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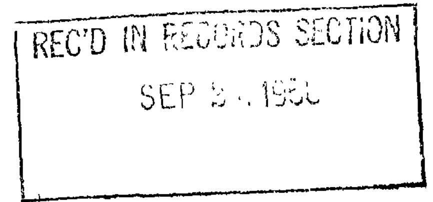
September 22, 1958



To Members of the Federal Open Market Committee and Presidents of Federal Reserve Banks not presently serving on the Federal Open Market Committee

From R. G. Rouse, Manager, System Open Market Account

Attached for your information is a summary of the discussion at the first meeting of the Technical Committee of the New York Money Market, which was held at the Federal Reserve Bank of New York on September 15, 1958. Also enclosed is a photostatic copy of an article in The Wall Street Journal of September 22, concerning action which the New York Stock Exchange has taken against the firm of Garvin, Bantel in connection with the firm's activities in financing speculation in Government securities earlier this year.

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SEP 24 1958

CONFIDENTIAL -- (F.R.)

September 22, 1958

To Files

From R. G. Rouse and R. W. Stone

Subject: Summary of Meeting of Technical Committee of the New York Money Market - September 15, 1958.

The first meeting of the newly-formed Technical Committee of the New York Money Market was held at the Federal Reserve Bank of New York on September 15, 1958. The general subject of the first meeting was the recent disturbances in the Government securities market, and in particular the excesses of speculation that contributed so greatly to the development of those disturbances. This memorandum presents a brief summary of the discussion by the Technical Committee.

As suggested above, the discussion focused in good part on the speculative excesses that occurred in the Government securities market and, in particular, on a basic factor that made such excesses possible--the extension of too much credit on too easy terms. Funds were made available for speculative purposes both by bank and nonbank (mainly corporate) lenders, in good part through the intermediary of Stock Exchange firms. The group felt that, with one or two exceptions, the large New York banks were relatively cautious in extending loans for speculative purposes, and although a large volume of such loans was extended, these banks generally required higher margins than were demanded by other lenders. Corporations and many out-of-town banks, however, engaged in large-scale financing of unknown borrowers on little or no margin, and the funds advanced by corporations represented essentially short-term money secured by an obligation (the 2 5/8 per cent bonds) maturing in 1965.

It seemed to the Technical Committee that two general approaches might be explored in order to avoid or limit the possibility of a repetition of the massive speculation that occurred earlier in the year. First, it felt that an

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effort should be made to "educate" corporations and banks as to the fundamental unsoundness of advancing funds without knowing for whom such funds are ultimately destined and without requiring the protection of adequate margins. As regards corporations, this message might most effectively be put across by a direct statement of the issues to top corporate management, and it was felt that a meeting of the Business Advisory Council of the Department of Commerce would be an excellent forum in which to have the case stated--preferably by a high official of the Treasury. It was also felt that the American Bankers Association is in a position to emphasize this point for the benefit of bankers.

The second approach which the Committee felt should be explored is the possibility of establishing a formal system of margin requirements on loans against Government securities. It is understood that the Stock Exchange is considering some tightening of its regulations in this respect, and this, of course, would be helpful, but obviously the Exchange would be unwilling to do it fully unless others took similar action. Even if the Exchange were willing to tighten its rules substantially, other avenues of abuse would still be open, and thus there might still be room for a more general system of margin regulations. It was recognized that many difficult problems arise in connection with margin requirements on loans against Government obligations. Perhaps the chief problem is that Government securities dealers would have to be exempted from the requirements in order to avoid a serious impairment of their normal and legitimate business. But this would raise the difficult question as to how to distinguish between firms which are to be regarded as dealers and those which are not. It was emphasized that such distinctions should have some basis in law, and the responsibility for administering a system of margin controls should not be imposed upon any regulatory authority unless some legal basis exists for the distinctions that would have to be

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made. The group also felt that the administration of a system of margin regulations would be much facilitated if there existed some kind of association of Government securities dealers. It would be necessary for such an association to have some legal standing; no informal association organized by the dealers themselves on a voluntary basis would work, in the judgment of the Committee. Two members of the group have undertaken the preparation of memoranda, one on the subject of margin requirements, and the other on the possibility of the formation of a dealer association.

As regards the extension of credit by corporations against Government obligations, the suggestion was made that it might be worth looking into the possibility of instituting a reporting system under which a number of large corporations that lend funds against Governments would periodically report to the Federal Reserve System the volume of such loans outstanding.

We feel that the meeting was constructive, and believe that this feeling is shared by all who participated. The Committee plans to meet again after the two memoranda referred to above have been prepared in order to pursue further the discussion of margin regulations and the possibility of a dealer organization.

