

CORRESPONDENT BANKING'S FUTURE ROLE

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CORRESPONDENT BANKING'S FUTURE ROLE

American banking today is undergoing basic changes in scope, in operations and in management philosophy. Inevitably, correspondent bankers are involved. They face the question of whether the future now visualized for banking includes an expanding correspondent business and the encompassing uncertainty of how much of their traditional activity can be realistically carried forward into the future.

Recent trends in correspondent banking are not entirely obvious. So far as I am aware, relevant hard data on the volume of correspondent activities are not compiled by any official agency. Opinions differ on the inferences that can be drawn from the first-hand knowledge of correspondent bankers themselves or from such phenomena as comparative promotional efforts of correspondent banks at the annual meetings of the American Bankers Association. No one is talking about the "decline and fall" of correspondent banking but there is an obvious tone of concern in discussion of future prospects.

Information on "due-to" and "due-from" balances at correspondent and respondent banks, respectively, are the only regularly collected data that reflect correspondent activity. This evidence is far from complete. We have only the totals of balances "due-to" and "due-from" at each individual bank, and while we can sum these for various useful groupings of banks, we do not know the institutions to whom or from whom these "due-to" and "due-from" amounts are owed or owing. Nor are there data on the character of services rendered for the balances involved. We have no information about fee income attributable to correspondent services.

Nevertheless, if we go back a decade to 1962 for a "then-and-now" comparison of correspondent balances from the Call Reports of Condition, what might we learn? At the risk of exposing you to more numbers and relationships than are appropriate for a speech, I have put a few "then-and-now" questions to our well-stocked data bank, "then" being June 30, 1962, and "now" being June 30, 1972. In tabulating the data it has been useful to distinguish between member and non-member banks in order to highlight the insignificant role of non-members as correspondents and their very considerable role as respondents. For your convenience tables are available which contain the detailed information.

To start off with "due-to" balances of members, what has been the change over the period in the ratio of "due-to" balances to total deposits? Although "due-to" balances in member banks increased from \$12.0 billion in 1962 to \$23.3 billion in 1972, they did not increase as rapidly as total deposits (see Table I). In relative terms, therefore, "due-to" balances declined about 8 per cent. But we will see later that this showing is almost entirely due to activity at New York City banks. Taking the 49 States excluding New York, the decline in relative balances was 30 per cent.

Non-member "due-to" balances more than doubled from \$393 million to \$891 million but non-member deposits rose even more rapidly. In consequence there was a relative decline of 26 per cent in "due-to" balances at these institutions.

Secondly, what has been the change over the decade in "due-from" balances when they are related to total deposits? Here again the relative

change in member banks was small, -4 per cent. But excluding New York State, the relative decline was 28 per cent. At non-member banks the relative decline was even larger, 36 per cent. But in a sense this "loss" may have been only a change in the character of correspondent relations, for the non-members sold \$4.0 billion in Federal funds in 1972, presumably to their correspondents. If this sum is added to their "due-from" balances the decline is only 6 per cent. However one regards Federal funds sales, actual "due-from" balances maintained by non-member banks remain a significant element in the correspondent picture: \$8.4 billion, a sum equal to 7.2 per cent of their deposits, and 9 times as large as their "due-to" balances.

The overall impression from the foregoing review of national totals is that there has been only a small change in the relative position of correspondent banking at member banks over the decade. As we have already begun to note, this conclusion is substantially modified as the data are disaggregated to see what has been taking place in various States and regions.

Take, for example, each of the ten largest banking States as ranked by total deposits. We find that in New York, where 45 per cent of the "due-to" balances for the entire nation are located, there was a relative rise of 55 per cent in such balances at member banks (see Table II). However, in Illinois, Pennsylvania, Texas, Ohio, Michigan, and Florida, important States in the correspondent business, there were substantial relative declines ranging from 24 to 40 per cent. In

Massachusetts the decline was moderate; in California there was a moderate increase but in this State "due-to" balances amounted to no more than 1.8 per cent of deposits as compared to 11.4 in New York; 4.6 in Illinois; 3.7 in Pennsylvania; and 7.6 in Texas. In New Jersey there was no significant change, but correspondent banking in that State is very limited. Going beyond the ten largest banking States, the data reveal substantial declines, 10-40 per cent, in the midwestern unit-banking States and an even larger falling off in southern States.

