5/25/17
Group 4 - Iowa Bkrs Assn
New Hampton Ia

I consider it a privilege and an honor to have been invited to spend this day with the members of Group Four of the Iowa Bankers Association. In accepting your Secretary's invitation I told him I ~~would~~ should be delighted to come and discuss informally any points pertaining to the operation of the Federal Reserve Bank.

The Federal Reserve Banking System has now been in operation for two years and a half. You are all informed, at least in a general way, as to the character of the internal organization, ~~and~~ therefore I do not intend to go into this particular phase excepting to say a word in recognition of the splendid services rendered to the Federal Reserve Bank by the three Iowa members of its Board of Directors. Mr. Johnson, Mr. Meredith and Mr. Hutchison, all from your state, are highly representative of the best there is in banking, agricultural and commercial pursuits, just such men as the framers of the Federal Reserve Act intended should officiate. These men have given liberally of their time and their energy, and the Chicago Bank considers itself most fortunate in having the benefit of of their counsel and loyal co-operation in its efforts to secure every possible benefit intended under the Act on behalf of our member banks, and through this medium on behalf of the public at large.

The time has passed when any one can question the success of the Federal Reserve Banking System. While I shall be pleased to answer questions in so far as I am able to do so, I have thought it would be an opportune moment to say something concerning some of the points that appear to be uppermost in the minds of the banking public.

ALLOWING INTEREST ON RESERVE BALANCES

One of the objections to the Federal Reserve System which from the beginning has frequently been cited by member banks, also State banks and Trust Companies contemplating membership, lies in the fact that no interest is paid by the Federal Reserve Banks on the reserve balances. It has been most gratifying, however, to observe that such banks when presented with the underlying facts have, as a rule, admitted that payment of interest by the Reserve Banks on reserve balances would be unscientific and unsound. In substantiation of this, we have but to revert to the financial disturbance of 1907. At that time banks throughout the country maintaining so-called reserve balances with their correspondents in reserve and central reserve cities, were receiving interest thereon at rates varying from 2 to 3% in accordance with the city in which their deposits rested. Most of you during this period were brought face to face with the fact that what you believed to be dependable reserves were not available when needed - this for the simple reason that the contract under which the large banks were paying interest made it absolutely necessary that these banks in turn invest their funds; therefore, when in 1907 and again in 1914 the demands upon the reserve city banks became general, in other words banks from all parts of the country were calling for help, the reserves at the centers were gradually depleted to a point approaching exhaustion; whereupon, owing to the fact that the surplus reserves were invested, and moreover, to the fact that their good bills receivable and other assets could not be realized upon short of London or other foreign centers, suspension of money payments followed.

Is not this in itself convincing that the reserves deposited in the Federal Reserve Banks should be maintained as actual reserves, which would be impossible if the Federal Reserve Banks were permitted and undertook to pay interest on the balances?

As indicating the situation which would confront the Federal Reserve Bank of Chicago under a program of allowing 2 per cent interest on deposits, I have made some calculations, based on the statement of condition as of April 27th, 1917:

On that date the bank's capital was in round figures $7,000,000. on which the cumulative dividend is $420,000. per annum. The operating expenses for the year 1916 were in excess of $230,000. The member banks' reserves were $97,000,000. and government deposits $8,000,000. the total deposits being $105,000,000. on which interest at 2% per annum amounts to $2,100,000. The minimum requirement for earnings therefore, including the payment of 2% interest on deposits would be $2,750,000. per annum.

If we assume that the capital and deposits aggregating $112,000,000. were all in the shape of cash, and then set aside the legal reserve of 35% on deposits amounting to $36,750,000 there would remain for investment a maximum of $75,250,000. without making provision for maintaining balances for exchange purposes in New York or elsewhere. In order that the assets of the Federal Reserve Bank may be kept liquid, the law wisely restricts its investments, and the investment yield is necessarily low. Suppose, for the sake of argument, we assume that the $75,250,000. could be invested at 3%. The yield would be $2,257,500. or approximately $500,000. less than the requirement for earnings previously stated. It is therefore apparent that in order to pay interest on deposits the law would have to be amended to permit the Federal Reserve Banks greater latitude in the selection of investments, at the expense of safety and maintenance of the assets in a liquid condition. Furthermore, a forced increase in the volume of investments would result in competition with member banks, a thing which has been studiously avoided from the outset.

