Crayton

POSITION OF THE BOARD WITH RESPECT TO THE BANK OF AMERICA N.T. & S.A. SHOULD IT APPLY FOR MEMBERSHIP AS A STATE BANK

1. If the bank becomes a member, the Board will have to certify to the F.D.I.C. that, in connection with the admission to membership, consideration was given to:

   a. The financial history and condition of the bank
   b. The adequacy of its capital structure
   c. Its future earnings prospects
   d. The general character of its management
   e. The convenience and needs of the community to be served by the bank, and
   f. Whether or not its corporate powers are consistent with the purposes of section 12B of the Federal Reserve Act.

2. In accordance with the Board's policy of cooperation with other supervisory agencies, the terms and requirements in connection with admission to membership should be consistent with the program which the Comptroller of the currency has been attempting to effectuate. This is in accord with the policy of obtaining clearance from the F.D.I.C. in membership cases and with the following statement in the Board's letter of July 10, 1936, X-9647.

   ".....In particular, it is believed that a situation should not be permitted to develop where nonmember banks will seek admission to the System in order to escape their obligations to the Federal Deposit Insurance Corporation or to avoid reasonable requests of that Corporation made to promote sound banking."

3. Any program would apparently have to be acceptable to the Secretary of the Treasury since the bank would have to receive a license from him.

PROGRAM

An application for membership could be handled in either of two ways:

1. As an opportunity to effect a complete clean-up of all questionable assets and make drastic requirements as to policies and practices. It could also be used as a means for affording disciplinary action; or

2. As just another case to be accorded the same treatment as any other bank, large or small.

The proposal that the case be handled in the second manner is based upon the following considerations:

1. The bank has a real place in the community.

2. All values (including those of management) in the going concern should be conserved.

3. Although certain practices of the management cannot be condoned and in a number of respects the management has been slick, quibbling, evasive, and anything but cooperative with the supervisory authorities, the real values in the situation should not be sacrificed in order to make an example, assert superiority, or wreak revenge. In other words, the Board should not be a punitive agency.

The major problems of the bank are:

1. The asset condition, particularly the large amount of real estate, other real estate, and potential other real estate.

2. The low capital, particularly in view of the asset condition.

3. The involved relationships with affiliated and associated interests.

4. Management, particularly the domination and policies of A. P. Giannini. I understand that Mr. Clerk, of the Reserve Bank, is of the opinion that the Bank of America has a high grade, well-organized, and efficient operating management. If that be true, it seems to emphasize the need for unemotional judgment and perhaps patience in dealing with the situation, since A. P. Giannini is an old man and he must inevitably be out of the picture within a fairly short time.

The two problems of asset condition and adequacy of capital are related. Therefore, if the bank applies for membership, the bank should be given the opportunity of effecting necessary corrections in one of the two following manners:

1. Increased capital account, say $25,000,000 as a minimum, or

2. Have a substantial amount of undesirable assets removed from the bank for cash, say <u>$37,030,000.</u>

Both programs contemplate a <u>minimum</u> amount of required eliminations. In connection with the application, however, the bank should be urged to make additional charge-offs or to provide substantial valuation reserves as a matter of <u>sound banking practice</u>. These further eliminations should be in such amount that no further charge-offs would have to be made for losses in <u>present assets</u>. As a matter of self-interest it would seem that this should appeal to the management, since it is relatively easy to explain cleaning house once, but difficult to explain heavy continuing losses in old assets after a clean-up is supposed to have been made. It would seem also that the management would like to have its future earnings free from any drain for losses on old assets.

PROGRAM ONE

1. Estimated losses.

   Elimination of all of Classification IV except $6,927,000, the amount classified account of bank premises. This would leave $7,393,000 to be eliminated.

2. Depreciation on bank premises.

   Agreement that annually bank would charge off not less than the amount permissible under income tax regulations, plus, until arrearages have been cleared up, not less than $1,000,000 annually on account of depreciation claimed in prior years but not taken on the bank's books.

