

BRANCH BANKING IN CALIFORNIA

Material prepared for the information of the
Federal Reserve System by the
Federal Reserve Committee on
Branch, Group, and Chain Banking

Members of the Committee

E. A. Goldenweiser, Director, Division of Research and Statistics,
Federal Reserve Board, Chairman
Ira Clerk, Deputy Governor, Federal Reserve Bank of San Francisco
M. J. Fleming, Deputy Governor, Federal Reserve Bank of Cleveland
L. R. Rounds, Deputy Governor, Federal Reserve Bank of New York
E. L. Smead, Chief, Division of Bank Operations, Federal Reserve
Board

J. H. Riddle, Executive Secretary and Director of Research

The Committee was appointed February 26, 1930, by the
Federal Reserve Board

". . . to assemble and digest information on
branch banking as practiced in the United States,
group and chain banking systems as developed in
the United States and elsewhere, the unit banking
system of the country, and the effect of ownership
of bank stocks by investment trusts and holding
corporations."

LETTER OF TRANSMITTAL

To the Federal Reserve Board:

The Committee on Branch, Group, and Chain Banking transmits herewith a history and analysis of branch banking developments in California. The statistical series in this volume in most instances end with the year 1931.

Respectfully,

E. A. Goldenweiser
Chairman

CONTENTS

| | Page |
|---|------|
| <u>Chapter I</u> <u>Introduction</u> | 1 |
| <u>Chapter II</u> <u>The Historical Background</u> | 8 |
| Hard Money and Private Bankers | 9 |
| Incorporated Banks | 12 |
| Foreign Banks and Branches | 14 |
| National Banks | 16 |
| Branch Banking | 18 |
| <u>Chapter III</u> <u>California's Banking Laws</u> | 21 |
| Provisions for Branch Banking | 22 |
| Methods of Acquiring Branches | 27 |
| The Bank Act--General Provisions | 29 |
| Special Aspects of the Departmental System | 31 |
| <u>Chapter IV</u> <u>Growth of the Modern State System</u> | 34 |
| State-wide Expansion | 35 |
| The Methods of Expansion | 38 |
| Out-of-town Branches | 40 |
| Early Attitude of the Superintendent of Banks | 41 |
| The <u>De Novo</u> Rule | 43 |
| The Development of Controversy | 47 |
| Confirmation of the Power of the Superintendent of Banks | 50 |
| Abandonment of the <u>De Novo</u> Rule | 54 |
| <u>Chapter V</u> <u>Complications of Federal Reserve Membership</u> | 56 |
| The Elements of the Problem in California | 57 |
| The Case of the Large National Banks | 59 |
| The Small National Banks | 60 |
| Opposition of Independent Bankers | 61 |
| Federal Reserve Regulations Prior to 1927 | 62 |
| The McFadden Act | 66 |
| Further Growth of Branch Banking in California | 67 |
| <u>Chapter VI</u> <u>Mergers and Consolidations</u> | 70 |
| Procedure of Mr. Giannini and His Associates | 71 |
| Liberty Bank of America | 71 |
| Bank of America of California | 75 |
| Bank of America | 77 |
| Evolution of the Holding Companies | 78 |
| Security-First National Bank | 80 |
| American Trust Company | 81 |
| California Bank | 82 |
| The Financial Methods | 82 |

CONTENTS (Cont'd)

| | | Page |
|---------------------|---|------|
| <u>Chapter VII</u> | <u>Organization and Administration</u> | 86 |
| | The Present Methods in California | 90 |
| | The Local Management and Advisory Boards | 94 |
| | External Supervision | 96 |
| <u>Chapter VIII</u> | <u>Branch Banking Safety and Service</u> | 99 |
| | Favorable Failure Record in California | 99 |
| | Influence of Economic Conditions | 100 |
| | Effects of State Laws and Supervision | 100 |
| | Influence of Branch Banking | 101 |
| | Branch Banking Service | 103 |
| | Availability of Credit | 106 |
| | Large Individual Loans | 107 |
| | Loans in Relation to Deposits | 110 |
| | Interest Rates to Borrowers | 114 |
| | The Monopoly Question | 118 |
| <u>Chapter IX</u> | <u>The Cost of Branch Banking in California</u> | 119 |
| | Large Intercommunity Branch Operating Banks vs. All Other National Banks | 119 |
| | Country Branches and Country Banks | 122 |
| <u>Chapter X</u> | <u>Summary</u> | 129 |

CHAPTER I

INTRODUCTION

California is the only State in the Union in which modern inter-community branch banking has had a considerable development. A law was passed there in 1909 which permitted the creation under State charter of a state-wide branch banking system. By the end of 1931 nearly 60 per cent of the total banking resources of the State were in the hands of institutions with banking offices in more than one town or city, and the branches in operation comprised over two-thirds of all the banking offices in the State. The same tendency towards larger and fewer banks, which has been observed in Canada and other countries where branch banking has been the predominant system, has also been evident in California, where a few large branch organizations have grown up and are now transacting over half of the banking business of the State.

The percentage distribution of resources between the single office banks and the banks operating branches in the State on December 31, 1931, is illustrated in Chart 1. Table 1 shows the number of banks and branches in operation, together with their aggregate resources, according to the same classification.

CHART 1
DISTRIBUTION OF
BANKING RESOURCES OF CALIFORNIA
DECEMBER 31, 1931

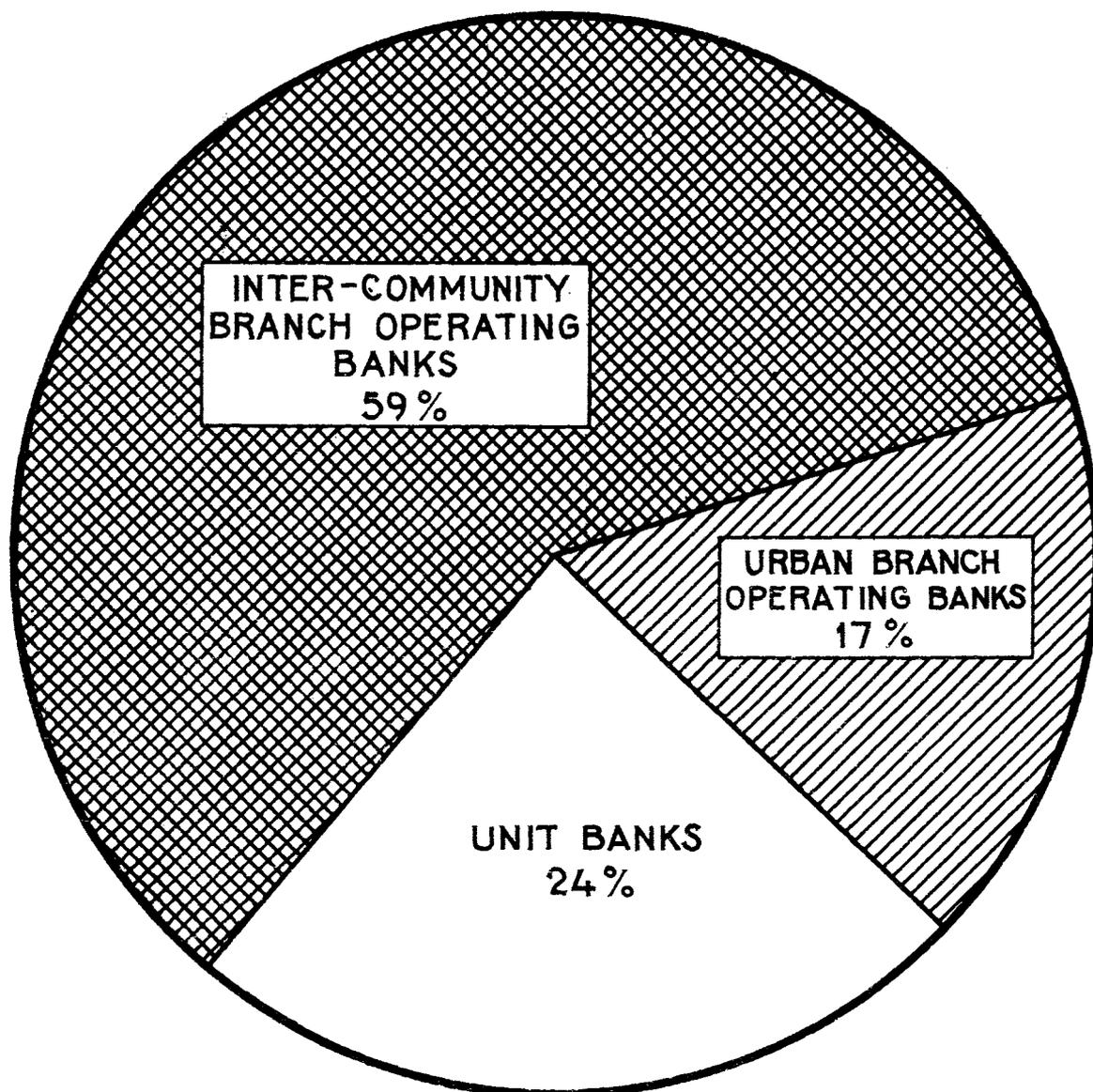


Table 1 - Banks and Branches in California, December 31, 1931⁽¹⁾

| | Number of banks | Number of branches | Total resources | |
|---|--------------------|--------------------------|----------------------|------------|
| | | | Amount | Percentage |
| Unit banks (including one holding company "group" of 18 banks with combined resources of about \$278,000,000) | 342 | | \$ 912,626,000 | 24 |
| Banks with branches only in metropolitan area of home office | 17 | 33 | 637,975,000 | 17 |
| Banks with branches in and outside of metropolitan area of home office | <u>34</u> | <u>772⁽²⁾</u> | <u>2,215,133,000</u> | <u>59</u> |
| Total | 393 | 805 | \$3,765,734,000 | 100 |

(1) Data from records of Federal Reserve Bank of San Francisco, for all incorporated banks in California.

(2) Includes 3 offices of Bank of California N. A., located in Seattle and Tacoma, Washington, and Portland, Oregon, with resources in those three cities of \$32,187,000; but does not include one foreign branch of Bank of America N. T. & S. A. located in London.

Of the 805 branches in operation at the end of the year 1931, those outside the metropolitan area of the home office amounted to 543, representing about 67 per cent of the total. Five banks were operating 488 of these out-of-town offices, or about 90 per cent of the total. The resources of these five institutions amounted to about 84 per cent of the total of all the banks operating out-of-town branches, and to nearly 50 per cent of the resources of all the banks in California.

Of the remaining 29 institutions operating out-of-town branches, none had more than 5 offices outside its home city and 15 had only one branch each. For the most part these 29 banks are located in small towns throughout the State, and operate branches in neighboring towns. In general they represent a type of branch banking which has been practiced in California

for over fifty years, and in other parts of the United States since long before the Civil War. They could hardly be described as branch organizations in the modern sense of the term, although a few of them have in the past several years embarked upon programs of moderate expansion which may eventually result in the more widespread aggregations of offices usually associated with the branch banking system. At all events, the development thus far has been accomplished, through mergers and the direct establishment of new offices, mainly by the five largest branch organizations named in Table 2.

Table 2 - Principal Branch Organizations in California
December 31, 1931

| Name of bank | Home office location | Home city branches | Out-of-town branches | Total branches | Resources |
|--|----------------------|--------------------|----------------------|----------------|--------------------|
| Bank of America N. T. & S. A. | San Francisco | 44 | 300 | 344 | \$ 914,199,000 |
| Bank of America (Under same ownership and control as Bank of America N. T. & S. A.) | San Francisco | - | 63 | 63 | 55,869,000 |
| Security-First National | Los Angeles | 68 | 57 | 125 | 540,145,000 |
| American Trust Company | San Francisco | 35 | 58 | 93 | 250,403,000 |
| California Bank | Los Angeles | 44 | 10 | 54 | 100,126,000 |
| All other branch operating banks(1) | | <u>71</u> | <u>55</u> | <u>126</u> | <u>992,366,000</u> |
| Total branch operating banks | | 262 | 543 | 805 | 2,853,108,000 |
| Unit banks | | - | - | - | 912,626,000 |
| Total all banks | | | | | \$3,765,734,000 |

(1) Includes 3 offices of Bank of California N. A., located in Seattle and Tacoma, Washington, and Portland, Oregon, with resources in those three cities of \$32,187,000; but does not include one foreign branch of Bank of America N. T. & S. A. located in London.

Of necessity, the foregoing description represents a mere sketch of the banking structure of California. Underlying the present situation and containing large but uncertain potentialities for the future, are a number of complex economic and political forces and tendencies. These arise out of the fact that the banking system of the State during the past fifteen to twenty years has been, and probably still is, in a state of transition. It did not develop originally as a branch banking system, as in Canada, but as an independent unit system, as in other sections of the United States. The present intercommunity branch organizations, moreover, were for the most part built up, not by the establishment of new offices, but by the conversion of existing independent unit banks into branches.

Another source of complication in the present situation is the fact that California, like all the other States, has three separate categories of banking institutions. There are first, those banks which are operating under national charter and are compelled by law to be members of the Federal reserve system; second, those operating under State charter which have voluntarily become members of the Federal reserve system; and third, those operating under State charter which have not become members of the Federal reserve system. All three categories are represented among the great branch operating banks of California, and no little confusion has resulted from the sometimes conflicting legal and administrative regulations under which they perform their functions. To add to the difficulty of a clear understanding of the situation and a dispassionate appraisal of branch banking on its merits, the whole subject has been further confused by controversy, much of which has had to do not with branch banking as such

but with the methods employed to build up certain branch organizations.

Branch banking in California, however, has attained to far more than local significance; it has assumed first-class national importance. The most immediate reason for this is the situation which involves the national banking organization and the Federal reserve system. Of equal or greater importance, however, is the fact that in California the development of modern intercommunity branch banking has taken place under American conditions. The growth of the system in that State constitutes therefore an important fund of experience, especially with respect to the problems involved in effecting a transition from one type of banking structure to another. This is true, primarily, for the reason suggested above, that modern branch banking began to develop in California after the existence in the State for over half a century of the same predominant type of independent unit banking common in the rest of the country.

The experience of California may not be expected always to furnish desirable criteria for legislation and banking practice for the country as a whole; it has doubtless provided certain object lessons in what to avoid. It is important, therefore, as far as possible to disentangle and make comprehensible the confused elements underlying the existing banking structure of the State. The discussion which follows is an attempt to accomplish this purpose.

In order to do so it will be necessary first to set forth something of the history and the economic background of banking in California. If possible, it should be made clear whether there was any special reason why branch operation should attain its fullest development in California rather than in some other State. To complete the background, it will be

of advantage to present a summary and analysis of the principal provisions of the Bank Act of 1909 and the subsequent revisions and amendments thereof. The second part of the discussion will deal with the administration of the law and the rapid development of branch banking; the sometimes confused relationship of California banking to the national banking system and the Federal reserve system; and with certain of the spectacular financial operations associated with the growth of the existing branch organizations. The third and last part of the discussion will be an attempt to appraise the system of branch banking as developed this far in California from the point of view of its safety and of its service to the economic community.

CHAPTER II

THE HISTORICAL BACKGROUND

California sprang into existence as a full fledged political entity almost overnight, following the gold rush of 1849. Thrown together from all over the two American continents and from Europe and Asia, its people brought with them nearly every kind of social and economic custom and doctrine known in the world. At the same time, their contact with the great Eastern centers of population of the United States was subject to two or three weeks' delay by the fastest means of communication then in existence. Thus isolated from the rest of the country, they were obliged to set to work with the human and material resources at hand to fashion their commonwealth. The predominant element of the population was American, and the political traditions were thus largely the same as in the East, but to an extent that has not always been fully realized elsewhere, California repeated the experiences of the Colonists of two hundred years before and became almost a new nation, with characteristics along many lines, economic, social, and cultural, which have continued well into the twentieth century.

Gold was the first great source of prosperity, but it did not turn out in the long run to be the most important. With the passage of time discovery was made of the extraordinary extent and variety of the potential agricultural wealth of the new State. Its soil, in different regions, was adapted to the profitable growth of nearly every food product of the North American Continent, from the grain of the northern latitudes to the subtropical and tropical fibres and fruits of the south. Other minerals, to prove

ultimately of greater value than the gold deposits, were found from time to time, notably the immense quantities of oil. From almost every point of view, the early Californians, perhaps without fully realizing it, were beginning the development of one of the richest areas on the face of the earth.

Hard Money and Private Bankers

California's early banking history differs essentially from that of most other sections of the United States.⁽¹⁾ Whereas in the East and Middle-west the chief incentive to the starting of banks was the possibility of issuing paper currency, this motive was never allowed to exist in California. The State came into the Union in 1850, after the sudden growth of population in 1848 and 1849, without passing through the preliminary stage of an organized territorial government,⁽²⁾ and its constitution forbade the issue of bank notes for circulating purposes.⁽³⁾ The reason for this prohibition was no

(1) Most of the material for the following sketch of the rise of banking in California has been taken from History of Banking in California, by Ira B. Cross, and from Banking in California 1849-1910, by Benjamin C. Wright.

(2) The area was under the jurisdiction of a military governor from the time of its acquisition in August, 1846, until organized under a State constitution on November 13, 1849. California was admitted to the Union on September 9, 1850.

(3) Sections 34 and 35 of Article IV of the original constitution were as follows:

"Sec. 34 The Legislature shall have no power to pass any act granting any charter for banking purposes; but associations may be formed under general laws for the deposit of gold and silver. But no such association shall make, issue, or put in circulation, any bill, check, ticket, certificate, promissory note, or other paper, or the paper of any bank, to circulate as money.

"Sec. 35 The Legislature of this state shall prohibit, by law any person or persons, association, company, or corporation, from exercising the privileges of banking, or creating paper to circulate as money."

Apparently the term "banking" was meant to refer only to the business of issuing currency, since this was generally looked upon at the time as the characteristic activity of banking.

doubt the prevalence of wildcat banking in other States and the resulting wide circulation of all kinds of paper currency, much of it of doubtful value or entirely worthless. California could dispense with the convenience of paper money because her principal industry at that time was the mining of gold, much of which entered into immediate circulation as currency. At first it circulated in the form of bullion or dust at around \$16 per ounce, and privately manufactured \$50 slugs. In 1854 a branch of the United States mint was established at San Francisco, and for more than sixty years thereafter gold coin remained the principal circulating medium in the hands of the people of the State.

For the most part the banking business of the eighteen-fifties was confined to San Francisco, which was the principal commercial center of the Pacific Coast. A number of private bankers were operating in Sacramento, however, and in some of the larger mining camps. One of these, later to play a prominent part in the financial development of California, was D. O. Mills, a merchant of Sacramento, who opened a private bank there in 1850.

The earliest banks generally were little more than privately owned places for the safe-keeping of gold. Since a fairly good iron safe was about the only material requirement, and the more prominent merchants and some of the express companies already had these, they became bankers for the convenience of their customers. Very soon, however, a number of genuine, though primitive and rudimentary, private banking institutions commenced operations. They accepted deposits and made loans, usually at very high rates of interest, bought and sold foreign exchange, and performed other elementary banking func-

tions. Several of these were express companies, notably Adams & Co., Palmer, Cook & Co., Page, Bacon & Co., and Wells, Fargo & Co., the latter now still existing as one of the great banks of San Francisco.(1)

Many of the early institutions called themselves savings banks, or indicated in some manner that their primary purpose was the safeguarding of the money entrusted to them. Thus at the beginning was emphasized another feature of banking in California which has been one of its distinguishing characteristics ever since, the predominance of savings banking alongside of and often in conjunction with commercial banking.

Because of the legal prohibition of the issue of paper currency, many of the worst features of wildcat banking were entirely avoided. But the early banks nevertheless soon encountered the difficulties which might have been expected from their mushroom growth and their often inexperienced management. In 1855 most of the express company banks closed their doors, some of them only temporarily. They were followed in short order by practically all the private banks in San Francisco. Of the express company banks only the Wells Fargo institution appears to have survived the difficulties of this and the following year. Several of the suspended private banks subsequently reopened and continued as before, but the heyday of uncontrolled and sometimes irresponsible private banking was coming to the end of its brief existence. Soon after the epidemic of failures in 1855 began the development in California of what might properly be described in growing degree as a

(1) Chartered as Wells Fargo & Co., Banking and Express, in 1852 under laws of New York; nationalized in 1905 by merger with Nevada National Bank; converted to State charter (California) in 1924 when merged with Union Trust Company.

genuine banking system.

Incorporated Banks

The early laws of California provided for the chartering of corporations similar to those existing in other States; but the few elementary provisions they contained with respect to banks were of a negative character.⁽¹⁾ Additions were made from time to time to the general corporation laws for the regulation and supervision of the banking business, but there was no comprehensive body of special legislation on the subject until the passage of the Bank Act in 1909. Meanwhile, as early as 1857 banks began to incorporate, and from that time forward banking became more and more a business to be engaged in only by corporations. The first institution to be incorporated was the Savings and Loan Society of San Francisco, which was followed two years later, in 1859, by the Hibernia Savings and Loan Society⁽²⁾ in the same city. A few years later the movement began to spread to the other towns of the State, corporate charters being granted in 1867 to banks in Sacramento, Oakland, and Stockton. Thereafter the growth of incorporated banking under the State law, both in San Francisco and in the interior, continued apace with the development of industry and commerce, although with the setbacks and difficulties to be expected from the ups and downs of business.

Following the failures incident to the depression of 1873 a law was passed in 1876 compelling "every corporation and all persons and every person hereafter doing a banking business in this State"⁽³⁾ to publish

(1) See footnote 3, p. 9.

(2) The Hibernia Savings and Loan Society was originally incorporated as a stock company, but was changed to a mutual basis in 1864 under a law which had been passed by the legislature in 1862. It is still in operation as one of the important banks of San Francisco and is the only mutual savings bank in California.

(3) Statutes of California.

semiannual statements of condition. Two years later a board of bank commissioners was set up, to supervise all incorporated institutions, and in 1887 private banks were required to submit to the board their statements of condition at the same time as the incorporated banks. In 1905 the private banks were brought fully under the supervision of the commissioners, after which some of the remaining ones applied for charters and became incorporated institutions, while the others played a gradually diminishing role in the banking system of the State. Finally, under the Bank Act of 1909, they were required to incorporate or retire from business.

Prior to 1863 all the incorporations were of savings banks, the commercial banking needs of the community being met mainly by private bankers. In that year, however, permission was granted savings banks to transact commercial business. Then began the development, in numbers which were to increase steadily for fifty years, of institutions classified as commercial banks. Wells, Fargo & Company, incorporated under the laws of New York, had been carrying on a commercial business in San Francisco since 1852, but the first California corporation chartered for this class of business was the Pacific Accumulation Loan Company⁽¹⁾ of San Francisco in 1863, which was followed in 1864 by the Bank of California. The latter, still in existence under the name of Bank of California N. A., had as its first president D. O. Mills, previously mentioned in connection with the first bank started in Sacramento. Of the many other institutions which were incorporated in sub-

(1) Name changed to Pacific Bank in 1866. According to the Mercantile Trust Review of the Pacific for June 15, 1924, the Pacific Accumulation Loan Company was chartered in 1863 as a savings institution, later changing its operations to those of a commercial bank. "But the Bank of California, organized in July 1864," the Review declares, "was the first concern to be incorporated as a purely commercial bank under the general laws of the State governing business corporations."

sequent years as commercial banks, a considerable number advertised and carried on a savings business as well. In 1900, and again in the year preceding the Bank Act of 1909, the distribution of banks and banking resources of the State was reported as follows:

Table 3 - Distribution of Banking Resources of California⁽¹⁾

| Type of institution | 1900 | | | 1908 | | |
|------------------------|-----------------|---------------|-------------------|-----------------|---------------|-------------------|
| | Number of banks | Resources | | Number of banks | Resources | |
| | | Amount | Per cent of total | | Amount | Per cent of total |
| State savings banks | 53 | \$173,873,000 | 44.9 | 134 | \$277,815,000 | 34.7 |
| State commercial banks | 171 | 123,217,000 | 31.8 | 349 | 233,442,000 | 29.1 |
| Private banks | 19 | 2,798,000 | 0.7 | 16 | 3,861,000 | 0.5 |
| Foreign banks | 7 | 23,278,000 | 6.0 | 7 | 23,914,000 | 3.0 |
| National banks | 37 | 64,417,000 | 16.6 | 143 | 262,217,000 | 32.7 |
| Total | 287 | \$387,583,000 | 100.0 | 649 | \$801,249,000 | 100.0 |

(1) From a tabulation in the Eighteenth Annual Report of the Superintendent of Banks, 1927, p. xiv.

