BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date February 17, 1949

To Governor Eccles

Subject:

From Governor Evans

The attached memorandum from Mr. Millard gives the suggestions he received from the examiners who attended the conference as to ways for making the Federal Reserve System more attractive to the non-member banks. This matter will be on the docket next Wednesday.

When reading this, please keep in mind Mr. Smead's memorandum of December 20, which was sent to you sometime ago.

RME

COPY

February 16, 1949

To Governor Evans — Subject: Deterrents to Membership of State Banks in the System

From E. R. Millard

In line with our telephone conversation in pursuance of a suggestion made by Mr. Morrill regarding the agenda for our recent Examiners' Conference, the officer in charge of examinations at each Reserve Bank was given a memorandum during the conference stating that we were interested in obtaining the views of the conferees in regard to "handicaps to membership," such as--(a) reserves, (b) capital requirements, (c) failure to render services, and (d) other handicaps.

During the "executive session" on the last day of the conference, oral reports were given as to the deterrents to membership in each District.

Our analysis of the comments made by the various Reserve Bank representatives indicates that the deterrents may be summarized, briefly, as follows:

1. Reserves required. (This is probably the greatest deterrent at this time.)
2. Capital requirements.
   - (a) Banks with branches.
   - (b) Basic requirement for membership.
3. Par clearance of checks. (This is a particular problem of long standing in Districts 5, 6, 8, 9, and probably 11.)
4. Attitude of State Supervisors and/or examiners.
5. Attitude of correspondent banks.
6. Failure of Reserve Banks to render services offered by correspondents.
   - (a) Immediate credit.
   - (b) Cash letters without sort.
   - (c) Nonpar items handled.
   - (d) Investment service.
   - (e) Participation in loans.
7. Attitude of FDIC Supervising Examiners and/or examiners.
8. Object to Governmental regulation.
9. Group and chain relationships.
10. Affiliates unwilling to be examined and to render reports.
11. Restrictions on loans to executive officers.
12. Requirement that title business be discontinued.

The deterrents listed are not common to all Districts as may be noted from the attached statement showing the detailed comments of the Reserve Bank representatives.

Attachment.

cc: Mr. Morrill.

C O P Y

.DETERRENTS TO MEMBERSHIP

,Comments of Reserve Bank Representatives During Examiners' Conference, February 2-4, 1949.

BOSTON: The principal deterrent to membership in our District is one of cost which involves reserves. Costs from the standpoint of potential loss of income as a result of meeting reserve requirements. We also have the situation of capital requirements, particularly with regard to branch banks, which is a definite deterrent. As far as these other two items, I don't believe there are any real handicaps. One other thing I might mention is that old bugaboo--they don't like to get too close to Government. State Supervisors have a negative attitude, no real obstacles. Not too strong opposition from correspondent banks.

NEW YORK: That just about set it up. No. 1 is the difference in costs of membership. If you could offset the cost of membership, we would get some member banks, I am pretty certain.

The differences in reserves is another item, not so much for us as elsewhere. Connecticut requirements are the same, and New York has gone as far as it can go under the law. New Jersey did not; there is a differential there which has cooled off prospects which we thought we might have had in New Jersey. Capital requirements, regarding branches, is the one thing that is binding now. We have had one withdrawal, another in process, and rumors of some more. We get the service thing; they don't like the idea of the Reserve System paying its earnings back to the Government. They think we could spend some of that money in providing additional services to the member banks. One of the things that looms up pretty large is the furnishing of wrapped coin. We have a program of furnishing some, not as much as some other Reserve Banks. I think some of the banks would be perfectly willing to pay for it if we would wrap for them. We furnish wrapped coin, two bags of each denomination per week, to banks under $3 million deposits.

We have two or three banks in New York City active in the field of building up correspondent relations, and one bait they hold out is sending their cash letters all in one package without doing any sorting. They have gotten some accounts that way, and some have been expensive, but they feel that they can build up their totals and make money on it overall, whereas they might lose on an individual bank. Some of their field representatives work that single package transit letter pretty hard.

In New York State, the State Supervisors have been of some help to us; I don't recall that they have in Connecticut or New Jersey.

PHILADELPHIA: We have the same two obstacles which have been mentioned. The State of Pennsylvania reserve requirements are lower than ours, and their effective reserves are much lower because a bank is allowed to carry part of its reserves in eligible Pennsylvania securities and in addition they are allowed to treat float as reserves.

On the second point, we have had one case of a good-sized bank which has not come into membership because they think that they may take over a branch bank in the near future.

The third deterrent, second in importance, is the policy of the Board in refusing to take in banks doing title business. I would like to make a little plea on that. We agree with the philosophy that title insurance is not a proper part of a bank of deposit, but in Pennsylvania, an act of 1875 authorized the title business, a lot of banks had the power, and a lot of them exercised it. In view of the desirability of taking into membership sound banks, we might give thought to a policy whereby we would admit banks doing title insurance business if they are otherwise sound and acceptable provided they were doing this business before 1933 or 1934 but not afterward.

There is a friendly attitude on the part of the State Supervisors in Delaware, but no active endeavor to help; New Jersey is friendly, but no endeavor to encourage membership; in Pennsylvania the attitude was neutral until a year or two ago, but now I think their attitude could be characterized as a little unfriendly, but no active effort to discourage it.