   Charge off of any write-up of bank premises during the past 10 years, either directly or through inter-company sales. If this amount could not be determined prior to admission to membership, an agreement should be obtained that the amount would be charged off immediately upon determination.

3. Increase capital account by not less than $25,000,000.

no

4. Agreement that the investment in Merchants Realty Corporation stock and the real estate contracts with Capital Corporation and California Lands should be reported as Item 9, "Assets Indirectly Representing Bank Premises or Other Real Estate".

This suggested program is predicated upon:

1. An understanding between the management of the bank, on one hand, and the Board and the Federal Reserve Bank, on the other, as to policies to be followed by the bank in such matters as dividends, treatment of profits on securities, write-up of assets, observance of sound banking practices, observance of the spirit as well as the letter of the law, regulations and agreements, and clarification of the inter-company accounts.

2. Assurance that the program will be acceptable to the Treasury Department in connection with the issuance of a license.

3. A satisfactory understanding between the management of the bank and the S.E.C.

PROGRAM TWO

1. The elimination of the following assets for cash at book value through proceeds of loans to Capital Corporation, California Lands, and Merchants Realty Corporation.

All real estate sales contracts	31,380,000
Other real estate carried in bank premises	1,202,000
Other real estate carried in Merchants Realty Corporation	4,448,000
	37,030,000

2. Estimated losses.

   Elimination of all of Classification IV except $6,927,000, the amount classified account of bank premises. This would leave $6,316,000 to be charged off since $1,077,000 of Classification IV (as well as $6,491,000 of Classification III) would be eliminated through the transaction referred to above.

3. Depreciation on bank premises.

   Agreement that annually bank would charge off not less than the amount permissible under income tax regulations, plus, until arrearages have been cleared up, not less than $1,000,000 annually on account of depreciation claimed in prior years but not taken on the bank's books.

   Charge off of any write-up of bank premises during the past 10 years either directly or through inter-company sales. If this amount could not be determined prior to admission to membership, an agreement should be obtained that the amount would be charged off immediately upon determination.

4. Agreement that the investment in Merchants Realty Corporation stock should be reported as Item 9, "Assets Indirectly Representing Bank Premises or Other Real Estate".

This program is predicated upon the same three points itemized at the bottom of the page of Program One.

Condensed Balance Sheet as of August 31, 1939, and
Classification of Assets. (From Mr. Cagle's memorandum.)

			Classifications			
			II	III	IV	
Cash		212,886				
U. S. Securities		383,161				
Municipal securities		124,220	13	25		
Other securities		29,121	363	1,820	923	
Loans		621,325	49,797	1,054	4,560	
Group advances		31,856	7,900		393	
ORE						
On books	5,726		5,301		425	
In bank premises (unoccupied)	1,202		711		491	
In Merchants Realty Corp.	4,448		3,290		586	
		11,376				
R/E sale contracts		31,380	21,630	6,491		
Bank premises						
On books (occupied)	25,502			1,490	4,846	6,927
In Merchants Realty Corp.	14,681			1,473	2,081	
		40,183				
Furniture & fixtures		7,946				
Other assets		33,639	481	5	15	
		1,527,093	89,486	12,358	14,320	

Deposits	1,387,313
Other liabilities	18,359
Capital	
Preferred	[illegible]
Common	50,000
Surplus	43,000
U/P and reserves	28,421
Total ($121,421,000)	
	1,527,093

Giving effect to a program involving sale of $25,000,000 preferred stock and charge off of all estimated losses except in bank premises

		Remaining Classifications II	III	IV
Cash	$ 237,886			
U. S. securities	383,161			
Municipal securities	124,220	13	25	
Other securities	28,198	363	1,820	
Loans	616,765	49,797	1,054	
Group advances	31,463	7,900		
ORE - direct and indirect	41,254	30,932	6,491	
Bank premises - direct and ind.	40,183			6,927
Furniture and fixtures	7,946			
Other assets	33,624	481	5	
	$1,544,700	$89,486	$12,358	$6,927

