September 23, 1938

Board of Directors,
Bank of America National Trust and Savings Association,
San Francisco, California.

Gentlemen:

The report of examination of your bank, completed September 15, has been received and reveals practically the same criticisms as shown in previous reports. The purpose of those criticisms and of the criticisms set forth in this letter is to assist the Board of Directors in a constructive manner to protect the interests of the depositors as well as of the shareholders of your bank.

Your attention is directed to the examiner's comments under the heading of "Historical Resume of Assets in General" starting on page 2 of the consolidated report. A comparative survey over the past five years reveals that the primary purpose of the management appears to be that of publishing large earnings statements and the payment of ever-increasing ill-advised dividends rather than a frank recognition of the asset problems of the bank and a desire to allocate the bank's earnings toward the amortization of frozen and unbankable assets, the creation of adequate reserves and the correction of the bank's under-capitalized condition. The management of the bank has persistently contested the examiner's classification of assets, has defended unbankable assets, and has rarely admitted losses and charged them off voluntarily.

On page 8, insert 2, there is shown under "Large Lines" the extension of credit to Transamerica Corporation and its subsidiaries, which has been criticised for years, aggregating approximately $76,000,000, or in excess of one and one-half times the capital stock of the bank. It is noted that the so-called "Guaranteed Loans" amount to $5,500,000 in round numbers. This amount should be fully collateralized by readily marketable securities, particularly in view of the method used to eliminate the contracts of the Inter-America Corporation by writing up United States and municipal securities approximately $14,000,000 and applying that amount as a credit on such contracts, which were then indicated to have been adequately secured by marketable collateral. It is the position of the Office of the Comptroller of the Currency that these contracts should have been eliminated, not by a weakening of the asset condition of the bank through writing up certain assets as indicated above, but by actual collection, with any deficiency taken care of out of the securities pledged.

Since the early part of 1932 it has been the bank's policy to sell properties acquired by the bank to the California Lands, Incorporated, and the Capital Company under contracts. At the time of the examination of the bank, the amounts which these corporations owed the bank by reason of these contracts and which amounts were carried in the assets of the bank, were as follows:

California Lands, Inc.	$12,051,526.09
Capital Company	27,687,820.37
	$39,739,346.46

The California Lands, Incorporated was further indebted to the bank in amount of $351,016.19 and the Capital Company owed the bank a further sum of $1,443,040.65, making, with the above, the total indebtedness of these two companies to the bank $41,533,403.30.

With reference to the contracts of the California Lands, Incorporated and Capital Company, the bank maintains that real estate owned by the bank is sold under continuing contracts with the two foregoing companies. As a result of the terms and conditions of those contracts the bank is enabled to carry parcels of land, which are either unsaleable or can only be liquidated at a substantial loss, for an unlimited period of years, through the device of crediting the proceeds of the sale of a given parcel as a payment on the balance of the total contracts instead of treating each transaction as an individual item.

It appears that no payments were required on those continuing contracts for a period of two years, namely, through 1934 and 1935, following which one-tenth of the purchase price became payable in 1936 and a like amount each year thereafter for ten years. Taxes on such land are paid by the bank. Presumably title does not pass with the execution of the contract. All of these contracts are carried in your loans and discounts, but in reality they appear to represent "Other Real Estate Owned". The lenient terms and conditions of the contracts are such that this arrangement constitutes in fact merely an agency agreement and not a bona fide sale. In the opinion of the Comptroller of the Currency this real estate should be shown as such on the books of the bank and so shown in future published reports of the bank.

