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MUTUAL SAVINGS BANKS AND THE FEDERAL RESERVE SYSTEM

The nature of our work is such that, in order to operate as effectively as possible, we are obliged to limit our public remarks so as not to hamper our activity in the direction of the public good.

The mutual savings banks are to my mind remarkable institutions, and I feel especially honored by this opportunity to address a conference of their representatives.

At the risk of boring you I am compelled, for the sake of proper sequence and relation, to state many facts about mutual savings banks with which you naturally are familiar.

As you know, the mutual savings banks are remarkable for their age. At the present time I understand that 55, or one-tenth of their total number, are a century old or more. Over 40% of them were established before the Civil War. I cannot think of any other class of business or financial institution in the country which has a more admirable record of longevity. There are a few commercial banks which are older than the mutual savings banks, but the total number that have behind them 100 years or more of continuous existence is extremely small. The same thing is true of insurance companies, factories, retail and wholesale establishments. Even among those which have some claim to 100 years of existence there have been in the majority of cases reorganizations and changes of corporate entity that have interrupted the continuity of their life. A very large proportion of the mutual savings banks, however, have undergone no essential change whatever in their identity. They are still, after a century or more of operation, the same legal entities that they were before the period of modern industrial and business development. A very large proportion of them had their beginnings in the days when railway transportation was little known or wholly unknown, when electricity had not yet been brought under control and made useful to man for purposes of lighting, communication and power, when large scale factory production of commodities was as yet undeveloped, when cities were small and the overwhelming majority of the inhabitants of the United States lived on farms, and when the country was as yet unvexed by the industrial and social problems that beset us today. It is a striking and unusual thing that so many of the mutual savings banks should have survived without essential alteration the social and industrial changes which have wrought profound transformation in so many of the older forms of business organization.

Even though the mutual savings banks are nearly all here in the northeastern part of the United States and draw their deposits to such an extent from this one region, they provide an important part of the long term credit for the country as a whole. They are among our largest institutional investors, especially as holders of real estate mortgages, and railway, utility, municipal and government bonds.

It is a curious fact that mutual savings banks should be at the same time so important an element in the financial structure of the country's business and so little known and understood outside a relatively small portion of the United States.

The importance of the mutual savings bank in our financial structure is most easily illustrated by the fact that the 560 mutual savings banks hold practically half of the total savings deposits there are in all banks in the United States. Altogether savings deposits in this country amount to twenty-two billion dollars. Of this amount, ten billions, or practically half, is in the 560 mutual savings banks, six and a half billions is in the national banks, some 5,000 in number, and five and a half billions is in State commercial banks, some 9,500 in number. In other words, about half of the country's savings deposits is in the 560 mutuals, and the other half is in some 15,000 commercial banks, national and State.

Yet in spite of their importance, the mutual savings banks, as I have already indicated, are largely confined to this corner of the United States comprising New England, New York, Pennsylvania and New Jersey. In these few States are 94% of all mutual savings banks, 94% of the deposits of all mutual savings banks, and 93% of all mutual savings bank depositors.

Another thing is the fact that these institutions, unlike most of the financial and business organizations with which we are familiar in our economic life are not typical privately owned corporations operated for profit. They are, as their name reflects, mutual or cooperative enterprises without stockholders. Their depositors are their owners. Though, outside the Federal Reserve System, the mutuals have shown a great interest in its operations.

The Federal Reserve System, only 24 years old, was called into being by those developments which make our own period so profoundly different from that period in which the older mutual savings institutions were organized. One hundred years ago individual banks were still more or less isolated in their own communities. Transportation and communication had not yet drawn communities and regions so close to one another as they now are. Banking institutions and the communities in which they operated were more nearly self-sufficient then than now.

With the characteristic changes I have referred to, however, interdependence became more and more the prevailing condition under which banks had to operate. With the increased volume of demand deposits and with the increased use of bank checks as a medium of payment, commercial banks were necessarily drawn closer and closer together. This was not true of banks alone. On the contrary, as the population increased, and as larger areas of the country came under development, interdependence in general between individuals, institutions and communities became more and more pronounced. The isolation and self-sufficiency of the earlier days when the population was small and diffused and scattered and when economic activity was more largely a matter of each man providing for his own wants was no longer possible.