I will not risk losing your attention by reciting further statistical details; some of you will find the circulated tables interesting if not surprising.

To summarize the meaning of this considerable volume of statistical relationships, I would note:

(1) In New York the large increase in both "due-to" and "due-from" balances seems to be mainly due to clearing activities related to security and Euro-dollar transactions. The really sharp rise began in 1968 and occurred at a limited number of banks. Not all of the large banks participated equally, but New York correspondents, without exception, have maintained their relative "due-to" positions very well.

(2) In state-wide branching and holding company States, correspondent balances tend to be relatively low--about 1 to 2 per cent of total deposits. If the data on balances within holding company organizations could be adjusted to eliminate

intra-organization balances, "due-to" totals would probably be even less important.

(3) In the regions where unit banking prevails--the Midwest and the South--relative "due-to" balances have been reduced sharply. Relative "due-from" balances in these States show a similar decline, perhaps because of the movement of respondent banks into the Federal funds market.

(4) Looking at the nation, excluding the ten largest banking States, relative "due-to" accounts of member and non-member banks are off by one-third and relative "due-from" accounts are off nearly 40 per cent.

This backward look at correspondent banking is useful in revealing presumptively, at any rate, that while such activity is expanding in absolute terms it is losing ground in terms of its share of the banking business. And since in this examination the banking business was defined by total deposits, the actual relative loss is even greater, given the rapid growth in non-deposit and foreign sources of funds and in activities "closely related" to banking. In my view, the correspondent banker concerned with the prospects for his business should feel that these trends indicate a compelling need for a thorough appraisal.

The issues for correspondent banking as I see them have to do with both the size and nature of its role in a rapidly and drastically changing banking environment. For example, the challenge coming from the multi-bank holding company is very real, though perhaps lesser in

degree than that arising from branching systems in some areas in the past. Can the services sold by correspondents be equivalent to or better than those obtained through a holding company affiliation? Can unit banks with correspondent affiliations hold their own competitively with holding company affiliates or branches of large banks? Can correspondents provide certain services of higher quality or at lower cost than can head offices of branching systems or lead banks of holding companies?

All of these questions become more acute in light of prospective changes in banking structure and in the scope of banking activities. The rapid change in banking structure now taking place may appear as either a threat or a challenge, depending on one's point of view, but it cannot be regarded as neutral to the interest of correspondent bankers. In this arena, correspondent banking has inherent advantages that have been overlooked in most discussions. I'd like to develop this point briefly, because it forms the basis for the viable future that I believe correspondent banking can enjoy if it builds on its inherent strengths.

Over the past several years the Board of Governors has, under guidelines determined by Congressional action, become deeply concerned with the problem of shaping the role of the nation's banking organizations and the character of banking structure. These regulatory responsibilities, which we are meeting both by administrative rule-making and case-by-case decisions, involve the institutional, functional, and territorial boundaries of banking both at home and abroad.

The Congressional guidelines interpret public interest in banking as avoiding actions by the Board and other Federal regulatory authorities which would lead to undue concentrations of market power, and, on the positive side, approving such proposals as are likely to lead to a more competitive environment in banking. Realistically, these expressions of broad intent mean to me that regulatory authorities should release or confine, as the case may be, entrepreneurial and competitive forces in a manner which will expand alternative sources of banking and related services and will enrich the quality and variety of such services offered to the public.

Correspondent banking is not disadvantaged by such public-interest criteria. In fact, its ability to provide specialized services to respondent banks without taking them over lock, stock, and barrel could be viewed as a substantial plus to the public interest in a more competitive system.

