1965-1966

The Comptroller of the Currency in Historical Perspective

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The underlying goals and the basic philosophy of this Office have been affirmed on many occasions during the past 5 years. It has appeared to some observers that we were charting a new course, one not in the tradition of the past 100 years and more. These last 5 years have, indeed, witnessed an infusion of new ideas and a genuine effort to make bank regulation a creative, positive process. In particular instances, rulings have been made that were at odds with those of previous incumbents. Yet, even these decisions were well within a tradition that gives wide latitude to the Comptroller of the Currency. In this historical review, we shall reflect on this tradition to see how change occurs within a continuity of fundamental policy.

This report does not pretend to give a full account of the history of this Office and its relationships with the other supervisory authorities.[1] It does trace the key points of change in three main categories of the Comptroller's responsibilities for banking structure: (1) chartering and entry; (2) certification of branches; and (3) action on mergers. The decisions of this Office do not, of course, fall without exception into a logically tidy classification. Indeed, decisions made in one area of policymaking may immediately and directly affect those in another. For example, actions to restrict entry of new banks in a particular State or trade area have often resulted in a steady rise there in applications for *de novo* branches. Or undue restrictions on branching have increased pressures to acquire new offices through mergers or chains. Similarly, a policy of restricting customary forms of multi-office banking has sometimes resulted in the spread of affiliate and satellite banking.

So previous Comptrollers, having dealt with one set of problems, often bequeathed to their successors a legacy of other problems on which to spend their energies. Meantime, the American economy has expanded mightily, often growing where growth was unexpected, occasionally retrogressing in areas that once flourished. But, the resultant of economic forces has been to produce an economic mechanism that demands more and more of its financial institutions. Within the past 2 decades, the most vexing problems of stabilizing the performance of the economy have been at least partly solved, with the consequence that agencies responsible for regulating the commercial banking system have recently been able to act with less trepidation. Yet, the continuing challenge to this Office, as it must be for all bank regulatory agencies, is to assure a banking system that properly lubricates the growth process while maintaining the confidence in the banking system that assures its solvency and liquidity. The Office has endeavored to meet this challenge through innovation consistent with the long tradition of bank regulation in America.

Chartering and Entry

The first Comptroller of the Currency, Hugh McCulloch, was appointed by President Lincoln in 1863. A long-time president of the successful Bank of Indiana, McCulloch brought to the Office a sophisticated knowledge of banking and exceptional administrative ability. A satisfactory solution of the problems confronting him demanded the full use of his talents.

At the outset there were two major barriers to entry into the National system. In the first place, State banks were reluctant to leave the haven of a State charter for the uncertainties of national supervision. Tightening the loosely drawn Currency Act of 1863 helped a little; but, rewritten and liberalized, the National Bank Act of 1864 exerted no magnetic attraction, either to existing banks or to new capital. So, on March 3, 1865, Congress levied a 10 percent tax on the circulation of State banks to force the conversion to National charter of those banks wishing to maintain their note issue. The effect of the tax was immediate and pronounced, as State banks converted in great numbers. In general, only relatively large banks, committed to deposits rather than note issue, stayed with their State charters.

For more than a decade after the establishment of the National banking system another major restriction, which had nothing to do with the merits of a particular charter application, inhibited entry. Under the Currency Act of 1863, the total circulation of Nationally chartered banks was set at $300 million. Moreover, the original statute provided for the apportionment among the States and territories of one-half this maximum circulation on the basis of population and the other half on the basis of wealth, resources, and existing banking facilities. This distribution formula was omitted from the 1864 act but was restored on March 3, 1865. On this same day, as a provision of the law levying the 10 percent tax on the note issue of State banks, the Comptroller was required until July 1, 1865, to give preference in granting charters to State banks over new associations.

So McCulloch was, for a time, forced to travel about the country selling the idea of a National banking system. Furthermore, caught between contradictory

[1] A more detailed history of the functions of the Office of the Comptroller of the Currency will be published early in 1967.

statutes he had to decide which of two laws took preference. The conversion of State banks in preference to granting new charters meant that a disproportionate amount of banks in the New England and Middle Atlantic States would enter the system, violating the "distribution rule." But since there could be no truly National banking system without conversion of the State banks, McCulloch and his immediate successors chose the alternative of preferring conversion, despite the violation of the apportionment law. Even after July 1, 1865, when preference for State bank conversion presumably ended, Comptroller Freeman Clarke continued the same procedure. By July 1867, the maximum circulation of $300 million was reached, banks in New England and the Middle Atlantic States having received the lion's share of the total. For more than a decade the upper limit on circulation harried the National chartering authority and was a source of continuing annoyance to the Southern and Western States.