A recapitulation of the amount invested in banking houses, furniture and fixtures and other real estate owned is shown on page 14, insert 1, and aggregates $97,660,265.39, including contracts of the California Lands, Inc., and Capital Company, totaling $39,739,346.46, previously referred to. These are included in this schedule to show properly the bank's entire real estate investments. Of the aggregate of $97,660,265.39 the amount of $47,685,166.67 represents banking houses and equipment, and $49,975,098.72 represents other real estate owned. When $14,004,116.02 of actual and probable foreclosures on real estate loans carried in loans and discounts, are added to the aggregate of $97,660,265.39 referred to, the total is $111,664,381.41 or approximately the entire amount of the bank's capital structure as shown by its books. It is self-evident that an asset concentration of this magnitude constitutes a problem demanding immediate corrective steps.

70 % owned by U.S. + Citta.

Attention is also directed to the concentration of credit in the direct and endorsed lines of A. O. Stewart aggregating $8,088,003.96 as set out on page 8, inserts 16-17 and 18; and the Pacific Coast Mortgage Company in amount of $2,925,000.00, as shown on page 8, insert 19, of which company, Mr. A. O. Stewart is president and a director in addition to being a major stockholder. Particular attention is directed to the nature of the collateral securing these lines and to the comments in connection therewith, as set forth on the inserts above referred to.

There are now carried in the International Banking Department, San Francisco, extensions under German Credits, largely under the "German Standstill Agreement", aggregating $7,964,961.76 of which $7,820,660.78, are classified as follows:

Slow	$3,723,441.32
Doubtful	2,097,219.46
Loss	2,000,000.00
	$7,820,660.78

At the time of the October 14, 1936 examination a loss of $1,000,000.00 was estimated and subsequently charged off on these items. By verbal agreement a like amount was to have been charged off at each succeeding examination until the amount classified as doubtful, which represented the exchange loss, was completely eliminated. At the time of the April 20, 1937 examination the management refused to charge off the second estimated loss of $1,000,000.00 and it is included in the present classified loss of $2,000,000.00. However, a recent communication from the bank states that on August 18, 1938 an additional reserve of $1,000,000.00 representing the loss estimated in the April 20, 1937 report, has been transferred to the International Banking Department, making an aggregate of $2,000,000.00, which has been applied to reduce the carrying value of these assets. Consequently there remains an additional loss of $1,000,000.00 yet to be charged off in order to comply with the verbal agreement above referred to. Both the agreement and classifications are believed to be liberal and the exchange loss should continue to be charged off at the rate of $1,000,000.00 at each succeeding examination. This arrangement is considerably more lenient than the charge offs voluntarily made by other large national banks holding these obligations.

Legal question

On page 8, insert 1, under the schedule "Loans exceeding the limits prescribed by Section 5200 of the Revised Statutes", there are listed obligations of Transamerica Corporation and obligations of certain subsidiaries thereof in which the Corporation owns or controls a majority interest, aggregating $23,118,152.87, resulting in a $14,118,152.87 excessive extension of credit. This violation of Section 5200, U.S.R.S. must be reduced to the bank's legal loaning limit of $9,000,000.00.

Your attention is directed to the examiner's comments under the heading of "Bonds and Securities" relating to certain substandard bonds carried and the option to purchase granted to the Transamerica Corporation covering 56,600 shares of National City Bank of New York at $48.00 a share; also his statements under the caption "Bond Write Up". During the years 1935 and 1936, the management wrote up certain government and municipal securities in amount of approximately $14,000,000.00 by various book entries and applied that amount as a reduction on the former fully secured Inter-America contracts, reference to which was briefly made elsewhere in this letter. The loss as shown in this report in connection with this write-up should be charged off, and in addition thereto, the remaining unliquidated portion of the original write-up should be reversed in its entirety. In the future investment securities must be carried not in excess of actual cost to the bank, less the required amortization.

A depositor is entitled to the protection of an adequate sound capital structure. According to the analysis of capital position as shown on page 3, insert 1, the net sound capital of your bank at the time of examination amounted to $96,447,599.77 after deducting estimated losses, doubtful items and liabilities not shown on the books, with deposits totaling $1,385,494,280.80, or a ratio of 1 to 14.36. The bank is under-capitalized to the extent of at least $42,000,000.00 without taking into consideration its asset condition. The need for such additional capital should be apparent and sound banking policy dictates that steps should be taken to provide it.

