



BRANCH BANKING FOR COUNTRY BANKS

ADDRESS TO BE DELIVERED AT MEETING OF
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I may say, by way of introduction, that I was persuaded to accept the invitation of the Alabama Bankers' Association to speak to you today on "Branch Banking for Country Banks," largely because country branch banking has seemed to me peculiarly a Southern development, a development that has been of real service in the South, a development not at all well known and not understood elsewhere - something in short which Southern bankers ought to encourage within proper limits.

In the early days of banking in the United States the right of any bank to establish branches if it cared to do so was rarely questioned. Both the First and Second Banks of the United States had branches, and many of the early state banks established branches. Branches were looked upon as the natural means of providing banking facilities and conveniences to the smaller communities, and they were frequently - probably generally - established at the request of the people of the smaller places. The early incorporated banks were chartered by special acts of the State legislatures, sometimes with the proviso that they should provide banking facilities in other places than the city of the main banking office, by means of branches. Philadelphia was the financial centre of the nation in the early days and it was there that the first incorporated bank (1781) was established. Boston had the second incorporated bank and New York the third (1784). The South was soon in the field with the Maryland Bank at Baltimore, February 1790, and the Bank of Richmond in 1792.

One of the very early banks of the then financial centre was the Philadelphia Bank, chartered 1804, and still in existence. This bank has published an interesting history in which (page 44) I find the following:

"In the early time the establishment of branches in the interior towns of Pennsylvania became an important part of the Bank business. Many places sent requests for branches, and in March 1809 the Legislature passed a supplement to the charter allowing the directors to establish offices, not exceeding eight in number, wheresoever they shall think proper, for the purpose of discount and deposit only. X X X During the following year branches were established at Columbia, Harrisburg, Washington and Wilkes-Barre and the directors of the parent bank annually elected local boards of directors for each of the branches."

Philadelphia, as I have said, was the financial centre of the United States, but the New York banks were making progress and at about the same time we find the Bank of the Manhattan Company establishing a few outside branches. Not much is known about them, excepting that there was in 1811 a branch of this Bank in Poughkeepsie and one in Utica, and in the records of one of the early Albany banks there is evidence that the directors once considered the proposition of making their bank a branch of the Bank of the Manhattan Company. So far as I have been able to ascertain no other New York City bank ever attempted to establish branches outside of the city and it is evident that the branches in Poughkeepsie and Utica were discontinued at an early date, probably about the time of the War of 1812. The Bank of the Manhattan Company I have been informed has no records which give any indication of the reasons for the discontinuance of these branches, but the Philadelphia Bank's history shows plainly that the branches "soon became more extended loaning offices than the parent institution and it took much time and trouble to regulate them." In June

1810 the central board found it necessary to place a limit upon the loans of each branch, but they could not be held down and were continually causing anxiety, which not many years later led to the determination to close them. In 1817 the Harrisburg and Washington branches were sold to incorporators who obtained separate banking charters for them from the State. In these days we frequently hear the argument raised against branch banking that branch managers would not take any interest in the communities they were serving. Evidently in the early days of banking in the United States they took too much interest. It is reasonably clear, at any rate, that at an early period - long before the first general or free banking acts were passed - the big banks in the largest cities of the North found branch banking unprofitable and gave it up. Probably they were already beginning to find out that they could do the cream of the business without the responsibility of managing branches, and that they could make more by acting as correspondents of country banks than by competing with them.

When the large banks discontinued their branches the Legislatures chartered banks in smaller places and these banks established a few branches, generally not over one or two, in still smaller places. Branch banking in New York State became a country bank proposition somewhere about the time of the War of 1812 or soon afterwards, but only a few branches were established in New York or in other Eastern states. Those were the days of note-issue banking with deposits almost unknown except in the largest cities. The New York Safety-Fund Act was passed in 1830 and the right of Safety-Fund banks to have branches was specifically recognized. More than eighty banks were organized or brought themselves under the terms of this

act, but I have never been able to find clear evidence that any of them ever had branches. The Free Banking Act, with currency secured by bonds and mortgages, was passed in 1838, apparently without any discussion of branches. In the South, however, branch banking was the general rule. Southern states, unlike several of the Western states did not go wild over the "free" banking idea started in New York and most of them stuck to the system of fairly good sized specially chartered banks until after the Civil War. Several of the new Western states after some disastrous experiences also sought to give their currency stability by organizing large banks with branches generally under partial or complete State ownership.

