in like degree, as is demonstrated by the far wider fluctuation of call rates and the higher points to which they go. The rates for call money do not determine and have not exerted an important influence on the rates for commercial borrowings. It is the universal custom of the banks, to satisfy first the commercial needs of their customers. They feel an obligation to customers but none to those who borrow in the open market on securities. Besides as the resources of the banks mainly come from the commercial customers, their own self-interest compels a preference in favor of their commercial borrowers, since failure to grant them reasonable accommodation would induce them to withdraw their deposits and so reduce the ability of the banks to do business. Although the money of the banks and trust companies comprises by far the greater proportion of the money loaned on the securities market, an examination of the prevailing rates on commercial paper at times when the call money market is particularly strained indicates that there is little causal relation between the rates for call money and those on commercial loans. Exhibits Nos. 1 and 2, showing respectively the rates for call money on the New York Stock Exchange during the years 1906-1919 and the rates for commercial paper in New York for the period from 1915 to 1920, are attached.

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POSSIBILITIES OF CHANGE IN THE CONDITIONS AND METHODS
OF THE CALL MONEY MARKET

So long as collateral call loans are made under prevailing conditions it is difficult to see how the present situation can be altered, because of the impracticability of controlling the underlying cause of high rates, which in the last analysis, is the excess demand over supply.

An attempt to control the rates for call loans by the establishment of an arbitrary limit at a low level, without the ability to modify the causes above enumerated which operate to increase rates, would be distinctly hazardous, for the reason that up to the point where the arbitrary rate would limit the supply of new money, speculation and expansion might proceed unchecked and the natural elements of correction or regulation would not obtain. In other words, high rates act as a deterrent to over-speculation and undue expansion of credit. On the other hand, should the supply of money available at a fixed maximum rate become exhausted, liquidation might suddenly be forced because the demands for additional accommodation for the consummation of commitments already made could not be met. The effect of such liquidation would be to embarrass not only investors and dealers in securities, but frequently might affect dealers and merchants in commodities as well. As an example of the latter, the case might be cited

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of a commitment to purchase a round amount of cotton on a certain day. Many of the houses on the Cotton Exchange are also members of the Stock Exchange and frequently borrow very largely on the Stock Exchange against investment securities to provide funds for settling their transactions in cotton. If, therefore, when an important cotton settlement is imminent, borrowings on securities could not be availed of, the cotton transaction could not be consummated and a drastic liquidation through sale either of securities or of the cotton might be required to avoid default. Similar consequences might obtain in the cases of transactions by members of other commodity exchanges who are also members of the Stock Exchange and have recourse to the call money market.

THE IMPORTANCE OF A "CALL MONEY" MARKET

Call money in some form is indispensable to every important financial center. There must be not only an outlet for the employment of funds temporarily idle, but a large volume of call and short time money is essential to the successful and economical conduct of business. It is particularly essential to the international and domestic commercial business but the diversion of the use of the major portion of such money to the securities markets is not in accordance with sound banking principles. It is to be noted that

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in no great world market, other than New York, is the call money market so dependent upon investment securities and so susceptible to speculative influences. In other markets the reverse is true, as their call money is based principally on commercial paper upon which realization can be had at the central bank, at a price, in case of need. We have seen that in this country call loans on securities lack this essential quality of liquidity required for quick and certain realization, and that this fact has now been more generally taken into consideration by our lenders. But the safe and successful divorce in this country of the use of call money from its dependence upon investment securities as a basis requires careful study in order that safe and adequate methods may be substituted for the present methods of the securities market.

Term Settlements.

The achievement of this end probably depends upon the successful development of a plan for term settlements of the balances resulting from operations on the Stock Exchange, in lieu of the present method of daily settlements. The principal effect of such a change of the method of settlements would be to relieve the call money market from the necessities of the securities market and release funds now used in collateral call loans based on investment securities for employment in call loans based on the collateral of more liquid securities, of a commercial

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nature, generally recognized abroad as the preferred bases for demand loans. From this change a broader discount market would naturally develop. Under term settlements the borrowing required by the securities market would be on the basis of short time accommodation, for the term between settlements, whether they were weekly, fortnightly or at other intervals.

Agitation for the improvement of the present method of settlement of stock exchange contracts has extended over some years and as the result of extensive studies and deliberations of officers and members of the New York Stock Exchange, as well as bankers, an important step has been taken to provide enlarged clearing facilities through the organization of a new corporation known as the Stock Clearing Corporation, which is expected to begin operations in April, 1920. A general description of the purposes and contemplated operations of the corporation is contained in the pamphlet attached hereto as Exhibit No. The functions of this corporation include providing facilities for clearing contracts between members, for the receipt and delivery of securities between members and banks, trust companies and others, and for the clearing of collateral call loans. It is not asserted or expected that the institution of these operations will materially affect either the amount of money loaned from one day to another on the call money market or the rates of such loans, but it is expected that it will operate materially to decrease the amount of bank certifications on day loans, which the present practice requires

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in the interval between paying one call loan and replacing it with another on the same day. It should be noted that the mechanism afforded by the corporation is an indispensable prerequisite to the establishment of a system of term settlements.

The more recent and definite development toward the substitution of term settlements for the present system of daily settlements may be said to have had its inception in the action of the American Acceptance Council at its annual meeting on December 4, 1919. At that time the following resolution was adopted:

"Whereas, The present method of daily stock exchange settlements, with its dominating and often unsettling effect on the call money market, influences adversely the development of a wide and healthy discount market in the United States:

"Resolved, That the Chairman of the Executive Committee be authorized to appoint a committee consisting of members of the Executive Committee and other individuals to study the advisability, ways and means of modifying the present system of settlements on the New York Stock Exchange and substituting therefor some system of periodical settlement, with power to take such steps as may seem advisable in the case."

A copy of the annual report of the American Acceptance Council is appended hereto as Exhibit No. 4, in which the resolution appears on page 5, and the report of the Chairman of the Executive Committee appears on pages 16 to 27, inclusive.

The Committee thus provided for was appointed and held two extended conferences in which the problem was fully discussed, both from the point of view of the banks and of the Stock Exchange.

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For illustration of the subject matter of the discussion there is attached hereto as Exhibit No. , a detailed report compiled by one of the members of the Committee, Mr. Samuel F. Streit Chairman of the Committee on Clearing House of the Stock Exchange describing the term settlement operations in London and on the European continent, which presently will be published by the American Acceptance Council. Through its courtesy an advance copy of the report has been received. There are also attached, as Exhibits Nos. 6 and 7, respectively, two other publications of the American Acceptance Council, "Acceptance Corporation" by F. Abbott Goodhue, Vice President of the First National Bank of Boston, Mass., and "The Acceptance as the Basis of the American Discount Market", by John E. Rovensky, Vice President of the National Bank of Commerce, New York, in which on pages 14 and 22 respectively, the necessity for term settlements as a means of relieving the call money market from the necessities of the securities market and as a precedent to a broad and stable discount market is discussed.

The members of the committee have unanimously expressed the opinion that the adoption of a term settlement by the Stock Exchange would offer advantages in that it would eliminate duplication of the handling of securities and in payments. The committee holds,

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however, that, inasmuch as the adoption of a term settlement by the Exchange would involve changes of great importance, both to banks and to members of the Exchange, it will require the most careful study of the subject by the committee, and in any case the term settlement can not be put into operation until the new system of daily Stock Exchange settlements through the Stock Clearing Corporation, above referred to, has been perfected and has been in practical operation for a reasonable time.

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March 27 1920.

Subject: Reply to Senate Resolution No. 338.

Sir:-

On March 8, 1920, the Senate adopted the following resolution:

"RESOLVED that the Federal Reserve Board be and is hereby directed to advise the Senate what is the cause and justification for the unvarious rates of interest on collateral call loans in the financial centers, under what law authorized, and what steps, if any, are required to abate this condition".

In reply the Board desires first to invite attention to the following tables showing discount and interest rates prevailing in various centers in all Federal reserve districts during the two thirty-day periods ended January 15, 1920, and February 15, 1920. It will be seen from these tables that the maximum and minimum rates on demand loans secured by collateral are approximately the same as those for commercial paper in all cities except Boston and New York. While the legal rate of interest in Massachusetts is 6%, higher contract rates are authorized, and consequently the 6% limitation is occasionally exceeded.

(Tables referred to
 appear on page
 286 and 287 of
 Federal Reserve Bank
 for the 20th 1920)

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The only financial center in this country in which there is maintained a call money market of national importance is New York City, and while the rates charged there on call loans are frequently in excess of the legal rates allowed for commercial paper, they are not "usurious" under the laws of the State of New York, which specifically exempt collateral call loans from the 6% limitation which lenders must observe on other loans on pain of incurring the penalty prescribed for usury. Section 115 of the Banking Law (L. 1914, Ch. 369; Consol. L. Ch. 2) provides that upon advances of money repayable on demand to an amount not less than \$5,000 made upon warehouse receipts, bills of lading, certificates of stock, etc., or other negotiable instruments as collateral, any bank may receive and collect as compensation any sum which may be agreed upon by the parties to such transaction. The section reads:

***Sec. 115. Interest on collateral demand loans of not less than five thousand dollars.**

*Upon advances of money repayable on demand to an amount not less than five thousand dollars made upon warehouse receipts, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds or other negotiable instruments, pledged as

collateral security for such repayment, any bank may receive or contract to receive and collect as compensation for making such advances any sum which may be agreed upon by the parties to such transaction."

Section 201 of the Banking Law, identical in language with Section 115 above quoted, makes the same provision in the case of collateral loans by trust companies. In the General Business Law (L. 1909, Ch. 25; Consol. L. Ch. 20) there is the following general provision of a like character:

"Sec. 372. Interest permitted on advances on collateral security.

In any case hereafter in which advances of money, repayable on demand, to any amount not less than five thousand dollars, are made upon warehouse receipts, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds or other negotiable instruments pledged as collateral security for such repayment, it shall be lawful to receive or to contract to receive and collect, as compensation for making such advances, any sum to be agreed upon in writing, by the parties to such transaction".

National Bank Act.

The National Bank Act provides that national banks may receive and charge on any loan or discount interest at the rate allowed by the law of the State, territory or district where the bank is located. The applicable provision reads:

"Limitation upon rate of interest which may be taken.

422. Sec. 3197. - Any association may take, receive, reserve and charge on any loan or discount made, or upon any note, bill of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory or District where the bank is located, and no more, except that where by the laws of any State a different rate is limited for banks of issue organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this Title. When no rate is fixed by the laws of the State or Territory or District, the bank may take, receive, reserve, or charge a rate not exceeding seven per centum, and such interest may be taken in advance, reckoning the days for which the note, bill, or other evidence of debt has to run. And the purchase discount, or sale of a bona fide bill of exchange, payable at another place than the place of such purchase, discount, or sale, at not more than the current rate of exchange for sight drafts in addition to the interest, shall not be considered as taking or receiving a greater rate of interest".

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It will be observed that the effect of the foregoing provisions is to authorize in the State of New York on collateral call loans of not less than \$5,000 rates of interest which may be in excess of those permitted for loans of other character, and that such higher rates are not prohibited as usurious.

As to the "cause and justification" of the high rates of interest which it thus appears may legally be charged on collateral call loans in New York, and as to the "steps *** required to abate this condition", there is, as is well known, a wide difference of opinion among persons who have given thought and study to the question. Indeed, broad and fundamental questions of general economic and social policy are involved - in the last analysis, the whole question of the utility of speculative dealings in securities and commodities on organized exchanges is involved; and more immediately, the question of the ~~methods~~ *methods and* practices of the leading speculative markets of the country, margining, stock manipulation, and kindred matters also susceptible of abuse. As to these the Board has never had occasion officially to form an opinion; the Federal Reserve Act specifically precludes the purchase or discount by Federal reserve banks of "notes, drafts and bills covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States". The Board could not undertake to form a judgment upon the matters above referred to without study and investigation of such a comprehensive nature as would seriously interfere with the conduct of its regular work and which, had the Board the requisite authority, would require the services of experts and assistants for the employment of which the Board does not feel authorized to expend funds accruing from statutory assessments on the Federal reserve banks for the purpose of defraying the ordinary expenses contemplated by the Federal Reserve Act.

There is submitted as an appendix hereto a memorandum prepared for the information of the Board by the Federal Reserve Agent in New York, explaining in general the nature and operation of the New York call money market and causes of high and fluctuating rates for call money in that center.

Respectfully,


Governor.

The President of the Senate.

THE NEW YORK CALL MONEY MARKET

Definition of Call Loans.

Collateral call loans, in the general acceptation of the term, are made chiefly in New York City, which is practically the only important call money market in the United States. They are loans which are payable on demand of the lender without previous notice, secured by the pledge of investment securities, i.e. stocks and bonds, generally those which are dealt in on the New York Stock Exchange. The interest rates on these loans, as on other classes of loans, are on the basis of a rate per annum.

The Borrowers.

The loans are made for the most part to houses which are members of the Stock Exchange and the money so borrowed constitutes a portion of the funds employed ordinarily in purchasing and carrying securities for their customers and sometimes for themselves.

The Lenders.

The principal supplies of money for collateral call loans are loanable funds of banks and bankers located both in and outside of New York City, including foreign banks and agencies of

2-

foreign banks; and similarly the loanable funds of firms, individuals and corporations seeking temporary investment. The proportion of the whole fund loaned by these several interests varies seasonally and in accordance with the attractiveness of other opportunities for investment, either locally or in other markets. The bulk of call money is lent on the floor of the New York Stock Exchange at "the money post" where through various brokers loanable funds are offered and bids for funds are received. Most of the business is done between the hours of 12 noon and 2:45 p.m. The important relation to the money market of the present system of daily settlement of balances resulting from the purchases and sales of securities on the Stock Exchange will be discussed more fully hereafter.

Commercial Requirements have the Prior Claim.

In the matter of the supply or attraction of funds to the call money market, there is generally a definite and well understood obligation on the part of banks to accommodate first their own commercial clients, so that it is only the excess of loanable funds which they may have from time to time that is available for the collateral call money market or for the purchase of commercial paper in the open market. This excess of loanable funds available for employment in the securities market varies, therefore, according to the commercial requirements of the country. It has long been recognized that for assurance of a sufficient amount of money to finance the volume of business in securities, reliance cannot be placed on a rate of interest limited to the rates which obtain or

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are permitted in commercial transactions whose prior claim on banking accommodations is universally conceded.

CAUSES ATTENDING CURRENT CALL MONEY RATES

The reference in the resolution to the present high rates for call money in the financial centers and the inquiry as to their causes require, it is felt, a survey of the operations of the money markets and the reflection therein of the underlying economic conditions which govern, in varying degrees, all money rates, including those for call money.

Present Demand Conditions of Supply.

In former times, and specifically prior to the institution of the Federal Reserve System, bankers, especially in reserve centers, were accustomed to look upon call loans as their principal secondary reserve on the theory that inasmuch as these loans were payable upon demand, funds so invested could always be promptly obtained on short notice to meet withdrawals of deposits or for other use. In these circumstances there was ordinarily available for collateral call loans a supply of funds sufficient for ordinary market requirements and at low rates, although at times the rates rose to high levels as the supply of funds diminished, or the demands increased.

This attitude of the banks toward call loans as their chief secondary reserves has been greatly modified by two causes. The

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first was the closing of the Stock Exchange at the outbreak of the European War in the summer of 1914, when it became practically impossible to realize on call loans secured by investment securities, which became, therefore, "frozen loans". This resulted in a more or less permanent prejudice against dependence upon call loans as secondary reserves. The second and more important factor was the creation of the Federal Reserve System. Under the terms of the Federal Reserve Act provision is made for the rediscount of commercial paper, but the rediscount of loans for the purpose of carrying investment securities, other than United States Government obligations, is excluded. Consequently, in order to maintain maximum liquidity, with suitable provision for secondary reserves that can be immediately availed of, banks, including foreign agency banks, now invest a greater proportion of their resources in assets that can be realized upon at the Federal Reserve Bank. Another changed factor in the present situation grows out of the fact that the war and post-war conditions have rendered unavailable supplies of money which formerly came from foreign banks. Since the summer of 1914, while total banking resources have largely increased, the volume of bank money available to the securities market at low or normal rates has not increased proportionately, but on the contrary has probably decreased. All of these circumstances, explain in ^{some} ~~a large~~ measure, the increased rates which have often been required during the past year for money loaned in the securities market.

Recent Changed Conditions of Demand

Changed conditions are also present in the factors governing

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the demand for money. Prior to the armistice agencies of Government were employed to restrict the issue of new securities for purposes other than those which were deemed essential for carrying on the war. At the same time, as the Treasury undertook to sell large amounts of certificates of indebtedness and Liberty Bonds bearing low rates of interest, the question arose as to whether the competition of the general investment markets might not prejudice the success of the Government issues. In these circumstances, *with full market standing* the officers and members of the New York Stock Exchange undertook to limit transactions which would involve the increased use of money for other purposes in consideration of which the principal banks of New York City *indebted* undertook to provide a stable amount of money for the requirements of the security market. *at the part of the Treas. Dept.*

After the armistice these restrictions were removed and ordinary market forces reasserted themselves. The issuance of new securities was resumed in unprecedented volume and consumed a vast amount of capital and credit, when bank credit was already expanded by the necessity of carrying large amounts of Government securities which the investment market was not prepared to absorb. This arose a *at times* further cause for the increased cost of accommodation on collateral call loans.

Since the armistice these causes have been augmented by the increased volume and velocity of transactions in securities generally. Before examining the figures, it should be explained that the amount of call money employed by the securities market fluctuates according to the amount of other funds available for this purpose, i.e. customers' money invested and time money borrowed, and also as the volume

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of business varies.

Volume.

The volume of money outstanding on call is more or less constant, fluctuating only over relatively long periods, and the amount which is loaned from day to day is but a small proportion of this constant volume. The constant volume of outstanding call loans bears a rate of interest which is determined daily and is known as the renewal rate. The daily borrowings, either in replacement of loans called for payment or representing new money borrowed, are made at rates which may or may not be the same as the renewal rate and which frequently vary during the same day.

Turning to the figures, it appears that over a period of years during the pre-war period the volume of all money, both time and call, employed in the securities market was estimated at about \$1,000,000,000., of which the average on call was about 60% and the average on time about 40%, or a normal volume of call money, say of \$600,000,000. The daily turnover in call money, i.e. old loans called for payment, loans made in replacement thereof, and new money borrowed, ranged from \$15,000,000 to \$30,000,000., and averaged about \$20,000,000. The daily turnover during the year 1919, however, ordinarily ranged from \$25,000,000 to \$40,000,000, and averaged about \$30,000,000. Moreover it is important to notice there has been a disproportionate increase in the amount of call loans, as distinguished from time money, with the consequence that the former, it is now estimated, constitute about 75% of the total money employed in the securities market. At a time of such heavy credit

At a time of such heavy credit requirements as the present, the greater volume of borrowings, not only in the aggregate but in the day to day demands, naturally often results in high rates for the money loaned. Indeed, so reluctant have the bankers been during the past few months to supply the large demand for credit based on securities that the occasional loaning of relatively small amounts of money at very high rates often represents a desire not to secure the high rate quoted but to prevent the rate from going very much higher with the consequent demoralization which might result.

Intermittent Factors.

There are certain other factors, the influence of which is principally manifested in intermittent wide fluctuations in the daily rates or in the rates which apply for brief periods. The increased volume of demand loans called daily for payment noted above, coupled with the decreased amount of time money loaned on securities, produces more or less apprehension on the part of borrowers as to their ability to re-borrow money called for payment. This apprehension, quickened by the number of insistent borrowers bidding at times when momentarily loanable funds are exhausted or are offered in small quantity, frequently results in competitive bidding for funds which advances the rates for a day or part of a day beyond the actual necessities of the situation.