I need not remind you also that during the long span of years which is covered by the existence of the mutual savings banks, collective and large scale economic enterprises became more and more common. During the course of those years railway companies gradually were amalgamated into widespread systems. Small factories employing hundreds expanded into large ones employing thousands and at the same time became amalgamated with other factories into enormous productive enterprises with units in various parts of the country. Communication systems felt the same impulse to amalgamate into unified networks.

In the field of banking the needs of growing interdependence were met by development of the correspondent relationship between banks in the country and banks in the larger centers. The correspondent system brought the scattered independent banks of the country into close relation with the money markets and enabled them to utilize those markets at times for the investment of their surplus funds and at times as sources of additional funds.

The correspondent relationship however could not wholly meet the changing requirements of our financial and economic order. Being wholly voluntary and embracing institutions which were operated for profit, it had to be governed by the particular interests of bank stockholders. Most of the time, to be sure, the interest of the individual institution coincided with the public interest or at least did not conflict with it. There were times, however, when conflict did arise - when individual institutions in order to protect their own solvency were forced to take action which considered collectively was contrary to the public interest and contrary even to the interest of the individual banks involved.

This condition was recognized when the Federal Reserve System was established. The Federal Reserve banks were set up under the authority of Congress as public instrumentalities. Since they are not operated for profit, the Federal Reserve banks never experience that conflict which in the case of privately managed institutions may arise between the public interest and the immediate interest of the stockholders.

The establishment of the Federal Reserve banks supplied a closer bond which was needed between the separate commercial banking institutions of the country. It made them better able to cope with the conditions of our modern industrial life - conditions profoundly different from those that prevailed when banking first began in this country. Let me describe what I consider the more important specific powers which the Federal Reserve banks were given in order that they might fulfill their purpose.

First is their lending power. A limitation that the banking system had been under before the organization of the Federal Reserve banks was that the lending power of the banks, since it was limited by their own reserves, might be in times of emergency very quickly exhausted. Banks in correspondent centers feeling a sudden demand upon them for credit, not only from their own local customers but from their correspondents in the agricultural west, found themselves unable to meet all the demands put upon them. The Federal Reserve banks are under no such limitation. Practically speaking their statutory powers enable them by the process of lending to expand the reserves of their member banks almost without limit. Their powers to buy and sell securities enable them at need either to expand or contract the reserves of member banks and thereby either restrain or encourage the extension of credit by the latter.

Bank deposits, especially those transferable by check, constitute, of course, the major part of the means of payment available to business and to the public in general for economic transactions. The importance of an adequate volume of the means of payment is self-evident yet difficult to measure. On the one hand it is a fact that demand deposits serve their principal purpose as a means of monetary payment and that their availability in adequate volume is as important as the availability of currency and coin, although in a somewhat different way. On the other hand, mere volume of deposits is not enough; there has to be use. This use is reflected in the turnover or velocity of deposits. The relation of a given volume of money to the volume of monetary transactions that may be effected by it is apparent, I think, when one remembers that a dollar bill may be carried in one's pocket-book for days without effecting a single payment; but the same dollar if spent by one person after another to whom it may be paid may in the course of the same period of time effect several dollars' worth of transactions. The existing volume of bank deposits, when turned over repeatedly, is in the same way capable of effecting monetary payments of many times greater volume.

The Federal Reserve System, operating through the twelve Federal Reserve banks and the Board of Governors, is empowered to perform certain central banking functions, and the primary purpose of such functions is to make the supply of money, not merely in the form of currency but mainly in the form of deposits, adequate for an active and healthy volume of business. Responsibility for the use of the funds made available rests, of course, in other hands. The Federal Reserve System can insure an adequate supply of funds to lend, but it cannot insure that borrowers will want to use them. It does not - it cannot - exercise an absolute control over the use of credit; it does exercise an influence over the use of credit. Its object is on the one hand to encourage sound business activity and on the other to discourage unsound activity.