Despite the requirement that he sell his wares to an unfriendly clientele, Hugh McCulloch did not consider himself bound to automatic approval of charter applications. Although he never articulated a philosophy of bank chartering, his views can be inferred from an 1864 *Manual of Instructions* sent to prospective organizers of National banks and from cryptic notes written in his own hand on letters requesting forms for charter applications. Before mailing forms for meeting procedural requirements for a National bank charter, McCulloch insisted on having three types of information. First, he wanted a summary of the economic potential of the community in which the proposed bank would be located—its population, the kinds and amount of business done there, and the prospects for growth. Second, he required "satisfactory references * * * from gentlemen of known character and reputation" about the "character and responsibility" of the parties proposing to organize an association. Finally, he investigated the extent of banking facilities in the city of the proposed bank and in nearby communities. Many a letter of inquiry contains such remarks as "Send law but express opinion bank not needed" or "Delay" or "Discourage, near Athol Depot." Procedures were less formal than those that ultimately emerged, but the first Comptroller made an investigation of the same kind that would be made 100 years later.

Freeman Clarke, who succeeded to the Comptrollership upon McCulloch's appointment as Secretary of the Treasury, likewise took the view that the Comptroller could exercise wide discretion in the granting of a bank charter. Like McCulloch, he operated within the constraints of provisions restricting the circulation, as did the third incumbent in the Office, Hiland R. Hulburd. At last, in the Specie Resumption Act of 1875, the limitation placed on the total circulation of National banks was repealed. In his *Annual Report* for 1875 Comptroller John J. Knox, historian and scholar, commented on the effect of currency restrictions:

> The National banking system was intended to be a free system, and from the beginning the organization of banks was open to all; but the amount of circulation originally authorized having subsequently become exhausted, the establishment of banks with circulation was, of necessity, for a time suspended. The act of January 14, 1875, however, removed all restrictions in this respect; and since that date every application which has conformed to the requirements of the law has been granted.

During Knox's tenure of just over 8 years, the view gradually emerged that the Comptroller could play only a passive role in the granting of charters. Wrote Knox in the 1881 *Annual Report:*

> The Comptroller has no discretionary power in the matter, but must necessarily sanction the organization or reorganization of such associations as shall have conformed in all respects to legal requirements.

Thus, by the 1880s the spirit of free banking pervaded the Office. There began what many observers have called a "charter race" between the Comptroller of the Currency and State banking authorities. Until about 1880 the note-issue privilege of National banks gave Federal charters a competitive edge. Another advantage of a National charter was its familiarity to nonresident investors, who were more likely to commit their capital under such a charter to newly developed sections of the country. But after 1880, the competitive advantage swung steadily in favor of State charters, which became more attractive for several reasons. They gave far greater latitude to bank management by permitting larger loans to single borrowers and a wider variety of loans and investments. More important, perhaps, were the lower reserve requirements of most States and the smaller capitals permitted. Between 1880 and 1900 the number of National banks increased from about 2,100 to approximately 3,700; in the same 20-year period, the number of State banks jumped from 650 to just over 5,000. In 1907, State banks outnumbered National banks by nearly two to one, though total resources of State banks were then about the same as those of National banks.

The period from 1880 to the Panic of 1907 comes as close to being one of free banking as this country has ever experienced. With few exceptions, State supervisory authorities had little discretion in granting bank charters. At the national level variation in the attitudes of successive Comptrollers was slight; for the most part they approved new charters provided the letter of the law was observed. To be sure, the 1884 edition of *Instructions in Regard to the Organization, Existence, and Management of National Banks* required that a new application be endorsed by a member of Congress or be accompanied by letters from prominent citizens "vouching for the character and responsibilities of the parties, and the necessities of the community where the bank is to be located." In the 1891 and 1900 editions of this manual the "necessities" criterion was omitted.

Under Comptrollers Knox, Cannon, and Trenholm charters were granted routinely. Data on new-bank formation between 1891 and 1900 suggests at first inspection that Comptrollers Lacey and Eckels may have been more strict in their approval policy. Yet, the decade of the 1890s was one of bad times; there were perhaps 1,000 bank failures during these 10 years, and investors were probably deterred by the accumulated bank investment of the 1880s. In any case, Comptroller Eckels in 1896 urged Congress to amend the National Bank Act to reduce minimum capital requirements in small towns, to permit branches of National banks in communities of less than 1,000, and to lower the proportion of small-bank capital mandatorily invested in Government bonds. Comptroller Charles G. Dawes supported the capital-reduction proposal, and it became law in the Gold Standard Act of 1900. Henceforth, National banks in places of 3,000 inhabitants or less, might be chartered with a capital of $25,000, and within a few years more than 2,500 of these applications were approved. From 1900 through 1907, there is little evidence of restrictions on chartering by the Comptroller.

