

Confidential

SOME COMPETITIVE ASPECTS OF THE DUAL BANKING SYSTEM
EVIDENCED BY STATUTORY CHANGES AND
ADMINISTRATIVE PRACTICES

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SOME COMPETITIVE ASPECTS OF THE DUAL BANKING SYSTEM
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ADMINISTRATIVE PRACTICES

During the decades just previous to the passage of the National Bank Act in 1863, all of the commercial banking business of the country was transacted by banks incorporated under the laws of the various States. The Federal Government neither chartered nor supervised banks. The National Bank Act provided for a system of commercial banks Federally chartered and supervised and the sponsors of the act hoped to displace completely the State chartered commercial banking system, as the following statement of Senator Sherman shows:

"The national banks were intended to supersede the state banks. Both cannot exist together; yet while the national system is extending, the issues of state banks have not materially decreased. Indeed, many local banks have been converted into national banks, and yet carefully keep out their state circulation...." ^{1/}

In 1865 Congress passed a prohibitive tax on State bank note issues, and it was thought that a commercial bank could not exist without the issue privilege. If the problem had been attacked directly and the right denied States to incorporate commercial banks, the results might have been different. The usages of commerce were changing, however; payments were coming to be made more and more by checks drawn on deposit accounts and less and less by the transfer of currency from hand to hand. By the beginning of this century State banks of deposit without the privilege of issuing circulating notes were flourishing and during the subsequent 20 years their numbers increased rapidly. Table 1 in the appendix

^{1/} Congressional Globe, 38th Congress, 2nd Session, p. 1139.

NOTE: A memorandum dealing in more detail with laxity in the administration of bank examination and supervision is now in the course of revision for submission to the Board.

shows that before the beginning of the century the number of State banks exceeded nationals. In the early 1920's when the number of banks reached its peak at approximately 30,000, there were more than two and a half times as many State banks as national.

This development--national banks on one side and State banks on the other--created what has been known as the dual banking problem. It might better be called the problem of multiple banking jurisdictions. During the first two decades of the century, there were few bank failures. It was an era of rising prices and banking mistakes were covered up by steadily appreciating values, particularly in agricultural areas. With the liquidation of the early twenties, the situation took on an entirely different aspect. Agriculture was for many years to go through strenuous readjustment from the heights of war time prosperity, and farm land values were deflated to adjust to a much lower level of commodity prices. A great wave of bank failures, largely in agricultural areas, ensued and was unabated even during the years of high general prosperity in the late twenties, as Table 4 in the appendix shows.

It became apparent that something was radically amiss with the country's system of banks of deposit. Diagnosis became common, and often referred to the competition in laxity associated with the multiple banking jurisdictions. Eugene Meyer, Jr., while Managing Director of the War Finance Corporation in 1923, said:

"....The competition that exists at the present time between State and national banks can not fail to remind one of the competition that prevailed a generation ago among the various States seeking to become domiciles for corporations--a competition that was based upon the laxity of the laws governing incorporation. Nothing could be more disastrous than competition between the State and national banking groups, based upon competition in laxity." 1/

D. R. Crissinger, while Comptroller of the Currency, summarized the competition between State and national systems as follows:

"....National banks are compelled to compete with State institutions, and if the laws of the States are more liberal than are the national banking laws they will constitute an inducement to banks to operate under the laws of the States rather than of the Nation. The very fact that the Federal reserve system establishes a measure of financial assurance....to the advantage of all kinds of banks, whether State or national, makes it easier for State banks to carry on under the more liberal charters which many States issue. So long as all banks enjoy the general advantages accruing from the workings of the Federal reserve system, there is obvious temptation to the particular institution to supplement these benefits by taking advantage of the wider liberality of State charters." 2/

Owen D. Young, Chairman, General Electric Company, in referring to banks chartered by the National Government and by each of the 48 States, said:

"....They are in competition, each endeavoring to offer the most attractive charters and the most liberal laws, to say nothing of the liberality of administrative officials in interpreting the laws. The national banking act has to compete not only with the most conservative States but the most liberal ones. Consequently, there has been a constant tendency to liberalize banking laws and to weaken their administration. In such cases the argument is always made that it is desirable to liberalize the law so as to enable the banks to be of greater service to borrowers." 3/

1/ U. S. Congress, 67th, 4th Session, Hearings on S. 4280 (H. R. 13033), 1923, p. 56.

2/ Annual Report of the Comptroller of the Currency, 1922, p. 2.

3/ U. S. Congress, 71st, 3rd Session, S. Res. 71, Part 2, Feb. 4, 1931, pp. 353-54.

Expressions of opinion similar in character were made by various other students of American banking, some of which are quoted in the appendix to this memorandum.

Relaxations of Federal Banking Statutes

The Federal banking statutes have been relaxed in a number of respects in the period since 1900. As in the case of most other legislation, it is not easy to fix a single cause as the motivation for this legislation. It is safe to say, however, that competition in laxity has been an important factor in these relaxations, if not the most important factor.

It seems clear that competition in laxity is an unnatural factor which should have no influence on banking legislation. Banking legislation involves exceedingly difficult questions in any event, and should be considered on its merits. The intrusion, over any period of time, of such an additional and unnatural factor as competition in laxity is clearly harmful to the banking system.

Some statutory changes brought about by competition in laxity have proved to be beneficial, but this result has been fortuitous. The general effect of competition in laxity upon banking legislation has been detrimental, and may lead to additional unsound legislation or prevent the enactment of sound legislation.

There are summarized below, chronologically, the more important changes in the Federal banking statutes since 1900 most of which appear to be at least in part attributable to competition in laxity. These, of course, are in addition to a number of suggested restrictions whose failure of enactment was similar in its effect to actual relaxations.

The first important measure relaxing the Federal banking statutes to enable national banks to compete with State banks was the reduction of minimum capital requirements from \$50,000 to \$25,000 for the establishment of national banks in towns under 3,000 as effected by the Act of March 14, 1900.

In 1906 there began a long series of relaxations of the limitations on loans to a single borrower. At that time the original requirement that a national bank could not lend one borrower more than 10 percent of its capital was changed so that a bank could lend up to 10 percent of its unimpaired capital and surplus if this did not exceed 30 percent of the total capital.

A number of relaxations of the Federal banking statutes were included in the Federal Reserve Act as passed in 1913. One of these was section 24 of the Federal Reserve Act which for the first time authorized national banks to make loans on real estate. This provision, which merely permitted national banks not in reserve or central reserve cities to lend on improved farm land, was the beginning of a series of relaxations of the provisions regarding real estate loans by national banks.

Section 11(k) of the Federal Reserve Act authorized the Board to grant permits to national banks to exercise certain trust powers, thus effecting a fundamental change in the activities of national banks.

It should also be noted that while the Federal Reserve Act improved the provisions regarding the maintenance of reserves by national banks against deposits, at the same time it considerably lowered the reserve requirements.

The Act of September 7, 1916 permitted national banks located in towns under 5,000 to act as insurance agents and real estate brokers, broadened the acceptance powers of member banks, and relaxed in some respects section 24 of the Federal Reserve Act regarding real estate loans by national banks.

The Act of June 21, 1917 contained a number of changes which relaxed the restrictions on State member banks and were generally understood to be intended to make Federal Reserve membership more attractive to State banks. These changes provided that State member banks should retain their full corporate powers subject to the provision of the Federal Reserve Act and the regulations thereunder; permitted withdrawal of State member banks from the System after 6 months' written notice; and relieved State member banks from complying with the limitations applicable to national banks regarding loans to a single borrower, although Reserve banks were forbidden to discount paper of a borrower who was borrowing in excess of the amount that could be lent by a national bank. In connection with the transfer of reserves to Federal Reserve banks reserve requirements were further lowered.

The Act of September 26, 1918 broadened the fiduciary powers that may be exercised by national banks under section 11 (k), and relaxed the reserve requirements in some respects by authorizing the Board to permit banks in outlying districts of central reserve and reserve cities to carry lower reserves.

The Act of March 4, 1923 changed the requirement that State banks have the capital necessary for organizing a national bank in order to be admitted to membership in the Reserve System and permitted them to be admitted to membership with only 60 percent of this amount, although they were supposed to build up their capital to this amount after entering the System.

The entire discussion and history of the so-called "McFadden Act" of February 25, 1927 indicate that its chief purpose was to enable national banks to compete more effectively with State banks. The Act is chiefly known for the recognition it gave to the establishment of branches by national banks. However, it also effected a number of relaxations in the provision regarding loans by national banks to a single borrower and further relaxed the provisions regarding real estate loans by national banks. In addition, it recognized the purchase of securities by national banks and fixed the rather high figure of 25 percent of the bank's capital and surplus as the amount of securities of one obligor that might be purchased.

The Banking Act of 1933 authorized national banks to establish branches at any point within the State in which the bank is located "if such establishment and operation are at the time authorized to State banks by the statute law of the State in question." The tying of the Federal branch bank provisions to the varying laws of 48 different States clearly indicates that, instead of being settled on its merits, the problem of branch banking was being dealt with on the basis of competition between the State and national systems, a makeshift treatment that is obviously unsatisfactory.

The provision of the Banking Act of 1933 that originally required Federal Reserve membership for all insured banks by July 1, 1936 was relaxed from time to time until the Banking Act of 1935 merely provides that insured banks with deposits of \$1,000,000 or more have to be members of the Federal Reserve System after July 1, 1942. At the same time the Banking Act of 1935 authorized the Board to waive certain requirements for admission to membership of banks that must be members in order to be insured.

While the Banking Act of 1935 clarified and made more workable the provisions of the Thomas amendment of 1933 authorizing the increasing of member bank reserve requirements, it introduced a provision that prevents the Board from more than doubling the requirements. There have recently been public statements to the effect that any legislation authorizing a further increase in reserve requirements would probably be rendered ineffective by the possibility of withdrawals from Federal Reserve membership.

Many of the matters outlined in the previous paragraphs will be developed further in the latter part of this memorandum. The discussion in this memorandum of liberalizations indicative of statutory competition in laxity is confined for the most part to changes in Federal laws. It has been deemed impracticable to analyze the history of changes in the banking statutes of all of the States. Moreover, the reasons for changes in State statutes are not ascertainable in many instances because State legislatures do not maintain satisfactory committee reports or other explanatory material.

It is a matter of general knowledge and experience that the banking laws of many States have never contained stringent restrictions and therefore liberalization of such laws has been unnecessary. In other words, statutory competition in laxity as far as many States are concerned is evidenced primarily by the absence from the beginning of desirable restrictions and limitations rather than by periodic liberalizations. Consequently, relaxations by Federal authorities may be said to have resulted as a matter of self-defense.