We have a pretty strong feeling that at least two or three of the larger correspondent banks aren't helpful at all, and I have a strong feeling that after the recent increase in reserves the correspondent representatives in two or three cases might have given advice not too favorable to us.

CLEVELAND: Reserves are the prime deterrent to members. Kentucky reserves are much lower, and they don't pay much attention to them. In other States they count cash as part of the reserve, so it is quite a factor and we are told about it. As far as capital requirements go, it is a deterrent only in connection with the establishment of branches. We have a couple of banks with branches that would no doubt come in if they could with their present capital. Our failure to render service--quite an angle has been made in the past that the Fed only gives deferred credit on checks sent in; and the single package shipment. There is an apparent lack of realization that they have to carry a larger balance with correspondents. Another thing is that correspondent banks will look over their investment accounts and advise them as to specific issues. As far as correspondent relationships go, many of them have existed for many years and they hesitate to break them. We have one correspondent bank that is definitely antagonistic and makes no "bones" about it. A couple of others that are more or less neutral. As far as supervisory agencies go, they are friendly but neutral. In Pennsylvania, there is this rather intensifying of State's rights attitude to the extent where they are not fostering membership in the System, although some Pennsylvania examiners have advised them to join the Fed to get away from arguments with the FDIC. State examiners in Ohio seem to resent Fed participation in examinations because they push them to do a decent job.

RICHMOND: The number one deterrent in the southern half of our district is the nonpar question of exchange, complicated by the presence of two relatively large nonmember banks who are absorbing in the neighborhood of $300,000 to $400,000 a year in exchange, actively soliciting accounts on that basis. In the northern part and throughout the district, it is the same as the others - reserves and capital accounts. There is a hostility fostered by regulations; they don't like to get too close to Government.

As far as our supervisory contacts are concerned, there is active hostility to membership in Maryland and North Carolina. There is a more or less passive attitude in Virginia and West Virginia and a favorable attitude in South Carolina. We have one correspondent member bank and two nonmembers in our district that are hostile. A representative of Chase National Bank discouraged a prospective member in the Baltimore zone and said that the Federal Reserve should not be allowed to solicit membership. The Vice President of Peoples-First National Bank and Trust Company, Pittsburgh, is antagonistic.

Package shipping is complicated again in our District by the par question. The fact that we can't handle nonpar checks necessitates a special arrangement for clearing them, which necessitates a correspondent relationship. There is some FDIC hostility to membership, the Supervisory Examiner actually requested a bank not to join. Because of a holding company affiliate relationship, we lost a member.

ATLANTA: The matter of reserves up to now has not been of particular importance. If reserves were increased further, it would be a deterrent. Capital requirements are keeping two or three banks with branches from coming in.

As to supervisory relations, I think we could sum it up with the brief statement that their attitude in our District is not hostile; perhaps negative. I believe that the Supervisor in Georgia is quite friendly. The No. 1 deterrent is exchange throughout the District. As for correspondent banks, I could name four that are openly antagonistic, and two others that are, to say the least, cool. We had FDIC hostility in the past, but we do not have it now. (We offer no clear-cut advantage that would overcome the disadvantages.)

CHICAGO: No. 1 deterrent is reserve requirements. State reserves are so much smaller. Second is capital requirements in connection with branches. We lost a few members in Michigan and Wisconsin who had been members for a long period of time on account of wanting to establish branches. They have indicated to us that they would like to be back in the System if they could get that requirement changed.

As far as correspondent banks are concerned, at the top level we are told that they do not discourage membership, but I think the bank relation people do not encourage it very much. Our State Supervisors are friendly, but they can't take sides or prefer not to. The FDIC is an old story in one part of the District.

ST. LOUIS: I go along with Chicago. Aside from reserves, the attitude and activity of correspondent banks, certain FDIC examiners and certain of their supervisors, certain State examiners, and the capital and nonpar situations. I could add the question of affiliates (they are unwilling to let us examine affiliates or furnish the reports required for affiliates) and Regulation O.

Representatives of our correspondent banks are very active in discouraging membership in our country banks and will go to almost any end to do that. For instance, making investment surveys and making recommendations as to the income which could be derived from investing "free reserves."

MINNEAPOLIS: Exchange, capital requirements and correspondents in that order. Correspondent banks leave no stone unturned to discourage membership, but I am satisfied that at the top level that is not the attitude. If banks knew that they had to be re-cleared by the FDIC if they withdrew from membership in the System, it might cause them to be hesitant to come in in the first place.

KANSAS CITY: About like the others reported. Reserve requirements is first, but capital requirement on basis of population is a factor. Our city bank correspondent representatives work hard to discourage membership.

DALLAS: No additional deterrents, aside from the loss of an outlet for "over" loans, which they feel is more assured by virtue of a higher balance with a correspondent bank. Then we have the problem of group and chain relationships. The larger key banks want large cash balances, and won't let their subsidiaries join. The attitude of the Texas Commissioner is quite favorable toward membership.

SAN FRANCISCO: Deterrents are reserve requirements and capital requirements. We have lost only one bank because of a desire to establish a branch, but I think capital requirements are important. We do not know of any hostility from correspondent banks. As far as State departments are concerned, we think we get a little better than an even break. So far as the FDIC is concerned, I think there is no active opposition there.