Another active and important influence which has recently affected the supply of funds available for collateral loans and precipitated at times a rise in the rates, has been the periodic transfers of Government deposits from depositary banks to the Federal reserve banks in connection with the fiscal operations of the Treasury. Such withdrawals result in the depositary banks calling money from the securities market, which causes sharp advances in the rate bid for call money in replacement of the loans called for payment.

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THE LAW AND DEMAND FOR THE CURRENCY
OF THE UNITED STATES.

The underlying cause of fluctuations and, especially of increases in call money rates is the operation of the law of supply and demand. In other words, as the supply of loanable funds diminishes in proportion to the volume of the demand, the rate for collateral demand loans advances. However, in the case of the daily borrowings of call money -- to which the abnormal high and low rates apply and which represent but a comparatively small proportion of the total outstanding loans -- other factors, incidental to the temporary circumstances and conditions of the market, tend in times of stress to greater fluctuations in rates than result from the more normal operation of the law which is reflected in the normal rate for the greater volume of the outstanding call loans. The normal rate is regarded as the real barometer of market conditions and its fluctuations throughout the longer periods more nearly reflect the relation between the amount of the loanable funds and the amount of the demand. In other words, high normal rates are usually due to other demands for credit, resulting in part from the increased requirements of the commercial community and in part from other temporary factors, such as depletion of bank reserves resulting either or both from credit expansion or loss of reserves through gold export, speculation in commodities and real estate, and congestion of commercial transactions incidental to slow or interrupted transportation.

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Commercial Rates are Similarly and Independently Determined.

The operation of the law of supply and demand is equally effective in determining the rate for commercial loans and all other borrowings. In fact, rates for commercial loans and rates for collateral call loans have a common root in the law of supply and demand, and the conditions which affect one, in the main affect the other, although not in like degree, as is demonstrated by the far wider fluctuation of call rates and the higher points to which they go. The rates for call money do not determine ~~and since the establishment of the Federal Reserve Bank~~ ^{and} have not exerted an important influence on the rates for commercial borrowings. It is the universal custom of the banks, to satisfy first the commercial needs of their customers. They feel an obligation to customers but none to those who borrow in the open market on securities. Besides as the resources of the banks mainly come from the commercial customers, their own self-interest compels a preference in favor of their commercial borrowers, since failure to grant them reasonable accommodation would induce them to withdraw their deposits and so reduce the ability of the banks to do business. Although the money of the banks and trust companies comprises by far the greater proportion of the money loaned on the securities market, an examination of the prevailing rates on commercial paper at times when the call money market is particularly strained indicates that there is little causal relation between the rates for call money and those on commercial loans. Exhibits Nos. 1 and 2, showing respectively the rates for call money on the New York Stock Exchange during the years 1906-1919 and the rates for commercial paper in New York for the period from 1915 to 1920, are attached.

POSSIBILITIES OF CHANGE IN THE CONDITIONS AND METHODS
OF THE CALL MONEY MARKET

So long as collateral call loans are made under prevailing conditions it is difficult to see how the present situation can be altered, because of the impracticability of controlling the underlying cause of high rates, which in the last analysis, is the excess of demand over supply.

An attempt to control the rates for call loans by the establishment of an arbitrary limit at a low level, without the ability to modify the causes above enumerated which operate to increase rates, would be distinctly hazardous, for the reason that up to the point where the arbitrary rate would limit the supply of new money, speculation and expansion might proceed unchecked and the natural elements of correction or regulation would not obtain. In other words, high rates act as a deterrent to over-speculation and undue expansion of credit. On the other hand, should the supply of money available at a fixed maximum rate become exhausted, liquidation might suddenly be forced because the demands for additional accommodation for the consummation of commitments already made could not be met. The effect of such liquidation would be to embarrass not only investors and dealers in securities, but frequently might affect dealers and merchants in commodities as well. As an example of the latter, the case might be cited

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of a commitment to purchase a round amount of cotton on a certain day. Many of the houses on the Cotton Exchange are also members of the Stock Exchange and frequently borrow very largely on the Stock Exchange against investment securities to provide funds for settling their transactions in cotton. If, therefore, when an important cotton settlement is imminent, borrowings on securities could not be availed of, the cotton transaction could not be consummated and a drastic liquidation through sale either of securities or of the cotton might be required to avoid default. Similar consequences might obtain in the cases of transactions by members of other commodity exchanges who are also members of the Stock Exchange and have recourse to the call money market.

THE IMPORTANCE OF A "CALL MONEY" MARKET

Call money in some form is indispensable to every important financial center. There must be not only an outlet for the employment of funds temporarily idle, but a large volume of call and short time money is essential to the successful and economical conduct of business. It is particularly essential to the international and domestic commercial business but the diversion of the use of the major portion of such money to the securities markets is not in accordance with sound banking principles, and the result ~~is the absorption of funds for speculative purposes at times resulting in detriment to the commercial and industrial community.~~

~~a condition which exists for connection.~~ It is to be noted that in no great world market, other than New York, is the call money market so dependent upon investment securities and so susceptible to speculative influences. In other markets the reverse is true, as their call money is based principally on commercial paper upon which realization can be had at the central bank, at a price, in case of need. We have seen that in this country call loans on securities lack this essential quality of liquidity required for quick and certain realization, and that this fact has now been more generally taken into consideration by our lenders. But the safe and successful divorce in this country of the use of call money from its dependence upon investment securities as a basis requires careful study in order that safe and adequate methods may be substituted for the present methods of the securities market.

Term Settlements.

The achievement of this end probably depends upon the successful development of a plan for term settlements of the balances resulting from operations on the Stock Exchange, in lieu of the present method of daily settlements. The principal effect of such a change of the method of settlements would be to relieve the call money market from the necessities of the securities market and release funds now used in collateral call loans based on investment securities for employment in call loans based on the collateral of ~~the~~ more liquid securities, commercial ^{paper} *actual,*

~~and short term government paper, generally~~

recognised abroad as the preferred bases for demand loans. From this change a broader discount market would naturally develop. Under ~~term~~ settlements the borrowing required by the securities market would be on the basis of short time accommodation, i. e. for the term between settlements, whether they were weekly, fortnightly or at other intervals.

Agitation for the improvement of the present method of settlement of stock exchange contracts has extended over some years and as the result of extensive studies and deliberations of officers and members of the New York Stock Exchange, as well as bankers, an important step has been taken to provide enlarged clearing facilities through the organization of a new corporation known as the Stock Clearing Corporation, which is expected to begin operations in April, 1920. A general description of the purposes and contemplated operations of the corporation is contained in the pamphlet attached hereto as Exhibit No. 3. The functions of this corporation include providing facilities for clearing contracts between members, for the receipt and delivery of securities between members and banks, trust companies and others, and for the clearing of collateral call loans. It is not asserted or expected that the institution of these operations will materially affect either the amount of money loaned from one day to another on the call money market or the rates of such loans, but it is expected that it will operate materially to decrease the amount of bank certifications on day loans, which the present practice requires in the interval between paying

one call loan and replacing it with another on the same day. It should be noted that the mechanism afforded by the corporation is an indispensable, prerequisite to the establishment of a system of term settlements.

The more recent and definite development toward the substitution of term settlements for the present system of daily settlements may be said to have had its inception in the action of the American Acceptance Council at its annual meeting on December 4, 1919. At that time the following resolution was adopted:

"Whereas, the present method of daily stock exchange settlements, with its dominating and often unsettling effect on the call money market, influences adversely the development of a wide and healthy discount market in the United States;

"Resolved, That the Chairman of the Executive Committee be authorized to appoint a committee consisting of members of the Executive Committee and other individuals to study the advisability, ways and means of modifying the present system of settlements on the New York Stock Exchange and substituting therefor some system of periodical settlement, with power to take such steps as may seem advisable in the case."

A copy of the annual report of the American Acceptance Council is appended hereto as Exhibit No. 4, in which the resolution appears on page 5, and the report of the Chairman of the Executive Committee ~~appears~~ appears on pages 16 to 27, inclusive.

The Committee thus provided for was appointed and held two extended conferences in which the problem was fully discussed, both from the point of view of the banks and of the Stock Exchange. For illustration of the subject matter of

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the discussion there is attached hereto as Exhibit No. 5 a detailed report compiled by one of the members of the Committee, Mr. Samuel M. Streit, Chairman of the Committee on Clearing House of the Stock Exchange describing the term settlement operations in London and on the European continent, which presently will be published by the American Acceptance Council. Through its courtesy ~~the Council~~ *has been received* an advance copy of the report. There are also attached, as Exhibits No. 6 and 7 respectively two other publications of the American Acceptance Council, "Acceptance Corporations", by L. Abbott Goodhue, Vice President of the First National Bank of Boston, Mass., and "The Acceptance as the Basis of the American Discount Market", by John A. Povensky, Vice President of the National Bank of Commerce, New York, in which on pages 14 and 22 respectively, the necessity for term settlements as a means of relieving the call money market from the necessities of the securities market and as a precedent to a broad and stable discount market is discussed.

The members of the committee have unanimously expressed the opinion that the adoption of a term settlement by the Stock Exchange would offer advantages in that it would eliminate duplication of the handling of securities and in payments. The committee holds, however, that, inasmuch as the adoption of a term settlement by the Exchange would involve changes of great importance, both to banks and to members of the Exchange, it will require the most careful study of the subject by the committee, and in any case

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M : THISTLETHWAITE
PRIVATE SECRETARY

*Per. C. C. Evans
my. & notes*

THE VICE PRESIDENT'S CHAMBER
WASHINGTON

FEDERAL RESERVE BOARD FILE

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Received this 27th day of March, 1920,
from the Secretary of the Governor of the Federal
Reserve Board a response to Senate Resolution
No. 328.

Mark Thistlethwaite
Private Secretary.

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March 27, 1920.

Subject: Reply to Senate Resolution No. 328.

Sir:-

On March 8, 1920, the Senate adopted the following resolution:

"RESOLVED that the Federal Reserve Board be and is hereby directed to advise the Senate what is the cause and justification for the usurious rates of interest on collateral call loans in the financial centers, under what law authorized, and what steps, if any, are required to abate this condition."

In reply the Board desires first to invite attention to the following tables showing discount and interest rates prevailing in various centers in all Federal reserve districts during the two thirty-day periods ended January 15, 1920, and February 15, 1920. It will be seen from these tables that the maximum and minimum rates on demand loans secured by collateral are approximately the same as those for commercial paper in all cities except Boston and New York. While the legal rate of interest in Massachusetts is 6%, higher contract rates are authorized, and consequently the 6% limitation is occasionally exceeded.

(Tables referred to appear on pages 286 and 287 of Federal Reserve Bulletin for March 1920.)

The only financial center in this country in which there is maintained a call money market of national importance is New York City, and while the rates charged there on call loans are frequently in excess of the legal rates allowed for commercial paper, they are not "usurious" under the laws of the State of New York, which specifically exempt collateral call loans from the 6% limitation which lenders must observe on other loans on pain of incurring the penalty prescribed for usury. Section 115 of the Banking Law (L. 1914, Ch. 369; Consol. L. Ch. 2) provides that upon advances of money repayable on demand to an amount not less than \$5,000 made upon warehouse receipts, bills of lading, certificates of stock, etc., or other negotiable instruments as collateral, any bank may receive and collect as compensation any sum which may be agreed upon by the parties to such transaction. The section reads:

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"Sec. 115. Interest on collateral demand loans of not less than five thousand dollars.

"Upon advances of money repayable on demand to an amount not less than five thousand dollars made upon warehouse receipts, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds or other negotiable instruments, pledged as collateral security for such repayment, any bank may receive or contract to receive and collect as compensation for making such advances any sum which may be agreed upon by the parties to such transaction."

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Section 201 of the Banking Law, identical in language with Section 115 above quoted, makes the same provision in the case of collateral loans by trust companies. In the General Business Law (L. 1909, Ch. 25; Consol. L. Ch. 20) there is the following general provision of a like character:

"Sec. 379. Interest on advances on collateral security.

In any case hereafter in which advances of money, repayable on demand, to any amount not less than five thousand dollars, are made upon warehouse receipts, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds or other negotiable instruments pledged as collateral security for such repayment, it shall be lawful to receive or to contract to receive and collect, as compensation for making such advances, any sum to be agreed upon in writing, by the parties to such transaction."

National Bank Act.

The National Bank Act provides that national banks may receive and charge on any loan or discount interest at the rate allowed by the law of the State, territory or district where the bank is located. The applicable provision reads:

"Limitation upon rate of interest which may be taken.

422. Sec. 3197.- Any association may take, receive, reserve and charge on any loan or discount made, or upon any note, bill of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory or District where the bank is located, and no more, except that where by the laws of any State a different rate is limited for banks of issue organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this Title. When no rate is fixed by the laws of the State or Territory or District, the bank may take, receive, reserve, or charge a rate not exceeding seven per centum, and such interest may be taken in advance, reckoning the days for which the note, bill or other evidence of debt has to run. And the purchase discount, or sale of a bona fide bill of

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March 7 1920.

Subject: Reply to Senate Resolution No. 328.

Sir:-

On March 8, 1920, the Senate adopted the following resolution:

"RESOLVED that the Federal Reserve Board be and is hereby directed to advise the Senate what is the cause and justification for the usurious rates of interest on collateral call loans in the financial centers, under what law authorized, and what steps, if any, are required to abate this condition".

In reply the Board desires first to invite attention to the following tables showing discount and interest rates prevailing in various centers in all Federal reserve districts during the two thirty-day periods ended January 15, 1920, and February 15, 1920. It will be seen from these tables that the maximum and minimum rates on demand loans secured by collateral are approximately the same as those for commercial paper in all cities except Boston and New York. While the legal rate of interest in Massachusetts is 6%, high discount rates are authorized, and consequently the 6% limitation is occasionally exceeded.

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The only financial center in this country in which there is maintained a call money market of national importance is New York City, and while the rates charged there on call loans are frequently in excess of the legal rates allowed for commercial paper, they are not "usurious" under the laws of the State of New York, which specifically exempt collateral call loans from the 6% limitation which lenders must observe on other loans on pain of incurring the penalty prescribed for usury. Section 115 of the Banking Law (L. 1914, Ch. 380; Consol. L. Ch. 2) provides that upon advances of money repayable on demand to an amount not less than \$5,000 made upon warehouse receipts, bills of lading, certificates of stock, etc., or other negotiable instruments as collateral, any bank may receive and collect as compensation any sum which may be agreed upon by the parties to such transaction. The section reads:

"Sec. 115. Interest on collateral demand loans of not less than five thousand dollars.

"Upon advances of money repayable on demand to an amount not less than five thousand dollars made upon warehouse receipts, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds or other negotiable instruments, pledged as

collateral security for such repayment, any bank may receive or contract to receive and collect as compensation for making such advances any sum which may be agreed upon by the parties to such transaction."

Section 201 of the Banking Law, identical in language with Section 115 above quoted, makes the same provision in the case of collateral loans by trust companies. In the General Business Law (L. 1909, Ch. 25; Consol. L. Ch. 20) there is the following general provision of a like character:

"Sec. 379. Interest permitted on advances on collateral security.

In any case hereafter in which advances of money, repayable on demand, to any amount not less than five thousand dollars, are made upon warehouse receipts, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds or other negotiable instruments pledged as collateral security for such repayment, it shall be lawful to receive or to contract to receive and collect, as compensation for making such advances, any sum to be agreed upon in writing, by the parties to such transaction".

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"Limitation upon rate of interest which may be taken.

422. Sec. 3197. - Any association may take, receive, reserve and charge on any loan or discount made, or upon any note, bill of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory or District where the bank is located, and no more, except that where by the laws of any State a different rate is limited for banks of issue organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this Title. When no rate is fixed by the laws of the State or Territory or District, the bank may take, receive, reserve, or charge a rate not exceeding seven per centum, and such interest may be taken in advance, reckoning the days for which the note, bill, or other evidence of debt has to run. And the purchase discount, or sale of a bona fide bill of exchange, payable at another place than the place of such purchase, discount, or sale, at not more than the current rate of exchange for sight drafts in addition to the interest, shall not be considered as taking or receiving a greater rate of interest".

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It will be observed that the effect of the foregoing provisions is to authorize in the State of New York on collateral call loans of not less than \$5,000 rates of interest which may be in excess of those permitted for loans of other character, and that such higher rates are not prohibited as usurious.

As to the "cause and justification" of the high rates of interest which it thus appears may legally be charged on collateral call loans in New York, and as to the "steps" required to abate this condition", there is, as is well known, a wide difference of opinion among persons who have given thought and study to the question. Indeed, broad and fundamental questions of general economic and social policy are involved - in the last analysis, the whole question of the utility of speculative dealings in securities and commodities on organized exchanges is involved; and more immediately, the question of the ~~unsound~~ practices of the leading speculative markets of the country, margining, stock manipulation, and kindred matters also susceptible of abuse. As to these the Board has never had occasion officially to form an opinion; the Federal Reserve Act specifically precludes the purchase or discount by Federal reserve banks of "notes, drafts and bills covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States". The Board could not undertake to form a judgment upon the matters above referred to without study and investigation of such a comprehensive nature as would seriously interfere with the conduct of its regular work and which, had the Board the requisite authority, would require the services of experts and assistants for the employment of which the Board does not feel authorized to expend funds accruing from statutory assessments on the Federal reserve banks for the purpose of defraying the ordinary expenses contemplated by the Federal Reserve Act.

There is submitted as an appendix hereto a memorandum prepared for the information of the Board by the Federal Reserve Agent in New York, explaining in general the nature and operation of the New York call money market and causes of high and fluctuating rates for call money in that center.

Respectfully,

Governor.

The President of the Senate.

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OFFICE OF
COMPTROLLER OF THE CURRENCY
ADDRESS ONLY TO
COMPTROLLER OF THE CURRENCY

TREASURY DEPARTMENT

WASHINGTON

March 24, 1920.



My dear Governor Harding:

Referring further to my letter to you of yesterday, I beg leave to advise that the reports of condition received from National Banks in Federal Reserve Cities show, inter alia, the following additional loans made at rates in excess of those permitted by law:

<u>Name of Bank</u>	<u>Number of Loans</u>	<u>Aggregate Amount</u>
Cleveland, Ohio:		
National City Bank	1	\$ 177,582.06
Richmond, Va:		
First National	10	203,200.
Merchants National (N.Y. call)	37	3,800,000.
Philadelphia, Pa:		
Broad Street National	6	30,000.
Textile National	12	281,327.
Penn National	3	30,000.
National Bank of Commerce	3	7,636.
Northern National	3	15,000.
Manayunk National	11	75,000.
Kensington National	1	10,000.
Girard National	7	421,703.
Franklin National	95	1741,950.
Fourth Street	1	50,000.
Brovers & Merchants National	14	25,676.
Central National	1	15,000.
Centennial National	12	70,000.
Bank of North America	5	85,000.
Tenth National Bank	11	275,000.
Eighth National Bank	17	290,000.
Second National Bank	55	482,500.
First National Bank	2	275,000.

Very truly yours,

J. S. Williams
Comptroller.

Hon. W. P. G. Harding,
Governor, Federal Reserve Board.

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Authority E.Q.10501OFFICE OF
COMPTROLLER OF THE CURRENCYADDRESS REPLY TO
COMPTROLLER OF THE CURRENCY

TREASURY DEPARTMENT

WASHINGTON

March 23, 1920.

