

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date June 15, 1950

To Mr. Eccles

Subject: _____

From Mr. Carpenter

At the joint meeting of the Presidents and the Board this morning, President Gidney handed me copies of the report of the Committee on Correspondent Bank Relations made by Mr. Gelbach, Chairman of the Committee, at the last meeting of the Reserve City Bankers' Association. Mr. Gidney suggested that the report be read by each of the members of the Board.

A copy of the report is attached.

Attachment



THE THIRTY-NINTH ANNUAL MEETING

REPORT OF COMMITTEE ON CORRESPONDENT BANK RELATIONS

By Loring L. Gelbach, Chairman

At the meeting of the Directors of the Association held in San Francisco last October, the Committee on Correspondent Bank Relations was instructed to report to this Convention on the competitive activities of the Federal Reserve Banks as related to correspondent bank relations.

A survey of the competitive activities of the Federal Reserve Banks reveals an increasingly aggressive attitude throughout the past year on the part of some of the Federal Reserve District Banks. The activities range from direct solicitation of non-member banks to join the system, to the rumored solicitation of member banks for a larger share of their excess reserve balances.

To establish a closer banking relationship with both member and non-member banks, the Federal Reserve Banks have instituted many additional banking services at little or no cost to the private banks. Included among the services offered private banks are the following:

1. Activity solicitation. Federal has aggressively solicited activity particularly among the country banks. It has been made clear to the member banks that by using Federal's facilities they can cut down on the compensating balances which they would otherwise have to carry with city correspondents. Federal justifies this solicitation on the ground that they have a responsibility to serve member banks in every way.

Federal Reserve Banks are in a much better position than private banks in soliciting this activity as they are to a certain extent the supervisory authority of the private banks through regulations and periodic examinations.

It is submitted that the active account of a correspondent bank is more profitable than a complimentary account;--this, almost without exception. Proof lies in analysis of correspondent bank accounts.

2. The absorption of forwarding costs on items shipped to other Federal Reserve Cities. This is a subject with which all are familiar and has resulted in loss of check clearance activity, and in numerous cases has resulted in major declines in balances carried by correspondent banks.

3. The almost system-wide elimination of sorting requirements on letters up to, say 250 items and the application of one-day availability on the total amount.

4. Currency shipments. Members of the Association are thoroughly familiar with this service offered to banks on a discriminatory basis. This service is not offered by the Federal Reserve Banks to banks located in the same city. And, of course, it is worthy of comment that city correspondents, when shipping currency to out-of-town banks, are not permitted to absorb forwarding costs because of Regulation Q.

5. Custody of securities. This safekeeping service is rendered on a discriminatory basis.

6. Government bond transactions. Federal Reserve Banks provide facilities for the purchase and sale of governments as agent for member banks. They apparently do not take these transactions into their own portfolio but pass the transactions along to government security dealers.

7. Non-member clearings. Federal Reserve solicits the clearings of non-member banks and after the services have been accepted by the non-member banks, suggests and obtains balances from the non-member as an offset against Federal clearing costs.

8. Federal Reserve Banks - at least a few of them - are giving assistance to member banks on operating problems - particularly proof and book-keeping. Information has been received that a Federal Reserve Bank is now considering the employment of management consultants to render such service and are planning to recruit the support of state bankers associations for such a program. Obviously, this would be a direct parallel to the survey service which Reserve City Banks have offered for a number of years, and which is provided by many banks in varying degrees.

9. Certain of the Federal Reserve Banks have embarked on a program of group meetings for country bankers which are held in the district banks, its branches or in the field. Certain of the banks have recruited a staff of economists, engineers, and agronomists, making their services available to member and non-member banks alike. Recently in the Cleveland District, group meetings of country bankers have been held by the Federal Reserve Bank on dates and in places that were competitive with similar meetings scheduled by the State Bankers Association, as well as a Reserve City Bank.

No doubt other services have been offered to the country banks in competition for correspondent bank balances and it is apparent that the Federal Reserve Banks are borrowing every idea developed by the city correspondents and thereby weakening the correspondent banking relationships. If the Federal Reserve System carries through to its ultimate goal of granting immediate availability for all items in transit, an important function of the Reserve City Banks will have been supplanted. But more about this later.

