X-9537

THE FEDERAL RESERVE SYSTEM AND THE BANKING ACT OF 1935

ADDRESS BY

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DELIVERED BEFORE

PACIFIC NORTHWEST CONFERENCE ON BANKING
UNDER THE AUSPICES OF THE
STATE COLLEGE OF WASHINGTON

AT

PULLMAN, WASHINGTON

Thursday, April 9, 1936
2:30 P.M.
110 Mechanic Arts Building

Released for Publication
April 10, 1936
Morning Papers.

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THE FEDERAL RESERVE SYSTEM AND THE BANKING ACT OF 1935.

The four states which are represented in this meeting - Washington, Oregon, Idaho and Montana - are remarkable for their highly diversified resources. Among a host of other things, they produce beef, butter, copper, fish, fruit, gold, grain, lumber, mutton, petroleum, and wool. These products moreover are all important - they are not merely incidental. The geography of your region is full of variety. You span the great Divide, and of your two great river systems, one carries you to the Pacific and one toward the Atlantic. You have in Puget Sound and in the mouth of the Columbia two of the greatest of American harbors. You have some of the most strikingly beautiful mountains in the world, and some of the loveliest lakes. Furthermore, the fixed plant that has been built up in your four states in the course of two generations is remarkable. You have great irrigation systems, hydro-electric systems, mines, docks, railways, and steamship lines. You have in abundance the things that should maintain your people in comfort and make their lives interesting.

I am not telling you these things to flatter you. I am speaking of them because they are the background to the banking of the region. Banking takes its character from the economic life in which it is carried on. It adapts itself to what the people do, and their interests become the banker's interests.

In one sense, banks are engaged in individual extensions of credit. It is a question of one risk after another - who can be safely financed and to what extent and on what security, and who can not. But that is

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not all. In another and larger sense banks are constantly engaged in moving the products of their regions out to the markets and consumers of the world and in moving in to their own population the things it buys in exchange. Here in the Palouse country where we are meeting, the bankers every year move the great wheat crop out to the ports and the mills. Over in Wenatchee they move the great crops of apples. Down in the Snake River valley in Idaho they move the crops of potatoes. Back in Billings they move the wool-clip. The value of the products shipped from your four states to the markets of the United States and of the world is great, and it is through the bankers that these products are exchanged for what the people of your region buy from the outside. During a long season of the year you are financing your farmers, your stock men, your orchardists. They are drawing on your reserves to meet the cost of equipment, of feed, of labor, and of supplies. Then as their crops are marketed and funds are placed to your credit in Chicago, in New York, in San Francisco, and other cities, your reserves again accumulate, and your customers are ready for the new season.

It is unfortunate that people generally fail to realize this fundamental function of the banks. They think of the banks as merely local affairs, which they have a hard time borrowing from at one season of the year and a hard time repaying at another. They do not see that because of the banks, credit is enabled to flow into the region to pay them for their products, and is enabled to flow out again in payment for the products they buy elsewhere. They see very plainly that steamers and

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railways carry away their wheat, their fruit, and their wool, and in exchange bring in to them from other regions the clothing and the machinery they need, but it is not so easy to see that without the system of credit the system of transportation would be of little use.

The importance of bank credit in the form of deposits is indicated by the fact that people almost invariably prefer it for payments in large amounts. A farmer who is selling his year's crop usually expects a check and would be surprised and inconvenienced if he were paid in currency or coin. The check represents bank credit; and when the farmer takes or sends it to the bank, the credit goes on the bank's books under his name. The arrangement is safe and convenient.

But there is far more to be said for bank credit in the form of deposits than that its use is convenient and safe. In our economy it has become indispensable. Without it how would it be possible for the people all over the United States and all over the world who use the products of your region, to pay for the timber, the metals, the wool-clip, and the salmon-pack, which you furnish them? Should currency be shipped in to pay for it all; and then shipped out again to pay for the carpets, the tractors, and the securities that your people buy?

