Governor Eccles

C O N F I D E N T I A L

TO: Board of Governors

DATE: MAR 23 1937

FROM: Messrs. Goldenweiser, Morrill, Paulger, Smead, and Dreibelbis

SUBJECT: Bank Suspension Study

Pursuant to an informal discussion which took place at a meeting of the Board last spring a memorandum was submitted to the Board dated May 5, 1936, outlining a proposed study for the purpose of determining possible means of improving the banking structure. It was proposed that methods of strengthening the American banking system be considered and investigated under the following related topics:

A. Improvements in the organization, functions, and management of banking institutions and in supervisory methods;

B. Unification of the banking system; and

C. Consolidation of the supervisory functions of various Federal agencies dealing with banks, including the lending or recapitalization functions of agencies which assist banks in difficulties.

The memorandum set forth an outline of recommended studies under sixteen major headings. A subcommittee drawn from the staffs of various divisions of the Board was constituted to prepare these studies.

There have been submitted to you three memoranda growing out of the work which has been done during the interval:

"Unification of the Commercial Banking System";

"Consolidation of Federal Supervision of Commercial banks"; and

"Branch and Group Banking"

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The need for unification of the commercial banking system and for consolidation of Federal supervisory agencies will be further developed by two other memoranda which are in process of preparation for submission to the Board on the subjects of:

"Competition in Laxity Associated with Multiple Banking Jurisdictions"; and

"Complexity of Banking Laws and Practices Relative to the Organization, Operation, and Supervision of Banks"

The preparation of these five summary memoranda has been facilitated by a body of material collected and filed and by the following series of detailed memoranda which have been prepared:

1. "Bank Suspensions, 1892-1935" (111 pp.)
2. "Banking Profits, 1890-1935" (50 pp.)
3. "Classification of Banks in Operation on Dec. 31, 1935" (40 pp.)
4. "The Complexity of Banking Laws and Practices Relative to the Organization, Operation, and Supervision of Banks" (288 pp.)
5. "Statutory Competition in Laxity" (151 pp.)
6. "Administrative Competition in Laxity" (112 pp.)
7. "Bank Management" (97 pp.)
   This memorandum is based in part on a review of banking statutes prepared by the Counsel's office under the title:
   "Provisions in Effect under State and Federal Law for the Improvement of Bank Management" (132 pp.)
8. "Branch Banking in the United States" (149 pp.)
   This memorandum is based in part on a review of banking statutes prepared by the Counsel's office under the title:
   "Compilation of Federal and State Laws Relating to Branch Banking within the United States" (88 pp.)
9. "Group Banking in the United States" (134 pp.)
   This memorandum is based in part on a review of banking statutes prepared by the Counsel's office under the title:

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"Compilation of Federal and State Banking Laws Relating to the Acquisition of Bank or Trust Company Stock by Banks and Trust Companies and Relating to Bank Stock Holding Companies and Chain or Group Banking" (72 pp.)

10. Government Credit Agencies:
    (a) "Investment in Capital Structure of Banks and Loans to Banks and Others by the Reconstruction Finance Corporation" (32 pp.)
    (b) "Federal Intermediate Credit Banks and Production Credit Associations" (39 pp.)
    (c) "Savings and Loan Associations under the Federal Home Loan Bank Board" (15 pp.)
    (d) "Federal Land Banks and Federal Farm Mortgage Corporation" (47 pp.)
    (e) "Home Owners' Loan Corporation" (30 pp.)
    (f) "Postal Savings System" (56 pp.)
11. "Study of Obsolete, Overlapping, Conflicting, Ambiguous, and Other Unsatisfactory Provisions in Existing Federal Banking Laws" (160 pp.)

These detailed memoranda are being revised after receipt of criticism and comments from members of the senior staff. The compilation of branch banking laws referred to under (8) above was published in the Federal Reserve Bulletin for November 1936. It is contemplated that basic statistical material produced on bank suspensions, classification of the banking structure, etc., may be published in the Bulletin from time to time.

On the following pages there is given a brief description of the scope and contents of each of the detailed memoranda listed above.