It is apparent from our information that while this competitive activity is more pronounced in certain Federal Reserve Districts than in others, the problem is national in scope. These competitive activities are introduced gradually over a period of time and are not announced as an overall policy of the System. It is also apparent that many Reserve City Bankers are not aware of the nature and seriousness of the threat and this is indicative of the magnitude of the problem.

It is evident that the monetary authorities regard the use of increased reserve requirements as an important tool in the effective management of our economy. The Federal Reserve considers it imperative that all banks be brought under its controls. Since legislative action to compel all federally insured banks to conform to reserve requirements has failed, a concerted effort is now

being made to get controls by inducement. All banks throughout the country should be made aware of this situation. They could then collaborate on a common policy.

Now we come to the subject of immediate availability. We have had telephone calls and letters asking why this subject becomes important at this time. It is not a new subject and reference is made to this Committee's report in 1948 at Coronado. In that report Dick Aishton said: "With a change in economic conditions it is altogether probably that consideration will be given to elimination of float. We should be aware therefore of the ramifications of this problem." On January 30, Gil Perkins and your Chairman were informed in the office of the Federal Reserve Board of Governors that the question of immediate availability was under consideration. As a consequence a report was made to this Committee at a meeting in New York February 6, following which a report was made to the Board of Directors of the Association. It was then suggested that a form of questionnaire be prepared. After considerable difficulty in developing a questionnaire, a form was decided upon and forwarded to approximately 215 banks represented in this Association. Additional questions were propounded, but after study it was decided to confine the questionnaire to the form used. The response to this questionnaire was gratifying and your Chairman has received replies from something better than 50% of the banks.

In a great number of instances the returned questionnaire was accompanied by comments or letters expressing a broad range of ideas on this subject of immediate availability. The majority of the comments were opposed to immediate availability, and in some few instances the bankers indicated that they were in favor of the Federal granting immediate availability and taking on the work of handling all cash items.

Following the mailing of the questionnaire to the banks and in discussions with the President of a Federal Reserve Bank, it was learned that the System proposed a shortening of all availability schedules to a maximum of two days, effective about May 1st. Subsequently we were informed that at the meeting of the presidents of the 12 Federal Reserve Banks the two-day maximum availability proposal was presented to the presidents and after discussion the two-day maximum schedule was approved and adopted by the Board to become effective as soon as new schedules are prepared and mechanical adjustments accomplished.

Discussions with Federal Reserve Bank authorities indicate that the majority of the presidents of the System at the present time are opposed to the immediate availability plan. The same conversations, however, indicate there is but one short step from two-day maximum availability schedules to one-day availability and the Board apparently is for further shortening of schedules.

It is a fact that the matter of reducing deferment and expediting collection of checks has been submitted to the presidents of the 12 banks for study and report to the Board of Governors. It is stated that these reports when received will be passed along to the technical staff for study with their conclusions and recommendations to be presented to the Board and the Federal Advisory Council. We are informed that there is a standing committee of officers of the System on this subject, which includes immediate availability, with a special committee of research men in Washington doing the work. It appears that

their present ideas are unformulated, but the study and the work do go forward.

Now, as to the figures on the questionnaires that have been returned to the Committee: - The figures have all been tabulated and an attempt made to analyze them. It became apparent after studying the first 30 or 40 returns that there was great variance in the thinking on the question and that it would be extremely difficult and hazardous to develop any conclusions from the figures themselves. This was borne out by additional returns. If we attempt to interpret the thinking that was indicated in the replies we must conclude that the smaller banks would experience results entirely different from the results expected by the larger institutions. It developed then that the problem is too complex to be solved by this approach alone because the questionnaire is restricted to the effect on earnings. A number of banks have pointed out that what appears on first analysis to be a profit may, when broader and more detailed study is made of their computations, prove to have been elusory and will be found to have been false when all the other phases of the problem have also been thoroughly analyzed and studied. Therefore, we believe it would not be advisable to circulate to the members or to those responding to the questionnaire a compilation of these figures and I have recommended to the Committee and to the Board of Directors that these figures should not be reported even though the letter accompanying the questionnaires promised such a report.