The system of bank credit ties together things that are far apart in space and time. It enables the cattle and sheep raiser to build up his herds and flocks over a period of years to the point of their greatest value. It enables the farmer to be paid for his wheat even when it is eaten on the other side of the earth. It enables funds

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which are idle in New York to be put to use in Spokane within a few moments. It enables the people of your region to enjoy the various products of regions different from theirs.

These things are possible because the system of bank credit covers the whole country like a net-work of power lines, and supplies means of payment wherever needed. Wherever and whenever local bank reserves run low, as must regularly be the case in a region which is predominantly agricultural, the temporary deficiency can be made up. Whenever things produced in one place are paid for and consumed by people in another place the system of bank credit makes it possible to effect the payment readily. There is, however, one essential - the credit must be everywhere liquid and based on sound values; otherwise the system becomes clogged and stops working. The loss in that event is more than a loss to local stockholders and depositors. The loss is to the community whose processes of production and consumption have been to some extent disrupted.

Before 1914 this country had quite inadequate means of mobilizing its bank credit. Every bank in the country constituted a separate pool of credit - a pool that was not always adequate for local purposes, and yet that had no close connection by which it could always be replenished swiftly and easily. The banking system bore the same relation to what we have now, as a scattered number of independent power plants with potential connections would bear to an articulated power net-work. The banks in regions such as yours were comparatively well off under such

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an arrangement because, as I said in the first place, your economic activities are highly diversified. But in the south and back in the middle west, where whole regions are dominated by a few great cash crops, and where everyone is being paid at one period of the year and is paying out the rest of the time, the difficulties of mobilizing bank credit were extreme.

It was such difficulties as these that led to the establishment of the Federal Reserve System. They were difficulties that arose from the fact that the nation-wide exchange of commodities and services - especially the inter-regional exchange - had to be accomplished with banks whose interests and facilities were primarily local. In order that banks might meet the requirements of their communities more adequately, they needed closer interconnections with other communities, and a system through which means of payment for their regional products might be always and unfailingly available. The Federal Reserve banks were established to meet that need. They bind the 6,400 member banks of the country into a system which can make credit available for production and trade wherever and whenever it is required and in any amount. Practically all the functions which the Federal Reserve banks perform were previously performed in one way or another by different agencies, but it is believed that they are now performed more systematically and smoothly than before.

II.

In the course of twenty-two years much experience and knowledge have been derived from the operations of the Federal Reserve System.

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Some problems which the System was devised to remedy have now been settled and others have taken their place. At the same time the conception of central banking functions has changed in many respects. The net result is that the System presents in certain ways a different aspect from what it did formerly.

Twenty-two years ago the ideas prevailed that the important functions of the Federal Reserve banks were to furnish an elastic currency, to lend to member banks which were short of money some of the reserve funds accumulated by other member banks, and to curb the speculative use of credit by rediscounting only paper representing self-liquidating commercial transactions. These ideas now appear quite inaccurate, or at least inadequate. Furnishing currency is seen to be less important than it was thought to be, because currency cuts a very small figure in the total of payments that are made by people in their dealings with one another. What they use for the most part, as I have already indicated, is bank credit in the form of deposits. The control of bank credit as a whole is, therefore, of greater importance than the control merely of the currency supply; it is also incomparably more difficult.

In the second place, the reserve banks do not depend on the deposits which member banks maintain with them for the ability to make loans and buy securities. They have the same kind of power you bankers have, to acquire additional assets by entering deposit credits on your books in favor of the person who discounts a note with you or sells you a bond or mortgage. Consequently, if a member bank's reserves

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are deficient, it can turn over some of its assets to the reserve bank and receive a credit to its reserve account. The reserve bank in such a transaction is not lending to one bank what it owes to another; it is exercising the familiar banking power of paying for assets by the entry of deposit credit.