A marked change in attitudes occurred with the appointment of Comptroller Lawrence O. Murray in April of 1908. The severe, if shortlived, depression of 1907–08 and its accompanying "money panic" doubtlessly colored his thinking, but his decisions marked a more fundamental turn in the charter philosophy of the Office. The 1909 edition of the *Instructions Relative to the Organization and Management of National Banks* required three public officials of a community to state their "belief that the conditions locally are such as to insure success if the bank is organized and properly managed." In successive reports, Comptroller Murray remarked the increasing care taken by the Office to scrutinize charter applications, observing that particular attention would be paid to applications from small communities. He noted, not without some wishful thinking, that State authorities were cooperating in refusing bank charters where prospective business did not warrant them. But the brakes applied by Comptroller Murray were eased by his successor, John S. Williams, and in the prosperity of World War I, State officials likewise became more lenient. By 1920, the number of commercial banks in the country totaled an incredible 30,000, more than 22,000 State banks and 8,000 National banks.

In the early 1920s, the Office maintained a liberal chartering policy, Comptroller D. R. Crissinger being especially anxious to assure charters in sufficient numbers to maintain the strength of the Federal Reserve System. From 1924 on, however, chartering policy became progressively more restrictive, the rejection rate for the years 1926–30 approximating ½ the applications received. In his 1927 *Annual Report*, Comptroller McIntosh remarked that "extreme care" should be exercised in granting charters for both National and State banks, adding that in 1926 he had approved only 44 percent of the applications received compared with an average approval rate of nearly 73 percent over the 8 previous years. In 1928, Comptroller John W. Pole reported that the Office was exercising "a policy of extreme care in granting charters for National banks based primarily on needs of a community for additional banking facilities."

The years 1931–35 were devoted largely to rescue operations. Although nearly 800 new National charters were approved in this period, more than 700 of them were worked out with the cooperation of this Office to save banks in difficulty. The period of free, or nearly free, banking that had begun around 1880 had clearly come to an end well before the onset of the Great Depression. It is testimony to the good sense of the Comptrollers of the Currency and a substantial number of State bank supervisors that selectivity in chartering began as early as the mid-1920s.

More cautious attitudes were doubtlessly prompted by the wave of bank suspensions that began with the precipitate depression of 1920–21. Beginning in 1921, the number of commercial banks decreased by several hundred each year, 5,411 failing over the 9-year span of 1921–29. From 1930 to 1933, 8,812 banks suspended, nearly half of them going under in 1933 alone. Of the 14,000 banks suspending between 1921 and 1933, 11,300 were State banks and 2,700 were National banks. More than 90 percent of these failures were in communities with less than 25,000 inhabitants, and 85 percent of the suspending banks had total assets of less than $1 million.

In part, of course, the failures that began a decade before the economic disintegration of the early 1930s were a response to the previous high rate of bank investment. For 40 years, banks had been springing up in hamlets and villages of 200 and 300 inhabitants; in a South Dakota community of 300 served by a State bank the competition became ruinous when the Comptroller of the Currency granted a National charter to another group. County seat towns of less than 1,500 people often boasted 3 or 4 banks, and a midwestern town with a population of 10,000 was blessed with 18. But the catastrophe of failure was the consequence of a more deep-rooted cause than "overbanking." Urbanization of the American population began in earnest in the 1920s, inexorably taking people from the agricultural communities and their purchasing power away from small-town businesses. Moreover, mortgages made on the basis of high World War I land values went steadily into default. With the deterioration of assets that occurred when loans to farmers and to businesses dependent upon farmers went bad, thousands of institutions found themselves in severe straits. At the onset of the depression, frightened depositors rushed to demand their money, with the consequence that even good assets had to be liquidated in falling markets. At last, as business declined disastrously, the very best credit risks could not meet their obligations. Vigorous and imaginative rescue work by the Federal Reserve might have saved the day, but the monetary authorities of that time did not understand the proper role of the central bank in a period of financial emergency.

With fewer than 100 suspensions in 1934–35, it was clear that except for some salvage work, the crisis was over. But there would no longer be business as usual, at least not for many years to come. Of the many changes in public-policy concepts, none was more drastic than the change in attitudes toward bank chartering. Nearly everyone in a position to make decisions was agreed that free banking, if it meant continuing competition between State and Federal authorities, should stop. A corollary of this proposition was that some kind of Federal control had to be exercised over bank formation under State charter. As it turned out, the Federal Deposit Insurance Corporation became the agency to exert this control. By the end of 1935, a few months after the permanent plan of Federal Deposit Insurance was introduced under the Banking Act of 1935, more than 90 percent of United States commercial banks were covered. Since Federal authorities could now withhold deposit insurance, considerable power would henceforth be exerted over State chartering.

From 1935 on, Federal supervisory agencies would also have almost unlimited discretion in regulating the organization of new banks. Among the criteria to be considered were the adequacy of a prospective bank's capital structure, its future earnings prospects, the character of its management, and the convenience and needs of the community it would serve. Thus, standards that had been intermittently used by this Office, and increasingly by State authorities, were written into the law.