Overbanked Condition

During the first two decades of this century, particularly, there was a great increase in the number of banks, which were often undercapitalized and poorly managed. This expansion, which reflected in part the competition between the national and State systems, led up to an unprecedented number of failures and forced reorganizations in the years following 1920 which reached a climax in the banking holiday of 1933.

The period of rapid expansion in the number of banks in operation, culminating about 1920 when there were somewhat more than 30,000 banks, brought into existence a large number of small banks with low capitalization. Table 3 shows that in 1920, 59 percent of the banks had a capital of less than \$50,000. Even before the depression of the 1930's developed, the results of the overexpansion which had occurred were clearly evident. From 1921 through 1929, 5,411 bank suspensions occurred, and as Table 5 shows, 72 percent of them were banks with less than \$50,000 capital. During the period of numerous bank suspensions, 1921-1929, bank charters continued to be issued in large numbers.

The overbanked condition which developed from 1900 to 1920 was most pronounced in agricultural areas. Table 6 shows the number of persons per bank in 1921 in several agricultural States as well as in States with the largest number of persons per bank. In some agricultural States there was a bank for every 1,000 persons or less in contrast with the condition in some of the Northeastern States where there were as many as 15,000-18,000 persons per bank.

This overbanked condition was one of the most unfortunate consequences of competition in laxity. The national and State systems of banking, each in an effort to control a large number of banks and a large volume of banking resources, relaxed legal and administrative standards. Statutory provisions for refusing charters were often inadequate. Supervisory authorities were frequently subject to political pressure to grant charters in order to gratify the ambition of promoters and the public to have another bank in the community. The following quotation taken from the foreword of a recent publication of the American Bankers Association aptly characterizes the course of events:

"....(the report) gives an impressive revelation of how great a part mistaken public policies in the chartering of banks in the United States played in creating the unsound banking structure which finally collapsed with the Bank Holiday in March 1933. The overproduction of banks, literally by thousands, which continued over many years in the face of insistent warnings not only from bankers and others who recognized the danger, but even more so from the mounting records of bank failures themselves, is here clearly shown to have constituted as a whole one of the greatest single economic errors in the history of the Nation." 1/

1/ R. V. Fleming, President of the Riggs National Bank of Washington, D. C., and President of the American Bankers Association 1935-36, in a foreword to the report of the Economic Policy Commission of the American Bankers Association, The Bank Chartering History and Policies of the United States, 1935, p. 1.

Phases of Laxity

The phases of regulation and supervision of banks in which competition in laxity has been manifested may be grouped in three general classes; namely, those relating to

- (1) The establishment of banks and the extension of their operations;
- (2) Types of banking powers, limitations, and restrictions; and
- (3) Certain matters with respect to examination and supervision.

Chartering of Banks

The quotations included in the appendix indicate that in the opinion of these prominent men the overchartering of banks represents the most apparent demonstration of competition in laxity. Overchartering has been associated among other things with small capital requirements, the exercise of discretionary powers by supervisory authorities; lack of economic necessity for banking facilities, and with weak management in the case of numerous banks.

Capital. - Before the end of the nineteenth century the relative growth of State banking systems compared with the national was a matter of serious concern to many persons including the Comptroller of the Currency. In his annual report to Congress for the year 1895 the Comptroller of the Currency pointed out that a minimum capital of \$50,000 was required for the organization of a national bank but that only 6 States required more than \$25,000 capital for the organization of a bank; 4 States no more than \$5,000; and 3 no more than \$10,000; while in some States there were no minimum requirements. In 1896 the Comp-

troller pointed out that the more stringent rules of the national banking system had been the means of giving it strength beyond any State system but that there was complaint against it "because the minimum capital stock required is so large that small towns and villages can not have the banking advantages which they might if less capital were required." In 1898 a member of Congress, speaking on a proposal to reduce the capital required for the organization of a national bank, said:

"What seems to me to be the valuable feature of this bill is in affording opportunities for the organization of small banks and the issue of currency by them in the South and West. A large part of our country is suffering seriously from a want of adequate banking facilities." 1/

The other side of the case was also indicated in Congress as follows:

"The purpose and object of this bill is to improve and liberalize the national bank system so that the State and private banks will come under it. We have banks enough. The thing to do is to induce them, rather than to compel them, to come in." 2/

Finally in 1900 the National Bank Act was amended to permit the organization of national banks with a minimum capital of \$25,000 in places having a population of 3,000 or less. In his report for the previous year, 1899, the Comptroller of the Currency had stated that the purpose of the proposed amendment to the National Bank Act reducing minimum capital for the organization of national banks to \$25,000 was to afford "our smaller communities the business advantages incident to increased banking facilities." 3/ There is little

1/ The Bank Chartering History and Policies of the United States, Economic Policy Commission, American Bankers Association, 1935, pp. 15-16.

2/ Ibid., p. 17.

3/ Annual Report of the Comptroller of the Currency, 1899, p. xx.

doubt that the failure of the national banking system at least to keep pace with the growth of State systems throughout the country constituted one of the reasons for the reduction of the minimum capital requirements. This relaxation of Federal standards was followed by further relaxations in some of the States. By 1909, when the situation was canvassed by the National Monetary Commission, banks could be organized in 20 of the States with capital of \$10,000 or less.

The Federal Reserve Act of 1913 provided that the same minimum capital be required of State banks entering the Federal Reserve System as that required for national banks. This act was amended in 1923 to facilitate the admission of State banks to membership in the System by reducing the capital requirement to 60 percent of that required for the organization of national banks, under certain conditions requiring the building up of capital out of net earnings. The Banking Act of 1933 restored the requirement that State banks entering the Federal Reserve System have paid-in capital as great as that required for a national bank, but it made an exception to permit the admission of a State bank which is located in a place the population of which does not exceed 3,000 and which has a capital of not less than \$25,000 if it was organized before the enactment of the Banking Act of 1933 or insured by the Federal Deposit Insurance Corporation.

Although the Banking Act of 1933 raised the minimum capital requirement for the organization of a national bank to \$50,000, the amount required prior to 1900, many of the States continued to have lower minimum capital requirements, as indicated by the survey reported in Rand McNally Bankers Monthly, July 1936, which showed the following:

<u>Minimum capital required</u>	<u>Number of States</u>
Not fixed by law	4
\$ 10,000	4
15,000	3
20,000	4
25,000	22
30,000	1
35,000	<u>1</u>
	39
50,000	8
100,000	<u>1</u>
	48

On December 31, 1935, 60 percent of the nearly 10,000 commercial banks with State charters had capital stock less than the applicable minimum statutory requirements for establishment of national banks. Nearly 4,000 of these State banks had capital of \$25,000 or less. During the years 1921-1936, 8,100 banks capitalized at \$25,000 or less failed.

Economic Necessity. - The economic need of the community is one factor which apparently was not given much consideration in the chartering of a great number of banks during recent decades. It has been stated that many banks have been granted charters which should never have been allowed to open--unneded banks, banks organized by unfit persons, "spite" banks, "political" banks, and banks that were just honest mistakes. Chartering of this character was most common in the fast growing West, where the surge of economic expansion seemed to warrant increasing the number of banking units. 1/

Chartering Procedures. - Reflecting to some extent reforms prompted by the difficult banking experiences of earlier years full power to authorize or deny the issuance of charters to new State banks

1/ The Bank Chartering History and Policies of the United States, Economic Policy Commission, American Bankers Association, 1935, pp. 11-12.

was held by the commissioner of banking in 21 States in 1934. In other States this power was exercised in conjunction with or subject to appeal to State banking boards or commissions. 1/

The minimum number of persons required as incorporators is not fixed by law in 2 States and ranges as high as 25 in Illinois, in certain cases.

"When you see that in South Carolina only two people are needed to incorporate a bank, and that in 12 other states, only three are necessary, you begin to wonder if bank chartering is really taken seriously." 2/

No specific qualifications are required of incorporators of banks in 12 States. In 21 States the qualifications of some or all of the incorporators are nominal and relate to age, residence, citizenship, or the requirement that stock subscribed must be paid for in cash. Florida requires that incorporators be subscribers for stock; Kentucky requires that they must be worth twice the amount of stock owned; while South Dakota requires that the incorporators must own stock. Only 11 States require that incorporators possess qualifications, in some form but varying in degree, as to character, integrity, financial responsibility, business or banking experience, or be satisfactory to the banking commissioner.

"The qualifications for incorporators are such that it is not difficult to understand why some banks in the past have been operated by persons who could not make them succeed because of inexperience." 3/

In many States investigations, varying considerably in scope, are made by the State banking department before charters are granted. These

1/ State Bank Supervision - Third Five-Year Survey, State Bank Division, American Bankers Association, 1934, pp. 31-32.

2/ "Laws Regulating Bank Charters," Rand McNally Bankers Monthly, July 1936, p. 410.

3/ Ibid.

investigations range from merely checking the facts stated in the application, or verifying compliance with legal requirements, to sending an examiner to investigate matters in connection with the application and making surveys to determine the need for the bank and the character and responsibility of the persons to operate the bank. The supervisor of banking in 22 States is required to make a survey of the territory in which the new bank is to operate, to establish the reasons for its need and the possibility of its success. In the majority of the States, however, only routine details are required in the application for a bank charter.

"....If this is carried out conscientiously, it ought to be quite a protection, but we must remember that the opinion as to the need and the possibility for success must be decided by one man." 1/

No doubt, the experience with political influence in other States has been similar to that of Indiana as thus described:

"....Intimate knowledge of individual failures, however, leads to the inescapable conclusion that many of the practices leading to bank failures, were directly caused by 'cut-throat' competition which sprang up in various communities as a result of too many banks or of the chartering, often for direct or indirect political reasons, of 'spite' banks." 2/

According to the Committee on Resolutions of the Missouri Bankers' Association

"....Political influence can be counted upon to bring pressure to secure charters, regardless of the economic need for additional banks." 3/

1/ Ibid., p. 411.

2/ Report of Study Commission for Indiana Financial Institutions, 1932, pp. 87-88.

3/ Proceedings of the 45th Annual Convention of the Missouri Bankers Association, May 1935, p. 90.