In the third place, it is recognized that there is no necessary connection between the form in which credit is procured from a bank and the form in which it is used. Money may be borrowed on acceptances and yet be used in the stock market. It may be borrowed on a real estate mortgage and yet be used to buy merchandise. It may be borrowed on the security of speculative stocks and yet be used to finance the production and shipment of commodities. Consequently, any discrimination for or against a certain type of paper offered for discount does not mean that speculation is being controlled or that credit is being supplied for the needs of commerce. The task of controlling the use of credit is far more difficult than such a supposition would imply.

The instrumentality that is now considered the most important for the control of credit is one that in the original reserve act was given only rudimentary attention. I refer to open market operations. These operations are important because they make it possible for the central banking organization - in this case the Federal Reserve banks directed by the Federal Open Market Committee - to exercise control over the volume of bank deposits and reserves. This means control over the volume of "money", or means of payment, required by the people in their economic life.

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The principle of open market operations is of course simple. If securities are sold in the market by the Federal Reserve banks, they must of necessity be paid for with bank funds, for they will be bought either by the banks themselves or by bank customers. Consequently, in the process of paying for them there will necessarily be debits to be entered against the reserve accounts maintained with the reserve bank by the member banks. Upon completion of these entries, the reserve bank will have disposed of certain assets and simultaneously will have decreased the total amount outstanding to the credit of member banks in their reserve accounts. The Reserve bank does not know in advance of its transactions what particular member bank accounts will be affected nor by how much, but it knows that if it sells a million dollars worth of securities, approximately a million dollars worth of available bank credit will be extinguished.

If, as a consequence, reserves are reduced to a minimum, the member banks are immediately impelled to restrict their extensions of credit, for they cannot continue making loans and increasing the deposit credit outstanding on their books without incurring a deficiency in their reserves. The result of the Reserve bank's action in selling securities, therefore, is to curtail the lending power of member banks and to tighten the money market.

On the other hand, if securities are bought by the Reserve bank, the result will be that in the process of paying for them the Reserve bank will have to credit the reserve accounts of member banks. Again

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it does not know to what extent particular member banks will be affected, but it does know that reserves in general will be increased. By the same token the lending power of the member banks will be increased and general credit conditions will be eased. In the first stages of a buying program, the effect will be to enable banks to pay off any obligations they may owe, but if a buying program is continued long enough it may result in an accumulation of excess reserves.

In addition to the effect upon the reserves of member banks, there is also an effect upon bank deposits in general - even non-member bank deposits; because, if an investor or an institution buys some of the securities sold by the Reserve bank, payment will ordinarily be made out of a checking account and deposits will be decreased by so much. If, on the other hand, the Reserve bank is buying securities, and institutions and individuals are selling to it, the payments made by the Reserve bank will increase the deposit credit outstanding on the books of banks. Accordingly, banks which are not members of the Federal Reserve System and banks which themselves have not purchased or sold securities as a result of the Reserve bank's action, will nevertheless be affected by it, either in their reserves or in their deposits, or in both. The money market as a whole will be influenced.

The effect of open market operations may be expressed in various ways, according to what one considers the most important aspect. It may be said when purchases are being made, that funds are thereby being placed at the disposal of member banks which can be used to pay off

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indebtedness at the Reserve banks or as a basis of additional credit expansion. Contrariwise, it may be said, when sales are being made, that funds are being withdrawn from the member banks and that the latter are being compelled either to increase their indebtedness at the Reserve banks or to contract their loans and investments. It may be said, therefore, that open-market purchases tend to encourage an expansion of credit and open-market sales tend to encourage a contraction of it.

Turning to the other side of the balance sheet, it may be said that open-market operations have the effect of expanding or contracting bank deposits and thereby of increasing or decreasing the volume of money, or means of payment, required by the people for the transaction of their business. It may be said, without confining the statement to member banks, that open-market operations increase or decrease the supply of funds in the money market, and if they are timely, that they moderate any tendencies either to tightness or excessive ease. All of these descriptions are fair; all merely emphasize various aspects of what open-market operations tend to accomplish.

