BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 24, 1943

To Mr. Eccles

Subject:

From Chester Morrill, Secretary.

Mr. Ransom has asked me to advise you that he would appreciate it very greatly if you would read carefully the attached copy of a letter dated August 20 addressed to Senator Wagner by Chairman Crowley of the Federal Deposit Insurance Corporation, which was received by Mr. Ransom about 5:15 on August 23, 1943, with a covering letter of that date, a copy of which is also attached.

This correspondence relates to the Board's letter dated August 23 to the Comptroller of the Currency, which was mailed to the Comptroller on that date, in regard to the absorption of exchange charges. Mr. Ransom was advised this morning by Comptroller Delano that he had received the letter.

CMW

Attachments.

COPY

FEDERAL DEPOSIT INSURANCE CORPORATION

WASHINGTON

Office of the Chairman

August 23, 1943

Honorable Ronald Ransom, Vice Chairman
Board of Governors of the Federal Reserve System
Washington 25, D. C.

Dear Governor Ransom:

In reply to your letter of August 6, 1943, we are enclosing herewith a copy of a letter which we have forwarded to Senator Wagner.

Sincerely yours,

(Signed) Leo T. Crowley

Leo T. Crowley,
Chairman.

Enc.

C O P Y

August 20, 1943

My dear Senator Wagner:

We are interested to read the proposed letter of the Board of Governors of the Federal Reserve System to the Comptroller of the Currency accompanying Governor Ransom's letter to you under date of August 6, a copy of which was sent us with advice that it would be mailed on August 23.

In this letter the Board of Governors holds that the absorption of exchange charges by a national bank constitutes a payment of interest in violation of Section 19 of the Federal Reserve Act and of the Board's Regulation Q which prohibit payment of interest on demand deposits by member banks.

The subject matter of this letter was discussed by representatives of this Corporation with members of the Federal Reserve Board staff in January 1943, at which time they were advised that this Corporation believes the Board of Governors' position to be untenable, as the question involved appears to be one which Congress has pointedly refrained from delegating to the Federal banking agencies for disposition and in which the theory of the Board of Governors would appear to require it to outlaw as well the absorption of service charges and other expenses for depositors which all banks now incur to some degree.

In practically all systems of service charges on deposit accounts, credit, up to a maximum amount of the charges, is given for the worth of the balance to the bank in terms of an assumed or hypothetical rate of interest. A survey of service charges conducted by the American Bankers Association in 1938 showed that out of 478 clearing houses replying to the inquiries, at least 387, or 81 percent, used service charge systems which in effect gave customers credit for interest on their accounts in determining the amount of service charges to be levied. Of course, no interest was actually paid; it was credited against charges which would otherwise be levied. The practice has become more widespread since that survey was made.

Under these methods of service charges the depositor whose account is considered to be desirable receives a pecuniary benefit which he would not otherwise receive in the form of free services, which represents essentially a rebate of charges. This benefit is an incentive for the maintenance of larger balances on deposit with the bank than might otherwise be maintained.

We know that it is a common practice of many depositors to balance the rate of return which they could secure on their funds, if invested, against the service charges which they would have to pay if their larger balances were withdrawn, and to base their decisions with respect to the use of their funds upon the relative advantage to accrue therefrom. The system of providing free services on the basis of minimum balances and of levying charges against those who do not maintain such balances appears to us to be as much a payment of interest as the absorption of exchange charges. In the latter case, the bank pays for something; in the former case, the bank refrains from collecting income which it would otherwise receive. The net result to the bank is precisely the same; the purpose is precisely the same. The only difference is an accident of accounting.

Therefore, if the absorption of exchange charges constitutes a prohibited payment of interest, it seems to us equally clear that the absorption of internal service charges, telephone and telegraph charges and postage for depositors is likewise a prohibited interest payment. Dollarwise, the volume of service charges and expenses absorbed by the banks is immeasurably greater than the exchange charges which the banks pay for their customers. Yet the Board of Governors, we believe, would frankly admit that to compel banks to pass on to their depositors expenses and charges of this character would not only be a disservice to the depositing public, but would, in their opinion, be as far beyond the scope of the Board's authority as we consider the proposed ruling to be.

As we view the proposed ruling, it is simply another attempt to force par clearance upon nonmember banks. In the past, all such attempts have been defeated administratively, legislatively, and judicially.

Over 2,100 insured banks charge exchange on items drawn against them and, while the total involved is relatively small, these charges constitute a vital source of income to these institutions. They have long fought the efforts of the proponents of free clearing to outlaw the practice and Congress was not unaware of that fact in enacting the interest provisions of the 1933 and 1935 Acts. Yet Congress did not attempt to deal with the question then, and we do not believe it intended that the banking agencies do so indirectly under the guise of an interest regulation. This Corporation does not intend to do so, and it hopes that the Board of Governors will not give rise to a situation where two Federal agencies make conflicting decisions to the consternation

of the public. In such a situation we consider it singularly appropriate to await precise directions from Congress.

A similar letter is being sent to Chairman Steagall and to Representative Doughton.

Very truly yours,

(Signed) Leo T. Crowley

LEO T. CROWLEY,
Chairman.

The Honorable Robert F. Wagner
United States Senate
Washington 25, D. C.