From 1909 until 1913 both the number and the resources of State incorporated banks increased steadily, the number reaching 548 in the latter year and the resources \$705,871,000. Afterwards the number began to decline, but the resources continued to increase steadily and rapidly until 1926, when a maximum was reached of \$2,662,558,000.⁽²⁾ Meanwhile, the Bank Act had been passed, and the modern State system was taking form.

Foreign Banks and Branches

Another feature of some importance in connection with the present

(2) All figures in this paragraph from a tabulation in the Eighteenth Annual Report of the Superintendent of Banks, 1927, p. xx.

discussion of banking in California was the early existence of foreign banks, or branches of foreign institutions, all doing business in accordance with the State law. This resulted, no doubt, partly from the cosmopolitan character of the growing city of San Francisco and its accessibility by sea to the great centers of wealth and population of the old world, partly from the influx of foreigners with wider commercial banking experience than was usually possessed by the American inhabitants during the pioneer period, and partly from a certain lack of clarity in the early California laws with respect to the chartering of banks. During the years 1863-1865 as many as five financial institutions operating under British charter opened branches or agencies in San Francisco.⁽¹⁾ Two of these were withdrawn or liquidated in 1866. Two others were in effect branches of Canadian banks, although chartered in England. The latter have since been consolidated with other Canadian banks which have continued to operate them without interruption. They are now branches of the Canadian Bank of Commerce and the Bank of Montreal, respectively. Their business has been reduced to that of agencies dealing in exchange, letters of credit, etc., although each of the Canadian banks referred to owns a separate bank in San Francisco, operating under State charter. The fifth British institution to establish an agency in California during the Civil War period was the London and San Francisco Bank, which continued in operation until 1905, when its banking business on the Pacific Coast was purchased by the Bank of California. It was through this transaction that the latter, while a State bank, acquired three branches in Portland, Oregon, and in Seattle and Tacoma, Washington, which were retained when the bank entered the national system in 1910.

(1) Ira B. Cross, History of Banking in California, pp. 256-258.

Several other foreign banks or branches were subsequently established, notably the Anglo-Californian Bank, Limited, the London, Paris and American Bank, Limited, the San Francisco branches of the Hongkong and Shanghai Bank, and the Yokohama Specie Bank. The two first named were incorporated in England in 1873 and 1884, respectively. Both continued in business separately until 1909, when they were merged to form the Anglo and London Paris National Bank, thus becoming legally, as well as in fact, an American institution. The two last named are still in operation as branches. Some of the institutions chartered abroad operated and still operate chiefly in the field of foreign exchange. Others, however, carried on a general commercial banking business. Up to the end of the nineteenth century, in fact, a considerable proportion of the total commercial banking business of San Francisco was carried on by institutions operating under foreign charters.

National Banks

No national banks were established in California until after 1870. Even then, because of the disinclination of the public to accept the paper currency of the United States or of the national banks (which at that time was not redeemable in specie), a special act of Congress had to be passed, authorizing the issue of gold notes repayable in gold coin by the issuing bank on demand, before any banker in California could be induced to take out a national charter. The first one to be opened for business was the First National Gold Bank of San Francisco, in 1871, which was later to become the important First National of that city. This was followed in 1872 by the National Gold Bank of D. O. Mills & Co., in Sacramento, an institution

finally merged in 1925 with the California National Bank in Sacramento under the title of the latter. By 1880 ten of these national gold banks were operating in the State. Following the resumption of specie payments in 1879 by the United States Treasury, these institutions dropped the word "gold" from their names and became ordinary national banks like those existing in other States. By 1900, as shown in Table 3 above, the number in operation had reached 37, and their resources were about 17 per cent of the banking resources of the State. Ten years later the number had increased to 187, and they accounted for about 42 per cent of the State's banking resources. By 1920 the number had reached a maximum of 305. It was not, however, until after the passage of the McFadden Act by the Congress of the United States in 1927, that as a result of conversions the resources of the national banks in California overtook and surpassed those of the banks operating under the State laws.

Many of the national banks, from the beginning, were formed by the conversion of State or private institutions. This was particularly true during the ten years following 1900, when the National Bank Act was changed to permit the chartering of institutions with \$25,000 of capital stock. Later on, there were several conversions back and forth from State to national and from national to State charter, as one or the other system appeared to offer greater advantages. It was, in fact, this shifting from one jurisdiction to another, together with the rise of problems in connection with branch operation and other developments, which contributed largely to the tangled story of banking in California to be dealt with in later chapters of this discussion.

Branch Banking

Previous to the passage of the Bank Act of 1909 branch banking was practiced in several other States on a much larger scale than in California, notably in Virginia, North Carolina, Maryland, and South Carolina.⁽¹⁾ As pointed out above, however, two Canadian banks (operating under English charters) had branches in San Francisco as early as the period of the Civil War, and their existence appears to have been taken as a matter of course. Likewise, some twenty years later in the interior of the State, the private banking firm of Rideout and Smith, located at Marysville, was operating banks in five other towns, Gridley, Oroville, Willows, Chico, and Sacramento.⁽²⁾ They were all connected by private telephone⁽³⁾ and administered either as a branch system, or possibly more after the manner of a modern group. At all events, the development does not seem to have occasioned any comment on the subject of branch banking. In 1890 the firm was incorporated as the Rideout Bank, and apparently some of the branches were afterwards discontinued or otherwise disposed of, since in 1905 the bank was operating only one "agency," at Gridley.

Apart from numerous agencies of express companies in mining camps for twenty years or so after the gold rush, the Rideout and Smith firm appears to have been about the only bank to operate branches in California until after the end of the century.⁽⁴⁾ Doubt as to the legality of the "agency" principle

(1) See Committee on Branch, Group, and Chain Banking, Branch Banking in the United States.

(2) S. D. Southworth, Branch Banking in the United States, 1928, p. 30.

(3) Ibid.

(4) The Bank of California, while it had no branches in California, was operating several in Nevada at the close of the century. These were later discontinued, although in 1905 the Bank of California acquired three branches in Oregon and Washington, which are still in operation.

has been suggested as the reason why the first example of this kind of banking was not more quickly followed.⁽¹⁾ Doubt was removed, however, by two opinions handed down by the attorney general, in 1903 and 1905, to the effect that corporations, including banks, could establish agencies for all practical purposes wherever they liked within the State. Afterwards there was moderate progress in the opening of branches until the passage of the Bank Act in 1909, when 19 "agencies" were in operation throughout the State.⁽²⁾ The majority of these were owned by country banks, operating one branch apiece in neighboring villages or towns.

Meanwhile a certain sporadic development of city branch banking had occurred in San Francisco, following the earthquake and fire of 1906. Most of the bank buildings had been destroyed, and after the debris was cleared away and the vaults were cool enough to be opened, temporary quarters had to be found in the less damaged residential sections of the town. Several offices were thus established, and some of them appear to have been retained after business was resumed at the main office. According to the annual report of the board of bank commissioners for 1908, there were then 8 branches in San Francisco altogether, and 11 in the remainder of the State. On the other hand, Wright, in referring to the establishment of branches after the calamity of 1906, declares that ". . . before the close of 1909 practically all of these branches were abolished and the business centered once more at the main office."⁽³⁾ At all events the facts do not appear to warrant the

(1) Nineteenth Annual Report of the Superintendent of Banks, 1928, p. 30.

(2) Ibid.

(3) Benjamin C. Wright, Banking in California, p. 142.

commonly repeated assertion that the catastrophe of 1906 was the principal cause of the rise of branch banking in California.

CHAPTER III

CALIFORNIA'S BANKING LAWS

A spectacular bank failure in the autumn of 1907 appears to have been the event chiefly responsible for California's Bank Act of 1909. This was the collapse of the California Safe Deposit & Trust Company, of San Francisco, the largest of some 32 State incorporated institutions and 11 private banks which were suspended during the panic and depression of 1907 and 1908. Just before its suspension the bank had established several branches in the city, in an effort to obtain additional deposits and thus stave off failure. The circumstances surrounding the closing of this large and apparently sound institution, involving the loss of all but \$2,500,000 of its \$12,600,000 of resources,⁽¹⁾ were such as to arouse widespread indignation and to precipitate a growing realization that the laws of the State were seriously deficient in the matter of banking regulation and supervision. A committee was appointed by the legislature, with instructions to make a study of sound banking in other States and countries, and to recommend remedial measures.

The legislative committee, in collaboration with a committee of the California Bankers Association, appears to have made a very thorough examination of the banking laws, not only of the United States and the various individual States, but of Canada and other countries as well. As a result

(1) Eighteenth Annual Report of the Superintendent of Banks, 1927, p. xv.

of its deliberations a law was drafted, incorporating many of what were considered the most desirable provisions of existing statutes elsewhere and certain additional features deemed necessary to meet the special requirements of California. The law was passed in the spring of 1909 and became effective on July the first of the same year. It will not be necessary to present here a detailed summary of this legislation, since the text of the law itself is readily available, but only to outline its provisions for branch banking and to examine certain aspects of the remainder of the act.

Provisions for Branch Banking

An interesting feature of the provisions for branch banking under the California law is that they appear to restrict a privilege already in existence before the passage of the Bank Act of 1909. Up to that time, as pointed out in the preceding chapter, there was nothing in the corporation law to prevent banks from operating offices or "agencies" wherever they liked within the State; although the board of bank commissioners could in fact regulate the establishment of branches, through their power to grant or withhold a license to conduct a banking business in a given locality. Section 9 of the Bank Act, on the other hand, with revisions up to the end of 1931, reads as follows:

"No bank in this state, or any officer or director thereof, shall hereafter open or keep an office other than its principal place of business, without first having obtained the written approval of the superintendent of banks to the opening of such branch office, which written approval may be given or withheld in his discretion, and shall not be given by him until he has ascertained to his satisfaction that the public convenience and advantage will be promoted by the opening of such branch office; provided, that no bank or any officer or director thereof, shall open or maintain any such branch office unless the capital of such bank, actually paid in, in cash, shall exceed the amount required by this act by the sum of fifty thousand dollars for

each branch office opened and maintained in the place where its principal business is transacted; and provided, that for each branch office opened or maintained by any bank, other than a bank transacting only the business described in section 6 of this act (trust companies), in any place in this state other than the place where the principal business of such bank is transacted, the capital of such bank, actually paid in, in cash, shall exceed the amount required by this act in the sum required by this act for every bank hereafter organized in the place where each branch office is to be opened or maintained, exclusive of the capital required for a trust department; and provided, also, that for each branch office opened or maintained by any corporation which has power to transact only such business as is described in section 6 of this act or in section 453x of the Civil Code (trust companies), in any place in this state other than the place where the principal business of such corporation is transacted, the capital of such corporation, actually paid in, in cash, shall exceed the amount required by this act in the sum of fifty thousand dollars; and provided, further, that no branch office may be discontinued without the previous written approval of the superintendent of banks.

"Every bank, before it opens a branch office, shall obtain the certificate of authority of the superintendent of banks for the opening of each of said branch offices. The applicant shall pay for such certificate a fee of fifty dollars; provided, however, that, in order to encourage saving among the children of the schools of this state, a bank may, with the written consent of and under regulations approved by the superintendent of banks and, in the case of public schools, by the board of education or board of school trustees of the city or district in which the school is situated, arrange for the collection of savings from the school children by the principal or teachers of such schools or by collectors. The principal, teacher or person authorized by the bank to make collections from the school children shall be deemed to be the agent of the bank and the bank shall be liable to the pupil for all deposits made with such principal, teacher or other person, the same as if the deposits were made by the pupil directly with the bank.

"Every bank and every such officer or director violating the provisions of this section shall forfeit to the people of the state the sum of one hundred dollars for every day during which any branch office hereafter opened shall be maintained without such written approval."

At first glance the language of Section 9, which down to the first "provided" is the same as the original law of 1909, would seem to indicate

an intention to curb the future growth of branch banking in California. But the very brief discussion of the subject by the legislature at the time the act was passed affords no reason to believe that the far-reaching changes which were to occur in the banking structure of the State were anticipated or even suspected. During the several years preceding enactment of the act of 1909, three State banks conducted by people of Japanese origin, having branches in some of the larger cities, had failed. Moreover, the rapid expansion of the California Safe Deposit & Trust Company, through the opening of city branches, had caused a scandal. The original provision appears to have been incorporated in the law, without debate, to take account of the situation then existing and to add certain safeguards against the abuse of the privilege of operating branches on the small scale already common in various regions of the State. It is possible that some members of the legislature, familiar with the practice of branch banking in Canada, may have foreseen and considered desirable something of the development which has since taken place, but no positive evidence to this effect has been discovered. Whatever the exact intentions of the legislature, however, the Bank Act of 1909 did in fact specifically provide that branch banking as previously practiced might continue to be extended, under definite supervision and control, to operation on a state-wide scale.

It will be observed that the superintendent of banks is vested with power to give or withhold approval for the establishment or maintenance of a branch, in his discretion. There is no qualification of this power, except that he shall not give his approval "until he has ascertained to his satisfaction that the public convenience and advantage will be promoted by the opening of such branch." Moreover, by a decision which will be discussed

more fully in the next chapter,⁽¹⁾ the Supreme Court of California has declared that this section of the law means exactly what it says.

The additional capital requirement for the opening of each new branch, apart from the minimum of \$50,000, is based on Sections 19 and 23 of the act as amended up to the end of 1931. The former lays down the minimum paid-up capital and surplus for commercial and savings banks, or departments, in percentages of deposit liabilities, exclusive of lawfully secured public moneys. For commercial banks (or departments) the requirements are 10 per cent of any amount up to and including \$1,000,000, and 5 per cent of any amount exceeding \$1,000,000. For savings banks (or departments) the minimum is as follows: 10 per cent of any amount up to and including \$1,000,000; 5 per cent of any amount exceeding \$1,000,000, up to and including \$3,000,000; 3 per cent of any amount exceeding \$3,000,000, up to and including \$25,000,000; and 1 per cent of any amount exceeding \$25,000,000. Section 23, in conjunction with Sections 60 and 82, prescribes a minimum capitalization of \$50,000, plus a "surplus and contingent fund equivalent to 25 per cent of such capital stock," for any bank, whether commercial, savings, or combined commercial and savings, "excepting that any savings bank organized without capital stock must have a reserve fund of at least \$1,000,000."⁽²⁾ This minimum of \$50,000 applies in towns and cities of up to 25,000 inhabitants. It is increased to \$100,000 for cities

(1) See discussion of the de novo rule, pp. 45-49 and 53-56.

(2) This exception appears to have been made only for the purpose of legalizing the position of mutual savings banks already in existence and having at least \$1,000,000 of reserves; since it would be hardly possible for a new bank without capital stock to commence business with such an amount of reserves.

of population ranging from 25,000 to 100,000; to \$200,000 for those of from 100,000 to 200,000; and to \$300,000 for cities of over 200,000. If a trust department is included, the paid-up capital and surplus must be increased by \$100,000 in all towns and cities of up to 100,000 inhabitants, and by \$200,000 in cities of 100,000 and over.

The additional capital requirement for new branches based on a percentage of deposit liabilities, unless they should include trust departments, does not represent any burden for a bank large enough to operate a large scale branch system. Although the total requirement must be calculated on the basis of a separate total of deposit liabilities for each city or town, no capital need be assigned to any particular branch. In effect, therefore, under this provision a bank with deposit liabilities of over \$1,000,000 is required merely to maintain paid-up capital and surplus of only 5 per cent (or less, in the case of savings banks or departments with deposits of over \$3,000,000) of combined deposit liabilities of all its branches or offices in excess of \$1,000,000.

On the other hand, the additional capital requirement based on the size of the city or town might act as a deterrent to a bank in the opening of new branches in a large city other than that of its principal place of business. A bank in San Francisco, for example, desiring to establish a large number of branches in Los Angeles, would have to increase its required minimum of capital funds by \$300,000 for each such branch; and unless the offices were fairly large, say with deposits of over \$3,000,000 apiece, the ratio of required capital funds to deposit liabilities of the parent institution might become high enough to call a halt to the program.

The foregoing provisions of the California law, as already noted, are those in effect at the end of 1931. Several changes, of varying importance, were made in the intervening period after 1909. One of the most important was an increase in the minimum capital requirement for all banks and branches from \$25,000 to \$50,000. Another was the stipulation described above, of additional capital for new out-of-town branches equivalent to the amount required for unit banks in the towns or cities concerned. The remainder were for the most part concerned with matters other than branch banking, referring to such subjects as the allocation of the expenses of maintaining the State banking department, examination procedure, and the like. In all essentials the provisions for branch banking have remained much the same as originally enacted in 1909.

Methods of Acquiring Branches

As emphasized in preceding chapters, California had in 1909 a fully developed unit bank service, with only a few scattered banks throughout the State operating one or two branches each in near-by villages or towns. It was therefore possible that any institution wishing to develop an extensive branch organization might encounter difficulty in convincing the superintendent of banks that the "public convenience and advantage" would "be promoted" by the opening of new branches to augment existing banking facilities. Clearly under such conditions the simplest method of procedure was to buy up existing independent banks and operate them as branches.

While the California law prohibits the purchase or ownership of the stock of one bank by another,⁽¹⁾ a bank may nevertheless sell its

(1) Bank Act, Section 37, as amended 1931. Exceptions are provided "to prevent loss to the bank on an obligation owned or on a debt previously contracted in good faith"; and for the purchase under certain conditions of the capital stock of joint stock land banks.

assets to another,⁽¹⁾ consolidate with another,⁽²⁾ or merge with another.⁽³⁾ In each instance the consent of the holders of two-thirds of the outstanding capital stock must be obtained before the transaction can be completed, and provision is made to indemnify any dissenting minority stockholders by means of an impartial appraisal of the value of their interests. When the assets are sold, the purchasing bank assumes also the liabilities (except to the stockholders) of the selling institution. The shell of the latter can then be liquidated and application made to the superintendent of banks for permission to operate a branch. In the case of consolidation under the California law, two or more institutions simultaneously relinquish their charters, form another corporation embracing the assets and liabilities of all, and apply for permission to continue the business of all but one of them as branches of the new bank. A merger involves procedure essentially similar to that of a consolidation, but technically one bank is simply swallowed up by another, the first relinquishing its charter and losing its identity, the second continuing without change of charter.

Various combinations of the methods outlined above, as well as certain new devices, have been employed from time to time for the legal acquisition of branches through the conversion of independent banks. These, however, are properly a part of the developments reserved for discussion in later chapters. It will be sufficient here to remark that all three of the sections of the act of 1909 permitting the acquisition of banks appear to have been designed for purposes other than the spread of branch banking.

(1) Ibid., Section 3l.

(2) Ibid., Section 3la.

(3) Ibid., Section 3lb.

The Bank Act--General Provisions

Two features of a general nature distinguished the Bank Act of 1909. The first was its comprehensive severity, coupled with arrangements for such changes as might later prove to be desirable; the second was its provision for the complete segregation of the commercial, savings, and trust departments of such banks as carried on those classes of business.

The severity of the act was deliberate, designed to provide against every sort of abuse of the privilege of conducting a banking business which had ever occurred in California or elsewhere. At the same time, however, in order to permit the modification of such parts of the law as might prove unnecessarily restrictive, and above all with the view to ensuring its adaptability to the future economic development of the State, provision was made whereby changes in the act might be recommended and considered by the legislature every two years.

A State banking department was established, to supersede the former board of commissioners, and a superintendent of banks was vested with the requisite power and responsibility for the enforcement of the law. This official, who since 1911 has been appointed by and holds office at the pleasure of the governor of the State,⁽¹⁾ is also required to submit recommendations, with his annual reports, for the biennial revision and amendment of the act. On the part of the banks of the State, the California Bankers Association soon after the passage of the law of 1909 set up a legislative committee of its own, to consult and advise with the superintendent of banks in the matter of recommending changes in banking legislation. Thus, theoretically at least,

(1) The original Bank Act of 1909 provided a definite term of 4 years for the superintendent of banks and required that he should be a man of tested banking experience. An amendment of 1911 left both the term of office of the superintendent and his qualifications to the discretion of the governor of the State.

adequate provision was made at the outset for the maximum of safety for the State's banking system and for steady progress, under expert guidance, towards perfection for its banking laws.

Departmentalized banking was made one of the fundamentals of the act, primarily in order to provide protection for savings deposits. This measure was emphasized, no doubt, because of the traditional importance of the savings business in California banking. The law, which in this respect has remained essentially unchanged, requires that any commercial bank accepting savings deposits shall maintain, as a part of the same corporation, what is in effect a separate bank. Section 27 stipulates that "All money and assets belonging to each department, whether on hand or with other banks, and the investments made, shall be held solely for the repayment of the depositors and other claimants of each such department, as herein provided, until all depositors and other claimants of each such department shall have been paid, and the overplus then remaining shall be applied to any other liabilities of such bank."

The most detailed, as well as the most restrictive provisions of the law, apply to savings banks, and equally to the savings departments of departmental banks. Among other things, their funds, whether obtained from depositors or shareholders, may be invested in bonds or other securities, but only of certain specified classes. Only those securities may be purchased which have been certified by the superintendent of banks as meeting the requirements of the law. Loans may be made only "on adequate security of real or personal property, and no such loan shall be made for a period longer than ten years."⁽¹⁾ Bankers' bills or acceptances, as well as com-

(1) Bank Act, Section 67. All quotations from the act are from the text as amended, 1931.

mercial paper, may be purchased or discounted, but only on conditions similar in effect to those applying to such operations by the Federal reserve banks.

Commercial banks, or commercial departments, are permitted to perform the usual functions authorized for such institutions by the laws of other States and by the National Bank Act. An interesting additional authorization, in view of the definite segregation of the savings function, is the provision that up to 35 per cent of the total assets of a California commercial bank or commercial department may be loaned against the security of real estate, for periods up to ten years.⁽¹⁾

Trust companies, or trust departments, are required to confine their activities to the operations strictly germane to such institutions. Since they are not, properly speaking, banks, the provisions of the law concerning them need not be discussed here.

Special Aspects of the Departmental System

As already emphasized, departmentalized banking as such would appear to permit merely the establishment in California of two kinds of banks operating under a single corporate charter. They are separate and distinct with respect to capital funds and all assets and liabilities, but their functions nevertheless and in considerable measure overlap. Commercial banks or departments, as distinguished from savings banks or departments, are permitted to lend a large part of their deposits for purposes which are unquestionably capital investment. They are specifically authorized to engage on a large scale in a class of business usually considered proper only for savings banks, or at most for the investment of a part of the time deposits of non-departmentalized banks. Canadian banks for example, although approximately two-thirds of their individual deposits are classified as

(1) Ibid., Section 47.