So much for principle. In practice, of course, all kinds of factors may conflict with a given program; just as all kinds of things may conflict with a man's attempt to drive his car straight through town without stopping. The proper exercise of open market powers is an art. It requires constant study of means and ends, and appraisal of the conditions under which a given program of action can be expected to accomplish its purpose.

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The Federal Reserve banks at first attempted to carry on their open market operations independently of one another, but it soon became clear that their actions must be coordinated. Otherwise they might find themselves competing with one another, and in conflict as between their own transactions and those transactions which as fiscal agents of the Government they were conducting for the United States Treasury. Accordingly, in 1922 a committee of Reserve bank officers was appointed for the purpose of coordinating the operations. About the same time the purpose of the operations was clarified. The principle laid down was: "That the time, manner, character, and volume of open-market investments purchased by Federal Reserve banks be governed with primary regard to the accommodation of commerce and business and to the effect of such purchases or sales on the general credit situation."

For some time prior to this there had been a tendency to allow purchases and sales of securities to be influenced by profit as an objective. The statement of principle which I have just quoted meant a definite abandonment of that objective. This was in line with the general policy of central banks in conducting open market operations; they do so definitely with the idea of correcting market tendencies and not for the purpose of making earnings.

The Banking Act of 1933 gave open market operations more specific recognition than they had had in the original Act. It gave statutory standing to the Federal Open Market Committee, which by then comprised one representative from each Federal Reserve bank. No Reserve bank

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could engage in open market operations except in accordance with regulations of the Board. At the same time the Act adopted substantially the same statement of purpose which had already governed open market operations.

The Banking Act of 1935 gave still further attention to the machinery of open market operations and to recognition of their importance. The Federal Open Market Committee was reconstructed to comprise the members of the Board of Governors of the Federal Reserve System and five representatives chosen regionally by the twelve Federal Reserve banks. This made the members of the Board constitute a majority of the Committee, and marked considerable development away from the original informal arrangements by which the Federal Reserve banks first conducted open market operations on their own initiative and then under the direction of a Committee on which the Board was not specifically represented. Furthermore, under the terms of the Banking Act of 1935, the Federal Reserve banks may neither engage nor decline to engage in such operations except in accordance with the directions and regulations of the Committee.

Another requirement of the Act is that a complete record be kept of the action taken on all questions of policy relating to open market operations, including a record of votes taken in connection with the determination of open market policies and a statement of the reasons underlying the action taken, and that this record be included in the Board's annual report. The publication of this record will give the public an opportunity to study the decisions as to open market policy

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and credit policy in general, and should help clarify public discussions of national credit policy. It will also accentuate the individual sense of responsibility, for members of the Committee will be called on not only to decide on credit policy, but to give publicly the reasons for their decisions.

It is clear, I think, that as a result of experience and statutory amendments, open market operations have taken a far more important place in general credit policy than they formerly had. It is also clear, I think, that open market operations have become a more important or at least a more positive device of credit control than discount rates. When the Federal Reserve Act was adopted the prevailing idea probably was that discount rates were not only the most definite means of credit control, but the most important. The thought was that as banks felt more and more demand from borrowers and went to the Reserve banks to procure the funds to meet it, they would encounter a rising discount rate, which would have the effect of tempering the demand and preventing an excessive use of credit. Conversely, as conditions improved, business activity would be encouraged by the fact that banks could procure funds to lend at a progressively lower rate. The most obvious difficulty with this theory, however, is that banks have not shown a disposition to borrow from the Reserve banks in order to relend. Banks don't like to borrow, and as a general thing they won't borrow unless they have to, no matter how low the discount rate is. Consequently, the effectiveness of the Federal Reserve discount rate is, by itself,

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rather limited. It is significant as an index of the cost of credit, but it does not come into action otherwise until a member bank finds it necessary to replenish its reserves. As I have already indicated, however, a member bank may be forced into such a position as the result of sales of securities by the Reserve bank, and the discount rate then becomes effective.

