Address at a Meeting of the American Bankers Association at Seattle, Washington, Sept. 8. 1915 by F. A. Delano, Vice-Governor of the Federal Reserve Board.

Much has already been said, and well said, about the Federal Reserve Act, and it is doubtful if I can add anything new. I wish, however, to call attention to some important features which have been accepted as mere commonplaces, but which are really deserving of more notice than they have received.

First, it should be borne in mind that it was necessary to frame the new law so as to provide for a complete change in our note issuing and credit basis, yet at the same time, so accomplish this as to cause no disturbance in business by the upsetting of our existing banking system. It was like the problem of reconstructing a great office building, changing an antiquated construction and substituting therefor steel and marble, yet accomplishing it all without serious inconvenience to the tenants.

The task was necessarily a difficult one and the law probided three years for its accomplishment.

Under the old law, banks were all independent of each other, reporting direct to the Comptroller of the Currency at Washington, but each bank for itself. The ownership of branches was forbidden, and thus it was that when the law went into effect there were seventy-six hundred separate and distinct National banks varying in capital from twenty-five thousand to twenty-five million, and in addition, approximately eighteen thousand state banks, trust companies and savings banks. These banks were not organized or grouped in any way except that those in three large cities (New York, Chicago and St.Louis) were classed as Central Reserve Banks and were allowed to hold a large share of the reserve deposits of National banks in other cities, while another group was formed of banks in some fifty cities known as Reserve Cities, which were allowed to hold a considerable share of country bank deposits and in turn deposit one-half their reserves in Central Reserve Banks. A third group represented all the banks in other and smaller cities, towns and villages, which were classed as non-reserve city or country banks. These were allowed to hold a minimum of reserves (15%) and deposit three-fifths of it in Reserve and Central Reserve Cities.

This loosely formed grouping of the banks did not bring about any real unity of action or an effective organization and even though some coordination of effort was accomplished by Bankers Associations, Clearing House Associations and similar voluntary organizations of banks and bankers, the fundamental idea underlying the American Banking System was "Everyone for himself and the devil take the hindmost." The framers of the new law were face to face with the problem of devising a way to retain the advantages of competition between banks yet so to group and assemble the banks as to make it possible to use reserve resources jointly and effectively for the benefit of all and for the protection of the public. This was accomplished by creating twelve different central joint stock banks, each of them the dominating or central bank of a large area. These banks as established represent from 385 to 982 member banks with a nominal capital ranging from $4,808,000 to 21,624,000 - only one-half of which has been paid in. These central banks were not created to transact business with the public but primarily as their name implies, for the purpose of holding the reserve deposits of their owning banks. Among the important services which they may render to their member banks, the most important is the right to rediscount their paper and issue bank notes against it. Manifestly then, the first great result of creating twelve banks has been to bind together all the National banks of the country into twelve strong regiments thereby creating an effective solidarity. Who can doubt the immense gain in doing that, even if nothing else had been accomplished by the Act? It is as if a man were asked to organise an effective police force in this splendid city, and found 7600 policemen all reporting to one chief. The first thing he would do would be to divide the force into divisions with suitable headquarters and a competent officer in charge of each. Indeed, without developing the simile further it should be apparent without elaborate argument that the creation of twelve central reserve banks was, from the standpoint of efficiency of operation alone, the greatest step in advance which has been made in the banking history of this country.

Reference has been made to the fact that under the old system in effect for fifty years, there had been developed a system of depositing reserves of smaller banks with other and larger banks. This had led not only to serious duplication of reserves which rapidly evaporated in times of stress, but in addition to this, the results of active competition for deposits led to many vicious practices, such as paying high rates of interest or granting special facilities or favors. Banks kept reciprocal balances with each other and by a system which might be likened to the time honored plan of "you tickle me, I tickle you", they got ahead, at least on paper. However, these methods were not conducive either to safe banking or to low and stable interest rates for the public. Hence, it was that one of the objections of this new law was to make banking less hazardous, make profits surer, but to accomplish it in such a way that the investor, the manufacturer, the merchant, each and all, could count on banking facilities in good times and bad and also a fair stability of interest rates. Banking which has to recoup big losses with big gains may be expected in a new and raw community, but should not exist in a well established, orderly community such as ours. I am not a banker by training, but I believe that the principles which apply to banking are similar to those which apply to business generally and require that losses must be compensated by gains. It has been repeatedly pointed out that the only way a merchant or manufacturer can permanently reduce his premium payments is by reducing actual losses. So it is that a Federal Reserve Bank can only be an effective instrument for improving the condition of the District of its domicile, by protecting its member banks against loss, by relieving necessity and by intelligently forseeing and forcasting events.

Of course during the first three years when reserve deposits are being gradually shifted from the reserve and central reserve city banks, we shall hear grumbling - but the far-seeing banker already appreciates that the immense advantages of the new system will more than compensate him for the loss of reserve deposits. But I may assume that there are some skeptics in this audience, some gentlemen from Missouri, perhaps, who want to be shown. To them I must say first, you must admit that the old scheme of reserves was, to say the least, very faulty. When you needed it most you did not have it and in fact as it was counted mostly twice, there really wasn't enough to go around when as in the fall of 1907 everyone called for it at once.

