Commercial Banking Undergoing Change

Commercial banking in the United States is rapidly developing into all-round banking. Commercial banks today have in excess of ten billion dollars of savings funds, while during the past four years their loans have decreased by some ten billion dollars. What should the credit policy of the commercial banker be under these conditions? Too many bankers with a generous proportion of their deposits in the time category have attempted to operate their banks as though they were strictly commercial banks and all deposits were of the demand type. This has led them to an almost slavish adherence to liquid investments consisting of gilt-edged bonds and short-term loans, generally referred to as eligible paper.

While there may have been some justification for this kind of a credit policy in years past, fundamental changes have come about which to my mind make such a restricted credit policy indefensible for any bank which accepts savings deposits, and unnecessary even for strictly commercial banks. It used to be claimed by most bankers and is still claimed by many, that it was necessary for the commercial bank to maintain a high degree of liquidity in order to meet sudden withdrawals by all depositors. The argument was that even savings accounts were potentially demand deposits since no bank of any standing would refuse to grant a withdrawal without requiring a legal notice. Whatever force this argument had prior to 1933 has been completely dissipated by two fundamental acts of Congress. The first was the law creating the Federal Deposit Insurance Corporation providing for the insurance of deposits in insured banks up to five thousand dollars for each depositor. So long as this law stands, no well-managed bank need fear a run of such proportions as would require a high degree of liquidity in the bank's assets.

Let us, however, be generous to those who still have any such fears and assume for the sake of argument that deposit insurance will not forestall abnormal demands by depositors for their funds. Prior to 1935, a bank in such a situation could not obtain credit from its Federal Reserve bank except against eligible paper and government bonds. The Banking Act of 1935, however, establishes the principle that Federal Reserve credit shall be available to member banks on the basis of soundness of the paper offered rather than its liquidity. Therefore, any member bank under the necessity of meeting an abnormal withdrawal of deposits can obtain credit from its Federal Reserve bank on its note "secured to the satisfaction of such Federal Reserve bank." To my mind, this change in the Federal Reserve Act removes the last valid excuse of any commercial banker who is unwilling to extend the various types of credit desired by the community.

Ten billions of savings funds held by the commercial banks of the country are in general the same type of thrift accumulations that find their way into mutual savings banks, life insurance companies, building and loan associations and other similar institutions. These funds should therefore be invested largely in the long-term field so as to yield a reasonable return for the saver. Depositors may tolerate a lesser rate for short periods as at present, but in the long run, if these savings deposits are not so invested by the commercial banker, they will eventually leave him and go to credit institutions which will employ them in the long-term field.

With the protection of deposit insurance and the provision of the Banking Act of 1935 referred to above, I consider it both the banker's duty and his opportunity to supply the community with credit of the type that is demanded. Many progressive commercial banks today are entering the field of instalment financing, personal or character loans, loans to industry, real estate loans, in fact practically all of the types of credit for which there is a demand in the community served. The commercial banker today is, as before, a merchant of credit. But he is no longer limited to any one type of article. On his counters, he may now safely and profitably display a variety of credit offerings to suit the varying needs of nearly all types of borrowers, just as he offers a multitude of services to his other customers. The alert commercial banker is not waiting for loans to come in, he is developing loans in the various fields above referred to. With the low average yield of the investm nt portfolio, this is the logical road to improved earnings. And with the fundamental changes in the banking law mentioned above, he may safely enter these wider fields of credit.