An important criticism will be found under the caption "Management and Supervision by Directors". The reports of the various committees appointed by the Board to supervise the operating functions of the bank should be incorporated in the minutes of the meeting of the Board in sufficient detail to be of value to the individual members thereof. The members of the Board have an important duty to perform in formulating the policies of operation of the bank and seeing that such policies are carried out by the active management. The minutes should clearly show the action, if any, taken by the Board with reference to such committee reports, and also which of the members approve or disapprove a given loan or transaction.

On page 16, insert 1, there is a schedule showing service charges on dormant accounts in the amount of $520,732.94 since April 10, 1933. The confiscation of dormant balances through such service charges is contrary to the rulings of the Comptroller of the Currency. All charges heretofore assessed contrary to such rulings should be restored to accounts charged. Unauthorized charges against dormant accounts remain deposit liabilities of the bank and must be so reported in statements of condition rendered to this office and in published reports.

On page 5, insert 5, are shown certain loans made upon the security of the bank's own stock in violation of Section 5201, U.S.R.S. These violations must be corrected and the law strictly observed.

Your particular attention is directed to the recapitulation of criticised and fixed assets, showing the major problems of the bank and their relation to its total capital structure, set forth in the conclusions of the examiner. The criticised and fixed assets of the bank aggregate $226,002,313.26 book value, of which $137,818,327.86 is subject to adverse classification. The serious nature of the problems involved is evident when it is realized that the adversely classified assets exceed the total capital structure of the bank by more than $25,000,000.

answered

The management has persistently refused to either recognize or admit that the unsatisfactory condition of the bank must be corrected. The past practice of capitalizing uncollected profits is pernicious. A sound policy would necessitate the proper charging off of depreciated and unbankable assets instead of deferring such charge-offs until all hope of any recovery has been abandoned.

The management appears to be dominated by the desire to publish ever-increasing earnings statements. The bank's earnings have been utilized to enhance dividend payments to the shareholders of Transamerica Corporation instead of being used to charge off the bank's losses and make adequate provision for other criticised assets. The amount of dividends paid by the bank has been the subject of repeated criticism by various examiners. Despite these repeated criticisms, the dividend rate has been constantly increased. During the year 1937 the dividend paid represented 70% of the net operating profits of the bank.

In a telegram to National Bank Examiner Palmer, which was read by Mr. Palmer to the Board of Directors of the bank at its meeting in Los Angeles on September 13, the position of the Comptroller of the Currency with reference to the declaration of any dividend was clearly stated, and the Board was advised that, in his opinion, the declaration of any dividend at this time would, unless proper provision for the criticised assets of the bank were first made, be and continue an unsafe and unsound practice in conducting the business of the bank, and, the Comptroller, pursuant to the provisions of Section 30 of the Banking Act of 1933, further warned the bank, its officers, the Board of Directors and the members thereof to discontinue such unsafe and unsound practice. The Office of the Comptroller of the Currency is informed that, despite this warning, the Board of Directors of the bank declared a dividend without first having made proper provision for the criticised assets of the bank. No further comment in connection with the declaration of this dividend is being made at this time except to state that nothing contained in Mr. A. P. Giannini's letter of September 15, 1938, alters in any way the comments set forth in our telegram of September 13 in respect of the declaration of the current dividend.

You are requested to consider the present letter at a special meeting of the Board called for this specific purpose and to reply in detail over the signatures of the attending members, setting out the corrections effected in each of the criticised matters and your plans for the complete elimination of the same. Copies of your reply to this letter should be forwarded to Chief National Bank Examiner William Prentiss, Jr., and National Bank Examiner L. H. Sedlacek, 155 Montgomery Street, Room 1103, San Francisco, California.

Very truly yours,

Marshall R. Diggs

MARSHALL R. DIGGS
Acting Comptroller of the Currency