The Bankers' Magazine for February 1843 has a list of "Banks of the United States" from which we find that in Ohio out of 48 banks, 29 were branches of the Ohio State Bank. Indiana lists 17 branches of the State Bank of Indiana and no independent banks, Missouri had one bank and five branches, Kentucky 3 banks and 13 branches, Tennessee 3 banks and 17 branches, Virginia 6 banks and 30 branches, North Carolina 4 banks and 14 branches, South Carolina 12 banks and 2 branches, Georgia 13 banks and 7 branches, Delaware 5 banks and 3 branches and Alabama 2 banks and 4 branches.

Illinois, Iowa, Mississippi, Florida and Arkansas came under a special heading as "States and Territories without Banks". Wisconsin had one bank and Michigan four.

The list of banks published in 1860 makes a similar showing, particularly as to the general prevalence of branch banking in the South. Dewey in his "State Banking Before the Civil War" says that "From the

beginning branch banking was the rule in North Carolina," which in 1860 had 16 banks and 26 branches in different parts of the State. Alabama appears to have had very much the same experience with early branches of the State bank, chartered in 1823 that Pennsylvania had with early branches. They couldn't be held down and got the banks and the state in trouble, so were discontinued. Dewey says "they were run too independently of the parent bank." Apparently nearly all the Southern states except Alabama continued branch banking down to the Civil War and I think it can be shown that some branch banking in some of the Southern states has continued from the earliest times of chartered banking until the present time. In the South as earlier in the North, however, branch banking tended more and more to become a country bank proposition.

I won't go greatly into the intricacies and iniquities of the note-issue banking of the early days. You all know that considered as a means of supplying currency we had the worst banking system in the world, and it seems almost incredible today that business men could have put up so long with bank notes which were almost always at a discount in the next state and even in the next town. Washington bank notes were at a discount in Baltimore and Baltimore notes in Washington much of the time. Many so-called banks in small towns particularly in the "wild cat" territory were not much more than satchels full of handsomely engraved bank notes and they tried all sorts of schemes for putting their notes in circulation as far away from home as possible. Some of them had agents in other places who redeemed their notes at a discount. In order to put a stop to this practice several Northern states passed laws about 1840 to 1850 which were later interpreted as prohibiting branch banking. One of the statutes

was the Act of 1848 amending the New York Free Banking Act so as to provide that "all banking associations or individual bankers, organized under the provisions of the act passed April 18, 1838 * * * shall be banks of discount and deposit as well as of circulation and the usual business of banking of said associations or individual banker shall be transacted at the place where such banking association, or individual banker shall be located." Millard Fillmore, then Comptroller of the State, explained this amendment at the time as follows:

"A practice had grown up under the general banking law, of establishing banks in obscure places, in remote parts of the state where little or no business was done, with a view of obtaining a circulation merely, and doing no other business. This circulation was then redeemed in New York or Albany by the agents of the bank, at one-half of one per cent discount, and again put in circulation without being returned to the bank, thereby enabling the bank to redeem its own paper at a discount, and then again put in circulation in the same place where it was redeemed. The object of the present law appears to be to break up that practice, and to ensure obedience to its requirements, the legislature have enacted that the president and cashier shall in every report made to this office, state that their business has been transacted at the place required by that act, and that such report shall be verified by their oaths." Bankers' Magazine, June 1848, Vol. 2, page 744.

This New York amendment was, therefore, probably not intended to apply to genuine branch banking. As the New York Free Banking Act became the model on which the National Banking Act was built during the Civil War it would soon probable that this New York Amendment of 1848 explains the origin of the provision in the National Banking Act of 1864 that the principal business of each bank must be transacted at "an office" in the place mentioned in its charter - a provision which Comptrollers later interpreted as prohibiting branches. It explains also the apparent inconsistency of the Act of 1865 which provided that State banks with branches could

convert into National banks and retain their branches wherever located, thus providing an indirect method of doing what another section of the law was interpreted as prohibiting.

The Legislators and the Congresses of the period evidently had currency in mind and do not appear to have been opposed to genuine branch banking. I have not been able to find any evidence in the publications of the day of any agitation on the subject of branches. Most of the big branch banking institutions of the South and West weathered the Panic of 1857 successfully, and seem to have given general satisfaction, though they were cordially hated by the wild cat free bankers whose notes they generally sent in promptly for redemption.