Dear Governor:

For the information of the Board I beg leave to advise that, in reply to inquiries contained in statement of condition of February 28, 1920, the following banks in New York City reported loans made by them "including items of paper 'bought', since December 31, 1919, at rates (including interest, discount, and commission) in excess of highest rate permissible by law under written contract" were as follows:

<u>NAME OF BANK</u>	<u>NUMBER OF LOANS</u>	<u>AGGREGATE AMOUNT.</u>
National Bank of Commerce,	5	\$1,801,464.86
Seaboard National Bank,	20	655,000.
Mechanics and Metals National Bank,	1	50,000.
Lincoln National Bank,	74	5,585,765.48
Liberty National Bank,	5	95,000.
Coal and Iron National Bank,	15	159,292.97
Chemical National Bank,	3	980,000.
Chase National Bank,	1	24,000.
Bank of New York, N. B. A.	38	2,765,505.47

Sincerely yours,

Hon. W. P. G. Harding,
Governor, Federal Reserve Board.

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SECRETARY OF THE TREASURY
CHAIRMAN
JOHN SKELTON WILLIAMS
COMPTROLLER OF THE CURRENCY

ADDRESS REPLY TO
FEDERAL RESERVE BOARD

FEDERAL RESERVE BOARD

WASHINGTON

FEDERAL

W. F. G. HARDING, GOVERNOR
ALBERT STRAUSS, VICE GOVERNOR
ADOLPH C. MILLER
CHARLES S. HAMLIN
HENRY A. MOEHLNPAH

W. T. CHAPMAN, SECRETARY
R. G. EMERSON, ASSISTANT SECRETARY
W. H. MULLAY, FISCAL AGENT

March 23, 1920.

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CARDED

Subject: Reply to Senate Resolution No. 328.

Sir:

On March 8th, 1920, the Senate adopted the following resolution:

"RESOLVED that the Federal Reserve Board be and is directed to advise the Senate what is the cause and justification for the usurious rates of interest on collateral call loans in the financial centers, under what law authorized and what steps, if any, are required to abate this condition."

In reply the Board desires to say that it has no information that rates of interest higher than legal rates for commercial paper have been charged on collateral call loans in any financial center except New York City. The rates which have been charged on collateral loans in that City, however, are not usurious since the laws of the State of New York specifically exempt such loans from the six per cent limitation which lenders must observe on other loans on pain of incurring the penalty prescribed for usury.

For fuller and further information of the Senate, there is appended hereto a statement of the nature and operation of the New York Call Money Market.

Respectfully,

Enclosure.

Governor.

The President of the Senate.

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THE NEW YORK CALL MONEY MARKET

Definition of Call Loans.

Collateral call loans, in the general acceptation of the term, are made chiefly in New York City, which is practically the only important call money market in the United States. They are loans which are payable on demand of the lender without previous notice, secured by the pledge of investment securities, i.e. stocks and bonds, generally those which are dealt in on the New York Stock Exchange. The interest rates on these loans, as on other classes of loans, are on the basis of a rate per annum.

The Borrowers.

The loans are made for the most part to houses which are members of the Stock Exchange and the money so borrowed constitutes a portion of the funds employed ordinarily in purchasing and carrying securities for their customers and sometimes for themselves.

The Lenders.

The principal supplies of money for collateral call loans are loanable funds of banks and bankers located both in and outside of New York City, including foreign banks and agencies of foreign banks; and similarly the loanable funds of firms, individuals and corporations seeking temporary investment. The proportion of the whole fund loaned by these several interests varies seasonally and in accordance with the attractiveness of other opportunities for investment, either locally or in other markets. The bulk of call money is lent on the floor of the New York Stock Exchange at "the money post" where through various brokers loanable funds are offered and bids for funds are received. Most of the business is done between the hours of 12 noon and 2:45 p. m. The important relation to the money market of the present system of daily settlement of balances resulting from the purchases and sales of securities on the Stock Exchange will be discussed

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more fully hereafter.

Commercial Requirements have the Prior Claim.

In the matter of the supply or attraction of funds to the call money market, there is generally a definite and well understood obligation on the part of banks to accommodate first their own commercial clients, so that it is only the excess of loanable funds which they may have from time to time that is available for the collateral call money market or for the purchase of commercial paper in the open market. This excess of loanable funds available for employment in the securities market varies, therefore, according to the commercial requirements of the country. It has long been recognized that for assurance of a sufficient amount of money to finance the volume of business in securities, reliance cannot be placed on a rate of interest limited to the rates which obtain or are permitted in commercial transactions whose prior claim on banking accommodations is universally conceded.

THE LAW RESPECTING THE RATES OF INTEREST ON
COLLATERAL CALL LOANS.

Law of New York.

The statutes of the State of New York acknowledge and recognize this principle in both the Banking and Business law in the sections regarding interest legally receivable.

Section 115 of the Banking Law (L. 1914 Ch. 369; Consol. L. Ch. 2) provides that upon advances of money payable on demand to an amount not less than \$5,000 made upon warehouse receipts, bills of lading, certificates of stock, etc., or other negotiable instruments as collateral, any bank may receive and collect as compensation any sum which may be agreed upon by the parties to such transaction. The Section reads:

"Sect. 115. Interest on collateral demand loans
of not less than five thousand dollars.

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Upon advances of money repayable on demand to an amount not less than five thousand dollars made upon warehouse receipt, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds or other negotiable instruments, pledged as collateral security for such repayment, any bank may receive or contract to receive and collect as compensation for making such advances any sum which may be agreed upon by the parties to such transaction."

Section 201 of the Banking Law, identical in language with Section 115 above quoted, makes the same provision in the case of collateral call loans by trust companies. In the General Business Law (L. 1909 Ch. 25; Consol. L. Ch. 20) there is the following general provision of a like character:

"Sect. 379. Interest permitted on advances on collateral security.

In any case hereafter in which advances of money, repayable on demand, to any amount not less than five thousand dollars, are made upon warehouse receipts, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds or other negotiable instruments pledged as collateral security for such repayment, it shall be lawful to receive or to contract to receive and collect, as compensation for making such advances, any sum to be agreed upon in writing by the parties to such transaction."

National Bank Act.

The National Bank Act provides that national banks may receive and charge on any loan or discount interest at the rate allowed by the law of the State, territory or district where the bank is located. The applicable provision reads:

"Limitation upon rate of interest which may be taken.

422. Sec. 5197. - Any association may take, receive, reserve and charge on any loan or discount made, or upon any note, bill of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory or District where the bank is located, and no more, except that where by the laws of any State a different rate is limited for banks of issue organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this title. When no rate is fixed by the laws of the State or Territory, or District, the bank may take, receive, reserve, or charge a rate not

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exceeding seven per centum, and such interest may be taken in advance, reckoning the days for which the note, bill, or other evidence of debt has to run. And the purchase, discount, or sale of a bona fide bill of exchange, payable at another place than the place of such purchase, discount or sale, at not more than the current rate of exchange for sight drafts in addition to the interest, shall not be considered as taking or receiving a greater rate of interest."

It will be observed that the effect of the foregoing provisions is to authorize in the State of New York on collateral call loans of not less than \$5,000 rates of interest which may be in excess of those permitted for loans of other character, and that such higher rates are not prohibited as usurious.

CAUSES AFFECTING PRESENT CALL MONEY RATES

The reference in the resolution to the present high rates for call money in the financial centers and the inquiry as to their causes require, it is felt, a survey of the operations of the money markets and the reflection therein of the underlying economic conditions which govern, in varying degree, all money rates, including those for call money.

Present Changed Conditions of Supply.

In former times, and specifically prior to the institution of the Federal Reserve System, bankers, especially in reserve centers, were accustomed to look upon call loans as their principal secondary reserve on the theory that inasmuch as those loans were payable upon demand, funds so invested could always be promptly obtained on short notice to meet withdrawals of deposits or for other use. In these circumstances there was ordinarily available for collateral call loans a supply of funds sufficient for ordinary market requirements and at low rates, although at times the rates rose to high levels as the supply of funds diminished, or the demands increased.

This attitude of the banks toward call loans as their chief secondary reserves has been greatly modified by two causes. The first was the closing of the Stock Exchange at the outbreak of the European War in the summer of

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1914, when it became practically impossible to realize on call loans secured by investment securities, which became, therefore, "frozen loans". This resulted in a more or less permanent prejudice against dependence upon call loans as secondary reserves. The second and more important factor was the creation of the Federal Reserve System. Under the terms of the Federal Reserve Act provision is made for the rediscount of commercial paper, but the rediscount of loans for the purpose of carrying investment securities, other than United States Government obligations, is excluded. Consequently, in order to maintain maximum liquidity, with suitable provision for secondary reserves that can be immediately availed of, banks, including foreign agency banks, now invest a greater proportion of their resources in assets that can be realized upon at the Federal Reserve Bank. Another changed factor in the present situation grows out of the fact that the war and post-war conditions have rendered unavailable supplies of money which formerly came from foreign banks. Since the summer of 1914, while total banking resources have largely increased, the volume of bank money available to the securities market at low or normal rates has not increased proportionately, but on the contrary has probably decreased. All of these circumstances, explain in a large measure, the increased rates which have often been required during the past year for money loaned in the securities market.

Present Changed Conditions of Demand.

Changed conditions are also present in the factors governing the demand for money. Prior to the armistice agencies of Government were employed to restrict the issue of new securities for purposes other than those which were deemed essential for carrying on the war. At the same time, as the Treasury undertook to sell large amounts of certificates of indebtedness and

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Liberty Bonds bearing low rates of interest, the question arose as to whether the competition of the general investment markets might not prejudice the success of the Government issues. In these circumstances the officers and members of the New York Stock Exchange undertook to limit transactions which would involve the increased use of money for other purposes in consideration of which the principal banks of New York City undertook to provide a stable minimum amount of money for the requirements of the security market.

After the armistice these restrictions were removed and ordinary market forces reasserted themselves. The issuance of new securities was resumed in unprecedented volume and consumed a vast amount of capital and credit, when bank credit was already expanded by the necessity of carrying large amounts of Government securities which the investment market was not prepared to absorb. Thus arose a further cause for the increased cost of accommodation on collateral call loans.

Since the armistice these causes have been augmented by the increased volume and velocity of transactions in securities generally. Before examining the figures, it should be explained that the amount of call money employed by the securities market fluctuates according to the amount of other funds available for this purpose, i. e. customers' money invested and time money borrowed, and also as the volume of business varies.

Volume.

The volume of money outstanding on call is more or less constant, fluctuating only over relatively long periods, and the amount which is loaned from day to day is but a small proportion of this constant volume. The constant volume of outstanding call loans bears a rate of interest which is determined daily and is known as the renewal rate. The daily borrowings, either in replacement of loans called for payment or representing new

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money borrowed, are made at rates which may or may not be the same as the renewal rate and which frequently vary during the same day.

Turning to the figures, it appears that over a period of years during the pre-war period the volume of all money, both time and call, employed in the securities market was estimated at about \$1,000,000,000., of which the average on call was about 60% and the average on time about 40%, or a normal volume of call money, say of \$600,000,000. The daily turnover in call money, i. e. old loans called for payment, loans made in replacement thereof, and new money borrowed, ranged from \$15,000,000 to \$30,000,000., and averaged about \$20,000,000. The daily turnover during the year 1919, however, ordinarily ranged from \$25,000,000 to \$40,000,000, and averaged about \$30,000,000. Moreover it is important to notice there has been a disproportionate increase in the amount of call loans, as distinguished from time money, with the consequence that the former, it is now estimated, constitute about 75% of the total money employed in the securities market. At a time of such heavy credit requirements as the present, the greater volume of borrowings, not only in the aggregate but in the day to day demands, naturally often results in high rates for the money loaned.

Intermittent Factors.

There are certain other factors, the influence of which is principally manifested in intermittent wide fluctuations in the daily rates or in the rates which apply for brief periods. The increased volume of demand loans called daily for payment noted above, coupled with the decreased amount of time money loaned on securities, produces more or less apprehension on the part of borrowers as to their ability to re-borrow money called for payment. This apprehension, quickened by the number of insistent borrowers bidding at times when momentarily loanable funds are exhausted or are being offered

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in small quantity, frequently results in competitive bidding for funds which advances the rates for a day or part of a day beyond the actual necessities of the situation.

Another active and important influence which has recently affected the supply of funds available for collateral loans and precipitated at times a rise in the rates, has been the periodic transfers of Government deposits from depositary banks to the Federal Reserve Banks in connection with the fiscal operations of the Treasury. Such withdrawals frequently make it necessary for the depositary banks to call money from the securities market, resulting frequently in sharp advances in the rate bid for call money in replacement of the loans called for payment.

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RATES ARE DETERMINED BY THE OPERATION OF
THE LAW OF SUPPLY AND DEMAND.

The underlying cause of fluctuations and, especially of increases in call money rates is the operation of the law of supply and demand. In other words, as the supply of loanable funds diminishes in proportion to the volume of the demand, the rate for collateral demand loans advances. However, in the case of the daily borrowings of call money -- to which the abnormal high and low rates apply and which represent but a comparatively small proportion of the total outstanding loans -- other factors, incidental to the temporary circumstances and conditions of the market, tend in times of stress to greater fluctuations in rates than result from the more normal operation of the law which is reflected in the renewal rate for the greater volume of the outstanding call loans. The renewal rate is regarded as the real barometer of market conditions and its fluctuations throughout the longer periods more nearly reflect the relation between the amount of the loanable funds and the amount of the demand. In other words, high renewal rates are mainly due to other demands for credit, resulting in part from the increased requirements of the commercial community and in part from other temporary factors, such as depletion of bank reserves resulting either or both from credit expansion or loss of reserves through gold export, speculation in commodities and real estate, and congestion of commercial transactions incidental to slow or interrupted transportation.

Commercial Rates are Similarly and Independently Determined.

The operation of the law of supply and demand is equally effective in determining the rate for commercial loans and all other borrowings.

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In fact, rates for commercial loans and rates for collateral ^{call} loans have a common root in the law of supply and demand, and the conditions which affect one, in the main affect the other, although not in like degree, as is demonstrated by the far wider fluctuations of call rates and the higher points to which they go. The rates for call money do not determine and since the establishment of the Federal Reserve Banks have not exerted an important influence on the rates for commercial borrowings. It is the universal custom of the banks, to satisfy first the commercial needs of their customers. They feel an obligation to customers but none to those who borrow in the open market on securities. Besides as the resources of the banks mainly come from the commercial customers, their own self-interest compels a preference in favor of their commercial borrowers, since failure to grant them reasonable accommodation would induce them to withdraw their deposits and so reduce the ability of the banks to do business. Although the money of the banks and trust companies comprises by far the greater proportion of the money loaned on the securities market, an examination of the prevailing rates on commercial paper at times when the call money market is particularly strained indicates that there is little causal relation between the rates for call money and those on commercial loans. Exhibits Nos. 1 and 2, showing respectively the rates for call money on the New York Stock Exchange during the years 1906-1919 and the rates for commercial paper in New York for the period from 1915 to 1920, are attached.

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POSSIBILITIES OF CHANGE IN THE CONDITIONS AND METHODS
OF THE CALL MONEY MARKET.

So long as collateral call loans are made under prevailing conditions it is difficult to see how the present situation can be altered, because of the impracticability of controlling the underlying cause of high rates, which, in the last analysis, is the excess of demand over supply.

An attempt to control the rates for call loans by the establishment of an arbitrary limit at a low level, without the ability to modify the causes above enumerated which operate to increase rates, would be distinctly hazardous, for the reasons that up to the point where the arbitrary rate would limit the supply of new money, speculation and expansion might proceed unchecked and the natural elements of correction or regulation would not obtain. In other words, high rates act as a deterrent to over-speculation and undue expansion of credit. On the other hand, should the supply of money available at a fixed minimum rate become exhausted, liquidation might suddenly be forced because the demands for additional accommodation for the consummation of commitments already made could not be met. The effect of such liquidation would be to embarrass not only investors and dealers in securities, ^{but} not infrequently might affect dealers and merchants in commodities as well. As an example of the latter, the case might be cited of a commitment to purchase a round amount of cotton on a certain day. Many of the houses on the Cotton Exchange are also members of the Stock Exchange and frequently borrow very largely on the Stock Exchange against investment securities to provide the funds for settling their transactions in cotton. If,

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therefore, when an important cotton settlement is imminent, borrowings on securities could not be availed of, the cotton transaction could not be consummated and a drastic liquidation through sale either of securities or of the cotton might be required to avoid default. Similar consequences might obtain in the cases of transactions by members of other commodity exchanges who are also members of the Stock Exchange and have recourse to the call money market.

THE IMPORTANCE OF A "CALL MONEY" MARKET.

Call money in some form is indispensable to every important financial center. There must be not only an outlet for the employment of funds temporarily idle, but a large volume of call and short time money is essential to the successful and economical conduct of business. It is particularly essential to the international and domestic commercial business but the diversion of the use of the major portion of such money to the securities markets is not in accordance with sound banking principles and the resulting absorption of funds for speculative uses has at times resulted in detriment to commerce and industry. The result of all this is a condition which calls for correction. It is to be noted that in no great world market, other than New York, is the call money market so dependent upon investment securities and so susceptible to speculative influences. In other markets the reverse is true, as their call money is based principally on commercial paper upon which realization can be had at the central bank, at a price, in case of need. We have seen that in this country call loans on securities lack this essential quality of liquidity required for quick and certain realization, and that this fact has now been more generally taken into consideration by our lenders.

But the safe and successful divorce in this country of the use of call money from its dependence upon investment securities as a basis requires careful study in order that safe and adequate methods may be substituted for the present methods of the securities market.

TERM SETTLEMENTS.

The achievement of this end probably depends upon the successful development of a plan for term settlements of the balances resulting from operations on the Stock Exchange, in lieu of the present method of daily settlements. The principal effect of such a change of the method of settlements would be to relieve the call money market from the necessities of the securities market and release funds now used in collateral call loans based on investment securities for employment in call loans based on the collateral of the more liquid securities, commercial paper and short term Government paper, generally recognized abroad as the preferred bases for demand loans. From this change a broader discount market would naturally develop. Under term settlements the borrowing required by the securities market would be on the basis of short time accommodation, i.e. for the term between settlements, whether they were weekly, fortnightly or at other intervals.

Agitation for the improvement of the present method of settlement of stock exchange contracts has extended over some years and as the result of extensive studies and deliberations of officers and members of the New York Stock Exchange, as well as bankers, an important step has been taken to provide enlarged clearing facilities through the organization of a new corporation known as the Stock Clearing Corporation, which is expected to begin operations in April, 1920. A general description of

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the purposes and contemplated operations of the corporation is contained in the pamphlet attached hereto as Exhibit No. 3. The functions of this corporation include providing facilities for clearing contracts between members, for the receipt and delivery of securities between members and banks, trust companies and others, and for the clearing of collateral call loans. It is not asserted or expected that the institution of these operations will materially affect either the amount of money loaned from one day to another on the call money market or the rates of such loans, but it is expected that it will operate materially to decrease the amount of bank certifications on day loans, which the present practice requires in the interval between paying one call loan and replacing it with another on the same day. It should be noted that the mechanism afforded by the corporation is an indispensable, prerequisite to the establishment of a system of term settlements.

The more recent and definite development toward the substitution of term settlements for the present system of daily settlements may be said to have had its inception in the action of the American Acceptance Council at its annual meeting on December 4, 1919. At that time the following resolution was adopted:

"Whereas, the present method of daily/^{stock} exchange settlements, with its dominating and often unsettling effect on the call money market, influences adversely the development of a wide and healthy discount market in the United States:

Resolved, That the Chairman of the Executive Committee be authorized to appoint a committee consisting of members of the Executive Committee and other individuals to study the advisability, ways and means of modifying the present system of settlements on the New York Stock Exchange and substituting therefor some system of periodical settlement, with power to take such steps as may seem advisable in the case."