"payable after notice," are forbidden to make any real estate loans.

Under the departmental system of California, the safeguards for savings deposits would appear to be as adequate as those applying to the mutual savings banks of the East. This is true, however, only so long as it is definitely and generally understood by savings depositors that their money is not withdrawable on demand. In the case of purely savings institutions, such as the mutual savings banks of the East, such an understanding usually, although not invariably, prevails. Almost everywhere, however, banks doing a commercial business, whether departmentalized or not, are accustomed to pay "savings" or time deposits on demand; and their customers are allowed to expect this privilege, irrespective of the legal rights of the bank. To the general public a bank is a place to deposit money which may be withdrawn at will by check, although a purely savings bank is usually thought of as something substantially different.

Now an important fact in connection with the California State banking system is that about two-thirds of all deposits in departmental banks are "savings." The total of these might under the law be invested in real estate loans of ten years' maturity. Since 35 per cent of the total assets of the commercial department may be invested in the same kind of loans, it becomes clear that a typical departmental bank might be operating, in full compliance with the law, with from 75 to 80 per cent of all its deposit liabilities tied up in long-term loans.

It would be only fair to add, that since the passage of the Bank Act of 1909 the departmental banks of California have not encountered the difficulties in connection with real estate loans which have wrecked so many State and national banks in the great agricultural regions of the Middlewest, Northwest, and South. One of the principal reasons for this, no doubt, is that California has enjoyed during the past twenty years an

economic development of extraordinary diversity and rapidity. Farm real estate values in the aggregate increased rapidly until 1920, as in other States, but afterwards decreased only slightly, as compared with the precipitous decline elsewhere.⁽¹⁾ Under such conditions almost any amount of real estate loans could be made by commercial banks without apparent danger, as was strikingly demonstrated in other sections of the country in the years preceding 1920. But with the decline in real estate values which after a period of rapid increase must always be looked upon as a possible contingency, the advisability of permitting commercial banks, or even departmental banks, to invest such large proportions of their deposits in long-term real estate loans is being seriously questioned by many authorities on banking, especially in view of the tendency noted above, of savings depositors to assume that they are privileged to withdraw their accounts at will.

(1) On the basis of 100 for the years 1912-1914, the index of farm real estate values for California was 167 in 1920 and 160 in 1929. The corresponding indexes for the United States as a whole were: 170 in 1920, and 116 in 1929.

CHAPTER IV

GROWTH OF THE MODERN STATE SYSTEM

For over ten years after the passage of the Bank Act of 1909, branch banking, in the unimportant degree to which it was practiced in California, remained predominantly an activity of comparatively small country banks. In the Bank of Italy, of San Francisco, there was one exception which was later to have far-reaching effects upon the entire banking structure of the State; but generally speaking the period up to 1920 marked the continuation of a gradual development which had been going on for many years. After 1920, branch banking began in increasing measure to be predominantly an activity of large metropolitan institutions, both in the home office cities and in other towns and villages throughout the State. A few country banks continued to operate one or two, or occasionally even three or four, branches apiece, but the volume of their business, as well as the number of banking offices involved, steadily declined in relation to the total banking business of the State. Meanwhile the total number of branches in the State increased rapidly, and the number of banks began to decline. Table 4 shows the number of banks from year to year and the growth in the number of home city and out-of-town branches.

Table 4 - Growth of Branch Banking in California(1)

| Year June 30(2) | Number of banks (State and national) | Number of branches | | Total |
|--------------------|--|----------------------------|-----------------------------|-------|
| | | Within home office city | Outside home office city | |
| 1900 | 269 | - | 6 | 6 |
| 1905 | 471 | - | 10 | 10 |
| 1910 | 676 | 13 | 32 | 45 |
| 1915 | 733 | 33 | 66 | 99 |
| 1920 | 723 | 58 | 121 | 179 |
| 1921 | 732 | 73 | 144 | 217 |
| 1922 | 724 | 168 | 211 | 379 |
| 1923 | 699 | 216 | 263 | 479 |
| 1924 | 675 | 251 | 297 | 548 |
| 1925 | 662 | 307 | 326 | 633 |
| 1926 | 621 | 328 | 338 | 666 |
| 1927 | 544 | 294 | 466 | 760 |
| 1928 | 496 | 334 | 486 | 820 |
| 1929 | 455 | 314 | 538 | 852 |
| 1930 | 437 | 297 | 552 | 849 |
| 1931 | 411 | 271 | 548 | 819 |
| Dec. 31, 1931 | 393 | 262 | 543 | 805 |

- (1) Figures compiled by Federal Reserve Committee on Branch, Group, and Chain Banking, from annual reports of the Comptroller of the Currency and of the California State Banking Department.
- (2) Data for the years before 1920 are not always as of June 30, but only of the nearest date thereto for which information is available.

State-wide Expansion

The spread of branch banking in California has to a large extent resulted from the activities of one man and the bank with which he has been identified--A. P. Giannini and the Bank of Italy (now the Bank of America National Trust and Savings Association). The elementary facts of the rise of this institution, apart from the operations of Mr. Giannini beyond the borders of California, may be summarized as follows:

The Bank of Italy was incorporated under the State law in 1904, its stockholders and customers being assembled mainly from the Italian

speaking population of San Francisco. Its original capital was \$150,000, but by the end of 1905 its capital and surplus had increased to \$310,000 and its total resources to \$1,021,290. The progress of the institution was phenomenal, its resources increasing over a thousandfold in the ensuing twenty-five years, to \$1,055,113,373 at the end of 1929. Its first out-of-town branch was established at San Jose in 1909. Afterwards, slowly at first and then with increasing rapidity, the bank began to build up a state-wide system of branches. By the end of 1919 it had 25 offices, only a few of which were in the head office city of San Francisco. By the end of 1929 the number had increased to 292, of which 40 were in San Francisco and the remaining 252 were out-of-town branches, scattered literally all over the State of California. Meanwhile the institution had become a national bank, but was also allied by common ownership with another branch operating bank under State charter,⁽¹⁾ comprising 39 offices in Los Angeles and 122 in other towns and cities of the State. Altogether the two banks which had been built up in California by the end of 1929 comprised 453 banking offices and aggregate resources of over \$1,400,000,000, to say nothing of their non-banking affiliates engaged in other kinds of business.

Two principal reasons have been put forward to explain the extensive development of branch operations by the Bank of Italy. The first, as expressed by a representative of Mr. Giannini himself,⁽²⁾ was the desire

(1) Bank of America of California, of which the head office was at that time in Los Angeles, although later moved to San Francisco. See discussion in Chapter VI.

(2) Hearings on Branch, Group, and Chain Banking, Committee on Banking and Currency, House of Representatives, 1930, p. 1340.

on the part of the bank's management to extend the services of a large metropolitan institution to country districts, through the building up of a state-wide branch organization. The second reason, usually assigned by other California bankers, was that the Bank of Italy developed a branch organization in lieu of the system of correspondent relationships existing between the other great metropolitan institutions and the country banks throughout the State. After 1920, so the explanation runs, the Bank of Italy began a struggle to establish its position as one of the big banks of California. In order to do so it needed a large number of country correspondents. Most of the existing country banks, however, were already being served by correspondent relationships of long standing with other metropolitan banks. As a newcomer in the field of large scale banking, the Bank of Italy was faced with the prospect of being able to obtain country correspondents only very slowly. This did not suit the plans of its management, so the alternative was adopted of buying up country banks and transforming them into branches.

It is not necessary to reject either of these explanations. The special form of the bank's development was probably a result of both a deliberate plan and the peculiar circumstances existing, and both have worked together to the same end. Moreover, there must be added a third reason, perhaps the most important of all: large scale branch operation was believed to be profitable. The consequences, however, of the process of buying up country banks and turning them into branches, have been far-reaching. Among other things the Bank of Italy immediately began to take over the services previously performed for the purchased banks by their erstwhile city correspondents. When the large banks of San Francisco and

Los Angeles began to lose increasing portions of their correspondent business, some of them began to build up branch organizations of their own. Thus to the successful example of the Bank of Italy was added another reason for the accelerated growth of wide scale branch operation on the part of other metropolitan banks, which embarked upon programs of branch expansion as a means of defending their position.

The Methods of Expansion. - Under the California law, as pointed out in the preceding chapter, branch banking can be expanded by two principal methods, the original establishment of branches as such, and the acquisition of existing banks and their transformation into branches. Both methods have in practice been employed, but the second has been almost universal in the establishment of out-of-town offices, because of the fact already emphasized that a system of unit banks was in well established operation when branch expansion began. An account of the actual procedure followed by the Bank of Italy was given by Mr. James A. Bacigalupi, at that time general counsel of the bank, in his testimony before the House Banking and Currency Committee in 1930.(1)

"Briefly told, the method used by the Bank of Italy in acquiring the stock of a bank prior to the early part of 1917 was as follows: California law forbade and still forbids a bank to purchase the stock of another bank. Section 31 of the bank act provides only for the purchase of the assets of another bank, while section 31a provides for consolidation. The Bank of Italy's practice was to follow section 31, as it never made it a rule to compel the exchange of stock. The selling stockholders were always left free to take all cash or part Bank of Italy stock and part cash in exchange. As a practical thing, therefore, it was never practicable to negotiate for the purchase of the assets of a bank and arrange for the conversion of that bank's business into a branch of the Bank of Italy until after a satisfactory sale of the stock

(1) Op. cit., pp. 1343-1345.

had been consummated. The selling stockholder naturally wanted his cash or Bank of Italy stock in hand before he consented to a transfer of the assets to another bank. As a consequence, one or several of the principal officers of the Bank of Italy gave his or their personal notes, secured by the shares of the bank being acquired, to the Crocker National Bank; paid the selling stockholders; perfected the procedure under section 31 of the bank act and, after consolidation, liquidated the shell of the selling banking corporation, in which was always left in cash and such assets as could not lawfully be taken over by the purchasing bank an amount equal to the capital, surplus, and profits of the selling bank plus such bonus as had been paid, if any, which was just sufficient to pay off the Crocker National Bank. In other words, a few men pledged their personal credit and the stock thus acquired for the benefit of all of the stockholders of the Bank of Italy without charging them anything for whatever personal risk might have been involved in the transaction. In the beginning this procedure, when the number of banks purchased was small, was not burdensome or inconvenient, but later the hardship became heavy and irksome.

"This fact, in addition to several other inconveniences encountered in operation, because of the restriction of the bank act--such as being forced to write off any and all real estate which had been carried on the bank's books for a period of five years, irrespective of its real value, and thereafter likely to become nobody's business in a profit-and-loss account, and so forth, it was decided to incorporate a general corporation under California laws, the beneficial interest in the stock of which corporation would be entirely owned by the Bank of Italy stockholders in exactly the same proportion as their Bank of Italy holdings. In this way this auxiliary could do many legitimate things which the bank could not do, and whatever profit or loss ensued would be enjoyed or borne by the identical stockholders in the exact proportion of their holdings. This auxiliary company was also intended to keep the bank cleaner. Whenever an asset of the bank became doubtful or an apparent loss it could be transferred for a nominal consideration to this auxiliary, where it would become some one's special duty to look after it, and thus the probability of its collection or realization be materially improved. . . . This company, first known as Stockholders Auxiliary Corporation, was incorporated under the laws of the State of California, June 20, 1917, with an original capital of \$500,000. Subsequent to said date Stockholders Auxiliary Corporation became the purchaser of the banks intended to be converted into the Bank of Italy system. . . .

"The name of Stockholders Auxiliary Corporation was changed to National Bankitaly Co. early in 1927."

Mr. Bacigalupi's statement applies primarily to the procedure of a single bank in building up its group of branches one by one. Later on, as will presently appear, the size of individual branch organizations, both in resources and geographic expansion, was also greatly enlarged by what might be described as the method of wholesale mergers and consolidations of existing branch systems.

Out-of-town Branches

The operation of branches, or "agencies," in towns or villages other than the principal place of business of the bank was the common method of early branch banking in California, as in other States. A bank, large or small, merely established a branch where it already had customers or saw good prospects of obtaining new business. Sometimes this was in the same city or town, usually in suburban centers, but frequently also in near-by separate towns or villages.

Some time between 1910 and 1920, however, a distinction began to be made between home city and out-of-town or intercity branch banking. The operation of home city branches appears to have been generally considered a simple and natural activity of metropolitan banks, especially after traffic congestion began to make access to the main financial districts increasingly inconvenient for the residents of suburban centers. But when the Bank of Italy began to operate an increasing number of offices in places outside the corporate limits of San Francisco, this development soon came to be looked upon as a fundamentally different kind of banking. The distinction, in view of modern facilities for communication, is somewhat arbitrary and not always logical. In the present discussion, however, to avoid misunder-

standing, it must be kept clearly in mind; for in California almost the whole of the question of branch banking, as a matter of public concern, has had to do with intercity or intercommunity operations.

Early Attitude of the Superintendent of Banks. - As noted in the preceding chapter, the superintendent of banks is authorized to give or withhold his approval of the opening of a branch office, in his discretion, although he may not give it "until he has ascertained to his satisfaction that the public convenience and advantage will be promoted by the opening of such branch office." There is nothing in this section of the law to compel him to authorize the opening of a branch anywhere, under any conditions. It appears to have been taken for granted, however, that the intent of the law was to permit some extension of branch banking under adequate supervision and control. Such has in fact been the policy of the successive superintendents since the passage of the Bank Act of 1909, although important differences of interpretation have arisen in the matter of control.

The first superintendent of banks, Mr. Alden Anderson, held office for less than two years and was occupied principally with matters of organization in his newly established department. In his one annual report, published near the end of the year 1910, branch banking is mentioned only incidentally. The next incumbent, Mr. W. R. Williams, occupied the office for over seven years, from February 20, 1911, to November 30, 1918. He seems to have considered it necessary to formulate a general policy with respect to a movement which, mainly through the activities of the Bank of Italy, was beginning to assume new and wider aspects. His first important public statement on branch banking appears in his annual report for the fiscal year ending June 30, 1916, which was in part as follows:⁽¹⁾

(1) Seventh Annual Report of the Superintendent of Banks, 1916, pp. vii, viii.

"One of the important economic facts of the fiscal year as it relates to the affairs of state banks was the licensing of fifteen new branch offices.

". . . Ordinarily such branch offices are located within the political subdivision in which the main bank has its principal place of business, and they may be viewed simply as additional tellers' windows provided for convenience of the public. They are justified because of changing centers of business or residential population within the cities and because of the tendency of some municipalities to absorb suburban communities into metropolitan areas. Without the expedient of licensing branch offices some of the more remote and isolated of these districts would be deprived of banking accommodation because of the capital required by the classification of the larger cities.

Economic Advantages of Branch Offices.

"Some of the branch offices have been opened in places far removed from the principal place of business of the parent bank. These branch offices represent an endeavor of the banks to expand the field of their operations beyond the territory which in a strictly local sense is naturally or financially tributary to them. These branch offices offer to the communities in which they are licensed greater assistance, larger loans and more extended credit than local institutions can afford. The justification of their existence rests in this fact and it is noteworthy that in every instance the parent bank entrusts very largely its loaning functions to the discretion of local advisory committees. These, briefly outlined, are the considerations which have directed favorable action in granting to banks the privilege of opening branch offices. Still another cause has often influenced my course in granting the desired license. Occasionally it happens that the general banking tone of a community will measurably be improved by the licensing of a branch office of a well established, safely conducted institution. Involved in the wish of such a corporation to enter the field is its plan to absorb by purchase a stagnant bank and thus to strengthen the credit situation."

Again in 1918 Mr. Williams further reported in part as follows:⁽¹⁾

"One of the most seriously considered and important activities of the state banking department during this period has been the elaboration of its theory of the essential character and value of branch offices in the state banking system. For many years such offices were licensed simply to serve the convenience

⁽¹⁾ Ninth Annual Report of the Superintendent of Banks, 1918, pp. 10, 11.

of the public in the political subdivision in which was located the main office of the bank. Each branch office possessed no further utility than that of an additional teller's window. The broader economic service of the branch office was unthought of until branch offices, under distinct authority of the statute, were licensed in territory remote from the principal place of business of the bank and in districts in no geographical sense contributory either financially or economically to the main bank.

"The establishment of these branches immediately accomplished a public good. Small communities, with rich tributary territory, found themselves the beneficiaries of larger loans and more substantial credit facilities. Interest rates were reduced and stabilized. Local situations were strengthened by the absorption of banks either stagnant or stationary."

Mr. Williams was succeeded on December 1, 1918, by Mr. Charles F. Stern, who in his annual reports does not mention any modification of the branch banking policy outlined by his predecessor in office. Mr. Stern resigned on June 20, 1921, and was succeeded by Mr. Jonathan S. Dodge, who promulgated the so-called de novo rule.

The De Novo Rule

While the main lines of the procedure outlined above for the building up of intercommunity branch organizations were those commonly followed in California, not only by the Bank of Italy but in later years also by other metropolitan institutions, most of the offices in the head office cities of the banks were originally established as branches. These came to be referred to presently as de novo branches, and in the course of time the question arose as to whether this method of expansion should be permitted for intercommunity operations. Only one instance is on record of the actual establishment of an out-of-town de novo branch by a large metropolitan institution,⁽¹⁾ but other applications to do so were made, and a long and

(1) A de novo branch of the Bank of Italy was established in Sacramento in July, 1921.

bitter controversy ensued, over the fundamental principle involved.

So long as the Bank of Italy, or other metropolitan banks, made it a practice to extend branch operations to new territory only by the acquisition of existing banks, it soon became evident that difficulty might sometimes be encountered in purchasing the particular institution required. The obvious alternative was to establish a de novo branch. It was to be expected that the mere declaration of intention to do this would be sufficient to cause the directors and stockholders of a local bank to change their minds about selling the institution, or, what was perhaps more probable, to accept the price offered. Inevitably, under such conditions, it became a matter of very great importance to many of the banks of California, whether or not the banks of other cities should be allowed to establish de novo branches in their vicinity.

Since the law vested the superintendent of banks with wide discretion to give or withhold his consent, this official was placed in a position of peculiar authority and responsibility. On the one hand, he could preserve and promote the interests of independent bankers throughout the State by withholding his permission for the opening of de novo branches, thus either protecting them from the direct competition of banks with head offices in other cities or making it possible for them to obtain the prices demanded for their institutions. By the exercise of a consistent policy of this kind he might materially retard the spread of branch banking, especially after it became generally known that certain metropolitan institutions had embarked upon programs of rapid and wide scale expansion. On the other hand, he might greatly facilitate the extension of branch operations by the opposite policy of liberality in granting applications for the establishment

of de novo branches.

The situation which necessitated a decision on the question of principle arose in 1921, not in connection with branch expansion into country districts but as the result of a bank in San Francisco beginning an aggressive extension of its operations into Los Angeles. Certain bankers in the latter city, who were themselves building up city-wide branch organizations, complained that their territory was being invaded and their rights infringed, since they were in a position to supply all the local banking service needed. The San Francisco institution had been operating so far in Los Angeles only through offices acquired by the purchase of existing banks, but was believed to be contemplating the establishment of de novo branches. Faced with the probability of being called upon to grant or refuse applications for such branches, Mr. Jonathan S. Dodge, at that time superintendent of banks, undertook in November, 1921, to formulate the policy of the State banking department by the promulgation of the so-called de novo rule. This was as follows:⁽¹⁾

"No branch of any bank shall be created in any locality other than the city or locality in which is located the principal place of business of such bank except by purchase of, or consolidation or merger with an existing bank in such city or locality in which it is desired to create or establish such branch bank unless the superintendent of banks in his discretion shall find that the public convenience and advantage require it."

This ruling, in effect, appears to have defined the conditions under which the superintendent of banks would thereafter approve the opening of out-of-town de novo branches, although even here his discretionary authority was reserved. By implication at least, he seemed to say that the pre-

(1) Statement of de novo rule as quoted in Petition for Writ of Mandate, S. F. 11,654, California Supreme Court.

vious existence of a purchased or consolidated or merged bank in any given out-of-town community would be acceptable evidence that "the public convenience and advantage" would be promoted by the continued operation of the institution as a branch office, in accordance with the permissive terms of Section 9 of the Bank Act. But before giving his approval for the opening of a de novo branch, he announced that he would have to "find that the public convenience and advantage require it." Mr. Dodge in the annual report of his department published shortly before his resignation on January 31, 1923, does not refer to the de novo rule directly, but makes the following statement on the subject of branch banking in general and the control of its expansion.(1)

"Branch banking under certain conditions and limitations has been so long permitted and practiced under the laws of this state as well as in other countries and states, that it can no longer be considered an experiment. There is no doubt but that under proper restrictions it has its advantages and enables strong institutions to afford banking facilities in localities which would otherwise be without them. The location of a branch office or the establishment of a new banking institution in a locality where there is a real need for banking facilities not

(1) Thirteenth Annual Report of the Superintendent of Banks, 1922, pp. 12-13.

only benefits the residents of the section or locality but it is of importance to the business and commerce of the state and of the country as well. It not only prevents hoarding with its attendant risk of loss through fire or robbery, but brings the funds which would have been hoarded into general circulation and public use."

Mr. Dodge was succeeded on February 1, 1923, by Mr. John Franklin Johnson, who not only accepted the de novo rule as an expression of policy for the State banking department, but further elaborated its provisions to make them more restrictive.

The Development of Controversy

Meanwhile, wide scale branch operation after 1920 was becoming the subject of increasingly bitter controversy among the bankers of California. The rapid expansion of the Bank of Italy appears to have caused not only the development of competitive branch organizations noted above, but a considerable feeling of apprehension on the part of other independent local bankers for the future prospects of their institutions. As a result there began presently an increasing amount of discussion over the fundamental principles involved in wide scale branch banking on the one hand and comparatively small scale independent local banking on the other, as predominant types of banking structure in the State. Such discussion, however, appears to have been confined, for several years at least, to the bankers. The general public seems to have been indifferent.

The first organized attempt to check the spread of branch banking was the formation in 1922 of the California League of Independent Bankers. For the most part this was composed of officers of the smaller banks of the State, including a good many national banks. A number of banks operating local or near-by branches were included, however, although these were

generally small institutions representing the type of branch banking which had been practiced in California before the passage of the Bank Act in 1909. The officers of the league were also members of the legislative committee of the California Bankers Association, although the two organizations were in no way officially connected.

It is not easy to define exactly the position taken by the League of Independent Bankers. Branch banking as such was apparently not opposed, but only intercommunity branch banking on a large scale. At the same time there appears to have been only a limited amount of opposition to out-of-town branches as such, since these also were frequently operated by small banks, although in fact the whole controversy centered around out-of-town branches. The real issue seems to have been a struggle on the part of the smaller banks, whether operating branches or not, for a favorable position from which to meet the danger of being engulfed by large branch operating metropolitan banks. Naturally the simplest way to get tangible results was through the State banking department.

As already noted, the de novo rule was promulgated in 1921, before the League of Independent Bankers was organized. To what extent the influence of the smaller independent bankers individually had been responsible for the ruling, it is not possible to say; but when the league was formed the de novo rule was heartily endorsed. It was not considered adequate, however, to curb the spread of large scale branch banking. Efforts were made to have the State legislature change the provisions of the Bank Act itself. When these tentatives proved unsuccessful, a still more restrictive ruling was requested of the superintendent of banks, to prevent the chartering of ostensibly independent institutions organized for the purpose of sale

to or merger with large branch operating metropolitan banks, and to strengthen the existing de novo rule. The result was a conference in 1923 between the superintendent of banks on the one hand and the League of Independent Bankers and the legislative committee of the California Bankers Association on the other. Out of this conference came first a compromise regulation known as the three-year rule. The requirement was laid down that before any bank could sell its assets to or consolidate or merge with another bank, it must have been in continuous operation for three years. A second ruling announced that thereafter no more than one out-of-town de novo branch could be established by any bank, while a third declared that none could be established "unless the Superintendent of Banks in his discretion shall find that the public convenience and advantage require it." The second and third of these rulings, it will be observed, had the effect of both reaffirming the de novo rule and extending it.