Great pressure has been brought to bear on the Bank of England time and again to pay interest on deposits, but the Governors of the bank successfully resisted such pressure, though much courage and breadth of viewpoint was at times required. They have consistently adhered to the principle that so long as the Bank of England held the reserves of the joint stock banks it could not afford to invest so large a proportion of its assets nor at such rates of interest as would enable it to pay interest on deposits. The Management of the Bank of England has not allowed the temptation to make large profits for its stock holders to influence its judgment as to the policy which would best preserve the liquid condition of its assets. Without adherence to the policy of "no interest on deposits" by the Bank of England, it is inconceivable that London could throughout so many generations have retained its commanding position as the financial center of the world.

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CURRENCY ISSUING POWER OF THE FEDERAL RESERVE SYSTEM

Considerable interest has been manifested in the extent to which the Federal Reserve Banks could supply demands for currency in an emergency. The Division of Reports and Statistics of the Federal Reserve Board prepared figures for the Federal Reserve Banks based on the condition of the banks as at the close of business March 23, 1917. On that date the total reserve held by the 12 banks was $573,201,000. The required reserves for 35% against deposits and 40% against Federal Reserve Notes aggregated $252,532,000. Gold held by the banks in excess of their reserve requirements aggregated $320,669,000. In addition to the reserve held by the banks, the Federal Reserve Agents on the same date held $349,519,000. gold against outstanding Federal Reserve Notes.

Omitting the details of the calculation with which we need not concern ourselves at this time, it was shown that gold aggregating $540,556,000. was available as a basis for the issuance of additional Federal Reserve Notes. The system as a whole therefore had the gold basis to issue additional Federal Reserve Notes to the extent of $1,350,000,000. while maintaining reserves of 35% against net deposits and 40% against Federal Reserve Notes.

The Federal Reserve Bank of Chicago on the same date had the gold basis for issuing $136,000,000. of Federal Reserve

Notes in addition to those outstanding, maintaining the reserve percentages just mentioned. Since that time, by the process of exchanging Federal Reserve Notes for gold, our basis of note issues has been increased. On April 20 the note issuing capacity of the Chicago Bank had been increased some $30,000,000. over the figures of March 23.

As a measure of preparedness to most extraordinary demands, arrangements are being perfected to keep available for immediate use a reserve stock of Federal Reserve Notes sufficient to meet demands whether ordinary or extraordinary.

If the Federal Reserve Notes issued by the entire system were increased by $1,350,000,000. every dollar's worth of notes would be secured by at least one hundred cents in commercial paper bearing the endorsement of member banks or prime bankers' acceptances, in addition to which a 40% reserve in gold would be held by the banks; moreover the notes are a first lien on all of the assets of the Federal Reserve

Banks, and finally, are direct obligations of the United States Government. Surely no one can question the safety of our Federal Reserve Notes.

<u>NOTE</u>:

Amount of Gold in United States 5/1/17 - $3,121,887,443

Amt. in Fed. Res. Bks.
5/18/17 - $541,000,000.
Amt. with Fed. Res. Agts. <u>448,000,000.</u> 989,000,000

THE COLLECTION SYSTEM

In legislating to compel the transfer of reserve funds from commercial banks to the Federal Reserve Bank, the framers of the Federal Reserve Act had in mind the important functions performed by reserve city and central reserve city banks in the collection of checks and felt it necessary to provide for a similar service in establishing the Federal Reserve Banks, so that any member bank which desired to carry funds only in its own vaults and in its Federal Reserve Bank would have available, adequate and economical facilities for the collection of checks deposited by its customers. The law as it now stands provides that after November 16th, 1917, legal reserves will be restricted to balances actually maintained in the Federal Reserve Bank and cash in vault. There is pending in Congress an amendment to the Act which, if enacted into law, would readjust the reserve provisions so that there would be only one reserve requirement for each given bank, viz: that certain fixed percentages of the demand deposits and the time deposits be maintained in the

Federal Reserve Bank. The amendment, if passed in the near future, would considerably advance the date after which balances with reserve agents would no longer count as legal reserve.