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A copy of the annual report of the American Acceptance Council is appended hereto as Exhibit 4, in which the resolution appears on page 5, and the report of the Chairman of the Executive Committee above referred to appears on pages 16 to 27, inclusive.

The Committee thus provided for was appointed and held two extended conferences in which the problem was fully discussed, both from the point of view of the banks and of the Stock Exchange. For illustration of the subject matter of the discussion there is attached hereto as Exhibit 5 a detailed report compiled by one of the members of the Committee, Mr. Samuel F. Streit, Chairman of the Committee on Clearing House of the Stock Exchange describing the term settlement operations in London and on the European continent, which presently will be published by the American Acceptance Council. Through its courtesy the Board has received an advance copy of the report. There are also attached, as Exhibits 6 and 7 respectively two other publications of the American Acceptance Council, "Acceptance Corporations", by F. Abbott Goodhue, Vice President of the First National Bank of Boston, Mass., and "The Acceptance as the Basis of the American Discount Market", by John E. Rovensky, Vice President of the National Bank of Commerce, New York, in which on pages 14 and 22 respectively, the necessity for term settlements as a means of relieving the call money market from the necessities of the securities market and as a precedent to a broad and stable discount market is discussed.

The members of the committee have unanimously expressed the opinion that the adoption of a term settlement by the Stock Exchange would offer advantages in that it would eliminate duplication of the handling

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of securities and in payments. The committee holds, however, that, inasmuch as the adoption of a term settlement by the Exchange would involve changes of great importance, both to banks and to members of the Exchange, it will require the most careful study of the subject by the committee, and in any case the term settlement cannot be put into operation until the new system of daily Stock Exchange settlements through the Stock Clearing Corporation, above referred to, has been perfected and has been in practical operation for a reasonable time.

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TREASURY DEPARTMENT
WASHINGTON

Assistant Secretary

March 22, 1920.

TO THE SECRETARY:

I have read and return herewith the draft of the Federal Reserve Board's reply to Senate Resolution No. 328 concerning rates on call loans.

In your letter of March 2nd to the President, dealing with this same subject you said:

"Speculative purchases of stocks are largely carried by loans on call. The law of New York places no limit on the rate of interest for such loans.. The law of the State governs national as well as state banks. Much might be said both for and against a proposal to amend the state laws in this respect. I am by no means satisfied that a change in the state usury laws would be the best solution of the problem. In times when credit is scarce a usury law may work actual denial of credit, with consequent acute distress, or it may be evaded, in which case the cost of the money to the borrower is apt to be increased because of the risk involved in the evasion of the law. The real remedy for the gyrations of the call loan market is to be found in insistence upon the furnishing of adequate margins by the brokers' customers and in reforming the archaic methods of financing and settling speculative transactions in stocks. These views have been brought informally to the attention of the responsible people and I hope progress may be made along these lines."

In my memorandum of January 26, 1920, to Governor Harding and Mr. Strauss I said:

"I am hoping very much that the Board will decide to take effective steps to require stock exchanges to adopt rules under which the brokers' customers' accounts will be adequately margined.

"I am satisfied that the method employed during the past two or three months for restricting credit for speculative transactions in stocks is injurious to the general situation. The denial or the strict limitation of credit, or very high

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rates for call money for stock market purposes reflect unfavorably upon the market for acceptances, for Treasury Certificates, Liberty Bonds and Victory Notes, for commercial transactions. Refusal of credit by New York banks or very high rates for call money attract money into the stock market from the country banks. This creates a very vulnerable situation. I think that at least until an equilibrium is struck between the supply and demand for commodities there will be a serious risk of a new bull movement in stocks with a resulting strain upon credit and that immediately steps should be taken to put into effect what appears to me to be the safest, soundest cure, namely, the requirement that customers' accounts be adequately margined".

Secretary Glass in his letter of November 5, 1919, to

Governor Harding said:

"We cannot trust to the copybook texts. Making credit more expensive will not suffice. There is no precedent in history for the great war which we have been through nor for the conditions now existing. The Reserve Bank governor must raise his mind above the language of the textbooks and face the situation which exists. He must have courage to act promptly and with confidence in his own integrity to prevent abuse of the facilities of the Federal Reserve System by the customers of the Federal Reserve Banks, however powerful or influential.

"Speculation in stocks on the New York Stock Exchange is no more vicious in its effect upon the welfare of the people and upon our credit structure than speculation in cotton or in land or in commodities generally. But the New York Stock Exchange is the greatest single organized user of credit for speculative purposes. It is the organized instrument of a countrywide speculation. I believe that the practice of financing speculative transactions in stocks by loans on call, with daily settlements, is unsound and dangerous to the general welfare. Call money loaned to carry speculative transactions in stocks is only liquid when there is no need. The paper is not self-liquidating and, in the case of an emergency, as, for example, upon the outbreak of the European war, and throughout the period of our participation in the war, such loans are in the mass uncollectible. The use of Liberty Bonds, Victory Notes and Treasury Certificates as collateral for borrowings made by member banks from the Federal Reserve Banks for the purpose of carrying speculative transactions in stocks makes it the right as well as the duty of the Federal Reserve authorities to see to

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it that the methods of financing such transactions are reformed and reformed immediately.

"Open and notorious manipulation of stocks has been taking place during the period of, say nine months, since the removal of the control of the Subcommittee on Money of the Liberty Loan Committee. This manipulation, which takes the form of putting up the price first of one stock and then of another, no matter what may be the conditions, for the purpose of stimulating interest on the part of the uninitiated public, is, I imagine, contrary to the law of the State of New York and the rules of the New York Stock Exchange. In any event, it needs only vigorous action to put an end to it. The Federal Reserve Bank of New York in its relation to the Subcommittee on Money of the Liberty Loan Committee, which Committee was at all times in touch with the officers of the Stock Exchange, naturally sought the views of the Treasury by reason of the fact that its prime duty concerned the sale of Liberty Bonds. A control now put into effect will be primarily for the conservation of the general credit situation and should therefore be initiated and supervised, not by the Treasury, but by the Federal Reserve Board.

"I need not say that such steps should be taken not only firmly but with discretion and in such a way as not to involve grave hardship to individuals or injury to the general welfare."

In my memorandum of December 19, 1918, to Mr. Treman, then Acting Governor of the Federal Reserve Bank of New York I said:

"Holding these views, the Treasury, though not always in agreement as to the methods pursued, has been heartily in accord with the efforts made by the Money Subcommittee and by the authorities of the stock exchange to prevent further expansion in the loan account. As to methods, the Treasury has felt and still feels, that reliance should be placed rather upon the requirement of increased margins, made effective not merely as regards stock exchange brokers but as regards their customers also, than upon the attempt to ration credit to the brokers themselves. The Treasury, however, has not felt and does not feel, that it should seek to impose its own views as to the particular methods to be employed to accomplish the desired result.

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"It is the earnest hope of the Treasury that, growing out of the very salutary action of the Money Subcommittee and of the stock exchange authorities during the period of the war and the present period of readjustment, there may be evolved some plan for preventing the recurrence, after the restoration of peace conditions, of those erratic and violent fluctuations in rates for call money and those feverish movements of prices on the stock exchange, which in the past have been the source of great concern to the judicious and in the future can only prove a stumbling block in the effort of America to take and keep the place which she has won in the world's commerce and finance."

My conclusions on reading the proposed reply to Senate Resolution No. 325 are three:

1. High rates for call money on stocks, etc., are not usurious because the law does not make them usurious and I do not think the law should be changed in this respect. High rates for call money operate as a safety valve. A real call money market is essential to the proper functioning of a world financial center. Without a call money market to act as a safety valve in time of credit stringency we should have unnecessary panics. No place can claim to be a money center where money can not be had at a price.. If money can not be had at a price, the consequence is dumping of securities in the effort to produce cash. I should say that the market prices of Liberty Bonds and Victory Notes would be the first to show the effect of an absolute refusal of money at any price, just as they reflect first excessive rates for money.

2. The call money market should be based on acceptances and not on stocks. Nothing is really liquid in a time of great

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world crisis such as the outbreak of the war in Europe; but acceptances are more liquid than securities.

3. The real vice in the present situation is that the gambler in stocks is permitted to have the first call on funds in a period of stringency because he is permitted to finance his transactions on call and is not required to produce adequate margin. I think the Stock Exchange should be required to reform itself promptly by substituting term settlements and by requiring brokers' customers' accounts to be margined adequately. It may ultimately be necessary to go even further than this and prohibit buying on margin altogether. To go to a bank and borrow money to speculate with is very different from buying stocks on margin. Many a man who would not have the face to ask his bank for loans for speculative purposes will buy stocks on margin, and many a bank which would not think of lending money to an individual customer to speculate with will lend money to his broker to carry him.

It will be seen from the foregoing that I differ from the views indicated in the reply to Senate Resolution No. 328 more in matters of emphasis than in matters of detail. The proposed reply is sound in substance, but it is unsound, it seems to me, in the general impression which it creates that everything is about right in respect to the New York Stock Exchange and the call money market. It may be that the difficulty could be overcome by dealing only with the specific question raised by the Senate Resolution, namely, the

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Turning to matters of detail: On page 9 the statement is made that the operation of the law of supply and demand is equally effective in determining the rate for commercial loans and all other borrowings. This, of course, is not the fact. The usury law imposes a limit upon the rate for commercial loans and other time borrowings, while it imposes no such limit upon call loans.

I do not share the view advanced in the memorandum, page 12, ff., that the organization of the stock clearing corporation is an important step towards the solution of the problem. Undoubtedly it is a step towards making more efficient the credit which is made available for carrying stocks. It is not, however, a step in the direction of limiting the amount of credit used for that purpose - quite the contrary.

To summarize the whole matter, I would say that the object of remedial measures should be not to furnish cheap money for stock speculation, but to prevent the scandalous manipulation of stocks and to limit the stupendous demands for credit for speculation in stocks.

R. L.

DECLASSIFIED

Authority E.Q. 10501

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TREASURY DEPARTMENT
WASHINGTON

Office of
Comptroller of the Currency

March 23, 1920.

Dear Governor:

For the information of the Board I beg leave to advise that, in reply to inquiries contained in statement of condition of February 28, 1920, the following banks in New York City reported loans made by them "including items of paper 'bought', since December 31, 1919, at rates (including interest, discount, and commission) in excess of highest rate permissible by law under written contract" were as follows:

<u>NAME OF BANK</u>	<u>NUMBER OF LOANS</u>	<u>AGGREGATE AMOUNT</u>
National Bank of Commerce,	5	\$1,801,464.86
Seaboard National Bank,	20	655,000
Mechanics and Metals National Bank,	1	50,000
Lincoln National Bank,	74	5,585,765.48
Liberty National Bank,	5	95,000
Coal and Iron National Bank,	15	159,292.97
Chemical National Bank,	3	980,000
Chase National Bank,	1	24,000
Bank of New York, N. B. A.	38	2,765,505.47

Sincerely yours,

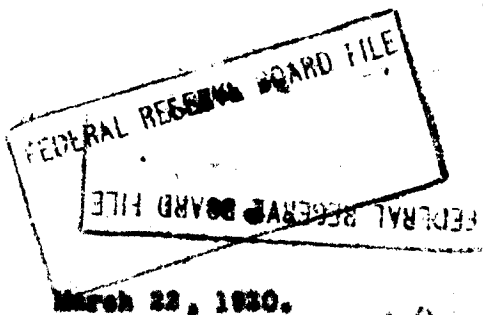
(Signed) J. S. Williams

Hon. W. P. G. Harding,
Governor, Federal Reserve Board.

DECLASSIFIED

Authority E.O. 10501

10
 Gov. Harding
 March 23/20



March 22, 1920.

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TO THE SECRETARY;

I have read and return herewith the draft of the Federal Reserve Board's reply to Senate Resolution No. 328 concerning rates on call loans.

In your letter of March 2nd to the President, dealing with this same subject you said:

"Speculative purchases of stocks are largely carried by loans on call. The law of New York places no limit on the rate of interest for such loans. The law of the State governs national as well as state banks. Much might be said both for and against a proposal to amend the state laws in this respect. I am by no means satisfied that a change in the state usury laws would be the best solution of the problem. In times when credit is scarce a usury law may work actual denial of credit, with consequent acute distress, or it may be evaded, in which case the cost of the money to the borrower is apt to be increased because of the risk involved in the evasion of the law. The real remedy for the gyrations of the call loan market is to be found in insistence upon the furnishing of adequate margins by the brokers' customers and in reforming the archaic methods of financing and settling speculative transactions in stocks. These views have been brought informally to the attention of the responsible people and I hope progress may be made along these lines."

In my memorandum of January 26, 1920, to Governor Harding and Mr. Strauss I said:

"I am hoping very much that the Board will decide to take effective steps to require stock exchanges to adopt rules under which the brokers' ~~margin~~ accounts will be adequately margined.

• • • • •

"I am satisfied that the method employed during the past two or three months for restricting credit for speculative transactions in stocks is injurious to the general situation. The denial or the strict limitation of credit, or very high

- 2 -

rates for call money for stock market purposes reflect unfavorably upon the market for acceptances, for Treasury Certificates, Liberty Bonds and Victory Notes, for commercial transactions. Refusal of credit by New York banks or very high rates for call money attract money into the stock market from the country banks. This creates a very vulnerable situation. I think that at least until an equilibrium is struck between the supply and demand for commodities there will be a serious risk of a new bull movement in stocks with a resulting strain upon credit and that immediately steps should be taken to put into effect what appears to me to be the safest, soundest cure, namely, the requirement that customers' accounts be adequately margined?

Secretary Glass in his letter of November 5, 1919, to Governor Harding said:

"We cannot trust to the copybook texts. Making credit more expensive will not suffice. There is no precedent in history for the great war which we have been through nor for the conditions now existing. The Reserve Bank governor must raise his mind above the language of the textbooks and face the situation which exists. He must have courage to act promptly and with confidence in his own integrity to prevent abuse of the facilities of the Federal Reserve System by the customers of the Federal Reserve Banks, however powerful or influential.

"Speculation in stocks on the New York Stock Exchange is no more vicious in its effect upon the welfare of the people and upon our credit structure than speculation in cotton or in land or in commodities generally. But the New York Stock Exchange is the greatest single organized user of credit for speculative purposes. It is the organized instrument of a countrywide speculation. I believe that the practice of financing speculative transactions in stocks by loans on call, with daily settlements, is unsound and dangerous to the general welfare. Call money loaned to carry speculative transactions in stocks is only liquid when there is no need. The paper is not self-liquidating and, in the case of an emergency, as, for example, upon the outbreak of the European war, and throughout the period of our participation in the war, such loans are in the mass uncollectible. The use of Liberty Bonds, Victory Notes and Treasury Certificates as collateral for borrowings made by member banks from the Federal Reserve Banks for the purpose of carrying speculative transactions in stocks makes it the right as well as the duty of the Federal Reserve authorities to see to

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it that the methods of financing such transactions are reformed and reformed immediately.

"Open and notorious manipulation of stocks has been taking place during the period of, say, nine months, since the removal of the control of the Subcommittee on Money of the Liberty Loan Committee. This manipulation, which takes the form of putting up the price first of one stock and then of another, no matter what may be the conditions, for the purpose of stimulating interest on the part of the uninitiated public, is, I imagine, contrary to the law of the State of New York and the rules of the New York Stock Exchange. In any event, it needs only vigorous action to put an end to it. The Federal Reserve Bank of New York in its relation to the Subcommittee on Money of the Liberty Loan Committee, which Committee was at all times in touch with the officers of the Stock Exchange, naturally sought the views of the Treasury by reason of the fact that its prime duty concerned the sale of Liberty Bonds. A control now put into effect will be primarily for the conservation of the general credit situation and should therefore be initiated and supervised, not by the Treasury, but by the Federal Reserve Board.

"I need not say that such steps should be taken not only firmly but with discretion and in such a way as not to involve grave hardship to individuals or injury to the general welfare."

In my memorandum of December 19, 1918, to Mr. Tremain, then Acting Governor of the Federal Reserve Bank of New York I said:

"Holding these views, the Treasury, though not always in agreement as to the methods pursued, has been heartily in accord with the efforts made by the Money Sub-Committee and by the authorities of the stock exchange to prevent further expansion in the loan account. As to methods, the Treasury has felt and still feels, that reliance should be placed rather upon the requirement of increased margins, made effective not merely as regards stock exchange brokers but as regards their customers also, than upon the attempt to ration credit to the brokers themselves. The Treasury, however, has not felt and does not feel, that it should seek to impose its own views as to the particular methods to be employed to accomplish the desired result.

* * * * *

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"It is the earnest hope of the Treasury that, growing out of the very salutary action of the Money Sub-Committee and of the stock exchange authorities during the period of the war and the present period of readjustment, there may be evolved some plan for preventing the recurrence, after the restoration of peace conditions, of those erratic and violent fluctuations in rates for call money and those feverish movements of prices on the stock exchange, which in the past have been the source of great concern to the judicious and in the future can only prove a stumbling block in the effort of America to take and keep the place which she has won in the world's commerce and finance."

My conclusions on reading the proposed reply to Senate

Resolution No. 328 are three;

1. High rates for call money on stocks, etc., are not usurious because the law does not make them usurious and I do not think the law should be changed in this respect. High rates for call money operate as a safety valve. A real call money market is essential to the proper functioning of a world financial center. Without a call money market to act as a safety valve in time of credit stringency we should have unnecessary panics. No place can be claimed to be a money center where money cannot be had at a price. If money ^{can} ~~could~~ not be had at a price, the consequence is dumping of securities in the effort to produce cash. I should say that the market prices of Liberty Bonds and Victory Notes would be the first to show the effect of an absolute refusal of money at any price, just as they reflect first excessive rates for money.

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- 5 -

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Authority E.O. 10501

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(Initialed) RCH

ENCLOSURE

DECLASSIFIED

Authority E.O. 10501

from

FEDERAL RESERVE BOARD

Reed

WASHINGTON

OFFICE OF THE GOVERNOR

March 1920

Subject: Reply to Senate Resolution No. 328

Sir:

In March 8th, 1920, the Senate adopted the following resolution:

"RESOLVED that the Federal Reserve Board be and is hereby directed to advise the Senate what is the cause and justification for the usurious rates of interest on collateral call loans in the financial centers, under what law authorized and what steps, if any, are required to abate this condition."

In reply the Board desires to say that it has no information that rates of interest higher than legal rates for commercial paper have been charged on collateral call loans in any financial center except New York City. The rates which have been charged on collateral loans in that city, however, are not usurious since the laws of the State of New York specifically exempt such loans from the six per cent limitation which lenders must observe on other loans on pain of incurring the penalty prescribed for usury.

For fuller and further information of the Senate, there is appended hereto a statement of the nature and operation of the New York Call Money Market.

Respectfully,

The President of the Senate.

Governor

THE NEW YORK CALL MONEY MARKET

Definition of Call Loans.

Collateral call loans, in the general acceptance of the term, are made chiefly in New York City, which is practically the only important call money market in the United States. They are loans which are payable on demand of the lender without previous notice, secured by the pledge of investment securities, i. e. stocks and bonds, generally those which are dealt in on the New York Stock Exchange. The interest rates on these loans, as on other classes of loans, are on the basis of a rate per annum.

The Borrowers.

The loans are made for the most part to houses which are members of the Stock Exchange and the money so borrowed constitutes a portion of the

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funds ~~which they~~ employ ordinarily in purchasing and carrying securities for their customers and sometimes for themselves.

