W. Clayton

January 29, 1940
B. Magruder Wingfield

CONFIDENTIAL

MEMBERSHIP STATUS OF A STATE BANK RESULTING FROM A SO-CALLED CONVERSION OF A NATIONAL BANK INTO A STATE BANK

Does a national bank which converts into a State bank under a State statute which provides for the transfer, by operation of law, of all the assets and liabilities of the national bank into the State bank continue to be a member of the Federal Reserve System after its conversion into the State bank?

CONCLUSION

The answer to the above question is clearly "no", for a number of reasons which will be hereinafter discussed.

DISCUSSION

Board's established position. It has been the consistent position of the Board since at least as early as 1923 that a State bank resulting from a so-called conversion of a national bank does not continue to be a member of the Federal Reserve System. In cases where the question has been involved, the Board has required that an application for membership be made by or on behalf of the State bank and that it only be admitted to membership with the Board's approval and subject to such conditions as the Board deems advisable. Apparently the principal fact upon which the Board has based its conclusion is that in any such case the national bank involved must be placed in liquidation in order to terminate its existence.

A similar position has also been taken by the Board with reference to Clayton Act permits. It is the Board's position that where a permit was issued to a person to serve a national bank and other banks under the Clayton Act and the national bank went through a so-called conversion into a State bank the permit covering the service of the national bank did not permit service of the resulting State bank. Here again the determining fact apparently was that the national bank must be placed in liquidation in order to terminate its existence.

Provision made for admission of State banks to membership. The circumstances under which a bank may become a member of the Federal Reserve System is for the determination of the Congress of

the United States. Where, as in this case, Congress has authority to legislate, its enactments are supreme and cannot be controlled or their application interfered with by State legislation. (See Farmers and Mechanics National Bank v. Dearing, 91 U. S. 29 (1875), Davis v. Elmira Savings Bank, 161 U. S. 275 (1896), Easton v. Iowa, 188 U. S. 220 (1903), and State of Missouri v. Duncan, 265 U. S. 17 (1924))

Congress, in the Federal Reserve Act, has prescribed in detail the manner in which banks may become members of the System and has not provided that a State bank resulting from a so-called conversion of a national bank shall become a member of the System by reason of such conversion. The provisions of the Federal Reserve Act clearly demonstrate that the statute does not permit a State bank to become a member of the System in this manner. The following facts show that this is the case.

The existence of a national bank may be terminated only through the appointment of a receiver or through voluntary liquidation by action of the stockholders. Sections 5 and 6 of the Federal Reserve Act provide that in either event the stock held by the national bank in a Federal Reserve bank "shall" be surrendered and canceled.

In order to avoid the possibility that a national bank shall cease to do a banking business and still remain a member of the Federal Reserve System, section 6 of the Federal Reserve Act further provides that if a national bank which has not gone into liquidation and for which a receiver has not already been appointed, for other lawful cause shall discontinue its banking operations for a period of 60 days, the Comptroller may appoint a receiver for such bank. Upon the appointment of such a receiver, the Federal Reserve bank stock held by the bank "shall" be canceled.

There is no provision of the National Bank Act which recognizes the conversion of a national bank into a State bank without the liquidation of, or the appointment of a receiver for, the national bank. Therefore, in the case of any so-called conversion of a national bank into a State bank, the Federal Reserve bank stock held by the national bank, under the above mandatory requirements of the Federal Reserve Act, must be canceled upon its liquidation or receivership; and a State bank resulting from a so-called conversion of a national bank could not continue to hold such stock and by virtue of such holdings remain a member of the Reserve System.

In addition to the above, Congress has specifically provided the manner in which a State bank may become a member of the Reserve System.

It is provided in section 9 of the Federal Reserve Act that a State bank desiring to become a member of the System may make application to the Reserve Board under such rules and regulations as it may prescribe for the right to subscribe to the stock of the Federal Reserve bank of the district in which the State bank is located. The Board is specifically authorized to permit the bank to become a stockholder of the Federal Reserve bank "subject to such conditions" pursuant to the Federal Reserve Act as the Board may prescribe.

In acting upon the application of any State bank, the Board is required to consider the financial condition of the applying bank, the general character of its management and whether or not the corporate powers exercised are consistent with the purposes of the Federal Reserve Act. If the applying State bank is a noninsured bank, the Board is required to certify to the Federal Deposit Insurance Corporation that in acting upon the application it has considered "the financial history and condition of the bank, the adequacy of its capital structure, its future earnings prospects, the general character of its management, the convenience and needs of the community to be served by the bank, and whether or not its corporate powers are consistent with the purposes of this section". (Section 12B of the Federal Reserve Act)

In view of these provisions, it is clear that Congress contemplated and required that a State bank shall become a member of the System only with the approval of the Reserve Board and subject to such conditions as it may prescribe.