The League of Independent Bankers did not limit its activities to attempts to have branch banking curbed by the State banking department. An aggressive campaign was organized to oppose the spread of branch banking, not only in California but elsewhere in the United States. One of the first moves of the league was to form an affiliation with a national association organized about the same time in Chicago known as the "United States Association Opposed to Branch Banking." Shortly afterwards, in 1923, the California league cooperated with other organizations in opposing branch banking in Missouri, in connection with the so-called St. Louis case, which was a court proceeding to test the right of national banks to establish branches.⁽¹⁾

(1) See Committee on Branch, Group, and Chain Banking, Branch Banking in the United States.

Another move was the founding on February 1, 1924, of a monthly publication known as "The Independent Banker," for the purpose of influencing public opinion against the spread of branch banking and in favor of independent unit banking. This publication was continued until 1927 and consisted largely of a monthly compilation of quotations, articles, and news items calculated to arouse the opposition of the people of California and elsewhere to banking monopolies, money trusts, absentee ownership of banks, and the like.

Still another activity of the league was the sending of delegations to Washington. Two of these made the journey, the first in 1923 to present the case of the independent banks before the Federal Reserve Board, the second in 1924 to appear before the House Committee on Banking and Currency in connection with the McFadden bill. Both these subjects will be discussed more fully in the next chapter. They are mentioned here only to show the extent of the campaign waged against branch banking.

The accomplishments of the league in stirring up public opinion in California do not appear to have been great. With the State banking department, on the other hand, a considerable degree of success was obtained for the time being, although, as will presently appear, a new superintendent of banks in 1927 swept such accomplishments aside with a single pronouncement of policy. Moreover, some of the most energetic leaders of the league later became themselves officers of large branch operating banks. Before this occurred, however, they were to engage in a successful battle in defense of the de novo rule.

Confirmation of the Power of the Superintendent of Banks

As pointed out above, the controversy over the de novo rule arose in connection with the establishment of out-of-town branches, not in country

districts, but in another large city. Likewise the dispute was finally brought to a head as a result of the same situation. The Bank of Italy as such, apart from the operations of its affiliated or associated institutions, did not make any considerable expansion of its facilities in Los Angeles for several years after 1921, but declared later that it had been prevented from opening new branches there because of the known attitude of the superintendent of banks in his application of the de novo rule.⁽¹⁾ The first important result from the point of view of public policy occurred in 1925. It was an attempt on the part of the Bank of America of Los Angeles, which was known to be closely associated with the Bank of Italy, and later by the Bank of Italy itself, to have the State legislature change the terms of the Bank Act so as to limit the power of the superintendent of banks to withhold his approval for the opening of branch offices. Since the legislative proposals to this effect failed of enactment, they need not be discussed here, but the second action of the Bank of Italy, which also occurred in 1925, was to have important consequences.

It was an appeal to the Supreme Court of California for a writ of mandate directing the superintendent of banks to give his approval for the opening of two de novo branches in the city of Los Angeles, after an application for such approval had already been denied. The brief accompanying the petition of the Bank of Italy also attacked the de novo rule directly, arguing that it was invalid,⁽²⁾

" . . . (a) because contrary to the plain implications of section 9 of the Bank Act; (b) because there is no statutory provision authorizing the promulgation by the superintendent of banks of

(1) See terms of Petition for Writ of Mandate, S. F. 11,654, California Supreme Court.

(2) Ibid.

such a regulation; and (c) if there had been, the statute would have been invalid as involving unconstitutional delegation of legislative power."

Thus the California Supreme Court was called upon to decide, in effect, whether the superintendent of banks was empowered by the law and the Constitution to lay down such regulations as the de novo rule as expressions of policy.

The League of Independent Bankers promptly engaged counsel and joined forces with the superintendent of banks. A voluminous answer was filed to the brief of the Bank of Italy's representatives. It defended both the de novo rule and the right of the superintendent to refuse his approval of the two branches in Los Angeles. The case was heard by the Supreme Court in April, 1926, and in the oral arguments a new issue was injected into the controversy by counsel for the superintendent of banks. He declared in effect that restrictions had to be placed on the opening of de novo branches by the Bank of Italy in order to prevent independent banking in California from being wiped out. Argument with opposing counsel led to the filing of an "addendum to brief for respondent," the last paragraph of which was as follows:⁽¹⁾

"The Bank of Italy, the Liberty Bank, or any other one of the branch banks belonging to this chain, in and of themselves are legitimate, and by themselves, without being externally controlled and dominated from one brain and one organization, could be completely and satisfactorily regulated in the interests of the depositing public and of the state by the Banking Department of the State of California, but the chain banking system of the Bancitaly Corporation cannot be reached for these purposes. The only recourse left open to that Department, if it is to do its duty and serve the public, in so far as yet remains possible, is to halt the growth of the various members of that system, each legitimate in itself, but whose operation as parts of a chain banking system is opposed to public policy and public convenience and advantage

(1) Ibid.

and in its very nature a menace to the people of the State of California. Not only is this huge system monopolistic in its tendency, but the desperation with which it has sought to break down the power of the State Banking Department, as evidenced by this proceeding itself, its mushroom growth, the extraordinary prices it is willing to pay for banks to add to its chain, and the great lengths to which it will go by indirect methods to acquire new banks, all demonstrate that its tendencies for monopoly have not been neglected, but have been and are being used with effectiveness, and we desire here and now to point out to this Court that the attempt in this proceeding to attack the power of the Superintendent of Banks under section 9 of the Bank Act is the opening gun of the final attempt upon the part of this huge octopus to irrevocably fix for all time its monopolistic tentacles upon the banking resources of the State of California."

The Supreme Court of California handed down its decision on December 15, 1926, upholding the superintendent of banks on both his specific and his more general contentions. The court refused to grant the writ of mandate petitioned by the Bank of Italy and held that the de novo rule was a⁽¹⁾

". . . lawful exercise of the powers of the superintendent of banks as a policy to be followed by him and as an indication to applicants for branch bank permits of the showing necessary to be made to entitle them to obtain affirmative action on their applications, but in no sense as restricting, modifying, or controlling his statutory discretion."

More important, perhaps, than the confirmation of the power of the superintendent of banks to promulgate rules for the opening of branches, were the comments of the court upon the discretionary power of this official in general.⁽²⁾

"(8) Furthermore, the Legislature has not attempted to indicate whether, in the use of the word 'public' in the phrase 'public convenience and advantage,' reference was thereby made to the people of the state at large, or to the people of the particular portion of the public affected or to be served by the particular branch bank sought to be established. We incline to the view that the interest of the public immediately

(1) The Pacific Reporter, Vol. 251, p. 798.

(2) Ibid., pp. 789, 790.

contiguous to the proposed branch bank, or of the public reasonably subject to service by the proposed branch, should first be considered by the superintendent of banks, but we are not prepared to hold that the superintendent of banks may not, in the administration of the duties imposed upon him, take into consideration the question whether the convenience and advantage of the people of the entire state would be promoted or retarded by the unlimited establishment of state-wide branch banks. He is a state-wide officer and, as such, is not limited by the statute to purely local considerations in passing upon any application for his written authority. Such being the fact, we do not feel justified in laying down a rule that would remove from his consideration all questions of state-wide policy in the administration of his office."

It is at least clearly implied in these comments that the superintendent of banks has the power and responsibility of exercising a very wide control over the banking structure of the State. The court appears to have taken full account of the considerations outlined in the addendum to the superintendent's brief and to have indicated in a general way that he ought in fact to base his decisions upon his view of the convenience and advantage of the whole State as well as of a particular community. After this decision there remained little room for doubt of the effective power of the banking department either to facilitate the growth of branch banking under State charter, or considerably to curb it. And since the superintendent of banks is appointed by and holds office at the pleasure of the governor, who is elected by the people of the State, branch banking in California in 1926 became more than ever a political issue.

Abandonment of the De Novo Rule

In January, 1927, a new governor assumed office in California and appointed as superintendent of banks Mr. Will C. Wood. Promptly Mr. Wood abolished the de novo rule. He appears to have adopted, in fact, a policy

with respect to branch banking very similar to that of Mr. W. R. Williams in the period 1911 to 1918. Thus essentially all the accomplishments of the League of Independent Bankers in shaping the policy of the State banking department were summarily destroyed.

CHAPTER V

COMPLICATIONS OF FEDERAL RESERVE MEMBERSHIP

No State bank in California joined the Federal reserve system until 1918. Four small institutions applied for and obtained membership in that year, but their combined resources were less than 1 per cent of the aggregate resources of the eligible banks operating under State charter. It was not until the latter half of 1919 that an important movement into the system began, the membership at the end of the year representing over 40 per cent of the aggregate resources of the eligible State banks. Obstacles to membership existed or seemed to exist in both the Federal Reserve Act and the California Bank Act. In the first instance, the State bankers appear to have been doubtful whether they could become members and retain their rights and privileges under the State law, including the right to establish and operate branches. In the second place, the State banks were required by the California Bank Act among other things to keep a considerable part of their legal reserves in cash. Membership in the Federal reserve system would have resulted in their being obliged to add their reserve deposits with the Federal reserve bank to their other non-earning assets.

The first obstacle was removed when Section 9 of the Federal Reserve Act, laying down the conditions of State bank membership, was amended in 1917 to read in part as follows:

" . . . Subject to the provisions of this act and to the regulations of the board made pursuant thereto, any bank becoming a member of the Federal Reserve System shall retain its full

charter and statutory rights as a State bank or trust company, and may continue to exercise all corporate powers granted it by the State in which it was created, and shall be entitled to all privileges of member banks: . . . "

The California law was amended in 1919 to permit State institutions, whether member banks or not, to count as reserves their deposits in the Federal Reserve Bank of San Francisco. Apparently this action removed the principal remaining difficulty in the way of State banks joining the system. During the first six months following the amendment, which became effective on July 1, 1919, about 20 of them applied for membership. These were for the most part the larger institutions, as had already been the case with the movement of State banks into the system in the rest of the country. By the end of 1920 the total number of State members and applicants for membership had increased to 42. These institutions represented only about 12 per cent of the number eligible for membership, but their combined resources made up over 50 per cent of the aggregate resources of eligible State banks, and over 40 per cent of the resources of all State banks. Thus the movement of State banks into the Federal reserve system in California, although somewhat retarded, had by the end of 1920 overtaken the movement in most other States and surpassed it in many of them.

The Elements of the Problem in California

Generally by the end of 1920 the largest banks operating under State charter had begun to build up branch organizations. In most instances their branches were as yet confined either to the limits of their home office cities--usually San Francisco, Oakland, and Los Angeles--or to the immediately surrounding territory. The Bank of Italy, however, as noted in the preceding chapter, had already embarked upon a program of state-

wide expansion. Several other institutions, moreover, as shown by subsequent events, were getting ready at this time to extend their branch operations over wider areas.

The Bank of Italy had become a member of the Federal reserve system in 1919, along with a number of other large institutions. By the end of 1920 several other important branch operating State banks of San Francisco and Los Angeles had joined the system, as well as a few smaller branch operating banks located in country towns throughout the State. All national banks were of course members, as a matter of Federal law.

The total membership of California banks at the end of 1920 consisted of 349 institutions, of which 307 were national banks and 42 were operating under State charter.⁽¹⁾ Their combined aggregate resources were \$1,653,000,000, or about two-thirds of the total banking resources of the State. Of these 349 member banks, the 20 largest had resources of \$1,112,000,000, or over two-thirds of the total for all member banks. Average resources of the remaining 329 were only \$1,643,000 apiece, and the largest of the entire group had less than \$15,000,000. Of the 20 largest member institutions 12 were national banks and 8 were State banks. The Bank of California N. A. was operating 3 branches, 1 at Seattle and 1 at Tacoma, Washington, and 1 at Portland, Oregon,⁽²⁾ but no other national bank in California had any branches at all. Of the 8 larger State member banks, 7 were operating branches, and 4 of these were either already engaged in expanding their branch organizations or were about to embark upon such a program, the Bank of Italy, of course, being the leader in the movement.

(1) Three of these State banks were actually in the position of applicants, and were not admitted to membership until after the end of the year 1920.

(2) These branches are and have been operated virtually as independent banks, in contrast with other cases of branch banking cited.

Although, as already noted, several of the smaller State members were also operating a few branches in country towns throughout the State, branch banking in the modern sense was being practiced or embarked upon mainly by the larger State member institutions and one or two nonmembers.

Such in general terms was the state of affairs in California at the end of 1920 with respect to branch operating membership in the Federal reserve system. In the circumstances it was perhaps inevitable that certain conflicting forces or tendencies should arise which were to give cause for serious consideration of their effects upon the system.

The Case of the Large National Banks. - In the first place, the large national banks, which were not permitted to extend their operations through branches, considered themselves handicapped in their ability to compete, even within the limits of their own cities, with the large State banks, particularly when the latter began the rapid expansion of their branch organizations. This disadvantage was accentuated by the loss of country correspondent business, as more and more country banks, both State and national, were bought up by the large State branch operating institutions. Such a situation created a strong incentive for large national banks to consider giving up their charters and becoming State institutions. Of the 20 largest banks referred to above only one actually left the national system during the years 1921-1926 inclusive, by direct conversion to State charter, but several national banks of considerable size entered the State system by merger or consolidation with State banks. The most important were the Wells Fargo Nevada National Bank in 1924 (which was converted for

reasons having nothing to do with branch banking),⁽¹⁾ the First National Bank of Oakland in 1924, the Merchants National Bank of San Francisco in 1923, and the First National Bank of Bakersfield in 1922. These four institutions alone transferred \$127,220,000 of resources from the national to the State banking system, although under their new status their resources remained within the Federal reserve system. They were nevertheless now in a position of purely optional membership, as were large numbers of smaller national banks which had been bought up by large branch operating State banks.

The Small National Banks. - The second principal cause for concern within the Federal reserve system arose out of the movement of small national banks into the State system. Many of them were indeed bought by branch operating State members, but frequently they left the Federal reserve system also, by merger with nonmember banks or by converting to State charter and then not applying for membership. During the six years 1921 to 1926, altogether 112 national banks were converted or merged into the State system, transferring aggregate resources of \$455,362,000. The effect of this was partly offset by the movement of 13 State banks, with aggregate resources of \$90,684,000, into the national system, but the net loss to the latter during the period was still 99 banks and \$364,678,000 of resources. On account of the mergers of smaller banks with, or their purchase by, member

(1) The Wells Fargo Nevada National Bank was merged on January 2, 1924, with the Union Trust Company, to become the Wells Fargo Bank and Union Trust Company, under the State charter of the latter. The institution has never embarked upon a program of branch banking, merely operating the former Union Trust Company in a separate building a few blocks away in San Francisco since the merger, for reasons of convenience and housing facilities.

institutions, the net loss to the Federal reserve system amounted to only \$123,000,000 of resources, but the results were still too important to be ignored.

Opposition of Independent Bankers. - A third source of difficulty was the growing opposition on the part of small member banks, whether national or State, to the spread of wide scale branch banking. How this opposition was manifested within the State system has already been described in the preceding chapter. Within the Federal reserve system it appears to have been expressed at first by complaints to the Federal Reserve Bank of San Francisco. On December 13, 1921, Governor Calkins of that bank wrote to the Governor of the Federal Reserve Board in part as follows:

"The situation here is such that country bankers in many parts of the state have become seriously apprehensive and are disposed to think that it is hopeless for them to try to continue in business as independent banks and expedient for them to sell to one of the institutions now actively engaged in buying banks for conversion into branches, at the first opportunity."

Throughout the State, the smaller independent bankers appear to have realized that under the California law branch banking could be curbed to only a limited degree. The movement by 1921 and 1922 had already reached such proportions that to stop it would be impossible without the help of outside forces. In the circumstances the logical resort was an appeal to the Federal reserve system to prohibit the expansion of branch operations by its members. Demands to this effect were made with increasing persistence, especially after the formation in 1922 of the California League of Independent Bankers. Among other measures taken, as noted in the preceding chapter, a delegation of the league was sent to Washington in 1923 to argue its case before the Federal Reserve Board. These efforts were seconded by

the nation-wide association opposed to branch banking, and the question became, chiefly among bankers, a matter of nation-wide controversy. Meanwhile, in April, 1922, two members of the Federal Reserve Board had gone to California to study the situation on the ground. Out of their investigations and the subsequent deliberations of the board came a series of regulations.

Federal Reserve Regulations Prior to 1927

The Federal reserve authorities confronted in California a situation in which there were three conflicting elements. These were: (1) the large State member institutions which had come into the system as banks already embarked upon programs of branch expansion; (2) the large national banks that wanted similar branch banking privileges in order to improve their competitive position; and (3) the small independent member banks, both State and national, who wished to curb the spread of branch banking.

It must be borne in mind that prior to 1927 the Federal Reserve Board had no definite legislative authority to regulate branch banking by State member banks. Clearly it could not authorize national banks to operate branches and thus meet the competition of the California State institutions. The Comptroller of the Currency was indeed authorizing a certain number of "additional offices" of national banks within the limits of their home cities, but such concessions were wholly inadequate to establish a satisfactory competitive position for the large national banks in California. With the view to finding at least a partial solution of this problem, the Federal Reserve Board as early as 1915 had recommended changes in the law which would permit national banks to engage in a limited amount of branch operation. Further recommendations to the same effect were made from time to time during

the following twelve years, but prior to 1927 no branch banking legislation for national banks was passed. The Federal Reserve Board, therefore, was left to do what it could to cope with the situation through its power to regulate the establishment of branches by State member banks.

Up to November, 1923, in dealing with applications to establish additional branches within the system in California, the Federal Reserve Board dealt with each case on its merits. No application was made to the board until authorization had been received from the State superintendent of banks, whereupon the board took into consideration such matters as public convenience and advantage, the capacity of the parent bank to organize and coordinate the business of the new office with proper regard to solvency and liquidity, and other matters of a general or specific nature. As far as possible due consideration was given to all questions relating to the proper conduct of the Federal reserve system in general and the local banking system in particular. Expansion of member bank branch organizations was permitted under State supervision and control, in so far as such expansion was considered consistent with sound banking principles.

The opposition of the independent bankers of California to branch expansion continued to increase, however, and the board undertook to formulate certain general principles for the future regulation of the movement, adopting on November 7, 1923, the following resolution:

"WHEREAS, under the terms of the Federal Reserve Act national banks are required to become members of the Federal Reserve System and cannot withdraw therefrom, while State banks may become members by voluntary choice and may withdraw therefrom at will, and,

"WHEREAS, the Federal Reserve Act contemplates a unified banking system in which State and National banks can participate on a basis fair to both, and,

"WHEREAS, State banks in certain States have been permitted by law or regulation to engage in State-wide branch banking, while national banks are restricted by the Federal Statutes from establishing branches or offices beyond the limits of the city in which the parent bank is located, and,

"WHEREAS, the Board believes that this results in an inequitable situation which renders it impossible for national and State banks to exist together in the Federal Reserve System on a fair competitive basis unless the powers of State and national member banks to engage in branch banking are reconciled, and,

"WHEREAS, in the interest of the successful administration of the Federal Reserve System, it appears necessary and desirable to confine the operations of member banks within reasonable territorial limits, and,

"WHEREAS, the Federal Reserve Board is authorized by the Federal Reserve Act to prescribe conditions under which applying State banks may become members of the Federal Reserve System,

"NOW, THEREFORE, BE IT RESOLVED, that the Board continue hereafter as heretofore to require State banks applying for admission to the Federal Reserve System to agree as a condition of membership that they will establish no branches except with the permission of the Federal Reserve Board;

"BE IT FURTHER RESOLVED, that as a general principle, State banks with branches or additional offices outside of the corporate limits of the city or town in which the parent banks are located or territory contiguous thereto ought not be admitted to the Federal Reserve System except upon condition that they relinquish such branches or additional offices;

"BE IT FURTHER RESOLVED, that, as a general principle, State banks which are members of the Federal Reserve System ought not be permitted to establish or maintain branches or additional offices outside the corporate limits of the city or town in which the parent bank is located or territory contiguous thereto;

"BE IT FURTHER RESOLVED, that in acting upon individual applications of State banks for admission to the Federal Reserve System and in acting upon individual applications of State banks which are members of the Federal Reserve System for permission to establish branches or additional offices, the Board, on and after February 1, 1924, will be guided generally by the above principles;

"BE IT FURTHER RESOLVED, that the term 'territory contiguous thereto' as used above shall mean the territory of a city or town whose corporate limits at some point coincide with the corporate limits of the city or town in which the parent bank is located;

"BE IT FURTHER RESOLVED, that this resolution is not intended to affect the status of any branches or additional offices established prior to February 1, 1924, either those of banks at the present time members of the Federal Reserve System or those of banks subsequently applying for membership in said System."

It will be observed that the rulings announced in the resolution adopted by the board were not to come into force until February 1, 1924. Thus a period of nearly three months was allowed for the branch operating State member banks in California to adapt themselves to the new conditions. Several of them did not, however, consider this time allowance sufficient, notably those banks which were actively engaged in building up branch organizations in the areas surrounding San Francisco and Los Angeles. They protested against the rulings of the board, on the ground that unless they cancelled their Federal reserve membership they would be placed in a position of serious disadvantage with respect both to their nonmember competitors and to member banks which had already established intercommunity branch organizations. Because of certain developments presently to be described, the board recognized that there was some justice in this contention. Consequently on January 24, 1924, a special and temporary definition was promulgated of the term "contiguous territory" as applied to San Francisco and Los Angeles. This ruling was to be in effect only until August 1, 1924, but it extended for the time being the area in which branches of State member banks could be established, sufficiently to allow the banks in question to complete at least a part of their programs.

On April 7, 1924, the board announced a revision of its regulation governing membership of State banks and trust companies. The conditions for the establishment of branches laid down in this revision were summarized in the Federal Reserve Bulletin for April, 1924, (page 250) in part as follows:

"(1) The establishment of branches will be restricted to the city of location of the parent bank and the territorial area within the State contiguous thereto (as defined in the Board's resolution of Nov. 7, 1923), except where State banking authorities have certified and the Board finds that public necessity and advantage renders a departure from the principle necessary or desirable."

This new ruling, as applied to the original establishment of branches, was somewhat similar in its effective meaning to the de novo rule as elaborated in 1923 by the California superintendent of banks (see discussion in the preceding chapter). Under it, in effect, the Federal Reserve Board resumed its former policy of considering each case of an application to establish a branch on its merits. Considerable possibilities were still left for the extension of branch banking within the system, until the ruling was superseded by the McFadden Act of 1927.

The McFadden Act

The purpose of the legislation was in part to improve the competitive position of the large national banks by permitting them to operate local branches. At the same time the law was designed to halt the out-of-town expansion of branch operations by all member banks of the Federal reserve system. National banks in towns and cities of 100,000 inhabitants and over,⁽¹⁾ where State banks were allowed to operate branches, were given the legal right to establish and maintain as many branches as they liked within the head office town or city, upon authorization of the Comptroller of the Currency. On the

(1) National banks were also permitted one branch each in towns of 25,000 to 50,000, and two each in towns of 50,000 to 100,000.

other hand, State member banks were in effect forbidden to establish any additional branches beyond the limits of their home office cities after the date of the approval of the McFadden Act (February 25, 1927).