The Lenders.

The principal supplies of money for collateral call loans are loanable funds of banks and bankers located both in and outside of New York City, including foreign banks and agencies of foreign banks; and similarly the loanable funds of firms, individuals and corporations seeking temporary investment. The proportion of the whole fund loaned by these several interests varies seasonally and in accordance with the attractiveness of other opportunities for investment, either locally or in other markets. The bulk of ~~the~~ call money is lent on the floor of the New York Stock Exchange at "the money post", where through various brokers loanable funds are offered and bids for funds are received. Most of the business is done between the hours of 12 noon and 2:45 p. m. The important relation to the money market of the present system of daily settlement of balances resulting from the purchases and sales of securities on the Stock Exchange will be discussed more fully hereafter.

Commercial Requirements Have The Prior Claim.

In the matter of the supply or attraction of funds to the call money market, there is a definite and well understood obligation on the part of banks to accommodate first their own commercial clients, so that it is only the excess of loanable funds which they may have from time to time that is available for the collateral call money market or for the purchase of commercial paper in the open market. This excess of loanable funds available for employment in the securities market ~~must vary~~, therefore, according to the commercial requirements of the country. It has long been recognized that for assurance of a sufficient amount of money to finance

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the volume of business in securities, reliance cannot be placed on a rate of interest limited to the rates which obtain or are permitted in commercial transactions whose prior claim on banking accommodations is universally conceded.

THE LAW RESPECTING THE RATES OF INTEREST ON COLLATERAL
CALL LOANS.

Law of New York.

The statutes of the State of New York acknowledge and recognize this principle in both the Banking and Business Law in the sections regarding interest legally receivable.

Section 115 of the Banking Law (L. 1914 Ch. 369; Consol. L. Ch. 2) provides that upon advances of money repayable on demand to an amount not less than \$5,000 made upon warehouses receipts, bills of lading, certificates of stock, etc., or other negotiable instruments as collateral, any bank may receive and collect as compensation any sum which may be agreed upon by the parties of such transaction. The section reads:

"Sec. 115. Interest on collateral demand loans of
not less than five thousand dollars.

Upon advances of money repayable on demand to an amount not less than five thousand dollars made upon warehouse receipts, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds or other negotiable instruments, pledged as collateral security for such repayment, any bank may receive or contract to receive and collect as compensation for making such advances any sum which may be agreed upon by the parties of such transaction."

Section 201 of the Banking Law, identical in language with Section 115 above quoted, makes the same provision in the case of collateral call loans by trust companies. In the General Business Law (L. 1909 Ch. 25; Consol. L. Ch. 20) there is the following general provision of a like character:

"Sec. 379. Interest permitted on advances on collateral security.

In any case hereafter in which advances of money, repayable on demand, to any amount not less than five thousand dollars, are made upon warehouse receipts, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds or other negotiable instruments pledged as collateral security for such repayment, it shall be lawful to receive or to contract to receive and collect, as compensation for making such advances, any sum to be agreed upon in writing, by the parties of such transaction."

National Bank Act.

The National Bank Act provides that national banks may receive and charge on any loan or discount interest at the rate allowed by the law of the State, territory or district where the bank is located. The applicable provision reads.

"Limitation upon rate of interest which may be taken.

422. Sec. 5197. - Any association may take, receive, reserve and charge on any loan or discount made, or upon any note, bill of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory or District where the bank is located, and no more, except that where by the laws of any State a different rate is limited for banks of issue organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this Title. When no rate is fixed by the laws of the State, Territory, or District, the bank may take, receive, reserve, or charge a rate not exceeding seven per centum, and such interest may be taken in advance, reckoning the days for which the note, bill, or other evidence of debt has to run. And the purchase, discount, or sale of a bona fide bill of exchange, payable at another place than the place of such purchase, discount, or sale, at not more than the current rate of exchange for sight drafts in addition to the interest, shall not be considered as taking or receiving a greater rate of interest."

It will be observed that the effect of the foregoing provisions is to authorize in the State of New York on collateral call loans of not less than \$5,000 rates of interest which may be in excess of those per-

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mitted for loans of other character, and that such higher rates are not prohibited as usurious.

CAUSES AFFECTING PRESENT CALL MONEY RATES.

The reference in the resolution to the present high rates for call money in the financial centers and the inquiry as to their causes require, it is felt, a survey of the operations of the money markets and the reflection therein of the underlying economic conditions which govern, in varying degree, all money rates, including those for call money.

Present Changed Conditions of Supply.

In former times, and specifically prior to the institution of the Federal Reserve System, bankers, especially in reserve centers, were accustomed to look upon call loans as their principal secondary reserve on the theory that inasmuch as those loans were payable upon demand, funds so invested could always be promptly obtained on short notice to meet withdrawals of deposits or for other use. In these circumstances there was ordinarily available for collateral call loans a supply of funds sufficient for ordinary market requirements and at low rates, although at times the rates rose to high levels as the supply of funds diminished, or the demands increased.

This attitude of the banks toward call loans as their chief secondary reserves has been greatly modified by two causes. The first was the closing of the Stock Exchange at the outbreak of the European War in the summer of 1914, when it became practically impossible to realize on call loans secured by investment securities, which became, therefore, "frozen loans". This resulted in a more or less permanent prejudice against dependence upon call loans as secondary reserves. The second and more important factor was the creation of the Federal Reserve System. Under the

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terms of the Federal Reserve Act provision is made for the rediscount of commercial paper, but the rediscount of loans for the purpose of carrying investment securities, other than United States Government obligations, is excluded. Consequently, in order to maintain maximum liquidity, with suitable provision for secondary reserves that can be immediately availed of, banks, including foreign agency banks, now invest a greater proportion of their resources in assets that can be realized upon at the Federal Reserve Bank. Another changed factor in the present situation grows out of the fact that the war and post-war conditions have rendered unavailable supplies of money which formerly came from foreign banks. Since the summer of 1914, ~~therefore~~, while total banking resources have largely increased, the volume of bank money available to the securities market at low or normal rates has not increased proportionately, but on the contrary has probably decreased. These circumstances, of themselves, explain, in large measure the increased rates which have often been required during the past year for money loaned in the securities market.

Present Changed Condition of Demand.

Changed conditions are also present in the factors governing the demand for money. Prior to the armistice agencies of Government were employed to restrict the issue of new securities for purposes other than those which were deemed essential for carrying on the war. At the same time, as the Treasury undertook to sell large amounts of certificates of indebtedness and Liberty Bonds bearing low rates of interest, the question arose as to whether the competition of the general investment markets might not prejudice the success of the Government issues. In these circumstances the officers and members of the New York Stock Exchange undertook to limit transactions which would involve the increased use of money for other purposes in consideration

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of which the principal banks of New York City undertook to provide a stable minimum amount of money for the requirements of the security market.

After the armistice these restrictions were removed and ^{ordinary market} ~~natural laws~~ ^{forces} reasserted themselves. The issuance of new securities was resumed in unprecedented volume and consumed a vast amount of capital and credit, when bank credit was already expanded by the necessity of carrying large amounts of Government securities which the investment market was not prepared to absorb. Thus arose a further cause for the increased cost of ^{accommodating} ~~accommodating~~ on collateral call loans.

Since the armistice these causes have been augmented by the increased volume and velocity of transactions in securities generally. Before examining the figures, it should be explained that the amount of call money employed by the securities market fluctuates according to the amount of other funds available for this purpose, i. e. customers' money invested and time money borrowed, and also as the volume of business varies.

Volume.

The volume of money outstanding on call is more or less constant, fluctuating only over relative ^{by} long periods, and the amount which is loaned from day to day is but a small proportion of this constant volume. The constant volume of outstanding call loans bears a rate of interest which is determined daily and is known as the renewal rate. The daily borrowings, either in replacement of loans called for payment or representing new money borrowed, are made at rates which may or may not be the same as the renewal rate and which frequently vary during the same day.

Turning to the figures, it appears that over a period of years during the pre-war period the volume of all money, both time and call, employed in the securities market was estimated at about \$1,000,000,000., of which the

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average on call was about 60% and the average on time about 40%, or a normal volume of call money, say of \$600,000,000. The daily turnover in call money, i. e. old loans called for payment, loans made in replacement thereof, and new money borrowed, ranged from \$15,000,000 to \$30,000,000., and averaged about \$20,000,000. The daily turnover during the year 1919, however, ordinarily ranged from \$25,000,000 to \$40,000,000, and averaged about \$30,000,000. Moreover it is important to notice there has been a disproportionate increase in the amount of call loans, as distinguished from time money, with the consequence that the former, it is ~~not~~^{now} estimated, constitute about 75% of the total money employed in the securities market. At a time of such heavy credit requirements as the present, the greater volume of borrowings, not only in the aggregate but in the day to day demands, naturally often results in high rates for the money loaned.

Intermittent Factors.

There are certain other factors, the influence of which is principally manifested in intermittent wide fluctuations in the daily rates or in the rates which apply for brief periods. The increased volume of demand loans called daily for payment noted above, coupled with the decreased amount of time money loaned on securities, produces more or less apprehension on the part of borrowers as to their ability to re-borrow money called for payment. This apprehension, quickened by the number of insistent borrowers bidding at times when momentarily loanable funds are exhausted or are being offered in small quantity, frequently results in competitive bidding for funds which advances the rates for a day or part of a day beyond the actual necessities of the situation.

Another active and important influence which has recently affected the supply of funds available for collateral loans and precipitated at times a

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rise in the rates, has been the periodic transfer of government deposits from depositary banks to the Federal reserve banks ^{in connection with the fiscal operations of the Treasury} for such withdrawals frequently make it necessary for the depositary banks to call money from the securities market, resulting frequently in sharp advances in the rate bid for call money in replacement of the loans called for payment.

RATES ARE DETERMINED BY THE OPERATION OF THE
LAW OF SUPPLY AND DEMAND.

The underlying cause of fluctuations and, especially of increases in call money rates is the ~~unstable~~ operation of the law of supply and demand. In other words, as the supply of loanable funds diminished in proportion to the volume of the demand, the rate for collateral demand loans inevitably advances. However, in the case of the daily borrowings of call money -- to which the abnormal high and low rates apply and which represent but a comparatively ^{small proportion} ~~insignificant part~~ of the total outstanding loans -- other factors, incidental to the temporary circumstances and conditions of the market, tend in times of stress to greater fluctuations in rates than result from the more normal operation of the law which is reflected in the renewal rate for the greater volume of the outstanding call loans. The renewal rate ^{regarded as} is the real barometer of market conditions and its fluctuations throughout the longer periods ^{more nearly reflect} ~~are the natural result of~~ the relation between the amount of the loanable funds and the amount of the demand. In other words, high renewal rates ^{mainly other demands for} are due to the ~~scarcity of~~ credit, which results in part from the ^{increased} ~~prior~~ ~~requirements~~ of the commercial community and in part from other temporary factors ~~which may be injected from time to time~~, such as ~~the~~ depletion of bank reserves resulting either or both from credit expansion or loss of reserves through gold export, speculation in commodities and real estate, and congestion of commercial transactions incidental to slow or interrupted transportation.

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Commercial Rates are Similarly and Independently Determined.

The operation of the law of supply and demand is equally effective in determining the rate for commercial loans and all other borrowings. In fact, rates for commercial loans and rates for collateral call loans have a common root in the law of supply and demand, and the conditions which affect one, in the main affect the other, although not in like degree; as is demonstrated by the far wider fluctuation of call rates and the higher points to which they go. *and since the establishment of the Fed* The rates for call money do not determine ~~and but~~ *Real Reserve Banks* ~~have not exerted an important influence on~~ *for* ~~the rates on~~ commercial borrowings. It is the universal custom of the banks, to satisfy first the commercial needs of their customers. They ~~have~~ *feel* an obligation to customers but none ~~whatsoever~~ to those who borrow in the open market on securities. Besides as the resources of the banks mainly come from commercial customers, their own self-interest compels a preference in favor of their commercial borrowers, since failure to grant them reasonable accommodation would induce them to withdraw their deposits and so reduce the ability of the banks to do business. Although the money of the banks and trust companies comprises by far the greater proportion of money loaned on the securities market, an examination of the prevailing rates on commercial paper at times when the call money market is particularly strained indicates that there is little causal relation between the rates for call money and those on commercial loans. Exhibits Nos. 1 and 2, showing respectively the rates for call money on the New York Stock Exchange during the years 1906-1919 and the rates for commercial paper in New York for ~~the~~ period from 1915 to 1920, are attached.

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POSSIBILITIES OF CHANGE IN THE CONDITIONS AND METHODS OF THE
CALL MONEY MARKET.

So long as collateral call loans are made under prevailing conditions ^{is difficult to see how} ~~would seem impossible to alter~~ ^{can be altered} the present situation, because of the impracticability of ^{controlling} ~~altering~~ the underlying cause of high rates, which, in the last analysis, is ~~simply~~ the excess of demand over supply.

An attempt to control the rates for call loans by the establishment of an arbitrary limit at a low level, without the ability to modify the ^{above enumerated} ~~natural~~ causes which operate to increase rates, would be distinctly ~~undesirable and dangerous~~, for the reason that up to the point where the arbitrary rate would limit the supply of new money, speculation and expansion might proceed unchecked and the natural elements of correction or regulation would not obtain. In other words, high rates ^{act as} ~~and the ever-present possibility of higher rates are~~ a deterrent to over-speculation and undue expansion of credit. On the other hand, should the supply of money available at ~~the~~ ^a fixed maximum rate become ^{be} ~~exhausted~~, liquidation ^{might} ~~would~~ suddenly be forced because the demands for additional accommodation for the consummation of commitments already made could not be met. The effect of such liquidation would be to embarrass not only investors and dealers in securities, and ^{not} ~~also it should be noted~~, ^{infrequently} ~~might affect~~ dealers and merchants in commodities as well. As an example of the latter, the case might be cited of a commitment to purchase a round amount of cotton on a certain day. Many of the houses on the Cotton Exchange are also members of the Stock Exchange and frequently borrow very largely on the Stock Exchange against investment securities to provide the funds for settling their transactions in cotton. If, therefore, when an important cotton settlement was imminent, borrowings on securities could not be availed of, the cotton transaction could not be consummated and a drastic liquida-

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tion through sale either of securities or of the cotton might be required to avoid default. Similar consequences might obtain in the cases of transactions by members of other commodity exchanges who are also members of the Stock Exchange and have recourse to the call money market.

THE IMPORTANCE OF A "CALL MONEY MARKET."

in some form
 A call money market is indispensable to every important financial center. *There must be an* It serves not only as an outlet for the employment of funds temporarily idle, but a large volume of call and short time money is essential to the successful and economical conduct of ~~the~~ business of the ~~country~~. It is particularly essential to the international and domestic commercial business, *but* and the diversion of the use of the major portion of

such money to the securities markets is not in accordance with sound banking principles. *and the resulting absorption of funds for speculative uses, has at times resulted in detriment to commerce and industry. The result of all this is a condition which calls for correction. It is to be noted that* In no great world market, other than New York, is the call money market dependent principally upon investment securities. In other markets the reverse is true, as their call money is based principally

on commercial paper upon which realization can be had at the central bank, at a price, in case of need. We have seen that in this country call loans on securities lack this essential quality of liquidity required for quick and certain realization, and that this fact has now been more generally taken into consideration by our lenders. But the safe and successful divorce in this country of the use of call money from its dependence upon investment securities as a basis requires careful study in order that safe and adequate methods may be substituted for the present methods of the securities market.

And so susceptible to speculation influences.

Term Settlements.

The achievement of this end probably depends upon the successful development of a plan for term settlements of the balances resulting from operations on the Stock Exchange, in lieu of the present method of daily settlements. The principal effect of such a change of the method of settlements would be to relieve the call money market from the necessities of the securities market and release funds now used in collateral call loans based on investment securities for employment in call loans based on the collateral of the more liquid securities, commercial paper and short term Government paper, generally recognized abroad as the preferred bases for demand loans. From this change a broader discount market would naturally develop. Under term settlements the borrowing required by the securities market would be on the basis of short time accommodation, i. e. for the term between settlements, whether they were weekly, fortnightly or at other intervals.

Agitation for the improvement of the present method of settlement of stock exchange contracts has extended over some years and as the result of extensive studies and deliberations of officers and members of the New York Stock Exchange, as well as bankers, an important step has been taken to provide enlarged clearing facilities through the organization of a new corporation known as the Stock Clearing Corporation, which is expected to begin operations in April, 1920. A general description of the purposes and contemplated operations of the corporation is contained in the pamphlet attached hereto as Exhibit No. 3. The functions of this corporation include providing facilities for clearing contracts between members, for the receipt

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and delivery of securities between members and banks, trust companies and others, and for the clearing of collateral call loans. It is not asserted or expected that the institution of these operations will materially affect either the amount of money loaned from one day to another on the call money market or the rates of such loans, but it is expected that it will operate materially to decrease the amount of bank certifications on day loans, which the present practice requires in the interval between paying one call loan and replacing it with another on the same day. It should be noted that the mechanism afforded by the corporation is an indispensable, prerequisite to the establishment of a system of term settlements.

The more recent and definite development toward the substitution of term settlements for the present system of daily settlements may be said to have had its inception in the action of the American Acceptance Council at its annual meeting on December 4, 1919. At that time, following the observations of the Hon. Paul M. Warburg, Chairman of the Executive Committee and the Committee on Policy and Operations, in which the defects of our present system were referred to, the following resolution was adopted:

"Whereas, The present method of daily stock exchange settlements, with its dominating and often unsettling effect on the call money market, influences adversely the development of a wide and healthy discount market in the United States;

"Resolved, That the Chairman of the Executive Committee be authorized to appoint a committee consisting of members of the Executive Committee and other individuals to study the advisability, ways and means of modifying the present system of settlements on the New York Stock Exchange and substituting therefor some system of periodical settlement, with power to take such steps as may seem advisable in the case".

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A copy of the annual report of the American Acceptance Council is appended hereto as Exhibit 5, in which the resolution appears on page 5, and the report of the Chairman of the Executive Committee above referred to appears on pages 16 to 27, inclusive.

The Committee thus provided for was appointed and held two extended conferences in which the problem was fully discussed, both from the point of view of the banks and of the Stock Exchange. For illustration of the subject matter of the discussion there is attached hereto as exhibit 6 a *detailed* ~~detailed~~ report compiled by one of the members of the Committee, Mr. Samuel F. Streit, Chairman of the Committee on Clearing House of the Stock Exchange, describing the term settlement operations in London and on the European continent, which presently will be published by the American Acceptance Council. Through its courtesy the Board has received an advance copy of the report. There are also attached, as Exhibits 7 and 8 respectively two other publications of the American Acceptance Council, "Acceptance Corporations", by F. Abbott Goodhue, Vice President of the First National Bank of Boston, Mass., and "The Acceptance as the Basis of the American Discount Market", by John E. Rovensky, Vice President of the National Bank of Commerce, New York, in which on pages 14 and 22 respectively, the necessity for term settlements as a means of relieving the call money market from the necessities of the securities market and as a precedent to a broad and stable discount market is discussed.

The members of the committee have unanimously expressed the opinion

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that the adoption of a term settlement by the Stock Exchange would offer advantages in that it would eliminate duplication of the handling of securities and in payments. The committee holds, however, that, inasmuch as the adoption of a term settlement by the Exchange would involve changes of great importance, both to banks and to members of the Exchange, it will require the most careful study of the subject by the committee, and in any case the term settlement cannot be put into operation until the new system of daily Stock Exchange settlements through the Stock Clearing Corporation, above referred to, has been perfected and has been in practical operation for a reasonable time.