Court decisions to effect that corporate entity continues. Certain court decisions have been cited as holding that where a national bank converts into a State bank there is no change in the corporate entity. Even if these decisions are legally correct with respect to this theory, it is not believed that they are in point or have any bearing on the question whether the converted State bank would continue to be a member of the Federal Reserve System. As heretofore pointed out, Congress has not made provision for any such continuation of membership and has clearly made provision to the contrary.

The cases referred to involve questions of creditor or similar relationships between the bank and third parties. The cases

hold quite properly that where a national bank has converted into a State bank liability for obligations incurred with respect to the national bank is not terminated. In so holding, the courts, even in cases where the record before the court showed that the national bank was, in fact, placed in liquidation under the National Bank Act, have used language (believed to be a dictum) describing the transaction as resulting in a continuation of the same body retaining its identity under a changed jurisdiction. However, the questions before the courts in those cases were so entirely different from the question whether a national bank, when converted into a State bank, continues to be a member of the Federal Reserve System that I do not believe the cases have any precedent value on the latter question. Copies of headnotes of two of such cases, Jewett City Sav. Bank, v. Board of Equalization of Connecticut, 116 Conn. 172, 164 Atl. 643; and First Commercial Bank v. Talbert, 103 Mich. 625, 61 N. W. 888, are attached hereto.

Board's position regarding holding of Federal Reserve bank stock by a national bank resulting from conversion of State member bank. It is the Board's position, as reflected in its Regulation I since 1920, that when a State member bank is converted into a national bank it may continue to hold as a national bank its shares of Federal Reserve bank stock previously held as a State bank. The certificate of stock issued in the old name of the member bank, however, is surrendered and canceled, and a new certificate is issued in lieu thereof in the new name of the member bank.

This position of the Board, however, is not a precedent for the proper position with regard to the continued holding of Federal Reserve bank stock by a State bank resulting from a so-called conversion of a national bank into a State bank. There are two principal reasons for this conclusion.

A national bank becomes a member of the System by virtue of requirements of law rather than with the approval of the Board, and an application for Federal Reserve bank stock is not legally required in any such case. As a matter of maintaining records, new national banks, other than those resulting from conversion of State member banks, do make application to the appropriate Federal Reserve Agent for Federal Reserve bank stock. In the case of a conversion of a State member bank into a national bank, it apparently has not been considered necessary, even as a matter of record for an application for stock to be made. When the Board included in its Regulation I the provision with reference to Federal Reserve bank stock held by a national bank resulting from a conversion of a State member bank it apparently had in mind the fact that the

national bank was considered the same corporate entity under a changed jurisdiction and that it lawfully held the Federal Reserve bank stock previously issued to the converted State member bank. However, as will be shown hereafter, a conversion of a State bank into a national bank does not result in the liquidation of the State bank.

The National Bank Act provides that a conversion of a State bank into a national bank may not take place if "in contravention of the State law". It is believed that under this provision of the law a conversion cannot be effected where under the State law the State bank must be placed in liquidation. This position is supported by a statement in an opinion rendered by Judge Elliott in 1916 and published on page 117 of the Federal Reserve Bulletin of February 1, 1917. It is also supported by an opinion of the Supreme Court rendered in connection with the attempted conversion of a State savings and loan association into a Federal savings and loan association in the case of Hopkins Federal Savings and Loan Association v. Cleary, 296 U. S. 313, 56 Sup. Ct. 235 (1935). A headnote of the decision in this case is attached hereto. So far as I have been able to determine, the office of the Comptroller of the Currency has not taken a position on this question in writing. However, I am informed by an attorney in that office that he and other members of the staff of the Comptroller's office concur in this conclusion.

In the circumstances, the Board's position with reference to the continued holding of Federal Reserve bank stock previously held by the State member bank which converted into the national bank does not have a bearing on the Board's position with reference to the so-called conversion of a national bank into a State bank, since in the latter case the national bank must be placed in liquidation.

The California conversion statute. The above discussion has purposely been on the basis of a very broad State conversion statute which might or might not in terms provide for the liquidation of a national bank involved in a conversion into a State bank. However, the California conversion statute specifically recognizes that a dissolution of the national bank must take place under the National Bank Act.

In terms, the California statute authorizes a national bank to become incorporated as a State bank, provided such national bank "has authority by virtue of any law of the United States, to dissolve its organization as a national banking corporation". A national bank desiring to become a California State bank is required,

among other things, to "take such action, in the manner prescribed or authorized by the laws of the United States, as shall make its dissolution as a national banking corporation effective at a future date certain".

