(MW. Pl H.)

"BRANCH BANKING AS A MEANS OF PREVENTING BANK FAILURES"

ADDRESS TO BE DELIVERED BY EDMUND PLATT, VICE GOVERNOR OF THE FEDERAL RESERVE BOARD, BEFORE THE ROBERT MORRIS ASSOCIATES, JUNE 9, 1925.

Branch banking has not been in favor among American bankers, as a rule, and when from time to time they have found branches appearing here and there, after periods of financial depression, they have usually denounced them and have sought through their associations to procure the passage of legislation to suppress them, or to limit them to as narrow a territory as possible.

Occasionally the argument has assumed considerable heat and has brought forth assertions that branch banking is un-American, and represents merely an effort of the big banks to acquire a monopoly of banking and to gobble up all the country banks.

On the other hand a recent study of branch banking in the United States the first comprehensive study ever made - has shown that in some sections of
the country branch banking has been in existence for a good many years. I think
it a fair conclusion that it has been giving satisfactory service and extending
itself so slowly as to give rise to no serious apprehensions of monopoly, in spite
of the general prejudice of bankers against it. Furthermore this study has
shown that the country banks engaging in branch banking far out-number the city
banks - 397 banks located in cities of less than 100,000 maintaining branches,
as compared with 284 in cities of more than 100,000. The preponderance of country
banks in branch banking is much more strikingly shown if we compare only banks
which maintain branches outside the city of the home office - the banks against
which Section 9 of the recent McFadden Bill was directed. Of the 310 banks which
have branches outside the home city 229, or almost seventy-five per cent are located in cities of less than 25,000, and 129, or more than forty per cent are in

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"cities" of less than 2,500 inhabitants. The study, in fact, appears to me to show that banks in large cities have rarely sought to establish branches in smaller outside towns, save in one state where conditions are exceptional because of its great extent north and south, the great contrasts between its sections in climate, in rainfall and in crops produced.

All this suggests that perhaps some of the prejudice among American bankers, and particularly among country bankers, is unwarranted. The facts seem to show branch banking as it has so far developed in this country to be chiefly a country bank proposition. It is evident that branch banking comes forward after every financial depression, often modestly and unobtrusively so far as the number of banks with branches is concerned, but enough to command some attention, and to suggest that there may be some good reason for it, some reason related to sound economics and safer banking. The panic of 1893 brought a flood of small bank failures and was followed by the establishment of branches by a few institutions still maintaining branches. The panic of 1907 with its attendant bank failures not only brought to a focus the agitation that led to the establishment of the Federal Reserve System, but gave an impetus to branch banking in several states that ied to the enactment of several state laws relating to the subject notably the California Bank Act of 1909 recognizing and regulating state-wide branches, and the New York Act of the same year recognizing and limiting city branch banking. The business depression that followed the great war has brought the question again to the front, with much more general discussion than ever before, so that there is prospect that the discussion may not only lead to further State legislation but to federal legislation in the direction of branch banking for national banks within limited territory.

My subject is "Branch Banking as a Means of Preventing Bank Failures" and I must not get too far afield. I am not going to state the arguments for or

against branch banking, excepting as they relate to the matter of bank failures. You are all familiar with the fact that we have had in this country a tremendous number of bank failures during the past few years - more than 2,000 since 1920, and no less than 753 last year, a year of plentiful credit supply and, generally speaking, of business recovery. Furthermore these failures of banks are continuing this year at the rate of eight or ten a week - there were 295 from the first of January down to and including May 29th. The situation is highly discreditable and disgraceful to us as a commercial nation. We have had recurring periods of bank failures ever since the early days of our history, yet have been unable or unwilling to adopt a remedy, though the experience of every other commercial nation clearly shows that there is a remedy. We seem to regard bank failures as something inavitable, an epidemic not to be avoided, and no adequate study of their causes has ever been made. We have, it is true, adopted various palliatives required reserves, pooling of reserves in Federal reserve banks, legal restrictions of various kinds, particularly with reference to loans, and governmental supervision - but they have not prevented bank failurs, they have only made them less excusable.