In other words, an important difference between discount rates and open market operations in practical effect is that open market operations give the central banking organization the initiative in the control of credit, whereas the discount rate by itself offers the controlling authority no handles to seize; it must bide its time passively until the situation is so bad that demand for funds is voluntarily made. This delay may seriously impair the power of the Federal Reserve bank to help the situation.

The Banking Act of 1935 made only one change in respect to discount rates. This was to require that they be established every fourteen days or oftener. It is not necessary that the rates be changed every time, but they must at least be reviewed and reestablished.

With respect to the reserves which member banks are required to maintain, the Banking Act of 1935 makes a very important change, by simplifying the conditions under which the Board of Governors of the Federal Reserve System may alter the amount of reserves which is prescribed in the law. Prior to 1933, there was no authority to change reserve requirements administratively, but an act of May 12 of that

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year empowered the Board, with the approval of the President, to declare that an emergency existed and during the emergency to increase or decrease the reserve balances to be required. The Banking Act of 1935 allows reserve requirements to be changed by the Board without declaration that an emergency exists and without approval of the President. It does not permit, however, requirements to be reduced below the percentages stated in the statute nor to be more than doubled. The purpose of any change made in the requirements must be, in the words of the law, "to prevent injurious credit expansion or contraction."

With this power to alter reserve requirements and with the change by which the members of the Board constitute a majority of the Federal Open Market Committee, the Banking Act of 1935 definitely strengthened and centralized the control of credit. Another movement in the same direction was taken by the Securities Exchange Act of 1934, which authorized the Board to regulate the amount of security to be required on margin accounts by stock brokers and dealers and to regulate the making of loans by banks and others for the purpose of purchasing and carrying listed securities. These changes give the Governors of the Federal Reserve System more effective powers for the control of credit than ever before.

On the other hand, the regional autonomy of the Federal Reserve banks in their relations with member banks is preserved. Generally speaking, the Reserve banks are responsible for member bank relations and act as the agencies of system activities, while the Board in

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Washington, with the help of representatives of the Reserve banks, is responsible for central credit and monetary policy.

The Banking Act of 1935 also made important changes in the constitution of the governing body of the Federal Reserve System, which is no longer known as the Federal Reserve Board, but as the Board of Governors of the Federal Reserve System. The Secretary of the Treasury and the Comptroller of the Currency ceased to be ex officio members of the Board February 1, and provision was made for the Board to consist thereafter of seven members appointed by the President. The members now in office have terms ranging from 2 to 14 years and upon the expiration of the present terms all succeeding members will be appointed for terms of 14 years instead of 12 years as under the previous law. As formerly, not more than one member may be appointed from any one Federal Reserve district, and the President, in selecting the members, is to "have due regard to a fair representation of the financial, agricultural, industrial and commercial interests and geographical divisions of the country".

Since March 1, under the provisions of the Act, the chief executive officer of each Federal Reserve bank has the title "president", instead of "governor", and the title "vice-president" replaces that of "deputy governor". Both the president and the first vice-president are appointed by the Board of Directors for a five-year term with the approval of the Board in Washington. Formerly, as you know, the offices of governor and deputy governor were not specifically recognized by statute.

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The responsibilities of the Federal Reserve banks as fiscal agents of the United States were not changed by the Banking Act of 1935, except for a provision which permits the Reserve banks to buy government obligations only in the open market; direct purchases from the Treasury are not authorized.

III.

I think I have covered sufficiently the more prominent changes which the Banking Act of 1935 made with respect to Federal Reserve functions, and I wish to speak now of those features of the Act which more directly affect the operations of member banks.

The first of these has to do with lending powers.

