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"THE FEDERAL RESERVE -- ITS ROLE IN TODAY'S BANKING"

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(Following is the complete text of a talk to be given by Mr. Hickman at the annual Executive Bankers Conference sponsored by the Ohio Bankers Association at the Neil House, Columbus, Ohio, on Wednesday afternoon, December 8, 1965. About 200 of the state's leading bankers are expected to be in attendance)

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Today, perhaps more than ever before in its 51 years of operation, the Federal Reserve System is subject to intense scrutiny and review. Let me assure you that we in the System are fully aware of our responsibilities to you, the bankers, as well as to the public in general. We welcome all fair-minded and objective criticisms of our organization and its operations. At the same time, if you think we are doing a good job, then we deserve your active support.

The basic purpose of the Federal Reserve System is to insure that the money and credit needs of the economy are met in a stable, orderly manner.

As the fountainhead of bank credit, the System would like to have everyone enjoy the benefits that flow from an efficient and effective banking system in current with the tides of our economic life.

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Some of these benefits are shared by all banks, whether they are members of the Federal Reserve System or not. These include benefits derived from an elastic currency, a well-developed money market, improved methods of handling government funds, and nationwide facilities for check clearing and collection.

The benefits of membership in the Federal Reserve System are of two types -- one, tangible or dollars-and-cents values, and two, intangible values. In my opinion, the most important benefit of membership in the System is an intangible one -- the sense of prestige and satisfaction derived from being a part of a public service institution dedicated to the support and development of a sound banking system responsive to the needs of the public.

Perhaps the most important tangible benefit of membership in the Federal Reserve System is the privilege of borrowing at the discount window -- to cover emergency needs for credit. In using the discount window, member banks may borrow on U. S. Government securities, may rediscount their commercial paper, or may pledge practically any other sound collateral.

Most country banks, of course, have well-established correspondent relationships with large city banks and look to them for normal credit needs (for which, incidentally, they are required to maintain compensating balances). But in the absence of a Federal Reserve System, what would happen should emergency needs for cash arise?

I don't have to remind you of the situation prior to the establishment of the Federal Reserve System, when seasonal loan demands often caused pressures to pervade the banking system and individual banks were unable to obtain credit accommodation -- at any price, I might add. A parallel might be drawn from the recent power "blackout" that occurred in the East: the "overload" of demand for cash in rural areas cascaded into the big money market banks and the whole network of banks had a "cash blackout."

Right now, many city banks are pretty well loaned up. The loan-to-deposit ratio in some larger banks is running as high as 70 percent. In a situation like this, where can a bank borrow? The answer is that you can always get a loan from the Federal Reserve if you are a member bank.

Thus, the availability of Federal Reserve credit in all kinds of economic weather provides an additional source of funds when needed and an additional measure of safety. And, as I have indicated, this accessibility of credit from outside the commercial banking system virtually eliminates any "cascading" effect.

In addition to the privilege of borrowing, various other services are rendered by the Federal Reserve to its member banks. Just as a reminder, let me list a few of them:

Shipment of currency and coin to and from the Reserve banks -- at the expense of the Fed.

Wrapping of coin -- at cost. This is a popular service since about 97 percent of the coin the Federal Reserve Bank of Cleveland ships out is in wrapped form.

Direct use of the System's check collection service. We pay all the costs and carry a large volume of float at our own expense, providing free credit to member banks.

Availability of a rapid nationwide system of transferring funds at no cost for member banks and at telegram cost for others, and the transferring of Government securities for a fee paid to the U. S. Treasury.

Safekeeping of securities owned by country member banks, at no charge. This service includes the clipping of coupons from Government and other securities and collection and crediting of such coupons as well as maturing bonds to the member bank's reserve account. We pass credit for coupons promptly on the coupon date and carry the float until the proceeds are actually collected.

Purchase and sale of U. S. government securities through the Federal Reserve banks -- in this District through our three offices in Cleveland, Pittsburgh and Cincinnati -- at the best price obtainable and again at no charge.

Free informational, research and advisory services.

At the Cleveland bank, our newest service to member banks is the Functional Cost Analysis Program. This program was introduced for two primary reasons: one -- to provide information needed by the central bank on commercial bank behavior, and, two, to strengthen bank performance in the Fourth District through lower costs and increased profits. Many small and intermediate banks have long felt the need for such a program but, because of limited resources, could not put it into effect.

At present, on a pilot basis, 119 of the 408 member banks in the District with deposits of $3 million to $150 million, are participating in this program. The end product will be an annual confidential cost analysis report for each participating bank. It will provide information on costs and rates of return in areas such as consumer credit, mortgage loans, municipal securities, time deposits and the like, which will permit each bank to compare its income, expenses and earnings with groups of banks of similar size and deposit structure.

Recently, one of my friends, the president of a large bank in eastern Kentucky, told me, and I quote -- We think the Functional Cost Analysis Program sponsored by the Cleveland Fed is wonderful, and we are cooperating fully. Costs are the acutely critical area in banking today, and we believe this program will result in substantial savings to our bank -- unquote.

Because this program has been so successful thus far, and because we're convinced it's a worthwhile and needed service, the Cleveland bank will expand the service to a larger number of member banks next year.

Speaking of member banks, it is interesting to note that in the Fourth District, member banks outnumber nonmembers by 504 to 343, although in the country as a whole nonmembers are in a slight majority. In Ohio, the boxscore is: member banks, 352; and nonmember, 192.

