

FEDERAL RESERVE BOARD

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WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

X-6759

November 13, 1930.

SUBJECT: Reply to Letter from Prof. Westerfield
re Collateral Loans.

Dear Sir:

Referring to the Board's telegram of October 23, there is attached hereto copy of a letter which Governor Meyer is today forwarding to Mr. Ray B. Westerfield of Yale University in reply to his questionnaire of October 15, regarding collateral loans. It would seem that a further reply to Professor Westerfield's letter by the individual Federal reserve banks, will not be necessary.

Very truly yours,

E. M. McClelland,
Assistant Secretary.

Enclosure.

TO CHAIRMEN OF ALL FEDERAL RESERVE BANKS.

COPY

November 13, 1930 .

Mr. Ray B. Westerfield
Professor of Political Economy
Yale University
New Haven, Connecticut

Dear Mr. Westerfield:

Your questionnaire to certain of the Federal reserve agents relative to collateral loans has been referred to the Board for reply.

Our reply to your inquiry has reference to the trend of member bank loans secured by stocks and bonds, as there is no adequate information regarding loans on other collateral, nor on loans by nonmember banks.

The principal factors underlying the growth during recent years in the proportion of member bank loans that is represented by loans on securities are believed to be the financial policy of corporations and the growth in public participation in the stock market.

In the relatively easy money market conditions prevailing in recent years and with the high level of corporate earnings, corporations found it both desirable and possible to provide themselves with a large part of their working capital from profits and from the issue of securities rather than through borrowing at banks. This policy has been facilitated by the increasing willingness of the public to buy common stocks during a period of rising security prices. This development has operated both to reduce bank borrowing by corporations on line-of-credit loans and to provide the public with securities eligible as collateral for security loans.

An important factor in the increase of security loans during the period from 1922 to 1929 has been the growth of speculation in listed stocks, which

resulted in a growth in the demand for loans by brokers. The ease with which loans to brokers could be negotiated was in itself a factor in the growth of security loans.

Judging by the member bank reports for the system as a whole the change appears to have affected all classes of banks. You will find some data on this subject in the Board's Annual Report for 1928 (Table 52) and 1929 (Table 44), also in recent issues of the Member Bank Call Report, of which copies for June, 1929 and June, 1930 are enclosed. Corresponding data are not available prior to 1925, and they have not been assembled separately for the different classes of banks in each district. A special tabulation that may be of interest to you will appear in the forthcoming November issue of the Federal Reserve Bulletin.

The Federal reserve banks have done nothing whatever to encourage member banks to increase the proportion of their security loans. On the contrary, the desirability from the point of view of member banks of having a large part of their loans in the form of paper eligible for rediscount at the reserve banks has been an influence against the growth of security loans which are ineligible. The preference of member banks for eligible loans is reflected in the fact that customer loans on stocks usually bear a higher rate than other customer loans, as can be verified by reference to the table of rates charged customers that is published regularly in the Federal Reserve Bulletin.

According to our information, as furnished by the Federal reserve agents, it is not customary in any Federal reserve district for banks to "insist on chattel mortgage or other security for practically all of their loans."

Very truly yours,

Eugene Meyer
Governor

Enclosures