Many unit banks might also come to regard closer ties with correspondents as a substantial plus to their interests too. A closer correspondent link is a feasible method of obtaining the advantages of specialization and some of the economies of scale while autonomy in the personalized banking relationships of a community or neighborhood is retained. A broad-based correspondent connection would give many unit banks both the skills and the confidence needed to relieve their apprehensions about meeting branching and holding company competition.

Most of the services that head offices in branching systems and lead banks in holding companies can provide with the greatest expertise and efficiency can also be supplied by a correspondent. Moreover, because in practice the correspondent is exposed to competitive pressures from a relatively large number of other correspondents, there is a potential advantage from the public standpoint. Changing correspondents to obtain better or cheaper services is always more feasible than disaffiliation of branches and holding company units from a moribund or dormant head office. While correspondent relationships have tended to be highly durable over time, presumably this is because they have met the competition from several potential sources.

The comparative advantages which correspondents enjoy are numerous: They can operate over a large area, unhampered by State or other political boundaries, an advantage neither branching nor holding company systems share. Their investment in respondents is relatively mobile; they are not burdened with the brick and mortar or glass and steel of a branching system or even the stock certificates of a holding company structure. They can slough off unprofitable affiliations, just as they themselves can be sloughed off by respondent banks.

The problem in exploiting these advantages is to divert correspondent bankers' concentration away from "balances" and "availability" where it has been focused in the past to the far broader opportunities in today's banking environment. The idea ought to be emblazoned on their perception for the future that they can offer a correspondent

relationship as a "full-service" alternative to a holding company affiliation or a branching commitment.

Perhaps the way to do this is to tighten the correspondent relationship, when it proves to be a profitable one. This might be done, for example, by linking correspondent compensation not only to balances or fees but also to the earnings of the respondent. This closer affiliation by the correspondent with ownership as distinct from management interests might become constructive. While little new ground needs to be broken in the panoramic scope of correspondent expertise, intriguing methods of packaging existing services and relationships are clearly needed.

In conclusion, I would like to comment on challenges to correspondent banking which I believe are coming from the explosive effect of opportunities for some banking managements to diversify and extend their markets all over the world; and, similarly, for those managements who cannot, or opt not to, go abroad, from the chance to broaden the home base by engaging in activities that have been or may in the future be found to be "closely related" to banking.

In my experience nothing has activated as much banking management interest and imagination as the recent amendments to the Bank Holding Company Act. The changes already made as a result of that Act, as well as those in process and others in prospect, will, in my opinion, have a considerable impact on correspondent banking and the environment in which it operates.

But there is more involved than the new vistas under the Holding Company Act. For the largest U.S. banks, many of whom have been most active in correspondent banking, expansion into foreign banking activities has become a major outlet for growth and performance objectives. Several U.S. banks have extended experience abroad and the foreign deposits of those banks as a group now amounts to 37 per cent of their total deposits. But several newcomers have been moving rapidly into the foreign field, and one could identify a group of a dozen or so whose foreign interest measured by deposits is now of the order of 30 per cent. These trends are far more than a matter of vanity and status or of frustration with constraints on expansion in the U.S., although both of these considerations are peripherally involved. Diversification, growth and profit are the underlying factors of compelling importance.

Can correspondent bankers persuade their managements that correspondent banking is more attractive than these new and glamorous ways of growing, diversifying as well as making money? Can they show that in the pedestrian but essential task of raising funds they can do better than a good money man in the U.S. money market or the Euro-dollar market? Can they show that funds raised from respondents provide a more stable and economical source than funds raised from the bank's other customers? These are puzzling questions for me. I presume you will have to come up with the answers.

A final consideration affecting the prospect for correspondent banking--change in the payments mechanism--is so familiar to all of us it hardly needs analysis here. Surely there cannot be much difference of opinion that, in the easily foreseeable future, technology and economics will make electronic transmission of money practically universal. As that happens, immediate availability of credit for cash items will become a "free good" since it is an integral part of the system. Of course, the demand for computer and data transmission services will in no way be abated; it is likely to increase. Thus a fundamental basis for correspondent activity in the payments system will be changed, and the groundwork for relatively new and competitively attractive payments services to respondents will be laid.