~~Very truly yours,~~~~Author.~~~~The President of the Senate.~~~~U. S. Senate of the United States~~

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FEDERAL RESERVE BOARD FILE

FEDERAL RESERVE BOARD
WASHINGTON

March 1920.

Subject: Reply to Senate Resolution No. 328.

S i r :

On March 8th, 1920, the Senate adopted the following resolution:

"RESOLVED that the Federal Reserve Board be and is hereby directed to advise the Senate what is the cause and justification for the usurious rates of interest on collateral call loans in the financial centers, under what law authorized, and what steps, if any, are required to abate this condition."

Early fluctuations of
In reply, the Board desires to say that the only financial center of the country in which a call money market is maintained and where rates for call money are published is New York City. New York is, therefore, the only financial center with respect to which the rates charged on collateral call loans can be ascertained without detailed inquiry. Such information as the Board possesses, however, does not indicate that rates of interest higher than the rates charged for commercial paper are charged on collateral call loans in ~~any~~ financial center of the country outside of New York. *readily*

materially
As to New York, while the rates charged there on call loans are frequently in excess of the legal rates allowed for commercial paper, they are not "usurious" under the laws of the State of New York, which specifically exempt collateral call loans from the six per cent. limitation which lenders must observe on other loans on pain of incurring the penalty prescribed for usury. Section 115 of the Banking Law (L. 1914 Ch. 369; Consol. L. Ch. 2) provides that upon advances of money repayable on demand to an amount not less than \$5,000 made upon warehouse receipts, bills of lading, certificates of stock, etc., or other negotiable instruments as collateral, any bank may receive and collect as compensation any sum which

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where by the laws of any State a different rate is limited for banks of issue organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this Title. When no rate is fixed by the laws of the State or Territory, or District, the bank may take, receive, reserve, or charge a rate not exceeding seven per centum, and such interest may be taken in advance, reckoning the days for which the note, bill, or other evidence of debt has to run. And the purchase, discount, or sale of a bona fide bill of exchange, payable at another place than the place of such purchase, discount, or sale, at not more than the current rate of exchange for sight drafts in addition to the interest, shall not be considered as taking or receiving a greater rate of interest."

It will be observed that the effect of the foregoing provisions is to authorize in the State of New York on collateral call loans of not less than \$5,000 rates of interest which may be in excess of those permitted for loans of other character, and that such higher rates are not prohibited as usurious.

As to the "cause and justification" of the high rates of interest, which it thus appears may legally be charged on collateral call loans in New York, and as to the "steps * * required to abate this condition," there is, as is well known, very wide difference of opinion among persons who have given thought and study to the question. Indeed, broad and difficult questions of general economic and social policy are involved as to which the Board has never had occasion officially to form an opinion and as to which it could not reach a judgment without undertaking such comprehensive investigations and hearings as would seriously interfere with the conduct of the Board's regular work and which would require the employment of experts and assistants, for the employment of which the Board does not feel authorized to expend monies raised by it through levies on the Federal Reserve Banks for the purpose of defraying the expense of administering the Federal Reserve Act.

For the information of the Senate there is, however, appended hereto a memorandum prepared at the instance, and for the use, of the Board explaining in general the nature and operation of the New York call money market and causes of high and fluctuating rates for call money.

Respectfully,

G o v e r n o r

The President of the Senate.

THE NEW YORK CALL MONEY MARKET

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Prior to the enactment of the Federal Reserve Act, there was justification for the loaning of funds by banks in the New York call loan market ^{on investment securities,} for the reason that at times when the demand for commercial credits was small, banks could send their surplus funds to New York to be loaned out on securities which were considered to be liquid. The Federal Reserve System, however, has provided a discount market, in which banks can freely invest their surplus funds ⁱⁿ with acceptances, which experience has shown are much more liquid than investment securities in times of stress and panic.) It is undoubtedly true that banks, from time to time, have used the facilities of the New York call loan market to the detriment of the industry, commerce, and agriculture of the country; at times, for example, of feverish speculation which have often occurred in the United States, although there may be a concurrent great demand for commercial credits, banks all over the country have been tempted to place their funds in the New York market to secure the benefit of the abnormally high interest rates, which at such times prevail. While it may be true that these banks do not neglect their regular customers, yet there is little doubt that if this enormous surplus of funds were kept at home, it might result in lower rates to their regular customers. While it is difficult to devise adequate means for checking this undoubted evil, it is believed that if the loans of all banks, national and state, upon the New York call loan market were made public at frequent intervals by the Comptroller of the Currency and the Superintendents of the state banks, respectively, it would go far towards checking this evil. A merchant who applies for a commercial loan from his bank, and is either refused by the bank or given a loan at rates higher than he believes to be warranted,

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on the ground of stringency of credit, should have the right to be informed as to the amount of funds which his bank at the time may be leaning upon the New York call loan market, perhaps hundreds or thousands of miles away. Such publicity would undoubtedly go far towards preventing banks from devoting an abnormal portion of their resources to the feeding of speculation in the call loan market.

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March , 1920

Subject: Reply to Senate Resolution No. 328

Sir:

On March 8th, 1920, the Senate adopted the following resolution:

RESOLVED that the Federal Reserve Board be and is hereby directed to advise the Senate what is the cause and justification for the usurious rates of interest on collateral call loans in the financial centers, under what law authorized and what stops, if any, are required to abate this condition."

In reply the Board desires to say that it has no information that rates of interest higher than legal rates for commercial paper have been charged on collateral call loans in any financial center except New York City. The rates which have been charged on collateral loans in that city, however, are not usurious since the laws of the State of New York specifically exempt such loans from the six per cent limitation which lenders must observe on other loans on pain of incurring the penalty prescribed by usury.

For fuller and further information of the Senate, there is appended hereto a statement of the nature and operation of the New York Call Money Market.

Respectfully,

The President of the Senate.

Governor

THE NEW YORK CALL MONEY MARKET

Definition of Call Loans.

Collateral call loans, in the general acceptance of the term, are made chiefly in New York City, which is practically the only important call money market in the United States. They are loans which are payable on demand of the lender without previous notice, secured by the pledge of investment securities, i. e. stocks and bonds, generally those which are dealt in on the New York Stock Exchange. The interest rates on these loans, as on other classes of loans, are on the basis of a rate per annum.

The Borrowers.

The loans are made for the most part to houses which are members of the Stock Exchange and the money so borrowed constitutes a portion of the

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ASSISTANT SECRETARY

TREASURY DEPARTMENT

Washington,

FEDERAL RESERVE BOARD FILE
X 1870 3/23/20
460-11

March 22, 1920.

TO THE SECRETARY:

I have read and return herewith the draft of the Federal Reserve Board's reply ^{X 1870 3/23/20} to Senate Resolution No. 328 concerning rates on call loans.

In your letter of March 2nd to the President, dealing with this same subject you said:

"Speculative purchases of stocks are largely carried by loans on call. The law of New York places no limit on the rate of interest for such loans. The law of the State governs national as well as state banks. Much might be said both for and against a proposal to amend the state laws in this respect. I am by no means satisfied that a change in the state usury laws would be the best solution of the problem. In times when credit is scarce a usury law may work actual denial of credit, with consequent acute distress, or it may be evaded, in which case the cost of the money to the borrower is apt to be increased because of the risk involved in the evasion of the law. The real remedy for the gyrations of the call loan market is to be found in insistence upon the furnishing of adequate margins by the brokers' customers and in reforming the archaic methods of financing and settling speculative transactions in stocks. These views have been brought informally to the attention of the responsible people and I hope progress may be made along these lines."

In my memorandum of January 26, 1920, to Governor Harding and Mr. Strauss I said:

"I am hoping very much that the Board will decide to take effective steps to require stock exchanges to adopt rules under which the brokers' customers' accounts will be adequately margined.

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"I am satisfied that the method employed during the past two or three months for restricting credit for speculative transactions in stocks is injurious to the general situation. The denial or the strict limitation of credit, or very high

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rates for call money for stock market purposes reflect unfavorably upon the market for acceptances, for Treasury Certificates, Liberty Bonds and Victory Notes, for commercial transactions. Refusal of credit by New York banks or very high rates for call money attract money into the stock market from the country banks. This creates a very vulnerable situation. I think that at least until an equilibrium is struck between the supply and demand for commodities there will be a serious risk of a new bull movement in stocks with a resulting strain upon credit and that immediately steps should be taken to put into effect what appears to me to be the safest, soundest cure, namely, the requirement that customers' accounts be adequately margined.

Secretary Glass in his letter of November 5, 1919, to Governor Harding said:

"We cannot trust to the copybook texts. Making credit more expensive will not suffice. There is no precedent in history for the great war which we have been through nor for the conditions now existing. The Reserve Bank governor must raise his mind above the language of the textbooks and face the situation which exists. He must have courage to act promptly and with confidence in his own integrity to prevent abuse of the facilities of the Federal Reserve System by the customers of the Federal Reserve Banks, however powerful or influential.

"Speculation in stocks on the New York Stock Exchange is no more vicious in its effect upon the welfare of the people and upon our credit structure than speculation in cotton or in land or in commodities generally. But the New York Stock Exchange is the greatest single organized user of credit for speculative purposes. It is the organized instrument of a countrywide speculation. I believe that the practice of financing speculative transactions in stocks by loans on call, with daily settlements, is unsound and dangerous to the general welfare. Call money loaned to carry speculative transactions in stocks is only liquid when there is no need. The paper is not self-liquidating and, in the case of an emergency, as, for example, upon the outbreak of the European war, and throughout the period of our participation in the war, such loans are in the mass uncollectible. The use of Liberty Bonds, Victory Notes and Treasury Certificates as collateral for borrowings made by member banks from the Federal Reserve Banks for the purpose of carrying speculative transactions in stocks makes it the right as well as the duty of the Federal Reserve authorities to see to

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it that the methods of financing such transactions are reformed and reformed immediately.

"Open and notorious manipulation of stocks has been taking place during the period of, say, nine months, since the removal of the control of the Subcommittee on Money of the Liberty Loan Committee. This manipulation, which takes the form of putting up the price first of one stock and then of another, no matter what may be the conditions, for the purpose of stimulating interest on the part of the uninitiated public, is, I imagine, contrary to the law of the State of New York and the rules of the New York Stock Exchange. In any event, it needs only vigorous action to put an end to it. The Federal Reserve Bank of New York in its relation to the Subcommittee on Money of the Liberty Loan Committee, which Committee was at all times in touch with the officers of the Stock Exchange, naturally sought the views of the Treasury by reason of the fact that its prime duty concerned the sale of Liberty Bonds. A control now put into effect will be primarily for the conservation of the general credit situation and should therefore be initiated and supervised, not by the Treasury, but by the Federal Reserve Board.

"I need not say that such steps should be taken not only firmly but with discretion and in such a way as not to involve grave hardship to individuals or injury to the general welfare."

In my memorandum of December 19, 1918, to Mr. Treman, then

Acting Governor of the Federal Reserve Bank of New York I said:

"Holding these views, the Treasury, though not always in agreement as to the methods pursued, has been heartily in accord with the efforts made by the Money Sub-Committee and by the authorities of the stock exchange to prevent further expansion in the loan account. As to methods, the Treasury has felt and still feels, that reliance should be placed rather upon the requirement of increased margins, made effective not merely as regards stock exchange brokers but as regards their customers also, than upon the attempt to ration credit to the brokers themselves. The Treasury, however, has not felt and does not feel, that it should seek to impose its own views as to the particular methods to be employed to accomplish the desired result.

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"It is the earnest hope of the Treasury that, growing out of the very salutary action of the Money Sub-Committee and of the stock exchange authorities during the period of the war and the present period of readjustment, there may be evolved some plan for preventing the recurrence, after the restoration of peace conditions, of those erratic and violent fluctuations in rates for call money and those feverish movements of prices on the stock exchange, which in the past have been the source of great concern to the judicious and in the future can only prove a stumbling block in the effort of America to take and keep the place which she has won in the world's commerce and finance."

My conclusions on reading the proposed reply to Senate

Resolution No. 328 are three:

1. High rates for call money & stocks, etc., are not usurious because the law does not make them usurious and I do not think the law should be changed in this respect. High rates for call money operate as a safety valve. A real call money market is essential to the proper functioning of a world financial center. Without a call money market to act as a safety valve in time of credit stringency we should have unnecessary panics. No place can be claimed to be a money center where money cannot be had at a price. If money ^{can} ~~could~~ not be had at a price, the consequence is dumping of securities in the effort to produce cash. I should say that the market prices of Liberty Bonds & Victory Notes would be the first to show the effect of an absolute refusal of money at any price, just as they reflect first excessive rates for money.

2. The call money market should be based on acceptances and not on stocks. Nothing is really liquid in time of great

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world crisis such as the outbreak of the war in Europe, but acceptances are more liquid than securities.

3. The real vice in the present situation is that the gambler in stocks is permitted to have the first call on funds in period of stringency because he is permitted to finance his transactions on call and is not required to produce adequate margin. I think the Stock Exchange should be required to reform itself promptly by substituting term settlements and by requiring brokers' customers' accounts to be margined adequately. It may ultimately be necessary to go even further than this and prohibit buying on margin altogether. To go to a bank and borrow money to speculate with is very different from buying stocks on margin. Any man who would not have the face to ask his bank for loans for speculative purposes will buy stock on margin, and many a bank which could not think of lending money to an individual customer to speculate with will lend to his broker to carry him.

It will be seen from the foregoing that I differ from the views indicated in the reply to Senate Resolution No. 328 more in matters of emphasis than in matters of detail. The proposed reply is sound in substance, but it is unsound, it seems to me, in its general impression which creates the impression that everything is about right in respect to the New York Stock Exchange and that all must be well. It may be that the difficulty could be overcome by dealing only with the specific question raised by the Senate Resolution.

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rates for call money, and omitting the dissertation about Stock Exchange practices.

Turning to matters of detail: On page 9 the statement is made that the operation of the law of supply and demand is equally effective in determining the rate for commercial loans and all other borrowings. This, of course, is not the fact. The usury law imposes a limit upon the rate for commercial loans and other time borrowings, while it imposes no such limit upon call loans.

I do not share the view advanced in the memorandum, page 12, ff., that the organization of ^{the} ~~a~~ stock clearing ^{Corporation} ~~organization~~ is an important step towards the solution of the problem. Undoubtedly it is a step towards making more efficient the credit which is made available for carrying stocks. It is not, however, a step in the direction of limiting the amount of credit used for that purpose - quite the contrary.

To summarize the whole matter, I would say that the object of remedial measures should be not to furnish cheap money for stock speculation, but to prevent the scandalous manipulation of stocks and to limit the stupendous demands for credit for speculation in stocks.

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COMPTROLLER OF THE CURRENCYADDRESS REPLY TO
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TREASURY DEPARTMENT

WASHINGTON *H 68 11*

March 17, 1920.

MEMORANDUM FOR GOVERNOR HARDING.

I have read with much interest the preliminary draft which you were kind enough to furnish me yesterday afternoon of your proposed reply to the Senate in regard to the Owen Resolution on call money rates, etc. You have made a very able and interesting presentation of the subject, and while I agree with many of your conclusions, I am afraid that I will have to dissent from that portion of your report contained on pages 11 and 12. I do not agree that it would be either "undesirable or dangerous" to attempt to control the rates for call loans even though we may not have power over the numerous natural causes which may operate to increase rates, including among these natural causes the propensity of lenders to charge all the traffic will bear or all they can get within the law, and sometimes without the law. I see nothing in the situation in New York which should serve to give that market immunity from the laws against usury. The excessive call rates which in times past have been as high as 100% in New York, are unknown elsewhere in this country, or in any other quarter of the globe, and in my judgment they can be and should be restrained in New York City, whether we have fortnightly stock settlements or do not have them.

The establishment and exaction of an excessive rate does not increase the money supply. Intelligent and prudent administration on the part of the banks in curtailing or refusing loans would be or should be just as effective as a "deterrent to ~~over~~ speculation and undue expansion of credit," "as the granting of loans at two, three, five or ten times the usual rate. You say;

"On the other hand, should the supply of money available at the fixed maximum rate become exhausted liquidation would be suddenly forced because the demands for additional accommodation for the consummation of commitments already made could not be made."

Under such conditions the banks could with moderation call in some of their loans and increase the supply of funds available for those whose needs were most urgent for legitimate requirements. That does not mean that all loans should be called at once, or that the bottom would be knocked out of everything. It is assumed that the banks would have intelligence enough to proceed with caution and wisdom in meeting such a situation and provide credit for those entitled to it, and at the normal and legal rate. It is not supposed that there would be any concert of action on the part of the banks to call in loans in a wholesale fashion to precipitate a crisis, as it is charged has been done in times gone by. You say;

"The effect of such liquidation would be to embarrass not only investors and dealers in securities, but also it should be noted dealers and merchants

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in commodities as well. As an example of the latter, the case might be cited of an agreement to purchase an amount of cotton on a certain day. Many of the houses on the Cotton Exchange are also members of the Stock Exchange and frequently borrow very largely on the stock exchange against investment securities to provide the funds for settling their transactions in cotton. If, therefore, when an important cotton settlement was imminent, borrowings on securities could not be availed of the cotton transactions should not be consummated and a hasty liquidation through sale either of securities or of the cotton might be required to avoid deficit".

I cannot agree with this argument. It should be much easier to obtain money on cotton warehouse receipts or bills of lading than on securities. Why should a New York banker borrow money on securities to carry cotton? Why should not he borrow his money on the cotton? A member bank could afford to lend a customer money on cotton when it could not afford to lend him money on securities because the lending bank could get a rediscount from the Federal Reserve Bank on cotton bills but could not get it on a collateral loan made on bonds and stocks.

You suggest that "high rates and the ever present possibility of high rates are a deterrent to over-speculation and undue expansion of credit."

Within certain limitations, an increase in interest rates is at times salutary and beneficial; but I have been unable to see the justification for the general marking up in rates on call loans secured by bonds and stocks which it is understood has taken place in New York so generally in the past few months, the increased rates not only applying to new loans but to loans of long standing which are carried on call, perhaps in many cases originally placed at four or five percent.

During this period of more stringent money, many banks are reported to have marked rates up each day to the rate fixed by a select committee of the stock exchange of 12%, or 15% or 18% or 20%, as the case may be.

It has been suggested that some banks have discriminated as to the loans upon which the advanced rates are charged; but it is understood that the imposition of the increased rate has been very general as applied to the great mass of call loans carried by the banks and trust companies in New York City.

In your memorandum you say:

"It appears that over a period of years during the pre-war period, the volume of all money, both time and call employed in the securities market was estimated at about \$1,000,000,000, of which the average on call was about 60%, and the average on time about 40%, or a normal volume of call money say of \$600,000,000."

Your statement further says "it is important to notice there has been a disproportionate increase in the amount of call loans as distinguished from time money, with the consequence that the former it is now estimated constitutes about 75% of the total money employed in the securities market."

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Are not these figures erroneous?

The statement which I have before me suggests that they are. I have not before me the figures for the State Banks and Trust Companies of New York City as of June 30, 1919, but I have the figures for National Banks, which show that on the date mentioned the total amount loaned on bonds and stocks by the National Banks in New York City was \$1,134,000,000, of which \$455,000,000, or 40% of the total, not 75%, were being loaned on call and \$679,000,000, or 60% on time.

Furthermore, the statement that "there has been a disproportionate increase in the amount of call loans as distinguished from time money" would not apply if we consider the whole country instead of the City of New York. In June, 1915, the total money loaned by National Banks "on demand" on bonds and stocks was \$883,000,000; on June, 1919, this had increased to \$1,307,000,000, or about 48% increase. In the same period the time loans on bonds and stocks, which were on June 30, 1915, \$866,000,000, increased on June 30, 1919, to \$2,130,000,000, an increase of about 146%.

