

X-4007
March 26, 1924.

Federal Reserve Board

SUBJECT: Bonus Bill (H. R. 7959) as it
affects the Federal Reserve System.

om: Mr. Wyatt, General Counsel.

Mr. Lee, of the Senate Drafting Service, called me on the telephone Monday morning and advised me that Senator Smoot desires to have a member of the Federal Reserve Board, or a representative of the Board, appear before the Finance Committee of the Senate to discuss Section 502 of the Bonus Bill (H. R. 7959), which provides for bank loans against the security of "adjusted service certificates" and for the rediscount of such loans by the Federal reserve banks. He said that Senator Smoot will probably address a formal request to the Board, but he thought the Board would like to know about it as soon as possible in order that it might have an opportunity to study the bill.

GENERAL PROVISIONS OF THE BILL.

In general, this bill provides for additional compensation to each veteran in an amount equal to \$1.25 for each day of overseas service and \$1.00 for each day of home service, the total amount received by any veteran to be limited to \$500 in the case of veterans who performed no overseas service and \$625 in the case of veterans who did perform overseas service. In all cases in which such additional pay amounts to \$50 or less it is to be paid in cash, but where it amounts to more than \$50 it is to be paid in the form of "adjusted service certificates" which are in substance paid-up 20-year endowment insurance policies in amounts equal to the amount of 20-year endowment insurance that could be purchased by a single premium equal to the amount of such adjusted service credit increased by 25 per cent. The face value of such certificates is payable (1) to the veteran twenty years after date of the certificate, or (2) upon the death of the veteran prior to the date of expiration of such period, to the beneficiary named therein. These certificates also bear a loan value which is not in excess of either (1) 90 per cent of the reserve value of the certificate, computed on the basis of an annual premium for twenty years and calculated in accordance with the American Experience Table of Mortality and interest at four per cent per annum, compounded annually; or (2) 60 per cent of the face value of the certificate.

LOAN PRIVILEGES.

There is given below a brief analysis of the loan privileges accorded under Section 502 of the bill:

(1) Loans may be made only in accordance with the provisions of this section.

(2) National banks and State banks and trust companies are authorized, after the expiration of two years after the issuance of such certificates, to make loans to veterans upon their promissory notes secured by such certificates in amounts not exceeding the loan basis of such certificates.

(3) The rate of interest charged on such loans shall not exceed by more than two per cent the Federal reserve rediscount rate on commercial paper.

(4) Such notes may be sold by one bank to another or may be discounted or rediscounted by one bank with another.

(5) Upon the endorsement of any bank, and subject to regulations to be prescribed by the Federal Reserve Board, such notes shall be eligible for discount by Federal reserve banks, regardless of whether or not the discounting bank is a member of the Federal Reserve System. In order to be eligible for rediscount, however, such notes must have a maturity at the time of rediscount not in excess of nine months, exclusive of days of grace.

(6) The rate of interest charged by a Federal reserve bank on such rediscounts shall be the same as that charged on commercial paper.

(7) Such notes are eligible as collateral security for the issuance of Federal reserve notes.

(8) The Federal Reserve Board may permit Federal reserve banks to rediscount such notes with each other at rates to be fixed by the Board.

(9) Whenever a note is sold, the bank making the sale shall promptly notify the veteran.

(10) If the veteran does not pay the principal and interest of such loan at maturity the bank holding the note may, "after the expiration of six months after the loan was made", present it to the Director of the Veterans Bureau who "may, in his discretion," accept the certificate and note and pay the bank in full satisfaction of its claim the amount of the unpaid principal due it with interest to date.

(11) Such certificates may be redeemed by the veteran upon payment of the principal and interest of the loan.

(12) If such certificates are not redeemed, the Director of the Veterans Bureau deducts the amount of the loan with interest and pays the balance to the veteran on the maturity of the certificate, or to his beneficiary in the event he dies before the maturity of the certificate.

(13) Where a veteran dies before the maturity of a loan, the amount thereof with interest becomes immediately due and payable in which event the Director of the Veterans Bureau pays the note with interest to the bank holding such note, deducting the amount from the face value of the certificate.

(14) If the certificate matures during the life of a veteran, any bank holding an unpaid note secured by such certificate presents it to the Director of the Veterans Bureau who pays the note with interest and deducts the amount from the face value of the certificate.

(15) No payment upon any note shall be made under this section by the Director of the Veterans Bureau to any bank unless the note when presented to him is accompanied by an affidavit by an officer of the bank which made the loan stating that such bank has not charged or collected, or attempted to charge or collect, directly or indirectly, any fee or other compensation (except interest as authorized by this section) in respect of any loan made under this section by the bank to a veteran.

QUESTIONS OF POLICY.

This presents several important questions of policy for the Board's consideration, including the following:

- (a) The advisability of having such notes made eligible for re-discount by Federal reserve banks.
- (b) The advisability of permitting Federal reserve banks to re-discount such notes for nonmember banks.
- (c) The advisability of permitting such notes to be used as security for the issuance of Federal reserve notes and thus become a basis for our currency.

CONCLUSION.

After I have had an opportunity to study this bill more carefully, I probably shall submit some criticisms of the legal phraseology of Section 502.

I am having this memorandum mimeographed and shall furnish a copy to each member of the Board, together with a copy of the Bill.

Respectfully,

Walter Wyatt,
General Counsel.