Those correspondent banks that have the vision, the vitality and the determination to develop and merchandise these services can occupy an important niche in the payments network and the banking system of the future. The American public will benefit from their performance, and both Congress and bank regulators can be expected to take cognizance of that fact. Those other correspondent banks too phlegmatic and tradition-bound to differentiate between an opportunity and a threat will get the nostalgic sympathy we reserve for the glories of the past, but not much more.

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TABLE I. ALL INSURED COMMERCIAL BANKS IN THE U.S.

"Due-To" and "Due-From" Balances Compared to Total Deposits
June 30, 1962 and June 30, 1972

	Total deposits	"Due-to" balances		"Due-from" balances		Percentage change in ratio of balances to total deposits 1962 - 1972		
		Millions of dollars	Millions of dollars	Percent of total deposits	Millions of dollars	Percent of total deposits	"Due-to"	"Due-from"
Member 1972	\$433,993	\$23,328	5.4%	\$14,375	3.3%	- 8%	- 4%	
1962	206,040	11,991	5.8	7,089	3.4			
Non-Mem. 1972	115,992	891	.8	8,384	7.2	-26	-36	
1962	37,816	393	1.0	4,300	11.4			
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TABLE II. TEN LARGEST BANKING STATES

"Due-To" and "Due-From" Balances Compared to Total Deposits
June 30, 1962 and June 30, 1972

	Total deposits	"Due-to" balances		"Due-from" balances		Percentage change in ratio of balances to total deposits 1962 - 1972		
		Millions of dollars	Millions of dollars	Percent of total deposits	Millions of dollars	Percent of total deposits	"Due-to"	"Due-from"
<u>New York</u>								
Member	1972	\$91,262	\$10,413	11.4%	\$ 4,009	4.4%	+55%	+421
	1962	45,812	3,369	7.4	386	.9		
Non-Mem.	1972	3,086	34	1.1	324	10.5	+ 3	+ 6
	1962	1,406	15	1.1	139	9.9		
<u>California</u>								
Member	1972	52,956	958	1.8	902	1.7	+ 6	+38
	1962	25,813	441	1.7	318	1.2		
Non-Mem.	1972	5,530	45	.8	393	7.1	+37	- 8
	1962	1,632	10	.6	125	7.7		
<u>Illinois</u>								
Member	1972	31,444	1,439	4.6	636	2.0	-39	-35
	1962	16,194	1,219	7.5	507	3.1		
Non-Mem.	1972	8,858	52	.6	596	6.7	+202	-42
	1962	2,570	6	.2	297	11.6		
<u>Pennsylvania</u>								
Member	1972	25,675	949	3.7	739	2.9	-24	+ 1
	1962	13,266	643	4.8	376	2.8		
Non-Mem.	1972	6,955	9	.1	359	5.2	+41	-32
	1962	1,924	2	.1	146	7.6		
<u>Texas</u>								
Member	1972	22,249	1,693	7.6	1,199	5.4	-37	-46
	1962	10,793	1,295	12.0	1,078	10.0		
Non-Mem.	1972	8,109	175	2.2	915	11.3	-15	-33
	1962	2,232	57	2.6	376	16.8		

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(Continued) TABLE II. TEN LARGEST BANKING STATES

"Due-To" and "Due-From" Balances Compared to Total Deposits
June 30, 1962 and June 30, 1972