The Federal Reserve Bulletin for February contained an analysis of the 753 bank failures that occurred last year, 1924, showing that no less than 65 per cent of them were banks with a capital of \$25,000 or less, and only 10 per cent of them were banks with a capital of more than \$100,000. One of the Federal Reserve Agents, who has been making a study of his own, informs me that only 4 national banks cut of about 2,000 with a capital of \$250,000 or more have failed since 1920. These figures in themselves present strong prima facie evidence of the greater stability of the larger banks, and it seems to me rather remarkable that more of the larger banks have not been dragged down by the great number of small bank failures. Every bank failure has elements of tragedy for some of the people

and frequently for the whole neighborhood where it occurs, and every bank failure locks up a portion of the purchasing power of the people. I think it not too much to say that the bank failures of the past year and of the past five months have been a factor of great importance in preventing the business of the country from responding as it should have responded to the favorable influences that have been evident for the past ten months.

The question will doubtless be asked - doesn't the Federal Reserve System prevent bank failures? Of course it does. It prevents the failure of sound, Well managed banks by preventing panics. Without it 20,000 banks instead of 2,000 might have been forced to close their doors since 1920, and a large ma-Jority of them would have been sound banks forced to close because of inability to realize on good security in an emergency. But the Federal Reserve System can do little for banks which have no good and eligible security, whether their condition has been the result of bad management or of unavoidable involvement in neighborhood disaster. Even when they have eligible security it is often more than doubtful whother loaning money to an already over extended institution does good or does. harm. The Federal reserve banks can't make the loans of the member banks and can't supply good management to banks which are not well managed. Furthermore, of the 753 bank failures of the year 1924 no less than 78-1/2 per cent in numbers and 66-1/2 per cent in capital were non-member state banks. The Federal Reserve System cannot provide a remedy for bank failures in their case. The underlying banking system must be sound in order to give the Federal Reserve System a chance to render adequate service.

Surely if there is a remedy for bank failures the credit men and particularly the Robert Morris Associates should be interested in advocating its adoption. It seems to me that the remedy is clearly suggested by the evidence presented. We must have larger banks, banks large enough to afford good manage-

ment and large enough to spread their risks over a variety of industries and over a considerable territory. The larger banks have a better chance to weather financial storms because they are able to secure, and generally do secure, good management, and also because they are not under the same temptation to put all their eggs in one basket. The large bank serves, as a rule, a greater variety of industries than a small bank and often spreads its loans so widely that it cannot be vitally affected by disaster to any one industry.

In fact the largest banks of our great cities do a national business in spite of the fact that they are not allowed to have branches. Every large manufacturing industry and every large mercantile establishment wherever located carries an account in New York, and frequently also in Chicago and Boston or Philadelphia. The big business of the big city banks has recently been augmented by the formation of cooperative marketing associations in the great agricultural states — associations so large that they cannot obtain banking accommodation from local banking institutions but must go to the great banks of the great cities,

Little banks cannot go outside their own territory for business in this way. They are neighborhood institutions and frequently are compelled by force of circumstances to make all of their loans not only in a very narrow territory, but to persons dependent upon one industry, or at most to persons depending upon a very few industries. Such banks are seriously affected when the neighborhood industry suffers depression, and if that industry is agriculture it frequently happens that the local bank fails and ties up the farmer's funds just when the industry itself is recovering. That is what happened last year. Agriculture made a notable recovery, but 753 banks failed in the United States, nearly all of them in our agricultural states. With agricultural conditions exactly the same - or if anything not quite so good - Canada had no bank failures.

The large bank has another marked advantage over the small bank - it can

rarely be ruined by a defalcation. It is physically impossible for the officers of a very large bank to get their hands on enough of the bank's money to affect its solvency. Fraud isn't a major cause of bank failures today, but it is a rather important cause of the failure of small banks. Too many small banks are one-man banks, the one man having control of cash, securities and even in some cases of the keys to safe deposit boxes. Human nature is human nature and it isn't fair to put too many temptations before the best intentioned persons.