Many member banks desire to continue relations of long standing with their city correspondents, while others desire to loan their funds as closely as maintenance of reserve requirements will permit, relying on the privilege of rediscounting with the Federal Reserve Bank to take care of extraordinary demands. The latter class particularly needs a comprehensive system of check collection through the Federal Reserve Banks.

In the effort to meet this need in accordance with the provisions of the Federal Reserve Act and under the authority of the Federal Reserve Board, the Federal Reserve Banks inaugurated a system of check collection last summer, under which checks on all of the more than 7,600 member banks, and a still larger number of state institutions, are now collectible through the system, practically at par. More than 16,000 banks out of a total of some

28,000 in the United States are now included in the Federal Reserve Bank par list. In the New England States, the State of New York and in the Pacific Coast States, all banks are included in the par list. In the Seventh Federal Reserve District, the Federal Reserve Bank of Chicago collects checks on its 1,044 member banks and nearly 1,900 non-member banks.

You will note the statement that these collections are made practically at par. There is a service charge made against the depositing bank on all items payable outside of Chicago of 1½¢ per item. No service charge is made on Chicago items. This service charge of 1½¢ per item is estimated to cover the actual cost of handling in the Federal Reserve Bank of Chicago. It includes postage, clerk hire, depreciation of machines, a portion of the rent, and other miscellaneous expenses properly chargeable to the operation of the Transit Department. It does not include a fee to collecting banks, and feeling that it is essential to treat all alike in the operation of the collection system, this bank has consistently declined to even furnish postage for return remittances in the few cases where requests for such postage have been made.

The non-member banks which have undertaken to remit at par for checks drawn on them have done so as a service rendered to their customers, the drawers of the checks, in order that the checks might be more acceptable in the hands of holders. Knowing that we make this charge of 1½¢ per item against the depositing banks, many banks have offered to remit for checks on themselves at the same rate. They apparently do not take into consideration that our charge is made against the depositing bank for collecting out of town items, and that we make no charge for checks on the Federal Reserve Bank, or for that matter for checks on any bank in Chicago.

The rule requiring that member banks provide funds to cover at par checks received from or for account of their Federal Reserve Bank, does not prevent the member banks from charging its depositors for the service of collecting out of town items. The Federal Reserve Board has publicly stated that there is nothing in the law nor in its rulings to prevent a member bank making reasonable charges against its depositors for the service of collecting checks, and such charges may even include interest on the credit advanced where the depositor draws against the proceeds of checks before they can be collected. I know a great many country banks believe it is impossible for them to charge their depositors for collecting checks, and that to do so involves a considerable reversal of existing customs. On the other hand, such charges are made in the larger cities, and there can be no question as to the right of a bank to compensation for services rendered. Many of the country banks have followed the line of least resistance by charging for remitting for checks on themselves. In so doing, they have either directly or indirectly been charging each other instead of the real beneficiary of the service. If a country bank which remits for its own checks at par, sends to its city correspondents checks on a bank which charges for remitting, it must keep with its city correspondents a balance of sufficient size to justify the city correspondents in absorbing the expense involved. It therefore pays for the service in one form or another and should recover the expense from its own depositor.

As previously stated, more than half the banks in the United States are now included in the Federal Reserve Bank par list. Is it exactly fair that the minority should make charges for remitting for checks on themselves at the expense of the majority?

It is a recognized fact that a check on a bank is payable in cash at the bank's own counter. While the holder of a check cannot compel the drawee bank to pay the check in exchange on another city, he can compel payment in full in money at the bank's counter. It is usual for country banks to remit in payment of their checks, exchange on Chicago or some other financial center. Many banks hold the view that in making such remittances in exchange, they are rendering a service for which they should be paid.

I am going to ask you to look at the transaction from another angle. Let us suppose that some of the checks on a country bank came into the hands of the Federal Reserve Bank of Chicago for collection and that it appointed a local collecting agent to whom it forwarded all checks on the country bank, with instructions to collect actual cash.

How long do you suppose this process would be continued before the country bank would regard it as a privilege to remit in Chicago Exchange without deduction, for all checks on itself?