One other provision of this legislation should be noted before considering its consequences in California. A subsection of the act reads as follows:

"(b) If a State bank is hereafter converted into or consolidated with a national banking association, or if two or more national banking associations are consolidated, such converted or consolidated association may, with respect to any of such banks, retain and operate any of their branches which may have been in lawful operation by any bank at the date of the approval of the Act."

It will be observed that any office which had been in existence as a branch of any bank prior to February 25, 1927, could later be continued as a branch of a national bank, if the latter acquired it through consolidation with its parent bank, although the parent bank itself could not be continued as a branch.

Further Growth of Branch Banking in California

The Bank of Italy, which by 1923 was already the largest branch operating bank in California, did not join in the protests of other branch operating banks against the Federal Reserve Board's resolution of November 7. A procedure had been developed by which to continue the expansion of branch operations and at the same time to retain the advantages of Federal reserve membership. This was accomplished by using closely allied (but not technically "affiliated")⁽¹⁾ State nonmember banks to expand branch operations.

(1) According to an opinion of counsel for the Bank of Italy, not tested in the courts because never officially challenged, one corporation is "affiliated" with another in California only when the stock ownership of both is identical.

A detailed description of the way in which holding companies were utilized will be given in a later chapter. The principal steps by which the development of the period 1921 to 1930 was accomplished are summarized in the following paragraphs.

By the beginning of 1927 the various holding companies associated with the Bank of Italy had built up a large branch organization operated by several nonmember State banks. Then during the interval between January 1, 1927, and the coming into force of the McFadden Act on February 25 of the same year, a series of mergers was carried out, whereby the Bank of Italy increased its number of branches from 98 to 276. Its organization was now truly state-wide, its branches being located in about 150 separate cities, towns, and villages. A few days later, on March 1, 1927, the institution was converted into a national bank, under the name of Bank of Italy National Trust and Savings Association.

The bank's program of branch expansion did not stop with that series of transactions, however, but was actively continued by the use of allied nonmember banks. Through numerous mergers another controlled nonmember institution was built up, until at the end of October, 1930, it was operating 161 banking offices. On November 3, 1930, this institution was merged into the Bank of Italy N. T. & S. A. under the new name of Bank of America National Trust and Savings Association. But only 70 of the newly acquired out-of-town branches had been in operation as branches prior to February 25, 1927. These, together with 10 others in San Francisco, making 80 altogether, were taken over by the national bank but the remaining 81 had to be otherwise provided for. Some of them were merged with existing branches of the former Bank of Italy N. T. & S. A., and the others were used to form still another new nonmember bank under State charter.

The methods of branch expansion within the Federal reserve system which have been briefly outlined above have also been employed to some extent by institutions other than the Bank of Italy and its present successor, the Bank of America N. T. & S. A. The whole branch banking movement in California since 1920 has in fact been accomplished largely by means of extensive mergers and consolidations.

CHAPTER VI

MERGERS AND CONSOLIDATIONS

No other feature of the rise of branch banking in California has attracted so much attention throughout the United States as the mergers and consolidations⁽¹⁾ by which the present structure has been chiefly built up. In California some measure of regulation and control of the branch banking movement has been applied, or attempted, by both State and national authorities; and yet, through the device of holding company operations, mergers have been used to accomplish desired ends in spite of all legal and regulatory restrictions. The methods employed have been described in a general way in the preceding chapter, and it will be necessary in the present chapter to examine only those aspects of the development in California which relate particularly to the transition from one system of banking to another. This can be most conveniently accomplished by giving an account of the more important mergers involved in building up the principal branch banking organizations now in operation.

(1) According to the law of California, a "merger" of banks may be described as the absorption of one institution by another, the latter retaining the same charter as before; while a "consolidation" involves the union of two or more banks under a new charter. The words are used with these specific meanings in the present discussion, and it will be observed that practically all the operations referred to were technically "mergers."

Procedure of Mr. Giannini and His Associates⁽¹⁾

Until about 1921 or 1922 the principal method employed by the Bank of Italy in building up its branch organization was the one described in Chapter IV above. That is, an affiliated non-banking company of identical share ownership bought up individual unit banks and merged them into the Bank of Italy, whereupon they became branches of the latter. This method, rendered relatively slow by the restrictions exercised by the Federal Reserve Board, was in course of time largely superseded in the program of expansion carried out by Mr. Giannini and his associates by the method of using closely allied nonmember State banks to build up supplementary branch organizations, which were then merged into the Bank of Italy.

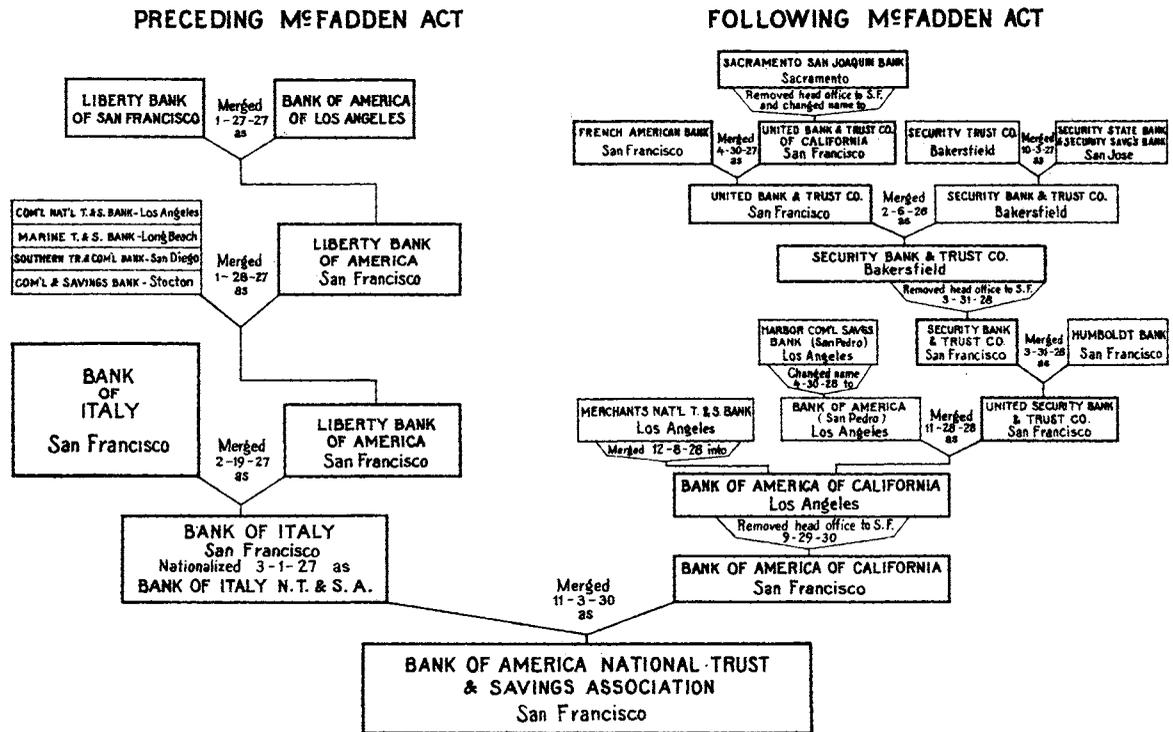
Two main operations of this kind have been carried out since 1921. The first culminated in the series of mergers which took place during the first two months of 1927 and centered around the coming into force of the McFadden Act. The second led up to the merger of November 3, 1930, which created the present structure of the Bank of America National Trust & Savings Association.

Liberty Bank of America. - This was the final name of the non-member State bank utilized to carry out the first of the operations above referred to. The principal mergers by which it was built up are shown on the left hand side of Chart 2.

It will be observed by referring to this chart that the principal

(1) The names of the numerous holding companies employed from time to time to build up the present organization of banks and other enterprises associated with Bank of America N. T. & S. A. are often so much alike as to make it difficult to distinguish one from another. In order to avoid confusion in the following discussion, therefore, the actual names involved will be used only when necessary to make clear the more important developments; while the term "Giannini interests" will suffice to explain in a general way what is meant.

CHART 2 PRINCIPAL BRANCH OPERATING BANKS AND BANKING UNITS MERGED TO FORM BANK OF AMERICA NATIONAL TRUST & SAVINGS ASSOCIATION SAN FRANCISCO



institutions involved in the development were the Liberty Bank, in San Francisco, and the Bank of America of Los Angeles. The former was organized by the Giannini interests in 1921. One of its main activities was to build up a branch organization in the northern half of the State. This was accomplished for the most part by the acquisition of existing country banks.

The Bank of America of Los Angeles appears to have entered into the general plan of the Giannini interests in 1923, when they took options upon blocks of its shares. Exactly when complete control was obtained is not definitely known to the public, although by 1925 the institution was acting in accord with the Bank of Italy in the attempts described in a preceding chapter to have the State legislature limit the power of the superintendent of banks in the matter of disapproving applications to establish de novo branches. At all events, the Bank of America of Los Angeles began in 1923 a rapid expansion of its branch organization, both within the city limits and in the southern half of the State generally. Out-of-town branches were acquired by the purchase through a holding company of existing banks, while those in Los Angeles were for the most part established de novo.

The principal holding companies utilized for the purposes outlined above were the Bancitaly Corporation and its subsidiary, the Americommercial Corporation. In order to make clear the operations of these two holding companies, it will be necessary to outline something of their origin and the reasons for their existence. Bancitaly Corporation was organized in New York by the Giannini interests in 1919, for the purpose of acquiring certain banks there and bringing them under the same general control as the Bank of Italy in California. But unlike the Stockholders Auxiliary Corporation, its share

ownership was not identical with that of the Bank of Italy. Americommercial Corporation was formed in California in 1923 after the purchase by the Bancitaly Corporation of the Commercial National Bank in Los Angeles and the options mentioned above upon blocks of shares of the Bank of America of Los Angeles, to take over the holdings of the Giannini interests in these two institutions. It became in effect the local office of the Bancitaly Corporation, with the same characteristic of not being directly affiliated with the Bank of Italy by identical share ownership.

The Bank of Italy had agreed with the Federal reserve authorities on January 23, 1922, that neither the bank nor its affiliate would acquire in excess of 20 per cent of the stock of any other banks, unless authorized by the Federal Reserve Board to take them over as branches. But in the opinion of the Bank of Italy's counsel neither the Bancitaly Corporation nor the Americommercial Corporation was an affiliate of the Bank of Italy, because share ownership was not identical. If this was the case, then both corporations could be used to acquire banks to be converted into branches of their own nonmember institutions, principally the Liberty Bank and the Bank of America of Los Angeles. This was done on a large scale, and on January 27, 1927, the Bank of America of Los Angeles was merged into the Liberty Bank in San Francisco, which was owned by the Bancitaly Corporation, to form the Liberty Bank of America, as shown in the chart. The operation was completed within the next few weeks, by merging first the Commercial National Bank (which in the meantime had become the Commercial National Trust and Savings Bank) and other owned institutions, into the Liberty Bank of America, and

then the latter into the Bank of Italy, which on March 1, 1927, converted from the State to the national system and became the Bank of Italy National Trust & Savings Association.

Bank of America of California. - This was the final name of the nonmember State bank used to bring into the main banking institution of the Giannini interests the second large group of branches. The principal units which were combined to form the Bank of America of California, as well as the evolution of names and the successive transfers of the head office of the bank from one town or city to another, are shown on the right hand side of Chart 2.

The Giannini interests were definitely known to have entered this development in April, 1927, when the United Bank and Trust Company of California, (1) San Francisco, merged with the French American Bank, San Francisco, under the name of United Bank and Trust Company (merely dropping the words "of California" from the name of one of the merging banks). The French American Bank was owned by the Bancitaly Corporation, and soon after the merger another holding company was utilized for building up a nonmember branch organization. This was the French American Corporation, and its operations were not essentially different from those of the Americommercial Corporation described above. It carried out the purchase of the various banks which were to be converted into branches of, or merged with, the different institutions involved from time to time in the development.

It will be observed that the head office of what constituted the main institution was moved several times in the course of the development.

(1) This bank had been previously built up by merger operations as follows: In March, 1923, the Sacramento-San Joaquin Bank, Sacramento, took over the Union National Bank, Fresno, and the Merchants National Bank, San Francisco; moved its head office from Sacramento to San Francisco; then changed its name to United Bank and Trust Company of California. It was known as the Spreckels Bank.

The move from San Francisco to Bakersfield resulted in bringing the word "Security" into the bank's title. Both the French American Bank and the United Bank and Trust Company of California had been members and the membership had been retained for their successor, the United Bank and Trust Company; then the latter left the system by being merged into the Security Bank and Trust Company of Bakersfield,⁽¹⁾ which was at that time a nonmember institution. The next move, back to San Francisco, was made shortly afterwards, and the next, to Los Angeles, was accompanied by restoration of the name "Bank of America" into that of the nonmember institution then being used to build up another branch organization, by the following procedure: The holding company controlling the United Security Bank and Trust Company, San Francisco, owned a small nonmember bank, the Harbor Commercial Savings Bank, in San Pedro (within the corporate limits of Los Angeles). Permission was obtained in 1928 to change the name of this institution to Bank of America (San Pedro). The United Security Bank and Trust Company then removed its head office to Los Angeles and merged with the Bank of America (San Pedro) under the charter of the latter, which changed its name to Bank of America of California. Shortly thereafter it absorbed the Merchants National Trust & Savings Bank, Los Angeles. The final move back to San Francisco made possible,

(1) This bank, as the Security Trust Company of Bakersfield, had also been a member of the Federal reserve system, until October 3, 1927, when it surrendered its charter and merged with two nonmember banks of San Jose, under the charter of one of the latter, and changed its name to Security Bank and Trust Company of Bakersfield.

under the terms of the McFadden Act, the merger of the Bank of America of California into the Bank of Italy National Trust & Savings Association, to form on November 3, 1930, the Bank of America National Trust & Savings Association.

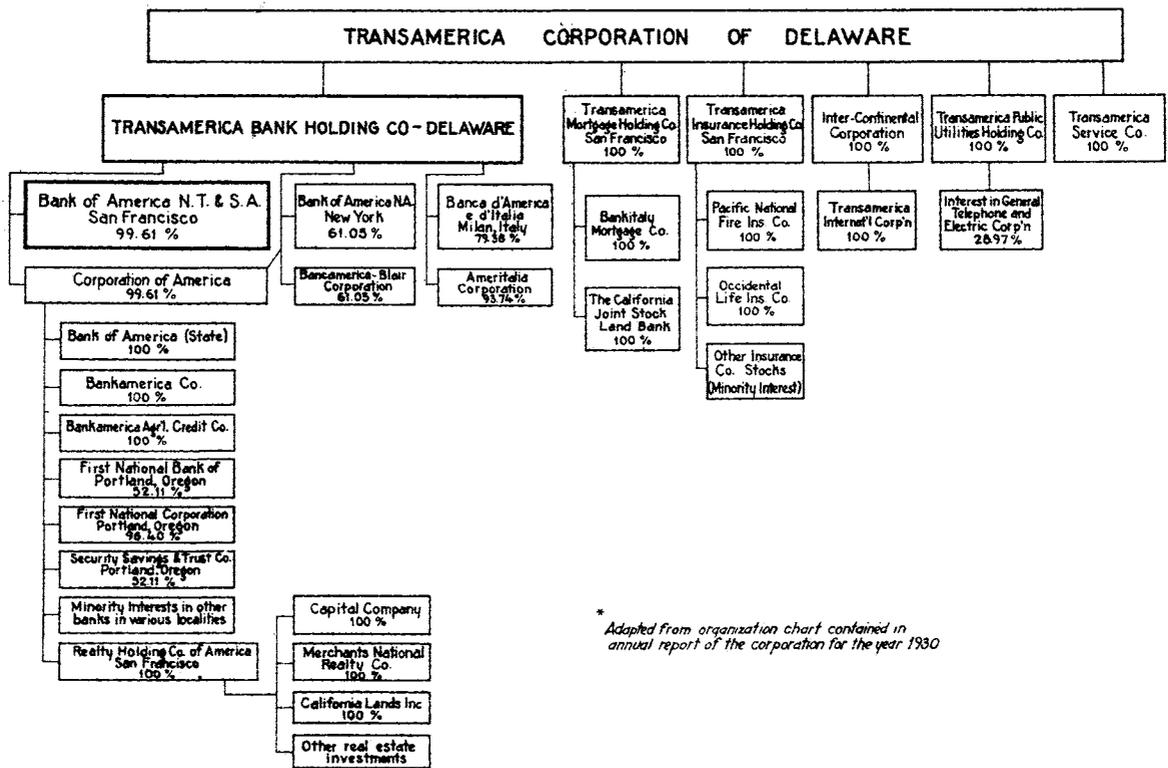
Bank of America. - This is the name of the nonmember State bank which was organized to take over the branches of the Bank of America of California which could not, under the terms of the McFadden Act, be brought into the Bank of America National Trust & Savings Association by the merger of November 3, 1930. On December 31, 1931, it was operating 63 branches, located for the most part in small towns and villages throughout the State. These appear to be administered almost exactly as if they were branches of the larger national bank. The relationship between the two institutions, in fact, does not appear to differ essentially from that which has been common for many years in California and elsewhere, between a national and an affiliated State bank under identical ownership and management.

The period since November, 1930, has been everywhere one of contraction rather than expansion of banking activity. Both the Bank of America N. T. & S. A. and the State chartered Bank of America appear to have completed, for the time being at least, their program of branch expansion. Some of their branches have in fact been merged with other offices, or temporarily closed, although officially still in existence. They are said to be "consolidating their position," in the matter of improving internal organization and administration, marking time meanwhile in the matter of further extending their branch operations. On December 31, 1931, the Bank of America N. T. & S. A. and the Bank of America had combined resources of \$970,068,000 and were oper-

ating through 407 banking offices in 237 cities and towns in California (12 of which were within the corporate limits of other cities).

Evolution of the Holding Companies. - Among the numerous holding companies utilized successively by the Giannini interests to accomplish the results described above, two main sequences are to be distinguished. First are those which have confined their operations essentially to California and have been technically affiliated (by identical share ownership) with the main banking institution. Their evolution has been as follows: Stockholders Auxiliary Corporation was founded in 1917; National Bancitaly Company was founded in 1927 and absorbed Stockholders Auxiliary Corporation; Corporation of America was founded in 1930 and absorbed National Bancitaly Co. The second sequence consists of those companies linking the holdings of the Giannini interests in New York and elsewhere with those in California. The main units have been the Bancitaly Corporation, founded 1919, and the Transamerica Corporation, which was founded in 1928 and absorbed not only the Bancitaly Corporation but also, either directly or through intermediate holding companies, all the bank and other holdings of the Giannini interests in California and elsewhere. The Transamerica Corporation, therefore, served to bring together for the first time the varied and scattered Giannini interests into a single holding company. As of March 9, 1931, its component subsidiary corporations and other holdings were as shown in Chart 3. Since that date it has sold the Bank of America N. A. in New York to the National City Bank of New York and acquired in exchange a substantial minority interest in the latter institution. Other changes have been proposed, and a struggle has occurred for control of Transamerica Corporation, but there has been as yet (end of 1932) no

CHART 3
HOLDINGS OF TRANSAMERICA CORPORATION
 MARCH 9, 1931 *



* Adapted from organization chart contained in annual report of the corporation for the year 1930

essential changes in the interrelationships of the units comprising the banking structure built up by the Giannini interests in California.

Security-First National Bank

This institution is the second largest branch operating bank in California. Its branch organization, covering approximately the southern half of the State, was built up by methods somewhat less indirect than those of the Giannini interests, although the final results were accomplished by means of two great mergers. The principal differences were that the three most important institutions eventually brought together had been members of the Federal reserve system since 1919 and the holding company operations involved were confined essentially to California.

The program of branch expansion was begun in 1921 by an affiliate of the First National Bank of Los Angeles, the Los Angeles Trust and Savings Bank. This was a combination of the kind previously referred to, of a national and a State bank under identical ownership and control. In September, 1922, the name of the State bank was changed to Pacific Southwest Trust and Savings Bank. The out-of-town branch expansion was carried on exclusively by the State institution, since the national bank was not permitted by law to engage in such operations. The method of expansion was through the purchase of existing country banks for conversion into out-of-town branches and the original establishment of branches in the city in which the head office was located. For the expansion through purchase, the holding company employed was the affiliated First Securities Company (organized June 8, 1920).

By September 1, 1927, the Pacific Southwest Trust and Savings Bank

had built up an organization of 100 offices. It was then merged under the existing national charter, with its affiliated First National Bank, to become the Los Angeles First National Trust and Savings Bank.

The second important merger, which completed the present structure of the institution, occurred on April 1, 1929, with the Security Trust and Savings Bank. This was a branch operating State institution which had been developed independently of the other bank. Its branches, 54 in number, were all concentrated in and around Los Angeles. Upon completion of the merger, again under the existing national charter, the new institution assumed its present name, the Security-First National Bank. On December 31, 1931 the Security-First National Bank had resources of \$540,145,000 and was operating through 125 banking offices in 60 cities and towns in California (12 of which were within the corporate limits of other cities).

American Trust Company

This is the third largest of the branch operating banks in California. Most of its branches are concentrated within an area extending not farther than 50 or 60 miles from San Francisco, although one office is located at Los Banos, about 100 miles away. The actual operations carried out in building up the organization were not essentially different from those involved in the development of the Security-First National described above, except that there was involved a change from national to State charter of one principal institution. On December 31, 1931, the American Trust Company was owned by the American Company, which was in turn a subsidiary of the Goldman Sachs Trading Corporation of New York. The American Trust Company had resources of \$250,403,000 and was operating through 93 banking

offices in 34 cities and towns in California.

California Bank

The branch organization of this bank is so closely concentrated in and around the city of Los Angeles that its operations could hardly be described as intercommunity branch banking. It is nevertheless a large institution, operating outside of the Federal reserve system with over 50 branches. The principal steps by which the bank assumed its present structure were as follows: The Home Savings Bank, originally incorporated in 1904, was reincorporated May 26, 1920, after absorbing a number of other banking institutions in and around Los Angeles. On November 12, 1920, its name was changed to California Bank. In 1926 its affiliated holding company, California Group Corporation, acquired control of the National City Bank, Los Angeles, which was absorbed by the California Bank on August 17, 1928. On December 31, 1931, the California Bank had resources of \$100,126,000 and was operating through 54 banking offices in 19 cities and towns in California (11 of which were within the corporate limits of other cities).

The Financial Methods

In building up the great branch banking organizations in California much new capital was required. How this was raised is a part of the story of the phenomenal rise of the securities markets which ended in the autumn of 1929. Bank stocks and the shares of bank holding companies during the period under consideration were particularly subject to speculative activity. Large trading profits were realized, or hoped for, and the desire of the general

public to participate in them was stimulated by the frequent reports of spectacular mergers and consolidations of banks. Stock brokers and bond departments of banks were being constantly provided with material for sales talk that was adapted to influencing the investing and speculating public. Under such conditions it was not difficult for those engaged in the expansion of branch banking organizations to obtain all the additional funds they required, through the issue and sales of shares at rising prices.

In common with many of the largest banks everywhere in the United States, the growing branch operating institutions in California organized securities affiliates. These were frequently used both to underwrite and to distribute the stock of the banks themselves or of the holding companies affiliated with or superimposed upon them. Through the numerous branches of the banks the affiliated securities companies were in a particularly advantageous position to dispose of their share issues among large numbers of their customers. In this manner, as well as through the operations of brokers, an exceedingly wide distribution was obtained for the shares of either the principal branch banking institutions themselves or the holding companies controlling them.