It is further provided that a majority of the directors of the bank shall, with the approval of the owners of at least two-thirds of the stock of the national bank, execute articles of incorporation and take such action "as shall create a corporation for the purposes set forth in the said articles of incorporation". If the Superintendent of Banks issues his certificate of authorization to transact business, the bank's "corporate existence as a State bank shall begin as soon as its dissolution as a national banking corporation becomes effective". When the corporate existence of the State bank begins, "all the property of the dissolved national banking association shall immediately by act of law and without any conveyance or transfer be vested in and become the property of such State bank". The directors of the dissolved corporation shall be the directors of the bank created until the first annual election of directors thereafter.

A review of the above provisions of the California conversion statute clearly demonstrates that such statute contemplates the termination of the existence of the national bank and the creation of a new State corporation. Certain provisions are made in the State law to facilitate the transfer of the property of the national bank to the State bank and to facilitate the uninterrupted continuance of the business. However, it is apparent that under the provisions of this statute a national bank, when converted into a State bank, could not continue to be a member of the Federal Reserve System in the light of the provisions of the Federal Reserve Act which have heretofore been discussed in detail.

Attachments 3

JEWETT CITY SAV. BANK v. BOARD OF EQUALIZATION OF CONNECTICUT, 116 Conn. 172; 164 Atl. 643.

Facts. - Thames Bank was chartered by the State of Connecticut in 1825. In 1864, the bank converted into Thames National Bank. A state statute provided that where a State bank became a national bank, its charter should not be deemed surrendered but, instead, only suspended and that, upon the bank ceasing to exist as a national bank, the State charter should cease to be suspended and be in full force. In 1929, pursuant to this statute, the bank resumed its rights and powers under its original (State) charter. The national bank was placed in voluntary liquidation by action of its stockholders, a liquidating agent was appointed, and the State bank purchased from the liquidating agent all of the assets and goodwill of the national bank and assumed its liabilities. Subsequently, the State bank consolidated with Bankers Trust Company under the name Thames Bank & Trust Company. The plaintiffs were savings banks which owned stock of Thames Bank & Trust Company, the stock held by them representing investments made in stock of Thames Bank and Thames National Bank prior to April 1, 1901. Under a State statute, they were entitled to a tax exemption with respect to such stock if their investment therein had been made prior to April 1, 1901 or if, in connection with a merger, the stock had been taken in exchange for stock acquired prior to that date.

Decision. - The court held that when Thames Bank became Thames National Bank "it was a mere transition, a change of jurisdiction only, and not the creation of a new bank with new stockholders", and that the "same principle applies where a bank withdraws from the national and returns to the State jurisdiction and operates as a State bank". Thus, the court concluded: "The original investment of these plaintiffs had not lost their identity to the time of the consolidation of the Thames Bank with the Bankers Trust Company."

The court then went on to hold that such consolidation should be considered a merger within the meaning of the tax statute and it may be of interest to note that, in this connection, the court stated:

> "The vote of the directors of the Thames Bank & Trust Company, passed after the merger of the Bankers' Trust Company, in which they authorized certain of their officers to apply to the Federal Reserve Bank for the cancellation of certain stock in it stated to have been held by the president, directors, and company of the Thames Bank, inaccurate as it is in details, evidently used the expression that that bank had ceased to exist only in a qualified sense, in order to take advantage of a provision in the Federal Reserve Act concerning the surrender of stock by a member bank which had ceased to exercise its banking functions."

FIRST COMMERCIAL BANK v. TALBERT, 103 MICH. 625; 61 N. W. 888

Facts. - A national bank held commercial paper endorsed by Leroy Moore & Co., a partnership composed of Moore and Talbert. Talbert gave the national bank a letter authorizing Moore to use his name as one of the firm of Leroy Moore & Co. as endorsers on paper sent the bank for renewals. The national bank was reorganized as a State bank. The State bank took all the papers of the national bank, assumed all its liabilities and had the same board of directors and stockholders at the time of the reorganization. Court stated that reorganization evidently was effected under State law authorizing reorganization of a national bank as a State bank and providing in part as follows:

> "Thereupon all assets, real and personal, of said dissolved national bank shall, by act of law, be vested in and become the property of such state bank, subject to all liabilities of said national bank not liquidated under the laws of the United States before such reorganization."

This was a suit by the State bank against Talbert on a renewal note endorsed by Leroy Moore & Co.