	Total deposits	"Due-to" balances		"Due-from" balances		Percentage change in ratio of balances to total deposits 1962 - 1972		
		Millions of dollars	Millions of dollars	Percent of total deposits	Millions of dollars	Percent of total deposits	"Due-to"	"Due-from"
<u>Ohio</u>								
Member	1972	\$21,485	\$ 416	1.9%	\$ 541	2.5%	-40%	-29%
	1962	10,533	344	3.3	374	3.6		
Non-Mem.	1972	2,722	2	.1	149	5.5	-13	-46
	1962	1,291	1	.1	131	10.2		
<u>Michigan</u>								
Member	1972	20,771	405	2.0	788	3.8	-30	+32
	1962	8,625	239	2.8	248	2.9		
Non-Mem.	1972	2,985	5	.2	132	4.4	+229	-49
	1962	1,170	1	.1	102	8.7		
<u>New Jersey</u>								
Member	1972	15,264	169	1.1	411	2.7	+12	-17
	1962	6,994	68	1.0	228	3.3		
Non-Mem.	1972	2,204	1	.1	140	6.4	-77	-32
	1962	779	2	.3	73	9.3		
<u>Florida</u>								
Member	1972	10,994	570	5.2	551	5.0	-31	-42
	1962	3,660	274	7.5	315	8.6		
Non-Mem.	1972	6,028	37	.6	427	7.1	-42	-31
	1962	1,625	17	1.1	167	10.3		
<u>Massachusetts</u>								
Member	1972	9,681	453	4.7	191	2.0	- 5	- 9
	1962	5,006	247	4.9	109	2.2		
Non-Mem.	1972	1,865	5	.2	143	7.6	-81	-24
	1962	526	7	1.3	53	10.1		
<u>All other states</u>								
Member	1972	132,212	5,863	4.4	4,408	3.3	-32	-37
	1962	59,344	3,852	6.5	3,150	5.3		
Non-Mem.	1972	67,650	526	.8	4,806	7.1	-36	-40
	1962	22,661	275	1.2	2,691	11.9		

TABLE III. SELECTED MIDWESTERN STATES

**"Due-To" and "Due-From" Balances Compared to Total Deposits
June 30, 1962 and June 30, 1972**

		Total deposits	"Due-to" balances		"Due-from" balances		Percentage change in ratio of balances to total deposits 1962 - 1972	
		Millions of dollars	Millions of dollars	Percent of total deposits	Millions of dollars	Percent of total deposits	"Due-to"	"Due-from"
<u>Indiana</u>								
Member	1972	\$8,468	\$267	3.2%	\$350	4.1%	-16%	-37%
	1962	3,794	142	3.8	248	6.5		
Non-Mem.	1972	3,995	13	.3	233	5.8	-11	-49
	1962	1,180	4	.4	134	11.4		
<u>Iowa</u>								
Member	1972	3,692	294	7.9	172	4.6	- 9	-31
	1962	1,669	145	8.7	113	6.8		
Non-Mem.	1972	3,887	7	.2	263	6.8	-49	-37
	1962	1,541	6	.4	167	10.8		
<u>Kansas</u>								
Member	1972	3,130	178	5.7	159	5.1	-14	-43
	1962	1,601	105	6.6	142	8.9		
Non-Mem.	1972	2,617	13	.5	212	8.1	-31	-42
	1962	1,006	7	.7	141	14.0		
<u>Minnesota</u>								
Member	1972	6,641	440	6.6	189	2.8	-33	-16
	1962	3,150	310	9.8	107	3.4		
Non-Mem.	1972	3,395	5	.2	196	5.8	-30	-42
	1962	1,339	3	.2	133	9.9		
<u>Missouri</u>								
Member	1972	7,025	713	10.2	195	2.8	-35	-35
	1962	4,338	678	15.6	185	4.3		
Non-Mem.	1972	5,534	81	1.5	458	8.3	-36	-35
	1962	1,926	44	2.3	244	12.6		

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(Continued) TABLE III. SELECTED MIDWESTERN STATES

"Due-To" and "Due-From" Balances Compared to Total Deposits
June 30, 1962 and June 30, 1972