Deposits	$1,387,313
Other liabilities	18,359
Capital	
Preferred	25,000
Common	50,000
Surplus	43,000
U/P and reserves	21,028
Total ($139,028,000)	
	$1,544,700

Undivided profits and reserves - book	$28,421
Charge off	7,393
	$21,028

Giving effect to a program of taking out $37,030,000 1/ through proceeds of loans and charge off of other losses except in bank premises

		Remaining Classifications		
		II	III	IV
Cash	$ 249,916			
U.S. securities	383,161			
Municipal securities	124,220	13	25	
Other securities	28,198	363	1,820	
Loans	616,765	49,797	1,054	
Group advances	31,463	7,900		
ORE	5,301	5,301		
Bank premises - direct and indirect	40,183		2,963	6,927
Furniture and fixtures	7,946			
Other assets	33,624	481	5	
	$1,520,777	$63,855	$5,867	$6,927
Deposits	$1,387,313			
Other liabilities	18,359			
Capital				
Common	50,000			
Surplus	43,000			
U/P and reserves ($115,105,000)	22,105			
	$1,520,777			

1/ Eliminations through cash:

R/E sales contracts	$31,380	
ORE in bank premises	1,202	
" in Merchants Realty Co.	4,448	
		$37,030

Book profits and reserves			28,421
Less losses		$14,320	
Not charged off	$6,927		
Taken out by cash proceeds	1,077	8,004	6,316
			$22,105

August 31, 1939

(000 omitted)

Assets	Per books	Classifications II	Classifications III	Classifications IV	Eliminations Classifications II	Eliminations Classifications III	Eliminations Classifications IV	Balance Amount	Balance Classifications II	Balance Classifications III	Balance Classifications IV
Cash and due from banks	$ 212,886	$ -	$ -	$ -	$ -	$ -	$ -	$ 212,886	$ -	$ -	$ -
U. S. securities	383,161	-	-	-	-	-	-	383,161	-	-	-
Municipal securities	124,220	13	25	-	-	-	-	124,220	13	25	-
Other securities	29,121	363	1,820	923	-	-	923	28,198	363	1,820	-
Loans and discounts:											
Outsiders--Commercial	245,981	8,063	632	427	-	-	427	245,554	8,063	632	-
" --On real estate	371,496	41,734	422	538	-	-	538	370,958	41,734	422	-
Real estate sales contracts	31,380	21,630	6,491	-	-	-	-	31,380	21,630	6,491	-
Other group advances	31,856	7,900	-	393	-	-	393	31,463	7,900	-	-
German credits	3,848	-	-	3,595	-	-	3,595	253	-	-	-
Other real estate on books	5,726	5,301	-	425	-	-	425	5,301	5,301	-	-
Merchants Natl. Realty Corp. stock:											
Representing O.R.E.	4,448	3,290	-	586	-	-	586	3,862	3,290	-	-
Representing bank premises	14,681	-	1,473	2,081	-	-	-	14,681	-	1,473	2,081
Bank premises on books:											
Occupied	25,502	-	1,490	4,846	-	-	-	25,502	-	1,490	4,846
O.R.E. (unoccupied)	1,202	711	-	491	-	-	491	711	711	-	-
Furniture and fixtures	7,946	-	-	-	-	-	-	7,946	-	-	-
Other assets	33,639	481	5	15	-	-	15	33,624	481	5	-
Total	$1,527,093	89,486	12,358	14,320	-	-	7,393	$1,519,700	89,486	12,358	6,927

Liabilities	Per books	Balance Amount
Deposits:		
Demand	602,127	602,127
Time	785,186	785,186
Total	1,387,313	1,387,313
Other liabilities	18,359	18,359
Capital structure:		
Capital stock	50,000	50,000
Surplus	43,000	43,000
Undivided profits & reserves	28,421	21,028
	121,421	114,028
Total	$1,527,093	$1,519,700

Capital to deposits 8.2% or 1 to 12.