SOUTHERN PACIFIC COMPANY
65 Market Street
San Francisco

Wm. Sproule,
President.

December 24, 1925.

Honorable C. S. Hamlin,
Federal Reserve Board,
United States Treasury Bldg.,
Washington, D. C.

Dear Mr. Hamlin:

I have yours of 11th instant and have not forgotten your desire for a memorandum of the bank organization that would seem to be more effective than the present.

My views are given with some reluctance lest they be deemed a presumption or mischievous.

Fact is the suggestions offered are of value only as they are constructive toward putting the Federal Reserve Board in such control of the banks as will cause them to function in their daily work upon policies suggested by the Federal Reserve Board, with local representation in carrying out the policies effectively, which will give recognition to the Government's interest in the net returns from each bank, requiring adequate supervision of the bank's operations. In this I do not refer to one bank but to any Federal Reserve Bank.

I think it better to put the memorandum in detached form, marked - "Controlling Influences in Federal Reserve Banks."

Yours truly,

Encl

(signed) Wm. Sproule

P.S.--I have been quite free in expressing myself in the memorandum as I understand it to be so desired, and confidential.

W.S.

Controlling Influences in Federal Reserve Banks

A controlling influence in a Federal Reserve Bank is either in Washington or is local.

The Manager of the Bank is apt to be selected by the local majority in the directory of the Bank, whose feeling is apt to be that the local interests in the area served by the Bank are best protected by strengthening the Manager, who is elected by will of the local majority even when the election is unanimous. A Manager not agreeable to the local majority in its directory could not be elected.

The Manager should be the Manager of the Bank in the conduct of its daily transactions and general routine; but this is not the way it works. He starts with the title of Governor, which is a misnomer. He is not a Governor; neither is he a Managing Director. He is not a Director and should not be. His business should be to run the Bank as an organization, under the direction of the Board of Governors. The Board of Governors are merely given, for convenience, the more general title of Board of Directors. The Board of Governors should give its instructions to the Manager. The Manager should be given these instructions through the Chairman of the Board of Governors (i.e. Directors.)

Chairman of the Board and Federal Reserve Agent is the only official of the Bank named in the statute. As such, his official functions are joint and continuous. He should not be expected to abdicate either of his joint functions at any time. His chairmanship should not cease when the meeting of the Directors adjourns, any more than his functions as Federal Reserve Agent cease when the Directors have meeting. The duties of the

Chairman of the Board of Directors and Federal Reserve Agent are lodged in one official to the end that he should be directed as to general policies by the Federal Reserve Board and so give direction to the policy of the Board of Directors. As policies of management arise from time to time, which warrant consideration in Washington at the instance of the Bank, the questions should be presented through the Chairman of the Board of Directors.

Recognition of this official by the Board as their direct and responsible representative is important. Any procedure that tends to submerge him, or go past him in the transactions of the Federal Reserve Board with the bank, impairs his usefulness to the Board and does not tend in the direction of strengthening the Board. By virtue of his office he should be Chairman of all committees, and vote in committee.

The Chairman of the Board and Federal Reserve Agent should be regarded not only as the official representative of the Federal Reserve Board; it should be known that he is also the direct adviser of the Board by virtue of the joint office and its statutory character. As your adviser, his calls to Washington could well be separate and distinct from your calls upon the Governor for conference with the latter. The calls upon the Governor by the Federal Reserve Board should be through the Statutory Officer, and it could well be made optional with him as to whether he should go to Washington for the same conference or not, unless your Board wishes him specifically to go. When he so goes, the conference to be so handled that the Statutory Officer's official relationship to the Board is given the importance of the position, without being in any way made offensive in the Governors. He should have precedence.

Even matter of compensation should be dealt with according to common usage, which is in terms of salary. By virtue of his office the Statutory Officer has to perform regular daily duties, maintaining and being responsible for an organization with office and field forces. In business life, terms of such responsibility are interpreted in terms of compensation. Alike to officers and employes of the Bank and of the Federal Reserve Agent, the senior officer of highest responsibility is that officer whose compensation is the greatest. With the Manager of the Bank getting $25,000 a year, for example, the Statutory Officer should be paid not less than $30,000 as a mere matter of wholesome organization.