A former president of the California Bankers Association has pronounced a strong charge against the supervisory authorities in this connection:

"Our critics say that banks are operating with insufficient capital and with untrained men as officers and directors. May I ask in all fairness at whose door the blame should be laid? Who made the laws and chartered the banks and approved the management? How often have banks been licensed by state and national banking departments, when a committee of experienced and impartial bankers would have definitely refused the charters? The matter of adequate capital and qualified personnel has been too often of minor consideration by those in authority." 1/

Prior to the establishment of Federal deposit insurance the Comptroller of the Currency had the power which he still has to withhold his certificate authorizing the commencement of business by a national bank whenever he has reason to suppose that the shareholders have formed the bank for any other than the legitimate objects contemplated by the provisions of the National Bank Act. 2/ Five persons are required to sign an organization certificate as incorporators. At the time when a newly chartered national bank is admitted to insurance by the Federal Deposit Insurance Corporation, the Comptroller of the Currency must certify to the Corporation that consideration has been given to the following matters:

"....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 banks, and whether or not its corporate powers are consistent with the purposes of this section." 3/

1/ William A. Kennedy, President of the First National Bank of Pomona, California, The California Banker, June 1934, p. 203.

2/ Section 5169, U. S. R. S.

3/ Sec. 12B(g) of the Federal Reserve Act.

The Federal statutes provide similar requirements as to applications for membership in the Federal Reserve System and for voting permits.

With respect to national banks Comptroller of the Currency

O'Connor has remarked:

"The Comptroller of the Currency makes the sole determination as to whether or not a national bank shall be chartered in a given community. I know of no greater power than is vested in his office in the interests of depositors who are going to deposit in the bank, and in the interests of the people who invest in it as stockholders." 1/

It has been the practice for the Federal Reserve bank to investigate and make recommendation to the Comptroller in connection with the application of a national bank in its district for a charter. The law does not require a procedure of this character and Comptrollers have not always followed the recommendations made. Because of the statistical and other information of a general economic nature concerning the district developed through the operations of a Reserve bank, it is in a better position to determine the economic necessity for a bank than the Comptroller's office in Washington, or even the Comptroller's representatives, the district chief national bank examiner and the field examiners.

Since the power to charter a national bank is vested in the Comptroller and is exercised in his sole discretion, the care with which it is exercised in the last analysis depends upon the characteristics of the individual who may happen to be Comptroller and

1/ The California Banker, June 1934, page 247.

who may or may not be guided in the granting of a charter by the recommendations of his staff and the Federal Reserve bank.

During the era of rising prices and general prosperity from 1900 to 1920, not much action was taken with respect to the great number of banks to which charters were issued. Subsequently, when banking mistakes could no longer be covered up by increasing prices and when liquidation had to be effected and losses had to be taken, the results of laxity in chartering and regulation of banking began to show up. The speeches and writings of many prominent men, some of whom are quoted in the appendix to this memorandum, place emphasis upon the ill effects of excess chartering of banks.

Since the completion of the work of chartering new banks to fill the need for banking facilities after the banking holiday of 1933, the granting of charters has in general been substantially restricted. Chartering authorities realize that too many charters were granted in the past, resulting in extensive banking difficulties, and that steps should be taken to prevent a return to an overbanked condition. Moreover, funds have not been seeking investment in bank capital since bank operations over the past few years have been relatively unprofitable.

The fear is often expressed that when bank operations become more profitable, when the lessons of recent years are forgotten, and when capital again seeks investment in the bank field, increased

demands for bank charters will be made upon the chartering authorities. Then another period of excess chartoring may ensue, particularly if State bank commissioners are not subject to the restraint of some central authority in granting charters, Numerous State bankers associations have passed resolutions commending the efforts now being made by the supervisory authorities to restrict the granting of charters and requesting that efforts be continued in this matter, as indicated by the resolution of the Missouri Bankers Association in 1933, as follows:

"...In order that we may not be visited by a recurrence of our recent banking troubles, we recommend rigid supervision of existing banks and utmost caution in granting new charters."1/

Establishment of Branches

For some time prior to the enactment of the McFadden Act in 1927, it was well known that national banks were at a considerable competitive disadvantage with State banks in States under the laws of which branch banking was permitted. Additional powers given national banks in recent years with respect to branch operation were in the direction rather of equalizing the competitive situation than of fixing standards. In the Comptroller of the Currency's annual report for 1922 a definite warning was given that more liberal provisions of State laws were a serious menace to the very existence of the Federal Reserve System, and the Comptroller recommended that Congress grant to national banks, within the discretion

1/ Proceedings of the 43rd Annual Convention of the Missouri Bankers Association, May 1933, page 105.

of the Comptroller, the privileges enjoyed in each State by its State banks.

Prior to 1927 newly organized national banks could not establish branches but a State bank converting into a national bank was permitted to bring such branches as it had into the national system. For a few years just prior to the passage of the McFadden Act the Comptroller of the Currency permitted national banks to open offices with limited powers in the city of the head office in States in which State banks exercised similar powers. After much consideration the McFadden Act included an amendment allowing national banks to operate branches in the city of the head office if State banks were permitted such branches by State law. The committee reports are not particularly helpful in determining the precise purpose of the enactment of the amendment, except for general statements that the whole bill would serve to put new life into the national banking system and that the cumulative effect of its provisions would produce a situation in the Federal Reserve System where the powers of national banks would be more nearly on a par with those of State member banks.

The Banking Act of 1933 also amended Federal statutes with respect to branch banking. The principal effect of this amendment was to authorize the establishment by national banks of out-of-town branches under certain conditions in those States the laws of which specifically granted State banks such authority affirmatively and not merely by implication or recognition. It was generally understood at the time that one of the purposes of this enactment was to enable national banks to compete with State banks in those States in which State-wide branch banking was permitted.

For many years prior to 1933 arguments for and against branch banking were frequently made. In discussing the extension of branch banking within trade areas the Comptroller of the Currency in his annual report for the year 1929 stated in part:

"These suggestions for branch banking are made not with the intention primarily to deal with the question of the decline in the number of national banks through defection from the national to the State systems, but rather as a remedy for what appears to be a serious and fundamental weakness in our systems of banking both national and State. Such a grant of power to the national banks would, however, give them such an outstanding operating advantage that it would seem reasonable to expect that the exodus of banks from the national system would practically cease and that many now under State supervision would return to the national charter which they have forsaken." 1/

"The announced legislative policy of the so-called McFadden Bank Act of February 25, 1927, was parity between the national and State systems. The purpose of the bill was to make the charter powers of national banks approximately equal in operating advantage to those of the State banks. Nearly three years of operation under that act has demonstrated that it has failed of its purpose in this respect." 2/

"....legislation, based not upon the theory of equalizing the national with the State bank charter powers but giving a real advantage to the national charter, would be fully justified under existing conditions which seriously jeopardize the maintenance of the national banking system. The State legislatures have for years given to the State banks operating advantages which the national banks did not possess and it is in this situation that we find the motive for the abandonment of national charters. There is appended hereto a list of 127 large national banks which have within the past 10 years given up their national charters for the purpose of operating under State charters." 3/

1/ Annual Report of the Comptroller of the Currency, 1929, p. 5.

2/ Ibid., pp. 8-9.

3/ Ibid., p. 5.

"....Boards of directors of banks and their stockholders, in giving consideration to the question of whether the corporation should operate under the national or the State charter, are not moved by questions of sentiment or patriotism.....The corporation must in the nature of the case be moved almost solely by consideration of the most profitable use of the capital invested in the enterprise." 1/

In his report for 1930, again urging branch banking for national banks, the Comptroller stated:

"Upon the enactment of the McFadden bill the conversion into national banks of several larger State branch banking institutions and the consolidation of several State banks with national banks under the national charter gave rise to the hope that the national banking system would reclaim the most important banks which had left it to operate under State charters. However, this hope was short lived, for there soon followed through State legislative or State judicial action new advantages for State banks, particularly with respect to the operation of the trust business and desertions from the national charter in favor of those offered by the States began to increase." 2/

Amendments to Federal banking statutes in connection with branch banking apparently have been enacted for the purpose of equalizing the competitive situation between national and State banks. Inequalities continue to exist, however. As the Federal statutes now stand a national bank may not establish an out-of-town branch

"....unless it has a paid-in and unimpaired capital stock of not less than \$500,000: Provided, That in States with a population of less than one million, and which have no cities located therein with a population exceeding one hundred thousand, the capital shall be not less than \$250,000: Provided, That in States with a population of less than one-half million, and which have no cities located therein with a population exceeding fifty thousand, the capital shall not be less than \$100,000.

"(d) 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."

1/ Ibid., p. 8.

2/ Ibid., 1930, p. 5.

These provisions are applicable also to State bank members of the Federal Reserve System.

There are only two States in which the capital requirements for the establishment of out-of-town branches are higher for State banks than for national banks in all cases and only two other States in which such requirements are in all cases equal. In a number of other States the statutes as construed might conceivably require as much or more capital for out-of-town branch operation by State banks as for national banks but in most of such States there is considerable latitude permitted for the operation of out-of-town branches by State banks with less capital than that required for such operation by national banks. In a considerable number of States the requirements for State banks are definitely lower than those for national banks.

Laxity may be associated with granting permission for the operation of new branches by administrative authority just as in the case of granting charters for new banks. In considering applications made by State member banks to establish branches, the Board obtains, among other things, information as to the present banking facilities in the place in which the branch is to be located, the possibilities for the successful operation of the branch, the kind of supervision to be given by the head office, and whether the appropriate State authorities favor its establishment. As a condition precedent to the establishment of branches, it has been the general policy of the Board to require applicant banks to make eliminations of estimated losses as well as depreciation in corporate stocks and in securities other than those rated in the four highest grades.

Often other corrections when needed are insisted upon, such as increase of capital and improvement in management. It is understood that the Comptroller of the Currency in considering approval of the establishment of branches of national banks requires corrections and improvements as an administrative measure. Information is not available as to the degree to which requirements of this character are made by the authorities in the 36 States which permit branch banking in varying degrees. In passing upon applications of State member banks for branches, however, instances have been noted where the State supervisory authorities have not, as an administrative matter required corrections or additional capital, even where these were clearly desirable.