In taking such corrective action the Federal Reserve System is able under the coordinating control of the Board of Governors in Washington to follow a uniform policy. It is able to provide the country with an orderly and mobile means of meeting monetary needs. It frees the commercial banks of the country from the embarrassments and dangers that would be apt to arise if the means of cooperation and of unifying leadership in monetary policy were lacking.

Another important central banking function of the Federal Reserve System, closely allied with what I have just been discussing, is that of issuing currency. As many of you recall, before the establishment of the System the machinery for the provision of currency was inefficient. The currency lacked elasticity. The Federal Reserve banks make it possible now for seasonal and other demands for currency to be met smoothly and adequately. They also make it possible for surplus currency to be promptly retired. In the exercise of the currency function, the Federal Reserve banks effect an automatic response to the requirements of the public as manifested by their request at times for an increased amount of currency and by their deposit at other times of currency which they do not wish to keep on hand. Money will not be drawn out or kept in circulation except to the extent that people want it, and the Federal Reserve banks are governed by the public demand in determining the volume of currency to be supplied.

Another function of the System is to furnish a nation-wide and uniform means for the transfer of funds and for the clearance and collection of checks and other items. As I have already indicated, the growth in the importance of demand deposits transferable by check as a means of payment was one of the important business developments of the nineteenth century. In the days when the first mutual savings banks were organized, deposits were still of relatively minor importance in commercial banks. In fact, the growth of mutual savings banks with their emphasis upon deposits was one of the factors which led commercial banks to cultivate deposit business. For a long time, however, commercial banks continued to look upon their circulating notes as more important than their deposits. The difference between mutual savings banks and commercial banks was rendered more obvious then by the fact that the liabilities of the mutuals were in the form of deposits, whereas the liabilities of commercial banks were mainly in the form of circulating notes. Now that commercial banks no longer issue circulating notes but carry their obligations mostly in the form of deposits, the distinction between the commercial bank and the mutual savings bank is on the surface less apparent. Fundamentally, of course, the distinction between the demand deposits characteristic of the commercial bank and the savings deposits characteristic of the mutual corresponds to the distinction between the circulation of commercial banks a hundred years ago and the deposits in mutual savings institutions at that time.

It is a necessary condition of the use of checks as a means of payment on the scale with which we are familiar that their clearance and collection should be facilitated in every way possible. When the banks of the country were dependent exclusively upon the correspondent relationship for this function, the routes followed by checks on their way from the creditor bank to the debtor bank were, as many of you will recall, so indirect as to be fantastic. Complicated arrangements grew up whereby checks instead of going by the shortest course from the bank with which they were deposited to the bank on which they were drawn would travel from point to point in great circuits in order to avoid exchange charges. This meant the existence of an enormous float which was expensive through loss of interest, through clerical and transportation costs, and through losses arising from delayed collection. At the present time under the machinery provided by the twelve Federal Reserve banks the collection and clearance of items has been greatly expedited.

In what I have said so far in description of the Federal Reserve System I have not discussed its functions as they relate specifically to the mutual savings banks. This question may be considered from two different points of view. One is the point of view of the mutuals as potential members of the Federal Reserve System, the other is the point of view of the mutuals as institutions standing outside the System.

As you are aware, the Banking Act of 1933 made provision for the first time for the admission to the Federal Reserve System of mutual savings banks. Mutual savings banks that have surplus and undivided profits amounting to not less than the amount of capital required for the organization of national banks in the same localities are now eligible for membership. Upon approval of its application for membership, a mutual savings bank is required to subscribe to stock in the Federal Reserve bank equal to six-tenths of one per cent of its total deposit liabilities or, if the State law does not permit it to purchase such stock, it may simply deposit an equal amount in a special account with the Federal

Reserve bank. Upon admission to membership a mutual savings bank, of course, is entitled to all of the privileges of membership like any other member bank.