1936 began a 25-year period of drastic reduction in the rate of formation of new banks. On the average, 86 new institutions annually were started from 1936–60. This rate was not constant over the entire period, for it began to pick up in the early 1950s as profits of commercial banks improved in the postwar years. Actually, between 1936–45, 480 new State banks were chartered; the figure for 1946–55 was 705 and for the 5-year period, 1956–60, 435. The corresponding figures for National banks were 55, 156, and 124. From 1936 to the end of 1960, applications for National bank charters averaged about 50 each year, or one-sixth the annual average from 1911 through 1935. Over the quarter century from 1936–60, National bank charters accounted for less than one-fifth of the nearly 2,000 banks organized.

There are several reasons why only 335 National banks were chartered in this quarter century. Relatively low returns to capital invested in commercial banking were partially responsible, while a 40 percent rejection rate on applications must have deterred some prospective bank organizers. But the most obvious reason for the low number of bank charters was the attitude of post-depression Comptrollers. Although there is little discussion of chartering policies in successive *Annual Reports,* it is apparent that this Office was for 25 years extremely reluctant to admit new banks to the competition. In a drastic swing in the pendulum of authority, "convenience and needs" were severely scrutinized, and decisions to charter new banks went from the extreme of free banking to the extreme of unduly restricted approvals.

It is well-known that, beginning in 1962, this Office encouraged applications for new charters. In 1961, Comptroller Ray M. Gidney's last year in office, 97 applications were received. In 1962, this Office received 176 requests for new charters, the number increasing to 490 in 1963 and 468 in 1964. This total of 1,134 charter applications was more than had been submitted in the previous 20 years. In the 4-year period 1962–65, this Office granted 513 new charters, while State authorities, unquestionably stimulated to greater liberality by the Comptroller's actions, granted 502. The public clearly understood that the closed-industry image would be changed and that, at least for a time, a decision had been taken to increase the banking resources of the country in trade areas where they were deficient.

Other post-depression Comptrollers were sensitive on occasion to the need for new banks in places where existing facilities were plainly inadequate. These officials were, without exception, motivated by concern for the public interest. Yet, from 1936–61, the pre-occupation of this Office was still with the problem of bank failure, and its main objective was to preserve existing banks. Beginning in 1961, the Office adopted the view that banks, despite their considerable regulation, are not public utilities and, thus, are not entitled to complete protection from competition.

While showing due concern to prevent overinvestment in banking in particular trade areas, we, at the same time, moved to permit adequate banking services where the public interest required them. In the *Annual Report* for 1964, it was noted that new charters would have to be rejected for particular areas once a certain level of investment was reached. As the record shows, the rate of rejection of charter requests climbed steadily in 1963–64, reaching 70 percent for 1965. In retrospect, the increase in new charters granted by this Office over the years 1962–65 is seen as a needed adjustment required by particular communities if growth in those communities was not to be inhibited by lack of financial resources.

Certification of Branches

During the first 75 years of American commercial banking, the right of banks to have branches was rarely questioned. Typically, banks organized under the early charters had only one or two branches; but as years went on, banks in New England and the Middle Atlantic States tended to divest themselves of branches, not because of political opposition but because there was no economic reason for keeping them. In this early period, branches were almost invariably intercity. In the long-settled regions of the United States, places requiring a bank were not without wealthy citizens who could provide the necessary capital should there be a prospect of a profitable business. At the same time, no saving resulted from operating in two or more cities; in fact, problems of communication and transportation implied diseconomies of scale, where scale was achieved by widely separated offices. The consequence was that, by the late 1840s, there were no branches in any of the New England States and only two in the State of New York.

Both the first and second banks of the United States operated profitable branches, setting a pattern for the organization of pre-1860 branch systems in the South and West. Because of slow communication and great distances between branches and headquarters, it was impossible for the head office to exercise day-to-day supervision of a network of branches. Consequently, each branch, under its own board of directors, developed a large degree of autonomy, maintaining an independence of action far greater than that enjoyed by branches in 20th-century America.

This same principle of organization was carried over into the great branch systems of the West. One of the best of them, the State Bank of Indiana, had a structure imitated by the State banks of Ohio, Iowa, and several other States. The board of directors of the Bank of Indiana was resident in Indianapolis, the capital city. Yet, each of the 13 branches was locally organized, had its own capital subscribed by its own stockholders, and paid its own dividends, subject only to the approval of the supervisory board of control in Indianapolis.

Branch systems of the kind in use today, dominated by the head office, were found in certain border and Southern States. Southern capital was largely committed to the plantation system and was not available for a unit bank in each community able to support one. Head offices of banks in these areas tended to be in urban centers, and branches, without local capital contributions in the areas they served, were, therefore, directed from the top with little branch autonomy.

At the time of establishment of the National banking system there was little or no controversy over branch banks. Examination of the legislative history of the Currency Act of 1863 and of the National Bank Act of 1864 reveals no special concern about branches. Not until passage of the 1865 law levying the 10 percent tax on State bank notes was there statutory mention of the matter. This legislation allowed State banks converting to National charters to keep their branches provided that definite capitals were assigned to the "mother bank and branches." There was no apparent controversy over this section of the act.