The laws of many States require a demonstration of economic necessity before supervisors may authorize new branches, but there is considerable room for the exercise of judgment in this connection as well as with respect to the capabilities of the management. Bankers have the opportunity of playing the State supervisory agency off against the national in attempting to obtain approval for the operation of a new branch. The Comptroller of the Currency has stated that his office made a careful investigation of an application by a national bank for the establishment of a branch in a town in which a new State bank had been granted a charter some months before. It seemed that there was no necessity for a competitive office in the locality and that there was not sufficient public demand for two banking offices. Therefore, the Comptroller denied the application of the national bank to establish a branch and was much surprised to learn a few weeks later that the banking commissioner of the

State had granted "to the same interests a charter for a branch of a State bank" to be located in the community. The new branch would, of course, be in competition with the previously chartered State bank. He indicated that such occurrences were the exception and not the rule, however. 1/

Licensing of Banks

There are abundant indications that many State authorities were more liberal in licensing banks after the holiday of March 1933 than were the Federal authorities. In fact, in several States all or practically all nonmember banks which desired to reopen were authorized to do so. Many of these subsequently closed or had to be reorganized with the aid of Reconstruction Finance Corporation capital.

As of April 12, 1933, there were 12,819 licensed banks in the country with deposits of \$30,932,000,000. Members of the Federal Reserve System comprised 42.3 percent of the total number and held 84.0 percent of the total deposits, while nonmember banks comprised 57.7 percent of the total number and held 16.0 percent of the total deposits. Of the 183 licensed banks with deposits of \$146,672,000 which suspended between the holiday and December 31, 1933, only 8.2 percent (15 banks) of the number suspended were member banks with deposits of 14.2 percent (\$20,849,000) of the total deposits involved in the suspensions, while nonmember banks comprised 91.8 percent (168 banks) of the total number suspending and held 85.8 percent (\$125,823,000) of the total deposits involved. During 1934-1936 only 6 licensed member banks with deposits of \$5,860,000 suspended, while in the same period there were suspensions of 129 nonmember banks with deposits of \$52,398,000.

1/ Proceedings of the National Association of Supervisors of State Banks, November 1935, pp. 99-100.

In some instances where State member banks could not be licensed to resume normal banking operation, they withdrew from membership in the Federal Reserve System so as to place themselves under the sole jurisdiction of State authorities for the purpose of reopening under a plan for full or partial release of deposits. A State bank in a Western State in making application for immediate withdrawal from the System in March 1933 stated that it had been refused a license by the Secretary of the Treasury and that it was in a position to meet the demands of its State Banking Department for the resumption of business under such restrictions as would be proposed or promulgated by that department. In an Eastern city two trust companies, both members of the System, which were not licensed to reopen after the banking holiday, submitted a plan of reorganization after a long delay which involved the issuance of preferred stock to depositors with a retirable value equal to the full amount of their deposits but with an aggregate par value of a considerably less amount. After the Board ruled that their capital was still impaired and these banks had withdrawn from membership in the System, they received licenses from the State banking department to reopen and operate on an unrestricted basis.

Cases of this sort, illustrative of many others, substantiate the view expressed by Upham and Lanke that State supervisory authorities appear to have been more lax than Federal officials in the licensing of banks.^{1/}

^{1/} Upham and Lanke, Closed and Distressed Banks, 1934, p. 48.

Trust Powers

Prior to the granting of certain trust powers to national banks first provided for in the Federal Reserve Act of 1913 and the extension of such powers by amendments to the Act in 1918, the right to exercise fiduciary powers by banking institutions in New York was vested exclusively in trust companies. On the subject of this newly developed competition between national banks and the many State banks in New York (not having trust powers), an annual report of the Superintendent of Banks for New York contains the following:

"It seems strange as well as inconsistent with any theory of state rights that, in order to protect national banks from competition or to enable them to compete with State institutions, it should be considered proper to take from the States the right to determine the qualifications of executors, administrators and trustees, or to provide that, when the exercise of such powers by national banks is expressly in contravention of State laws, it shall not be deemed in contravention of such laws, if any competing institutions are permitted to exercise them....

"Under existing circumstances and conditions, even discriminatory legislation, if passed by the National Government, must be accepted in good faith, and some amendments to the State Banking Law are, in my judgment, rendered necessary by the enactments above referred to.

"....It has been the general policy of the Department not to authorize trust companies in small places where there was neither occasion nor opportunity for the exercise of trust powers to any considerable extent." 1/

"The trust companies are the first institutions of this State to be affected by the determination upon the part of the Federal authorities to confer the distinctive powers and privileges of State institutions upon national banks and to subject State institutions to as much competition as possible in their special spheres." 2/

1/ Report on Banks of Deposit and Discount and Private Bankers, New York, 1918, pp. 12-14.

2/ Report on Savings Banks, Trust Companies, Safe Deposit Companies, Miscellaneous Corporations and Personal Loan Brokers, New York, 1918, p. 12.

The New York Legislature in 1919 amended the banking laws so as to authorize the exercise of trust powers by State banks. Trust companies, of course, had previously possessed such powers.

In 1914 the Commissioner of Banks of Michigan recommended a change in the Michigan banking act to give State banks the same powers and privileges with respect to trust activities as granted to national banks, except that these would be limited to banks of at least \$100,000 capital and surplus and located in cities of at least 5,000 population. The legislature, however, did not confer upon Michigan State banks the right to exercise trust powers until 1925.

It is an unfortunate fact that, as the fields of trust activities of banks have been broadened from time to time, fields of operations have been invaded which have been not only unprofitable but dangerous. An important element of competition in laxity in connection with the exercise of trust powers lies in the administration of the statutory provisions, particularly in connection with the approval of applications and the later examination and supervision of trust activities.

The division of responsibilities for the supervision of trust activities of banks itself is conducive to competition in laxity. Under the provisions of the laws, the Board of Governors grants trust powers to national banks and prescribes regulations under which such powers may be exercised, while it is the responsibility of the Comptroller to examine and supervise the activities of the national banks, including subsequent trust activities. State banks admitted to membership when not exercising trust powers are usually subject to a condition of membership which requires them to obtain the permission of the Board before

engaging in such business. Trust activities of State nonmember banks and trust companies are subject only to such regulation, if any, as may be imposed by the respective States.

In passing upon an application for trust powers, the Board considers the size and condition of the bank, the possibility of profitable trust activities in the community, the general character of the bank's management, and the specific qualifications of proposed trust officers.

Little information is available in the Board's files as to the extent of laxity in these matters by the State banking departments in the various States. Instances have arisen, however, from time to time where it is obvious that very little effort is made by the authorities in several States to supervise trust activities and very few requirements other than the more or less superficial provisions of the statutes are considered at the time of granting trust powers. Indeed, in many States the laxity which has characterized the chartering of banks applies equally to the extension of trust powers to banks and other fiduciary institutions.

Conversion of State Banks into National Banks

Section 312 of the Banking Act of 1935 added to Section 515⁴ of the Revised Statutes the following paragraph relative to the conversion of State banks into national banks:

"The Comptroller of the Currency may, in his discretion and subject to such conditions as he may prescribe, permit such converting bank to retain and carry at a value determined by the Comptroller such of the assets of such converting bank as do not conform to the legal requirements relative to assets acquired and held by national banking associations." 1/

1/ U. S. Congress, 74th, 1st Session, Public No. 305, p. 31.

In recommending the enactment of this amendment, the Comptroller of the Currency stated in his annual report to Congress in 1933:

"....There has been an increased number of State banks which have applied to the Comptroller of the Currency for conversion. In examining these banks it is found that they possess some assets which it is not legal for national banks to acquire and hold. To require a State bank to eliminate these assets places a burden on it which it may be unable to meet and many times results in its inability to join the national system." 1/

In the case of a State bank converting into a national banking association the Comptroller of the Currency is authorized to waive under certain conditions the requirement added by the Banking Act of 1935 that

"....No such association shall hereafter be authorized to commence the business of banking until it shall have a paid-in surplus equal to 20 per centum of its capital." 2/

It is evident that these amendments offer to State banks converting into national banks considerable competitive advantages over existing as well as new national banks. It is also apparent that one of the important purposes of the amendments was to further extend the facilities and influence of the national banking system although at some sacrifice of the standards of the national system.

Admission of State Banks to Membership in the Federal Reserve System

When the United States entered the World War in 1917, not many State banks had joined the Federal Reserve System. On April 23, 1917, Mr. Glass introduced in the House of Representatives a bill amending in several particulars the Federal Reserve Act. Of this bill, it was stated:

1/ Annual Report of the Comptroller of the Currency, 1933, p. 16.

2/ U. S. Congress, 74th, 1st Session, Public No. 305, p. 29.

"One thing of immediate and pressing importance is to further strengthen the Federal Reserve System so that the colossal financial operations of the Government may be facilitated and the commercial interests of the country be undisturbed. The amendments to the Federal Reserve Act, unanimously recommended by the Federal Reserve Board, are of infinite importance at this time. They have been carefully considered with relation to present problems and to those which must arise out of the conduct of the war, and the entire board is impressed with the imperative necessity of strengthening the Federal Reserve System in the manner proposed, in order that there may be no doubt about its ability to meet any test the future may impose upon it." 1/

The bill became a law on June 21, 1917 and had the effect of relaxing previous statutory provisions in several important respects in order to facilitate the admission of State banks to membership in the System.

These changes provided that State member banks should retain their full corporate powers subject to the provision of the Federal Reserve Act and the regulations thereunder; permitted withdrawal of State member banks from the System after six months' written notice; and relieved State member banks from complying with the limitations applicable to national banks regarding loans to a single borrower, although Reserve banks were forbidden to discount paper of a borrower who was borrowing in excess of the amount that could be lent by a national bank. In connection with the transfer of reserves to Federal Reserve banks reserve requirements were further lowered.

1/ Letter from the Secretary of the Treasury to Mr. Glass, dated April 25, 1917, U. S. Congress, 65th, 1st Session. H. R. 35.

Numerous changes were also included in the McFadden Act of 1927, apparently designed to facilitate or induce State banks to join the System. The general purposes of this act were indicated as follows:

"....The general purpose of the bill is to adjust the national banking laws to modern banking conditions along the lines of conservative banking.....Some of the provisions of the bill extend and enlarge the powers of national banks, but only in ways in which State banks and trust companies generally have been successfully operating within recent years....."

"Your committee believes that the enactment of this bill into law will put new life into the national banking system. The cumulative effect of its provisions will produce a situation in the Federal reserve system where the rights of the national banks will be more nearly on a par with those of the State member banks." 1/

"As a result of the passage of this act, the national bank act has been so amended that national banks are able to meet the needs of modern industry and commerce and competitive equality has been established among all member banks of the Federal Reserve System. This action was necessary; otherwise national banks were sure to seek the greater advantage offered by State banking laws, and in that event the Federal reserve system without the compulsory support of national banks would be only a theory, not a reality as is now assured." 2/

The Banking Act of 1935 contained the following provisions (Section 202):

"In order to facilitate the admission to membership in the Federal Reserve System of any State bank which is required under subsection (y) of section 12B of this Act to become a member of the Federal Reserve System in order to be an insured bank or continue to have any part of its deposits insured under such section 12B, the Board of Governors of the Federal Reserve System may waive in whole or in part the requirements of this section relating to the admission of such bank to membership.....(subject to certain provisos)."