At the same time that funds were so easily obtainable from the general public in payment for share issues, several banks were engaged in keen competition to expand their branch organizations. The result frequently was the payment of very high premiums for the stock

of the unit banks taken over, as well as the negotiation of long-term contracts to engage the services of former officers at high salaries. Sometimes the purchased banks' assets were badly frozen, or serious losses had been incurred. Occasionally the holding company carrying out the operation, instead of paying anything for the stock of the acquired bank, actually obtained a guarantee against loss, although this was very unusual. Under the spur of competition, in combination with the readiness of the public to supply new money, the tendency was to buy banks freely, trusting to the future expansion of business to make them, as branches, profitable in the long run. After the collapse of the stock market boom in the autumn of 1929, many investors in the stock of branch operating bank holding companies suffered heavy losses.

The facts outlined above are matters of common knowledge. They require further considerations here only in those particulars which may be expected to show the distinction between what is essentially a part of branch banking development and what has resulted from more general causes.

The raising of additional capital through the sale of securities by associated or affiliated companies, while characteristic of the branch expansion that has developed in California, is to be considered as but one of the ways in which capital may be obtained for such purposes. Other methods would include the sale of securities through completely independent investment banking houses. Branch organizations might be built up, furthermore, much more slowly, without the use of additional capital. On the other hand, it is doubtful whether the branch expansion

which has occurred in California could have been carried out so rapidly without the stimulus which existed in the rising stock market.

The extensive employment of mergers and consolidations has been another essential element in the rapidity with which the development has taken place in California. If the absorption of unit banks had been accomplished in California by some other method, such as that of absorbing one banking office at a time, the transition would certainly have been greatly prolonged. It could evidently have been made more deliberate, moreover, by appropriate regulation of the operations of bank holding companies.

CHAPTER VII

ORGANIZATION AND ADMINISTRATION

The following discussion will be limited essentially to the large scale intercommunity branch banking which has been in operation in California for only a few years. It is engaged in at present by only five banks at the most; and only three of these, if the State chartered Bank of America be included as an integral part of its larger national affiliate, operate on a geographic scale even approximately comparable to that of the great branch operating banks of Canada and other countries. A glance at the accompanying maps (Charts 4, 5, and 6) will suffice to show the location of the offices of the five institutions.

As far as the available information will permit, the questions considered in this and the remaining chapters of the discussion have to do with the operations of large scale branch systems in California, and not with the methods by which the existing branch organizations have been built up. More specifically, they relate to such matters as the organization and administration of the branch operating banks, the influence of branch banking upon the safety to depositors of the banks of the State as a whole, the quality and cost of branch banking service, the danger of a monopoly of credit through the concentration of banking control, and the earnings and expenses of intercommunity branch operating banks as compared with those of other banking institutions.

CHART 5
SECURITY FIRST NATIONAL BANK OF LOS ANGELES
LOCATION OF OFFICES
DECEMBER 31, 1931

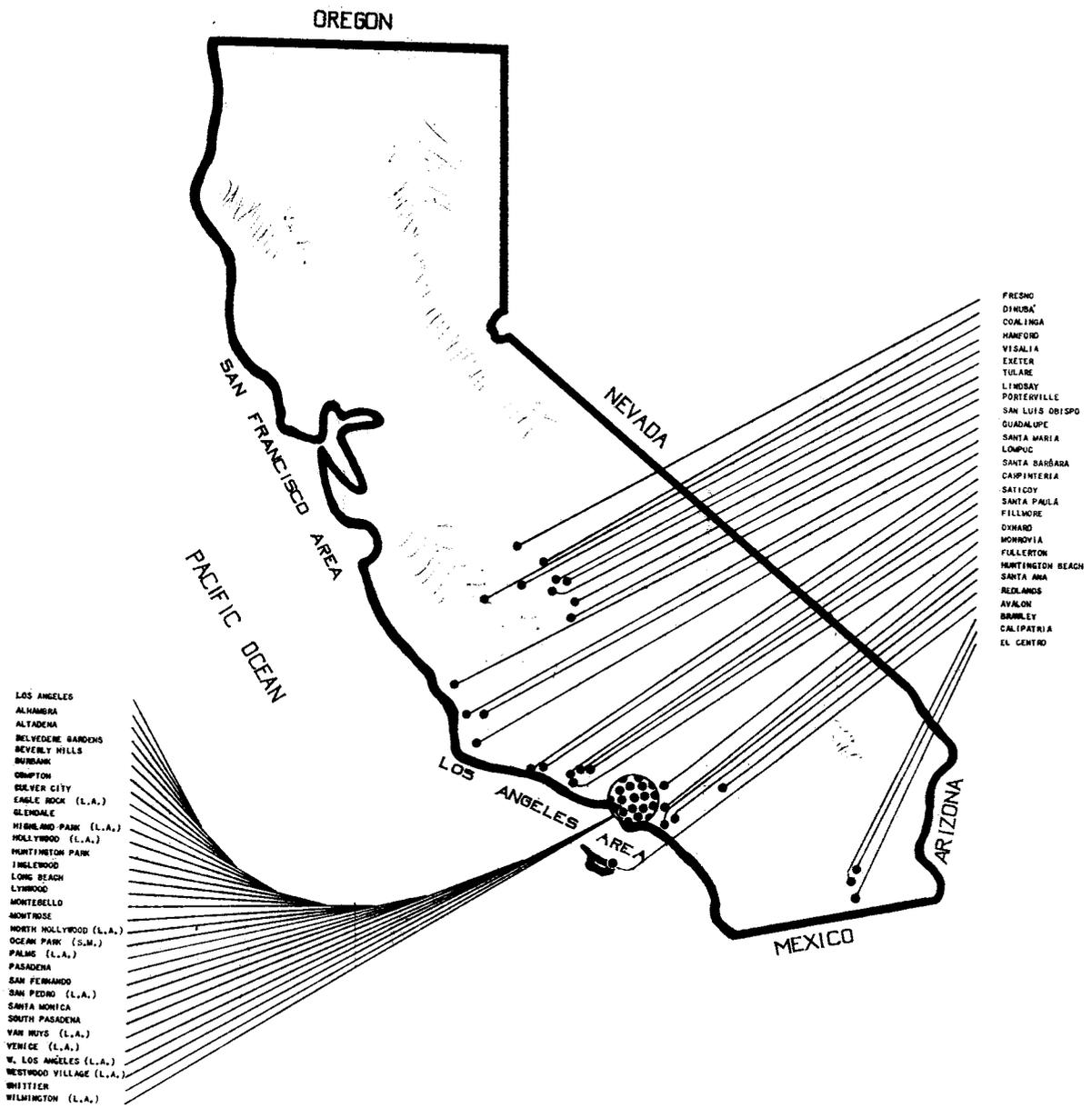
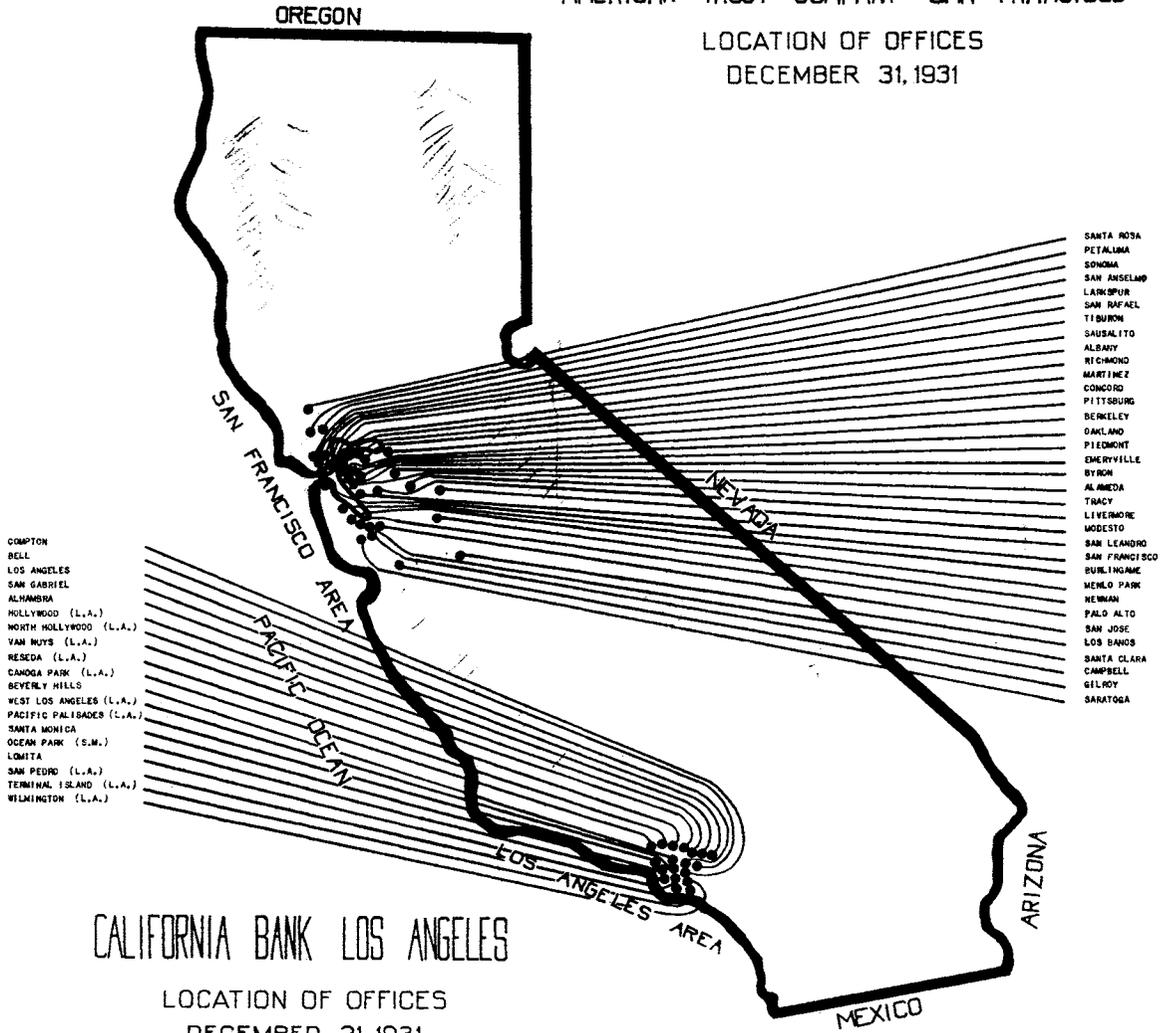


CHART 6

AMERICAN TRUST COMPANY SAN FRANCISCO

LOCATION OF OFFICES
DECEMBER 31, 1931



CALIFORNIA BANK LOS ANGELES

LOCATION OF OFFICES
DECEMBER 31, 1931

It should be remembered, however, that the large intercommunity branch operating banks of California are not as yet fully matured branch organizations. Notwithstanding their wide geographic extension, they still represent in considerable measure merely the continuation of the activities of large aggregations of formerly separate banks. These formerly separate banks have indeed been coordinated into unified organizations, but there has not been sufficient time to permit them to accumulate a fund of experience and establish a record of operations in which their characteristics as branch banking systems can be separately appraised from their other characteristics. In these conditions, any attempt to appraise their performance as branch banking systems must be necessarily inconclusive.

The Present Methods in California

As already suggested, the methods of organization and administration of branch banking in California, are to a considerable extent still in a stage of experimentation and development. This is true both because the advent of the system is comparatively recent and because of the special conditions under which the branch organizations are still operating. The special conditions arise out of the fact already noted, that in a large number of instances the banks now operating as out-of-town branches were only a few years ago independent unit institutions. In turning them into branches, the usual practice has been to retain either the former president or the former cashier as branch manager, as well as to continue the employment of most of the remainder of the staff of the institution in former

capacities. Even the former directors have generally been retained to function as local advisory boards. Such arrangements have resulted partly from the fact that no other operating personnel has been available in sufficient numbers and partly from the policy of the expanding branch organizations to minimize the more obvious effects of the change from one system to another.

Of necessity, therefore, the great majority of the operating personnel of the present branch organizations is made up of officers and employees originally trained in the conduct of independent unit banks. Gradually these are gaining experience in branch operation and acquiring the habits of thought of members of unified institutions composed of multiple banking offices.

As in England and Canada, all the varied activities of the branches of a particular bank are coordinated, supervised, and to some extent directed, by the head office of the institution. The head office itself consists of the usual departments, committees, and officers subsidiary to the board of directors likely to be found in any large bank. Except for ordinary customer relationships, which are usually with the branches, the head office deals

directly with all the larger affairs of the bank, such as the making of investments, transactions with other banks, and the formulation of general policies. Its functions are different from those of the general management of any large bank only in its coordination and supervision of the activities of the branches. The chief executive officer of the head office is the president, and his principal assistants are usually vice presidents. The Canadian and English designation of these officials as the general manager and assistant general managers has not been adopted in California.

Only one institution, Bank of America National Trust and Savings Association, operates on a geographic scale considered by its management wide enough to require resident supervisory officers outside the city in which the head office is located. The branches of this bank in the spring of 1932 were divided into seven districts, each under the supervision of an executive vice president. Four of these were resident in San Francisco and three in Los Angeles. The other large intercommunity branch organizations are in each case administered from the head office directly. It has been the common practice in some of these institutions thus far, however, for the manager of the most important branch in a given district to exercise a sort of informal supervision over smaller neighboring branches, although

the latter are for all purposes of administration and accounting in direct communication with the head office.

An important division of the head office organization is the department of inspections and examinations. All branches are examined at irregular intervals and without notice, and a complete record of the condition and progress of each is kept in the head office. Usually the department of inspections and examinations is separately constituted, and is responsible either to the board of directors or to the most important governing committee of the bank, made up of directors.

In all the larger institutions the head office organization also includes a central credit department, responsible for investigating important applications for the granting or renewal of credits, and a cashier's department, in general charge of routine operations. Subordinate to the latter are the comptrollers's and accounting departments. The principal contacts of the branches are with these departments, either directly or through the executive vice presidents in charge of the various districts.

The activities of each branch are under the immediate direction of a local manager, whose functions correspond approximately to those of the president of a local independent bank, although his more important lending operations must receive the prior approval of the head office. The branches do not keep accounts with each other, and all interbranch transactions are carried out through the head office by means of a daily entry clearance system.

Each branch is allowed a certain lending limit, within which loans may be made without authorization from the head office, depending

partly upon the size of the branch but more upon the experience and proven ability of the local management. An attempt is made to set this limit high enough to cover the great majority of local loans. Where this is not possible, larger borrowers are encouraged to arrange for lines of credit in advance of their needs, so that they may obtain immediate accommodation without referring each transaction to head office.

Accounting practices differ from those likely to prevail in any large metropolitan bank only in the elaborations necessary to coordinate the records of branch activities. Each branch is required to submit various reports to the head office, some daily, some weekly, and others monthly, depending upon the purpose served. The details of branch accounting are more technical than would be suitable for treatment here. It will be sufficient to remark that the methods used in California, particularly in the matter of interbranch clearings and ordinary routine reports, appear already to have become standardized, as far as fundamental principles are concerned, along the lines common among Canadian⁽¹⁾ and English banks. Profit and loss accounting for individual branches is a subject presenting peculiar difficulties, which will be dealt with incidentally in a later chapter on the earnings and expenses of branch banking in California.

The Local Management and Advisory Boards. - It is in the constitution of the local management of the out-of-town branches that the most important departures have been made from standard branch banking practice.

(1) Brief technical descriptions of different phases of accounting practices in Canadian banks will be found in Banking Principles and Practice, by E. L. Stewart Patterson, pp. 147-203 (Textbook of Alexander Hamilton Institute, New York). A more detailed discussion is contained in H. M. P. Eckardt's Manual of Canadian Banking, published by Monetary Times, Toronto.

Before the advent of the new system the public in California, as in other States, had always been accustomed to deal with local bankers fully empowered to act for their institutions upon their own initiative. Consequently the branch operating banks of California have taken special pains from the outset to make the changed ownership and control of purchased banks as little apparent as possible. It was partly with this end in view, as pointed out above, that the officers and employees of the purchased banks were usually retained in approximately their former capacities to operate the branches. Where the purchased bank was of considerable size or importance, the former chief executive officer, in addition to being made branch manager, was frequently given the title of vice president.

Recognizing the traditional importance of personal relationships in the banking business of the out-of-town communities entered, the expanding branch organizations have laid particular stress in public announcements and in advertising matter upon the continued and enhanced power of the local bankers to serve their communities. They have emphasized, for example, the fact that an advisory board has been set up for most of the out-of-town branches, to furnish aid and counsel to the local manager in his more important lending and other operations. This local advisory board, composed usually of former directors of the purchased bank, has continued to hold regular meetings as before and probably to perform most of the functions actually performed by the directors of many independent country banks. Being usually influential men in their communities, the members of the boards have continued to maintain and establish business connections, to obtain credit and other information, and to furnish advice valuable alike to the local manager and to the bank as a

whole. However, they do not generally exercise any definite power over the granting of loans in excess of the lending limit of the local manager, although their recommendations are said to carry considerable weight in determining the decisions of the head office of the bank.

The use of local advisory boards in the manner outlined above appears to be a genuine innovation in wide scale branch banking practice. As far as it has been possible to ascertain, no such methods are used in Canada or other countries where the branch system is predominant. Whether the practice will become permanent in California, it is as yet too early to predict. For the time being, however, the large branch operating banks appear to consider their local advisory boards to be of considerable importance. Testifying before the House Committee on Banking and Currency in 1930, a representative of the Bank of Italy National Trust and Savings Association (now Bank of America National Trust and Savings Association) declared that ". . . The important conscientious service rendered by the bank's approximately 1,700 advisory board members is regarded as a most valuable asset."(1)

External Supervision

As pointed out above, an important feature of the structure and administration of large branch operating banks is their own system of internal supervision, involving thoroughgoing inspections and examinations of branches without prior notice. With offices scattered over wide areas this appears in fact to be indispensable to the sound conduct of branch banking

(1) Hearings on Branch, Group, and Chain Banking, Committee on Banking and Currency, House of Representatives, 1930, p. 1347.

institutions. Such supervision, however, is primarily in the interest of the shareholders as represented by the board of directors; and while the interests of the shareholders with respect to safety are in the long run undoubtedly the same as the interests of the general public as represented principally by depositors, the latter are considered to be entitled to additional safeguards in the form of supervision of the institution as a whole by governmental authorities.

In California, as in other States, there are three separate kinds of external supervision of banks: that of the State banking department for State chartered institutions; that of the Comptroller of the Currency for national banks; and that of the Federal reserve authorities for all member banks, both national and State. In practice, the examinations made by the Comptroller of the Currency and the State banking department, where these are considered efficient, are usually accepted as satisfactory by the Federal reserve authorities.

Wide scale branch banking in California was for several years believed to present special difficulties in the matter of external supervision. The State banking department, in accordance with a requirement of the Federal Reserve Board, undertook for a while to begin its examination of all the branches of a member bank simultaneously. The same procedure was followed when the Federal Reserve Bank of San Francisco itself undertook the examination of a member bank. Before long, however, the number of branches of several member banks had grown so large that simultaneous examinations became virtually impossible. A new method was adopted in February, 1923, when the Federal Reserve Bank's examiners entered only

three offices of one of the large branch operating banks, taking statements from the other branches. Thereafter the new method became the standard practice; that is: To enter the head office of the institution and a few of the largest branches simultaneously, requiring at the same time a condition statement and a complete schedule of all important assets, of every other branch as of that date. After the completion of the examination at the center of the institution, so to speak, all the other branches are examined by making an examination upon entrance and reconciling important items with the statements submitted when the examination of the bank as a whole was begun. Since the branches generally carry no accounts with correspondent banks and keep no investments, examinations are greatly facilitated.

CHAPTER VIII

BRANCH BANKING SAFETY AND SERVICE

Up to the time of writing (end of 1932), no bank in California which could be properly described as a large metropolitan institution, whether operating as a branch organization or not, had been suspended since 1907. During the period 1921-1931, furthermore, for which statistics of bank suspensions have been examined in detail, the banks of California taken as a whole, including banks of all types and all sizes, had a record of suspensions substantially better than that of the banks of the United States as a whole.

Favorable Failure Record in California

A summary record of suspensions for the eleven years 1921-1931 is shown in Table 5.

Table 5 - National and State Bank Suspensions in California and the United States As a Whole, 1921-1931(1)

| | California | United States as a whole |
|--|-----------------|-----------------------------|
| Number of active banks, June 30, 1920 | 720 | 28,499 |
| Number suspended 1921-1931 | 56 | 8,916 |
| Percentage suspended | 7.8% | 31.3% |
| Total loans and investments of active banks, June 30, 1920 | \$1,891,000,000 | \$36,074,967,000 |
| Total loans and investments of banks suspended 1921-1931 | 42,514,000 | 4,716,322,000 |
| Percentage suspended | 2.2% | 13.1% |

(1) Calendar years. Data compiled by Committee on Branch, Group, and Chain Banking, from reports of Comptroller of the Currency, State banking supervisors, etc. See volume entitled Bank Suspensions, 1892-1931. Number of banks in California in 1920 here given is 3 less than the number shown in Table 4, because taken from different sources; but the difference makes only a very slight change in the percentages shown.

It is to be noted, however, that these figures throw little light on the safety of branch banking, as such, in comparison with independent unit banking.

Influence of Economic Conditions. - California has enjoyed in recent years more favorable economic conditions than many other States, particularly those of the great grain growing regions of the Middlewest and Northwest and the cotton planting areas of the South. This is true mainly because of the extent and the diversity of California's natural resources, coupled with the rapid economic development, especially in the southern part of the State, which has taken place since the World War. The production of petroleum in and around Los Angeles, and the moving picture industry in the same vicinity, are examples. Considerable wealth has been brought into the southern part of the State, moreover, by an influx of retired farmers and others, particularly from the Middlewest and Northwest, who have settled in California and transferred all or part of the value of their possessions to their new home. These and other causes have tended to offset the influences which during the past ten or twelve years have caused so much difficulty to the smaller independent banks in many other States.

Effects of State Laws and Supervision. - Another factor which appears to account in part for the safety record of California's banks is the structure and administration imposed upon those operating under State charter, by law. Some of the principal provisions of the Bank Act have already been described in a preceding chapter.

In California the total number of suspensions of State chartered banks in the eleven years 1921-1931 amounted to 30. This was 7.2 per cent of the total number of State chartered banks in operation on June 30, 1920.

The national banks suspended in the State during the same period numbered 26, which was 3.6 per cent of the total number of national banks in operation on June 30, 1920. The ratios of loans and investments of suspended banks to total loans and investments of the two classes of institutions in operation on June 30, 1920, were: for State banks, \$18,527,000 to \$1,091,050,000, or 1.7 per cent; for national banks, \$23,987,000 to \$799,950,000, or 3.0 per cent.(1)

From these figures it appears that in California the safety record of the State banks was better than that of the national banks. In most other States, on the other hand, the safety record of national banks was better than that of State banks. For the United States as a whole the ratios of the number of suspensions during the years 1921-1931 to the total number of banks in operation on June 30, 1920, were as follows: for State banks, 37.0 per cent; for national banks, 16.7 per cent. In terms of total loans and investments the same ratios were: for State banks, 19.3 per cent; for national banks, 6.5 per cent.(2)

Influence of Branch Banking. - Supplementing the foregoing explanations, it may be noted that branch banking in California, by extending the methods and practices of large metropolitan banks to small communities all over the State, may have had influence in the direction of causing local independent bankers, in competing with the branch operating institutions, to conduct their own institutions along conservative lines. That this view was not without standing among banking officials is shown by the following

(1) Data compiled by Committee on Branch, Group, and Chain Banking. See volume entitled Bank Suspensions, 1892-1931.