Moreover, there is little evidence that the framers of the legislation of 1863 and 1864 meant to preclude branch banking. Nevertheless, two clauses in the National Bank Act were so interpreted. Section 6 of the act required persons forming an association to specify "the place" where business would be carried on, and section 8 required that usual business be transacted at "an office or banking house" located in the city specified in the organization's certificate. This use of singular nouns was common in State free-banking statutes and was originally intended to outlaw the location of offices in inaccessible places for the purpose of hindering note redemption. Nevertheless, as a condition of granting a National charter, Comptroller Freeman Clarke refused to allow the Washington County Bank in Williamsport, Maryland, to keep its branch office in Hagerstown. He wrote: "The sixth section (of the law) requires that (the organizers) shall specify in their organization certificate the particular place (not places) at which their operations of discount and deposit shall be carried out." Whatever the Congress had intended, this decision was followed by Comptrollers for years to come. For decades the opinion made little difference one way or another. In the North and East branch banking had nearly disappeared. In the South, where in antebellum years multiple-office banking of today's type was concentrated, many branch banks were destroyed by the war, were dissolved by State authorities, or entered the National system with each former branch as a unit. And, in the free banking spirit that pervaded western areas, State laws were passed making it easy to form new banks in the towns and cities that could support them.

As a result, the branch bank question did not become an issue for many years. In 1887 and again in 1888, the Comptroller of the Currency recommended that National banks be allowed to establish additional offices in the head-office city, but nothing came of the suggestion. During the 1890s, however, there was a growing demand for increased banking facilities in small towns. The first strong advocates of branch banking based their case largely on rural need, Comptroller Eckels' 1896 proposal for branches in places of less than 1,000 population being a typical public-policy prescription. Consequently, the force of branch banking arguments was greatly weakened with passage of the 1900 statute reducing to $25,000 the capital requirement for a National bank in a place of 3,000 or less. With the ensuing rapid creation of small banks by the hundreds, the chief argument for branch banking was undermined. By the same legislative stroke, the ultimate potential of the antibranch lobby in State legislatures was bolstered by thousands of new country bank offices.

For a year or two there was continuing discussion of the issue. In a classic profession of faith in branch banking Comptroller William B. Ridgely, in 1902, placed this Office squarely on the side of branch-bank proponents. But the first economic pressure for branching had disappeared, to be gradually renewed as the continuing growth of cities moved their peripheries farther and farther away from the business centers. In 1900, banks with branches accounted for only 2 percent of resources of American banks; 20 years later, they accounted for nearly 15 percent. But as the number of branches grew, the number of unit banks grew also, so that in 1920 branch banks controlled only 6 percent of total banking offices in the country. From 1920 on, branch banking increased in relative importance, for as the number of commercial banks was cut by one-half over the next 15 years, the number of branch-bank offices more than doubled.[2] In 1935, branch banks controlled more than one-half the resources of American commercial banks.

Since 1935, the trend toward multiple-office banks has been uninterrupted, with the rate of increase of branch-bank offices increasing remarkably in the early 1950s. Between 1935–50, the number of unit banks declined to about 13,000, while the number of branch-bank offices, including home offices, rose to nearly 6,500. More specifically, at the end of 1950, 1,241 banks operated 4,721 branches; 3,276 of the offices were in the main-office city, and 2,686 were outside the main-office city. Resources controlled by branch banks were still just over 50 percent of the total of all commercial banks.

In 1950, there were almost 19,000 banking offices in the United States. By the end of 1965, this figure had increased to more than 29,000. During this interval, the number of unit banks fell from 12,923 to 10,678, while the number of branch banks increased from 1,241 to 3,140. Meantime, the number of branches soared from 4,721 to 15,486 so that the total number of branch-bank offices rose to 18,626. Branch-bank offices then accounted for almost 64 percent of total banking offices and controlled approximately two-thirds of the banking resources of the country.

The economic forces compelling the growth of branch banking have been persistent and inexorable. Moreover, branch banking would have shown even more dramatic gains in the absence of legislation, Federal and State, passed with the primary intent of pro-

[2] The expression "branch-bank offices" is used in this section to denote all offices of branch banks, including home offices.

tecting unit banks from competition. This legislation has, in some States, absolutely stopped an increase in multi-office banking, leaving the flourishing city institutions to squeeze themselves into ever more inefficient banking houses. In other States, it has led to expansion in the two other forms of multi-office banking, groups and chains, which have flourished where the more straightforward branch-bank organizations could not be organized.