Decision. - In overruling defendant's contention that, since the letter of authority executed by him was directed to the national bank, the State bank could not act upon it and charge the defendant, the court stated that the State bank "is substantially identical" with the national bank. The court stated that it considered the question involved precisely analogous to that which was considered in Bank v. Phelps, 97 N.Y., 44, where the court held that a national bank which was converted from a State bank retained its identity so that a guaranty of payment made to the State bank could be enforced by the national bank. The court quoted the following from Bank v. Phelps:

> "....All property and rights which they held before organizing as national banks are continued to be vested in them under their new status. Great inconveniences might result if this saving of their existing assets did not include pending executory contracts and pending guaranties as well as vested rights of property. Although, in form, their property and rights are state banks purport to be transferred to them in their new status as national banks, yet in substance there is no actual transfer from one body to another, but a continuation of the same body under a changed jurisdiction. As between it and those who have contracted with it, it retains its identity, notwithstanding its acceptance of the privilege of organizing under the national banking act."

[This case was followed in Hicks v. Steel, 142 Mich. 292, 105 N.W. 767.]

HOPKINS FEDERAL SAVINGS & LOAN ASS'N. v. CLEARY, 296 U.S. 313, 56 S. Ct. 235.

Facts. - This was a suit brought by the Wisconsin State Banking Commission to annul proceedings whereby a State building and loan association had attempted to convert itself into a Federal savings and loan association and to compel the directors and officers of the association to continue the business in accordance with Wisconsin law or wind it up. In stating the facts, the court pointed out that building and loan associations organized under the laws of Wisconsin were subject to strict supervision by administrative agencies of the State, both in the course of doing business and in that of liquidation; that they were quasi public corporations, chartered to encourage thrift and promote the ownership of homes; that the statutes provided for voluntary and involuntary liquidation of the associations; and that there was nothing in the State statutes whereby the associations might be transmuted into associations chartered by the Federal Government. The attempted conversion had been in accordance with the procedure set forth in the Federal Home Owners' Loan Act.

Decision. - The court first held that the Federal statute could not be interpreted as meaning that the conversion of State associations into Federal associations should be conditioned upon the consent of the State or compliance with its laws. It then held that the Federal statute, to the extent that it permitted the conversion of State associations into Federal associations in contravention of the laws of the State, was an unconstitutional encroachment upon the reserved powers of the State. In the latter connection, the court stated:

> "A corporation is a juristic person organized by government to accomplish certain ends, which may be public or quasi public, though for other purposes of classification the corporation is described as private. * * * This is true of building and loan associations in Wisconsin and in other states. They have been given corporate capacity in the belief that their creation will advance the common weal. The state, which brings them into being, has an interest in preserving their existence, for only thus can they attain the ends of their creation. They are more than business corporations. They have been organized and nurtured as quasi public instruments. * * * They may not divest themselves of a franchise when once it is accepted if the local statutes or decisions command them to retain it. * * * How they shall be formed, how maintained and supervised, and how and when dissolved are matters of governmental policy, which it would be an intrusion for another government to regulate by statute or decision, except when reasonably necessary for the fair and effective exercise of some other and cognate power explicitly conferred.

"Wisconsin, planning these agencies in furtherance of the common good and purposing to preserve them that the good may not be lost, is now informed by the Congress, speaking through a statute, that the purpose and the plan shall be thwarted and destroyed. By the law of the state, associations such as these may be dissolved in ways and for causes carefully defined, in which event the assets shall be converted into money and applied, so far as adequate, to the payment of the creditors. By the challenged Act of Congress, the same associations are dissolved in other ways and for other causes, and from being creatures of the state become creatures of the Nation. In this there is an invasion of the sovereignty or quasi sovereignty of Wisconsin and an impairment of its public policy, which the state is privileged to redress as a suitor in the courts so long as the Tenth Amendment preserves a field of autonomy against federal encroachment.

* * *

" * * * The power of Congress in the premises, if there is any, being not exclusive, but at most concurrent, and the untrammeled coexistence of federal and state associations being a conceded possibility, we are constrained to the holding that there has been an illegitimate encroachment by the government of the Nation upon a domain of activity set apart by the Constitution as the province of the states."

The case of Casey v. Galli, 94 U.S. 673, relating to the conversion of a State bank into a national bank, was distinguished by the court on various grounds, including the fact that the constitutional question had not been raised, that the State had apparently acquiesced in the conversion, and that there might be a distinction between the powers of Congress with respect to banks and its powers with respect to building and loan associations. The court stated that, in any event, all that was said in that case with respect to the necessity of consent by the State was unnecessary to the decision if it was meant to do more than define the meaning of the Federal statute.

The court finally concluded:

"Confining ourselves now to the precise and narrow question presented upon the records here before us, we hold that the conversion of petitioners from state into federal associations is of no effect when voted

against the protest of Wisconsin. Beyond that we do not go. No question is here as to the scope of the war power or of the power of eminent domain or of the power to regulate transactions affecting interstate or foreign commerce. The effect of these, if they have any, upon the powers reserved by the Constitution to the states or to the people will be considered when the need arises."