Banks of all kinds in the South naturally suffered severely from the war but it seems to have been expected in 1866, when the state bank notes were taxed out of existence, that the successful Western State banks with branches, such as the Bank of Indiana, would come into the national system and retain their branches. As a matter of fact with the exception (not really an exception as it did not nationalize until 1910) of the Bank of California, they did not - they brought the branches in as independent unit banks. This may perhaps be taken as evidence of some popular feeling in favor of unit banking. Doubtless there was such feeling, particularly on the part of the small banks, but it was not this that impelled the banks with branches to surrender the advantages of larger size and greater diversification of loans, but the general belief that the national system with its bond secured currency and federal supervision had solved most of the problems of American banking.

Possibly the unit banking system would not have been brought into serious question had it been possible to keep the capitalization of banks as large as it was in the old days. If you look over the lists of banks published in 1860 you will find that outside of Illinois and Wisconsin there were comparatively few banks in any state with a capital less than \$100,000. Alabama in 1860 with nine banks had only two with a capital as low as \$100,000 and only three with a capital less than \$500,000. Louisiana had no banks with a capital less than \$500,000. Nearly all the banks in Illinois and Wisconsin were banks with a capital less than \$100,000, and it seems odd today that there was only one bank in Chicago and that was not by any means the largest bank in the State. The National Banking Act authorized banks with a capital of \$50,000 in the smaller towns and naturally this gave a great impetus to the organization of small banks - but the movement did not stop there. The States, particularly in the West, or in what is now the Middle West, ran wild in the effort to provide banking facilities in the very smallest towns by permitting the organization of independent banks with a capital as small as \$10,000, and even in a few states \$5,000. There were of course some warning voices against the dangers of this system of little banklets and there were a few states, very few, and a few wise country bankers who saw clearly that there was a better and safer way of providing banking facilities in small places. Alabama has the honor of having been one of those very few States, and the Tennessee Valley Bank began establishing its branches in 1892, if our records are correct, seven of its branches having been opened in that year. Charles F. Dunbar, Professor of Banking at Harvard University, was one of

the warning voices and in October 1892, he published in the Quarterly Journal of Economics a paper in which he declared that many of the banks being established in the West were below the minimum of safety and that "with their trifling resources, it is impossible that they should command for their service, such experience and capacity as their operations, although on a small scale, really require in the interest of the community." He pointed out that sparsely settled states like Nebraska, which had recently permitted the establishment of banks with a capital as small as \$5,000 were attempting to secure, by the multiplication of independent banks the same advantages in "which/England and Scotland have been obtained through the multiplication of branches by a limited number of banks," and he added that it would be a real improvement "if the multiplication of branches were once fairly recognized again in the United States as a natural method as it has been in the past."

Professor Dunbar's voice, however, was the voice of one crying in the wilderness. Outside of a few Southern states - possibly California should be included - there was yet no interest in branch banking. The day of reckoning for the very small banks came nevertheless the very next year in the great panic of 1893. So many of them failed, particularly in the Middle West that remedies were much discussed and branch banking was not only suggested but was recommended, this time not by students of banking alone but by some well known bankers and by two successive Comptrollers of the Currency in Washington, James S. Eckles and Charles G. Dawes. Furthermore, in the South a few country bankers followed the lead of the Tennessee Valley Bank, notably the Grenada Bank of Grenada, Mississippi, which established the first of its twelve branches in September 1898. This bank has

also had a successful career which demonstrates admirably what country branch banking under good management can accomplish.

Now let us see what the recommendation of Comptroller Charles G. Dawes was with relation to branch banking, with some evidence as to whether he was right or wrong, as this evidence will enable us to get away from somewhat ancient history and come down to recent events in banking. In his annual report for the year 1898 Comptroller Dawes said "The Comptroller recommends, in accordance with the former recommendations of his predecessor, that domestic branch banking should be legalized in communities of less than 2,000 inhabitants, many of which are now unable to support independent banks. This would afford some smaller communities banking privileges which are now without them, but would not materially interfere with the scope of the work now so well performed by the existing banks of the smaller communities." Following these words was an argument against branch banking on broader lines.

As to whether Mr. Dawes was right or wrong let us look at some of the figures of recent bank failures. Since 1920 - that is for the years 1921 to 1926 inclusive - there have been 3,851 bank suspensions, according to figures compiled by the Federal Reserve Board. Of those only 464 banks were reported as having reopened. Of the 3,851 suspensions no less than 60.7 per cent or almost two-thirds were in places having a population of less than 1,000, - 70.6 in places with a population less than 1,500 and almost 80 per cent (79.8 per cent to be exact) in places with a population of less than 2,500. I regret that our figures do not show the exact percentages in places of less than 2,000 inhabitants, but it is doubtless not less than 75 per cent or three quarters of all the bank suspensions of the past six

years. Almost two-thirds of the suspended banks had a capital of \$25,000 or less and 72 per cent of them had a capital less than \$50,000.