1/ U. S. Congress, 69th, 1st Session, Report of Senate Committee on Banking and Currency, S. Rept. 473, March 25, 1926.

2/ Remarks of Mr. McFadden on floor of House of Representatives, March 3, 1927.

National Banks As Insurance Agents or Real Estate Loan Brokers

The Federal Reserve Act was amended in 1916 to authorize national banks located in any place the population of which does not exceed 5,000 inhabitants to act, under certain conditions, as agent for any fire, life, or other insurance company, and to act as broker or agent for others in making or procuring loans on real estate. In recommending that this authority be extended to national banks (in towns not exceeding 3,000 population) the Comptroller stated in a letter to Senator Robert L. Owen in 1916:

"For some time I have been giving careful consideration to the question as to how the powers of these small national banks might be enlarged so as to provide them with additional sources of revenue and place them in a position where they could better compete with local State banks and trust companies which are sometimes authorized under the law to do a class of business not strictly that of commercial banking." 1/

This extension of the field of activity of national banks was probably desired most by the large number of small national banks which came into existence after the law was changed in 1900 permitting a minimum capital of \$25,000 rather than \$50,000 as previously required.

Real Estate Loans

From time to time the Federal statutes have been amended to liberalize the restrictions and limitations on real estate loans in order to equalize the competitive position of national banks compared with State banks.

Prior to 1913, national banks were not permitted to make real estate loans. The original Federal Reserve Act authorized national banks not in central reserve cities to lend on "improved and unencumbered farm land" under certain conditions. This power was extended and liberalized by an amendment in 1916 to permit any national bank to make loans on farm lands

1/ Congressional Record, 64th Congress, 1st Session, p. 11,001.

situated in its Federal Reserve district or within a radius of 100 miles of the place in which such bank is located, irrespective of district lines, and also to make loans on other real estate for periods not exceeding one year.

In explanation of this amendment, the Senate Committee on Banking and Currency in its report on the bill stated:

"The reason for this amendment is that the State banks have a more liberal provision in this respect which subjects national banks to difficult competition...." 1/

The Comptroller in his annual report to Congress for the year 1924 recommended that section 24 of the Federal Reserve Act be liberalized again so that national banks could meet the competition of State banks, and stated:

"Section 24 prohibits a national bank from lending money upon first mortgage security upon city property for a longer period than one year and further limits the aggregate amount of such loans to a sum not in excess of one-third of the time deposits. The State banks and trust companies in active competition have no such limitations imposed upon them." 2/

The McFadden Act of 1927 further liberalized the Federal Reserve Act with respect to real estate loans, permitting all national banks, including those located in central reserve cities, to make loans secured by real estate under certain conditions for periods not in excess of five years and in amounts not in excess of 25 percent of capital and surplus or 50 percent of savings deposits.

The report on the bill containing the amendment by the Committee on Banking and Currency of the Senate included this statement:

1/ U. S. Congress, 64th, 1st Session, S. Rept. 481, May 18, 1916.

2/ Annual Report of the Comptroller of the Currency, 1924, p. 11.

"The State banks and trust companies are authorized to make long-time loans upon the security of first mortgage upon city real estate. National banks, by being limited to a one-year period, have found themselves handicapped in meeting the demands of their customers in this respect.....it has become necessary to recognize the right of a national bank with certain definite restrictions to use these funds (savings) in the same general manner in which the State banks and trust companies are using them, which includes the right to make loans upon city property, as provided above." 1/

Section 24 of the Federal Reserve Act was again amended in 1934 in connection with insured loans under the National Housing Act, and again by the Banking Act of 1935 with respect to loans made to established industrial or commercial businesses. Section 208 of the Banking Act of 1935, however, further liberalized the provisions of section 24 principally by increasing the aggregate amount of such loans to not in excess of unimpaired capital stock and surplus or in excess of 60 percent of the amount of time and savings deposits, whichever is greater.

State member banks, however, are not subject to specific Federal statutory restrictions upon the making of real estate loans and their power to make such loans is derived from the State laws under which they were organized. An effort was made during the progress of the banking legislation of 1935 to provide Federal regulation for State member banks with respect to their real estate lending operations, but the provisions were not enacted.

Limitations on Loans to Single Borrower

Although Federal statutes with respect to loans to a single borrower have been changed several times, most of them liberalizing

1/ U. S. Congress, 69th, 1st Session, Report of Senate Committee on Banking and Currency, S. Rept. 473, March 25, 1926. (Material in parentheses supplied.)

limitations, the committee reports and other sources of information indicate that such amendments were made largely because changing conditions of commerce and industry make it necessary for banks to be enabled to accommodate the increasing number of large business concerns. There are, however, some general comments in the legislative history of the Act of June 21, 1917 which indicate that competitive reasons were partly responsible for State member banks' being relieved of restrictions of this sort that apply to national banks.

Reserves

The provisions of the Federal Reserve Act in 1913 lowered reserve requirements of national banks and similar action was soon taken by several states. 1/ In this connection the Board's annual report for 1915 stated:

"It is an unfortunate fact that in some of the States reserve requirements for State banks and trust companies have been materially lowered by legislative enactment since the adoption of the Federal Reserve Act. The only justification for the reduction of the reserve requirements for national banks is the fact that the national banks are members of the Federal Reserve System and that the Federal Reserve Banks hold a part of the consolidated reserves of the national banks, and are, therefore, in position to come immediately with all of their resources to the support of the national banks in case of necessity or emergency." 2/

One outstanding example of the activities of States in this connection is illustrated by the action taken in California. In his annual report for 1914 the Superintendent of Banks made the following recommendation with regard to reserve requirements:

1/ Annual Report of the Federal Reserve Board, 1915, p. 104.

2/ Ibid., p. 13.

"I desire also to suggest an amendment to the Bank Act which will equalize the reserve requirements of state banks with that of national banks and members of the regional federal reserve banks.....If we insist upon the present state law requirement, state commercial banks will unnecessarily be placed at a disadvantage." 1/

Thereafter the California Legislature liberalized the California statutory reserve requirements both with respect to the ratios and the amount required to be held in cash on hand or deposited in banks.

In his annual report for 1920 the Superintendent of Banks of California stated:

"....It remains for us, through appropriate legislation, to remove the remaining obstacles in the way of the development of commercial banking in our state system, to the end that the state bank may in all fields be at least an equal competitor with the national bank. To this end a series of amendments will be presented to the 1921 legislature, which I trust shall have your entire approval and support. These amendments will not only remove the shackles on the commercial departments of our state banks, but will also open wider opportunities for commercial support from the savings banks." 2/

In June 1917 reserve requirements of member banks were again reduced and it was required that all legal reserves be carried with the Reserve banks. It was hoped that as a result the gold holdings of the country would be concentrated in the Reserve banks in order to enable the System to better withstand any exigency that might ensue by reason of conditions arising out of the European war. Reserve requirements of banks in outlying districts of central reserve cities and reserve cities were reduced in 1918. Enactments of 1933 and 1935 gave the Board of Governors authority to increase the reserve requirements of member banks in certain circumstances. Evidence does not indicate these changes to be associated with competition between the national and State systems,

1/ Annual Report of the Superintendent of Banks of the State of California, 1914, p. 9.

2/ Ibid., 1920, p. 11.

but a distinct competitive advantage of State nonmember banking institutions in some States may result from recent increases in reserve requirements put in force by the Board of Governors under the authority granted by legislation of 1933 and 1935, particularly since not a great deal of effort is made by some of the State supervisory authorities to obtain the enactment of increased reserve requirements or to actively enforce those already on the statute books.

Examinations

Adequacy of Staffs. - It has been said that the prime purpose of bank supervision is to protect the public and that superficial or ineffective examinations do nothing more than to stultify the law. ^{1/} The failure in any jurisdiction--State or national--to provide for adequate examining staffs and effective examinations of banks constitutes evidence of inexcusable administrative competition in laxity, especially in view of the recent history of bank failures.

The Comptroller of the Currency, whose examining staff covers the entire country, is generally able to shift his examiners to meet the varying needs of the several districts, but his district chief examiners have at times found it necessary to obtain assistance from the staffs of the Federal reserve banks in making examinations of large national banks by reason of the size of the institutions or the existence of branches.

State banking departments with small examining staffs are faced with serious difficulties in examining large State banks and those

^{1/} A Type Study of American Banking, University of Minnesota, 1934, p. 148.

with branches. Reasonably satisfactory examinations of such institutions can often be made only by an unusual mobilization of examiners, borrowed in part from other supervising agencies.

Marked weaknesses in examining staffs are evident in many States. The Superintendent of Banks of Georgia has a staff of one assistant superintendent, four examiners (no assistants), and two stenographers. This staff is required by law to examine, twice annually, approximately 226 chartered banks, 43 private banks, 75 credit unions, and 59 building and loan associations. This would constitute more than 55 banks per examiner or more than 110 examinations per year for each examiner, without assistance, in addition to the examination of the private banks, credit unions, and building and loan associations.

Six of these banks have total resources of more than \$4,800,000 each, the largest having over \$28,000,000 of resources in addition to which it has a considerably larger volume of trust assets. There are several nonmember banks in the State with resources of more than \$2,000,000 each. In addition, there are several sizable trust departments but the State has no examiner with any worthwhile trust examining knowledge or experience and makes little pretense as to trust examinations.

The gross inadequacy of the staff is further indicated by the fact that the annual salary of each examiner is limited by law to \$2,400 per year.

Several other Southern States have comparable situations.

In 1934 Rhode Island reported six examiners.^{1/} At the end of 1936 one of its trust companies had total assets of more than \$130,000,000, and there were two State banks with assets of more than \$60,000,000 and several others with assets ranging from \$4,000,000 to \$36,000,000.

In 1934 Missouri reported nine examiners (maximum salary \$2,400) with approximately 72 banking offices for each examiner. In that State there are several comparatively large banks including one bank with total resources of \$165,000,000, another with \$95,000,000, and several ranging in size from \$1,000,000 to \$15,000,000.