The Federal Reserve Board, of course, in matters of detail cannot control the routine of the Bank's business, but can deal with discount rates, open market operations, unusual credits given or proposed to be given by any Reserve Bank to any of its member Banks; also with policies under one-product conditions which call for special consideration and caution in granting or withholding of credit, or other conditions of an abnormal character arising from time to time. These are dealt with now in mixed fashion. The open shop operations are under the Governor for instance, although such operations belong to the realm of policy in which the voice of the Statutory Officer might properly have weight. The giving of credits is in charge of an Executive Committee the Chairman of which is the Governor who is not a Director. It is true, as a further example, that the Federal Reserve Agent is supposed to be a check on the paper submitted for loans but this is in the nature of an unpleasant veto power, of which I understand he has been deprived by a ruling that makes the Executive Committee's action final.

A Loan Committee might be created to consist of the Chairman, Deputy Chairman, a member of the Bank's Board representing the major Banks, and one representing the minor Banks, each of these four members to vote. This would give two Class C Directors and two of the Directors representing member Banks, so that all interests would be protected. There would seldom be a tie, but a tie would have the effect of negative action. It should not be too easy to tie up the reserve of the Banks in doubtful cases. The losses to the Banks through bad loans might well be checked up for closer information. There is no rule that takes the place of consideration of question as to whether member Banks' capital is unimpaired, value and character of its surplus, and the soundness of its management. True, in these three, Washington's interest is general but it is not remote, because it runs not only to the returns derived by the Government from the Reserve Banks' operations, - it runs finally to the soundness of the member Bank in its relations to the depositors the Reserve System is in part designed to protect.

The Manager of the Bank may sit ex officio as now with the Board of Directors, without vote, to give them information they require. In like manner and for same purpose, he could sit in the Loan Committee or in any other committee desirable.

In matters of policy, it may occur from time to time that there are differences of opinion upon matters deemed material. This may occur even in matters of appointments. The Federal Reserve Board could require that in such cases whenever the Chairman of the Board and one or both of the Class C members dissent from the vote of the majority, the subjects are to be submitted to the Federal Reserve Board with statement of the vote and reasons for or against, to the end that approval may be given or denied as advisable, the Chairman to decide upon wisdom of such submission to Washington.

In summary, the present working of Federal Reserve Bank organization is centrifugal so to speak. The Federal Reserve Board, on the contrary, is interested in Reserve Bank organization that will have a centripetal tendency, in preserving the proper relation and influence of Washington within the councils of the Bank. This can still be done by the firm and consistent attitude of Washington in support of the Chairman of the Board and Federal Reserve Agent as a joint officer who functions in that duel official relation continuously and not intermittently. As such, Washington looks to him to be the dominant factor in conserving the interests of Government in the stability of the Federal Reserve Banks, and their functioning as a system of Banks rather than as widely scattered banking units. The Federal Reserve Board has to decide whether the Manager of the Bank is the dominant figure in the Board, or the Statutory Officer is to be that figure. If the Manager is to be dominant, then the Chairman of the Board is merely the person designated to preside when there is a Directors' meeting, which is the present drift. As to which it is to be, this is for Washington to decide in order that the present unseemly uncertainties may be brought to a conclusion, even though that conclusion be gradual once the policy is fixed and consistently adhered to. Putting the moral influence of the Board strongly behind the Statutory Officer in the Bank, will alone be a start in the direction desired, and the councils of the Bank should gradually be reorganized to fit.

No one Bank serves for criterion. The Board might consider it well to call into council three or more Directors of the broadest experience from Class C in three or more Federal Reserve Banks, if Washington is not satisfied with the present trend of Reserve Banks. The trend appears to be the localizing of the Reserve Banks in view of the Class C Directors being in a minority. With strong Chairmen strongly supported by Washington, that support gradually established, but pursuant to a fixed policy interpreted by regulations issued from time to time, there should come without undue friction a better recognition of the immediate interest of Government in the conduct of the Bank, both as to policies and as to conservation of the capital resources of the Bank and of its member Banks, that the reserves may be put to their best uses, and providently.

It may be conceded that such a change would make the chairmanship the dominant place and the Manager of the Bank would run the machine under the dominating influence of the Statutory Officer. If the Federal Reserve banking system is to have the Federal Reserve Board for its hub, it would seem that this policy will become necessary, whatever may be the machinery designed to carry it out. Otherwise there seems to be little reason why the Federal Reserve Board's influence in the Banks should be any more than merely to enable the Directors of the Banks to get by without conflict with the Federal Reserve Act.

The fact is that defects in the law leave undefined the functions of these officers and so challenge human nature. It is not fair to blame men for conditions of conflict they have not created but of which they are the victims. This will have to be corrected sooner or later.

San Francisco, Cal.,

December 24, 1925.