Evidently Comptroller Charles G. Dawes was right in his recommendation of 1898 and the small towns would have been saved much money and much unnecessary distress if they had been given banking accommodations by means of branches of larger banks instead of little local independent banks. A considerable part of the depression in the great agricultural states today and for the past several years has been due to the loss or locking up of the money of the farmers in the numerous small bank failures, and that doesn't tell the whole story either. Many of these small banks by unwise loaning got their customers into serious difficulties which could and should have been avoided. They not only did not hold down the wave of land speculation that came soon after the high war prices for staple farm products, but they too frequently encouraged it. A liberal loaning policy isn't always good for the borrower. I have sometimes heard it said that the managers of the Canadian branch banks in the prairie provinces of Canada are not so liberal in making loans to the western wheat farmers as the American banks are, but it seems pretty well established that in every period of depressed wheat prices the Canadian farmers come through better than the farmers of the Dakotas and Montana, doubtless because they haven't borrowed quite so much money. Furthermore the Canadian farmers have lost nothing from bank failures while \$298,070,000 in deposits has been tied up, and at least 50 per cent of it lost, in the bordering states of Montana, North and South Dakota and Minnesota in 1134 bank suspensions in the past six years, nearly all of it in small towns and in small banks.

Some one will perhaps say that there have been bank failures in Canada which have caused wide-spread distress. There have been a few in the past, but for ten years or more, covering the period of the war and the war inflation and subsequent deflation, there has been only one failure from which depositors lost anything - that of the Home Bank of Toronto in August 1922. This bank was an Ontario institution and had few branches in the West, only two in the great wheat growing province of Alberta.

I do not believe in the Canadian or the English or Scotch system of nation-wide branch banking for the United States. What I do believe we need and must have is larger country banks with a limited number of branches along the lines of the development that has taken place in many of the Southern states for many years. Branch banking is a country bank proposition and the recently enacted McFadden Act, in my judgment, discriminates unfairly against country banks and against states where country banks have branches. It gives city banks in the big cities privileges which are denied to country banks. The fact is that the McFadden bill was originally drawn in ignorance of the fact that there were any country banks with branches, and Deputy Comptroller Collins in his excellent little book on "Branch Banking in the United States" admits that the existence of these comparatively small banks with branches in the South was scarcely known.

Let us see how many of these country branch banking institutions there are. The Federal Reserve Bulletin for this month, just out, contains an article on "Branch Bank Developments in 1923" which has a sub-heading entitled "Country banks and large city systems," under which branch systems are classified with reference to the population in which the parent bank is located, and the number of parent banks and of home city and outside branches in individual branch systems. From this it appears that more than one-half of the cities in which or from which branches are operated are cities or places of less than 25,000 inhabitants. There are 401 cities in the United States having branch banking, and of these 276 are cities or places of less than 25,000. In fact a good many of them - rather too many - are cities of less than 2,500. In these 276 cities there are 297 banks operating a total of 490 branches, or less than two branches to a bank, and of these 490 branches 431 are outside of so-called city limits - that is they are in other neighboring small towns. The McFadden Act, therefore, in seeking to outlaw, so far as a Federal statute can, branch banking in small towns and outside so-called city limits shuts out more than half of the cities or places where branches are at present operated. Of course the Act recognizes branches at present in operation and of course it does not apply to State banks that are not members of the Federal Reserve System, but if any of these small town non-member banks find it advantageous to establish another branch, perhaps by taking over some neighboring small institution so as to avoid a failure, such bank is barred from joining the Federal Reserve System unless it gives up its added branch. That appears to me to be unfair and unwarranted discrimination against country branch banking - a form of branch banking of far more economic importance than branch banking

within city limits. A very large proportion, about half, of the banks in towns of less than 25,000 operating branches outside the town limits are in the Southern states. To be exact, according to the records of the Federal Reserve Board, there are 146 banks in 135 small cities or towns in the South operating 288 branches. Five of these banks operating 19 branches are in Alabama, and 10 operating 24 branches are in Mississippi, neither of which states at present permit the opening of new branches either by consolidation with existing banks or de novo.