Indirectly, the Act tends to broaden member bank lending powers by giving the Reserve banks authority to make advances to member banks on any satisfactory security. The former provisions still stand as to paper that is known under the original terms of the Federal Reserve Act as "eligible" for discount - paper, that is, which originates in connection with industrial, commercial or agricultural transactions - and they also still stand as to advances to member banks on notes secured by eligible paper or by Government obligations. The new provisions are added to these old ones without altering them. Advances authorized by the new provisions are simply required to be secured to the satisfaction of the Reserve bank, to bear a rate of interest at least one-half percent above the Reserve bank's discount rate, and to have maturities of

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not more than four months. At present, when the banks have large excess reserves, this new provision in the law may not seem very important. But times may change. If and when they do, the new provisions mean that, assuming a bank's assets are good, the Federal Reserve bank will be able to advance money on them, no matter what the type of paper, or the nature of the transactions in which they originated. In other words, borrowing from the Federal Reserve bank has now been made possible on other than technical conditions of eligibility alone. This is very important. Many banks in recent years would have had much less trouble if they could have taken to the Reserve bank some of their assets which were good, but not legally eligible under the old terms of the law, instead of having to sacrifice them on a demoralized market. Provision for such advances was first adopted as a temporary, emergency measure in 1932, but the Banking Act of 1935 made it permanent.

The original provisions of the law with respect to eligible paper were based on the principle that since the liabilities of banks were payable on demand they should be offset by short-term self-liquidating paper based on specific transactions involving the exchange of goods. The amendments added by the Banking Act of 1935 are based on the principle that in fact American banks do not specialize in one type of credit as against another. They deal in credit of all sorts. They combine long term and short term credit functions. There is not enough short-term commercial paper to fill more than a small part of their portfolios. They accept the savings and time deposits of their

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communities and they also hold long term obligations of their communities. The new provisions for eligibility make the Federal Reserve Act cognizant of these realities and adapt the powers of the Reserve banks to them.

In a more direct way, the Banking Act of 1935 broadened lending powers by liberalizing the conditions under which National banks may make real estate loans. The old stipulation that the real estate upon which such loans are made must be situated in the bank's Federal Reserve district or within a hundred miles of the bank, has been removed; and loans which are amortized are now permitted in amounts up to 60 percent of the appraised value of the property and with maturities of as much as ten years, provided installment payments are sufficient to repay at least 40 percent of the principal in that time.

The permissible aggregate of real estate loans which a national bank may hold has been changed by the Act from 25 percent of its capital and surplus or 50 percent of its savings deposits, whichever is greater, to 100 percent of its capital and surplus or 60 percent of its time and savings deposits, whichever is greater.

In connection with this subject of enlarged lending powers I want also to mention the provision of the Federal Reserve Act authorizing loans for working capital purposes. The provision is a year older than the Banking Act of 1935, but it belongs logically with these more recent ones I have just been discussing.

Under this provision loans with maturities not exceeding five years

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which have been made by member banks or other financing institutions to established industrial and commercial businesses in need of working capital may be discounted by the Federal Reserve bank. Nor is that all. If the member bank wishes to hold the loan, but wishes also to be assured that it can be disposed of at any time if need be, a commitment may be procured binding the Federal Reserve bank to take over the loan when and if requested to do so. It may also be arranged that the loan be taken over without recourse for as much as 80 percent. Under such circumstances, the member bank has a loan which is insured 100 percent as to liquidity and 80 percent as to loss. This arrangement, however, is not restricted to member banks; it is open to non-members as well.

These loans have been made to all kinds of enterprises, industrial and commercial. In many cases they have been loans which bankers have not been accustomed to making, and which would not have been made were it not for the fact that the Reserve bank stands behind them.

I think I have now covered the changes of most general interest that were brought about by the Banking Act of 1935, but there are numerous other provisions that it may be worth while to mention without attempting to discuss them.

First there is the matter of deposit insurance, which has been made permanent on a basis similar to that originally adopted as temporary. As you know, insured banks are now subject to an annual assessment at a fixed rate - one-twelfth of 1 percent of deposits - instead

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of being under unlimited liability as would have been the case under the old permanent plan. Insurance covers deposits up to $5,000 for any one depositor, instead of $10,000 or more as the first permanent plan contemplated.