Member banks hold 88 percent of the total banking resources in the District. Of the 36 banks in the District with assets totaling more than $100 million, only one is a nonmember, and that bank is now considering membership. It is also significant that a sizable majority of the District's banks with assets of $25 million or under are members of the System. Of these, 407 are member banks, as opposed to 323 that are not members.

From these figures it is evident that for a large bank membership in the System is practically a must. They also more than suggest that membership for most small banks is highly desirable.

Speaking of the smaller banks, let me cite here another reason why membership in the Fed is particularly valuable to the country bank. To a very large degree, membership provides the country bank the same services and opportunities as the larger city bank, thereby making it equally well equipped to serve its local trade area.

Now, there is no doubt that nonmember banks -- through their correspondents -- are often able to take advantage of many of the services I have referred to. The Federal Reserve is, in effect, our largest correspondent bank -- with assets of about $60 billion -- but nobody is out trying to sell it. We do not attempt to offer our facilities in competition with commercial banks, and do not attempt to interfere with correspondent bank relationships.

A state bank contemplating membership in the Federal Reserve System should clearly understand that such membership does not remove the desirability of maintaining correspondent bank relationships. And, indeed, the large correspondent banks should recognize this fact -- that the Fed, rather than competing with them, is constantly attempting to aid and complement their efforts. The correspondent banking system is an important part of the independent competitive banking system in the United States, and the Federal Reserve has no desire or intention to alter it.

Looking at the other side of the coin, I will be the first to concede that for some banks the cost of membership may exceed the immediate dollars-and-cents benefits. Frequently mentioned in this respect are the reserves required of member banks, in contrast to the nonmember bank reserves that are set by state laws.

In Ohio, for example, the law provides that nonmember banks must maintain 15 percent of their total demand deposits and 10 percent of their total time and savings deposits as reserves against those deposits.

Comparable reserve ratios for member banks are: for Reserve City banks, 16-1/2 percent of net demand deposits and 4 percent of time and savings deposits, and for country banks, 12 percent of net demand deposits and, again, 4 percent of time and savings deposits.

Nonmember banks, however, are not required to include so-called hypothecated deposits as deposits against which reserves must be maintained. On the other hand, member banks must include hypothecated deposits in calculating reserves because of a longstanding rule of the Board of Governors. I am well aware that this ruling is controversial and am happy to report to you today that the matter is under active consideration.

The Ohio law also provides that three-fifths of the 10 percent reserve against the time and savings deposits of nonmember banks may consist of bonds of other obligations issued, or guaranteed as to principal and interest, by the United States government. This, in effect, reduces the non-earning portion of reserves against time and savings deposits to 4 percent -- exactly the same as the ratio required of member banks.

The question of competitive inequities between member and nonmember banks appears to revolve largely around the variety, volume and value of the services provided by the Federal Reserve as compared with those provided by the correspondent bank. Any consideration of this problem must take into account the fact that additional compensating balances may be called for by the correspondent city bank in rough proportion to cover any increased cost of services to the country bank. Also to be taken into account are the many services rendered by the Federal Reserve at no cost to its member banks.

It is sometimes assumed that membership in the System involves additional costs to banks, particularly smaller ones, but the proof of the pudding is in the eating. Since most nonmember banks are small rural banks, we should compare the performance of country member banks with nonmember banks. And here, the advantage has clearly been with member banks. Country member banks since 1961 have shown a higher ratio of after tax income to capital accounts than their nonmember counterparts. This, despite the well-known efforts of the Federal Reserve System to strengthen capital accounts. The same is also true for most recent years of the ratio of net after tax income to assets, and of net current earnings to capital accounts and assets.

The figures thus indicate that member banks have fared well in comparison with nonmembers. But, again, let me remind you that there is more than just the dollars-and-cents side of the picture.

There are, as I indicated earlier, many intangible elements of prestige attached to membership in the Federal Reserve System. For one thing, depositors in a member bank derive a sense of security from the fact that their funds are being held by a well organized, soundly administered bank, which is under regular and constant supervision. For another, stockholders, directors and management should realize that, through System membership, they are a vital and integral link in a coordinated system working for the furtherance of sound and effective banking practices in a dynamic economy.

Many bankers believe -- and I am one of them -- that it is only right and proper for banks to belong to a system dedicated to the economic well-being of the nation. To those who say, "I have only one bank, so what difference does it make if I'm not a member of the Federal Reserve System?," we reply: "You sound like the man who doesn't vote on Election Day because he only has one vote."

In conclusion, then, the role of the Federal Reserve in our economy remains essentially what it has been over the years: to provide money and credit conditions that will help achieve the nation's basic goals -- economic growth, full employment, stable prices, and equilibrium in the balance of payments. In this task, we need the help of a vigorous commercial banking system, which, with the aid of the Federal Reserve, can satisfactorily discharge its responsibilities and obligations to the general public.

No one, and certainly not I, will claim that the Federal Reserve System has been, or is now, perfect. However, as an institution manned by fallible individuals who carry very heavy responsibilities, I think the System on balance has done a commendable job.

Let me just add parenthetically that the Federal Reserve's role is not always a popular one, to say the least, particularly in the area of monetary policy. As William McChesney Martin, Jr., chairman of our Board of Governors, once put it: "The Fed is always the one who takes away the punch just when the party's getting good."

Be that as it may, we try to do our job in the best way that we know how. With your support -- as well as that of all the banks -- small, medium, and large -- member and nonmember -- we will continue to work towards achieving the type of monetary policy and the type of banking system that are most consistent with the nation's economic goals.

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