Now the Federal Reserve Bank of Chicago does not say to the country banker - "You may have the choice of remitting without deduction for all of your checks in Chicago Exchange or of paying for all of them to our authorized agent in money at your own counter" - but instead it says - "We shall appreciate your co-operation in the development of a universal p check collection system by remitting in Chicago Exchange without deduction for checks on your bank, and if you find it desirable to pay for part of such checks in money, you may ship the money to us at our expense."

The privilege of sending his personal check to a distant point to pay for a purchase is a great convenience to the farmer, the professional man and the merchant. It eliminates the necessity of a trip to the bank to buy exchange and in addition furnishes him automatically a receipt for the payment made. If no one ever issued a check before the funds to meet the check were actually at his credit in the bank, the value of depositors' accounts would be greatly increased. The profit in the banking business has been curtailed by the practice of issuing a check to make a payment in anticipation of the receipt of funds which are expected to be available before the check is presented to the drawee bank. The accounts of depositors who practice such methods are usually unprofitable and I strongly urge your consideration of the custom prevailing in many cities of making charges of 50¢ or $1. per month against the accounts of depositors whose balances average less than a fixed minimum.

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MEMBERSHIP OF STATE BANKS

See special memorandum.

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It is highly gratifying to those upon whose shoulders the management of the Federal Reserve System rests, to notice increasing interest and satisfaction with the workings of the new banking system. Member banks should not forget that these banks are organized on lines substantially the same as their own banks - that is with a Board of Directors, the majority of which are elected by the stockholders, the officers of which in turn are elected by the Board of Directors. In other words, the management is dominated by its stockholders, who are the member banks.

In so far as the rediscounting operation is concerned we have now progressed to a point where there is no question in the minds of the majority of our shockholders as to their having an abundance of eligible paper, moreover we have succeeded in convincing member banks that the rediscounting procedure is a very simple one and that the resources of the Federal Reserve System are available to member banks at all times.

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<u>LIBERTY LOAN</u>

<u>See special memorandum.</u>

LIBERTY LOAN

As a matter of immediate and pressing importance the flotation of the Liberty Loan must be considered as occupying first place among the subjects touched upon in these remarks. No doubt you have all received copies of the official prospectus of the Loan issued by the Secretary of the Treasury, and the official application blanks There is little for me to add by way of information as to the Loan itself, and rather than trespass upon your patience by repeating facts with which you are familiar I would prefer to answer at the proper time such questions as may occur to you.

Before leaving Chicago last evening I received two telegrams from one of the cities of this district having a population of more than one hundred thousand, calling attention to the fact that Associated Press dispatches indicating that the initial two billion dollar offering would be over-subscribed, are acting as a damper on the efforts to obtain subscriptions. This seems particularly unfortunate. The initial offering is not over-subscribed, and furthermore the earnest efforts of each one of us will be necessary to accomplish the desired result. Two billion dollars is an enormous sum to raise at a single operation even in this day of large figures in the realm of finance, and none of us should gain the impression that it can be raised if we stand idly by and expect the ordinary investors to take the entire sum.

Comment has been received from your own state to the effect that we could not expect to sell a Government Bond bearing three and one-half percent interest in communities where four percent is paid by some of the banks. Frankly such comment has been received with surprise. Aside from all question of ones patriotic duty to support the Government in this undertaking, surely the obligation of the United States yielding three and one-half percent is a better investment than a credit at a bank yielding four percent. I cannot believe that comments of this nature represent the feeling of any large percentage of the citizens of Iowa.

Let me express the sincere hope that every one present will go home after this meeting impressed with his personal responsibility that each individual whom he meets from now until June Fifteenth becomes a purchaser of one or more Liberty Bonds.

In the words of our President - -

"The World must be made safe for Democracy."

"The right is more precious than peace, and we shall fight for the things which we have always carried nearest our hearts - for democracy, for the right of those who submit to authority to have a voice in their own governments, for the rights and liberties of small nations, for a universal dominion of right by such a concert of free peoples as shall bring peace and safety to all nations and make the world itself at last free."

"To such a task we can dedicate our lives and our fortunes, everything that we are and everything that we have."