The Banking Act of 1935 amended the Federal Reserve Act so as to give the Reserve banks permanent authority to make advances to their member banks against any sound assets, including mortgages and industrial bonds. This placed the Reserve banks in a much better position to render financial assistance to any mutual savings banks which might choose to join the System. The Federal Reserve Banks can lend against mortgages and industrial bonds as well as against Government securities and member banks need not be forced to liquidate their mortgages or to dump their bonds on the market and force the price down.

However, there are various reasons, I presume, why mutuals have not sought membership in the System. As representative of what I imagine is a common point of view among mutual savings banks I should like to quote from the April issue of the Savings Bank Journal the following words of Judge William H. Speer, who is a member of the board of managers and of the investment board of the Provident Institution for Savings, of Jersey City.

> "There is a great difference between what is known as a mutual savings bank and a commercial bank, a distinction which never has been, but now should be definitely established in the mind of the public...
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> "If we employ language accurately, savings banks do not conduct a banking business, nor are such institutions 'banks' in the strict sense of that word. In their early history they were not termed banks. The oldest mutual savings bank in this state was and still is 'The Provident Institution for Savings', and the largest was and is known as the 'Howard Savings Institution'...
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> "The deposits of savings banks are not lent on personal security, but invested..."

The feeling on the part of mutual savings banks that they are in a class by themselves distinct from commercial banks is, of course, supported by the fact that the mutuals have no demand deposits and make their investments primarily in the long term capital market. They may therefore be classed with institutional investors such as insurance companies rather than with commercial banks. Their deposits have not the same monetary function as the demand deposits of commercial banks, though of course savings deposits, may be readily converted by depositors into demand deposits of commercial banks. This of course is also true of time and savings deposits held by the commercial banks themselves. Savings deposits as such however do not serve as immediate means of payment the way demand deposits do nor have they the flexible powers of expanding and contracting as the volume of business expands and contracts. For this reason, the mutual savings banks' need of facilities for rediscount, for procurement of currency, and for the clearance and collection of checks is much less than the corresponding need of commercial banks for those services. These considerations, I take it, incline them to remain outside the Federal Reserve System.

At the same time, from the point of view of monetary regulation, their membership is not as essential as is the membership of commercial banks. The reason for this in theory is that mutual savings banks are primarily intermediaries for the investment of the savings of the community, and not create new money to the extent that commercial banks do; although, it must be admitted that from the standpoint of lending and investment activities the distinction between commercial banks and mutual savings banks is less marked than it used to be.

These considerations, which explain in part the absence of the mutual savings institutions from membership in the Federal Reserve System, do not mean, however, that the existence of the system is of no consequence or concern to the mutual savings banks; nor on the other hand that the mutual savings banks and their interests are not a matter of concern to the Board of Governors in shaping and coordinating the System's monetary and credit policies. Those policies are not based in any sense upon a narrow view of member bank interest alone; they are based on the public interest. In formulating them and carrying them out, the Board recognizes that they may affect the soundness of all mortgage loans wherever held and the value of all investments. The mutuals, therefore, as agencies for the investment of the public's savings in the long term capital market, have a particularly close interest in the central banking policies of the Federal Reserve System. Those policies influence the demand for funds and the yield upon investments. This makes the System of the utmost importance and concern to the mutuals - a fact that is especially apparent in the System's open market operations in government securities, of which the mutuals hold well over $2,000,000,000. The Federal Reserve Banks buy and sell such securities with the object of regulating the available supply of money and stabilizing the market, and this action is always of obvious moment to the holders of such securities.

Likewise, as you know, the mutuals carry large balances in commercial banks, which fact alone provides a direct interest in the System and its operations as well as an interest in the mutuals by the System.

I should like to assure you in conclusion, therefore, that in determinations of the System's policy and action, your interests are constantly taken into account. It is never forgotten that whether you are members of the Federal Reserve System or not, the value of your assets and the volume of your business are affected by what the System does. I do not mean, of course, that the mutuals are in any way singled out for consideration. What I mean, as I know you understand, is that the business of the country as a whole, of which you are an important part, is the object of the Board's interest and of the Federal Reserve banks' interest. The Federal Reserve Banks and the Board were established for the purpose of serving the public interest and there are no considerations of profit or other motive to interfere with their obedience to that interest.