The new plan seeks to put the reserves where you can count on them. In a bank of which you and the other con-

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tributing banks of the district are the sold stockholders, your stock is assured a 6% return and all earnings above that go to the government, after the central bank's own reserves have been strengthened. The reserves in the (Central) Reserve Bank of the District are used expansively as the basis of note issue, so that instead of these reserves being unavailable in time of need, they are at once available to the fullest extent. The operation, simple enough to most of you, consists in allowing member banks to bring around their commercial paper, and provided it complies with the not onerous provisions of the law and rules of the Federal Reserve Board, you are given a credit on the books of the bank or, at your option, the Federal Reserve notes for the full amount. When issuing notes to you, the Federal Reserve Bank deposits against such note issue, and as additional security above the commercial paper bearing your endorsement, 40% in gold. In other words, the reserve deposits which your bank and others have contributed become potentially capable of sustaining a paper circulation 2½ times its face vaule - or stated in another way, if allowance is made for 35% reserve against all deposits and 40% reserve against note issue, each one hundred dollars of reserve money is capable of expansion when you bring in your commercial paper to $162.50. Here then is a service which no Central Reserve or Reserve City Bank in the past was ever able to perform. Here is a real insurance and something which fully compensates you for loss of interest on a portion of your reserve deposits.

Under the old system every National bank was required to hold United States Government bonds and these in turn were the basis for Bank Note circulation. The fundamental idea underlying that system was to make a market for United States bonds. The law served its purpose admirably and the banks who were among the first to enter the system made great profits from the appreciation of value of their bonds and made money with their bank note circulation as well, but it has long been recognized as a very rigid, inelastic system, which led to a shortage of note circulation in busy times and a super-abundance or redundance in dull times.

The new law lets the National bank note currency pretty much alone, provides for the gradual retirement of United States bonds through a period of 20 years and supplements it with an elastic currency known as Federal reserve notes, based, not on United States bonds, but on short time commercial paper, as heretofore described. This feature of the law is something that American banks of this generation have had no experience with and it is perhaps not easy form them to adjust themselves to it. Many of them have been taught to believe that loans should be made preferably against securities as collateral, such for example as well known stocks and bonds. To them the new plan seems revolutionary or at least difficult to comprehend. In point of fact it is the basis upon which banks of issue in our own country, before the Civil War, and practically all European countries have operated. The theory upon which the issue of notes on short time paper is justified and preferred to the idea of issuing notes against good bonds, is, that if Bank note currency is to be really flexible, it must expand or contract in volume exactly as the business of the country expands and contracts. Furthermore, it must be based on articles of daily use and necessity, articles which like food and clothing are being consumed and, therefore, bought and paid for every day. This, experience here and abroad has taught, is a better basis for currency than Government bonds or any other slow or long time investment security.

In what I have said, I have tried to explain briefly some neglected features of strength in the new banking law. To me they are important. Experience has taught me that the greatest necessity in modern industrial life is intelligent organization. Without it we can not secure cooperation or efficiency. It was a misnomer to call the old banking system, a system. If it was a system, it was so against the spirit of the law which created it, and came about by purely adventitious methods. Now we have what can really be called a system, - 7,600 or more banks grouped into 12 Districts, each District headed by a central bank which, being the mutual, jointly owned bank of all the member banks of the District, should serve the necessary purpose of creating an organization in a hitherto unorganized aggregation of units.

These Reserve Banks belong to the banks so largely represented here. They are created and managed by your Directors. The Federal Reserve Board, a quasi-governmental body, has no desire to interfere with their management. It is obviously our aim to have the spirit of the law complied with, and our duty to have the letter of the law obeyed, but we have no thought that it will ever be necessary to adopt harsh or arbitrary methods to accomplish that purpose. We are glad to exchange views with you, glad of your suggestions and criticisms. While only two of our number are bankers of experience and training, all are equally desirous of making the system a success, and we know full well that success can not be had unless the member banks as well as the business men of the country fare well under its operation. We hear much of the danger of competition of the Federal Reserve Banks with member banks. It isn't strange perhaps that in a time when business is poor and a plethora of money exists that there should be those who resent the fact that Reserve Banks are permitted to enter the open market,- but those who really study the question, will soon realize that these open market operations at most are negligible when compared to the aggregate of such operations by state and national banks. The rediscounting of commercial paper of member banks by the Reserve banks is the chief function of these banks and while it creates some competition in dull times with large banks who have heretofore rendered this service for their correspondents it too is negligible in volume and in busy times would be welcomed. The fact that the new law lowered reserve requirements, of course released reserve money which competed with previously existing funds and tended to lower interest rates, but that will soon adjust itself when business improves.

Per contra and over against all the arguments which the skeptic and the grumbler may assert, I ask you to consider the benefits of organization and coordination of effort, resulting from the grouping of banks into districts, each under a strong mutually owned bank.

If you gentlemen who are complaining of the ruinous effect of competition brought about by the Reserve System, will apply yourselves loyally to the task you can make this Federal Reserve System, chartered as it is under Federal law, the bulwark against the fiercest kind of competition, unfair competition, competition which makes for payment of high rates of interest for bank or individual deposits, or else retains or encourages other equally absurd practices.

You know these things better than I, and I believe you can find a way to abolish many of these absurd schemes and by means of your Reserve Bank, create a real system. - a system in fact as well as in name, which will make for better banking, safer banking, more stable profits for the owner, and more uniform interest rates and certain accommodation for the merchant, manufacturer, or producer who are your clients.

I am willing to give up some valuable years in my life to bring this about and I hope I may appeal to the enlightened self interest of this Association to cooperate.