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Big Board Disciplines Garvin, Bantel for Its Bond Market Activities

WALL ST. JOURNAL

G. K. Garvin Suspended for 3 Months, Total of $25,000 in Fines Levied for Violation of Rules

SEP 2 2 1958

By a WALL STREET JOURNAL *Staff Reporter*

NEW YORK—The New York Stock Exchange found Garvin, Bantel & Co., a member firm specializing as money brokers, guilty of violating Exchange regulations as a result of its activities in the Government bond market earlier this year.

The firm's senior partner, George K. Garvin, was suspended for three months as an allied member of the Exchange. He and the firm's 11 other partner were fined a total of $25,000. Mr. Garvin thus must dissociate himself from the 27-year-old firm until the suspension expires; the firm, however, continues to operate. Other disciplinary action taken against the other 11 was official censure by the Board of Governors at a special meeting Friday morning. The decision of the Board was arrived at after a meeting that ran late into Thursday evening.

The firm's partners, including Mr. Garvin's wife, Ruth Mitchell Garvin, and his son, George K. Garvin, Jr., were disciplined on five charges brought against the firm itself.

Treasury Offering Dealings

The dealings of Garvin, Bantel which resulted in the Exchange's disciplinary action were mainly concerned with the U.S. Treasury's exchange offering of 2⅝% bonds, made late in May, and continuing into July.

The charges, in substance, were that in its dealings in U.S. bonds, Garvin, Bantel failed in some instances to require margin payments by customers of at least 5% of the purchase price as prescribed by New York Stock Exchange rules; that it did not use due diligence to learn essential facts concerning some of its customers; that it failed to keep proper customers' ledger accounts as required by Big Board rules; that, in general, its activities were "detrimental to the interest and welfare of the Exchange."

A fifth charge held that the firm failed to follow "sound business practices" in borrowing funds, largely from corporations and banks outside New York City, to buy the coming Treasury issue for resale to its customers. These funds were secured by the bonds.

Here's how such "repurchase agreements" worked:

The brokerage firm sold "rights" to the coming 2⅝% Treasury bond issue to its customers. The customers, in effect, paid interest to the banks and corporations through the money broker for the loans. This interest was greater than if the banks or corporations had bought Treasury securities, even though the brokerage firm got a fee for arranging the transaction.

Upon actual issue of the bonds, the money broker acquired them in the names of his customers. The Exchange charged that some customers did not have to put up any cash—no deposit with a broker, no margin.

An unlooked-for decline in the prices of bonds, however, diminished the value of them. This resulted in calls for margin cash, or more margin if the customer had put up some, and possible losses to a customer who planned to sell the bonds before they matured. If the customer held on to the bonds until maturity he would of course, stand to receive face value, not the current market value of them.

Margin Requirements

The 5% margin requirement on purchases of Government bonds is imposed by the New York Stock Exchange. The Federal Reserve margin rate, now 70%, applies only to stocks.

Mr. Garvin said last July that his firm had actively helped in financing the purchase of approximately $800 million of the [illegible] way. He said the Exchange had asked him to discontinue this financing activity, and [illegible] he had complied.

Garvin, Bantel specializes in [illegible] loans to brokers and dealers [illegible] ties as collateral and also in [illegible] of so-called Federal funds [illegible] banks of the Federal Reserve System. [illegible] are excess reserves of the [illegible] loaned to other member banks [illegible] short of reserves.

The Stock Exchange charged that [illegible] ing the repurchase agreements, Garvin, Bantel did not follow "sound business practices in assuming the sizable commitments [illegible]," even though such commitments were "[illegible] contracts."

Slight Activity

In commenting on the Garvin, Bantel case generally, the Exchange said member firm activity in the U.S. Government bond market in recent years has been relatively slight. Member firms' participation in the mid-June Government market, when three new issues of [illegible] billion were sold, was about [illegible] exclusive of $400 million participation by member firm Government bond dealers, the Exchange stated.

The charges and penalties against the money-brokerage firm and partners were read from the rostrum of the Exchange trading floor Friday morning. Later, Mr. Garvin said in a statement, "The Board's decision speaks for itself, and the firm has no other comment."

Subsequently on Friday, Mrs. Garvin made an additional statement emphasizing that the firm was continuing in business, and denying that the three-month suspension of Mr. Garvin meant any interruption in the functioning of the firm.

Of the other partners, Walter J. McAdams, Jr., the firm's Government bond floor broker, is a member of the Exchange. All the rest were allied members of the Exchange at the time of the alleged violations. They were Rudolph J. Petke, George K. Garvin, Jr., Ralph De Paola, Bertram M. Ostrau, Arnold R. Runestead, Allan J. Stypeck, Gordon G. Daniel, John P. O'Brien and Junius W. Peake.

Mr. Peake, who resigned from the firm August 7, said he had quit as a result of a disagreement for some time "with the firm over their policies in this situation."