The questionnaire has, however, provoked widespread interest in the subject and has developed much thinking and study among the banks. We believe it has focused serious attention on the subject of availability; has developed questions that had not heretofore occurred to your Committee, and this Committee hopes that as the result of these questionnaires the Association will see fit to immediately undertake a program of study of this question by men having full time and the ability to cover the subject thoroughly.

We would like to quote from some of the comments received by our Committee.

One - "Oddly enough, there are some commercial banks which advocated that their local Federal Reserve Banks accept cash letters, eliminating sorting requirements. Presumably they had in mind passing on some of their clerical work to the Federal and eliminating some expense on their own account. I feel that the Reserve City members should realize that if they make such requests of the Fed, they will be working against their own interests in the event they do a correspondent banking business."

Another - "This subject arouses in my mind many thoughts, one of the most serious in connection with all banks having correspondent relationships and again, all banks in this country in connection with one more step towards government control.

Another - "They tell me that immediate availability of cash letters deposited with the Federal Reserve Bank has a tendency to put non-member banks into the Federal Reserve System and with the Federal Reserve and the RFC in the small lending business and the country banker growing more conscious that he can use Government agencies to handle excess credit lines, our present correspondent bank relationship could evolve merely into a social relationship."

Another - "It is our opinion that if the Federal Reserve System does

establish this plan, it will immediately set in motion certain forces that could affect many phases of Reserve City Bank operations. The ramifications of these effects could be far-reaching, and, furthermore, these effects are difficult to measure, as they touch at the very foundation stones of the present system of banking."

Another - "Your form letter of March 3rd has challenged us to formalize our thinking regarding the possibility of immediate availability on all cash items deposited and its possible effect on this bank."

Again - "Most of our correspondents have been sending their cash letters to the Federal for some time so that the immediate effect is not hard to judge. The implications beyond that are, of course, many, but as long as some degree of individuality remains in the human race there will be room for the storekeeper who serves best, even though he does not provide a bargain sale every other day."

Another - "It must be borne in mind that these figures of ours may in some way be distorted from others of similar size in that, while our bank is a reserve city bank there is no Federal Reserve Bank or branch located here and the volume of items drawn on our bank is large and important enough for a great many institutions throughout the country to maintain relationships with us so that they will obtain one day's quicker availability on their items by sending them direct to us. It would appear to us, therefore, that should the FED grant immediate availability on all cash items we would be faced with a loss of a substantial portion of our correspondent bank balances."

There is a thought for those Reserve Cities that do not have a Federal Reserve Bank or branch. However, as many of you know, there has been suggested that the classifications "Central City," "Reserve City", and "Country" be eliminated and all member banks placed on the same reserve requirements.

Another letter - "There would be very little savings in the cost of operations; however, that does not complete the picture, for the next move the Board will make will be the absorption of postage on all cash letters of the member banks sending their items direct to the Federal. When that is done, the city banks will lose 90% of the correspondent bank accounts, for everything will go direct to the Federal Reserve Bank with the exception of non-cash and off par par items. It is just another step toward the elimination of our present banking system."

Another - "One thing that has not been mentioned, which in my opinion is very important, is that should they adopt this immediate availability scheme the result would be that the reserve of many banks would consist largely of float. Should we ever have a financial panic or return to a very tight or nervous condition, such as we have had in the past, I believe the Federal Reserve Banks would have to immediately go back to a collected balance basis."

