

X-45.

A MEMORANDUM PREPARED BY A BANKER OF 40 YEARS' EXPERIENCE AND  
SUBMITTED TO A MEMBER OF THE FEDERAL RESERVE BOARD.

WHY THE RIGID DEAD LINE IN THE MAINTENANCE OF RESERVES.

If a catechism of banking was prepared the first question might with propriety be, what is the chief end of Banking Law and Practice? The answer to this which I think would meet with general acceptance would be that the chief end of banking law and practice is the maintenance of the percentage of lawful reserve. In my judgment we surround the matter of reserves with a sanctity which is undeserved. We have made that which should be of service to us, our master.

In a communication appearing in the New York Times some months ago from Mr. C. Scott-Dalgleisch on the subject of Rural Credits he says, "As the music is the accompaniment to the voice in a song so should the music of legislation merely accompany and modulate the voice of the performance". This important sentiment so poetically expressed I should like to see as a declaration of principles painted on the walls of the houses of Congress and of every legislative chamber in the land. Let us see how far we have departed from this standard in one feature of banking.

Let us consider a transaction in some moderate sized bank. A valued customer comes in and says that he has immediate need of say \$2,000. The security, his name, the bills receivable or col-

lateral, as the case may be, that he brings are entirely satisfactory. The banker tells him so, but states that in view of the fact that his reserve is low he is unable to accommodate him; as the law provides that under such circumstances he must not increase his loans. The banker adds, however, "If you can wait until tomorrow I can let you have the amount, as several large loans will then be paid off. Many bankers in this situation take what is called a common sense view of the matter, ignore the law, and make the loans. If the banker does not do this the business man may be and often is seriously inconvenienced.

It has been the practice of the Comptroller of the Currency to ask on the reports called for, "What has been the average reserve for the thirty days preceding the date of the report?" I find no lawful basis for such a question and it suggests that the Comptroller also is willing to ignore the law and take a common sense view.

The present Comptroller has recently brought to light an almost forgotten clause of the National Bank Act which prohibits banks from accepting more than the lawful rate of interest, and calls attention to the Directors' Oath that banks shall be conducted in accordance with the law. Mr. Warburg has called attention to the fact that our usury laws are not based on common sense but that is another story which I would like to tell at

another time. The point I now want to make is that the violation of the usury feature of the law is no more perjury than is that which applies to the reserve.

I understand that in Great Britain the banks are not required to keep any stated percentage of reserve and I have never heard that the banks or the business interests of the country suffer thereby. In my long experience as a banker and as one closely in touch with other bankers I have never found any benefit to the banks or the business public in such lawful requirements. I do not mean that banks should not maintain adequate reserves and I do not regard the percentage specified by law as excessive. My complaint is that the requirement of a fixed and rigid proportion of deposits, as reserve, tends to handicap banks in the performance of their proper functions in the community. If the reserve restrictions were removed all intelligent and wise bankers would keep sufficient reserves, but many considerations have to be taken into account to determine what is sufficient. Income in sight has been alluded to. Character of the deposits in certain banks differ. Seasons of the year may have some bearing. Under previous conditions readiness or unwillingness of reserve agents to extend rediscounts made a difference. Geographical proximity to a source of supply of currency is also to be considered. The fact that in periods of money stringency the lawful reserves have never been

regarded as sufficient also shows the inadequacy of the law. Varying conditions indicate that the percentage of reserve should fluctuate accordingly.

Banks as a rule deal in money and credit and are the source of supply of these facilities in their immediate locality, just as a corner grocery store supplies food to the neighborhood in which it is located. Let us apply the principles complained of in banking to the operations of the grocery store. Let us suppose that the Secretary of Agriculture had supervision over such stores and that he learned that occasionally some stores allowed their stock of standard foods to become depleted. In his zeal to regulate, he might have an Act of Congress passed which should require that every grocery store should always have on hand a reserve supply of standard articles of food, at least enough to last five days. Under the operations of such a law a housewife might call for oatmeal, beans, sugar, and flour and be told by the grocer that he was very sorry but he could not accommodate her as his reserve would be trenched upon. He would have plenty on hand tomorrow as he had just received word from the freight house that a shipment from the wholesale house in the city had arrived and he would have his team haul it to the store the first thing in the morning. In the conduct of a grocery store this action seems to be so absurd that I am almost ashamed to speak of

it as a possibility. Five days' supply of food on the shelves and more in sight and the neighborhood population compelled to shop somewhere else or go hungry! In the case of the grocery the people can go a couple of blocks away and supply their needs. In the case of the bank this is not as a rule feasible as the depositor has no account elsewhere and his standing is not known - and when he goes where he is not known asking for accommodation he almost invariably is looked on with suspicion.

Let us take another illustration to shed light upon our banking practice. We have heard much of mobilizing troops and also of mobilizing bank reserves. To my notion bank reserves are or should be treated as soldiers are on the firing line. The latter are in position to do serious work and in war it is to be expected that many of them will be killed. What would be thought of a military commander who was so careful of his soldiers on the firing line that his energy was spent in seeing that none of them ever got shot? While his regard for human life is commendable it would render futile the purposes for which the army was created.

Bank reserves should be in constant use in meeting the daily needs of the banking business in supplying money and proper credit. It should be taken as a matter of course that the percentage of reserve should fluctuate one or two points above or below what was determined to be the proper average. Please remember

that I am not complaining of banks being compelled to carry too much money as reserve but only of the rigidity of the requirements. The spirit of the law is good but the application is not wise. We have it on good authority that the spirit of a law giveth life but that the letter killeth. The rules regarding the observance of the Sabbath day in old Judea were rigid and burdensome; what a relief it was when it was declared that the Sabbath was made for man and not man for the Sabbath. The requirements of law should be designed to insure the safe and convenient carrying on of the daily affairs of the people. The people should not be compelled to conform to the requirements of laws framed by those not fully conversant with the details of the conditions of our life and business.

In proposing a change in the matter spoken of it would not be necessary to go the extent of abolishing all laws as to reserve but the relief I think we should have for ourselves as bankers and for the benefit of business generally could be obtained by making the reserve percentage an average one for the month. With each report called for by the Comptroller there could be sent a statement of the daily reserve for the two or three calendar months preceding, showing the average for each month. With this much freedom of

action allowed to the banks it would not be an inexcusable hardship if the penalty of a fine should be a condition of law.

The continuance of poorly working laws upon our statute books results in handicaps in business or else in the disregard of law. Either of these results is surely of enough importance to warrant us in requesting that laws be changed to harmonize with the normal requirements of business.

Under the operations of the Federal reserve law while technically less reserve has to be carried, practically more will be required, for the reason that the banks will all have to carry balances with their correspondents. These balances now are reserve but after they cease to be so considered they will still have to be maintained as a matter of convenience. This is an added reason why the relief suggested should be granted.

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