(2) Ibid.

passage, quoted in Chapter IV above, from the 1916 annual report of the State superintendent of banks:⁽¹⁾ ". . . Still another cause has often influenced my course in granting the desired license. Occasionally it happens that the general banking tone of a community will be improved measurably by the licensing of a branch office of a well established, safely conducted institution."

A special factor contributing, during the period examined, to the safety record of California's banks was the absorption of independent unit banks into the expanding branch organizations. A considerable number of independent unit banks are known to have been taken over in order to prevent their suspension. In certain cases, as previously noted, consolidation took place under a contract by which the absorbing bank, instead of having to make payment to the stockholders of the institution taken over, received either an actual payment from the latter or a guarantee of indemnity against loss.

It is of interest to observe in this connection, that some of the branch operating banks followed the practice, when taking over a unit bank, of selling its slow or doubtful assets to an affiliated or associated holding company.⁽²⁾ At the same time the bank holding companies were realizing large sums from the nation-wide sale of their stock at high prices. They were thus in a position for the time being to absorb heavy losses, if necessary, upon the assets taken over from the unit banks. In such cases, whatever the subsequent history of the holding companies, the investing and speculating public of the United States as a whole made at least temporary contributions to the safety of California's banks.

(1) Seventh Annual Report of the Superintendent of Banks, 1916, p. viii.

(2) See testimony of a representative of Bank of Italy N. T. & S. A., in 1930, quoted in Chapter IV above.

No satisfactory figures are available concerning either the number of suspensions which were prevented in California by the taking over of endangered banks by branch organizations or the amount of resources involved. It is evident, however, that in the period examined the spread of branch banking in California through merging independent unit banks made substantial contribution to the safety record of the banks of the State as a whole. When a bank was in difficulties, and yet not actually insolvent, it was almost always possible, in the circumstances of the period, to have one of the large metropolitan institutions take it over and transform it into a branch. The machinery for carrying out such operations was in existence; the procedure, while cumbersome as far as the law was concerned, had nevertheless been well established and simplified; and since it was widely known that intercommunity branch organizations were being built up by the taking over of unit banks, the obvious measures could usually be taken without danger of impairing the confidence of a given community in its local bank. There is, of course, every reason to believe that the great majority of the unit banks absorbed by the branch operating banks of California were in sound condition when taken over. Those in financial difficulty were undoubtedly the exception rather than the rule.

Branch Banking Service

Most of the controversial discussion of wide scale branch banking, in California as elsewhere, centers around the adequacy and cost of its service to the borrowing public. The following paragraphs, therefore, will be devoted primarily to an examination of California's experience with large branch operating banks as lending agencies.

About the only essential difference in the formalities of negotiating a loan from a well conducted unit bank and from a branch of a branch operating bank occurs when the amount involved is greater than the discretionary lending limit of the branch manager. In either case, the prospective borrower applies for the credit and submits a statement of his financial condition. This is analyzed and probably discussed by the borrower and the unit bankers, or by the borrower and the branch manager, as the case may be; then, in either case, if the amount involved is within the discretionary lending limit of the branch manager, the credit is granted or refused, perhaps after consultation with the local advisory board of the branch or the board of directors of the unit bank, but without other authorization. If the amount is above the discretionary lending limit of the branch, the manager may first consult the local advisory board, but at all events he must forward the application, together with the financial statement and his recommendations, to the proper officer at the head office (who may be a resident supervisor nearer at hand than the head office city) and wait for authorization from the latter before making the loan. The local unit banker, on the other hand, if the credit applied for is within the legal limit of his bank, will either make the loan himself or, when the amount is large, refer the matter to his board of directors.

Delay in granting loans is often avoided, in practice, by both classes of institutions, through the establishment, once a year or oftener, of lines of credit for prospective borrowers in advance of their needs. Once this is done, loans may be made immediately, whether the application is to a branch or to a unit bank. Information is not available as to how

widespread this practice is among unit banks, but an officer of the largest branch operating institution in California has testified that ". . . As a matter of fact, after a branch has been in operation for a year or more, experience shows that easily 80 per cent of the annual commercial credits extended by the branches are renewals under established lines."⁽¹⁾

The adequacy of the service which may properly be demanded from banks as purveyors of credit depends essentially upon whether, within the limits of the funds at their disposal, they grant all applications for loans which are economically justifiable and which will not endanger the safety of the deposits entrusted to them. Consequently, the decision to make or refuse loans is very largely a matter of judgment on the part of the management, and the measure of adequacy of lending service is determined by the degree of competence of the management.

As pointed out in a preceding chapter, the managers of the great majority of the country branches of the large intercommunity branch operating banks of California are themselves former unit bankers. Since they became branch managers, members of the staff of a metropolitan bank, the quality of management that they have displayed has reflected both their own earlier experience as unit bankers and the effect of their new staff connection. In particular, their own judgment as lending officers has been conditioned, where substantial amounts have been involved, by that of the central credit department of the head office, a factor difficult to isolate for separate appraisal. Their effectiveness as lending officers, however, may well have been increased by the fact that the head office relieves them of all work and responsibility in connection with investments and the general financial administration of

(1) United States Congress, 71st, 2nd Session, Hearings under H. Res. 141 on Branch, Chain and Group Banking, House Committee on Banking and Currency, p. 1348.

the bank.

With the passage of time it is to be expected the branches will be managed for the most part by men less well trained in the operation of unit banks and better trained in branch operation. Pending the development of that condition, the evidence afforded by California experience concerning the quality of local management under branch banking must be considered inconclusive.⁽¹⁾ British and Canadian experience have been reviewed in other studies of the Committee.⁽²⁾

Availability of Credit. - It is stated by advocates of the branch system that the lending service it provides is not only as good as that of unit banking but better. Two principal characteristics of branch banking are cited to prove the point. The first is that small branches can and often do make individual loans much larger than could be extended by unit banks in the same communities. The second is that, through the mobility of funds in a branch organization, the aggregate of loans extended in a given community is not limited by the deposits of that community. To establish both these claims, a large amount of data was submitted to the Committee on Banking and Currency of the House of Representatives in 1930 by an official of the Bank of Italy N.T. & S.A.

(1) John Philip Wernette, of Harvard University, after traveling widely over the State of California during the summers of 1930 and 1931 and interviewing persons in small towns, writes as follows with respect to the service to borrowers rendered by branches as compared with unit banks:

"The matter of the wisdom and fairness of the comparative lending policies is one on which judgment is difficult. Any would-be borrower, who has been refused a loan, and there are many of them, will damn the bank as a soulless, unsympathetic institution. The feeling is fairly general in branch towns that the branch banks are stingy with loans. This question was the subject of especially careful inquiry and the writer believes that, on the whole, the branch banks' lending policies have been wise. They have been, it is true, increasingly cautious during the past few years and, in some cases, unduly restrictive. Due to the relatively unprofitable condition of agriculture during the past few years all banks, both branch and unit, have been restricting their agricultural credit. In some cases, where the branch banks have erred on the side of conservatism, local banks have taken over the rejected business. In general, however, the branch banks seem to have refused very few loans which the local banks would have been willing to make."--
Branch Banking in California, pp. 138-139, (a doctoral thesis on file in the library of Harvard University, 1932).

(2) See Branch Banking in Canada and Branch Banking in England.

Large Individual Loans. - A tabulation was presented, showing individual loans made by branches which had formerly been independent country banks. The legal lending limit of the independent banks, based on their paid-up capital and surplus, was indicated in each case, to illustrate the larger credit facilities actually extended to customers after the same institutions had become branches of the Bank of Italy N. T. & S. A. In order to avoid the possibility of revealing the names of borrowing customers, both the location of the branches and the borrowers were designated by numbers and letters respectively. The original tabulation contains data for 70 branch offices. To conserve space, the relevant figures are here reproduced only for each fifth branch as shown in Table 6.

Table 6 - Examples of Loans Outstanding in Excess of Legal Lending Limit to Individual Borrower of Former Independent Bank⁽¹⁾
Spring of 1930

| City | Former legal lending limit of unit bank | Borrower | Business | Credit outstanding from branch |
|--------|---|--|----------------------------------|--|
| No. 1 | \$ 5,000.00 | Mr. A | Cattle | \$ 8,500.00 |
| No. 5 | 42,500.00 | Mr. A Mr. B | Butcher Sheep and farming | 80,000.00 98,968.10 |
| No. 10 | 6,500.00 | Mr. A Mr. B Mr. C Mr. D Mr. E Mr. F | Retired Automobiles do | 13,300.00 12,767.00 11,000.00 10,000.00 11,761.00 10,285.00 |
| No. 15 | 56,500.00 | Mr. A | Hay and grain | 162,000.00 |
| No. 20 | 17,500.00 | Mr. A (also borrows at another branch) | Cattle | 65,000.00 |

Table 6 - Examples of Loans Outstanding in Excess of Legal Lending Limit to Individual Borrower of Former Independent Bank(1)
Spring of 1930 (Continued)

| City | Former legal lending limit of unit bank | Borrower | Business | Credit outstanding from branch |
|-----------|---|----------|--------------------|--------------------------------|
| No. 25 | \$45,000.00 | Mr. A | Orchardist | \$ 50,000.00 |
| | | Mr. B | Realtor | 63,000.00 |
| | | Mr. C | Wholesale grocer | 200,000.00 |
| | | Mr. D | Rancher | 63,000.00 |
| | | Mr. E | Tractors | 50,000.00 |
| | | Mr. F | Realtor | 50,000.00 |
| | | Mr. G | Automobiles | 75,000.00 |
| | | Mr. H | Rancher | 50,000.00 |
| No. 30 | 12,500.00 | Mr. A | Capitalist | 32,000.00 |
| | | Mr. B | Hotel | 30,000.00 |
| | | Mr. C | Automobiles | 70,000.00 |
| | | Mr. D | Garage | 35,000.00 |
| | | Mr. E | Farmer | 48,000.00 |
| No. 35 | 47,700.00 | Mr. A | Lumber | 500,000.00 |
| | | Mr. B | do | 300,000.00 |
| | | Mr. C | Cattle | 120,000.00 |
| No. 40 | 7,750.00 | Mr. A | Stock raiser | 12,000.00 |
| | | Mr. B | Hay and grain | 13,000.00 |
| | | Mr. C | Contractor | 10,000.00 |
| | | Mr. D | Livestock | 11,000.00 |
| | | Mr. E | | 21,000.00 |
| | | Mr. F | | 30,000.00 |
| No. 45 | 5,600.00 | Mr. A | Sheep | 75,000.00 |
| | | Mr. B | Capitalist | 57,000.00 |
| | | Mr. C | Sheep | 45,000.00 |
| | | Mr. D | Automobiles | 51,000.00 |
| | | Mr. E | Hardware and ice | 19,535.00 |
| No. 49(2) | 60,000.00 | Mr. A | Manufacturer | 250,000.00 |
| | | Mr. B | Canner | 2,790,000.00 |
| | | Mr. C | Canner and rancher | 1,481,000.00 |
| | | Mr. D | do | 680,000.00 |
| | | Mr. E | Cooperative | 3,000,000.00 |
| | | Mr. F | Canner | 225,000.00 |
| | | Mr. G | Canner and rancher | 194,000.00 |
| | | Mr. H | Dried fruits | 119,000.00 |
| | | Mr. I | Canner | 111,000.00 |
| | | Mr. J | Dried fruit broker | 213,000.00 |
| | | Mr. K | Dried fruits | 150,000.00 |
| | | Mr. L | Cattle | 166,000.00 |
| | | Mr. M | Building and loan | 1,000,000.00 |

Table 6 - Examples of Loans Outstanding in Excess of Legal Lending Limit to Individual Borrower of Former Independent Bank(1)
Spring of 1930 (Continued)

| City | Former legal lending limit of unit bank | Borrower | Business | Credit outstanding from branch | | |
|--------|---|-----------|-----------------------|--------------------------------|------------|-----------|
| No. 55 | \$20,000.00 | Mr. A | Automobiles | \$ 171,898.73 | | |
| | | Mr. B | do | 43,553.46 | | |
| | | Mr. C | do | 113,466.33 | | |
| | | Mr. D | Farming | 37,000.00 | | |
| | | Mr. E | Realtor and insurance | 82,177.00 | | |
| | | Mr. F | Contractor | 30,000.00 | | |
| | | Mr. G | Capitalist | 36,000.00 | | |
| | | Mr. H | Theater | 55,000.00 | | |
| | | Mr. I | | 23,500.00 | | |
| | | Mr. J | | 33,800.00 | | |
| | | Mr. K | | 25,000.00 | | |
| | | No. 60 | 12,700.00 | Mr. A | Dairyman | 23,000.00 |
| | | No. 65 | 20,000.00 | Mr. A | Capitalist | 31,700.00 |
| Mr. B | do | | | 31,478.00 | | |
| Mr. C | | | | 248,000.00 | | |
| Mr. D | General Merchandise | | | 25,000.00 | | |
| Mr. E | Transportation | | | 30,000.00 | | |
| Mr. F | Merchant | | | 35,000.00 | | |
| Mr. G | Cattle | | | 26,800.00 | | |
| Mr. H | Contractor | | | 70,000.00 | | |
| Mr. I | Orchardist and shipper | | | 25,000.00 | | |
| Mr. J | do | | | 71,763.00 | | |
| Mr. K | Ice and storage | | | 35,000.00 | | |
| Mr. L | Baker | | | 22,000.00 | | |
| Mr. M | Orchardist | | | 36,000.00 | | |
| Mr. N | Orchardist and shipper | | | 37,000.00 | | |
| Mr. O | Merchant | | | 31,647.75 | | |
| Mr. P | Laundry | 31,000.00 | | | | |
| Mr. Q | Rock and gravel | 75,000.00 | | | | |
| No. 70 | 12,500.00 | Mr. A | Orchardist | 175,000.00 | | |
| | | Mr. B | Orchardist and canner | 150,000.00 | | |
| | | Mr. C | Miller | 25,000.00 | | |

(1) Compiled from tabulation submitted to Committee on Banking and Currency, House of Representatives, Hearings on Branch, Group, and Chain Banking, 1930, pp. 1392-1398.

(2) Data for No. 49 used because figures for No. 50 of the original tabulation are incomplete.

To assume that all these borrowers would have failed to obtain so much credit had the branch banking system not been in operation, would hardly be justified. Undoubtedly the needs of some of them would have been and previously were met through the intermediary of independent banks by the city correspondents of the latter. Or, in some instances, the required funds might have been obtained by borrowing from two or more independent country banks. Moreover, certain of these loans were doubtless extended to local divisions of important firms which could readily have borrowed from metropolitan banks, but kept their accounts in near-by branches as a matter of convenience. Consequently it is not possible to determine the exact extent to which the borrowers referred to in the tabulation actually received more ample credit accommodation from the branches than they would have obtained from independent unit banks in the same communities.

Loans in Relation to Deposits. - Another tabulation submitted by the Bank of Italy N. T. & S. A. in 1930 was one showing the amounts of deposits and loans of its branches in the different cities and towns of California. From this tabulation the list shown in Table 7 has been taken, of branch locations where the average of loans outstanding on February 28 of the three years 1927-1929 amounted to over 70 per cent of average deposits.

Table 7 - Loans and Deposits of Selected Branches, Average As of
February 28 for 3 Years 1927-1929(1)

| Name of branch | Loans | Deposits (demand and time) | Ratio of loans to deposits (per cent) |
|-------------------|--------------|----------------------------------|--|
| 1. Bakersfield | \$ 4,986,000 | \$ 6,733,000 | 74.1 |
| 2. Wasco | 843,000 | 450,000 | 187.3 |
| 3. Petaluma | 2,665,000 | 3,069,000 | 86.8 |
| 4. Gilroy | 1,858,000 | 1,424,000 | 130.5 |
| 5. Hollister | 2,874,000 | 1,889,000 | 152.1 |
| 6. Hayward | 2,260,000 | 2,555,000 | 88.5 |
| 7. King City | 1,007,000 | 498,000 | 202.2 |
| 8. Lompoc | 857,000 | 799,000 | 107.3 |
| 9. Los Banos | 1,308,000 | 1,089,000 | 120.1 |
| 10. Madera | 1,207,000 | 1,324,000 | 91.2 |
| 11. Merced | 3,718,000 | 5,082,000 | 73.2 |
| 12. Gridley | 1,345,000 | 1,394,000 | 96.5 |
| 13. Live Oak | 294,000 | 272,000 | 108.1 |
| 14. Marysville | 2,836,000 | 2,834,000 | 100.1 |
| 15. Paso Robles | 751,000 | 943,000 | 79.6 |
| 16. Napa | 3,016,000 | 2,444,000 | 123.4 |
| 17. Redwood City | 2,587,000 | 1,861,000 | 139.0 |
| 18. Watsonville | 2,173,000 | 2,418,000 | 89.9 |
| 19. San Jose | 12,397,000 | 14,491,000 | 85.5 |
| 20. San Mateo | 2,746,000 | 2,799,000 | 98.1 |
| 21. Sunnyvale | 739,000 | 808,000 | 91.5 |
| 22. Santa Clara | 1,902,000 | 2,013,000 | 94.5 |
| 23. Stockton | 13,273,000 | 15,531,000 | 85.5 |
| 24. Ventura | 3,342,000 | 3,805,000 | 87.8 |
| 25. Tracy | 1,015,000 | 1,056,000 | 96.1 |
| 26. Vacaville | 732,000 | 874,000 | 83.8 |
| 27. Woodland | 1,627,000 | 2,283,000 | 71.3 |
| 28. Ontario | 1,578,000 | 1,598,000 | 98.7 |
| 29. Salinas | 5,084,000 | 4,198,000 | 121.1 |
| 30. Shafter | 187,000 | 134,000 | 139.6 |
| 31. San Juan | 182,000 | 200,000 | 91.0 |
| 32. Arcadia | 999,000 | 719,000 | 138.9 |
| 33. Santa Ana | 1,736,000 | 1,625,000 | 106.8 |
| 34. San Fernando | 799,000 | 897,000 | 89.1 |
| 35. Fairfax | 251,000 | 312,000 | 80.4 |
| 36. Crescent City | 880,000 | 1,130,000 | 77.9 |
| 37. Tulare | 823,000 | 1,161,000 | 70.9 |
| 38. Lakeport | 357,000 | 466,000 | 76.6 |
| 39. Daly City | 1,238,000 | 667,000 | 185.6 |
| 40. Burlingame | 1,263,000 | 1,094,000 | 115.9 |
| 41. Healdsburg | 992,000 | 1,053,000 | 94.2 |
| 42. Roseville | 1,165,000 | 1,550,000 | 75.2 |
| 43. San Bruno | 268,000 | 285,000 | 94.0 |

Table 7 - Loans and Deposits of Selected Branches, Average As of
February 28 for 3 Years 1927-1929(1) (Continued)

| Name of branch | Loans | Deposits (demand and time) | Ratio of loans to deposits (per cent) |
|-------------------------|--------------|----------------------------------|--|
| 44. Eureka | \$ 2,277,000 | \$ 2,887,000 | 78.9 |
| 45. Gustine | 540,000 | 562,000 | 96.1 |
| 46. Ukiah | 629,000 | 502,000 | 125.3 |
| 47. Willows | 553,000 | 682,000 | 81.1 |
| 48. Winters | 404,000 | 447,000 | 90.4 |
| 49. Fall Valley | 744,000 | 881,000 | 84.4 |
| 50. Concord | 372,000 | 494,000 | 75.3 |
| 51. Manteca | 581,000 | 463,000 | 125.5 |
| 52. South San Francisco | 330,000 | 459,000 | 71.9 |
| 53. Alameda | 1,834,000 | 2,207,000 | 83.1 |
| 54. San Leandro | 798,000 | 1,111,000 | 71.8 |
| 55. Santa Maria | 346,000 | 1,202,000 | 70.4 |
| 56. Santa Paula | 249,000 | 279,000 | 89.2 |
| 57. Yuba City | 1,437,000 | 1,226,000 | 117.2 |
| 58. Pasadena | 1,462,000 | 1,975,000 | 74.0 |
| 59. Glendale | 1,414,000 | 1,667,000 | 84.3 |
| 60. Brawley | 869,000 | 1,015,000 | 85.6 |
| 61. Escondido | 1,485,000 | 1,255,000 | 118.3 |
| 62. National City | 644,000 | 739,000 | 87.1 |
| 63. Half Moon Bay | 514,000 | 552,000 | 93.1 |
| 64. San Rafael | 700,000 | 973,000 | 71.9 |
| 65. San Anselmo | 161,000 | 213,000 | 75.6 |
| 66. El Centro | 2,787,000 | 2,992,000 | 93.1 |
| 67. Ojai Valley | 490,000 | 669,000 | 73.2 |
| 68. Fillmore | 605,000 | 806,000 | 75.1 |
| 69. Anaheim | 683,000 | 874,000 | 78.7 |
| 70. Pomona | 1,592,000 | 1,526,000 | 104.3 |
| 71. Santa Barbara | 2,539,000 | 2,444,000 | 103.9 |
| 72. Placentia | 446,000 | 499,000 | 89.4 |
| 73. Burbank | 545,000 | 685,000 | 79.6 |
| 74. Walnut Creek | 712,000 | 620,000 | 114.8 |
| 75. Monrovia | 995,000 | 1,190,000 | 83.6 |

(1) Compiled from tabulation submitted to Committee on Banking and Currency, House of Representatives, Hearings on Branch, Group, and Chain Banking, 1930, pp. 1385-1388.

This tabulation illustrates several aspects of branch banking practice. In the first place, it should be recalled that well conducted banks

are generally unable to lend locally as much as 70 per cent of their deposits. During the three years in question, for example, the Bank of Italy N. T. & S. A. as a whole had an average of \$662,553,000 in gross deposits.⁽¹⁾ The average total of loans and discounts outstanding, including call loans, commercial paper, and bankers' acceptances (important items of secondary reserve), amounted to \$418,035,000, or about 63 per cent of gross deposits.⁽¹⁾ Total loans and discounts of all country member banks of the Federal reserve system during that ~~same~~ period averaged 64 per cent of gross deposits in California and 66 per cent in the United States as a whole. Sound banking practice requires that considerable sums be employed as reserves, in the form of cash or balances due from other banks, call loans, and investments of one kind or another. Under ordinary circumstances the only way in which the ratio of local loans to deposits of unit banks can be increased beyond a maximum usually under 70 per cent is by borrowing, a practice which is not generally regarded as sound when pursued as a regular policy. It is fairly certain, therefore, that the loans of most of the branches listed above were substantially greater in relation to their deposits than would have been the case had those branches been independent banks.

In the second place, since the ratio of loans to deposits of the branches referred to was greater than that of the average of the bank as a whole, it follows that other communities were in effect furnishing the funds to make up the excess. Other branches of the bank were of necessity lending, at the time referred to, less than the average amounts in relation to their deposits. This state of affairs doubtless represents to a considerable extent a seasonal situation. At some other period of the year many of the branches

(1) Average reported to the Comptroller of the Currency in response to calls during each of the years 1927, 1928, and 1929.

tabulated would probably have had outstanding substantially smaller amounts of loans, while others, operating in regions then in their season of greatest economic activity, would in turn have been making larger aggregates of loans. The tabulation illustrates, therefore, in effect, the mobility of loanable funds resulting from the operations of a branch system.