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1 - Bank Suspensions, 1892-1935 (111 pp.)
(In process of revision)

This memorandum gives detailed statistics on bank suspensions during 1892-1935, by years and periods, classes of banks, States, size of banks, etc. Figures of suspensions are compared with figures of active banks, thereby establishing a "suspension rate" among the various classes and sizes of banks. Analyses are presented of losses sustained by depositors and stockholders of suspended banks and of expenses of liquidation by classes and size of suspended banks. Loans to banks by Governmental agencies, such as the War Finance Corporation and the Reconstruction Finance Corporation, and purchases of capital obligations of banks following the national banking holiday by the Reconstruction Finance Corporation are briefly summarized. An effort is made to evaluate the causes of bank suspensions and to distinguish between weaknesses in the banking structure and general economic factors contributing to the large numbers of bank suspensions in the past 15 years.

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2 - Banking Profits, 1890-1935 (50 pp.)
(In process of revision)

This memorandum shows changes in the rate of gross income, expenses, losses, and net profits of banks over a period of years, and analyzes the source of income and items of expense and losses. It presents operating results by geographic regions, by size of towns and cities, by size of banks, etc. Indications are developed as to the type of bank which appears to have the best chance of making a sufficient profit in normal times to protect its depositors and, at the same time, to render a reasonable return to stockholders.

A brief statement is included with respect to recent developments affecting bank profits, such as those resulting from Governmental policy, Government securities replacing other loans and investments, high liquidity of banks, lower interest rates, service charges, etc.

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3 - Classification of Banks in Operation on December 31, 1935 (40 pp.)
(In process of revision)

This memorandum is a part of a larger project analyzing (1) changes which have taken place in the banking structure during the period 1921-1935 from the standpoint of number of banks in operation, by classes and by size of banks; (2) the changing character of bank assets and liabilities; and (3) the present banking structure. All of the information collected on these topics has not as yet been reduced to a formal memorandum.

A formal memorandum has analyzed and classified banks in operation on December 31, 1935 according to (1) ratio of demand to total deposits, (2) size of banks, (3) population of towns and cities, (4) ratio of capital to deposits, (5) eligibility for Federal Reserve membership and for conversion into national banks, and (6) membership in Federal Reserve collection system.

Another section of this project on which information has been assembled but not reduced to formal memorandum relates to the origin and development, number and importance and functions of quasi banking institutions (such as building and loan associations and credit unions) in an attempt to show the extent of competition by such institutions with banks for deposits and for loans and investments.

A statement of the historical background of the American banking system, partly by way of introduction and partly to show the development of our present complex banking structure, is also part of the whole project.

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4 - The Complexity of Banking Laws and Practices Relative to the Organization, Operation, and Supervision of Banks (288 pp.)
(In process of revision)

This memorandum is primarily concerned with the complexities arising from the diffusion of banking regulation and supervision among the various agencies of the Federal Government and the 48 States. It analyzes the problem from the standpoint of conflicting provisions of law arising from this diffusion of authority. It also cites certain cases in which such conflicting laws or administrative policies have produced confusion, although these cases are not as complete as they might be since they have necessarily been confined to material within the Board's files and to cases with which certain members of the Board's staff are familiar.

The memorandum is divided into two parts, the first dealing with complexity with respect to the organization and operation of banks, and the second dealing with complexity with respect to the supervision of banks. Under the organization and operation of banks, there are considered complexities with respect to the statutory provisions and the practices relating to chartering of banks, trust powers, establishment of branches, capital structure, reserves against deposits, loans, investments, banking premises, deposits, exchange and collection charges, management, relations with affiliated organizations, corporate changes (consolidations, reorganizations, liquidations) and certain miscellaneous matters. The discussion of supervision deals chiefly with complexities with respect to examinations, reports of examinations, condition reports, and other reports, with some analysis of the statutory provisions on these matters.

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5 - Statutory Competition in Laxity (151 pp.)
(In process of revision)

This memorandum analyzes the alterations in both Federal and State banking statutes which reflect a competition in laxity between the different jurisdictions. Debates, committee reports, annual reports of the Comptroller of the Currency and of the Federal Reserve Board, etc., were examined with respect to all amendments to the National Bank Act and the Federal Reserve Act which relaxed existing provisions. Amendments to Federal banking laws which are covered concern minimum capital requirements, branch banking, trust powers of national banks, real estate loans, reserves against deposits, limitation on loans to a single borrower, dealing in investment securities, national banks as insurance agents or real estate brokers, increase of capital through issuance of stock dividends, reports of condition, acceptances, conversion of State banks into national, indeterminate charters of national banks, foreign banking corporations, facilitating admission of State banks to Federal Reserve membership, etc.