For perhaps 2 decades after the turn of this century, intracity branching showed more strength than intercity branching. As cities pushed outward and increasing traffic congested the streets, banks found it progressively more difficult to reach the household unit. It was almost precisely at this time that the American middle class was becoming affluent enough to make household and small personal accounts profitable. In a society of spatially separated communities, bearing an isolation that we find hard to imagine today, uncertain communication and bad roads continued to slow the establishment of branch offices outside the home city. Yet, even before 1920, intercity branches were increasing in a dozen states, notably in California. After 1920, intercity branching became the more important type, as banks moved to place offices in the burgeoning suburbs. Underlying this change, its character in part determined by the urbanization or a peripatetic population, have been the increasing returns to scale in banking. In part, the advantages of larger units have been encouraged by technical advances in the processing of data, which have been accompanied by reductions in costs of communication. More fundamental has been the advantage to large units of first-class managerial talent, for in an increasingly complex world, financial institutions, possibly more than other business firms, require the benefits of the improving quality of management that, within certain limits, comes with size.

Statutory and regulatory resistance to this course of economic events, while by no means evident everywhere, has been persistent in certain geographic areas. However, at both Federal and State levels the trend of the past half century has been toward liberalization of 19th century supervisory judgments about branch banks.

Comptrollers following Freeman Clarke consistently ruled that National banks could not have branches. In 1911, Comptroller Murray asked Attorney General Wickersham for an opinion, and Wickersham responded that the power to branch was not implied in the National Bank Act. In 1915, the Federal Reserve Board recommended that legislation be passed to permit National bank branching within the main-office city or county, and a controversy that had smouldered for years erupted at the 1916 convention of the American Bankers Association, which adopted resolutions opposing branch banking in any form. So vehement was the opposition to the Federal Reserve proposal that it was dropped. Only the devious path of the Consolidation Act of 1918 opened the way to multiple-office structure for National banks. This statute permitted a National bank that had converted from State to National charter, keeping its branches, to consolidate with another National bank, retaining the branches involved in the consolidation. Thus, in States permitting branching, a National bank could acquire branches by organizing a State bank with branch offices, converting the State bank to a National charter, and then merging with it. Although an awkward procedure, the method nevertheless enabled more than 100 National banks to acquire branches in just a few years.

By 1920, the problem of providing banking facilities convenient to residential areas of a city was changing to the problem of creating outlets for mushrooming suburbs. For years, the Office of the Comptroller had considered the possibility of allowing metropolitan banks to open "offices." In 1921, Comptroller D. R. Crissinger recommended that the National Bank Act be amended to permit limited branching, but there was no response from Congress. Crissinger then began to permit the use of intracity offices or tellers' windows wherever State branching was permitted. These offices could receive deposits and cash checks but could not make loans or carry on other business requiring policy decisions. Again, in his *Annual Report* for 1922 Crissinger asked that National banks be granted branching authority at least to the extent enjoyed by State banks, and again he was rebuffed. Crissinger's immediate successor, Comptroller Henry M. Dawes, essentially an opponent of branch banking, requested an opinion from the Attorney General about the legality of additional offices such as his predecessor had authorized. This time the Attorney General responded favorably, holding that National banks could operate limited-service offices within their city of location. For several years these offices served as outlets for the considerable pressures that were building.

In 1924, the Supreme Court of the United States upheld a lower court decision that branching by a National bank, where prohibited by a State statute, was illegal.[3] By this time the Comptroller of the Currency had prepared recommendations for a Federal statute governing National bank branching, and bills containing his suggestions were introduced in both the House and the Senate in 1924. After 3 years of noisy argument, the McFadden Act was finally passed in 1927. The law, for the first time, permitted branches that were unlimited with respect to function. Nevertheless, many considered the McFadden Act to be an anti-branching bill, for it permitted members of the Federal Reserve System to establish new branches only within the limits of "the city, town, or village in which said association is situated if such establishment and operation are at the time permitted to State banks by the law of the State in question." Thus, although National banks could henceforth establish full branches in States permitting branches, they as well as State member banks could not establish branches outside of the home city.

Almost at once agitation began for liberalization of this restrictive law. In his *Annual Report* for 1929, Comptroller John W. Pole proposed that National banks be allowed to branch over their trade areas. In the same year, President Hoover, noting the growth of group and chain banking, suggested to Congress that it consider permitting National banks to branch in limited areas. Even the American Bankers Association began to soften its opposition to branching, indicating that "community wide" branching in cities and "county wide" branching in rural areas might be economically justifiable. With such support, it appeared that bills introduced by Senator Carter Glass, which would have permitted State-wide branching and even branching across State lines to a distance of 50 miles, would receive favorable consideration. But such sweeping change led to bitter, if minority, opposition in the Senate, with the consequence that the law providing today's basic rule became a part of the Banking Act of 1933. In effect, this provision allows National banks to branch in any State within the geographic limits specifically authorized by the laws of that State. To the basic limitation was added certain discriminatory capital requirements for member banks branching outside their head-office cities, requirements that proved a serious deterrent to many banks. In 1952, the law was changed to permit member banks wishing to branch to meet the same capital requirements of State law for branch banks, and Comptroller Ray M. Gidney noted in his 1952 *Annual Report* that "provisions of the new law are proving to be eminently satisfactory." [4]

National banks might be " * * * on a parity, for all practical purposes, with State chartered banks," as Comptroller Gidney remarked, but 17 states then limited branching, and 11 prohibited branches. Nevertheless, by 1960, National banks maintaining branches accounted for nearly 39 percent of all commercial banks having branches, a jump from 26 percent in 1950. At the end of 1950, 905 National banks operated 5,325 branches, and 1,424 State banks operated 6,381 branches.