The tabulation also provides evidence that the branch system furnishing the data had not drawn off funds needed in small communities for use in large commercial and industrial centers. The branches designated in the tabulation are nearly all located in small towns all over the State. The period 1927-1929, to which the figures relate, was characterized in general by a great demand for funds at high rates in the call money markets, not only of New York and Chicago but of San Francisco and Los Angeles as well. It appears, therefore, that the bank was obliged, presumably as a matter of long run business policy, to take care of the customers of its country branches, irrespective of temporary opportunities for larger immediate profits from funds lent at call in the cities.

Interest Rates to Borrowers. - The Committee has endeavored to ascertain whether the advent of wide scale branch banking in California has or has not resulted in lowering interest rates to borrowers in the rural communities. Available statistical evidence, however, has

been found to be neither comprehensive nor conclusive. In the first place, sufficient data are not available to show in fairly representative manner what the effective interest rates to borrowers in rural districts actually have been at any time. Different banks, both unit and branch operating, follow different practices with respect to the amount of balances which borrowers must leave on deposit without interest. Moreover, it is possible that the customs of banks generally in this respect may have changed during the past ten or fifteen years. Such differences or changes would affect the real interest charged for loans. In some banks service charges are made for granting small loans; in others, where large credits are involved, the prevailing rates are sometimes reduced in order to get the business. Consequently, since it would be a hopeless task to try to allow for all these and other influences tending to change the cost of bank credit, it must be borne in mind that the common or "going" rate on loans is but a rough indication of the real interest charges paid.

With the view to ascertaining what has actually been the movement of the common or "going" rates to borrowers in the rural districts of California during the past ten or fifteen years, two separate inquiries have been made. The first was an examination of the records of notes submitted to the Federal Reserve Bank of San Francisco for rediscount in the spring of the years 1921 and 1932, from selected towns in various regions of the

State. In 1921 the notes came from independent member banks, while in 1932 they were from the branches of metropolitan member banks which had in the meantime succeeded to the business of the same independent institutions. Out of about 30 towns investigated in this manner, 11 were found where there was some evidence that rates had been lowered after the independent bank was converted into a branch. From one town, in the northern part of the State, the notes submitted for rediscount all carried the rate of 8 per cent in 1921 and 7 per cent in 1932. From another, in the southern part of the State, the records definitely indicate a change from 10 to 8 per cent. In the case of 9 other towns, a considerable proportion of the notes bore in 1921 a higher rate than in 1932.

The second inquiry was the sending of a questionnaire by the Federal Reserve Bank of San Francisco in April, 1932, to unit national banks in 30 selected country towns throughout the State. About half the banks questioned were located in towns where there was competition from branches of metropolitan institutions, while the others were not far away from communities served by branches. These banks were asked to indicate "what was the common interest rate to borrowers from your institution or in your community," in the spring of each of the years 1915 to 1932. They were further requested, in the event that any changes had occurred in the period under consideration, to indicate what in their opinion were the principal reasons therefor.

Twenty-six answers to the questionnaire were received. Of these, 21 reported that there had been no material change in the seventeen year period. The other 5 reported reductions, in two cases from 10 to 8 per cent, and for 3 banks, from 8 to 7 per cent. By way of explanation of the change, one institution in the southern part of the State declared that: "For many

years we had no paper in our bank bearing less than 10%. Following the entrance of Branch Banking into the valley the rate was gradually reduced until now the prevailing rate is 8%. At least 95% of our paper bears 8% interest."

A bank in the northern half of the State explained the change as follows:

"From about 1923, there has been a constant decrease from 8% to 7% due to the reduction in rate by competitive banks and to general economic conditions."

The results of these attempts to arrive at the facts cannot be said to be conclusive. In general they seem to indicate that the prevailing rate in rural communities for the past four or five years has been about 7 per cent, except for certain small areas of the State, where the usual charge has been 8 per cent. From ten to fifteen years ago, the rates in the same areas appear frequently to have been 8 per cent and 10 per cent respectively.

As previously emphasized, however, the prevailing rates on customers' loans may not be taken as an accurate measure of the effective rates paid. Even if a change in effective rates could be shown to have taken place since the advent of branch banking, it would not necessarily follow that such change has resulted from branch banking. Other influences have been at work during the past ten to fifteen years, both in California and elsewhere, which might tend to lower interest rates, notably the pronounced improvement in means of communication. With the greater ease of transportation resulting from good roads, the price of almost everything in rural districts, including bank credit, has probably been affected to some extent by competition from the cities. Moreover, California has been for many years gradually passing from the stage of pioneer development into that of an older, more settled community; and generally such a "settling down" process results in lower interest rates on loans.

For these and other reasons, no positive conclusion appears to be possible concerning the influence of branch banking in such changes as may have occurred in effective interest rates to borrowers in California.

The Monopoly Question. - The facts of banking concentration in California have already been set forth in sufficient detail to show that wide scale branch operation there, as in Canada and other countries, tends to result, through mergers and consolidations, in larger and larger and fewer and fewer banks. Up to the present time, however, it is clear that the different branch operating systems in California are in active competition with one another. Furthermore, there are still several hundred different banks operating in the State, and even those towns which are served only by branches of one institution are usually near enough to independent banks in near-by places for convenient access to them by existing means of transportation.

As bearing on the prospective degree of banking concentration in California, material presented in preceding chapters may here be recalled. This showed that the present degree of such concentration was attained with extraordinary speed in consequence of a combination of circumstances that prevailed at the time when it was going on. These may be summarized as: (1) the banking laws of California; (2) the personality and the ambition of individuals; (3) the adaptability of the State's economic activity to branch banking, because of diversification; (4) the extensive use of affiliated or associated holding companies to buy unit banks, to raise money by the sale of stock, and to accomplish wholesale mergers and consolidations; and finally (5) the existence for a considerable period of a rapidly rising stock market, making possible the sale at high prices of the shares of banks and bank holding companies.

CHAPTER IX

THE COST OF BRANCH BANKING IN CALIFORNIA

Experience with branch banking in California up to the present has not been sufficient to warrant conclusions as to costs of operation. Comparisons between the earnings and expenses of the large branch operating banks and those of other banks are not conclusive. The branch banking movement has progressed so rapidly that the branch banking institutions have had considerable expenses of a non-recurrent kind in perfecting details of their administrative structure. On the other hand, deductions from earnings on account of losses have been decreased in the largest branch operating banks by the use of affiliated non-banking companies to take over slow or doubtful assets.⁽¹⁾ It is impossible to determine the extent of either the increase in operating costs attributable to transition or of the decrease in losses through transfers to affiliates. Consequently comparisons of costs and profits made between wide scale intercommunity branch operating banks and other banks are subject to reservations.

Large Intercommunity Branch Operating Banks vs. All Other National Banks

In an attempt to arrive at some comparison, however, earnings and expenses and loans and investments for the four years 1927-1930 have been aggregated and averaged for the three largest intercommunity branch operating banks in the State, or their predecessors, on the one hand, and for all other national banks in the State, on the other. The three branch operating

(1) See testimony of a representative of Bank of Italy N. T. & S. A., Chapter IV above.

banks during the period referred to may be considered as a state-wide branch banking system made up of two national banks and one State bank. These are the Bank of America N. T. & S. A., the Security-First National Bank, and the American Trust Company. All three are members of the Federal reserve system. The three branch systems operated through twice as many banking offices as the "other national banks," with nearly twice the amount of loans and investments. Consequently the average size of the offices of each system is roughly comparable. The results of this calculation are shown in Table 8.

Table 8 - Earnings of Three Large Intercommunity Branch Operating Banks Compared with Other National Banks in California, Average of Four Years 1927-1930⁽¹⁾

| | Three large branch operating banks | Other national banks ⁽²⁾ |
|--|------------------------------------|-------------------------------------|
| <u>Annual averages of:</u> | | |
| Number of banking offices (banks and branches) | 499 | 249 |
| Loans and investments | \$1,280,964,000 | \$736,265,000 |
| Capital, surplus, undivided profits, and reserves (except reserves for expenses, etc.) | 153,302,000 | 112,960,000 |
| <u>Earnings and expenses per \$100 of loans and investments</u> | | |
| Interest on loans and investments | \$5.36 | \$5.61 |
| Other earnings | <u>1.52</u> | <u>0.92</u> |
| Total earnings | 6.88 | 6.53 |
| Salaries and wages | 1.55 | 1.50 |
| Interest paid on deposits | 2.55 | 2.12 |
| Other expenses | 1.36 | 1.14 |
| Net losses | <u>0.36</u> | <u>0.68</u> |
| Total expenses and net losses | 5.82 | 5.44 |
| Net profits | 1.06 | 1.09 |
| <u>Net profits per \$100 of invested capital</u> | 8.90 | 7.13 |
| <u>Ratio of time deposits to total deposits</u> | 64.7% | 37.0% |

(1) For the method by which these schedules were drawn up, see Committee on Branch, Group, and Chain Banking, Banking Profits, 1890-1931.

(2) A few small national banks were excluded because complete figures could not be obtained; but since the tabulation has to do only with averages of aggregates, the omission makes no appreciable difference.

When expressed as percentages of loans and investments, gross earnings were higher for the branch operating banks than for the other banks, the difference arising, however, not from interest charges, but from other earnings. Operating expenses were likewise higher for the branch systems, with the result that net profits per \$100 of loans and investments were nearly the same for both groups of banks. Average net profits on invested capital were higher for the branch operating banks than for the other banks because they had a smaller invested capital in proportion to loans and investments.

Interest on loans and investments was substantially lower for the branch systems than for the "other national banks." But since the data do not show whether the ratio between investments and loans was approximately the same in each case or the yield on the investments the same, it does not necessarily follow that the actual interest collected on loans was at a lower rate in the branch systems than in the "other national banks."

Other earnings of the branch systems were nearly 65 per cent higher than those of the "other national banks." This is probably accounted for by the larger number of functions performed by the branch systems. A considerable part of the difference is doubtless represented by commissions on the purchase and sale of securities for customers. But if earnings from services other than strictly banking business were greater in the branch systems, such services might naturally be expected to result in greater operating expenses. And in fact, operating expenses, as embodied in the two items of salaries and wages and other expenses, were higher, although the difference in the case of salaries and wages was very small.

Interest paid on deposits was substantially higher for the branch systems, reflecting in part the higher ratio of time deposits to gross deposits. Net losses appear to have been substantially lower for the branch systems. But this may be accounted for, in part at least, by the custom of the branch operating banks already emphasized, of turning over slow and doubtful assets to affiliated non-banking companies when converting unit banks into branches.

Altogether the comparison made possible by these tabulations is inconclusive. It does appear to indicate, however, that there has been very little difference in cost per unit of business, between the large intercommunity branch operating banks in California and the other national banks of the State. Economies of operation of the branch systems have not so far been demonstrated by the statistical information available, although it is possible that expenses incident to the building up of the branch organizations themselves may have offset any economies otherwise effected.

Country Branches and Country Banks

If there is any considerable saving in the operating costs of wide scale intercommunity branch banking as compared with unit banking, the difference should be apparent in the results of country branch and country unit bank operations. Unfortunately, for reasons which will appear presently, accurate and comprehensive comparisons between the two types of banking cannot be made. A statistical compilation has nevertheless been attempted, in the hope of indicating approximately the differences between at least a few items of earnings and expenses. Statements for each of the five years 1926-1930 of the earnings and expenses and the principal balance sheet items (averages of the condition statements issued during the year) were obtained

for 31 country branches of the three principal intercommunity branch operating banks of California. These branches were selected by the Federal Reserve Bank of San Francisco with such geographical distribution as to constitute, as far as possible, a representative cross-section of country branch banking in the State. At the same time, to provide a basis for comparison, corresponding data were assembled for 30 national banks operating either in the same towns as the branches or in the nearest neighboring places.(1)

When the statements were received for the 31 branches, it was found that, while the principal balance sheet items and the ordinary items of earnings and expenses appeared to have been reported on the same basis by the three institutions, certain other items obviously had not. These were (1) interest allowed the branches on balances due from the head office, (2) interest charged the branches on balances due to the head office, and (3) the charge against the branches for their share of the expense of maintaining the head office. These items in branch accounting are of necessity determined arbitrarily, and in fact each of the three branch operating banks concerned uses an accounting basis differing widely in some particulars from those of the other two. In order therefore to obtain averages of earnings and expense data for the 31 branches which would be approximately consistent, it was necessary to adjust these items to a common basis. This has been done by combining some of the methods of the three banks and using composite percentages as follows: (1) interest allowed on balances due from head office, 5 per cent; (2) interest charged on balances due to head office, 5 per cent; and (3) charge for head office supervision, 0.21 per cent

(1) The schedules referred to in the report on Banking Profits, 1890-1931 of the Committee on Branch, Group, and Chain Banking were used for this purpose.

(approximately) of earning assets.(1)

With these adjustments, Table 9 shows average annual figures for the five year period 1926-1930 of the principal earnings and expenses and balance sheet items for the 31 branches and the 30 national banks.

Table 9 - Earnings and Expenses and Balance Sheet Items
Average of Five Years 1926-1930

| | Average for 31 branches | Average for 30 unit banks |
|---|----------------------------|------------------------------|
| <u>Earnings and Expenses</u> | | |
| Interest on loans and investments | \$ 33,561 | \$ 96,885 |
| Interest on balances due from head office | 14,824(2) | - |
| Other earnings | <u>2,143</u> | <u>17,531</u> |
| Total earnings | 50,528(2) | 114,416 |
| Salaries and wages | 10,401 | 27,429 |
| Interest paid on deposits | 17,927 | 36,602 |
| Interest on balances due to head office | 2,237(2) | - |
| Supervision of head office | 1,626(2) | - |
| Other expenses | 7,403 | 20,276 |
| Net losses | <u>1,297</u> | <u>13,900</u> |
| Total expenses and net losses | 40,891(2) | 98,207 |
| Net additions to profits | 9,637(2) | 16,209 |
| Loans and investments | 488,243 | 1,593,607 |
| Due from head office | <u>296,470</u> | <u>-</u> |
| Total earning assets | 784,713 | 1,593,607 |
| Capital, surplus, and undivided profits | - | 218,740 |
| Time deposits | 483,877 | 781,228 |
| Total deposits | 763,247 | 1,664,890 |
| Due to head office | 44,735 | - |

(2) Items in which adjustments have been made, as described in the text.

In order to determine the average rate of earnings and expenses

(1) This is approximately the percentage actually assessed against the branches of the largest intercommunity branch operating bank for head office supervision, on the basis of several years of experience.

of the branches and the unit banks, it is necessary, since the branches have no capital assigned to them, to adopt as the basis of calculation their earning assets. For the branches this means in effect their loans plus their balances due from head office, since they do not generally have any other investments. If they were unit banks presumably they would have capital funds to dispose of; but any increase in earning assets which they might have on this account would probably be more than offset by the funds immobilized in buildings and fixtures and the reserves of cash and deposits in the Federal reserve or other banks required by law. Generally the bank buildings of the branch operating banks are owned by an affiliated company, to which the branches pay rent.

It will be observed that the average amount of earning assets of the unit banks referred to in the tabulation is approximately twice as large as that of the branches. The difference was unavoidable in the process of selecting national banks located as near as possible to the branches. But since it has been shown in another part of the Committee's report⁽¹⁾ that the expenses and losses of unit banks with earning assets of from \$1,000,000 to \$2,000,000 are generally lower per unit of business transacted than those of unit banks with from \$500,000 to \$1,000,000, this fact should be kept in mind in the comparison. At the same time, there are so many other possible sources of error in the compilation that this factor should not be overemphasized.

In the light of the foregoing considerations, it is evident that earning assets as a basis for determining the rate of earnings and expenses of the two classes of banking offices are only an approximation. Even so,

(1) Banking Profits, 1890-1931, Ch. III.

however, they are probably accurate enough to provide a fairly reliable comparison between those items for which no adjustments have been made, and to give a rough indication with respect to the others. The relevant figures for such a comparison are shown in Table 10.

Table 10 - Earnings and Expenses of Branch and Unit Banks
Average of Five Years 1926-1930

| | Average for 31 branches | Average for 30 unit banks |
|---|----------------------------|------------------------------|
| <u>Amount per \$100 of earning assets</u> | | |
| Interest on loans and investments | \$4.28] | \$6.03 |
| Interest on balances due from head office | 1.39(1)] | \$6.17(1) |
| Other earnings | | <u>1.10</u> |
| Total earnings | | 6.44(1) |
| Salaries and wages | | 1.32 |
| Interest paid on deposits | | 2.28 |
| Interest on balances due to head office | 0.29(1)] | |
| Supervision of head office | 0.21(1)] | 1.27 |
| Other expenses | 0.94] | <u>1.27</u> |
| Net losses | | <u>0.87</u> |
| Total expenses and net losses | | 5.21(1) |
| Net additions to profits | | 1.23(1) |
| Ratio of time to total deposits | 64% | 47% |
| Interest paid per \$100 of total deposits | \$2.35 | \$2.20 |

(1) Items in which adjustments have been made, as described in the text.

Total earnings of the branches appear to be considerably smaller than those of the unit banks, apparently because of the smaller "other earnings"; but the total for the branches includes (in lieu of yield from investments) the arbitrary interest allowance of 5 per cent on balances due from head office, which may be higher or lower than the average yield of the investments of the independent banks. Moreover, the item "other earnings" of the unit banks includes interest received on balances due from

correspondent banks, which might be compared with a part of the interest allowed the branches on balances due from their head offices. The most that can be said of the comparison is that it gives some reason to believe that average gross earnings of country branches are somewhat smaller per unit of business done than those of country unit banks.

Among the several items of expense, salaries and wages for the branches are shown to have been definitely lower than for the unit banks. This would still be true even though the entire item of head office supervision were added to it. The difference seems to substantiate one claim of the advocates of branch banking with respect to operating economies, namely, that the operating staff of a small branch need consist only of a manager who is essentially a lending officer (assisted by the central credit department of the head office) and ordinary clerks. The aggregate salaries and wages of these should be lower per unit of business done than in the case of a unit bank, because the operating personnel of the latter must be capable of attending to all such matters as the investment of funds and the general financial administration of the bank.

Interest paid on gross deposits in the two classes of banking offices appears to be about the same per \$100 of earning assets. Inasmuch as the ratio of time deposits to gross deposits in the unit banks averaged considerably lower than in the branches (47 per cent as compared with 64 per cent), either the rate paid on time deposits by the former must have been substantially higher or they must have paid substantial interest on other classes of deposits.

Other expenses of the branches, including adjusted figures for head office supervision and interest on head office funds used, appear to

be somewhat greater than those of the unit banks. The figures for both classes of banking offices are supposed to include the cost of occupancy and maintenance of buildings and fixtures, insurance, stationery, telephone and telegraph, advertising, and other miscellaneous items; and while presumably the branch operating banks should be able to effect some savings by centralization of purchases, the extra costs of supervision by the head office would be likely to offset these.

Net losses appear to be much smaller for the branches than for the unit banks. In all probability, however, a part of the difference is accounted for by the fact noted above, that some of the branch operating banks have made it a practice, when taking over unit banks and before turning them into branches, to transfer their slow and doubtful assets to affiliated non-banking companies. Such branches have thus started without any heritage of previous losses to write off. The experience in California cannot, therefore, be considered as having provided an answer to the question whether losses are smaller in branch banking systems than in unit banks.

CHAPTER X

SUMMARY

California provides an especially favorable environment for wide scale intercommunity branch banking, primarily because of the great diversity of the economic activities of the different regions of the State. It appears, however, that this circumstance was of less importance as a factor in the rapidity of the development of the branch system in California than a combination of other circumstances, made up of the career of A. P. Giannini as banker and financial organizer, the somewhat guarded provisions of the State law sanctioning branch operation, and an unusual opportunity for stock flotation through the existence for several years of rising security markets. The branch banking movement gained headway after 1920 and within a few years the banking structure of the State was transformed. Starting with a system of unit banking of the type predominant in the United States generally, California witnessed the rise of a small number of branch operating banks, which before the end of the decade controlled well over half of her total banking resources.

There are two separate but closely interrelated aspects of the development. On the one hand is the matter of the transformation itself, the processes by which a large number of the banks in California gave up their status as independent institutions and became branches of metropolitan banks. On the other hand is the actual performance as banks of the large branch organizations, upon which may be based a tentative appraisal of wide

scale intercommunity branch banking as practiced in California to date. This second aspect of the development has thus far been largely influenced by the first. Moreover, the commonly expressed opinions of the merits or demerits of branch banking in California have been based more upon the particular methods by which the existing branch organizations have been built up than upon their performance as banks. To avoid confusion, the two aspects must be considered separately. In the long run the process of building up branch organizations has little or nothing to do with the merits or demerits of branch banking as such.

The development in California, if not too rapid for compatibility with the public interest, was so rapid that it escaped effective control by governmental agencies. During the five or six years following 1920, the State superintendent of banks, under whose jurisdiction alone intercommunity branch operation was permitted by law, was presented at times with applications the granting of which would extend the scope of branch banking far beyond what most bankers believed was in the minds of the framers of the 1909 act. Unit banks throughout the State were bought up by holding companies affiliated or associated with branch operating banks, and then the superintendent was called upon to authorize their transformation into branches. Usually he granted the applications. Otherwise he would have been unable to exercise effective supervision over these large group organizations.

From as early as 1919 the most important branch operating State banks of California were members of the Federal reserve system. But the

restrictions on branch banking prescribed by the Federal Reserve Board were rendered ineffective by the utilization of affiliated or associated non-member banks to build up branch organizations, which later were to be absorbed by merger with the member institutions. Restrictions were conditioned by the complexities of dual banking control, and by the fact that all membership in the Federal reserve system is in effect voluntary, since State members may withdraw from membership and national banks may surrender membership by converting into State banks.

The procedure employed to escape the regulations of the board was to use the bank holding company, which purchased the stock of the unit banks concerned and merged them together into the nonmember branch operating bank. Such transactions were greatly facilitated by the rising stock market, which made possible the sale of shares of the holding companies at such prices as to draw large sums from the public for use in the purchase of banks at high prices. This was accompanied by speculation and stock promotion, sometimes through the branches of the affiliated or associated institutions themselves. Without the holding company device the development of intercommunity branch banking in California could not have taken place with such speed.

Consideration of the safety record of branch banking in California appears to show that branch expansion, as distinguished from branch operation, has been an important factor in reducing bank failures in the State. While there has been no suspension of any large scale branch organization in California, the experience there has been too short and limited to too few banks to be accepted as a test of the safety of branch banking.

In the matter of service to the community, the evidence available

indicates that many small towns and villages in California have been supplied with more extensive credit accommodation by branches of metropolitan banks than could have been provided by local independent banks. Individual loans have frequently been made in amounts much larger than would have been legally permitted for unit banks of a size the community could support. The aggregates of loans made by branches have frequently been a great deal larger than the deposits of those branches. This has reflected the transfer of funds assembled as deposits and not needed in one community at a particular time to branches in other communities where there was a demand for credit.

No evidence has been found in California that branch banking has resulted in draining small communities of their funds, when such funds have been needed locally for loans. On the contrary, a tabulation of the loans and deposits of country branches of an important branch operating bank in the State, as of February 28 of the three years 1927-1929, shows that the average of loans outstanding at seventy-five offices amounted to over 70 per cent of deposits and in a great many cases to over 100 per cent, as compared with 64 per cent for all country member banks in California and 66 per cent for all country member banks in the United States. This was during a period of exceedingly brisk demand for call loans at high prices in the financial centers of the country.

Economies of operation of the branch system, claimed to result from centralization of all the functions of general financial administration, have not been demonstrated by the statistical information available as to California's experience. Expenses incident to the building up of the branch organizations themselves may have tended to offset any economies otherwise effected.