If we must have larger banks in order to afford good management and to give the management a fair chance for success then we must either subject many people living in small communities, or in rather thinly settled agricultural communities, to great inconveniences or we must provide them with banking accommodation through branches - not necessarily on any very large scale as in Camada, but on a scale large enough to serve the people adequately and safely. Probably in many communities branch banking by counties would answer. County branch banking has been in vogue in Louisiana for a considerable number of years and appears to have been reasonably successful. Tennessee has recently adopted it not as an original scheme, but as a limitation. Maine has branch banking in the county of the parent bank "and an adjoining county" which gives more latitude. Several other states permit state-wide branch banking, with results that appear to be satisfactory.

I have recently made a visit to California and am convinced that state-wide branch banking in that state works well, and certainly makes for safety. There have been very few bank failures in California since 1909 and state banks have made a better record in this matter than national banks - something which I think cannot be said of any other state.

Several Southern states have had branch banking for many years and have not sought to restrict it to counties or localities. Most of the Southern branch

banking institutions are nevertheless small - averaging less than two branches to a bank. With the exception of a few such institutions as the Citizens and Southern of Savannah, and the Wachovia Banking and Trust Company of Winston-Salem the banks with branches in the South are distinctly country banks - in some cases groups of small banks consolidated under one corporate management. In spite of the comparatively small size of these institutions there have been almost no failures among them - so far as I know only one in 1924. Here again the evidence appears to be that the additional spread of risk and the ability to pay for better management than a small unit bank can afford make for safety.

So much for the fundamental safety of branch banking as compared with small unit banking. There is more than this to be said in favor of "Branch Banking as a Means of Preventing Bank Failures". I have heard a State Superintendent of Banking quoted as declaring that one of the great advantages of branch banking lies in the opportunities it affords for preventing failures through consolidations. Both the Comptroller of the Currency and the State Superintendents frequently advocate the taking over of a weak bank by a strong one in order to prevent a failure, but obviously you can't consolidate two banks located at a distance from each other, as a rule, unless you can keep them both open - one as a branch of the other. A considerable part of the recent growth of branch banking has been due not so much to the desire of certain branch banking institutions to expand, as to the economic pressure of the times - in many cases to the direct request of the banking authorities.

Branch banking, as I have already said, has started to develop after every financial reverse, after 1893, after 1907 and now again after 1920. The establishment of branches is a natural, common law right, where no legal restriction exists. Laws relating to branch banking in the states where they exist were passed after branches had begun to appear, and were passed for the purpose of limiting or regulating the establishment of branches as a rule, or in some cases

to prohibit further branches. The prohibitions of branch banking have proven unfortunate and the states which have permitted branches under proper regulation and supervision have fared better than those which have prohibited them - under similar conditions.

I believe it is unfortunate that the National Banking Act has been generally interpreted as not authorizing branch banks. It contains no prohibition of branch banking and in fact specifically authorizes branch banking through conversion of state banks with branches. Historically, it seems to me, the evidence is clear that the Congresses which passed and revised the National Banking Act, from 1863 to 1866, did not intend to prohibit branch banking. They certainly did not intend to prohibit branch banking within city limits, and it appears reasonably clear that they did not intend to prevent National banks from having the same privileges with relation to branches that State banks have.

National banks have made a much better showing than state banks in the matter of failures during the past four years, but that again is in large measure because they are generally larger banks. There were nevertheless 127 National bank failures in 1924, which is altogether too many. The proportion of failures of banks with a capital less than \$50,000, was fairly large - 55 out of the total of 127. The National banking system would be much stronger if we could provide that in the future no banks should be chartered with a capital less than \$50,000 (as in the National Banking Act before 1900) or better \$100,000, which is no more than \$50,000 represented in the early days of the National Banking Act. Where smaller banks are necessary to accommodate the people branches should be permitted.