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April 22, 1918.

My dear Governor:

I have read with much interest the letter of Mr. F. C. Williams, President of the National Association of Supervisors of State Banks, dated April 15, 1918, written to you in criticism of certain recommendations made by me to the Federal Reserve Board in a memorandum on the subject of State and Federal legislation.

It is very evident that the purpose of these recommendations has been misunderstood and I am glad to have an opportunity to explain my position in the matter.

Mr. Williams is of the opinion that the adoption of the policy advocated will have a very unpleasant and disturbing result and will seriously interfere with that cordial cooperation which exists at the present time between the State and Federal banking authorities.

This view is obviously predicated upon the assumption that the purpose of the legislation proposed is, or the probable effect would be, to encroach upon, if not to destroy, the State systems.

I wish to disclaim any intention of recommending legislation that has this end in view, and to state in the beginning that I fully agree with Mr. Williams that no action should be taken which would have a tendency to destroy that very splendid spirit of cooperation which exists as between the State and Federal banking authorities, or which would antagonize the several thousand State banks and trust companies which have rendered and are rendering such patriotic and valuable assistance to the Government in the conduct of its fiscal affairs.

I respectfully submit that the adoption of the policy recommended if properly understood should have neither effect.

As pointed out in the memorandum referred to, the Supreme Court of the United States has decided that Congress may vest national banks with any powers enjoyed by State corporations which come into competition with national banks.

I have merely suggested that the powers of national banks in accordance with this decision should be extended so as to enable them to meet successfully the competition of State banks and trust companies on a basis of equality, and to extend to their customers the character of accommodation desired.

Experience has shown that the bank customer prefers to deal with one rather than with several classes of banking institutions. In

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theory, it may seem advisable to require commercial banks to confine their operations to the business of commercial banking, to require trust companies to engage only in the trust company business and to prohibit savings banks from doing any commercial banking business.

State corporations, however, have found it profitable to combine these several functions and national banks have admittedly been at a serious disadvantage in meeting competition of State banks and trust companies which have enjoyed much broader corporate powers.

In creating the Federal Reserve System, Congress has extended the privilege of membership to State banks and trust companies. The Federal Reserve Act expressly provides that "subject to the provisions of this Act and to the regulations of the Board made pursuant thereto, any bank becoming a member of the Federal Reserve System, shall retain its full charter and statutory rights as a State bank or trust company and may continue to exercise all corporate powers granted it by the State in which it is created, and shall be entitled to all privileges of member banks."

The Act, therefore, admits to membership banks which admittedly possess broader powers than national banks. It also recognizes the right of these banks to withdraw from the system, while national banks are required to go into liquidation in the event of withdrawal.

Under the circumstances, the State authorities could hardly be said to be justified in refusing to cooperate with the Federal authorities if Congress should undertake to broaden the powers of national banks so as to place them on an equality with other member banks.

Mr. Williams is opposed to any attempt to pass legislation which might in any way be construed as intended to drive State banking interests into the Federal Reserve System and seems to feel that any broadening of national banking powers should be construed as an effort to accomplish this purpose.

In my opinion, legislation designed to place all member banks on a basis of equality should not be construed as intended to drive State banks and trust companies into the system, but on the contrary, should forestall the possibility of legislation having this purpose in view.

In other words, legislation intended to force State banks into the system would probably take the form of some penalty or tax imposed upon those remaining out of the system. For example, it has been suggested on more than one occasion that a tax should be imposed on all interstate checks drawn against banks which are not members of and do not clear

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through Federal Reserve banks. It is obvious that legislation of this sort would seriously impair the activities and affect the business of State banks and trust companies remaining out of the system.

It may be contended that it is by no means likely that Congress will undertake any such radical action. You will recall, however, that the lack of uniformity in the laws of the several States and the failure of many States to adopt proper safeguards to protect State bank circulation resulted in 1864 in the passage of a Federal statute imposing a tax of ten per cent. on State bank circulation, thus depriving such banks of this privilege. Prior to the passage of this Act, State banks had been offered by the Act of 1863 the privilege of issuing circulating notes against the security of United States Government bonds, but failed to avail themselves of this privilege. I do not mean to imply that it will be necessary for Congress to follow the precedent established in that case, or that it is likely that such a bill will be passed. On the contrary, every indication points to the fact that the banks outside of the system will respond to the appeal made by the President to become members in sufficient numbers to make any such legislation unnecessary. The bankers generally realize that we are now faced with a situation which calls for the scientific utilization of our entire banking powers. This is not merely a temporary, but a continuing situation. The demands made upon our banking resources during the period of readjustment following the war will in all probability be as great or greater than during the present time. No radical legislation should, therefore, be necessary to force the banks to become members.

Mr. Williams has obviously overlooked the fact that membership does not deprive State banks of the right to exercise the powers granted them by the States, but as above stated, merely involves a compliance with those restrictions which apply to all member banks and which are adopted for the protection of those dealing with such banks; nor does it impair the supervision of the State authorities over the operations of banks and trust companies organized under State law. The Federal Reserve Board is authorized to accept the examinations made by the State authorities in lieu of those required by the Federal Statute, and in many, if not most instances, does accept these examinations.

I respectfully submit, therefore, that the legislation recommended by me should not disturb the cordial relations existing between the State and Federal authorities, and should not antagonize those in charge of the operations of State banks and trust companies.

In conclusion, it is hardly necessary to say that I fully agree with the suggestion made by Mr Williams that the Federal Reserve board should give careful consideration to all aspects of the situation before

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reaching any conclusion as to the legislative policy to be adopted. It will, of course, do this in any event. The memorandum prepared by me was offered merely as a tentative suggestion and has not been acted upon by the Board and has not been published. With the consent of the Board, copies were furnished to representatives of some of the committees of the American Bankers Association and to the Federal Reserve agents.

Under the circumstances, if an issue can be said to have been created, it seems to be "Shall Congress broaden the powers of national banks in accordance with the decision in the case of Bank v. Fellows, or would such an attempt have an unfortunate and disastrous effect upon the State systems and upon the banks which compose those systems?"

In order that the Board may have before it all facts necessary to enable it to reach a conclusion, I would suggest that Mr. Williams point out in just what way the extension of national banking powers will encroach upon or have a tendency to destroy the State systems, and why such systems will be injuriously affected if additional State banks and trust companies become members of the Federal Reserve system.

Respectfully,

(Signed) M. C. Elliott

Counsel.

Hon. W. P. G. Harding,
Governor, Federal Reserve Board.

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