In June, 1915, total loans on Bonds and Stocks by National Banks in New York City were \$605,000,000, of which the demand loans were \$357,000,000, or 59%, and time loans \$248,000,000, or 41%;

In June, 1919, the totals were \$1,134,000,000, of which 40%, or \$455,000,000, were demand, and 60%, or \$679,000,000, time.

So far from demand loans having increased more rapidly than the time loans, as stated in the memorandum referred to, we find that between 1915 and 1919 the demand loans secured by bonds and stocks in the National Banks of New York City have increased only 27%, while time loans secured by bonds and stocks increased in the same period 173%.

Please note the following table:

<u>LOANS IN NATIONAL BANKS ON BONDS AND STOCKS IN NEW YORK CITY.</u>				
		<u>1915</u>	<u>1919</u>	<u>Increase</u>
Demand	59%	357 millions;	40% 455 million;	98 millions, 27%
Time	41%	248 millions;	60% 679 million;	431 millions, 173%
		605	1,134	529

The statement furnished you to the effect that the volume of all money, both time and call, employed in the securities market, is about One Billion Dollars is, I think, under-estimated in view of the fact that the figures show that the National Banks in N.Y. alone in June last were lending 1,134 Million Dollars on the securities of Bonds and Stocks. It is well known that the Trust Companies make more of a specialty of lending on bonds and stocks than do the National Banks, as a rule.

In my judgment, it is quite possible that all of the Banks in New York are lending, on bond and stock collateral, not less than Two Billion Dollars instead of One Billion, if we include the Trust Companies and State Banks.

In speaking of this matter before the Board, you suggested that the One Billion Dollars referred to as being loaned in the Securities Markets were

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Authority E.O. 10501

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"brokers loans" and not loans made directly to holders of bonds or stocks, whether they be investors or speculators.

In my opinion, there is not much difference between a loan of a Hundred Thousand Dollars made to John Smith & Company for the purpose of carrying a Hundred Thousand Dollars' worth of stocks bought by them for John Brown, and a loan of a Hundred Thousand Dollars made by the Bank to John Brown direct secured by stocks purchased by him in the market.

My suggestion is that it might be well to give a little further consideration as to whether it is desirable under these circumstances to use the figures of One Billion Dollars as representing the "volume of money, both time and call, employed in the Securities market" (see page 8 of your letter).



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March 10, 1920.

Honorable George A. Sanderson,
Secretary, United States Senate,
Washington.

Sir:

Receipt is acknowledged of Senate
Resolution No. 338, adopted March 8, 1920, re-
questing certain information with respect to the
various rates of interest on collateral call loans.

Time: 9.15 o'clock A.M., March 9, 1920.

Respectfully,

Secretary.

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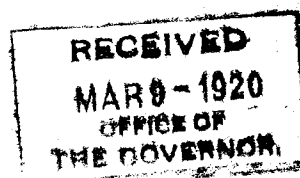
Authority E.O. 10501

GEORGE A. SANDERSON,
SECRETARY.

United States Senate,

OFFICE OF THE SECRETARY.

March 8, 1920.



Gentlemen:

I have the honor to hand you herewith
a resolution of the Senate of the United States,
dated March 8, 1920, requesting certain information
with respect to the usurious rates of interest on
collateral call loans.

Will you kindly acknowledge the receipt
of the resolution upon the enclosed form?

Please address the response to this reso-
lution to the President of the Senate.

Respectfully,

Secretary.

Federal Reserve Board,

Washington, D. C.

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GEORGE A. SANDERSON,
SECRETARY.

United States Senate,

OFFICE OF THE SECRETARY.

Washington, D. C.,
March , 1920.

Receipt is acknowledged of Senate Resolution No. 328, adopted March 8, 1920, requesting certain information with respect to the usurious rates of interest on collateral call loans.

Time: _____

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UNITED STATES SENATE

Washington D. C.
March , 1920.

Receipt is acknowledged of Senate Resolution No. 328, adopted March 8, 1920, requesting certain information with respect to the usurious rates of interest on collateral call loans.

Time: _____

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S. RES. 328.

In the Senate of the United States,

March 8, 1920.

RESOLVED, That the Federal Reserve Board be, and is hereby, directed to advise the Senate what is the cause and justification for the usurious rates of interest on collateral call loans in the financial centers, under what law authorized and what steps, if any, are required to abate this condition.

Attest:

Secretary.

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FEDERAL RESERVE BOARD FILE

**MEMORANDUM FOR REPLY TO THE SENATE RESOLUTION REQUESTING ADVICE
FROM THE FEDERAL RESERVE BOARD RELATIVE TO THE RATES OF INTEREST
ON COLLATERAL CALL LOANS IN THE FINANCIAL CENTERS**

~~The resolution reads:~~

"RESOLVED that the Federal Reserve Board ^{Office of the Governor} and is hereby directed to advise the Senate ^{of the} cause and justification for the usurious rates of interest on collateral call loans in the financial centers, under what law authorized and what steps, if any, are required to abate this condition."

It may be observed at the outset that so far as ~~the financial~~ ^{city} centers, New York, is concerned, ~~there is no changing of usurious rates on~~ ^{changed} ~~are not usurious,~~ collateral call loans since, ~~as later indicated,~~ the laws of New York specifically exempt such loans from the 6% limit which lenders must observe on other loans ^{penalty of incurring the} ~~on penalty of violating the usury prohibition.~~ ^{prescribed for usury.}

THE NEW YORK CALL MONEY MARKET.

**DEFINITION OF
CALL LOANS**

Collateral call loans, as referred to in the resolution, are principally those made in New York City, which is practically the only call money market in the United States. They are loans which are repayable on demand of the lender without previous notice, secured ~~generally~~ by the pledge of investment securities, i. e. stocks and bonds

^{generally those} which are dealt in on the New York Stock Exchange. ^{the} Interest rates ^{on these loans} ~~are~~ ^{as on other classes of loans are} ~~always stated on an annual basis~~ ^{of a rate per annum.}

THE BORROWERS

The loans are made for the most part to houses which are mem-

-2-

bers of the Stock Exchange and the money so borrowed constitutes a portion of the funds which they employ ordinarily in purchasing and carrying securities for their customers and sometimes for themselves.

THE LENDERS

The principal supplies of money for collateral call loans are loanable funds of banks and bankers located both in and outside of New York City, including foreign banks and agencies of foreign banks; and similarly the loanable funds of firms, individuals and corporations seeking temporary investment. The proportion of the whole fund loaned by these several interests varies seasonally and in accordance with ^{the attractive ness of} other opportunities, ~~and their attractiveness~~, for investment either locally or in other markets. The bulk of call money is lent on the floor of the New York Stock Exchange at "the money post," where through various brokers loanable funds are offered and bids for funds are received. Most of the business is done between the hours of 12 noon and 2:45 p. m. The important relation to the money market of the present system of daily settlement of balances resulting from purchases and sales of securities on the Stock Exchange will be discussed more fully hereafter.

COMMERCIAL RE-
QUIREMENTS HAVE
THE PRIOR CLAIM

In the matter of the supply or attraction of funds to the call money market, ~~it is important to bear in mind that~~ there is a definite

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and well understood obligation on the part of banks to accommodate first their own commercial clients, so that it is only the excess of loanable funds which they may have from time to time that is available for the collateral call money market ^{or for} ~~and other open market operations,~~ ^{in the open market.} ~~such~~ the purchase of commercial paper. This excess of loanable funds available for employment in the securities market must vary, therefore, according to the commercial requirements of the country. It has long been recognized, ~~moreover,~~ that for assurance of a sufficient amount of money to finance the volume of business in securities, reliance cannot be placed on a rate of interest limited to the rates which obtain or are permitted in commercial transactions whose prior claim on banking accommodation is universally ^{conceded} ~~recognized~~.

-4-

THE LAW RESPECTING THE RATES OF INTEREST ON COLLATERAL CALL LOANS.

LAW OF NEW YORK

The statutes of the State of New York acknowledge and recognize this principle in both the Banking and Business Law in the sections regarding interest legally receivable.

Section 115 of the Banking Law (L. 1914 Ch. 369; Consol. L. Ch. 2) provides that upon advances of money repayable on demand to an amount not less than \$5,000. made upon warehouse receipts, bills of lading, certificates of stock, -etc., or other negotiable instruments as collateral, any bank may receive and collect as compensation any sum which may be agreed upon by the parties to such transaction. The section reads:

"Sec. 115. Interest on collateral demand loans of not less than five thousand dollars.

Upon advances of money repayable on demand to an amount not less than five thousand dollars made upon warehouse receipts, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds or other negotiable instruments, pledged as collateral security for such repayment, any bank may receive or contract to receive and collect as compensation for making such advances any sum which may be agreed upon by the parties to such transaction."

Section 201 of the Banking Law, identical in language with Section 115 above quoted, makes the same provision in the case of collateral call loans by trust companies. In the General Business Law (L. 1909 Ch. 25; Consol. L. Ch. 20) there is the following general provision of a like character:

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"Sec. 372. Interest permitted on advances on collateral security.

In any case hereafter in which advances of money, repayable on demand, to an amount not less than five thousand dollars, are made upon warehouse receipts, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds or other negotiable instruments pledged as collateral security for such repayment, it shall be lawful to receive or to contract to receive and collect, as compensation for making such advances, any sum to be agreed upon in writing, by the parties to such transaction."

NATIONAL BANKS
Act

The National Bank Act provides that national banks may receive and charge on any loan or discount interest at the rate allowed by the law of the State, territory or district where the bank is located. The applicable provision reads:

"Limitation upon rate of interest which may be taken.

422. Sec. 5197. - Any association may take, receive, reserve, and charge on any loan or discount made, or upon any note, bill of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory, or District where the bank is located, and no more, except that where by the laws of any State a different rate is limited for banks of issue organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this Title. When no rate is fixed by the laws of the State, or Territory, or District, the bank may take, receive, reserve, or charge a rate not exceeding seven per centum, and such interest may be taken in advance, reckoning the days for which the note, bill, or other evidence of debt has to run. And the purchase, discount, or sale of a bona fide bill of exchange, payable at another place than the place of such purchase, discount, or sale, at not more than the current rate of exchange for sight drafts in addition to the interest, shall not be considered as taking or receiving a greater rate of interest."

It will be observed that the effect of the foregoing provisions is to authorize in the State of New York on collateral call loans of not less than \$5,000. rates of interest which may be in excess of those per-

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mitted for loans of other character, and that such higher rates are not prohibited as usurious.

CAUSES AFFECTING PRESENT CALL MONEY RATES.

The reference in the resolution to the present high rates for call money in the financial centers and the inquiry as to their causes require, it is felt, a survey of the operations of the money markets and the reflection ^{therein} ~~in those centers~~ of the underlying economic conditions which govern, in varying degree, all money rates, including those for call money.

PRESENT CHANGED
CONDITIONS OF
SUPPLY

In former times, and specifically prior to the institution of the Federal Reserve System, bankers, especially in reserve centers, were accustomed to look upon call loans as their principal secondary reserve on the theory that inasmuch as those loans were payable upon demand, funds ^{so invested} always could be promptly ^{obtained} ~~secured~~ on short notice to meet withdrawals of deposits or for other use. ^{In} ~~Under~~ these circumstances there was ordinarily available for collateral call loans a supply of funds sufficient for ordinary market requirements and at low rates, ^{although at times the rates rose to high levels as the supply of funds diminished, or the demands increased.} This attitude of the banks toward call loans as their chief ^{has been} secondary reserves ~~was~~ greatly modified by two causes. The first was the closing of the Stock Exchange at the outbreak of the European War in the

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summer of 1914, when it became practically impossible to realize on call loans secured by investment securities, which ^{became} ~~were~~, therefore, "frozen ^{loans} ~~assets~~." This resulted in a more or less permanent prejudice against dependence upon call loans as secondary reserves. The second and more important factor was the creation of the Federal Reserve System. Under the terms of the Federal Reserve Act provision is made for the rediscount of commercial paper, but the rediscount of loans for the purpose of carrying investment securities, other than United States Government obligations, is excluded. Consequently, in order to maintain maximum liquidity, with suitable provision for secondary reserves that can be immediately availed of, banks, including foreign agency banks, ^{now} ~~invest~~ ^{invest} a greater proportion of their resources in assets that can be realized upon at the Federal Reserve Bank. Another changed factor in the present situation ^{grows out of} ~~exists~~ in the fact that the war and post-war conditions have rendered unavailable supplies of money which formerly came from foreign banks. Since the summer of 1914, therefore, while total banking resources have largely increased, the volume of bank money available to the securities market at low or normal rates has not increased proportionately, but on the contrary has probably decreased. These circumstances, of themselves, explain, in large measure the increased rates which have ^{often} ~~been~~ ^{during the past year} required for money loaned in the securities market.

PRESENT CHANGED
CONDITIONS OF
DEMAND

Changed conditions are also present in the factors governing

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the demand for money. ~~It will be recalled that~~ Prior to the armistice agencies of Government were employed to restrict the issue of new securities for purposes other than those which were deemed essential for carrying on the war. *At the same time, as*

~~It will also be remembered that after this country went into the war and~~ *certificates of indebtedness and* the Treasury undertook to sell large amounts of Liberty

bonds bearing low rates of interest, the question arose as to whether the competition of the general investment markets might not prejudice the success of the Government issues. *In* ~~Under~~ these circumstances the officers and members of the New York Stock Exchange undertook to limit transactions which would involve the increased use of money for other purposes in consideration of which the principal banks of New York City undertook to provide a stable minimum amount of money for the requirements of the security market.

After the armistice these restrictions were removed and natural laws reasserted themselves. The issuance of new securities was resumed in unprecedented volume and consumed a vast amount of capital and credit, when bank credit was already ~~strained~~ *expanded* by the necessity of carrying large amounts of Government securities which the ~~investing~~ *new* market was not

-9-

prepared to absorb. Thus arose a further cause for the increased cost of accommodation on collateral call loans.

Since the armistice these causes have been augmented by the increased volume and velocity of transactions in securities generally.

Before examining the figures, it should be explained that the amount of call money employed by the securities market fluctuates according to the amount of other funds available for this purpose, i. e.

customers' money invested and time money borrowed, and also as the

volume of business varies. *V* The volume of money outstanding on call

is more or less constant, fluctuating only *relatively* over long periods, and the

amount which is loaned from day to day is but a small proportion of

this constant volume. The constant volume of outstanding call loans

bears a rate of interest which is determined daily and is known as the

renewal rate. The daily borrowings, either in replacement of loans

called for payment or representing new money borrowed, are made at

rates which may or may not be the same as the renewal rate and which

frequently vary during the same day.

Turning to the figures it appears that over a period of years during the pre-war period the volume of all money, both time and call,

VOLUME

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~~10~~

5

employed in the securities market was estimated at about \$1,000,000,000., of which the average on call was about 60% and the average on time about 40%, or a normal volume of call money, say of \$600,000,000. The daily turnover in call money, i. e. old loans called for payment, loans made in replacement thereof, and new money borrowed, ranged from \$15,000,000. to \$30,000,000., and averaged about \$20,000,000. The daily turnover during the year 1919, however, ordinarily ranged from \$25,000,000. to \$40,000,000., and averaged about \$30,000,000. Moreover it is important to notice there has been a disproportionate increase in the amount of call loans, as distinguished from time money, with the consequence that the former, it is now estimated, constitute about 75% of the total money employed in the securities market. *at a time of such heavy credit expansion* The greater *requirements as the present* volume of borrowings, not only in the aggregate but in day to day demands, *often results in* ~~is~~ naturally ~~followed by~~ high rates for the money loaned.

Intermittent Factors

There are certain other factors, the influence of which is principally manifested in intermittent wide fluctuations in the daily rates or in the rates which apply for brief periods. The increased volume of demand loans called daily for payment noted above, coupled with the decreased amount of time money loaned on securities, produces

~~11~~ 9

more or less apprehension on the part of borrowers as to their ability to re-borrow money called for payment. This apprehension, ^{quickness} ~~multiplied~~ by the number of ^{insistent} ~~necessitous~~ borrowers bidding at times when momentarily loanable funds are exhausted or are being offered in small quantity, frequently results in competitive bidding for funds which advances the rates for a day or a part of a day beyond the actual necessities of the situation.

Another active and ~~more~~ important ^{which has recently} ~~force~~ affecting the supply of funds available for collateral loans and ^{precipitating} at times a

influence

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rise in the rates, ^{has been} ~~lies in the~~ ^{possible} withdrawal of Government deposits from depositary banks to ~~replenish Treasury balances in the Federal reserve banks which had previously been depleted by Government expenditures for service and commodities.~~ These expenditures, of course, place new ~~purchasing power in the hands of the public, which is translated into deposit balances with the banks and absorbed in credit expansion.~~

^{Such} ~~Upon the withdrawal of Government deposits from depositary banks, it~~ ^{make it} ~~frequently becomes necessary for the~~ ^{depository banks} ~~latter to call the money from the securities market.~~ ⁱⁿ ~~The result of such operations is frequently a sharp~~ ^{rise} in the rate bid for call money in replacement of the loans called for payment.

RATES ARE DETERMINED BY THE OPERATION OF THE LAW
OF SUPPLY AND DEMAND.

~~It will be observed from the foregoing that~~ ^{especially} ~~The underlying~~ cause of fluctuations and, ~~for example,~~ of increases in call money rates is the unescapable operation of the law of supply and demand. In other words, as the supply of loanable funds diminishes in proportion to the volume of the demand, the rate for collateral demand loans inevitably increases. ~~It will have been noted, however, that~~ in the case of the daily borrowings of call money--to which the abnormal high and low rates apply and which represent but a comparatively insignificant

-11-

part of the total outstanding loans--other factors, incidental to the temporary circumstances and conditions of the market, tend in times of stress to greater fluctuations in rates than result from the more normal operation of the law ^{which is} reflected in the renewal rate for the greater volume of the outstanding call loans. The renewal rate is the real barometer of ~~the~~ market condition^s and its fluctuations throughout the longer periods are the natural result of the relation between the amount of the loanable funds and the amount of the demand. In other words high renewal rates are due to the scarcity of credit, which results in part from the prior satisfaction of the requirements of the commercial community and in part from ~~such~~ other temporary factors ^{which} may be injected from time to time, ^{such as} ~~Among these may be mentioned the~~ depletion of bank reserves resulting either or both from credit expansion or loss of reserves through gold export, speculation in commodities and real estate, and ~~also~~ ^{congestion} ~~interruption~~ of commercial transactions incidental to slow or interrupted transportation.