During the past 5 years, this Office has taken the position that a healthy growth of branch-bank systems should be encouraged so as to maintain all possible options for banking expansion. As the annals attest, branch systems have long been consistent with economic and sociologic change in the United States. The Office has approved *de novo* branches where State law permits provided that community circumstances indicated profitable support of a new branch. That competition has been increased by this policy is suggested by the data. From the end of 1960 to the end of 1965, the number of National banks maintaining branches rose from 905 to 1,331, an increase of 48 percent. Meantime, the number of branches operated by National banks increased from 5,325 to 8,754, a jump of 64 percent. (Branches operated by State banks rose in this interim from 4,918 to 6,732, an increase of 37 percent.) At the end of 1965, offices of National banks operating branches totaled 10,085 compared with the State bank figure of 8,541.

The geographic consequences of recent change are remarkably various. The stronghold of unit banking is largely between the Rockies and the Mississippi River, with Montana, Wyoming, Colorado, Nebraska, Kansas, Oklahoma, Texas, Minnesota, and Missouri lying within this area. Illinois, West Virginia, and Florida are the only other States that absolutely prohibit branches in any form. Yet, branching is so restricted in a few of the so-called "limited" branching

[3] See: *First National Bank in St. Louis* v. *State of Missouri*, 263 U.S. 640–668, decided January 28, 1924.

[4] A floor on capital requirements of National banks and their branches is established by Federal law. Specifically, "the aggregate capital of every National banking association and its branches shall at no time be less than the aggregate minimum capital required by law for the establishment of an equal number of National banking associations situated in the various places where such association and its branches are situated." However many branches a National bank may have in one place, the capital requirements for all of them is only what it would be for *one* bank.

States that they, for all practical purposes, exclude themselves from the economic benefits of branch banking systems.

Action on Mergers

For half a century after passage of the Sherman Act, banks were not threatened with litigation, nor did the more specific prohibitions of sections 7 and 8 of the Clayton Act seem a cause for apprehension. Mergers were considered a means of rescuing foundering institutions rather than a way to monopolistic restraints. Moreover, many observers felt that since banking was regulated by specific Federal and State statutes the antitrust laws did not generally apply.

The first faint rumblings of commercial bank exposure to Sherman Act prosecution came in the 1940s. In 1945, the Justice Department filed suit against a New York trade association, composed of mutual savings banks and trust companies but including one commercial bank, alleging a section 1 Sherman Act violation. Three years later, a similar suit was brought against the Chicago Mortgage Bankers Association, which included several commercial banks, the defendants being charged with fixing minimum fees and rates in connection with their lending activities. After more than a decade of inattention to such activity, the Justice Department, in 1961, brought a price fixing charge against certain New Jersey banks alleging collusion in setting service and other charges. Similar action was shortly taken against banks in Dallas, Texas, and in certain Minnesota cities. In each case, groups of commercial banks were charged with conspiring to fix various rates and terms, whether of interest to be paid or charges for services. In each instance, proceedings were terminated by consent decree or other agreement, and some defendants were fined after pleading no contest. Early in 1962, this Office instructed all National banks to determine service charges and banking hours without collusion, whether through clearinghouse agreements or otherwise. Individual boards of directors were made responsible for determination of such practices, and National bank examiners were instructed to insure compliance. As noted in the 101st *Annual Report* of this Office, we have maintained a close surveillance on National banks regarding such activity.[5]

Section 8 of the 1914 Clayton Act aimed at the prohibition of interlocking corporate managements. After much congressional deliberation, directors and other officers of banks above a certain size were specificially prohibited from sitting on more than one board, though exceptions in this and subsequent amending legislation, notably the Banking Act of 1935, made the law fuzzy and uncertain of enforcement. The Federal Reserve Board has held hearings on alleged section 8 violations, but these cases have not found their way into the courts on appeal. Data on exemptions granted by the Federal Reserve as authorized by the statutes are not available.

In 1962, the Comptroller's Advisory Committee on Banking recommended "* * * that the law and its application by the supervisory authorities should restrict interlocking directorates, and not only between competing commercial banks (as is now the case) but also between commercial banks and certain other types of competing financial institutions."[6] This Office has consistently taken the view that conflicts of interest in the financial structure should be removed and that laws regarding interlocking directorates should be clarified and strengthened.