In my opinion, instead of stopping or even discouraging the establishment of country bank branches the practice should be encouraged through consolidations of present small banks, as a sound sensible way of extending better and safer banking facilities to small places. The history of branch banking in the United States and particularly in the South shows that branch banking develops slowly and demonstrates to my mind conclusively that the well managed country banks, not too small, have nothing to fear from it. You can limit branch banking as you please - to counties as in Louisiana and Tennessee, or leave open state-wide privileges with a limit on the number of branches and the requirement that the state authorities must find that public convenience and advantage will be promoted by opening each new branch. I personally like the Maine law which permits branch banking in the county of the parent bank and any adjoining or contiguous county. That gives a chance for wider diversification of loans than single counties would afford and yet keeps the branches within easily managed groups. There is of course no element of absentee banking in this kind of country branch banking. Every branch town can readily be represented on the board of directors, and that I think is the general practice. In the Southern states where branches may be state-wide in extent - and these include all the states

along the Atlantic coast from Delaware and Maryland to and including Georgia and no great state-wide development has taken place in all these years, and the big banks of the large cities have shown little or no disposition to put branches in the smaller towns. The largest branch banking institution in the South - The Citizens and Southern of Savannah - has branches only in the larger towns and cities of Georgia, Atlanta, Augusta, Athens, Macon and Valdosta. No bank in Baltimore, the largest Southern city and one of the great cities of the country, has a branch outside the city limits except one recently established in contiguous territory. There is, however, a bank in Annapolis with a branch in Baltimore. The largest branch banking system in the South in point of number of branches is a country bank - the Eastern Shore Trust Company of Cambridge, Md., which has 20 branches, one of which maintains itself almost in the suburbs of Washington, at Upper Marlborough.

Branch banking for country banks would do for country banks to some extent at least what big city banks are able to do without branches - extend their risks over a wider territory with greater diversification. The great banks of our great Eastern cities receive deposits from and make loans in every city of any considerable size all over the United States. They have no need of outside branches, but obtain the widest diversification without them. Every big industry has an account in New York or Chicago or both, and the same is true of many well-to-do people. In the older Northern and Eastern states unit banking, even with rather small banks - works reasonably well for two reasons. First the banks in those states nearly all have more money on deposit than they can loan at home so that they are forced to seek outside investments, as Professor Sprague recently pointed out in an article in the Journal of the American

Bankers' Association. The second reason is that there is so great a diversification of industry in their own territory that they can't very well loan too large a proportion of their money to one industry.

Conditions are very different in the West and in much of the South, where most of the smaller banks cannot from their own resources take care of peak local demands, and are practically forced to loan all their money in one narrow territory and frequently to one industry, or even to one crop. Under such conditions independent unit banking is necessarily dangerous, and no amount of supervision or burdensome legislative restrictions can make it as safe as it should be. Guaranteeing deposits has been given ample trial and has failed. The only remedy in my opinion is the remedy which has been successful in every other commercial country - branch banking. Not necessarily branch banking without limit or restriction, but larger banks with some branches established with a view to a wider diversification of loans, better and safer service to customers.

Branch banking, as I have already said, was for many years only of academic interest, discussed occasionally by a few economists. Then after the Panic of 1893 the subject was for a time not only discussed by economists and by leading bankers like J. B. Forgan, but by Comptrollers of the Currency and State banking superintendents. Branch banking was still, however, a subject of interest almost exclusively to economists and bankers. The fight over the McFadden bill brought the matter to more general notice. Business men and the general public are becoming interested as shown strikingly by an editorial in the current number of World's Work entitled "Too Many Bank Failures". This editorial contains some significant sentences. "The meaning of the

"epidemic" (of bank failures) says the writer "is that unit banking in areas depending upon a single crop or a single industry is fraught with exceptional hazards. Safety in banking flows from a capacity to diversify loans - to keep all the eggs out of one basket.."

"Up to the present time", quoting from the same article, "the issue of branch banking has resolved solely around the bankers' interest. The time has come to consider the question from the broader standpoint of the depositor and the borrower, whose interest is closer to the public weal. It has long been argued that the local banker knew his community better than an agent of a large city bank could, and that he was likely to be more lenient in extending loans. The rural communities have been suffering from the fact that local bankers were too closely tied up with local business situations and too generous in granting credit. Greater severity in lending would have been a boon to borrower and lender alike."

World's Work suggests that "Ultimately the country may be persuaded to the viewpoint that country-wide branch banking, such as is successfully administered in England and Canada is the solution."

Such a decision would in my opinion be unfortunate but stranger things have happened in the history of American banking legislation. Some very drastic restrictive measures have already been seriously proposed in some states, as for instance recently by the Governor of Iowa. Limited branch banking would be far better for bankers, small and large, than many of the legal restrictions proposed, and country bankers in their own interest should seriously study the subject of limited country branch banking as a real remedy for bank failures.