After July 1, 1942, no state bank with average deposits of $1,000,000 or more may be an insured bank without becoming a member of the Federal Reserve System. This provision had the effect of postponing required membership for several years. At the same time, the Board was given the power to waive in whole or in part the statutory requirements with respect to admission of State banks to membership.

The former prohibition against a member bank's purchasing and holding more than 10 percent of a particular issue of investment securities has been eliminated, but the total of the obligations of one obligor which may be purchased and held by a member bank is reduced from 15 percent of the bank's capital and 25 percent of its surplus to 10 percent of its capital and surplus. Banks are not required to dispose of securities lawfully held at the time the law was enacted. It has also been made clear, in conformity with previous rulings of the Board and of the Comptroller of the Currency, that member banks may purchase and sell stocks for the account of their customers. They may not purchase and sell stocks for their own accounts, however.

Several important changes were made by the Banking Act of 1935 with respect to affiliates and holding company affiliates of member banks. These changes modify considerably the original requirements. When the

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first legislation defining affiliates and requiring reports of them was adopted in the Banking Act of 1933, it was undoubtedly directed primarily at securities affiliates and affiliates formed for the purpose of engaging in activities in which member banks were either not authorized to engage or in which it was not felt expedient for them to engage. The definitions, however, were made extremely comprehensive, and as a result a very large number of organizations were caught in a net that was never intended for them. It frequently happened that banks were surprised to discover that under the law they had "affiliates", when as a matter of fact no such idea was in their minds. A bank might find that it had as an affiliate a corporation which belonged to an estate of which it was trustee; or it might find that it had as an affiliate a corporation whose stock happened to be owned by persons who owned the bank's stock. There might be no financial connection between the two and yet at every call date a report would have to be procured from the affiliate and published. The original purpose of the law had been accomplished so far as affiliates dealing in securities were concerned, for they all disappeared, but the number of other affiliates reported to the Board was increasing - not because banks were forming new affiliations, but because unknown and unintended affiliations, quite accidental in fact, were constantly coming to light.

Under amendments made by the Banking Act of 1935 the Board and the Comptroller of the Currency are now authorized to waive reports which are not necessary to disclose fully the relations between a member bank

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and its affiliate and the effect thereof upon the affairs of the bank. The result of the new provisions will be to relieve a large number of banks from the requirement originally imposed without exception. Roughly speaking, under the conditions of waiver that have been announced, organizations which are affiliates under the terms of the law need not submit reports unless they are indebted to the affiliated member bank or unless shares of their stock or other obligations are owned by the member bank in excess of certain minimum amounts. Reports of affiliations which are based solely on ownership or control of an organization's stock by a member bank in a fiduciary capacity are also waived. This, it is believed, has been welcome news to many banks.

In addition, organizations which own or control the stock of a bank, but are found by the Board of Governors of the Federal Reserve System not to be engaged as a business in holding bank stocks, have been exempted by the law from the requirements imposed on holding company affiliates, except in the matter of indebtedness to their affiliated member banks. This provision has made possible a distinction between holding companies organized for the purpose of holding bank stock, and companies which incidentally own control of a bank, while their principal business lies in a different field.

Double liability on National bank stock issued <u>after</u> June 16, 1933, was ended by the Banking Act of 1933, and under the Banking Act of 1935 National banks may terminate on July 1, 1937, or thereafter, the double liability on stock issued <u>prior</u> to June 16, 1933. It is possible,

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therefore, that all shareholders of active National banks will soon be relieved of personal liability on their shares. At the same time National banks are required to accumulate a surplus equal to the amount of their common capital. This change should be better both for bank shareholders and for the public. Personal liability for bank shares has never been a satisfactory protection to depositors, and it has placed a burden on shareholders of banks not borne by shareholders of other corporations.