In 1934 several other States reported more than 50 banks per examiner and in many of the cases two examinations per year of each such bank are required by law. In nine States the commissioner's salary was reported as \$3,600 or less; the lowest salary paid was \$2,400 in North Dakota.

One inevitable result of such situations is laxity in examinations as well as in follow-up work and the failure to provide for an adequate number of experienced and capable examiners evidently indicates competition in laxity of a dangerous and inexcusable sort.

Quality of Examinations. - With respect to the quality of examinations, the following point of view was recently expressed by Mr. Carl K. Withers, New Jersey Commissioner of Banking and Insurance:

^{1/} State Bank Supervision - Third Five-Year Survey, State Bank Division, American Bankers Association, 1934.

"Generally speaking, the supervision of national banks, by reason of longer and wider experience, has been made more uniform than evident in many of the States....Supervisors and examiners....for the most part are 'career' men, and derive their experience from the examination of institutions over wider areas than sometimes possible within the confines of a single State." 1/

Reports of examinations of State member banks made by examiners for the Federal Reserve banks are often more complete with respect to details relating to both State and Federal laws and regulations and more thorough with respect to investments, loans, and management than reports of examination by national examiners.

Moreover, reports of examinations made by a large majority of the State authorities are not so complete or thorough as either the national or Federal Reserve reports. Although some of the States have recently lengthened their form of reports to approach a degree of conformity with the Federal Reserve, Federal Deposit Insurance Corporation, or national reports, many still do not include a number of important matters. State examiners usually are not interested in examining possible violations of the Federal Reserve Act, regulations, or conditions of membership. In many particulars State laws are not so restrictive as Federal laws, and, therefore, State examiners are neither required to, nor are particularly interested in, going into many important details.

1/ The Financial Age, June 4, 1936, p. 387.

In several States, as a general rule, the State examiners do not conduct independent examinations of State member banks. In a few of the States no detailed report or practically none is prepared by the State examiners for the member bank or the Federal Reserve bank. Sufficient numbers of State reports of examination have come to the attention of Federal Reserve examiners in Washington to indicate clearly that these reports in at least a large number of the States are not sufficiently detailed in many respects, including classifications or descriptions of assets, statements of financial condition, management, and policies, to serve the purposes of the Federal Reserve System. In practically all cases the State reports are entirely inadequate with respect to matters affected by the Federal Reserve Act, the Board's regulations, and conditions of membership.

Classification of Assets. - Competition in laxity has often in the past been indicated by "liberal" classifications of assets in examiners' reports. The practice is still evident in many States. Liberal practices of this character result in lowering the basic standards imposed by the primary supervisory authorities. The "liberal" classification of assets is sometimes made in view of and limited by the amount of surplus, undivided profits and reserves available for

the elimination of estimated losses, rather than in accordance with the apparent value of the assets concerned. In this manner banks are sometimes reported to have sound and unimpaired capital and surplus, whereas, if classifications of assets were made in accordance with actual values, it would happen that surplus and sometimes the capital stock would be impaired or practically wiped out. When requirements as to eliminations are based upon such classifications, administrative competition in laxity of the worst sort is manifest.

Examinations of State member banks made by examiners for Reserve banks jointly with State examiners have at times developed material differences in the adverse classification of assets, those made by State examiners generally being more lenient.

Under centralized bank supervision the variations in classifications of a bank's assets as made by various sets of examiners could be avoided to a great extent since it would be much easier to set up proper standards. This would result in reducing or in eliminating one element in which administrative competition in laxity is frequently indicated.

A large number of banks have been closed not necessarily because of anticipatory action by the supervisory authorities but because of inability to meet depositors' withdrawals due to condition of assets. In earlier examinations of such a bank the assets apparently may not have been classified in a way that the capital was shown to be wiped out or even greatly impaired. Nevertheless, after the failure of such a bank the assets were classified or appraised by liquidators or receivers in such manner that "estimated losses" exceeded the combined

capital accounts and unsecured depositors ultimately lost large percentages of their balances. In many of such cases it cannot be said that the weakened condition of the banks resulted in the last few weeks or months of their existence. It is more correct to say, in many cases at least, that they illustrate cases of gross laxity in classifications or other supervisory responsibilities.

Some banks operating up to the time of the banking holiday were not licensed to reopen although in no worse condition than for some time before the holiday; many licensed banks were not admitted to deposit insurance until such strengthening of their capital had been effected as examinations made by the Federal Deposit Insurance Corporation indicated to be necessary. In many other cases it has been necessary to merge or close banks even though they had been admitted to deposit insurance.

Eliminations of Losses and Depreciation. - For some time it has been the policy of the Board to require State banks upon admission to membership to eliminate all estimated losses and depreciation in securities other than those in the four highest grades. The Board does not have adequate power, however, with respect to requiring State banks after their admission to make similar eliminations and can only point out to such banks its views as to the desirability of making eliminations to this extent. Thus banks are admitted to membership under a standard with respect to eliminations which the Board does not have adequate power to require them to maintain as members.

Federal Reserve banks are seriously handicapped when requesting State member banks to make eliminations in cases in which State exam-

iners recommend lesser eliminations. No doubt the Federal Deposit Insurance Corporation experiences similar difficulties in cases in which joint examinations of nonmember insured banks are made with State authorities.

The Board's letter dated November 10, 1934 (X-9018) outlined its requirements for elimination of unsatisfactory assets by subsidiary banks of holding company affiliates as a condition to the issuance of voting permits. These were the same as those required of banks upon admission to membership and which the Board endeavors to have State member banks follow. In such cases the Board has endeavored to obtain the elimination of

- (a) all losses in loans and discounts
- (b) all depreciation in stocks, defaulted securities, and other securities not of the four highest grades to the extent such depreciation is not offset by appreciation in the four highest grades
- (c) all other losses.

In some cases the holding company affiliates declined to comply, one principal reason being that competing banks, both national and State, not in holding company groups were not required or requested to make similar corrections. Difficulties have also been experienced in obtaining full eliminations where on joint examinations State, Federal Reserve System, or Federal Deposit Insurance Corporation examiners have reported different amounts of estimated losses and depreciation, and in which classifications the State examiners have been more lenient. The Indiana State Banking Department in a circular letter dated December 28, 1933, advised banks and trust companies in that State as follows:

"Since there is some disagreement in many instances between our examiners and the examiners of the (Federal Deposit) insurance corporation, we have decided to place the responsibility for determination of losses upon each individual Board of Directors. Each individual board is asked to consider the paper of the institution carefully and to designate that which is believed to be a loss or very doubtful and charge all such paper off, in addition to bond depreciation referred to above." (Depreciation in securities other than those rated in the four highest grades.) 1/

Overvaluation of doubtful assets may have disastrous consequences whether practiced by banks' officers or supervisory authorities. Authorities should be permitted by law to compel an institution to charge off bad and doubtful assets, or to set up adequate reserves or both. 2/ Failure on the part of primary supervisory authorities to require banks under their jurisdiction to make adequate provision for losses and depreciation, thus permitting such banks to issue statements of condition which are misleading to the public, may be said to constitute a vicious form of administrative laxity. The presence of the Federal Reserve System with legal power to make examinations but with inadequate power to force eliminations of losses and depreciation leaves the public under a misapprehension as to its duties and responsibilities with respect to this phase of supervision. If the supervision of the banks of the country were vested in a central authority, this element of administrative competition in laxity would be eliminated, together with others.

Statements of Condition Given to the Public

The character of official statements of condition given by banks to the public is regarded by some as a serious problem as the following quotation indicates:

1/ See Division of Examinations file - "General - Capital Debentures" (Material in parentheses supplied.)

2/ A Type Study of American Banking, University of Minnesota, 1934, p. 152.

"One of the flagrant current violations of the principle of government protection of the public in respect to banking is the form and content of bank statements as commonly published. The law requires that a true statement of condition be disclosed. The purpose of the statute is to provide information for the guidance of depositors. This purpose is largely defeated because of two facts. First, the form is so brief that many items are concealing rather than revealing.....

"Secondly,.....the form is technical rather than popular, and the depositor with no training in accounting is therefore impressed but not informed by what he reads." 1/

The Study Commission for Indiana Financial Institutions in its report stated that:

"....When banks are forced to inform the public regularly as to the amount of their questionable assets, their relations with their affiliates, their trust accounts, and their public funds, no longer will they dare abuse sound principles in connection with these accounts." 2/

The Banking Act of 1935 provided that State member banks must publish their reports of condition, and it also gave to the Board of Governors authority to prescribe the form, contents, and manner of publication of such reports. Prior to this enactment the Board had endeavored to have some such banks set out certain of their assets as separate items in their published statements of condition. It attempted to accomplish this through conditions of membership and conditions prescribed in connection with the granting of voting permits. In the case of a certain State bank, the Board prescribed a condition precedent to the granting of a voting permit that the bank show as a separate item in all of its published statements any extension of credit to and investment in its affiliated company holding title to its banking house. In another case it prescribed a condition of membership in December 1933 that the bank show separately in all of its published statements its extensions of credit to and investments in

1/ Ibid., pp. 154-55.

2/ Report of Study Commission for Indiana Financial Institutions, 1932, p.119.

a subsidiary realty company. The banks involved objected to publishing their statements in the manner prescribed largely because competing banks in similar situations were not required to do likewise. In the case of a national bank in the South the Comptroller advised the bank that its investment in an affiliate which held title to its banking house and also owned some stock in other banks should be included in its security investments and so reflected in its published reports. These are but a few of the many specific cases where the Board endeavored to have banks publish pertinent information as to their assets while different positions were taken by other authorities who issued instructions which have the effect of making published statements concealing rather than revealing. Such positions obviously constitute administrative competition in laxity.

Strengthening of Management.

The Banking Act of 1933 gave the Board of Governors and the Comptroller of the Currency for the first time direct legal power to remove the management of a State member bank or a national bank for continued violation of laws relating to such banks or continued unsafe or unsound practices in conducting their business. The banking Act of 1935 gave to the Federal Deposit Insurance Corporation power to terminate the insured status of nonmember banks, as well as national and State member banks, for violations of law or regulations or for continued unsafe or unsound practices. There is some difference of opinion among State

supervisory authorities as to whether the power to remove inefficient officers after a hearing is desirable although in a number of States this power is at present held by such authorities. 1/

In the years 1934 and 1935, when considering applications for individual permits to serve as directors of banks under the provisions of the Clayton Act, the Board in a number of instances denied permits to individuals who had abused the credit facilities of banks---whether members or nonmembers---of which they were directors or had grossly neglected their duties and responsibilities as such. The unfitness of the directors in many such cases must have been known to the primary supervisory authorities who, however, by reason of lack of adequate powers or unwillingness to force the issue, apparently had taken no steps to have such directors terminate their services.