	Total deposits	"Due-to" balances		"Due-from" balances		Percentage change in ratio of balances to total deposits 1962 - 1972		
		Millions of dollars	Millions of dollars	Percent of total deposits	Millions of dollars	Percent of total deposits	"Due-to"	"Due-from"
<u>Nebraska</u>								
Member	1972	\$2,616	\$179	6.8%	\$ 93	3.6%	-41	-45
	1962	1,233	144	11.7	82	6.7		
Non-Mem.	1972	1,404	5	.4	106	7.6	-39	-49
	1962	480	3	.6	71	14.7		
<u>Oklahoma</u>								
Member	1972	4,918	295	6.0	288	5.9	-37	-49
	1962	2,373	220	9.3	272	11.4		
Non-Mem.	1972	1,800	9	.5	161	9.0	-55	-50
	1962	466	5	1.1	84	18.1		
<u>Wisconsin</u>								
Member	1972	6,057	285	4.7	177	2.9	-17	-39
	1962	2,986	169	5.7	144	4.8		
Non-Mem.	1972	4,965	14	.3	302	6.1	+229	-40
	1962	1,782	2	.1	179	10.0		

TABLE IV. SELECTED SOUTHERN STATES

"Due-To" and "Due-From" Balances Compared to Total Deposits
June 30, 1962 and June 30, 1972

	Total deposits	"Due-to" balances		"Due-from" balances		Percentage change in ratio of balances to total deposits 1962 - 1972		
		Millions of dollars	Millions of dollars	Percent of total deposits	Millions of dollars	Percent of total deposits	"Due-to"	"Due-from"
<u>Alabama</u>								
Member	1972	\$4,347	139	3.2	189	4.3	-30	-35
	1962	1,719	79	4.6	116	6.7		
Non-Mem.	1972	1,761	47	2.7	118	6.7	+381	-49
	1962	494	3	.6	65	13.1		
<u>Georgia</u>								
Member	1972	5,357	338	6.3	148	2.8	-33	-40
	1962	2,139	200	9.4	99	4.6		
Non-Mem.	1972	3,394	28	.8	267	7.9	+340	-45
	1962	914	12	.2	131	14.3		
<u>Kentucky</u>								
Member	1972	3,583	283	7.9	146	4.1	-25	-35
	1962	1,489	158	10.6	94	6.3		
Non-Mem.	1972	2,623	21	.8	256	9.8	+15	-32
	1962	893	6	.7	128	14.3		
<u>Louisiana</u>								
Member	1972	4,848	287	5.9	167	3.4	-31	-41
	1962	2,173	188	8.6	127	5.8		
Non-Mem.	1972	3,036	113	3.7	272	9.0	+45	-49
	1962	883	59	6.7	154	17.5		
<u>Mississippi</u>								
Member	1972	1,958	83	4.2	116	5.9	-56	-41
	1962	657	63	9.6	66	10.0		
Non-Mem.	1972	1,871	19	1.0	160	8.6	-37	-46
	1962	761	12	1.6	120	15.8		

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(Continued) TABLE IV. SELECTED SOUTHERN STATES

"Due-To" and "Due-From" Balances Compared to Total Deposits
June 30, 1962 and June 30, 1972

	Total deposits	"Due-to" balances		"Due-from" balances		Percentage change in ratio of balances to total deposits 1962 - 1972		
		Millions of dollars	Millions of dollars	Percent of total deposits	Millions of dollars	Percent of total deposits	"Due-to"	"Due-from"
<u>North Carolina</u>								
Member	1972	\$5,800	\$304	5.2%	\$102	1.8%	-49%	-54%
	1962	1,669	173	10.4	64	3.8		
Non-Mem.	1972	3,029	33	1.1	206	6.8	-76	-33
	1962	1,216	55	4.5	123	10.1		
<u>Tennessee</u>								
Member	1972	6,433	507	7.9	248	3.9	-37	-50
	1962	2,629	330	12.6	204	7.8		
Non-Mem.	1972	2,658	5	.2	195	7.3	-62	-46
	1962	892	5	.5	121	13.6		
<u>Virginia</u>								
Member	1972	7,845	187	2.4	157	2.0	-48	-54
	1962	2,840	129	4.5	123	4.3		
Non-Mem.	1972	1,924	7	.4	103	5.4	- 3	-41
	1962	622	2	.4	56	9.0		