August 13, 1934

MEMORANDUM

TO Mr. Eccles
FROM R. L. Hoguet, Jr.

I find that no one in Washington has any conclusive figures to show the effect of a non-uniform reduction on rates paid on savings deposits in one single city. I talked to Mr. Stark, Mr. Sanford of the New York Federal Reserve Bank, Mr. Thomas of the Federal Reserve Board, Mr. Stronk of the FDIC and my father. They all have somewhat different opinions, varying from those who believe that the savings customer has no personal relationship with the bank and is therefore out to get all the interest he can, to those who believe that the bank paying the lowest rate of interest must be the safest place to have one's account.

In the City of New York, there is about $2,500,000,000 of savings money in mutual banks and it is estimated about $250,000,000 in the CID departments of the clearing house banks. The two largest mutuals, representing $950,000,00 of the $2,000,000,000, recently introduced a split-rate, that is 3 per cent up to $1,500 and 2½ per cent on accounts above that. During the month of July they lost between them about $8,000,000. However, the total loss by the mutuals of the city was $14,000,000, so that their loss could hardly be ascribed to their rate reduction. The other mutual banks in town are paying a straight 3 per cent rate. The rate paid by the commercial bank CID departments is not at all uniform, varying from 1½ per cent to 3 per cent. Those who believe that the higher rate attracts the savings deposits say that the only reason that the commercial banks have any savings money is because of their far-flung net work of branches, that is that it is more convenient for depositors to put their money in a local branch of a commercial bank than to go a fair distance to a mutual bank which have only one branch apiece. It seems to me that the deciding factor would always be peculiar to the particular town and banks involved, that is if all the banks had been established for a long time and enjoyed a good reputation, the chances are that many would not move from the banks paying the lower rate to the bank paying the higher rate.

Likewise, those people who are customers of long-standing would probably not be tempted to move their accounts. All other things being equal, it would seem, however, that anyone opening a new account would prefer to go to the bank paying the higher rate. The insurance of bank deposits had some influence, for part of the reason for which a depositor would continue to keep his account with a bank paying a lower rate of interest, was because he believed it was safer there, but now there is more temptation to move it to the so-called less conservative bank.

In Washington, I am told that bank clearing and non-clearing house banks are paying a uniform rate of 2½ per cent on all new accounts. However, this rate does not affect old deposits made prior to the introduction of the 2½ per cent rate.

The Riggs National Bank did not believe that it was fair to discriminate in favor of some of the depositors as against others, and accordingly reduced its rate on old deposits to $2\frac{1}{2}$ per cent. The other banks did not follow this move. Of course old Riggs' customers cannot in any event get more than $2\frac{1}{2}$ per cent, still they might presumeably move elsewhere in anticipation of a further drop in rates so that their accounts would then be old accounts with other banks. However, the Riggs National Bank people tell me that they have lost no accounts as a result of their move.

With regard to the FDIC's control of interest rates, I find that they state that they derive their power to prescribe such maximum interest rates from the following two excerpts:

> From Sub-Section L of the Act - "The corporation may make such rules, regulations and contracts as it may deem necessary in order to carry out the provisions of this section."

> From Sub-Section Y of the Act - "It is not the purpose of this section to discriminate in any manner against state non-member and any other national or member banks; but the purpose is to provide all banks with the same opportunity to obtain and enjoy the benefits of this section."

They argue that if the Federal Reserve were to prescribe a maximum rate for its members that the non-member banks would thus have an unfair advantage in violation of the second clause quoted above. Their maximum rate is, of course, 3 per cent, the same as is in force by the Federal Reserve System at present. They state that they have had no trouble so far enforcing that rate and ascribe this to the fact that their penalty, a fine of $100, is easily enforced. The penalty for violation of any regulation of any Federal Reserve regulation, including Regulation Q is the expulstion of the bank from the System. This is obviously too drastic to be effective. No mention is made in the contract between the bank and the FDIC with regard to interest rates. However, there is a provision under which the bank promises to live up to such rules and regulations as the FDIC may prescribe in accordance with the first of the above two excerpts.