Adequacy of Capital

The Board of Governors has for years stressed the necessity for an adequate capital structure in relation to deposits and included in Regulation H, effective January 1, 1936, a condition of membership requiring that the net capital and surplus funds of a bank thereafter admitted to membership should be adequate in relation to the character and condition of its assets and to its deposit liabilities and other corporate responsibilities, and that its capital should not be reduced except with permission of the Board of Governors.

1/ State Bank Supervision - Third Five-Year Survey, State Bank Division, American Bankers Association, 1934, pp. 10, 33-35.

In certain holding company affiliate cases, involving national and State nonmember banks, the Board has endeavored, through conditions precedent to the granting of voting permits, to bring about increases in the capital of subsidiary banks of the group. In these cases other supervisory authorities lent less than half-hearted efforts to bring about the increases in capital, and the president of one of the subsidiary banks was openly critical of the Federal Reserve System authorities because of their efforts in this connection.

In the efforts at rehabilitation of banks through the sale of preferred stock or debentures to the Reconstruction Finance Corporation and other sources, both before and after the banking holiday of 1933, the Federal Reserve System has often found it necessary to assume the lead or the entire responsibility in enforcing the necessary strengthening of capital of State member banks, as well as the elimination of undesirable assets and improvement in management. In many of these cases the State supervisory authorities were grossly indifferent or even openly in sympathy with the banks in opposition to the necessary strengthening programs. The effects of such laxity are far-reaching and difficult to overcome effectively under the dual banking system.

Joint Occupancy of Banking Quarters

The Comptroller's office has stated that it does not look with favor upon an arrangement whereby a national bank occupies quarters with another financial institution and that, while there appeared to be no legal means whereby the Comptroller's office might require the separation,

it would in any such case point out to the national bank the undesirability of such a situation. The Board has taken the position that the sharing of quarters by State member banks with other financial institutions is undesirable. Difficulties have been experienced in attempting to carry out such a policy because of long existing practices, which many State authorities make no attempt to change.

Permitting Insolvent Banks to Continue Operating

The view has been expressed that one of the most difficult problems encountered in government supervision of banking is the proper timing of intervention by the authorities to suspend the activities of a bank that is in difficulty. In order to escape the charge of having acted prematurely, authorities often postpone action to close a bank until its condition has deteriorated to the point where the remaining deposit liabilities have inadequate security in the assets still in the portfolio. In many cases both of national and State banks closed at the time of the banking holiday and previously, capital was wiped out or heavily impaired through depreciation and losses, and it was apparent that the condition had existed for some time.

There are a number of different provisions regarding the closing of national banks. In addition to provisions for the forfeiture of the charter (usually after court proceedings) or the appointment of a receiver because of violations of particular provisions of the banking laws, there is a general provision that the Comptroller of the Currency

"may" appoint a receiver "whenever the Comptroller shall become satisfied of the insolvency of a national banking association." 1/ A more recent provision 2/ provides that whenever the insured status of a national bank is terminated by the Federal Deposit Insurance Corporation because of continued unsafe or unsound practices or violations of law, the Comptroller of the Currency shall appoint a receiver for the bank. The application of these provisions involves considerable discretion.

In some States supervisory authorities have discretionary power to close a bank and appoint a receiver, while in other States the supervisory authorities must go to a court of competent jurisdiction and request the appointment of a receiver.

Gross negligence on the part of a State supervisory authority in allowing insolvent State banks to continue operations was reported by the Attorney General of South Dakota as a result of his investigation of the State banking department. He said

"Allowing insolvent banks to operate....was the most serious and dangerous of all the negligence or violation of law which we found in the investigation of the banking department.

"We examined a total of 242 banks. We found on (sic^{3/}) two or three which had been closed by order of the banking department. The remaining banks had been allowed to run until they had exhausted all their cash, had pledged or sold most of their good assets, and had then voluntarily closed their doors with nothing but the dregs of their assets left. These dregs could produce little in dividends and were more expensive and slow of liquidation than good assets would have been.

1/ U. S. C. Title 12, Sec. 191.

2/ Sec. 12B(1)(2) of the Federal Reserve Act, as amended by the Banking Acts of 1933 and 1935.

3/ Probably should read: "only."

"Practically no banks were closed, no matter for how long, nor how much, their reserve fell below the legal requirements; and no matter how plain became the other evidences of insolvency. The banks were allowed to run as reliable, going concerns, attracting deposits of the public and gradually using up their assets with expense, losses, and borrowings from other banks." 1/

A study made of failed State banks in Minnesota

"....reveals that delay of suspension has regularly resulted in further loss to creditors...."

"The liquidation records show that certain Minnesota banks have been operated after the shareholders' interest had been entirely wiped out by losses." 2/

In periods of Nation-wide depression when the values of banks' assets have been greatly depressed, primary supervisory authorities have doubtless considered the effect on the public interest of the exercise of their power to close banks. It is evident, however, that in a great many cases, at least, the failure of such authorities to close banks or to ask for the appointment of a receiver in the absence of willingness and ability of the shareholders of such banks to rehabilitate adequately an impaired capital position constitutes laxity on the part of such administrative authorities. This is not obviated by the fact that action was delayed owing to the desire to avoid the charge of having acted prematurely, of having been influenced by political pressure, or of having acted because of other such reasons. This was especially true in those cases where such laxity contributed to withdrawals by wise depositors, necessitating the liquidation of the best assets, and to the ultimately heavy loss of depositors not in a position to or capable of ascertaining the real condition of the bank.

1/ Attorney General's Report and Supplemental Report to the South Dakota Legislature of the Investigation of the Department of Banking and Finance, February 27, 1930, pp. 4 & 7.

2/ A Type Study of American Banking, Unidernity of Minnesota, 1934, p. 151.

APPENDIX

Table 1 - Number of Incorporated Commercial Banks 1/
1860-1935

Year <u>2/</u>	National	State	Total
1860	-	1,562	1,562
1861	-	1,601	1,601
1865	1,294	349	1,643
1868	1,640	247 (a)	1,887
1870	1,612	325	1,937
1880	2,076	650	2,726
1890	3,484	2,250	5,734
1892	3,759	3,773 (b)	7,532
1900	3,731	5,007	8,738
1905	5,664	9,018	14,682
1910	7,138	14,348	21,486
1915	7,597	17,748	25,345
1920	8,024	20,635 (c)	28,659
1921	8,150	21,267 (d)	29,417
1925	8,066	19,573	27,639
1930	7,247	15,798	23,045
1935	5,386	9,743	15,129

1/ Exclusive of mutual savings and private banks.

2/ Figures as of June 30 with some exceptions in early years.

(a) Lowest number.

(b) State banks exceed national for first time since 1865.

(c) Resources of State banks exceed national and remained in excess until 1933. See Table 2.

(d) Peak for State banks (national banks reached peak of 8,244 in 1922). In addition 1,242 private banks were reported, making a grand total of 30,659 in 1921.

Table 2 - Resources of Incorporated Commercial Banks 1/
1863-1935

Year <u>2/</u>	National	State (in millions of dollars)	Total
1863	16.8	1,185.4	1,202.2
1867	1,494.5	151.9	1,646.4
1870	1,565.7	201.5	1,767.2
1880	2,035.4	481.8	2,517.2
1890	3,061.7	1,374.6	4,436.3
1900	4,944.0	3,375.3	8,319.3
1905	7,325.2	6,417.0	13,742.2
1910	9,891.9	8,684.4	18,576.3
1915	11,789.8	11,433.8	23,223.6
1920	23,401.6	23,490.3 (a)	46,891.9
1925	24,338.8	29,352.7	53,691.5
1930	29,072.4	34,219.0	63,291.4
1931	27,598.6	30,981.0	58,579.6
1932	22,325.3	23,405.3	45,730.6
1933	20,817.6	19,155.0	39,972.6
1934	23,855.5	20,382.3	44,237.8
1935	26,013.4	22,156.9	48,170.3

1/ Exclusive of mutual savings and private banks.

2/ Figures as of June 30 with some exceptions in early years.

(a) State bank resources exceeded national for the first time since 1864.

Table 3 - Distribution of Incorporated Commercial Banks
by Size of Capital Stock - June 30, 1920

Size group capital stock	State	National	State and national
\$25,000 and less	12,490	2,149	14,639
25,001 - 49,999	1,939	456	2,395
50,000 - 99,999	3,272	2,454	5,726
100,000 - 199,999	1,908	1,790	3,698
200,000 and over	<u>1,252</u>	<u>1,175</u>	<u>2,427</u>
Total	20,861 <u>1/</u>	8,024	28,885 <u>1/</u>

1/ These figures do not agree with those in Table 1 for the reason among others that a number of private banks in Illinois were being incorporated during 1920 and many of them were included in this capital classification.