Like clearinghouse association agreements, acquisition of commercial banks through purchase by nonbanking corporations of stock or assets came under administrative and legislative scrutiny in the 1940s. After years of discussion among the Federal supervisory agencies and the Department of Justice, the Board of Governors of the Federal Reserve System in 1948 initiated a proceeding under sections 7 and 11 of the Clayton Act against the Transamerica Corporation, a West Coast holding company, alleging a violation of section 7 because of systematic acquisition of the voting stock of independent banks in 5 States. The Board's 1952 order to Transamerica to divest itself of 47 majority-owned banks was set aside by a circuit court of appeals in 1953, and the Supreme Court refused to review the lower court's decision.

Meanwhile, some congressional sentiment was developing for legislation that would bring bank acquisitions under the control of Federal bank regulatory agencies. For example, a 1945 bill sponsored by Senator Kefauver would have exempted bank acquisitions from section 7 of the Clayton Act, requiring that bank mergers be approved by the Comptroller of the Currency, the Federal Reserve Board, or the Federal Deposit Insurance Corporation. Neither this nor sub-

[5] See 101st *Annual Report* of the Comptroller of the Currency, 1963, p. 29.

[6] *National Banks and the Future,* Report of the Advisory Committee on Banking to the Comptroller of the Currency, 1962, p. 94.

sequent attempts to include Federal agency control of bank acquisitions secured congressional approval. When the 1950 Celler-Kefauver Amendment to the Clayton Act was passed, merger by asset acquisition as well as stock acquisition was brought within the section 7 provision of the Clayton Act. Bank mergers were not included in this legislation, probably because the bill would not have passed if they had been included.

Despite repeated attempts to bring mergers and consolidations under the proscriptions of section 7, notably by Congressman Celler and Senator Sparkman in 1955, a succession of bills for this purpose failed to gain congressional approval. After a decade of consideration, the Bank Merger Act of 1960 provided for administrative control of bank mergers by the Federal agencies and made explicit the consideration of banking as well as competitive criteria in determining the merits of a particular merger. In addition to the effects of merger on competition, regulatory agencies were to consider at least five banking criteria, including "the convenience and needs of the community to be served."

Careful review of the legislative history of the 1950 and 1960 legislation left no doubt in the minds of most economists and lawyers about the intent of Congress to exclude commercial bank mergers from Clayton Act prosecution. But, the 1960 statute did not explicitly state such exclusion, and in the *Philadelphia* bank decision of 1963, the Supreme Court, though wondering aloud why the Celler-Kefauver Amendment made no explicit mention of mergers not subject to Federal Trade Commission jurisdiction, could perceive "the basic Congressional design" and could infer that bank mergers were subject to the Clayton Act.

This opinion, when coupled with the decision in the *Lexington* case, subjects commercial banks to more stringent antitrust regulation than applies to firms in unregulated industry. The 1966 Amendment to the Bank Merger Act has imposed a single set of standards upon the banking agencies, the Department of Justice, and the courts by which to assess the legality of a merger. This Office must now make an antitrust judgment and, finding a substantial lessening of competition, can approve a merger only if banking advantages outweigh the competitive disadvantages. The Department of Justice can now postpone a bank merger by merely commencing an action against it instead of seeking an injunction in the courts.

As we have remarked before, in the expansion of banking, merger may often be preferable to new charters or *de novo* branching.[7] The Comptroller of the Currency, with other Federal regulatory agencies, is now unnecessarily hindered in determining the optimum allocation of commercial-bank resources. Decisions made by this Office in the light of 104 years of experience are presently subject to interference by a department of the Government with no experience in bank regulation and a patent inability to perceive the nature of competition in banking and to ascertain relevant banking markets.

For the past 5 years, the authority of this Office has been chiefly exercised to assure a new and vital competition among commercial banks and between commercial banks and nonbank financial intermediaries. In that period, the Office issued more than 6,000 decisions and interpretations under existing statutes and has recommended to Congress legislation that would permit further changes in the direction of truly competitive financil markets. In a substantial number of instances, decisions have increased the powers of commercial banks and so their freedom to compete. On many occasions, however, a determination has been made to restrain activity with probable anticompetitive effects, our actions against possible collusion among banks with respect to service charges and banking hours typifying rulings of this kind.

The preoccupation of the Office has been to assure the economic entry of resources into commercial banking by means that have appeared appropriate in each particular case. Charters, *de novo* branches, and mergers have been approved in accordance with a long tradition of adjusting the supply of banking services to the demand for them. This Office has made economic judgments not only with an eye to historical experience but with due consideration for the future financial requirements of a growing economy.

Observers of the financial community frequently remark the rise of a recent enthusiasm in commercial banking, an *esprit* that is carrying the industry forward through a rapid rate of technical innovation to new peaks of service to the community. This change was under way in the 1950s. It was the role of this Office, through creative regulation based on sound precepts of law and economics, to encourage this spirit, this new competitive sense, and so to strengthen the resource base of this country.

[7] 102nd *Annual Report* of the Comptroller of the Currency, "The Banking Structure In Evolution," 1964, p. 5.