Another banker writes as follows: "In the business area any unrealistic treatment of actual facts sets in motion a series of forces which ultimately adversely affect everyone. It seems to me that Federal's deferred schedule should reflect the actual facts of check collection. We should not rely on the Reserve System for a temporary convenience which is proposed unrealistic procedure may provide. High support prices for commodities in the face of continued expanding surpluses, immediate availability for checks and a half million unnecessary employees on Government payrolls are all part of the seduction of citizenship by which free enterprise has been attacked. Several years ago the Reserve City Bankers Association was much exercised over the socialism of banking from other areas. The adoption of --- and I am still quoting --- immediate availability by mandate of the Reserve System merely because it is a quasi Government agency and regardless of the fact that there is no immediate availability of a check except in the bank on which it is drawn, walks the Federal Reserve System with a firm tentacle into the operating department of every member of the System in the United States. This backdoor approach I regard as not in the public interest and a most unfortunate procedure since it is not based on the facts of collecting experience. All of the above is exclusive of any consideration of the propositions as to whether the banks of the country ought to let the Federal Reserve do anything more in any way for them when developments seems to show that the System has lost its autonomy and is today rather more than less a branch of the Treasury."

Here is a banker who suggests, - and I now quote: "I am positive that we would eliminate all but three of our present correspondent accounts. These three accounts would be reduced to a minimum balance which would allow us to clear our transfers in New York, Chicago and on the west Coast. It is also our belief that the correspondent accounts which we have in two states and who are members of the Federal Reserve System would do likewise."

One banker has injected the question of service charges and writes as follows: "Although not mentioned in the questionnaire, another consideration would be the loss of service charge income resulting from the elimination of float and producing a higher income credit allowance on accounts against which charges are now being made."

A banker in the Southwest writes that it seems to him "the treasurers of most of the large corporations are rather astute gentlemen and if they become aware of the fact banks do not have to take into consideration float with the Federal Reserve Banks, they might keep their funds more closely invested and not maintain the substantial balances they have in the past."

And there are a number of other letters. Here is a banker who says "there is sharp distinction between commercial banks giving immediate credit where the only problem is to discourage the use of uncollected funds by a customer, and reserve banks giving immediate credit for collections. In the latter case, the credits are used as reserves. It has been a long accepted principle of banking that reserves of banks should be in collected funds. The proposed action of the Reserve System does violence to this principle."

Another banker feels that in five or six large accounts, and he mentioned national names, would immediately reduce balances with his bank to take advantage of the immediate credit which is now carried in the form of float. And there are many other letters raising other questions.

Then, I turn to the relatively few letters from bankers who have no particular objection to immediate availability and in fact would welcome it. One banker writes: "We would do just what the Federal does, and if past experience is any criterion, do it better." He does not think there would be any material differences in the bank balances maintained with Reserve City Banks because of the value of these special services given to the country banks, services the Federal Reserve Banks cannot offer. He expressed the opinion, and I quote "that it would be ill-advised for us as bankers to oppose the proposed change in policy, which we must admit is desirable from the standpoint of improving the clearing facilities, solely on the basis that we might lose a portion of our correspondent bank balances. Rather, it behooves us to strengthen our position with the country banks through special services, including two-way participation in over-limit loans, thus welding more closely the ties that bind our correspondents to us." And he goes on to say - and I still quote: "If I seem rather complacent about the effect of this change on Reserve City Banks, it is because I can remember so many times before when we bankers have become upset over similar matters only to find by experience that we have been harmed not one whit by the specter that has been raised before us. In fact, we have found that the very regulation we have looked upon with trepidation has resolved itself into a beneficent thing not only for us but for the banking system as a whole. 'The old order changeth', and with the ability we have demonstrated in the past to adapt ourselves to change, we should have no trouble getting over the hurdle once more."

So gentlemen, you see that the Committee is perplexed by the comments and questions and suggestions of many members of the Association and we have come to the conclusions that your Committee does not have the tools at its command to answer these questions:

1. Is the granting of immediate availability sound?
 - (a) Is a reserve based on uncollected items sound?
 - (b) Will immediate availability bring increased reserve requirements?
2. What will be the effect of immediate availability on the banking system as a whole?
3. What effect will it have on our overall economy? Is it inflationary or is it deflationary?
4. What effect will immediate availability have on the balances of corporations.
5. What effect will immediate availability have on correspondent bank relationships?

This Committee is opposed to shortening of deferment schedules beyond actual collection time and recommends that the Association and your Committee for the ensuing year immediately embark on a program of study and analysis of this complex and important subject.