There are several provisions which are of importance in connection with deposits and the interest payable thereon. In the first place, the rate of interest paid at offices of the Postal Savings system is not to exceed the maximum that Federal Reserve regulations allow to be paid on savings deposits by member banks in the same place; and postal savings depositories may deposit funds on time with member banks subject to the provisions of the Federal Reserve Act and to regulations of the Board of Governors of the Federal Reserve System regarding payment of interest on time deposits. In addition, the Federal Deposit Insurance Corporation was required to forbid the payment of interest on demand deposits by insured non-member banks, and to regulate the rate of interest paid by them on time and savings deposits. This provision explicitly gave the Federal Deposit Insurance Corporation authority with respect to non-member insured banks similar to that which the Board of Governors of the Federal Reserve System has with respect to member banks. The Act also repealed the former statutory definitions of demand and

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time deposits; the Board of Governors is authorized to formulate new definitions in their place, and to determine what is to be deemed a payment of interest.

For the purpose of computing the reserves which member banks are required to carry, amounts due from other banks (except Federal Reserve banks and foreign banks) and certain cash items in process of collection may now, as you know, be deducted from gross demand deposits. As a result of this change country banks, which hold no balances due to other banks, may now make their deductions on the same basis as city banks, which hold balances due to other banks in large volume.

I think it is not necessary to go further into details of the 1935 Act. They are numerous, but most of them that I have not mentioned are technical and minute. I have discussed the essential points of Title II of the Act, and a few of the more important points of Title I, which deals with deposit insurance, and Title III, which mainly clarifies or modifies technical provisions already in force.

You will realize that the changes effected by the law have necessitated a great deal of work upon the regulations which the Board has to issue. Regulations on new subjects have had to be prepared and old regulations have had to be altered.

IV.

The general results of the changes I have spoken of, which have been largely but not wholly effected by the Banking Act of 1935, may be summarized as follows:

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In the first place, the 6,400 member banks have broader lending powers, and the facilities of the Federal Reserve banks have been made available to them on less technical and restrictive terms.

Second, the Federal Reserve banks remain essentially unchanged in organization and function, though the importance of their central banking activities has been more clearly recognized.

Third, the Federal Open Market Committee has been given a more effective position in the System and more definite authority.

Fourth, the Board of Governors has been given larger powers and more direct responsibilities, and the principles upon which the System is to be administered have been more clearly developed.

I do not mean to imply that with these changes brought about by recent legislation the task of credit control has been made easy. Far from it. It is hard to imagine that the control of credit ever will be a simple matter. There are too many conditions affecting it. To mention only one thing that has an important bearing on credit control, there has never been a time when the membership of the Federal Reserve System included as many as half the banks in the country. It does not now. The majority of banks in the United States are outside the System. Although it is true that the System includes most of the large banks and that it, therefore, includes the bulk of the banking business of the country, still from the point of view of the communities they serve and of relations with other banks, the importance of the thousands of small banks which are outside the System is not negligible. But I

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feel that in spite of difficulties - indeed because of them, perhaps - there is a growing sense of the importance of the System as an instrumentality of public service. The function of central banking, which looks definitely to the public good as a whole, is one that legislation is more and more emphasizing.

What we are now seeking to do in the field of bank credit may well be compared with what past generations attempted to do in establishing coinages of uniform and honest value, in simplifying currency, and in preventing wholesale issues of counterfeit and spurious notes. In the past, repeated efforts had to be made almost universally in order to standardize and protect the legal-tender - efforts that were the more important because people more generally depended on paper currency and coin for means of payment then than they do now. Today, with the increasing use of deposit credit in our interdependent economic system, the nature of the monetary problem has changed again. Bank credit must be kept always available in adequate amounts for the monetary needs of the country. Whether our problem is harder than those that previous generations had, I will not pretend to say. In some respects it is the same, but in the swift pressure of our economic life it is always presenting new aspects even while we study it, and requiring the adaptation of the old instrumentalities to newly developed needs.

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