Table 4 - Number of State Incorporated Commercial and National Bank Suspensions 1921-1929

Year	Total all banks
1921	461
1922	343
1923	623
1924	738
1925	579
1926	924
1927	636
1928	479
1929	<u>628</u>
Total	5,411

Table 5 - State Incorporated Commercial and National Bank Suspensions, by Size of Banks 1921-1929

Size group capital stock	Number of banks
\$25,000 and less	3,411
25,001 - 49,999	482
50,000 - 99,999	973
100,000 - 199,999	397
200,000 and over	<u>148</u>
Total	5,411

Table 6 - Comparison of the 10 States Having the Smallest Number of Persons Per Incorporated Commercial Bank with the 10 States Having the Largest Number of Persons per Incorporated Commercial Bank in 1920

State	Persons per bank 1920
<u>Smallest</u>	
North Dakota	719
South Dakota	924
Nebraska	1,089
Wyoming	1,231
Montana	1,317
Kansas	1,318
Iowa	1,412
Minnesota	1,596
Idaho	1,968
Missouri	2,068
<u>Largest</u>	
Rhode Island	18,515
Massachusetts	14,423
New York	12,799
Connecticut	9,957
New Jersey	8,823
Louisiana	6,764
Alabama	6,702
Maine	6,517
Pennsylvania	6,169
Ohio	5,821

SELECTED COMMENTS BY PROMINENT MEN WITH RESPECT TO
COMPETITION IN LAXITY

1. D. R. Crissinger, while Comptroller of the Currency -

"...National banks are compelled to compete with State institutions, and if the laws of the States are more liberal than are the national banking laws they will constitute an inducement to banks to operate under the laws of the States rather than of the Nation. The very fact that the Federal reserve system establishes a measure of financial assurance..... to the advantage of all kinds of banks, whether State or national, makes it easier for State banks to carry on under the more liberal charters which many States issue. So long as all banks enjoy the general advantages accruing from the workings of the Federal reserve system, there is obvious temptation to the particular institution to supplement these benefits by taking advantage of the wider liberality of State charters." (1)

2. Eugene Meyer, Jr., while Managing Director of the War Finance Corporation in 1923 -

"Nothing could be more disastrous than competition between the State and National banking groups, based upon competition in laxity." (2)

3. Harvey C. Couch, while a director of the Reconstruction Finance Corporation -

"One of the greatest weaknesses in our banking system has been over-rapid increase in the number of banks." (3)

4. Owen D. Young, Chairman, General Electric Company, in referring to banks chartered by the National Government and by each of the 48 states

"...They are in competition, each endeavoring to offer the most attractive charters and the most liberal laws, to say nothing of the liberality of administrative officials in interpreting the laws. The national banking act has to compete not only with the most conservative States but the most liberal ones. Consequently, there has been a constant tendency to liberalize banking laws and to weaken their administration. In such cases the argument is always made that it is desirable to liberalize the law so as to enable the banks to be of greater service to borrowers." (4)

(1) Annual Report of the Comptroller of the Currency, 1922, p. 2

(2) U. S. Congress, 67th, 4th Session, Hearings on Rural Credit, S. 4280 (H. R. 13033), 1923, p. 56.

(3) The Mississippi Banker, May 1934, p. 32.

(4) U. S. Congress, 71st, 3rd Session, Hearings on S. Res. 71, February 1931, pp. 353-54.

5. Frank P. Bennett, editor of the "United States Investor", speaking at the 1934 convention of the American Bankers Association -

"The curious theory has prevailed in Congress that National banks must be held back from waywardness by sufficiently stern Federal laws, but that State banks may be left free to be quite as well behaved or quite as wayward as 48 different legislatures may allow." (1)

6. William H. Kniffen, Vice President, Bank of Rockville Centre Trust Company, Rockville Centre, New York -

"...There have been too many banks. The liberal chartering of banks both national and state has placed banks where they had no right to be and where they could never hope to succeed. We were overbanked everywhere...Many of these banks were of small capital structure, so that there was no safeguard to depositors; and the excessive numbers prohibited the acquirement of sufficient deposits to make profitable operation possible." (2)

7. George V. McLaughlin, President of the Brooklyn Trust Company, and former New York Superintendent of Banks -

"....not alone in the authorization of banks, but in their supervision. Supervision was entirely too liberal. The Comptroller of the Currency and many of the superintendents of banking throughout the country have hesitated on many occasions to take necessary action in the affairs of banks where they found practices which, unless corrected, were certain to lead to trouble." (3)

8. A. L. Lathrop, Vice President of the Union Bank and Trust Company of Los Angeles, California, and President of the California Bankers Association -

"The history of the chartering of banks in the United States reveals a wide spread disregard of the proper relationship between the economic needs of the country and the number of banks permitted to open for business during all of the time prior to the depression which began in 1929."

and further -

"....This overchartering of banks by public officials was a distinct cause of the abnormal bank failure conditions that prevailed from 1920 to the bank holiday in 1933." (4)

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- (1) The Commercial and Financial Chronicle, American Bankers Convention Section, November 17, 1934, p. 34.
(2) Better Banking, 1934, pp. 45-46.
(3) Proceedings of the 40th Annual Convention of the N. Y. State Bankers Association, June 1933, p. 174.
(4) Address before 45th Annual Convention of the California Bankers Association, The California Banker, June 1936, pp. 21-22.

9. Francis H. Sisson, Vice President of the Guaranty Trust Company of New York -

"It can fairly be said that a great part of this unsound bank chartering history was carried out by political banking officials and legislative bodies wholly against the earnest protests of the more responsible bankers who pleaded for stricter banking codes and policies, but were ignored and charged with selfishness and fear of competition." (1)

10. Report of the Committee on Resolutions of the State Bank Division of the American Bankers Association in 1932 -

"..... As a public benefit and in the interest of banking as a whole, we believe it is desirable at this time that controversies between banking groups be eliminated. We believe there should be a suspension of all endeavors to produce by means of legislation competitive advantages for either State or National banks." (2)

11. R. V. Fleming, President of the Riggs National Bank of Washington, D. C., and President of the American Bankers Association 1935-36, in a foreword to the report of the Economic Policy Commission of the American Bankers Association, The Bank Chartering History and Policies of the United States (1935), p. 1

The report "gives an impressive revelation of how great a part mistaken public policies in the chartering of banks in the United States played in creating the unsound banking structure which finally collapsed with the Bank Holiday in March 1933. The overproduction of banks, literally by thousands, which continued over many years in the face of insistent warnings not only from bankers and others who recognized the danger, but even more so from the mounting records of bank failures themselves, is here clearly shown to have constituted as a whole one of the greatest single economic errors in the history of the Nation."

12. A report of the Resolutions Committee of the California Bankers Association -

"One of the contributing causes of bank failures during the period 1920 to 1935 was the chartering of too many banks by national and state authorities." (3)

1/ Address before the annual convention of the American Bankers Association, The Commercial and Financial Chronicle, American Bankers Convention, September 23, 1933, p. 30.

2/ The Commercial and Financial Chronicle, Section 2, October 22, 1932, p. 60.

3/ Annual convention, May 1936, The California Banker, June 1936, p. 61.

13. Report of the Resolutions Committee of the Arkansas Bankers Association -

"One of the principal factors which contributed to the breakdown in the American banking system in 1923 was the indiscriminate granting of bank charters by State and Federal authorities, which commenced in 1900 and continued over a period of twenty-five years. During this period the door of banking was opened to virtually all who sought admittance, regardless of whether the particular community already had adequate banking facilities, and often regardless of whether the proposed capital structure was sufficient to provide a fair margin of safety for depositors." (1)

14. Study prepared in 1927 by the Economic Policy Commission of the American Bankers Association -

"The problem is complicated by the presence of two charter-granting authorities, the national and the state, which may be played off one against the other in doubtful cases by eager bank organizers. Both federal and state officials charged with the administration of the banking laws not unnaturally become imbued with the desire that the system of banks under their jurisdiction shall exhibit both absolute and relative growth. Many banks have unquestionably been chartered in the belief that a refusal would be followed by a more favorable response in the other quarter." (2)

15. J. W. Pole, while Comptroller of the Currency in 1932 -

"Within the last few years we have witnessed one large bank after another giving up its national charter and taking out a State charter. The motive for thus removing themselves from the direct supervision and control by the Federal Government was undoubtedly to gain, from the standpoint of the bank, more favorable operating conditions. It is true they have remained within the Federal reserve system. New restrictions by Congress applicable solely to national banks must inevitably accentuate this movement from national to State bank charters." (3)

(1) The Arkansas Banker, July 1936, p. 8.

(2) The Bank Chartering History and Policies of the United States, Economic Policy Commission, American Bankers Association, 1935, p. 27.

(3) U. S. Congress, 72nd, 1st Session, Hearings on S. 4115, March 1932, p. 423.

16. The Study Commission for Indiana Financial Institutions in 1932

"Authorities are unanimously agreed that the indiscriminate chartering of banks has been one of the major causes for the difficulties through which we have recently passed." (1)

17. Comptroller O'Connor, in addressing the American Bankers Association at New Orleans in November, 1935 -

"A mad scramble to establish a bank opposite every gasoline station across this continent is not a situation which can be contemplated with any degree of satisfaction." (2)

18. Leo T. Crowley, Chairman, Federal Deposit Insurance Corporation -

"The failure of 14,000 banks in 13 years is unmistakable evidence of the gross error that was made in the almost indiscriminate licensing of banks. We should not repeat that error." (3)

19. M. E. Bristow, Banking Commissioner of Virginia, before the annual convention of the National Association of Supervisors of State Banks

"...we have been permitting banks to be chartered in this country like drunken sailors - certainly banks were chartered which never had a chance to succeed." (4)

20. The Massachusetts Bank Commissioner in 1929 -

"..If they (State banks) find that the State Legislature is inclined to be a little harsh on them, it will be very simple for them to convert into a national bank and be received with open arms." (5)

21. The Chairman of the Senate Banking and Currency Committee, in 1931 -

"....from time to time....when we have had occasion to propose modifications of either the Federal reserve act or the national banking act it has seemed ... that instead of creating a national standard of sound banking which the State systems might be induced to follow, we have introduced into the national banking system some, if not many, of the abuses of the State systems, in order to enable national banks to compete with State banks." (6)

(1) Report of Study Commission for Indiana Financial Institutions, 1932, p. 87.

(2) The Bank Chartering History and Policies of the United States, Economic Policy Commission, American Bankers Association, 1935, p. 6.

(3) "Deposit Insurance As an Aid to Banking," The Commercial and Financial Chronicle, American Bankers Convention Section, November 17, 1934, p. 14.

(4) Proceedings of the National Association of Supervisors of State Banks, July 1932, p. 53.

(5) Ibid., 1929, p. 85.

(6) U. S. Congress, 71st, 3rd Session, Hearings on S. Res. 71, January 1931, p. 14.

22. Senator Glass of Virginia -

"Whenever we tried to do something to make the national banking system sounder than it is and to put it upon a high plane, we have always been confronted by the objection that that puts a national bank at a disadvantage with the State bank." (1)

23. In March 1932, a letter expressing the unanimous opinion of the Federal Reserve Board, read to the Committee on Banking and Currency of the Senate -

"....the establishment of a unified system of banking under national supervision is essential to fundamental banking reform." (2)

During the discussion at the hearing it was pointed out that competition between the State and national banking systems has resulted in weakening both steadily. At this point Senator Glass remarked:

"I think the curse of the banking business of this country is the dual system."

He requested the Board to

"suggest to us a constitutional method of creating a unified banking system in this country." (3)

24. Business Week, a leading journal of business news -

".... there should be a single banking system, to end the competition between Congress and the state legislatures whereby banking conditions are relaxed to make charters more acceptable." (4)

(1) U.S. Congress, 72nd, 1st Session, Hearings on S. 4115, March 1932, p. 249.

(2) Ibid., p. 358.

(3) Ibid., p. 395.

(4) "In Defense of Banks", Business Week, October 31, 1936, p. 56.