Investigation of alterations in State statutes arising from competition in laxity is difficult for several reasons. For example, records of legislative history in most of the States are not sufficiently complete to bring out the purposes behind specific enactments. With respect to New York, Maryland, Michigan, and California the annual reports of the State banking supervisory authorities were reviewed. Consideration is given, among other things, to the changes in the banking laws of these States which may have resulted from the authority conferred upon national banks to exercise trust powers and to the relaxations in State bank reserve requirements following the reduction in national bank requirements shortly after the enactment of the Federal Reserve Act.

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6 - Administrative Competition in Laxity (112 pp.)
(In process of revision)

This memorandum reviews competition in laxity in the administration of laws and in the exercise of discretionary authority by the agencies charged directly with the supervision of banks as this competition has developed under the parallel operation of the national and the 48 State banking systems. Part I sets forth typical views expressed by several prominent men relative to the nature and extent of competition between the banking systems, the competitive advantages of one system over the other, the practices of banks in shifting from one jurisdiction to the other, and the lax standards which result.

Part II reviews the machinery of supervision for the purpose of indicating some of the factors making for administrative competition in laxity. It sets forth the methods of selection of supervisory authorities and their qualifications, duties, powers, and responsibilities; data concerning their examining staffs; the lack of power in varying degrees to force corrective action; and other related matters.

In Part III illustrations are given of the elements of supervision in which administrative competition in laxity has been manifested, such as in the chartering of banks, the extension of their powers and operations, examinations, corrections of matters of criticism, etc.

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7 - Bank Management (194 pp., including appendices)
(Revised March 8, 1937)

This memorandum reviews the principal weaknesses of bank management as well as possible methods for improvement. Part I brings together the views of prominent bankers and others relative to the principal weaknesses of bank management and resulting effects. Part II describes three important means by which bank management might be improved, namely, legislation, cooperative efforts of bankers, and selection and training of personnel. A description is included of the provisions of Federal and State laws relative to qualifications of directors and officers; liability of officers and directors and provisions for their removal from office for mismanagement or violations of the banking laws; duties, responsibilities, and powers of directors; restrictions on financial interest of directors and officers in bank transactions; and other miscellaneous matters.

Proposals with respect to licensing bankers are reviewed, particularly from the standpoint of the many problems which would be involved in the formulation and administration of a satisfactory licensing system if required by law. Somewhat less attention is devoted to the activities of bankers for the improvement of bank management through associations and regional conferences, as well as through the selection, education and training of personnel. This memorandum is arranged in such a manner that the views of certain prominent bankers and others, as well as important provisions of the law relating to the subject, are reflected in the body of the memorandum while the views of a great many other persons and more detailed references to pertinent provisions of the statutes are included in appendices, with appropriate references in the table of contents. The portions of the study relating to statutory provisions are drawn largely from a memorandum entitled "Provisions in Effect under State and Federal Law for the Improvement of Bank Management," prepared by Counsel's Office.

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8 - Branch Banking in the United States (149 pp.)
(In process of revision)

This memorandum analyzes branch banking as a type of banking organization in the structure of banking in the United States. It develops the underlying or basic task of the structure of banking in a modern economy. The evolution, present status, and experience thus far with branch banking in the United States are described. The statistical status as of December 31, 1935 is analyzed in detail.

Branch banking is evaluated in terms of its advantages and disadvantages as a type of banking organization. Consideration is given to some of the problems as well as to some of the issues that would arise in connection with proposals for enlarging the areas within which branch banking might be permitted. As a part of the analysis of the present status of branch banking in the United States, the Board's counsel in cooperation with counsel of the Federal Reserve banks analyzed the existing State statutes with respect to branch banking.

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9 - Group Banking in the United States (134 pp.)
(In process of revision)

This memorandum analyzes group banking as a part of the banking structure of the United States. It shows the extent, distribution, and development of group banking; points out some of the principal features of organization and operation of the groups; reviews the changes and suspensions in banking groups through 1935; points out the principal advantages and weaknesses of group banking as compared with unit banking and with branch banking. Tabulations and compilations in the study relating to group banks are limited to groups having three or more banks as of December 31, 1935.