COMMERCIAL RATES
ARE SIMILARLY AND
INDEPENDENTLY
DETERMINED

The operation of the law of supply and demand is equally effective in determining the rate for commercial loans and all other borrowings. In fact, rates for commercial loans and rates for collateral call loans have a common root in the law of supply and demand,

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and the conditions which affect one, in the main affect the other, although not in like degree, as is demonstrated by the far wider fluctuation of call rates and the higher points to which they go. ~~It should~~
~~be borne in mind, moreover, that contrary to the opinion sometimes expressed,~~ rates for call money do not determine and but slightly influence,
if at all, the rates on commercial borrowings. ~~As explained above, it~~
is the universal custom of the banks, ^{first} to satisfy the commercial needs ^{they have an obligation to customers but more vitally, to those who borrow}
of their customers. ^{in the} ~~As the resources of the banks mainly come from commercial customers,~~ ^{open market on secondary} ~~they naturally must grant them first call upon their~~
~~facilities for accommodation, and furthermore the laws of most states~~ ^{Banks}
~~limit the rate of interest that can be received for commercial accommodation.~~
^{their own} ~~Not only the statutes, but the self-interest of the banks~~
^{their} ~~compels a preference in favor of its commercial borrowers, since persistent~~
failure to grant them reasonable accommodation would induce them to withdraw their deposits and so reduce ^{of the banks} ~~or extinguish~~ the bank's ability to do
business ~~at all.~~ ~~It should also be noted that after meeting the legitimate commercial requirements of its borrowers, a bank, as indicated above,~~
~~is likely to invest its secondary reserve in commercial paper and also~~

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~~Government paper which can be rediscounted by the Federal Reserve Bank.~~

~~As a general rule, therefore, and in normal circumstances, it is only~~

~~after the demands of commercial borrowers have been met, directly and~~

~~indirectly, that bank money is available for the securities market.~~

~~It may be added that~~ *although* the money of the banks and trust companies com-

prises by far the greater proportion of money loaned on the securities

market. *An* examination of the prevailing rates on commercial paper at

times when the call money market is particularly strained *indicates* ~~verifies the~~

~~accuracy of the statement~~ that there is little ~~or no~~ causal relation

between the rates for call money and those on commercial loans. Ex-

hibits Nos. 1 and 2, showing respectively the rates for call money on

New York the Stock Exchange during the years 1906-1919 and the rates for commer-

cial paper in New York for the period from 1915 to 1920, are attached.

POSSIBILITIES OF CHANGE IN THE CONDITIONS AND METHODS OF THE CALL MONEY MARKET.

So long as collateral call loans are made under prevailing

conditions it would seem impossible to alter the present situation, be-

cause of the impracticability, ~~for example~~, of altering the underlying

cause of high rates, which, in the last analysis, is simply the excess

of demand over supply.

ARBITRARY RATE
LIMIT IS UNDERIR-
-ABLE

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An attempt to control the rates for call loans by the establishment of ^{an} ~~artificial~~ and arbitrary limits at a low level, without the ability to modify the natural causes which operate to increase rates, would be distinctly undesirable and dangerous, for the reason that up to the point where the ^{arbitrary} ~~artificial~~ rate would limit the supply of new money, speculation and expansion might proceed unchecked and the natural ^{elements} ~~limits~~ of correction or regulation would not ^{obtain} ~~be available~~. In other words, high ~~er~~ rates and the ever-present possibility of higher rates are a deterrent to over-speculation and undue expansion of credit. On the other hand, should the supply of money available at the fixed maximum rate become exhausted, ~~and~~ liquidation would suddenly be forced, because the demands for additional accommodation for the consummation of commitments already made could not be met. The effect of such liquidation would be to embarrass ^{not only} investors ^{and dealers} in securities, and also it should be noted, dealers and merchants in commodities as well. As an example of the latter, the case might be cited of a commitment to purchase a round amount of cotton on a certain day. Many of the houses of the Cotton Exchange are also members of the Stock Exchange and frequently borrow very largely on the Stock Exchange against investment securities to provide the funds for settling their transactions in cotton. If,

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therefore, when an important cotton settlement was imminent, borrowings on securities could not be availed of, the cotton transaction could not be consummated and a drastic liquidation through sale either of securities or of the cotton might be required to avoid default. Similar consequences might obtain in the cases of transactions by members of other commodity exchanges who are also members of the Stock Exchange and have recourse to the call money market.

**EXPANSION OF THE
USES OF THE CALL
MONEY MARKET**

Importance ~~Nothing in the foregoing, however, should be construed as ad-~~
~~verse to measures which would tend to stabilize call money rates and~~
~~also to make the call money market more expansive to the commercial re-~~
~~quirements of the country and relieve it from its present dependence upon~~
~~investment securities as its principal basis.~~ A call money market is
indispensable to every ^{important} principal financial center. It serves not only
as an outlet for the employment of funds temporarily idle, but a large
volume of call and short time money is essential to the successful and
economic^{al} conduct of the business of the country. It is particularly
essential to the international and domestic commercial business, and the di-
version of the use of the major portion of such money to the securities

markets is not in accordance with sound banking principle.

~~It is not~~

In no great world market other than New York ~~is the call money market~~ *dependent principally*
~~so restricted in any other great world market.~~ *upon investment securities*
In ~~these~~ *other* markets the

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reverse is true, as their call money is based principally on commercial paper ~~and short term Government issues~~, upon which realization can be had at the central bank, at a price, in case of need. We have seen that in this country call loans on securities lack this essential quality of liquidity required for quick and certain realization, and that ~~this~~ ^{now} fact has been more generally taken into consideration by our lenders.

But The safe and successful divorce in this country of the use of call

money from its dependence upon investment securities as a basis requires ^{in order that safe and adequate methods} ~~however~~, careful study, ~~not only of the present methods of the securities market, but also to provide for substitution of safe and adequate methods~~ ^{may be substituted for}

TERM SETTLEMENTS

The achievement of this end probably depends upon the successful development of a plan for term settlements of the balances resulting from operations on the Stock Exchange, ~~which might be adopted~~ in lieu of the present method of daily settlements. The principal effect of such a change of the method of settlements would be to relieve the call money market from the necessities of the securities market and release funds now used in collateral call loans based on investment securities for employment in call loans based on the collateral of the more liquid securities, commercial paper and short term Government paper, generally recognized abroad as the preferred bases for demand loans, and From this

-17-

change, ~~it should be noted,~~ a broader discount market would naturally develop. Under term settlements the borrowing required by the securities market would be on the basis of short time accommodation, i. e. for the term between settlements, whether they were weekly, fortnightly or at other intervals.

Agitation for the improvement of the present method of settlement of stock exchange contracts has extended over some years and as the result of extensive studies and deliberations of officers and members of the New York Stock Exchange, as well as bankers, an important step has been taken to provide enlarged clearing facilities through the organization of a new corporation known as the Stock Clearing Corporation, which is expected to begin operations in April, 1920 ~~the very near future~~. A general descrip-

tion of the purposes and contemplated operations of the corporation is contained in the pamphlet attached hereto as Exhibit No. 3. ~~It will be~~

~~observed that~~ The functions of this corporation include providing facilities for clearing contracts between members, for the receipt and delivery of securities between members and banks, trust companies and others, and for the clearing of collateral call loans. It is not asserted or expected that the institution of these operations will materially affect either the amount

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of money loaned from one day to another on the call money market or the rates of such loans, but it is expected that it will operate materially to decrease the amount of bank certifications on day loans, which the present practice requires in the interval between the paying of one call loan and ~~the~~ replacing it with another on the same day. It should be noted that the mechanism afforded by the corporation is an indispensable prerequisite to the establishment of a system of term settlements.

The more recent and definite development toward the substitution of term settlements for the present system of daily settlements may be said to have had its inception in the action of the American Acceptance Council at its annual meeting on December 4, 1919. At that time, following the observations of the Hon. Paul M. Warburg, chairman of the Executive Committee and Committee on Policy and Operations, in which the defects of our present system were referred to, the following resolution was adopted:

"Whereas, The present method of daily stock exchange settlements, with its dominating and often unsettling effect on the call money market, influences adversely the development of a wide and healthy discount market in the United States;

"Resolved, That the Chairman of the Executive Committee be authorized to appoint a committee consisting of members of the Executive Committee and other individuals to study the advisability, ways and means of

-19-

modifying the present system of settlements on the New York Stock Exchange and substituting therefor some system of periodical settlement, with power to take such steps as may seem advisable in the case."

A copy of the annual report of the American Acceptance Council is appended hereto as Exhibit 5, in which the resolution appears on page 5, and the report of the chairman of the Executive Committee above referred to appears on pages 16 to 27, inclusive.

The committee ~~so~~ provided for was appointed and ~~it~~ held two extended conferences in which the problem was fully discussed, both from the point of view of the banks and of the Stock Exchange. For illustration of the subject matter of the discussion there is attached hereto as Exhibit 6 a detailed report compiled by one of the members of the committee, Mr. Samuel F. Streit, chairman of the Committee on Clearing House of the Stock Exchange, describing the term settlement operations in London and on the European continent, which presently will be published by the American Acceptance Council. *the Board has reviewed* ~~It is~~ ¹ Through its courtesy ~~that~~ an advance copy of ~~that~~ ^{the} report ~~is available here.~~ There are also attached, as Exhibits 7 and 8 respectively, two other publications of the American Acceptance Council, "Acceptance Corporations," by F. Abbott Goodhue, vice president of the First National Bank of Boston, Mass., and "The Acceptance as the Basis of the American Discount Market," by John E. Rovensky, vice president

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of the National Bank of Commerce, New York, in which on pages 14 and 22 respectively, the necessity for term settlements as a means of relieving the call money market from the necessities of the securities market and as a precedent to a broad and stable discount market is discussed.

The members of the committee have unanimously expressed the opinion that the adoption of a term settlement by the Stock Exchange would offer advantages in that it would eliminate duplication of the handling of securities and in payments. The committee holds, however, that, inasmuch as the adoption of a term settlement by the Exchange would involve changes of great importance, both to banks and to members of the Exchange, it will require the most careful study of the subject by the committee, and in any case the term settlement cannot be put into operation until the new system of daily Stock Exchange settlements through the Stock Clearing Corporation, above referred to, has been perfected and in practical operation for a reasonable time.

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EXHIBIT 1: Showing ~~Statistics~~ from a Reliable Source, the High, Low and Average
Rates for Call Money on the Stock Exchange, Arranged by Weeks during the Years,
1906 to 1919:

not enclosed

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EXHIBIT 2: Showing the Rates for Commercial Paper in New York by Weeks for the
Five-Year Period from 1906 to 1919.

not included

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EXHIBIT 3: General Description of the Stock Clearing Corporation of New York:

enclosed

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EXHIBIT 4: Report of Mr. Samuel F. Strait, Chairman of the Committee on Clearing House of the Stock Exchange, describing the term settlement operations in London and continental centers, published by the American Acceptance Council, with a foreword submitted by the committee of Bankers and Stock Exchange Members, under the chairmanship of the Hon. Paul M. Warburg, which is considering the question of the inauguration of term settlements on the New York Stock Exchange:

enclosed

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Authority E.O. 10501EXHIBITS 5, 6, and 7:

EXHIBIT 5: Annual report of the American Acceptance Council, December 4, 1919, report of chairman of the Executive Committee, recommending term settlements, pages 16 to 27 inclusive; resolution authorizing the appointment of committee to study advisability, ways and means of modifying the present system of settlements, etc., and statement of the personnel of the committee appointed, page 5. *(enclosed)*

EXHIBIT 6: Pamphlet entitled "Acceptance Corporations", showing on Page 14 the necessity for term settlements as a precedent to a successful discount market. *(enclosed)*

EXHIBIT 7: Pamphlet entitled "The Acceptance as the Basis of the American Discount Market," discussing on Page 22 the necessity for term settlements as a precedent to a successful discount market. *(enclosed)*

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ROBERT L. OWEN, OKLAHOMA,
CHAIRMAN.

Owen

United States Senate,
COMMITTEE ON FIVE CIVILIZED TRIBES OF INDIANS.

January 27, 1920

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FEDERAL RESERVE BOARD FILE

RECEIVED
JAN 28 1920
THE OFFICE OF
THE GOVERNOR

Hon. W. P. F. Harding,
Governor,
Federal Reserve Board,
Washington, D. C.

My dear Governor Harding:

Your letter of the 24th instant
is received in the absence of Sena-
tor Owen and will be brought to his
attention upon his return to Wash-
ington.

Yours very truly,

Henry G. Thomas
Secretary.

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Authority E.O. 10501

Re my market

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January 24, 1930.

My dear Senator Owens

Your letter of January 17th was duly received, and I have already discussed with you in person some of the suggestions made therein.

It does not appear that member banks in the City of New York have any control over the government of the stock exchange, and as you know, neither the Federal Reserve Board nor the Federal Reserve bank has any jurisdiction in the matter. Notes secured by investment securities of any kind are eligible for discount at a Federal Reserve bank except those secured by notes and bonds of the United States. The laws of New York which fix the legal rate of interest in that state at 6%, and impose a most rigid penalty for violation, by providing for the forfeiture of both the principal and interest, make an exception of demand notes of \$5,000 or more, which are secured by collateral, and impose no limitation whatever upon paper of this class.

The Revised Statutes of the United States authorize a national bank to charge rates of interest permitted by the laws of the state in which it is domiciled.

I shall be glad to discuss the question of discount rates at the Federal Reserve banks with you at any time which may be mutually convenient.

Very truly yours,

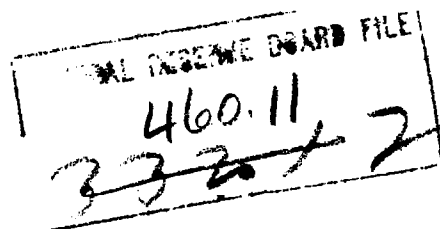
Governor.

Hon. Robert L. Owen,
United States Senate,
Washington, D. C.

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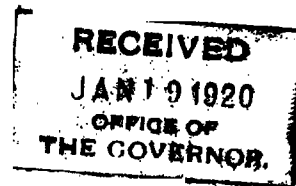
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ROBERT L. OWEN, OKLAHOMA,
CHAIRMAN.



United States Senate,
COMMITTEE ON FIVE CIVILIZED TRIBES OF INDIANS.

January 17, 1920



Hon. W. P. G. Harding, Governor,
Federal Reserve Board, Washington.

My dear Governor Harding:

My attention has been called to the gradual raise of the interest rates through the Federal Reserve Board.

I agree that the speculative spirit on the Stock Exchange has been going too far but a rule could be imposed requiring the banks to demand a larger amount of collateral and check the speculative fever there.

When the rate is raised by the Federal Reserve banks it has the effect of raising the rate on every commercial transaction in the country, which I think is very much against the interests of the producing element of the Nation. I think the jumping of the rates backward and forward by the banks on call loans is merely a mechanism by which the weak speculative element is separated from its money and I very urgently protest against this practice and appeal to the Board to put a stop to high rates on these call loans.

The Stock Exchange ought to be required to have bi-weekly settlements as in London and have a fixed rate of interest that should only vary through reasonable margins and without violence.

Yours respectfully,

R. L. Owen

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Authority E.O. 10501

C O P Y

November 17, 1919.

X-1727

My dear Senator:

Receipt is acknowledged of your letter of the 14th instant.

The Federal Reserve Act is intended for the benefit of commerce and industry and not for the stimulation of the investment market or of speculative movements. The short title of the Act reads, as follows: "An Act To provide for the establishment of Federal Reserve Banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes." Section 13 of the Act provides in part that Federal Reserve Banks may discount notes, drafts, and bills of exchange arising out of actual commercial transactions; that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes. It provides further that nothing contained in the Act shall be construed to prohibit such notes, drafts, and bills of exchange, secured by staple agricultural products, or other goods, wares, or merchandise from being eligible for such discount; "but such definition shall not include notes, drafts, or bills covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States".

The Board has repeatedly called attention to the fact that resources obtained from the Federal Reserve Banks should not be used for speculative purposes, and at various times when there has been unusual speculative activity it has issued public warnings as to the bad effect of such activities upon the banking situation. The first warning of this kind was issued as long ago as October, 1915, and the warning has been repeated on several occasions since that date when conditions made it necessary.

On June 10, 1919, the Board made public a letter, which it had addressed to all Federal Reserve Agents, reading as follows:

"The Federal Reserve Board is concerned over the existing tendency towards excessive speculation, and while ordinarily this could be corrected by an advance in discount rates at the Federal Reserve Banks, it is not practicable to apply this check at this time because of Government financing. By far the larger

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part of the invested assets of Federal Reserve Banks consists of paper secured by Government obligations, and the Board is anxious to get some information on which it can form an estimate as to the extent of member bank borrowings on Government collateral made for purposes other than for carrying customers who have purchased Liberty Bonds on account, or other than for purely commercial purposes."

This letter was sent out for the purpose of ascertaining to what extent Government obligations were being used to secure loans from Federal Reserve Banks for other than commercial purposes or for carrying subscriptions.

In its monthly publication, the Federal Reserve Bulletin, the Board has called attention repeatedly since that date to the dangerous speculative tendencies which have been prevalent.

In a printed statement during the summer, the Board made the specific announcement that it would not sanction any policy which would require the Federal Reserve Banks to withhold credits demanded by commerce and industry for the processes of production and distribution in order to enable member banks to furnish cheap money for speculative purposes.

In ordinary circumstances and normal times one check would have been to advance discount rates, but owing to the fact that the Government has sold over twenty-one billion dollars of Liberty Bonds and Victory Notes, many of which securities have been sold to persons who were unable to pay for them in full but were obliged to pay for them in instalments out of savings or accrued incomes, it was felt that an advance in the discount rate on notes secured by Government obligations should, so far as possible, be avoided.

The speculative movement continued; its demands on the banks for credit coming on top of commercial requirements, of the seasonal crop moving demand, and of demands arising out of the unusual congestion of export commodities at ports owing to the delays in transportation. As a consequence of these conditions, the reserves of the Federal Reserve Banks began to decline, and those of the Federal Reserve Bank of New York, in particular, dropped to such an extent that the Board, about two weeks ago, approved an increase in discount rates of that institution averaging about one-half of one per cent. All other Federal Reserve Banks, shortly afterwards, expressed the desire to put into effect a similar advance in their rates, which the Board approved.

The Federal Reserve Bank of New York, on November 2nd, the date on which the advance in its rates was made public, issued the following statement supplementing the repeated warnings of the Board:

"The reason for the advance in rates announced today by the Federal Reserve Bank of New York is the evidence that some part of the great volume of credit, resulting from both Government and private borrowing, which war finance required, as it is released from time to time from Government needs, is being diverted to speculative employment rather than to reduction of bank loans. As the total volume of the Government's loans is now in course of reduction corresponding reductions in bank loans and deposits should be made in order to insure an orderly return of normal credit conditions."

Notwithstanding this notice, activities on the exchanges continued and the reserves of the Federal Reserve Bank still declined. During the week ending November 5th the Federal Reserve Board sold to other Federal

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Reserve Banks ninety million dollars of acceptances for account of the Federal Reserve Bank of New York, but in spite of this action the reserves of the New York bank fell to forty per cent. In these circumstances, in order to prevent further expansion, it became necessary to call the attention of the large rediscounting banks to the situation.

The high rates for call money which have prevailed continuously for the past two weeks and intermittently for several months past, were in themselves very clear indication of the strained position into which the unbridled speculation had thrown the stock market and rendered a readjustment inevitable unless the resources of the Federal Reserve Banks were to be indirectly drawn upon for stock market purposes. The public has had ample notice of the Board's policy.

You are so familiar with the Federal Reserve Act that it is hardly necessary to call your attention to that paragraph of Section 4, which treats of the duties of the board of directors of a Federal Reserve Bank and which provides that "Said board shall administer the affairs of said bank fairly and impartially and without discrimination in favor of or against any member bank or banks and shall, subject to the provision of law and the orders of the Federal Reserve Board, extend to each member bank such discounts, advancements and accommodations as may be safely and reasonably made with due regard for the claims and demands of other member banks". This would, of course, afford means for a strict rationing of credits should such an extreme course ever become necessary. It is interesting to note that there no longer exists in the mind of the public or in fact a connection between call money rates and the commercial paper market, and it must be gratifying to all those interested in sound banking methods that the events of the past week have had no effect upon the market for commercial paper.

Very truly yours,

Governor.

Hon. R.L. Owen,
United States Senate.