A large amount of the data relating to group banks has been obtained from voting permit files of holding company affiliate groups. Banking chains are not included in the tabulations since satisfactory data relating to them are not available. As a part of the analysis of the present status of group banking in the United States, the Board's counsel in cooperation with counsel of the Federal Reserve banks analyzed the existing State statutes with respect to the ownership of bank stock by corporations.

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10 - Government Credit Agencies
(In process of revision)

(a) Investment in Capital Structure of Banks and Loans to Banks and Others by the Reconstruction Finance Corporation (32 pp.). - This memorandum brings out the terms under which the Reconstruction Finance Corporation invested in the capital structure of banks, the investment by geographic areas and by types of banks, and the progress of retirement. Some consideration is also given to the ability of banks to carry and retire this stock under existing contracts. Loans by the Reconstruction Finance Corporation not only to banks but to other financial institutions, such as those to mortgage loan companies, insurance companies, and building and loan associations are reviewed as are also loans to agricultural financing institutions, to railroads, and for self-liquidating projects.

(b) Federal Intermediate Credit Banks and Production Credit Associations (39 pp.). - This memorandum deals with the objectives of the Federal Intermediate Credit system, the source and cost of its funds, and the financing institutions using the system. The earnings of the system are reviewed. The Production Credit System, including both the corporations and associations, is dealt with at some length. An attempt is made to measure the importance of their lending activities as compared with commercial banks in agricultural communities and to assess the possibility of their surviving without Government subsidy.

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(c) Savings and Loan Associations under the Federal Home Loan Bank Board (15 pp.). - This memorandum describes the membership in the Federal Home Loan Bank system, the discount provisions and insurance arrangements of the system, and the capital subscriptions to associations made by the United States. Consideration is given to the problem of competition between Federal savings and loan associations and commercial banks.

(d) Federal Land Banks and Federal Farm Mortgage Corporation (47 pp.) This memorandum develops the history of Federal Land banks before the depression as well as their problems growing out of the depression, including the necessity of postponing principal and interest payments, strengthening of capital, and emergency refinancing of mortgages. It contains a review of the earnings experience of the banks, deals with the competitive relationship of the system with commercial banks, and attempts to measure the extent to which the Federal Farm Mortgage Corporation took over mortgages from banks and the extent to which banks have become investors in the guaranteed bonds of the Federal Farm Mortgage Corporation.

(e) Home Owners' Loan Corporation (30 pp.). - This memorandum develops the organization and methods of financing of this Corporation, analyzes its loans and investments, and describes the nature of loans to home owners. It reviews the collection and earnings experience of the Corporation and attempts to bring out the degree to which various types of mortgage lenders transferred their mortgage holdings to the Corporation and the extent to which commercial banks have become investors in the guaranteed bonds of this Corporation.

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(f) Postal Savings System (56 pp.). - This memorandum describes the nature of Postal Savings operations, traces the growth of deposits, and compares the facilities offered by the System with those of banks by geographic regions. It analyzes factors related to the redeposit of Postal Savings funds in banks and also deals with the earnings and expenses of the Postal Savings system.

(Note: Information has also been assembled on the subjects: Federal Housing Administration, Loans of Federal Agencies to Agricultural Cooperative Associations, and Commodity Credit Corporation. Formal memoranda on these topics have not been perfected.)

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11 - Study of Obsolete, Overlapping, Conflicting, Ambiguous, and Other Unsatisfactory Provisions in Existing Federal Banking Laws (160 pp.)
(In process of revision)

This memorandum analyzes and collects to a certain extent provisions of Federal banking laws which are unsatisfactory primarily because of drafting or technical reasons, rather than because of any substantial reason of policy. While such provisions cannot be rigidly classified, they are considered in several groups. Under obsolete provisions are treated those which have not been specifically repealed but which are nevertheless of no effect and therefore are confusing. This may result from implied repeal, complete execution of the provision, or subsequent enactment of more comprehensive provisions. Under overlapping provisions are treated those with respect to the same subject matter which appears to have a similar meaning and effect and therefore seems to involve unnecessary duplication. Under conflicting provisions are treated those relating to the same subject matter but inconsistent with each other. Under ambiguous provisions are treated those which do not clearly indicate the intent of Congress.

Certain other provisions are considered which are technically unsatisfactory for other reasons such as the omission of necessary language. There is also suggested a rearrangement of the Federal banking statutes which would put these statutes in more understandable and readily available form.

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